

AFFORDABLE RESIDENTIAL COMMUNITIES INC
Form PREM14A
October 17, 2006

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

SCHEDULE 14A

Proxy Statement Pursuant to Section 14(a) of
the Securities Exchange Act of 1934 (Amendment No.)

Filed by the Registrant

Filed by a Party other than the Registrant

Check the appropriate box:

- Preliminary Proxy Statement
- Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**
- Definitive Proxy Statement
- Definitive Additional Materials
- Soliciting Material Pursuant to §240.14a-12

Affordable Residential Communities Inc.

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

- No fee required.
- Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

(1) Title of each class of securities to which transaction applies:
NLASCO, Inc. common stock, par value \$0.01 per share

(2) Aggregate number of securities to which transaction applies:
75 shares of NLASCO, Inc. common stock

(3)

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Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

\$78,346,000, calculated pursuant to Rule 0-11(c)(i) and Rule 0-11(a)(4) of the Securities Exchange Act of 1934, as amended, which represents the book value of NLASCO, Inc. (the securities of which will be received by the Company in the transaction)

(4) Proposed maximum aggregate value of transaction:
\$78,346,000, calculated pursuant to Rule 0-11(c)(i) and Rule 0-11(a)(4) of the Securities Exchange Act of 1934, as amended

(5) Total fee paid:
\$8,384

o Fee paid previously with preliminary materials.

o Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

(1) Amount Previously Paid:

(2) Form, Schedule or Registration Statement No.:

(3) Filing Party:

(4) Date Filed:

Persons who are to respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB control number.

Affordable Residential Communities Inc.

**7887 E. Belleview Ave., Suite 200
Englewood, Colorado 80111
(303) 383-7500**

To Our Stockholders:

We cordially invite you to attend, either in person or by proxy, a special meeting of stockholders of Affordable Residential Communities Inc., a Maryland corporation, which will be held on _____, _____, at 9:00 a.m., local Denver, Colorado time, at _____, and any adjournments or postponements thereof. The purposes of the special meeting are to:

- (1) consider and vote upon a proposal to approve the issuance and sale to Gerald J. Ford, ARC Diamond, LP and Hunter's Glen/Ford, Ltd. of our common stock under the Investment Agreement by and among ARC, Gerald J. Ford, ARC Diamond, LP and Hunter's Glen/Ford, Ltd. at a price per share of \$8.00;
- (2) consider and vote upon a proposal to approve the issuance and sale to Flexpoint Fund, L.P. of 2,087,683 shares of our common stock under the Stock Purchase Agreement by and between ARC and Flexpoint Fund, L.P. at a price per share of \$9.58, subject to certain anti-dilution provisions;
- (3) consider and vote upon a proposal to amend our charter to restrict certain acquisitions of our securities in order to preserve the benefit of our net operating losses for tax purposes and to delete certain provisions of our charter which are no longer applicable to us as a result of the revocation of our status as a real estate investment trust;
- (4) consider and vote upon a proposal to approve any motion to adjourn or postpone the special meeting to a later date to solicit additional proxies if there are insufficient votes at the time of the special meeting to approve the foregoing proposals; and
- (5) consider and transact any other business as may properly come before the special meeting or any adjournment(s) or postponement(s) thereof.

On October 6, 2006, we and our subsidiary ARC Insurance Holdings Inc. signed an agreement to acquire NLASCO, Inc., for consideration consisting of \$105,750,000 in cash and 1,218,880 shares of our common stock. We will raise a portion of the cash consideration for the NLASCO acquisition by offering our stockholders the opportunity to purchase additional shares of our common stock pursuant to a rights offering in which each stockholder will receive, at no charge, one non-transferable subscription right for each share of common stock owned as of _____. Each subscription right will entitle its holder to purchase 0.242 shares of our common stock for \$8.00 per share, for aggregate gross proceeds of approximately \$80 million.

In addition, on October 13, 2006, we entered into an Investment Agreement with Gerald J. Ford, one of our directors and the beneficial owner of approximately 17.6% of our common stock, ARC Diamond, LP, an affiliate of Mr. Ford, and Hunter's Glen/Ford, Ltd., also an affiliate of Mr. Ford, pursuant to which Mr. Ford and ARC Diamond, LP, who are currently ARC stockholders, have agreed not to exercise their subscription rights to purchase 1,760,000 shares of our common stock that they will receive in the rights offering. Instead, Mr. Ford and ARC Diamond, LP have agreed to purchase the number of shares of our common stock that they otherwise would have been entitled to subscribe for in the rights offering in a private placement directly from us at the same price per share as in the rights offering. Pursuant to the Investment Agreement, Hunter's Glen/Ford, Ltd. has agreed to backstop the rights offering, meaning it has agreed to purchase all shares of common stock that remain unsubscribed for in the rights offering, other than shares which are covered by rights distributed to Mr. Ford and ARC Diamond, LP,

at the same price per share as in the

rights offering. As a result, if you vote to approve the issuance and sale of shares of our common stock under the Investment Agreement, you are voting to approve the sale of up to 10,000,000 shares of our common stock to Mr. Ford, ARC Diamond, LP and Hunter's Glen/Ford, Ltd.

On October 6, 2006, we entered into a Stock Purchase Agreement with Flexpoint Fund, L.P., whose general partner is Flexpoint Partners, LLC. Under the terms of that agreement, Flexpoint Fund, L.P. has agreed to purchase 2,087,683 shares of our common stock for \$9.58 per share, subject to certain anti-dilution provisions, for aggregate proceeds of approximately \$20.0 million. The per share purchase price of \$9.58 is based on the volume-weighted average sale price of ARC shares for the period September 21, 2006 to October 4, 2006, the ten day period immediately preceding our board of directors meeting on October 5, 2006. Flexpoint Fund, L.P.'s commitment is conditioned upon the closing of our transaction with NLASCO, stockholder approval of the Flexpoint Stock Purchase Agreement and certain other conditions. Flexpoint Partners, LLC assisted the Company in the sourcing, due diligence and negotiation of the NLASCO acquisition and the stock purchase agreement with NLASCO on a non-compensated basis. Gerald J. Ford is a limited partner of Flexpoint Fund, L.P.

On October 13, 2006, our Board adopted and declared advisable an amendment to our charter relating to certain net operating loss carryforwards which are available to us to offset our future taxable income. To attempt to ensure preservation of the net operating losses in accordance with U.S. Federal income tax law, the proposed charter amendment will generally prohibit any direct or indirect sale, transfer, assignment, conveyance, pledge or other disposition of shares of stock of the Company or warrants, rights or options to purchase stock of the Company or any other interests that would be treated as stock of the Company under the income tax regulations promulgated under the Internal Revenue Code of 1986, as amended, if as a result of such sale, transfer, assignment, conveyance, pledge or other disposition any person or group would beneficially own five percent or more of the market value of the total outstanding shares of common stock of the Company or the percentage of common stock of the Company owned by a five percent or greater stockholder would be increased.

Our board of directors recommends that you vote "FOR" each of the proposals set forth above.

If you have any questions prior to the special meeting or need further assistance, please contact Innisfree M&A Incorporated toll-free at 1-888-750-5834 (stockholders) or 212-750-5833 (banks and brokers).

Your vote is important. Please read the Proxy Statement and the voting instructions on the enclosed proxy card. Then, whether or not you plan to attend the special meeting in person, and no matter how many shares of voting securities you own, please sign, date and promptly return the enclosed proxy card in the enclosed envelope, which requires no additional postage if mailed in the United States.

Thank you for your cooperation and continued support.

Very truly yours,

Larry D. Willard
Chairman of the Board
and Chief Executive Officer

NEITHER THE SECURITIES AND EXCHANGE COMMISSION NOR ANY STATE SECURITIES COMMISSION HAS APPROVED OR DISAPPROVED OF, OR PASSED UPON THE FAIRNESS OR MERITS OF, THE TRANSACTIONS DESCRIBED IN THE ACCOMPANYING PROXY STATEMENT OR THE ADEQUACY OR ACCURACY OF THE ACCOMPANYING PROXY STATEMENT. ANY CONTRARY REPRESENTATION IS A CRIMINAL OFFENSE.

THE ACCOMPANYING PROXY STATEMENT IS NOT AN OFFER TO SELL OR A SOLICITATION OF ANY OFFER TO BUY SHARES OF OUR COMMON STOCK OR ANY OTHER SECURITIES, INCLUDING THE SUBSCRIPTION RIGHTS OR ANY SHARES OF COMMON STOCK ISSUABLE UPON EXERCISE OF THE SUBSCRIPTION RIGHTS. OFFERS AND SALES OF THE

SUBSCRIPTION RIGHTS OR THE SHARES OF COMMON STOCK ISSUABLE UPON EXERCISE OF THE SUBSCRIPTION RIGHTS WILL BE MADE ONLY BY MEANS OF A PROSPECTUS AND ON THE TERMS AND CONDITIONS SET FORTH IN THE PROSPECTUS.

The accompanying Proxy Statement is dated _____ and is first being mailed to the Company's stockholders on or about _____.

Affordable Residential Communities Inc.

**7887 E. Belleview Ave., Suite 200
Englewood, Colorado 80111
(303) 383-7500**

Notice of Special Meeting of Stockholders To Be Held On

To Our Stockholders:

WHAT: Special Meeting of Stockholders

WHEN: , at 9:00 a.m., local Denver, Colorado time

WHERE:

WHY: At this meeting, you will be asked to:

- (1) consider and vote upon a proposal to approve the issuance and sale to Gerald J. Ford, ARC Diamond, LP and Hunter's Glen/Ford, Ltd. of our common stock under the Investment Agreement by and among Gerald J. Ford, ARC Diamond, LP and Hunter's Glen/Ford, Ltd., all at a price per share of \$8.00;
- (2) consider and vote upon a proposal to approve the issuance and sale to Flexpoint Fund, L.P. of 2,087,683 shares of our common stock under the Stock Purchase Agreement by and between ARC and Flexpoint Fund, L.P. at a price per share of \$9.58, subject to certain anti-dilution provisions;
- (3) consider and vote upon a proposal to amend our charter to restrict certain acquisitions of our securities in order to preserve the benefit of our net operating losses for tax purposes and to delete certain provisions which are no longer applicable to us as a result of the revocation of our status as a real estate investment trust;
- (4) consider and vote upon a proposal to approve any motion to adjourn or postpone the special meeting to a later date to solicit additional proxies if there are insufficient votes at the time of the special meeting to approve the foregoing proposals; and
- (5) consider and transact any other business as may properly come before the Special Meeting or any adjournment(s) or postponement(s) thereof.

Only common stockholders and holders of our special voting stock, which is paired with limited partnership units of our operating partnership, of record at the close of business on _____ will receive notice of, and be eligible to vote at, the special meeting. The foregoing items of business are more fully described in the Proxy Statement accompanying this notice.

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Your vote is important. Please read the Proxy Statement and the voting instructions on the enclosed proxy card. Then, whether or not you plan to attend the Special Meeting in person, and no matter how many shares of voting securities you own, please vote by telephone, by Internet, or by signing, dating and promptly returning the enclosed proxy card in the envelope provided, which requires no additional postage if mailed in the United States.

By Order of the Board of Directors,

Scott L. Gesell
Executive Vice President, General Counsel
and Corporate Secretary

Englewood, Colorado

Affordable Residential Communities Inc.

7887 E. Belleview Ave., Suite 200
Englewood, Colorado 80111
(303) 383-7500

PROXY STATEMENT

FOR THE SPECIAL MEETING OF STOCKHOLDERS
To Be Held on

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INFORMATION CONCERNING SOLICITATION AND VOTING

WHY DID YOU SEND ME THIS PROXY STATEMENT?

The board of directors of Affordable Residential Communities Inc., a Maryland corporation, which we refer to as ARC or the Company, seeks your proxy for use in voting at the special meeting of stockholders on _____, or the Special Meeting. The Special Meeting will be held at _____, on _____, beginning at 9:00 a.m., local Denver, Colorado time. We intend to begin mailing this Proxy Statement, the attached notice of Special Meeting and the accompanying proxy card on or about _____, to all holders of our common stock, par value \$0.01 per share, and special voting stock, par value \$0.01 per share, which together we refer to as our voting securities, entitled to vote at the Special Meeting.

ON WHAT AM I VOTING?

At the Special Meeting, stockholders will be asked to:

- (1) consider and vote upon a proposal to approve the issuance and sale to Gerald J. Ford, ARC Diamond, LP, or ARC Diamond, and Hunter's Glen/Ford, Ltd., or Hunter's Glen/Ford, of our common stock under the Investment Agreement by and among the Company, Gerald J. Ford, ARC Diamond and Hunter's Glen/Ford, which we refer to as the Investment Agreement, at a price per share of \$8.00;
- (2) consider and vote upon a proposal to approve the issuance and sale to Flexpoint Fund, L.P., which we refer to as Flexpoint, of 2,087,683 shares of our common stock under the Stock Purchase Agreement by and between ARC and Flexpoint, which we refer to as the Flexpoint Agreement, at a price per share of \$9.58, subject to certain anti-dilution provisions;
- (3) consider and vote upon a proposal to amend our charter to restrict certain acquisitions of our securities in order to preserve the benefit of our net operating losses, or NOLs, for tax purposes and to delete certain provisions which are no longer applicable to us as a result of the revocation of our status as a real estate investment trust, which we refer to as a REIT;
- (4) consider and vote upon a proposal to approve any motion to adjourn or postpone the special meeting to a later date to solicit additional proxies if there are insufficient votes at the time of the Special Meeting to approve the foregoing proposals; and
- (5) consider and transact any other business as may properly come before the Special Meeting or any adjournment(s) or postponement(s) thereof.

WHO CAN VOTE AT THIS MEETING?

Only holders of record of our voting securities at the close of business on _____, the record date, will receive notice of, and be entitled to vote at, the Special Meeting. At the close of business on _____, _____ shares of our common stock and _____ shares of our special voting stock were outstanding and entitled to vote. Our common stock and our special voting stock, which we refer to as our voting securities, are the only securities entitled to vote at the Special Meeting. In deciding all matters, a holder of common stock on the record date will be entitled to cast one vote for each share of common stock registered in that holder's name and a holder of our special voting stock on the record date will be entitled to cast 0.519 of a vote for each share of our special voting stock registered in that holder's name, on each matter to be voted upon at the Special Meeting.

Stockholder of Record: Shares Registered in Your Name.

If, on _____, your shares of common stock were registered directly in your name with ARC's transfer agent, American Stock Transfer & Trust Company, or, in the case of special voting stock, with

us, then you are a stockholder of record. As a stockholder of record, you may vote in person at the Special Meeting or vote by proxy.

Beneficial Owner: Shares Registered in the Name of a Broker, Bank or Nominee.

If, on _____, your shares of common stock were held in an account at a bank, brokerage firm, or other agent or nominee, then you are the beneficial owner of shares held in "street name" and these proxy materials are being forwarded to you by that organization. The organization holding your account is considered the stockholder of record for purposes of voting at the Special Meeting. As a beneficial owner, you have the right to direct your bank, broker or other agent or nominee on how to vote the shares in your account. You are also invited to attend the Special Meeting. However, since you are not the stockholder of record, you may not vote your shares in person at the meeting unless you request and obtain a valid proxy from your bank, broker or other agent or nominee.

WHAT CONSTITUTES A QUORUM?

The presence in person or by proxy of holders entitled to cast a majority of all the votes entitled to be cast at the Special Meeting on any matter will constitute a quorum. Abstentions and broker non-votes (votes that are not cast by a broker on a non-routine matter because it has not received instructions from the beneficial owner), if any, will be counted as shares present for purposes of determining the presence of a quorum.

WHAT ARE THE VOTING RIGHTS OF THE HOLDERS OF OUR VOTING SECURITIES?

In deciding all matters, a holder of common stock on the record date will be entitled to cast one vote for each share of common stock registered in that holder's name, on each matter to be voted upon at the Special Meeting.

In deciding all matters, a holder of our special voting stock on the record date will be entitled to cast 0.519 of a vote for each share of special voting stock registered in that holder's name, on each matter to be voted upon at the Special Meeting.

Holders of shares of our common stock and our special voting stock vote collectively as one class on all matters submitted to a vote of stockholders of the Company.

WHAT VOTE IS REQUIRED TO APPROVE EACH PROPOSAL?

Investment Agreement

So long as a quorum is present, the affirmative vote of the holders of a majority of votes cast by the holders of our voting securities is required to approve the issuance and sale of shares of our common stock under the Investment Agreement, as more fully described elsewhere in this Proxy Statement.

Flexpoint Agreement

So long as a quorum is present, the affirmative vote of the holders of a majority of votes cast by the holders of our voting securities is required to approve the issuance and sale of shares of our common stock under the Flexpoint Agreement, as more fully described elsewhere in the Proxy Statement.

Charter Amendment

The affirmative vote of holders of a majority of the votes entitled to be cast by the holders of our voting securities on the matter is required to approve the amendment to the Company's charter, as more fully described elsewhere in this Proxy Statement.

Adjournment/Postponement

So long as a quorum is present, the affirmative vote of the holders of a majority of the votes cast is required to approve the adjournment or postponement proposal, as more fully described elsewhere in this Proxy Statement.

A properly executed proxy marked "abstain" with respect to a proposal will not be voted, although it will be counted for purposes of determining a quorum. Accordingly, abstentions will have the effect of a "Against" vote on the charter amendment proposal but will have no effect on the vote on the Investment Agreement, Flexpoint Agreement or the adjournment or postponement proposal. Failure to vote will also have the same effect as an "Against" vote on the charter amendment proposal, but will have no effect on the Investment Agreement, the Flexpoint Agreement or the adjournment or postponement proposal, except to the extent that it reduces the likelihood of a quorum being present.

Generally, the affirmative vote of a majority of votes cast is required for the approval of any other matters that may properly come before the Special Meeting. As of this date, the Company knows of no other business to be presented for stockholder action at this meeting.

WHO CONDUCTS THE PROXY SOLICITATION?

ARC's board of directors is soliciting the proxies and ARC will bear the entire cost of this solicitation, including the preparation, assembly, printing and mailing of this Proxy Statement and any additional materials furnished to our stockholders. Copies of solicitation materials will be furnished to banks, brokerage houses, other agents and nominees holding shares of common stock in their names that are beneficially owned by others so that they may forward these solicitation materials to these beneficial owners. In addition, if asked, we will reimburse these persons for their reasonable expenses in forwarding the solicitation materials to the beneficial owners. ARC has requested banks, brokerage houses and other custodians, nominees and fiduciaries to forward all solicitation materials to the beneficial owners of the shares of common stock they hold of record. ARC has also made arrangements with Innisfree M&A Incorporated to assist our board in soliciting proxies and has agreed to pay them a fee for these services, which it reasonably estimates to be approximately \$20,000, plus reasonable expenses.

HOW DO I VOTE IF I ATTEND THE SPECIAL MEETING?

If you are a stockholder of record, you can attend the Special Meeting and vote in person the shares of common stock or special voting stock you hold directly in your name. If you choose to do that, please bring the enclosed proxy card or proof of identification. If you want to vote in person at our Special Meeting and you hold our common stock through a bank, broker or other agent or nominee, you must obtain a power of attorney or other proxy authority from that organization and bring it to the Special Meeting. Follow the instructions from your bank, broker or other agent or nominee included with these proxy materials, or contact your bank, broker or other agent or nominee to request a power of attorney or other proxy authority. If you vote in person at the Special Meeting, you will revoke any prior proxy you or your bank, broker or other agent or nominee may have submitted with respect to the shares of voting securities you own of record or beneficially.

HOW DO I VOTE IF I DO NOT ATTEND THE SPECIAL MEETING?

If you hold your shares in your name, you may submit a proxy by telephone, via the Internet or by mail.

Submitting a Proxy by Telephone: You can submit a proxy for your shares by telephone until 11:59 p.m. Eastern Standard Time on _____ by calling the toll-free telephone number on the enclosed proxy card. Telephone proxy submission is available 24 hours a day. Easy-to-follow voice prompts allow you to submit a proxy for your shares and confirm that your instructions have been properly recorded. Our telephone proxy submission procedures are designed to authenticate stockholders by using individual control numbers.

Submitting a Proxy via the Internet: You can submit a proxy via the Internet until 11:59 p.m. Eastern Standard Time on _____ by accessing the web site listed on your proxy card and following the instructions you will find on the web site. Internet proxy submission is available 24 hours a day. As with telephone proxy submission, you will be given the opportunity to confirm that your instructions have been properly recorded.

Submitting a Proxy by Mail: If you choose to submit a proxy by mail, simply mark the enclosed proxy card, date and sign it, and return it in the postage paid envelope provided.

By casting your vote in any of the three ways listed above, you are authorizing the individuals listed on the proxy to vote your shares in accordance with your instructions.

If your shares are held in the name of a bank, broker or other nominee, you will receive instructions from the holder of record that you must follow for your shares to be voted. Please follow their instructions carefully.

WHAT IF I DO NOT SPECIFY HOW MY SHARES ARE TO BE VOTED ON THE PROXY CARD?

If you return the proxy card and the proxy card does not specify how your shares of voting securities are to be voted, all of your shares represented by the proxy card will be voted "FOR" the approval of Proposal 1, "FOR" the approval of Proposal 2, "FOR" the approval of Proposal 3 and "FOR" the approval of Proposal 4.

If any other matter is properly presented at the meeting, the individuals named on your proxy card will vote your shares of voting securities in their discretion.

HAS THE ARC BOARD OF DIRECTORS MADE A RECOMMENDATION REGARDING THE MATTERS TO BE ACTED UPON AT THE SPECIAL MEETING?

The ARC board of directors has unanimously (with the abstention of directors Ford, Webb and Staff with respect to Proposals 1 and 2) recommended that you vote "FOR" each of the following proposals:

- (1) the issuance and sale to Gerald J. Ford, ARC Diamond and Hunter's Glen/Ford of our common stock under the Investment Agreement at a price per share of \$8.00;
- (2) the issuance and sale to Flexpoint of 2,087,683 shares of our common stock under the Flexpoint Agreement at a price per share of \$9.58, subject to certain anti-dilution provisions;
- (3) the amendment to our charter to restrict certain acquisitions of our securities in order to preserve the benefit of our NOLs for tax purposes and to delete certain provisions which are no longer applicable to us as a result of the revocation of our status as a REIT; and

- (4) the approval of any motion to adjourn or postpone the Special Meeting to a later date to solicit additional proxies if there are insufficient votes at the time of the Special Meeting to approve the foregoing proposals.

CAN I CHANGE MY VOTE?

You may revoke your proxy by doing any of the following:

- (1) Send a written notice of revocation to our Corporate Secretary, dated later than the proxy you want to revoke, but before the vote is taken at the Special Meeting;
- (2) Properly execute and deliver a later dated proxy before the vote is taken at the Special Meeting;
- (3) Properly submit a proxy on a later date by telephone or via the Internet (only your last telephone or Internet proxy will be counted) before 11:59 p.m. Eastern Standard Time on _____ ; or
- (4) Vote in person at the Special Meeting (your attendance at the Special Meeting, in and of itself, will not revoke the earlier proxy).

Any written notice of revocation, or later dated proxy, should be delivered to:

Affordable Residential Communities Inc.
7887 E. Belleview Ave., Suite 200
Englewood, CO 80111
Attention: Scott L. Gesell, Corporate Secretary

IF MY SHARES ARE HELD IN A BROKERAGE ACCOUNT, WILL MY BROKER VOTE MY SHARES FOR ME?

Your broker, bank or other nominee will be permitted to vote your shares for you only if you instruct them how to vote. Therefore, it is important that you promptly follow the directions provided by your broker, bank or other nominee as to how to instruct them to vote your shares if you do not instruct your broker, bank or other nominee how to vote your shares. If you do not instruct your broker, bank or other nominee how to vote your shares that they hold, those shares will not be voted and the effect will be the same as a vote against the approval of the charter amendment, but it will not affect the vote with respect to the Investment Agreement, the Flexpoint Agreement or the proposal to adjourn or postpone the Special Meeting, except to the extent that it reduces the likelihood of a quorum being present.

WHO CAN I CALL WITH QUESTIONS ABOUT THE SPECIAL MEETING?

For more information, you should contact our proxy solicitor, Innisfree M&A Incorporated, toll-free at 1-888-750-5834 (banks and brokers may call collect at 212-750-5833).

YOUR VOTE AT THIS SPECIAL MEETING IS IMPORTANT, NO MATTER HOW MANY OR HOW FEW SHARES OF VOTING SECURITIES YOU OWN. PLEASE SIGN AND DATE THE ENCLOSED PROXY CARD AND RETURN IT PROMPTLY IN THE ENCLOSED POSTAGE-PAID ENVELOPE.

SUMMARY

This summary highlights selected information also contained elsewhere in this Proxy Statement related to the matters you are being asked to vote upon and may not contain all of the information important to you. You should read this entire document and the other documents to which this Proxy Statement refers you to fully understand the matters you are being asked to vote upon. Each item in this summary refers to the page where that subject is hereinafter discussed in more detail. Except as otherwise noted, references in this Proxy Statement to "ARC," the "Company," "we," "us," and "our" refer to the business of Affordable Residential Communities Inc. and its subsidiaries, and references in this Proxy Statement to "NLASCO" refer to the business of NLASCO, Inc. and its consolidated subsidiaries and its controlled affiliates.

Information about ARC and NLASCO

Affordable Residential Communities Inc. (Page 38)

**7887 E. Belleview Avenue, Suite 200
Englewood, Colorado 80111
(303) 383-7500**

ARC is a Maryland corporation that is engaged in the acquisition, renovation, repositioning and operation of primarily all-age manufactured home communities, the retail sale and financing of manufactured homes, the rental of manufactured homes and other related businesses including acting as agent in the sale of homeowners' insurance and related products, primarily to residents or prospective residents in our communities. We were organized in July 1998 and operate primarily through Affordable Residential Communities LP, which we refer to as the Operating Partnership or OP, and its subsidiaries, of which we are the sole general partner and owned 96.5% as of June 30, 2006. On February 18, 2004, we completed our initial public offering, or IPO. Through the years ended December 31, 2005, we were organized as a fully integrated, self-administered and self-managed equity REIT for U.S. Federal income tax purposes. In March 2006, our board of directors decided to revoke our election as a REIT for U.S. Federal income tax purposes beginning for the year ending December 31, 2006.

NLASCO, Inc. (Page 39)

**510 N. Valley Mills Drive
Waco, Texas 76710
(254) 399-0626**

NLASCO is a Delaware corporation that specializes in providing fire and homeowners insurance to low value dwellings and manufactured homes primarily in Texas and other areas of the south, southeastern and southwestern United States. NLASCO operates two insurance subsidiaries, National Lloyds Insurance Company, which we refer to as NLIC, and American Summit Insurance Company, which we refer to as ASIC. NLIC is rated "A" (Excellent) by A.M. Best Company, and ASIC is rated "B++" (Very Good) by A.M. Best. NLIC, chartered in 1948 and licensed in 18 states, is an insurance company on the Lloyd's plan domiciled in Texas. NLIC underwrites fire and limited homeowner's insurance through approximately 4,800 independent agents. Through approximately 1,800 independent agents and selected managing general agents, which we refer to as MGAs, ASIC offers homeowners and property and casualty insurance primarily to manufactured home owners. NLASCO's policies are typically written for actual cash value of up to \$250,000 in the low value dwelling market and replacement cost of up to \$125,000 in the manufactured home market. Liability on a homeowners policy typically provides coverage up to \$100,000 with a maximum of \$300,000 issued by a few select agents. The vast majority of NLASCO's property policies currently exclude coverage for water and mold and provide actual cash value payments as opposed to replacement costs. NLASCO has an experienced management team, a high quality agency force and an established track record of growth and underwriting profitability.

The NLASCO Acquisition (Page 39)

ARC and ARC Insurance Holdings Inc., a subsidiary of ARC, which we refer to as Buyer, on the one hand, and C. Clifton Robinson, C.C. Robinson Property Company, Ltd. and The Robinson Charitable Remainder Unitrust, which we refer to as the Sellers, on the other hand, have entered into a Stock Purchase Agreement dated as of October 6, 2006, which we refer to as the NLASCO Agreement. Subject to the terms and conditions of the NLASCO Agreement, at the closing we will purchase from Sellers all of the outstanding shares of capital stock of NLASCO in exchange for cash in the amount of \$105,750,000 and 1,218,880 shares of our common stock, which shares will be issued to Mr. Robinson and will be placed into escrow pursuant to an escrow agreement. We refer to this transaction as the NLASCO acquisition. The purchase price will be subject to adjustments based on (1) the GAAP stockholders' equity of NLASCO as of the closing date as finally determined by the parties and (2) the amount of actual losses as of the 36-month anniversary of the closing date for claims arising out of events or circumstances that occurred or existed on or prior to the closing date, compared to the reserves for losses as reflected on the closing balance sheet for both reported claims and for incurred but not reported claims.

Immediately before the closing, and subject to any necessary regulatory approvals or third party consents, Sellers will cause NLASCO to make a dividend or distribution to Sellers in an aggregate amount equal to the excess of (1) the closing date stockholders' equity over (2) \$71,009,382. At closing, NLASCO will repay approximately \$5.6 million aggregate principal amount of outstanding debt.

The NLASCO Agreement includes customary representations, warranties and covenants, as well as indemnification and termination provisions. At the closing, the parties will also enter into several ancillary agreements, including a noncompetition agreement, a registration rights agreement, an escrow agreement, a release, employment agreements and a share lock-up agreement. The NLASCO Agreement and the ancillary agreements are described below in "Information About the NLASCO Acquisition and NLASCO The NLASCO Agreement and Related Agreements."

Additional information regarding the NLASCO Agreement is set forth below in this Proxy Statement.

Opinion of Sandler O'Neill & Partners, L.P. (Page 43)

In connection with the NLASCO acquisition, Sandler O'Neill & Partners, L.P., or Sandler O'Neill, delivered its opinion to the ARC board that the purchase price to be paid by ARC in the NLASCO acquisition was fair to ARC from a financial point of view.

The full text of Sandler O'Neill's opinion is attached as *Appendix B* to this Proxy Statement. The opinion outlines the procedures followed, assumptions made, matters considered and qualifications and limitations on the review undertaken by Sandler O'Neill in rendering its opinion in connection with the NLASCO acquisition. The description of the opinion set forth in this Proxy Statement is qualified in its entirety by reference to the opinion.

The Rights Offering (Page 109)

We will raise a portion of the cash consideration for the acquisition of NLASCO by offering our stockholders the opportunity to purchase additional shares of our common stock pursuant to a rights offering in which each stockholder will receive, at no charge, one non-transferable subscription right for each share of common stock owned as of . Each subscription right will entitle its holder to purchase 0.242 shares of our common stock for \$8.00 per share, for aggregate gross proceeds of approximately \$80 million. The rights offering is conditioned upon the receipt of stockholder approval for the issuance and sale of our common stock under the Investment Agreement, but is not conditioned

upon the completion of the NLASCO acquisition or the issuance and sale of our common stock under the Flexpoint Agreement.

You are not being asked in this Proxy Statement to exercise your subscription rights in the rights offering. A vote in favor of the transactions contemplated by the Investment Agreement will not obligate any stockholder to purchase shares of common stock in the rights offering.

Additional information regarding the rights offering is set forth below in the Proxy Statement.

The Investment Agreement (Page 114)

On October 13, 2006, ARC, Mr. Ford, ARC Diamond and Hunter's Glen/Ford entered into an Investment Agreement pursuant to which:

Mr. Ford and ARC Diamond agreed to purchase in a private placement the full number of shares of our common stock that they would otherwise have been entitled to subscribe for in the rights offering at the same subscription per share;

Mr. Ford and ARC Diamond agreed not to exercise their rights in the rights offering;

Hunter's Glen/Ford agreed to backstop the rights offering by purchasing in a private placement all of the shares of our common stock that are not otherwise subscribed for in the rights offering by stockholders other than Mr. Ford and ARC Diamond at the same subscription price per share.

The issuance and sale of our common stock under the Investment Agreement is conditioned on the completion of the rights offering.

Additional information regarding the Investment Agreement is set forth below in this Proxy Statement.

The Flexpoint Agreement (Page 117)

On October 6, 2006, ARC and Flexpoint, whose general partner is Flexpoint Partners, LLC, entered into the Flexpoint Agreement. Flexpoint Partners, LLC, or Flexpoint Partners, is an equity investment firm based in Chicago, Illinois that focuses on the financial services and healthcare industries. Donald Edwards, the Managing Principal of Flexpoint Partners, is the former Chief Executive Officer of First Acceptance Corporation, a non-standard auto insurance company, and is experienced in insurance company operations and related matters. Under the terms of the Flexpoint Agreement, Flexpoint has agreed to purchase 2,087,683 shares of our common stock for \$9.58 per share, subject to certain anti-dilution provisions, for aggregate proceeds of approximately \$20 million, as more fully described in this Proxy Statement. The per share purchase price of \$9.58 is based on the volume-weighted average sale price of ARC shares for the period September 21, 2006 to October 4, 2006, the ten day period immediately preceding our board of directors meeting on October 5, 2006. Flexpoint's commitment to this purchase is conditioned upon the closing of the NLASCO acquisition and stockholder approval, as well as certain other conditions set forth in the Flexpoint Agreement. The Company will also reimburse Flexpoint Partners for its costs and expenses associated with the due diligence and negotiation of the NLASCO Agreement. Flexpoint Partners assisted the Company in the sourcing, due diligence and negotiation of the NLASCO acquisition and the NLASCO Agreement on a non-compensated basis. Gerald J. Ford, who is one of our directors and the beneficial owner of 17.6% of our common stock and who has entered into the Investment Agreement, is a limited partner of Flexpoint Fund, L.P., having committed \$50 million of total committed funding of \$225 million. As a limited partner of Flexpoint, Mr. Ford is *pari passu* with all other limited partners of Flexpoint and has no financial interest in, or management authority of, Flexpoint Partners, the general partner of Flexpoint. Upon the closing under the Flexpoint Agreement, Flexpoint will have the right to appoint an

observer to ARC's board of directors. It is anticipated that Flexpoint Partners will continue to assist the Company in the future regarding the Company's insurance-related operations.

Additional information regarding the Flexpoint Agreement is set forth below in this Proxy Statement.

Charter Amendment (Page 119)

On October 13, 2006, our board adopted and declared advisable an amendment to our charter relating to certain NOLs which are available to us to offset our future taxable income. To attempt to ensure preservation of the NOLs in accordance with U.S. Federal income tax law, the proposed charter amendment will generally prohibit any direct or indirect sale, transfer, assignment, conveyance, pledge or other disposition of shares of stock of the Company or warrants, rights or options to purchase stock of the Company or any other interests that would be treated as stock of the Company under the income tax regulations promulgated under the Internal Revenue Code of 1986, as amended, or the Code, if as a result of such sale, transfer, assignment, conveyance, pledge or other disposition any person or group would beneficially own five percent or more of the market value of the total outstanding shares of common stock of the Company or the percentage of common stock of the Company owned by a five percent or greater stockholder would be increased.

Any attempted transfer in violation of the foregoing restrictions will be null and void unless the transferor or transferee obtains the written approval of the Company's board of directors. The restrictions will not apply to an attempted transfer of the Company's common stock by Gerald J. Ford or his affiliates or associates unless such transfer would result in Gerald J. Ford and his affiliates and associates becoming the beneficial owner of more than 21% (subject to prospective or retroactive approval by the board) of the shares of common stock then outstanding. Our board intends to grant a waiver of this restriction to allow Mr. Ford and his affiliates and associates to acquire shares of our common stock under the Investment Agreement.

Additional information regarding the charter amendment is set forth below in this Proxy Statement.

SUMMARY HISTORICAL AND PRO FORMA FINANCIAL DATA

The following tables present summary historical financial information for ARC and NLASCO and pro forma combined financial information. The historical and pro forma results presented are not necessarily indicative of future results.

Our pro forma condensed consolidated balance sheet reflects adjustments to our historical financial data to give effect to (i) the NLASCO acquisition, (ii) the issuance of our common stock under the Flexpoint Agreement and (iii) the completion of our concurrent rights offering and the issuance of our common stock under the Investment Agreement and the resulting use of proceeds, as if each had occurred on June 30, 2006. Pro forma results incorporate only continuing operations.

Our pro forma condensed consolidated statements of operations reflect adjustments to our historical financial data to give effect to the (i) NLASCO acquisition, (ii) the issuance of our common stock under the Flexpoint Agreement and (iii) the completion of our concurrent rights offering and the issuance of our common stock under the Investment Agreement and the resulting use of proceeds, as if each had occurred on January 1, 2005.

The summary historical and pro forma financial data set forth below should be read in conjunction with the information contained in "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the consolidated financial statements and accompanying notes for each of ARC and NLASCO appearing elsewhere in this Proxy Statement or incorporated by reference.

AFFORDABLE RESIDENTIAL COMMUNITIES INC.
CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS DATA
(in thousands)

	Pro Forma Six Months Ended June 30, 2006	Six Months Ended June 30,		Pro Forma Year Ended Dec. 31, 2005	Year Ended December 31,		
	2006	2006	2005	2005	2005	2004	2003
	(unaudited)	(unaudited)		(unaudited)			
Revenue							
Rental income	\$ 103,040	\$ 103,040	\$ 93,342	\$ 191,558	\$ 191,558	\$ 171,557	\$ 116,629
Net premiums earned	63,208			107,752			
Sales of manufactured homes	5,666	5,666	23,854	39,331	39,331	14,224	21,965
Utility and other income	15,998	12,867	10,190	26,083	22,256	17,682	14,081
Net investment income	3,646			6,018			
Net consumer finance interest income	424	424					
Total revenue	191,982	121,997	127,386	370,742	253,145	203,463	152,675
Expenses							
Property operations	32,754	32,754	36,418	76,000	76,000	67,950	40,516
Real estate taxes	10,168	10,168	8,037	16,361	16,361	15,127	9,485
Losses and loss adjustment expenses	29,913			48,569			
Cost of manufactured homes sold	4,874	4,874	22,050	37,105	37,105	17,301	18,623
Retail home sales, finance and insurance	4,821	4,821	7,075	18,072	18,072	8,187	7,208
Property management	3,178	3,178	4,513	9,781	9,781	7,127	5,527
General and administrative	32,399	9,412	11,883	66,394	27,634	29,372	17,001
Initial public offering related costs						4,417	
Early termination of debt						16,685	
Depreciation and amortization	44,371	43,415	35,082	79,770	77,859	61,086	39,857
Real estate and retail home asset impairment				21,822	21,822	3,358	1,385
Goodwill impairment				78,783	78,783	863	
Loss on sale of airplane	541	541					
Net consumer finance interest expense			650	525	525	1,319	
Interest expense	42,509	39,605	32,742	77,735	72,569	58,357	58,726
Total expenses	205,528	148,768	158,450	530,917	436,511	291,149	198,328

AFFORDABLE RESIDENTIAL COMMUNITIES INC.
CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS DATA (continued)
(in thousands, except per share amounts)

	Pro Forma Six Months Ended June 30, 2006	Six Months Ended June 30,		Pro Forma Year Ended Dec. 31, 2005	Year Ended December 31,		
	(unaudited)	2006	2005	(unaudited)	2005	2004	2003
Interest income	(871)	(871)	(641)	(2,267)	(2,267)	(1,611)	(1,434)
Loss before allocation to minority interest and provision for income taxes	(12,675)	(25,900)	(30,423)	(157,908)	(181,099)	(86,075)	(44,219)
Provision for income taxes	(4,589)			(8,227)			
Loss before allocation to minority interest	(17,264)	(25,900)	(30,423)	(166,135)	(181,099)	(86,075)	(44,219)
Minority interest	77	562	1,172	3,839	7,313	5,557	6,110
Loss from continuing operations	(17,187)	(25,338)	(29,251)	(162,296)	(173,786)	(80,518)	(38,109)
Income (loss) from discontinued operations		2,309	1,039		(10,485)	3,078	948
Gain (loss) on sale of discontinued operations		25,909	(678)		(678)	(8,549)	3,333
Income tax expense on discontinued operations		(445)					
Minority interest in discontinued operations		(979)	(19)		476	296	(592)
Net income (loss)	(17,187)	1,456	(28,909)	(162,296)	(184,473)	(85,693)	(34,420)
Preferred stock dividend	(5,156)	(5,156)	(5,156)	(10,312)	(10,312)	(8,966)	
Net loss attributable to common stockholders	\$ (22,343)	\$ (3,700)	\$ (34,065)	\$ (172,608)	\$ (194,785)	\$ (94,659)	\$ (34,420)
Loss per share from continuing operations							
Basic loss per share	\$ (0.41)	\$ (0.74)	\$ (0.84)	\$ (3.18)	\$ (4.50)	\$ (2.36)	\$ (2.25)
Diluted loss per share	\$ (0.41)	\$ (0.74)	\$ (0.84)	\$ (3.18)	\$ (4.50)	\$ (2.36)	\$ (2.25)
Income (loss) per share from discontinued operations							
Basic income (loss) per share		\$ 0.65	\$ 0.01		\$ (0.26)	\$ (0.13)	\$ 0.22
Diluted income (loss) per share		\$ 0.65	\$ 0.01		\$ (0.26)	\$ (0.13)	\$ 0.22
Loss per share attributable to common stockholders							
Basic loss per share	\$ (0.41)	\$ (0.09)	\$ (0.83)	\$ (3.18)	\$ (4.76)	\$ (2.49)	\$ (2.03)
Diluted loss per share	\$ (0.41)	\$ (0.09)	\$ (0.83)	\$ (3.18)	\$ (4.76)	\$ (2.49)	\$ (2.03)
Weighted average share/unit information:							
Common shares outstanding	54,607	41,231	40,869	54,272	40,896	37,967	16,973
Common shares issuable upon exchange of OP units and PPU's outstanding	3,294	3,216	4,309	4,600	4,492	3,387	2,726

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Diluted shares outstanding	Pro Forma Six Months Ended June 30, 2006	Six Months Ended June 30,	Pro Forma Year Ended Dec. 31, 2005			
	37,901	44,447	58,872	45,388	41,354	19,699

CONDENSED CONSOLIDATED BALANCE SHEET DATA
(in thousands)

	Pro Forma June 30, 2006	June 30, 2006	December 31,		
			2005	2004	2003
	(unaudited)				
Rental and other property, net	\$ 1,419,349	\$ 1,419,032	\$ 1,454,689	\$ 1,408,328	\$ 797,817
Cash and cash equivalents	70,615	32,195	27,926	32,859	22,605
Loan reserves and restricted cash	45,283	45,283	42,110	38,340	50,098
Total assets	1,860,620	1,600,539	1,728,481	1,813,002	1,125,833
Notes payable	1,130,634	1,063,784	1,146,931	947,478	739,572
Total liabilities	1,280,052	1,128,862	1,252,484	1,097,296	817,849
Stockholders' equity	550,803	442,482	444,095	659,047	265,345

NLASCO, INC.
CONDENSED CONSOLIDATED STATEMENT OF INCOME AND OTHER DATA
(in thousands)

	Six Months Ended June 30,		Year Ended December 31,		
	2006	2005	2005	2004	2003
	(unaudited)		(unaudited)		
Revenue					
Net premiums earned	\$ 63,208	\$ 55,686	\$ 107,752	\$ 92,289	\$ 88,686
Net investment income	3,818	3,001	6,362	4,367	3,296
Other income	3,131	1,745	3,827	3,102	4,052
Total revenue	70,157	60,432	117,941	99,758	96,034
Expenses					
Losses and loss adjustment expenses	29,913	21,434	48,569	42,998	46,462
Policy acquisition and other underwriting expenses	25,318	21,429	42,781	31,677	30,631
Total expenses	55,231	42,863	91,350	74,675	77,093
Income before income taxes	14,926	17,569	26,591	25,083	18,941
Provision for income taxes					
Current	4,589	5,281	8,227	10,317	6,608
Deferred	(73)	851	987	(1,118)	(175)
Total income taxes	4,516	6,132	9,214	9,199	6,433
Net income	\$ 10,410	\$ 11,437	\$ 17,377	\$ 15,884	\$ 12,508
Other data:					
Loss and loss adjustment expense ratio (GAAP)	47.3%	38.5%	45.1%	46.6%	52.4%
Underwriting expense ratio (GAAP)	31.4%	33.6%	32.4%	28.6%	29.3%
Combined ratio (GAAP)	78.7%	72.1%	77.5%	75.2%	81.7%

Loss and loss adjustment expense ratio (GAAP) is the ratio (expressed as a percentage) of losses and loss adjustment expenses to net premiums earned. This is a basic measurement of underwriting profitability.

The underwriting expense ratio (GAAP) is the ratio (expressed as a percentage) of policy acquisition and other underwriting expenses, as adjusted, to net earned premiums. This is a measurement of management's relative efficiency in administering its operations. We adjust policy acquisition and other underwriting expenses by (a) other revenue that represents fee income and (b) interest expense included in underwriting expenses.

The combined ratio (GAAP) is the sum of the loss ratio and the expense ratio. If the combined ratio is at or above 100%, an insurance company generally cannot be profitable without sufficient investment income.

CONDENSED CONSOLIDATED BALANCE SHEET DATA
(in thousands)

December 31,

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	December 31,			
	June 30, 2006	2005	2004	2003
	(unaudited)		(unaudited)	
Investments	\$ 132,079	\$ 134,178	\$ 121,432	\$ 102,621
Cash and cash equivalents	40,136	29,068	17,961	7,338
Total assets	241,399	253,017	222,493	192,028
Loss and loss adjustment expenses	23,844	41,379	24,648	19,839
Unearned premiums	73,571	70,661	70,377	65,904
Notes payable (including related party notes payable)	56,377	56,382	59,333	52,029
Total liabilities	161,586	182,007	167,439	153,012
Stockholders' equity	79,813	71,010	55,054	39,016

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RISK FACTORS

Before you vote to approve any of the matters set forth in this Proxy Statement, you should carefully consider the risks described below in addition to other information contained in or incorporated by reference into this Proxy Statement, including the section entitled "Forward-Looking Statements." Additional risks not presently known to us or which we consider immaterial based on information currently available to us may also materially adversely affect us and/or NLASCO itself.

Risks Related to the NLASCO Acquisition

Our management has limited prior experience operating an insurance company like NLASCO and therefore may have difficulty in successfully and profitably operating NLASCO or complying with regulatory requirements applicable to insurance companies.

Our management has limited experience operating an insurance company like NLASCO or complying with regulatory requirements applicable to insurance companies like NLASCO. Operating an insurance company is complex. The insurance industry is highly competitive and has historically been characterized by periods of significant price competition, alternating with periods of greater pricing discipline during which competitors focus on other factors. In addition, insurance companies are subject to comprehensive regulation and supervision in those states in which they write insurance policies and in which they are domiciled. Significant changes in the political and regulatory climate could result in changes in these laws and regulations and could make it more expensive or less profitable for us to manage an insurance company. Because we could encounter difficulties in operating an insurance company and complying with regulatory requirements applicable to insurance companies, you should be especially cautious in drawing conclusions about the ability of our management team to execute its business strategies as they relate to this acquisition.

We may fail to realize many of the anticipated potential benefits of the NLASCO acquisition.

We will not receive any anticipated benefits of the NLASCO acquisition if it does not close, and achieving the anticipated benefits of the acquisition will depend in part upon whether we can integrate NLASCO's operations into our own in an efficient and effective manner. We may not be able to accomplish this integration process smoothly or successfully. The necessity of coordinating geographically separated organizations and addressing possible differences in corporate cultures and management philosophies may increase the difficulties of integration. The integration of certain operations following the acquisition will require the dedication of significant management resources, which may temporarily distract management's attention from day-to-day business. Employee uncertainty and/or lack of management focus during the integration process may also disrupt our business and NLASCO's business. Any inability of our management to integrate successfully NLASCO's operations into our own could have a material adverse effect on our business and results of our operations. We may not be able to achieve the anticipated cross-selling opportunities, the development and marketing of more comprehensive insurance product offerings, cost savings, revenue growth or the consistent use of our best practices. A failure of our due diligence process to identify significant issues with respect to product quality and development, information technology, and legal and financial contingencies or other liabilities could lead to unanticipated complications. Such complications could result in significant losses since the acquisition is structured as a stock purchase in which we will assume substantially all of the liabilities of NLASCO. An inability to realize the full extent of, or any of, the anticipated benefits of the acquisition, as well as any delays encountered in the transition process, could have an adverse effect upon our revenues, level of expenses and operating results, which may affect the value of our common stock after the closing of the acquisition.

Our ability to use net operating loss carryforwards to reduce future tax payments may be limited.

Based on our calculations prepared in consultation with our internal tax advisors, and in accordance with the rules stated in the Code, we do not believe that an "ownership change" (as generally described in the following paragraph and as defined in Section 382 of the Code) has occurred since our IPO with respect to our post-IPO NOLs and accordingly we believe that there is no annual limitation under Section 382 of the Code on our ability to use post-IPO NOLs to reduce future taxable income. The pre-IPO NOLs are subject to an annual limitation of approximately \$17 million annually. This annual limitation may cause \$12 million of our pre-IPO NOLs not to be utilized before the pre-IPO NOLs expire. In addition, based on our calculations prepared in consultation with our tax advisors and in accordance with the rules of the Code as to whether an ownership change will occur as a result of the rights offering or the NLASCO acquisition, we do not expect the consummation of the rights offering and/or the acquisition to result in an ownership change under Section 382 of the Code. However, the determination of whether an ownership change has occurred or will occur as a result of such transactions is complicated and may also depend on other changes in percentage stock ownership among stockholders not related to those transactions. Therefore, no assurance can be provided as to whether an ownership change has occurred or will occur in whole or in part as a result of such transactions. If the Company were subject to an ownership change (either previously or as a result of such transactions), the Company's ability to use its NOLs to offset its U.S. Federal income tax liability may be materially adversely affected. In addition, we have not obtained, and currently do not plan to obtain, an Internal Revenue Service, or IRS, ruling or opinion of counsel regarding either of these conclusions.

Generally, an ownership change occurs if certain persons or groups increase their aggregate ownership in the Company by more than 50 percentage points looking back over the prior three-year period. Generally, if an ownership change occurs, our ability to use our NOLs to reduce income taxes is limited to an annual amount, such limitation to be referred to as the Section 382 limitation, equal to the fair market value of our common stock immediately prior to the ownership change multiplied by the long term tax-exempt interest rate, which is published monthly by the IRS. In the event of an ownership change, NOLs that exceed the Section 382 limitation in any year will continue to be allowed as carryforwards for the remainder of the carryforward period and such excess NOLs can be used to offset taxable income for years within the carryforward period subject to the Section 382 limitation in each year. Regardless of whether an ownership change occurs, the carryforward period for NOLs is either 15 or 20 years from the year in which the losses giving rise to the NOLs were incurred. If the carryforward period for any NOL were to expire before that NOL had been fully utilized, the use of the unutilized portion of that NOL would be lost. Our use of new NOLs arising after the date of an ownership change would not be affected by the Section 382 limitation (unless there were another ownership change after those new NOLs arose).

It is impossible for us to ensure that an ownership change will not occur in the future. In addition, limitations imposed by Code Section 382 may prevent us from issuing additional common stock to raise capital or to acquire businesses or properties. To the extent not prohibited by our certificate of incorporation, we may decide in the future that it is necessary or in our interest to take certain actions that could result in an ownership change.

We must obtain governmental and other regulatory consents to complete the acquisition, which, if delayed, not granted or granted with unacceptable conditions, may jeopardize or postpone the completion of the acquisition, result in additional expenditures of money and resources and/or reduce the anticipated benefits of the acquisition.

We must obtain certain approvals and consents in a timely manner from Federal and state regulatory agencies prior to the completion of the acquisition. If we do not receive these approvals, or do not receive them on a timely basis or on terms that satisfy the conditions set forth in the NLASCO

Agreement, then we will not be obligated to complete the acquisition. The governmental agencies from which we will seek these approvals have broad discretion in administering the governing regulations. As a condition to approval of the acquisition, agencies may impose requirements, limitations or costs that could negatively affect the way that we conduct business after the acquisition. These requirements, limitations or costs could jeopardize or delay the completion of the acquisition. If we agree to any material requirements, limitations or costs in order to obtain any approvals required to complete the acquisition, these requirements, limitations or additional costs could adversely affect our ability to integrate NLASCO's operations into our own and reduce the anticipated benefits of the acquisition. This could result in a material adverse effect on our business and results of operations, or cause us to be unable to complete the acquisition.

NLASCO must obtain certain third party consents in order for us to be able to maintain certain loans and reinsurance contracts following the closing.

Certain of the existing loan agreements and reinsurance contracts that NLASCO currently has in place, and which we want to keep in place as part of the transaction, require the consent of the lender or reinsurer in the event of a change of control of NLASCO. This transaction will result in a change of control, and NLASCO will need to obtain consents in order to maintain these agreements and contracts. If NLASCO does not receive these consents, then we will not be obligated to complete the NLASCO acquisition.

The integration of NLASCO's information systems into our own may be more costly than we anticipate, may not be completed on time or the integrated systems may not function properly.

Our success after the acquisition will depend in part on our ability to efficiently integrate NLASCO's information systems with our information systems. Our business and NLASCO's business depend upon numerous information systems for operational and financial information. We may not be able to integrate NLASCO's systems into our own or implement new information systems that can integrate successfully the disparate operational and financial information systems. Furthermore, we may experience unanticipated delays, complications and expenses in implementing, integrating and operating our systems. In addition, the integration of information systems may require modifications, improvements or replacements that may require substantial expenditures and may require interruptions in operations during the integration period. Integration of these systems is further subject to the availability of information technology and skilled personnel to assist us in creating and integrating the systems. If the integration takes longer or is more expensive than anticipated, or if we fail to successfully complete the integration or if the integrated information systems fail to perform as expected, our operations may be disrupted and we may not comply with the requirements of Section 404 of the Sarbanes-Oxley Act of 2002, or SOX. This may increase our costs, reduce our revenue and/or harm our business.

If we acquire NLASCO, we may need to incur significant costs to ensure that NLASCO is in compliance with SOX, which may increase the time and costs of completing the acquisition and, even after making such expenditures, we may not be able to achieve compliance.

NLASCO is not currently required to be in compliance with the provisions of SOX regarding the adequacy of its internal controls. Since ARC affiliated entities are required to comply with SOX, we could incur substantial costs and use a substantial amount of our management's time to develop the internal controls of NLASCO to achieve compliance with SOX. The incurrence of substantial costs to achieve compliance could adversely affect our financial condition. If we fail to implement, achieve or maintain an effective system of internal controls or to prevent fraud, such failures would require additional disclosures in certain of our filings and we could suffer losses and could be subject to costly litigation. In addition, if we would be required to make additional disclosures in our SEC filings,

investors could lose confidence in our reported financial information, and our image and operating results could be harmed, which could have a negative effect on the trading price of our common stock.

If the acquisition's benefits do not meet the expectations of our stockholders or financial or industry analysts, the market price of our common stock may decline.

The market price of our common stock may decline as a result of the acquisition if:

we do not achieve the perceived benefits of the acquisition as rapidly as, or to the extent anticipated by, our stockholders or financial or industry analysts; or

the effect of the acquisition on our financial results is not consistent with the expectations of our stockholders or financial or industry analysts.

Accordingly, our stockholders may experience a loss as a result of a decrease in the price of our common stock.

We may experience difficulties in retaining NLASCO's current employees during integration and after the acquisition, which could cause us to fail to realize the anticipated potential benefits of the acquisition.

Our success in integrating the NLASCO acquisition will depend in part upon our ability to retain the key employees of NLASCO. Competition for qualified personnel can be very intense. In addition, key employees may depart because of issues relating to the uncertainty or difficulty of integration or a desire not to remain with us or NLASCO after integration. Accordingly, we may not be able to retain key employees to the same extent that we and/or NLASCO have been able to do so in the past.

We may experience difficulties in retaining NLASCO's current agents after the acquisition which could cause us to fail to realize the anticipated potential benefits of the acquisition.

Our success in integrating the NLASCO acquisition also will depend in part on our ability to retain NLASCO's current agents who write business with NLIC and ASIC. Our inability to retain these agents could have an adverse impact on our business.

Under the NLASCO Agreement, we are required to indemnify the Sellers against certain matters.

Under the NLASCO Agreement, we have agreed, subject to certain minimum and maximum thresholds and other limitations, to indemnify the Sellers against any breach of any representation, warranty or covenant made in connection with the acquisition. These indemnification obligations generally survive closing of the acquisition. Any indemnity payment that we may be required to make to the Sellers could harm our financial results and/or adversely affect our business.

Risks Related to NLASCO's Business and NLASCO's Industry

The occurrence of severe catastrophic events may have a material adverse effect on NLASCO, particularly because NLASCO conducts business in a concentrated geographic area.

NLASCO expects to have large aggregate exposures to natural and man-made disasters, such as hurricanes, hail, tornados, windstorms, floods, wildfires and acts of terrorism. NLASCO expects that its loss experience generally will include infrequent events of great severity. Hurricanes Katrina and Rita, which occurred on August 29 and September 24, 2005, respectively, are such examples. The risks associated with natural and man-made disasters are inherently unpredictable, and it is difficult to predict the timing of these events with statistical certainty or estimate the amount of loss any given occurrence will generate. Although NLASCO may attempt to exclude certain losses such as terrorism and other similar risks from some coverages NLASCO writes, it may not be successful in doing so. The extent of losses from a catastrophe is a function of both the total amount of policyholder exposure in

the geographic area affected by the event and the severity of the event. The occurrence of losses from catastrophic events may have a material adverse effect on NLASCO's ability to write new business and on its financial condition and results of operations. Increases in the values and geographic concentrations of policyholder property and the effects of inflation have resulted in increased severity of industry losses in recent years, and NLASCO expects that these factors will increase the severity of losses in the future. Factors that may influence NLASCO's exposure to losses from these types of events in addition to the routine adjustment of losses include: exhaustion of reinsurance coverage; increases in reinsurance rates; unanticipated litigation expenses; unrecoverability of ceded losses; impact on independent agent operations and future premium income in areas affected by catastrophic events; unanticipated expansion of policy coverage or reduction of premium due to regulatory, legislative and/or judicial action following a catastrophic event; and unanticipated demand surge related to other recent catastrophic events, among others.

NLASCO writes insurance primarily in the states of Texas, Arizona, Tennessee, Oklahoma and Louisiana. In 2005, premiums written in Texas accounted for 70% of direct written premiums. As a result, a single catastrophe, destructive weather pattern, wildfire, terrorist attack, regulatory development or other condition or general economic trend affecting this region or significant portions of this region could adversely affect NLASCO's financial condition and results of operations more significantly than other insurance companies that conduct business across a broader geographic area. Although NLASCO purchases catastrophe reinsurance to limit its exposure to these types of catastrophes, in the event of one or more major catastrophes resulting in losses to it in excess of \$150 million, NLASCO's losses would exceed the limits of its reinsurance coverage.

NLASCO is exposed to claims related to severe weather and the occurrence of severe weather may result in an increase in claims frequency and exposure amount and could materially adversely affect its financial condition.

NLASCO is subject to claims arising out of severe weather, such as hurricanes, tornados, rainstorms, snowstorms, hailstorms, windstorms and ice storms that may have a significant effect on its financial condition and results of operations. The majority of its business is written in Texas, Arizona and Oklahoma, which have been experiencing extreme drought conditions, making the risk of loss from wildfires more prevalent. The incidence and severity of weather conditions are inherently unpredictable. Some forecasters predict that the world is currently in a cycle of more numerous and more severe hurricanes.

NLASCO's insured risks generally exhibit higher losses in the second and third quarters of the year due to a seasonal concentration of weather-related events in its primary geographic markets. Although weather-related losses (including hail, high winds, tornadoes and hurricanes) can occur in any calendar quarter, the second quarter historically has experienced the highest frequency of losses associated with these events. For example, for the last five years, the contribution of weather-related catastrophes to the consolidated second quarter net loss ratio was on average approximately four points greater than the average contribution of such catastrophes in the other three quarters. Hurricanes are more likely to occur in the third quarter.

From 2001 through 2005, NLASCO's average annual net catastrophe losses after reinsurance recoveries were \$4.6 million, with an average of two catastrophic events in excess of \$1.0 million in losses per year. During this period, the year least impacted by catastrophes (2001) experienced no catastrophic events while the year most impacted (2005) experienced \$10.8 million in such losses with two events exceeding \$1.0 million. Before reinsurance recoveries, NLASCO incurred \$108.7 million (including loss adjustment expenses) in catastrophe related losses in 2005, primarily related to hurricane losses from Katrina and Rita. However, NLASCO's net loss after reinsurance for the two hurricanes was \$10.8 million. NLASCO incurred \$5.1 million (including loss adjustment expenses) in catastrophe related losses for the six months ended June 30, 2006. For the six months ended June 30, 2006,

NLASCO's net catastrophe loss experience was \$4.3 million after reinsurance. In addition, NLASCO is exposed to an increase in claims frequency and exposure amount under the homeowners and dwelling fire insurance it writes because property damage may result from severe weather conditions.

Due to the inherent inability to accurately predict the severity and frequency of catastrophe losses, higher than expected catastrophe losses could materially adversely affect NLASCO's financial condition.

NLASCO utilizes catastrophe modeling to assess its probable maximum insurance losses from hurricane and other wind/hail perils and to structure its catastrophe reinsurance program to minimize its exposure to high severity/high frequency types of losses. Hurricane Katrina highlighted the challenges inherent in predicting the impact of catastrophic events, such as a severe hurricane. The catastrophe models generally failed to adequately project the financial impact of Hurricane Katrina. This experience highlights the limitations inherent in the use of modeling as a means of risk assessment/abatement. If the exposure amount and frequency of catastrophe losses are higher than predicted under NLASCO's modeling, NLASCO's financial condition may be materially adversely affected.

If NLASCO cannot price its business accurately, its profitability and the profitability of its insurance companies could be materially and adversely affected.

NLASCO's results of operations and financial condition depend on its ability to underwrite and set premium rates accurately for a wide variety of risks. Adequate rates are necessary to generate premiums sufficient to pay losses, loss adjustment expenses and underwriting expenses and to earn a profit. To price its products accurately, NLASCO must (1) collect and properly analyze a substantial amount of data, (2) develop, test and apply appropriate pricing techniques, (3) closely monitor and recognize changes in trends in a timely manner and (4) project both severity and frequency of losses with reasonable accuracy. NLASCO's ability to undertake these efforts successfully and price its products accurately is subject to a number of risks and uncertainties, some of which are outside its control, including:

the availability of sufficient reliable data and NLASCO's ability to properly analyze available data;

changes in applicable legal liability standards and in the civil litigation system generally;

NLASCO's selection and application of appropriate pricing techniques;

NLASCO's ability to obtain regulatory approval, where necessary;

the uncertainties that inherently characterize estimates and assumptions; and

NLASCO's ability to obtain adequate premium rates to offset higher reinsurance costs.

Consequently, NLASCO could underprice risks, which would adversely affect its profit margins, or it could overprice risks, which could reduce its competitiveness and sales volume. In either case, its profitability and the profitability of its insurance companies could be materially and adversely affected.

If NLASCO's actual losses and loss adjustment expenses exceed its loss and expense estimates, its financial condition and results of operations could be materially and adversely affected.

NLASCO's financial condition and results of operations depend upon its ability to assess accurately the potential losses associated with the risks that it insures. NLASCO establishes reserve liabilities to cover the payment of all losses and loss adjustment expenses incurred under the policies that it writes. Such liability estimates include case estimates, which are established for specific claims that have been reported to NLASCO, and liabilities for claims that have been incurred but not reported, or IBNR. Loss adjustment expenses represent expenses incurred to investigate and settle claims. To the extent

that losses and loss adjustment expenses exceed estimates, NLIC and ASIC will be required to increase their reserve liabilities and reduce their income before income taxes in the period in which the deficiency is identified. In addition, increasing reserves causes a reduction in policyholders' surplus and could cause a downgrading of the ratings of NLIC and ASIC. This in turn could hurt the ability to sell insurance policies.

The liability estimation process for NLASCO's casualty insurance coverage possesses characteristics that make case and IBNR reserving inherently less susceptible to accurate actuarial estimation than is the case with property coverages. Unlike property losses, casualty losses are claims made by third parties of which the policyholder may not be aware and therefore may be reported a significant time after the occurrence, sometimes years later. As casualty claims most often involve claims of bodily injury, assessment of the proper case estimates is a far more subjective process than claims involving property damage. In addition, in determining the case estimate for a casualty claim, information develops slowly over the life of the claim and can subject the case estimation to substantial modification well after the claim was first reported. Numerous factors impact the casualty case reserving process, such as venue, the amount of monetary damage, legislative activity, the permanence of the injury and the age of the claimant.

The effects of inflation could cause the severity of claims from catastrophes or other events to rise in the future. Increases in the values and geographic concentrations of policyholder property and the effects of inflation have resulted in increased severity of industry losses in recent years, and NLASCO expects that these factors will increase the severity of losses in the future. As NLASCO observed in 2005, the severity of some catastrophic weather events, including the scope and extent of damage and the inability to gain access to damaged properties, and the ensuing shortages of labor and materials and resulting demand surge, provide additional challenges to estimating ultimate losses. NLASCO's liabilities for losses and loss adjustment expenses include assumptions about future payments for settlement of claims and claims handling expenses, such as medical treatments and litigation costs. To the extent inflation causes these costs to increase above liabilities established for these costs, NLASCO expects to be required to increase its liabilities with a corresponding reduction in its net income in the period in which the deficiency is identified.

Estimating an appropriate level of liabilities for losses and loss adjustment expenses is an inherently uncertain process. Accordingly, actual loss and loss adjustment expenses paid will likely deviate, perhaps substantially, from the liability estimates reflected in NLASCO's consolidated and combined financial statements. Claims could exceed NLASCO's estimate for liabilities for losses and loss adjustment expenses, which could have a material adverse effect on its financial condition and results of operations.

If NLASCO cannot obtain adequate reinsurance protection for the risks it underwrites, NLASCO may be exposed to greater losses from these risks or may reduce the amount of business it underwrites, which may adversely affect its financial condition and results of operations.

NLASCO uses reinsurance to protect itself from certain risks and to share certain risks it underwrites. During 2005, NLASCO's personal lines ceded 21% of its direct premiums written (primarily through excess of loss, quota share and catastrophe reinsurance treaties) and its commercial lines ceded 4% of its direct premiums written (primarily through excess of loss and catastrophe reinsurance treaties). The total cost of reinsurance inclusive of per risk excess and catastrophe has increased 73.3% in 2006. This includes additional catastrophe limits purchased. Reinsurance cost will likely increase for 2007, in part due to the frequency and severity of hurricanes and/or the lack of capacity in the reinsurance market.

From time to time, market conditions have limited, and in some cases have prevented, insurers from obtaining the types and amounts of reinsurance that they have considered adequate for their

business needs. Accordingly, NLASCO may not be able to obtain desired amounts of reinsurance. Even if NLASCO is able to obtain adequate reinsurance, it may not be able to obtain it from entities with satisfactory creditworthiness or negotiate terms that it deems appropriate or acceptable. Although the cost of reinsurance is, in some cases, reflected in NLASCO's premium rates, NLASCO may have guaranteed certain premium rates to its policyholders. Under these circumstances, if the cost of reinsurance were to increase with respect to policies for which NLASCO guaranteed the rates, NLASCO would be adversely affected. In addition, if NLASCO cannot obtain adequate reinsurance protection for the risks it underwrites, it may be exposed to greater losses from these risks or it may be forced to reduce the amount of business that it underwrites for such risks, which will reduce NLASCO's revenue and may have a material adverse effect on its results of operations and financial condition.

NLASCO could face unanticipated losses from war, terrorism and political unrest, and these or other unanticipated losses could have a material adverse effect on NLASCO's financial condition and results of operations.

Although NLASCO believes that it does not have exposure to the events of September 11, 2001 because it did not have insurance in-force at that time with respect to exposure to such events, NLASCO has exposure to unexpected losses resulting from future man-made catastrophic events, such as acts of terrorism and political instability. These risks are inherently unpredictable. It is difficult to predict the timing of such events with statistical certainty or to estimate the amount of loss that any given occurrence will generate. In certain instances, NLASCO specifically insures risks resulting from acts of terrorism. Even in cases where NLASCO attempts to exclude losses from terrorism and certain other similar risks from some coverages it writes, NLASCO may not be successful in doing so. Irrespective of the clarity and inclusiveness of policy language, a court or arbitration panel may limit enforceability of policy language or otherwise issue a ruling adverse to NLASCO. Accordingly, while NLASCO believes its reinsurance programs, together with the coverage provided under the Terrorism Act and the Terrorism Extension Act, are sufficient to reasonably limit its net losses relating to potential future terrorist attacks, its reserves may not be adequate to cover losses when they materialize. Under the Terrorism Act, after an act of terrorism is certified by the Secretary of the Treasury, NLASCO may be entitled to be reimbursed by the Federal Government for a percentage of subject losses, after an insurer deductible and subject to an annual cap. The Terrorism Act covers an insurance company's operations for up to 90% of its losses for 2005 and 2006 and for up to 85% of its losses for 2007, in each case subject to certain mandatory deductibles. The deductible is calculated by applying the deductible percentage to the insurer's direct earned premiums for covered lines from the calendar year immediately preceding the applicable year. Although the Terrorism Act and the Terrorism Extension Act provide benefits in the event of certain acts of terrorism, such acts may not be extended beyond 2007 or their benefits may be reduced. It is not possible to eliminate completely NLASCO's exposure to unforecasted or unpredictable events, and to the extent that losses from such risks occur, NLASCO's financial condition and results of operations could be materially adversely affected.

If NLASCO's reinsurers do not pay losses in a timely fashion, or at all, NLASCO may incur substantial losses that could materially and adversely affect its financial condition and results of operations.

As of December 31, 2005 and 2004, NLASCO had \$36.2 million and \$33.7 million, respectively, in reinsurance recoverables, including ceded paid loss recoverables, ceded losses and loss adjustment expense recoverables and ceded unearned premiums. For the six months ended June 30, 2006, NLASCO had \$8.2 million in reinsurance recoverables, including ceded paid loss recoverables, ceded losses and loss adjustment expense recoverables and ceded unearned premiums. NLASCO expects to continue to purchase substantial reinsurance coverage in the foreseeable future. Since NLASCO remains primarily liable to its policyholders for the payment of their claims, regardless of the reinsurance it has purchased relating to those claims, in the event that one of its reinsurers becomes

insolvent or otherwise refuses to reimburse NLASCO for losses paid, or delays in reimbursing NLASCO for losses paid, its liability for these claims could materially and adversely affect its financial condition and results of operations. As an example, if one of NLASCO's catastrophe reinsurers experienced financial difficulties following one of the major hurricanes in 2005 and had been unable to meet its obligations to NLASCO, NLASCO could have experienced difficulty meeting its obligations to its policyholders.

NLASCO relies on independent insurance agents to distribute its products, and if the agents do not promote NLASCO's products successfully, NLASCO's results of operations and financial condition could be adversely affected.

NLASCO's business depends in large part on the efforts of independent insurance agents to market its insurance products and on its ability to offer insurance products and services that meet the requirements of the customers. While NLASCO strives to offer products its agents require, NLASCO competes for business with other carriers based on the scope of coverage provided in its products, services, commissions and rates. NLASCO's competitors may offer coverage that is more attractive to particular customers than they offer for a specific product, may price their insurance products more aggressively, may offer higher agent commissions and may devote additional resources to improve their services. Accordingly, NLASCO's agents may find it easier to promote the programs of NLASCO's competitors rather than NLASCO's. If NLASCO's agents fail or choose not to market its insurance products successfully, its growth may be limited and its financial condition and results of operations may be adversely affected. Additionally, rather than utilizing an independent agent to buy their insurance, consumers may elect to deal with direct-writers or mass marketers who utilize the Internet to advertise and/or underwrite their business. Industry developments that centralize and commoditize insurance products could be detrimental to NLASCO's agency distribution model of doing business.

Because NLASCO relies on managing general agents to underwrite some of its products and to administer claims, such managing general agents could expose NLASCO to liability or allocate business away from NLASCO, which could cause NLASCO's financial condition and results of operations to be adversely affected.

NLASCO has developed programs with MGAs, whereby the MGA will, within the guidelines NLASCO establishes, underwrite insurance policies on NLASCO's insurance subsidiaries' behalf with oversight by NLASCO. An MGA is a person, firm or corporation that has supervisory responsibility for the local agency and field operations of an insurer in the state where it is organized or that is authorized by an insurer to accept or process on the insurer's behalf insurance policies produced and sold by other agents. While NLASCO exercises care in the selection of its MGA relationships and regularly audits the performance of its MGAs, NLASCO is at risk for their conduct as a result of the authority it has delegated to them. If one of NLASCO's MGAs binds NLASCO's insurance subsidiaries to policies that expose it to unexpected losses or fails to appropriately report claims, NLASCO's financial condition and results of operations could be adversely affected. For example, if a terminated MGA fails to continue to appropriately report claims during the runoff period, then liabilities for losses and loss adjusted expenses could be deficient, which would impact NLASCO's results of operations in future periods. Furthermore, subject to contractual limitations, MGAs have the ability to change carriers or increase or decrease the allocation to a particular carrier. An MGA might choose to change carriers or allocations for reasons such as pricing, service, conditions in the reinsurance market or a change in ownership of an MGA.

NLASCO's success depends in substantial part upon its key employees who have knowledge and experience in its target markets and lines of business.

In order to execute its business strategy successfully, NLASCO must attract and retain qualified executive officers, experienced underwriting and claims personnel and other skilled employees who are knowledgeable about its business. NLASCO relies substantially upon the services of its executive management team and the skilled underwriting, actuarial and claims management teams they supervise. While we anticipate that we will retain all of the key personnel in these areas, if NLASCO were to lose the services of certain members of its management team, its business could be adversely affected. ARC does not currently have any employment agreements with its employees, but upon consummation of the NLASCO acquisition, NLASCO will have employment agreements with Clifton Robinson, Gordon Robinson and Gregory Vanek. However, Clifton Robinson and Gordon Robinson will serve NLASCO in a reduced capacity following the acquisition, serving more in an advisory role as opposed to being in charge of day-to-day operations, and Gregory Vanek will assume additional responsibilities with respect to the operations of NLASCO. NLASCO does not currently maintain key man life insurance policies for any of its employees or employment agreements with any of its other employees.

NLASCO's future growth depends on its ability to hire additional underwriting and marketing personnel.

NLASCO's future growth will require it to hire additional underwriting and marketing talent as it expands its product offerings. NLASCO's underwriters manage and review all aspects of its commercial and personal insurance lines and personally underwrite all of its commercial lines policies, all of its personal lines policies that do not satisfy its established underwriting guidelines and a random sampling of those personal lines policies that otherwise do satisfy its established underwriting guidelines. As the underwriting function in many larger carriers becomes increasingly automated, there are fewer skilled underwriters of the type NLASCO requires. As a result, NLASCO may have difficulty finding talented replacements for members of its current underwriting team or additional underwriters that will enable its business to grow. If NLASCO is unable to find talented underwriters to meet the growing demand for its products, its business could be adversely affected.

A decline in NLIC's and/or ASIC's financial strength ratings by A.M. Best could cause either its sales or earnings, or both, to decrease.

Ratings have become an increasingly important factor in establishing the competitive position of insurance companies. A.M. Best maintains a letter scale rating system ranging from "A++ (Superior)" to "F (In Liquidation)" to rate the financial strength of insurance enterprises. NLIC has been rated "A (Excellent)" by A.M. Best, which is the third highest of fifteen rating levels. ASIC has been rated "B++ (Very Good)" by A.M. Best, which is the fifth highest.

Each of NLIC's and ASIC's financial strength ratings is subject to periodic review by, and may remain the same, be revised downward, upward or revoked at the sole discretion of, A.M. Best. A decline in either NLIC's or ASIC's rating or an announced negative outlook on the rating can cause concern about their viability among agents, brokers and policyholders, resulting in a movement of business away from NLASCO and its insurance company subsidiaries to more highly-rated carriers. In addition, the errors and omissions insurance coverage of many of NLASCO's independent agents does not provide coverage if the covered agents sell policies from insurers with an A.M. Best financial strength rating of "B+ (Very Good)" or below. As a result, the loss of NLIC's or ASIC's A.M. Best financial strength rating, or a reduction to "B+ (Very Good)" or worse, may adversely impact NLASCO's ability to retain or expand its policyholder base. Periodically, A.M. Best changes its rating methodology and practices. Such changes could result in a reduction of NLIC's or ASIC's A.M. Best rating.

If we acquire NLASCO, our financial condition could have an adverse impact on NLIC's and ASIC's financial strength ratings.

If we acquire NLASCO, our financial condition could have an adverse impact on NLIC's and ASIC's financial strength ratings by A.M. Best. A.M. Best evaluates a wholly-owned insurance subsidiary in a manner similar to that used with a commercial insurance company, but with consideration given to the financial risk of the parent. A.M. Best applies a risk-evaluation process to the parent and its relationship to the wholly-owned insurance subsidiary. A.M. Best focuses on balance sheet strength (including capital adequacy and loss and loss expense reserve adequacy), operating performance and business profile. As such, any deficiencies in our financial condition could have an adverse impact on NLIC's and ASIC's A.M. Best ratings. Any downgrade of these ratings could cause brokers, agents, retail brokers or insureds with whom NLIC and ASIC work to choose other, more highly rated competitors, thus adversely affecting their and our business and results of operations.

A decline in NLASCO's ratings coupled with a change of control could result in a default under one of its debt agreements.

NLASCO has entered into an indenture under which an aggregate of \$20 million in notes are outstanding, which provides that (i) if a person or group becomes the beneficial owner directly or indirectly of 50% or more of its equity securities and (ii) if NLASCO's ratings are downgraded by a nationally recognized statistical rating organization (as defined in the Securities Exchange Act of 1934, as amended, or the Exchange Act), then each holder of the notes governed by such indenture has the right to require that NLASCO purchase such holder's notes in whole or in part at a price equal to 107.5% of the outstanding principal amount prior to March 10, 2010, or 100.0% thereafter. A change of control under the indenture will occur as a result of an acquisition of NLASCO by ARC. As a result, if a downgrading occurs following the acquisition, then each holder of notes under the indenture would have the right to require NLASCO to repurchase its notes. This required repayment risk could cause liquidity issues to both NLASCO and ARC, could impair NLASCO's ability to obtain additional financing and would likely increase the cost of any financing that it does obtain.

The failure of any of the loss limitation methods NLASCO employs could have a material adverse effect on its financial condition and results of operations.

At the present time, NLASCO employs a variety of endorsements to its policies that limits its exposure to known risks, such as exclusions for mold losses and water damage. NLASCO's policies are also not designed to provide coverage for claims related to exposure to potentially harmful products or substances including, but not limited to, lead paint and silica. NLASCO's homeowners policies, other than policies specifically written for flood coverage, specifically exclude coverage for losses caused by flood, but generally provide coverage for damage caused by wind. In addition, NLASCO's policies contain conditions requiring the prompt reporting of claims and its right to decline coverage due to late claim reporting. NLASCO's policies also include limitations restricting the period during which a policyholder may bring a breach of contract or other claim against it, which in many cases is shorter than the applicable statutory limitations for such claims. It is possible that a court or regulatory authority could nullify or void an exclusion or legislation could be enacted modifying or barring the use of endorsements and limitations in a way that would adversely affect NLASCO's loss experience, which could have a material adverse effect on its financial condition and results of operations.

The effects of emerging claim and coverage issues on NLASCO's business are uncertain.

As industry practices and legal, judicial, social and other environmental conditions change, unexpected and unintended issues related to claims and coverage may emerge. These issues may adversely affect NLASCO's business by either extending coverage beyond its underwriting intent or by increasing the number or size of claims. In some instances, these changes may not become apparent

until long after NLASCO has issued insurance policies that are affected by the changes. As a result, the full extent of liability under NLASCO's insurance policies may not be known until after a contract is issued.

An example of the potential threats to NLASCO's business and that of the insurance industry as a whole are legal and regulatory actions that have emerged from the aftermath of Hurricane Katrina. Legal actions have been filed against other insurers in Mississippi and Louisiana seeking to extend coverage under homeowners policies to include rising water from the hurricane storm surge. Many cases on this issue remain pending and, in the event legal or regulatory mandates override the industry standard flood exclusion clauses in homeowners policies, NLASCO could experience a material adverse effect on its financial condition and results of operations. Changes in other legal theories of liability under NLASCO's insurance policies or the failure of any loss limitation it applies could also adversely impact NLASCO's financial condition and results of operations.

Because NLASCO's main source of premiums written is in Texas, unfavorable changes in the economic and/or regulatory environment in that state may have a material adverse effect on its financial condition and results of operations.

Texas accounted for approximately 70% of NLASCO's direct premiums written in 2005 and 70% for the six months ended June 30, 2006. The loss of a significant amount of NLASCO's premiums written in Texas, whether due to an economic downturn, competitive changes, regulatory or legislative developments or other reasons, could have a material adverse effect on its financial condition and results of operations.

If NLASCO is unsuccessful in competing against other competitors in the insurance industry, its financial condition and results of operations could be adversely affected.

The insurance industry is highly competitive and has historically been characterized by periods of significant price competition, alternating with periods of greater pricing discipline during which competitors focus on other factors. In the current market environment, competition in NLASCO's industry is based primarily on the following:

products offered;

service;

experience;

the strength of agent and policyholder relationships;

reputation;

speed and accuracy of claims payment;

perceived financial strength;

ratings;

scope of business;

commissions paid; and

policy and contract terms and conditions.

NLASCO competes with many other insurers, including large national companies who have greater financial, marketing and management resources than NLASCO. Many of these competitors also have better ratings and market recognition than NLASCO. NLASCO seeks to distinguish itself from its

competitors by providing a broad product line and targeting those market segments that provide the best opportunity to earn an underwriting profit.

NLASCO also faces competition from entities that self-insure, primarily in the commercial insurance market. From time to time, established and potential customers may examine the benefits and risks of self-insurance and other alternatives to traditional insurance.

In addition, a number of new, proposed or potential industry developments could also increase competition in NLASCO's industry. These developments include, but are not necessarily limited to, changes in practices and other effects caused by the Internet (including direct marketing campaigns by NLASCO's competitors in established and new geographic markets), which have led to greater competition in the insurance business and increased expectations for customer service. These developments could prevent NLASCO from expanding its book of business.

NLASCO also faces competition from new entrants into the insurance market. New entrants do not have historic claims or losses to address and therefore may be able to price policies on a basis that is not favorable to NLASCO. New competition could reduce the demand for NLASCO's insurance products, which could have a material adverse effect on its financial condition and results of operations.

NLASCO's investment performance may suffer as a result of adverse capital market developments or other factors, which may affect its financial results and ability to conduct business.

NLASCO invests the premiums it receives from policyholders until they are needed to pay policyholder claims or other expenses. As of June 30, 2006, NLASCO's invested assets consisted of \$113.7 million in fixed maturity securities, \$11.9 million in equity securities and \$5.9 million in real estate loans. As of December 31, 2005 and 2004, NLASCO's invested assets consisted of \$114.5 million and \$109.2 million in fixed maturity securities, \$12.6 million and \$11.5 million in equity securities and \$6.6 million and \$0.6 million in real estate loans, respectively. For the six months ended June 30, 2006, NLASCO had \$3.8 million of net investment income representing 5.4% of NLASCO's total revenues and 26.0% of its income before taxes. For the year ended December 31, 2005, NLASCO had \$6.4 million of net investment income representing 5.4% of its total revenues and 24.1% of its income before taxes. For the year ended December 31, 2004, NLASCO had \$4.4 million of net investment income representing 4.3% of its total revenues and 17.5% of its income before taxes. Although NLASCO's investment policies stress diversification of risks, conservation of principal and liquidity, its investments are subject to a variety of investment risks, including those relating to general economic conditions, market volatility, interest rate fluctuations, liquidity risk and credit and default risk. In particular, the volatility of NLASCO's claims may force it to liquidate securities, which may cause it to incur capital losses. If NLASCO's investment portfolio is not appropriately matched with its insurance liabilities, it may be forced to liquidate investments prior to maturity at a significant loss to cover these liabilities. Investment losses could significantly decrease its asset base and statutory surplus, thereby adversely affecting its ability to conduct business and potentially its A.M. Best financial strength rating. Further, developments in the world's financial and capital markets, including but not limited to Federal and state legislation related to terrorism insurance and reinsurance, such as the extension of or replacement for the Terrorism Risk Insurance Extension Act of 2005, could adversely affect the performance of NLASCO's investments. Additionally, inflation could increase beyond NLASCO's ability to earn investment income to keep pace.

NLASCO's investment results may be adversely affected by interest rate changes.

NLASCO's operating results are affected, in part, by the performance of its investment portfolio. NLASCO's investment portfolio contains instruments, such as bonds, that may be adversely affected by increases in interest rates. Because bond trading prices decrease as interest rates rise, a significant increase in interest rates could have a material adverse effect on NLASCO's financial condition and

results of operations. On the other hand, decreases in interest rates could have an adverse effect on NLASCO's investment income and results of operations. For example, if interest rates decline, investment of new premiums received and funds reinvested will earn less. Interest rates are highly sensitive to many factors, including governmental monetary policies, domestic and international economic and political conditions and other factors beyond NLASCO's control.

As of June 30, 2006, mortgage-backed and asset-backed securities constituted 20.3% of NLASCO's cash and invested assets. As with other fixed-income investments, the fair market value of these securities fluctuates depending on market and other general economic conditions and the interest rate environment. Changes in interest rates can expose NLASCO to prepayment risks on these investments. When interest rates fall, mortgage-backed securities typically are prepaid more quickly and the holder must reinvest the proceeds at lower interest rates. NLASCO's mortgage-backed securities currently consist of securities with features that reduce the risk of prepayment, but NLASCO can make no assurance that it will invest in other mortgage-backed securities that contain this protection. In periods of increasing interest rates, mortgage-backed securities typically are prepaid more slowly, which may require NLASCO to receive interest payments that are below the then prevailing interest rates for longer time periods than expected.

The debt agreements of NLASCO and its controlled affiliates contain financial covenants and impose restrictions on its business.

NLASCO's loan agreement governing its note due April 2007, with an outstanding principal balance of approximately \$3 million, contains restrictions on its ability to, among other things:

- create liens;
- sell assets;
- incur additional indebtedness;
- declare or pay dividends;
- consolidate or merge;
- engage in certain businesses;
- make certain loans, advances or investments;
- compensate its owners and executives; and
- enter into transactions with affiliates.

In addition, this loan agreement provides that an event of default will occur if C. Clifton Robinson or his affiliates fail to own 50% of the issued and outstanding stock of NLASCO. A change of control under the loan agreement will occur as a result of an acquisition of NLASCO by ARC. The loan agreement also requires that NLASCO meet certain financial tests and maintain certain financial ratios, including a minimum capital percentage ratio and minimum consolidated capital. The indebtedness under this loan agreement is guaranteed by C. Clifton Robinson, C.C. Robinson Property Company, Ltd., C.C. Robinson Property Company II, Ltd. and James Murphy. The indebtedness is secured by a lien on the assets of NLASCO. These restrictions may discourage the acquisition, and may delay, deter or prevent a change in control of NLASCO, unless consent of necessary parties is obtained under the terms of these debt agreements.

NLASCO's indenture governing its LIBOR plus 3.40% notes due 2035 contains restrictions on its ability to, among other things, declare and pay dividends and merge or consolidate. In addition, this indenture contains a change of control provision, which provides that (i) if a person or group becomes the beneficial owner directly or indirectly of 50% or more of NLASCO's equity securities and (ii) if

NLASCO's ratings are downgraded by a nationally recognized statistical rating organization (as defined in Exchange Act), then each holder of the notes governed by such indenture has the right to require that NLASCO purchase such holder's notes in whole or in part at a price equal to 107.5% of the outstanding principal amount at any time prior to March 10, 2010, and at 100% of the outstanding principal amount thereafter.

NLIC's surplus indentures governing its LIBOR plus 4.10% notes due 2033 and its LIBOR plus 4.05% notes due 2033 and ASIC's surplus indenture governing its LIBOR plus 4.05% notes due 2034 contain restrictions on dividends and mergers and consolidations. In addition, NLASCO has other credit arrangements with its affiliates and other third parties.

NLASCO's ability to comply with these covenants may be affected by events beyond its control, including prevailing economic, financial and industry conditions. The breach of any of these restrictions could result in a default under the loan agreements or indentures governing the notes or under its other debt agreements. An event of default under its debt agreements would permit some of its lenders to declare all amounts borrowed from them to be due and payable, together with accrued and unpaid interest. If NLASCO were unable to repay debt to its secured lenders, these lenders could proceed against the collateral securing that debt. In addition, acceleration of its other indebtedness may cause NLASCO to be unable to make interest payments on the notes. NLASCO will seek waivers of these covenants for the debt it intends to keep on its books subsequent to consummation of its acquisition by ARC, but there can be no assurances that NLASCO's lenders will grant any such waiver requested. If such waivers are not granted, NLASCO may need to pay off the debt and seek new financing. There can be no assurances that new financing will be available or, if available, will be on terms as favorable or acceptable to NLASCO.

Other agreements that NLASCO or its insurance company subsidiaries may enter into in the future may contain covenants imposing significant restrictions on their businesses that are similar to, or in addition to, the covenants under their existing agreements. These restrictions may affect NLASCO's ability to operate its business and may limit its ability to take advantage of potential business opportunities as they arise.

The regulatory system under which NLIC and ASIC operate, and potential changes to that system, could have a material adverse effect on their respective business activities.

NLIC and ASIC are subject to comprehensive regulation and supervision in those states in which they are domiciled and write insurance policies. Though NLIC and ASIC currently write most of their policies in Texas, Arizona, Tennessee, Oklahoma and Louisiana, NLIC is licensed in 18 states and ASIC is licensed in 27 states. Laws and regulations pertaining to NLIC and ASIC are generally administered by state insurance departments and relate to, among other things:

standards of solvency, including risk-based capital measurements;

restrictions on the nature, quality and concentration of investments;

required methods of accounting;

rate and policy form regulation and other market conduct; and

potential assessments for the provision of funds necessary for covered claims under certain policies provided by impaired, insolvent or failed insurance companies.

These state insurance departments also conduct periodic examinations of insurance companies and require the filing of annual and other reports relating to financial condition, holding company issues and other matters. Current or future regulatory requirements may adversely affect or inhibit each of the insurance company's ability to achieve some or all of its business objectives.

NLIC and ASIC may not be able to obtain or maintain necessary licenses, permits, authorizations or accreditations in states where they are currently licensed or in new states they intend to enter, or they may be able to do so only at a significant cost. In addition, they may not be able to comply fully with, or obtain appropriate exemptions from, the wide variety of laws and regulations applicable to insurance companies and insurance holding companies, which could result in restrictions on their operating flexibility and could subject them to fines and other sanctions that may have a material adverse effect on their business.

Significant changes in the political and regulatory climate could result in changes in applicable laws and regulations and could make it more expensive and/or less profitable to manage their business. In recent years, the U.S. insurance regulatory framework has come under increased Federal scrutiny, and some state legislators have considered or enacted laws that may alter or increase state regulation of insurance and reinsurance companies and holding companies. Moreover, the NAIC and state insurance regulators regularly reexamine existing laws and regulations and develop new laws. Changes in laws and regulations or their interpretation could have a material adverse effect on the insurance companies' financial condition and results of operations.

The activities of the insurance companies' MGAs are subject to licensing requirements and regulation under the laws of the states in which they operate. The insurance companies' MGAs' businesses depend on the validity of, and continued good standing under, the licenses and approvals pursuant to which they operate, as well as compliance with pertinent laws and regulations.

Company licensing laws and regulations vary from jurisdiction to jurisdiction. In all jurisdictions, the applicable company licensing laws and regulations are subject to amendment or interpretation by regulatory authorities. Generally these authorities are vested with relatively broad discretion to grant, renew and revoke licenses and approvals for various reasons, including the violation of law and conviction of crimes. Other sanctions may include the suspension of individual employees, limitations on engaging in a particular business for specified periods of time, revocation of licenses, censures, redress to policyholders and fines. Although NLASCO and its insurance subsidiaries endeavor to follow practices based on good faith interpretations of laws and regulations, or those generally followed by the industry, these practices may prove to be different from those that the regulatory authorities require.

If the states in which NLIC and ASIC write insurance drastically increase the assessments that insurance companies are required to pay, their and NLASCO's financial condition and results of operations will suffer.

NLIC and ASIC are subject to a variety of taxes, fines, levies, license fees, tariffs and other assessments that may, from time to time, be material. These assessments are made by the states in which NLIC and ASIC operate and include participation in residual market or involuntary risk plans in various states that provide insurance coverage to individuals or entities that otherwise are unable to purchase such coverage from private insurers. Due to this participation, NLIC and ASIC may be exposed to material losses. They are also subject to assessments in the states in which they write insurance for various purposes, including the provision of funds necessary to fund the operations of various insurance guaranty associations, which pay covered claims under certain policies issued by impaired, insolvent or failed insurance companies. These assessments are generally set based on an insurer's percentage of the total premiums written in the relevant state within a particular line of business for the relevant time period. From 1999 to 2004, NLASCO's other assessments in any year did not exceed \$1.0 million. For the year ended December 31, 2004, NLASCO paid no other assessments. For the year ended December 31, 2005, NLASCO's other assessments were \$10.4 million with \$4.4 million paid in 2005 and \$6.0 million paid in 2006, principally related to Hurricanes Katrina and Rita in Louisiana, Mississippi and Texas (see next paragraph), and additional or emergency hurricane-related assessments are likely to follow. For the six months ended June 30, 2006, NLASCO paid no other assessments but in July 2006, paid \$0.4 million to cover the claims of an impaired insurer in Texas. As NLIC's and ASIC's total premiums written grow, NLASCO's share of any assessments may

increase. However, NLASCO cannot predict with certainty the amount of future assessments, because such assessments depend on factors outside NLASCO's control, such as the insolvencies of other insurance companies, the market shares of other insurance companies writing in a particular state and the degree to which other companies write in coastal areas. Generally, in most states, NLIC and ASIC can take a credit against their premium taxes for these assessments over a stipulated number of years.

NLASCO is subject to assessments from the Georgia Underwriting Association, Louisiana Citizens Property Insurance Corporation or LCPIC, Mississippi Windstorm Underwriting Association, or MWUA, the Texas FAIR Plan Association and the Texas Windstorm Insurance Association, or TWIA. LCPIC, MWUA and TWIA have estimated plan losses due to losses incurred from the hurricanes that struck Louisiana and Texas in the third quarter of 2005, and are thereby able to levy regular and emergency assessments to participating companies and policyholders, respectively. During the year ended December 31, 2005, NLASCO's insurance company subsidiaries were assessed \$10.4 million based on estimated losses and NLASCO's market shares in Louisiana, Mississippi and Texas. Additional assessments may follow. NLASCO does not expect such assessments to have a net financial statement impact as all such assessments are recoverable (subject to treaty limits) under its reinsurance treaties. Further, NLASCO may be able to recoup a regular assessment through a surcharge to policyholders. Such recoupments will be refunded to reinsurers as the related premiums are written and collected. NLASCO is required to collect emergency assessments directly from residential property policyholders and remit them to LCPIC as they are collected.

NLASCO continues to monitor developments with respect to various state facilities such as the Georgia Underwriting Association, LCPIC, MWUA, the Texas FAIR Plan Association and the TWIA. The ultimate impact of Hurricanes Katrina and Rita on these facilities is currently uncertain, but could result in the facilities recognizing a financial deficit different than the level currently estimated. They may, in turn, have the ability to assess participating insurers when financial deficits occur. However, NLASCO will not incur any net expense or loss from any such assessments due to reinsurance recoveries.

NLASCO may be subject to high retaliatory taxes in several states as a result of its multistate operations, which could have a material adverse impact on its financial condition and results of operations.

Nearly all states impose a retaliatory tax on insurers operating in their state that are domiciled in another state. Retaliatory taxes are based on the principle that if the aggregate taxes, fees and obligations imposed by an insurer's domiciliary state are greater than the aggregate taxes, fees and obligations imposed by the taxing state, then the difference is payable to the taxing state as a retaliatory tax. For example, the State of Texas imposes various premium-based taxes that, in the aggregate, total approximately 2.0% of gross written premiums in Texas. The State of Illinois imposes various premium-based taxes that, in the aggregate, total approximately 0.5% of gross written premiums in Illinois. The Illinois retaliatory tax provisions would require a Texas-domiciled insurer operating in Illinois to pay the 0.5% aggregate Illinois taxes plus a 1.5% incremental amount representing the difference between the Texas effective rate and the Illinois effective rate. Thus, a Texas-domiciled insurer would pay a 2.0% effective tax in Illinois while an Illinois-domiciled insurer would only pay a 0.5% effective tax. Insurance companies with multistate operations, like NLASCO, may find themselves subject to high retaliatory taxes in several states, which could have a material adverse impact on NLASCO's financial condition and results of operations.

NLASCO's ability to meet ongoing cash requirements and pay dividends may be limited by its holding company structure and regulatory constraints.

NLASCO operates as a holding company. Dividends and other permitted payments from its operating subsidiaries are expected to be its primary source of funds to meet ongoing cash requirements, including any future debt service payments and other expenses, and to pay dividends, if

any, to its stockholders. NLIC and ASIC are subject to significant regulatory restrictions and limitations under debt agreements limiting their ability to declare and pay dividends, which could in turn limit NLASCO's ability to meet its ongoing cash requirements, including any future debt service payments and other expenses, or to pay dividends.

Current legal and regulatory activities, investigations, litigation proceedings or other activities relating to the insurance industry, including investigations into contingent commission arrangements and insurance quotes regarding NLIC and ASIC, could affect NLASCO's business, financial condition and results of operations.

Recently, the insurance industry has experienced substantial share price volatility as a result of current litigation, investigations and regulatory activity by various insurance, governmental and enforcement authorities concerning certain practices within the insurance industry. These practices include the payment of contingent commissions by insurance companies to insurance brokers and agents and the extent to which such compensation has been disclosed and the solicitation and provision of fictitious, inflated or mischaracterized quotes for insurance coverages. NLASCO paid less than 3.1% of its 2005 gross written premiums to its independent agents pursuant to contingent commission contracts.

NLASCO is unable to predict the potential effects, if any, that these investigations may have upon these arrangements in particular or upon the insurance markets and industry business practices in general or what, if any, changes may be made to laws and regulations regarding the industry and financial reporting. Any of the foregoing could materially and adversely affect its business, financial condition and results of operations.

NLIC and ASIC are subject to periodic financial and market conduct examinations by state insurance departments. If these examinations identify significant findings or recommend significant changes to its operations, either insurance company could lose its licenses and/or its financial condition and results of operations could be affected.

The insurance departments in every state in which NLASCO's insurance companies do business may conduct on-site visits and examinations of its insurance companies at any time and generally for any purpose, including review of NLASCO's insurance companies' financial condition, market conduct and relationships and transactions with affiliates. In addition, the Texas Department of Insurance will conduct comprehensive examinations of NLASCO's insurance companies every three to five years. NLIC's last regulatory exam was a full scope financial examination by the Texas Department of Insurance covering the period from January 1, 1997 through December 31, 2001, including material transactions and/or events occurring after December 31, 2001. ASIC's last regulatory exam was a full scope financial examination by the Texas Department of Insurance covering the period from January 1, 2001 through December 31, 2003, including certain material transactions and/or events occurring after December 31, 2003. Neither examination resulted in any significant regulatory compliance issues being raised by the Texas Department of Insurance.

The March 26, 2002 Market Conduct Examination Report for ASIC issued by Arizona's Department of Insurance contained a recommendation that the Arizona Director of Insurance determine if cause existed to take disciplinary action against ASIC for various apparent law violations cited in the report. Subsequent to the issuance of the report, ASIC entered into a voluntary Consent Order with the Arizona Department of Insurance pursuant to which ASIC agreed to undertake various remedial actions in respect of the apparent law violations cited in the report. ASIC made reports to the Arizona Department required by the Consent Order, and the Arizona Department of Insurance has advised that, while compliance with the Consent Order is subject to further verification upon future examination, the Arizona Department of Insurance is satisfied that ASIC has completed the remedial requirements of the Consent Order. While there were no material adverse findings or recommended

changes to NLASCO's or its insurance company subsidiaries' operations identified in the recently completed financial examinations conducted by the departments of insurance of other states, there can be no assurance that there will not be adverse findings or recommended changes identified by these or other state insurance departments in the future. In addition, significant adverse findings could lead to a revocation of NLASCO's or its insurance company subsidiaries' licenses. Any adverse findings or recommended changes resulting from such financial examinations, or from any future examinations, could have a material adverse effect on NLASCO's or its insurance company subsidiaries' financial condition and results of operation.

NLASCO relies on its information technology and telecommunications systems, and the failure or disruption of these systems could disrupt its operations and adversely affect its results of operations.

NLASCO's business is highly dependent upon the successful and uninterrupted functioning of its information technology and telecommunications systems. NLASCO relies on these systems to process new and renewal business, issue policies, provide customer service, make claims payments and facilitate collections and cancellations, as well as to perform actuarial and other analytical functions necessary for pricing and product development. NLASCO's systems could fail of their own accord or could be disrupted by factors such as natural disasters, power disruptions or surges, failure of third party systems or support, computer hackers, terrorist attacks or other factors beyond its control. Failure or disruption of these systems, or the back-up systems, for any reason could disrupt its operations and adversely affect its results of operations.

Failures in NLASCO's electronic underwriting system could adversely affect its financial condition and results of operations.

NLASCO's Internet-based Policy Agency Claim System, or PACS, was primarily developed in-house. PACS is fully integrated and is able to process quotes, policy issuance, billings, payments and claims. The system is designed for ease of use by agents and employees. PACS is an integral part of NLASCO's success, and the growth of its business is highly dependent upon it. Almost all applications are submitted online. Problems or errors of which NLASCO is not currently aware may have occurred in connection with the installation, upgrading or maintenance of this system or any of its other systems or may result from a major physical disaster or other calamity that causes damage to NLASCO's systems generally. A loss of PACS or any of NLASCO's other systems for a sustained period of time could have an adverse impact on its financial condition and results of operations.

Failure to develop an adequate knowledge transfer or a succession plan for NLASCO's information technology personnel could adversely affect its financial condition and results of operations.

The success of PACS and NLASCO's other systems depend heavily on the incumbent information technology team that developed the system. A loss of key members of this team without adequate knowledge transfer or a succession plan could disrupt NLASCO's operations and adversely affect its results of operations.

Claims by third parties that NLASCO infringes their proprietary technology could adversely affect NLASCO's financial condition and results of operations.

If NLASCO discovers that any of its products or technology that it licenses from third parties violate third party proprietary rights, NLASCO may not be able to reengineer its products or obtain a license on commercially reasonable terms to continue using the products or technology without substantial reengineering, or to otherwise modify programs. In addition, product and technology development is inherently uncertain in a rapidly evolving technology environment in which there may be numerous patent applications pending for similar technologies, many of which are confidential when filed. In addition, much of the software used by NLASCO may be used subject to a licensing

agreement, and NLASCO's failure to comply with the terms for usage under any such licensing agreement could subject it to claims which could adversely impact its business. Although NLASCO sometimes may be indemnified by third parties against claims that licensed third party technology infringes proprietary rights of others, this indemnity may be limited, unavailable or, where the third party lacks sufficient assets or insurance, ineffective. NLASCO currently does not have liability insurance to protect against the risk that its technology or future licensed third party technology infringes the proprietary rights of others. Any claim of infringement, even if invalid, could cause NLASCO to incur substantial costs defending against the claim and could distract its management from the business. Furthermore, a party making such a claim could secure a judgment that requires NLASCO to pay substantial damages. A judgment could also include an injunction or other court order that could prevent NLASCO from using the products and technologies. Any of these events could have a material adverse effect on NLASCO's business, operating results and financial condition.

Acquisitions could result in operating difficulties, dilution and other harmful consequences.

From time to time, NLASCO may engage in discussions regarding potential acquisitions, including potential acquisitions that could be material to its financial condition and results of operations. NLASCO may acquire whole businesses or books of business that fit its underwriting competencies from insurance companies, MGAs and other agents. In addition, NLASCO may expand its business, product offerings and policyholder base by acquiring businesses in areas in which NLASCO has limited operating experience. The process of integrating an acquired company or book of business may create unforeseen operating difficulties and expenditures. In particular:

NLASCO has achieved its prior success by applying a disciplined approach to underwriting and pricing in select markets that are not well served by its competitors. NLASCO may not be able to successfully implement its underwriting, claims management, pricing and product strategies in companies or books of business it acquires.

NLASCO could be required to implement or remediate controls, procedures and policies for an acquired privately-held company that prior to acquisition may not have been required.

An acquisition could present cultural challenges associated with integrating employees from the acquired company into the organization, which could result in a loss of employees from the businesses NLASCO acquires and other adverse consequences.

NLASCO's management may have to divert its time and energy from operating the business to integration challenges.

NLASCO could have no prior experience operating the type of business that it acquires, which could create difficulties and result in NLASCO failing to realize many of the anticipated potential benefits of the acquisition.

An acquisition could dilute NLASCO's book value per share or after-tax return on average equity.

The anticipated benefits of any acquisition may not materialize. Future acquisitions could result in the incurrence of debt or an assumption of inadequate liabilities for losses and loss adjusted expenses or claims management structures, any of which could harm NLASCO's financial condition. Future acquisitions may require NLASCO to obtain additional equity or debt financing, which may not be available on favorable terms or at all.

Applicable insurance laws may make it difficult to effect a change of control of NLASCO.

NLIC and ASIC are domiciled in Texas. Before a person can acquire control of an insurance company domiciled in Texas, prior written approval must be obtained from the Texas Department of

Insurance. Acquisition of control would be presumed on the acquisition, directly or indirectly, of 10% or more of NLASCO's outstanding voting stock, unless the regulators determine otherwise. Prior to granting approval of an application to acquire control of a domestic insurer, the Texas Department of Insurance will consider factors such as:

the financial strength of the acquirer;

the integrity and management experience of the acquirer's board of directors and executive officers;

the acquirer's plans for the management of the insurer;

the acquirer's plans to declare dividends, sell assets or incur debt;

the acquirer's plans for the future operations of the domestic insurer;

the impact of the acquisition on continued licensure of the domestic insurer;

the impact on the interests of Texas policyholders; and

any anti-competitive results that may arise from the consummation of the acquisition of control.

These laws may discourage potential acquisition proposals and may delay, deter or prevent a change of control of NLASCO, including transactions that some or all of our stockholders might consider desirable.

Risks Related to the Rights Offering, the Investment Agreement and the Flexpoint Agreement

The subscription price determined for the rights offering may not be indicative of the fair value of our common stock.

The subscription price for our common stock in the rights offering was set by our board of directors. In determining the subscription price, our board of directors considered a number of factors, including: our need for capital to complete the NLASCO acquisition; our business prospects; the need to offer shares of common stock at a price that would be attractive to our stockholders relative to the current trading price of our common stock; the historic and current market price of our common stock; general conditions in the securities market and any difficulty in market conditions prevailing for the raising of equity capital; the likely cost of capital from other sources; historic and current trading prices for our common stock; our operating history; and the liquidity of our common stock. In conjunction with its review of these factors, our board of directors also reviewed analyses of prior rights offerings by other public companies, including the range of discounts to market value represented by the subscription prices in those rights offerings. The subscription price will not necessarily bear any relationship to the book value of our assets, net worth, past operations, cash flows, losses, financial condition or any other established criteria for fair value. You should not consider the subscription price as an indication of the fair value of our common stock. After the date of this Proxy Statement, our common stock may trade at prices above or below the subscription price.

Stockholders who do not exercise their subscription rights may experience a dilution of their relative ownership interests.

The rights offering is designed to enable us to raise capital while allowing all stockholders on the record date for the rights offering to maintain their relative proportionate voting and economic interests in the Company, before giving effect to the NLASCO acquisition and the Flexpoint transaction. Gerald J. Ford, director and beneficial owner of approximately 17.6% of our outstanding common stock, and ARC Diamond, one of Mr. Ford's affiliates, have agreed to purchase the shares of our common stock that they would otherwise have been entitled to receive pursuant to the subscription privilege in the rights offering in a private placement directly from us and not to exercise the

subscription rights to purchase 1,760,000 shares of our common stock that they receive in the rights offering. In addition, Hunter's Glen/Ford has agreed to backstop the rights offering, meaning that it will purchase any shares of common stock that remain unsold in the rights offering, other than shares issuable under the subscription rights of Mr. Ford and ARC Diamond, at \$8.00, the subscription price per share for the rights offering. To the extent that a stockholder does not exercise its rights and shares of common stock are purchased by other stockholders in the rights offering, such non-participating stockholders' proportionate voting interest will be reduced, and the percentage that such stockholders' original shares of common stock represent of our expanded equity after the rights offering will be diluted, before giving effect to the NLASCO acquisition or the Flexpoint Agreement. If Mr. Ford and ARC Diamond purchase the shares of our common stock under the Investment Agreement, no stockholders exercise their subscription rights and Hunter's Glen/Ford backstops the rights offering in full and the transactions under the NLASCO Agreement and the Flexpoint Agreement are completed, then Gerald J. Ford's beneficial ownership interest in our common stock will increase to approximately 31.5% from approximately 17.6%, and the ownership interest of the remaining current common stockholders, who currently own in the aggregate approximately 82.4% of our common stock, will decrease to approximately 62.3%. In the event that Mr. Ford and ARC Diamond purchase the shares of our common stock under the Investment Agreement, no stockholders exercise their subscription rights and Hunter's Glen/Ford backstops the rights offering in full but the transactions under the NLASCO Agreement and the Flexpoint Agreement are not completed, then Gerald J. Ford's beneficial ownership interest in our common stock will increase to approximately 33.6%, and the remaining current stockholders' ownership interest will decrease to approximately 66.4%. In addition, after giving effect to the issuance and sale of our common stock in the rights offering and under the Investment Agreement, the holders of our special voting stock will experience dilution in their voting power.

The issuance and sale of our common stock pursuant to the Flexpoint Agreement and the NLASCO Agreement will result in the dilution of the relative ownership interests of our other stockholders.

Pursuant to the Flexpoint Agreement, Flexpoint has agreed to purchase 2,087,683 shares of our common stock for \$9.58 per share, subject to certain anti-dilution provisions. In addition, we will issue approximately 1,218,880 shares of our common stock to C. Clifton Robinson pursuant to the NLASCO Agreement upon the closing of the NLASCO acquisition. After giving effect to the issuance and sale of our common stock in the rights offering (and assuming pro rata exercise of our stockholders in the rights offering) and under the Investment Agreement and the issuance and sale of shares of our common stock under the Flexpoint Agreement and the NLASCO Agreement, Flexpoint will beneficially own approximately 3.9% of our outstanding common stock and Mr. Robinson will beneficially own approximately 2.2% of our outstanding common stock. As a result, the ownership interest of our other common stockholders, other than Mr. Ford and his affiliates, who currently own in the aggregate approximately 82.4% of our common stock, will decrease to approximately 77.4%. In addition, the holders of our special voting stock will experience dilution in their voting power as a result of the the issuance and sale of our common stock under the NLASCO Agreement and the Flexpoint Agreement.

If we are unable to obtain the approval of our stockholders for the Investment Agreement or the Flexpoint Agreement, we will be required to obtain alternative sources of financing for our acquisition of NLASCO, and if we cannot obtain alternate financing, we could be unable to close the NLASCO acquisition or be in breach of the NLASCO Agreement.

The Investment Agreement will ensure that ARC receives the full proceeds contemplated by the rights offering. If the Investment Agreement is not approved, we do not plan to complete the rights offering. A purpose of the rights offering is to raise capital to fund a portion of the purchase price of NLASCO, and it is intended that the issuance and sale of our common stock pursuant to the Flexpoint Agreement will fund an additional portion of the purchase price of NLASCO. Under the terms of the NLASCO Agreement, our obligation to consummate the NLASCO acquisition is not conditioned on

the completion of the rights offering or the issuance and sale of shares of our common stock under the Investment Agreement or the Flexpoint Agreement or on our ability to obtain alternative financing. If the NLASCO acquisition is not consummated and it is determined, pursuant to the terms of the NLASCO Agreement, that we did not use our "reasonable best efforts" to obtain sufficient financing to consummate the NLASCO acquisition, then we will have breached the NLASCO Agreement and may be required to pay damages to the Sellers. In addition, we will have diverted significant financial and management resources in an effort to complete the NLASCO acquisition, for which we will have received little or no benefit. We are required to use our reasonable best efforts to obtain sufficient financing in order to avoid a breach of the NLASCO Agreement and, if the Investment Agreement or the Flexpoint Agreement is not approved, we will have to seek alternative sources of financing. Alternative sources of financing may not be available at all or may be available only on unfavorable terms and the process of seeking alternative sources of financing could divert the attention of our management from our day-to-day business operations. If we are determined to have breached the NLASCO Agreement, our business, financial condition and results of operations could be materially adversely affected.

If Gerald J. Ford significantly increases his beneficial ownership percentage in the Company as a result of the rights offering, such increase could impact our board's determination that he is "independent".

In accordance with the definitional criteria of SOX and the rules and regulations of the New York Stock Exchange, which we refer to as the NYSE, a majority of our directors on our nine-director board are deemed to be independent. Failure to maintain an independent board of directors could result in the delisting of our common stock from the NYSE, which could result in there being no public market for shares of our common stock. In as much as Mr. Ford and ARC Diamond have agreed to purchase shares of our common stock under the Investment Agreement and Hunter's Glen/Ford has agreed to backstop the rights offering (meaning that it would purchase any shares of common stock that remain unsold in the rights offering at the same subscription price per share), Mr. Ford may significantly increase his beneficial ownership in the Company. A significant increase in Mr. Ford's beneficial ownership could impact our board's determination as to whether he is an independent director. In addition, Mr. Ford's affiliation with other independent directors Carl B. Webb and James R. "Randy" Staff could impact our board's determination that they are independent. If our board determines that Messrs. Ford, Webb and Staff are not independent, then we would have to increase the number of independent directors on our board in order to remain compliant with NYSE listing requirements, or we would not meet the same and could be subject to delisting. Recruiting independent directors could require the dedication of significant management resources, which may temporarily distract management's attention from our day-to-day business. In addition, adding directors to our board would make it more difficult and more expensive for us to maintain director and officer liability insurance, and we may be required to accept reduced coverage or incur substantially higher costs to maintain coverage. If we are unable to maintain adequate director and officer insurance, our ability to recruit and retain qualified officers and directors, especially those directors who may be deemed independent for purposes of the rules and regulations of the SOX and the NYSE, will be significantly curtailed.

FORWARD-LOOKING STATEMENTS

This Proxy Statement and the documents incorporated by reference herein include "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Exchange Act by the Private Securities Litigation Reform Act of 1995. All statements, other than statements of historical facts, included in this Proxy Statement that address results or developments that ARC and/or NLASCO expects or anticipates will or may occur in the future, where statements are preceded by, followed by or include the words "believes," "expects," "may," "will," "would," "could," "should," "seeks," "approximately," "intends," "plans," "projects," "estimates" or "anticipates" or the negative of these words and phrases or similar words or phrases, including such things as our business strategy, our ability to obtain future financing arrangements, estimates relating to our future distributions, our understanding of our competition, market trends, projected capital expenditures, the impact of technology on our products, operations and business are forward-looking statements.

The forward-looking statements are based on our beliefs, assumptions and expectations of our future performance taking into account all information currently available to us. These beliefs, assumptions and expectations are subject to risks and uncertainties and can change as a result of many possible events or factors, not all of which are known to us. If a change occurs, our business, financial condition, liquidity and results of operations may vary materially from those expressed in our forward-looking statements. These risks, along with the risks disclosed in the section of this Proxy Statement entitled "Risk Factors" beginning on page 13 and the following factors, could cause actual results to vary from our forward-looking statements:

failure to complete or timely complete the NLASCO acquisition;

failure of ARC to realize the benefits of the NLASCO acquisition or to complete it on favorable financing terms;

failure to adequately diligence the acquisition transaction;

failure of NLASCO's insurance subsidiaries to maintain their respective A.M. Best ratings;

failure to maintain NLASCO employees;

failure to maintain NLASCO's current agents;

lack of demand for insurance products;

cost or availability of adequate reinsurance;

changes in key management;

failure of NLASCO's reinsurers to pay obligations under reinsurance contracts;

failure of NLASCO to maintain sufficient reserves for losses on insurance policies;

failure of NLASCO to maintain appropriate insurance licenses;

competition confronting ARC from other forms of single or multifamily housing;

changes in market rental rates, supply and demand for affordable housing, the cost of acquiring, transporting, setting or selling manufactured homes;

the availability of manufactured homes from manufacturers;

the availability of cash or financing for ARC to acquire additional manufactured homes;

the ability of manufactured home buyers to obtain financing;

our ability to maintain or increase rental rates and maintain or improve occupancy;

the level of repossessions by manufactured home lenders;

the adverse impact of external factors such as changes in interest rates, inflation and consumer confidence;

our ability to identify acquisitions, have funds available for acquisitions, the pace of acquisitions and/or dispositions of communities and new or rental homes;

corporate debt ratings;

demand for home purchases in our communities and demand for financing of such purchases;

demand for rental homes in our communities;

the condition of capital markets;

actual outcome of the resolution of any conflict;

our ability to successfully integrate and operate acquired companies and/or properties;

our decision and ability to sell additional communities and the terms and conditions of any such sales and whether any such sales actually close;

issues arising from our decision not to continue to maintain our status as a REIT;

our ability to use NOL carryforwards to reduce future tax payments;

the impact of the Code and rules on our balance sheet and business operations;

our ability to pay dividends or make other distributions to our stockholders and the Operating Partnership's unitholders;

environmental uncertainties and risks related to natural disasters;

changes in and compliance with real estate permitting, licensing and zoning laws including legislation affecting monthly leases and rent control and increases in property taxes; and

changes in and compliance with licensing requirements regarding the sale of insurance and/or the sale or leasing of manufactured homes.

Consequently, all of the forward-looking statements made in this Proxy Statement are qualified by these cautionary statements and there can be no assurance that the actual results or developments anticipated by the Company will be realized, or even substantially realized, and that they will have the expected consequences to or effects on the Company and its business or operations. Forward-looking statements made in this Proxy Statement speak as of the date hereof. The Company undertakes no obligation to update or revise any forward-looking statement in this Proxy Statement.

INFORMATION ABOUT ARC

ARC is a Maryland corporation that is engaged in the acquisition, renovation, repositioning and operation of primarily all-age manufactured home communities, the retail sale and financing of manufactured homes, the rental of manufactured homes and other related businesses including acting as agent in the sale of homeowners' insurance and related products, primarily to residents or prospective residents in ARC communities. ARC was organized in July 1998 and operates primarily through the Operating Partnership and its subsidiaries, of which ARC is the sole general partner and owned 96.5% as of June 30, 2006. Through the years ended December 31, 2005, ARC was organized as a fully integrated, self-administered and self-managed REIT for U.S. Federal income tax purposes. In March 2006, ARC's board of directors decided to revoke the Company's election as a REIT for U.S. Federal income tax purposes beginning for the year ending December 31, 2006.

As of June 30, 2006, ARC owned and operated 276 communities (excluding four communities classified as discontinued operations) consisting of 57,359 homesites (excluding 989 homesites classified as discontinued operations) in 24 states with occupancy of 83.5%. ARC's five largest markets are: Dallas-Fort Worth, Texas, with 12.5% of total homesites; Atlanta, Georgia, with 8.7% of total homesites; Salt Lake City, Utah, with 6.6% of total homesites; the Front Range of Colorado, with 5.7% of total homesites; and Kansas City-Lawrence-Topeka, with 4.2% of total homesites. ARC also conducts a retail home sales business.

ARC's common stock is traded on the New York Stock Exchange under the symbol "ARC". ARC's Series A Cumulative Redeemable Preferred Stock is traded on the New York Stock Exchange under the symbol "ARC-PA". ARC has no public trading history prior to February 12, 2004.

ARC's principal executive, corporate and property management offices are located at 7887 E. Belleview Avenue, Suite 200, Englewood, Colorado 80111, and ARC's telephone number is (303) 383-7500. ARC's Internet address is www.aboutarc.com. The information contained on ARC's website is not part of this Proxy Statement.

For more information on ARC, please see "Incorporation of Certain Documents by Reference" in this Proxy Statement.

INFORMATION ABOUT THE NLASCO ACQUISITION AND NLASCO

The following description of the acquisition of NLASCO, including the summary of the certain terms and provisions of the NLASCO Agreement, which is incorporated herein by reference, and the opinion we received from Sandler O'Neill, is qualified in its entirety by reference to the more detailed Appendices to this Proxy Statement. We urge you to read all of the Appendices to this Proxy Statement in their entirety.

Transaction Structure

Subject to the terms and conditions of the NLASCO Agreement, at the closing we will purchase from Sellers all of the outstanding shares of capital stock of NLASCO in exchange for cash in the amount of \$105,750,000 and 1,218,880 shares of our common stock, which shares will be issued to C. Clifton Robinson and placed in escrow pursuant to an escrow agreement described below. The purchase price will be subject to adjustments based on (1) the GAAP stockholders' equity of NLASCO as of the closing date as finally determined by the parties and (2) the amount of actual losses as of the 36-month anniversary of the closing date for claims arising out of events or circumstances that occurred or existed on or prior to the closing date, compared to the reserves for losses as reflected on the closing balance sheet for both reported claims and for incurred but not reported claims.

Immediately before the closing, and subject to any necessary regulatory approvals or third party consents, Sellers will cause NLASCO to make a dividend or distribution to Sellers in an aggregate amount equal to the excess of (1) the closing date stockholders' equity over (2) \$71,009,382. In addition, NLASCO will repay approximately \$5.6 million aggregate principal amount of outstanding debt.

The NLASCO Agreement includes customary representations, warranties, covenants as well as indemnification and termination provisions. At the closing, the parties will also enter into several ancillary agreements, including a noncompetition agreement, a registration rights agreement, an escrow agreement, a release, employment agreements and a share lock-up agreement. The NLASCO Agreement and the ancillary agreements are described below in " The NLASCO Agreement and Related Agreements."

Background to the NLASCO Acquisition

As part of the ongoing evaluation of our business, we consider a variety of strategic alternatives. In that regard, representatives of the Company from time to time have discussed potential business acquisitions with representatives of various companies in complementary industries that might serve to expand our business, improve our competitive position and enhance stockholder value.

During late 2005, NLASCO's board of directors explored and evaluated potential strategic alternatives available to NLASCO. As part of this process, NLASCO engaged Banc of America Securities LLC, which we refer to as BAS, as its exclusive financial advisor in connection with the potential sale of NLASCO. During 2006, a number of parties were contacted to determine if they had a potential interest in pursuing a transaction with NLASCO. During the course of this process, parties that had expressed interest in a potential transaction with NLASCO and executed a confidentiality agreement with NLASCO were given access to an electronic data room where due diligence materials were made available and provided an opportunity to meet with senior management of NLASCO to answer questions.

In March 2006, Hunter's Glen/Ford, a private investment firm led by Gerald J. Ford, and Flexpoint Partners were independently contacted regarding a proposed purchase of NLASCO. Mr. Ford reviewed the investment opportunity and discussed with Flexpoint Partners whether Flexpoint Partners might be interested in pursuing the acquisition.

On April 6, 2006, Flexpoint Partners executed a confidentiality agreement with respect to NLASCO information and, on April 7, 2006, Flexpoint Partners began its due diligence.

In March and April 2006, representatives of Hunter's Glen/Ford and Flexpoint Partners reviewed the potential acquisition of NLASCO and determined to submit a joint indication of interest. At the time, Hunter's Glen/Ford and Flexpoint Partners had not determined which entity would serve as a potential buyer of NLASCO.

On April 17, 2006, representatives from Flexpoint Partners and BAS had a conference call to discuss the process and procedures for submitting an indication of interest.

On April 20, 2006, Hunter's Glen/Ford and Flexpoint Partners jointly submitted an indication of interest regarding the purchase of NLASCO.

Following the submission of the indication of interest by Hunter's Glen/Ford and Flexpoint Partners, representatives of the two investment firms had discussions with BAS regarding the proposed acquisition terms.

In May and June 2006, Hunter's Glen/Ford and Flexpoint Partners conducted further due diligence and performed internal analyses regarding the potential acquisition. In addition, representatives of these investment firms had several discussions about which entity would serve as an appropriate acquisition vehicle. In early June 2006, Hunter's Glen/Ford and Flexpoint Partners determined that an acquisition of NLASCO by ARC may be a beneficial transaction for the Company, and approached ARC regarding ARC's interest in pursuing the acquisition of NLASCO.

On June 8, 2006, at a meeting of ARC's board of directors, Gerald J. Ford informed ARC's board that there were a couple of potential acquisitions that were being reviewed that may benefit the Company, although nothing specific was mentioned about NLASCO.

On June 9, 2006, Clifton Robinson met with Gerald J. Ford to discuss the possible purchase of NLASCO. Mr. Ford indicated that the proposed acquisition would allow NLASCO to continue with its current business strategy and allow the business to be conducted in Waco, Texas.

On or about June 14, 2006, Gerald J. Ford informed Larry Willard, our chairman and chief executive officer, that Flexpoint Partners and Hunter's Glen/Ford had been looking at the possibility of acquiring NLASCO and stated that this could be a potential acquisition opportunity for ARC. Subsequently, ARC determined to look at the potential acquisition opportunity, and Flexpoint Partners and Hunter's Glen/Ford continued to assist ARC in the evaluation of the NLASCO acquisition.

Beginning in June 2006, ARC considered various ways to finance a possible acquisition of NLASCO. After extensively considering a number of possible financing alternatives, ARC decided to partially fund a possible acquisition of NLASCO by conducting a rights offering to its current stockholders. In connection therewith, ARC and Hunter's Glen/Ford discussed from time to time Hunter's Glen/Ford's acquiring our common stock in a private placement. After extensive discussions between the parties, on October 13, 2006, ARC and Hunter's Glen/Ford entered into the Investment Agreement, providing for the terms of Hunter's Glen/Ford's acquiring our common stock in the private placement. From time to time, ARC and Flexpoint had discussions regarding Flexpoint making an investment in ARC to help finance the NLASCO acquisition. After extensive discussions between the parties, on October 6, 2006, ARC and Flexpoint entered into the Flexpoint Agreement, providing for the terms of the Flexpoint's purchase of our common stock.

During June 2006, Flexpoint Partners, Hunter's Glen/Ford, ARC and BAS had several conversations regarding the proposed pricing and structure of the acquisition. BAS indicated that the NLASCO owners wanted to dividend or distribute out all earnings after 2005 and prior to the closing of any acquisition.

In June 2006, ARC retained Haynes and Boone, LLP, or Haynes and Boone, to represent ARC in the proposed acquisition of NLASCO. In June 2006, ARC asked Skadden, Arps, Slate, Meagher & Flom LLP, or Skadden, its regular counsel, to represent it in other corporate and securities matters in connection with the proposed acquisition, including the rights offering.

On June 22, 2006, in compliance with the June 22 bid submission deadline outlined by BAS, ARC submitted a final bid for the purchase of NLASCO. Following a review of all alternative offers and based on its determination that the proposal by ARC represented the superior proposal in terms consistent with NLASCO's strategic objectives, NLASCO chose to negotiate a definitive agreement with respect to an acquisition of NLASCO by ARC.

On June 28, 2006, BAS contacted representatives from Hunter's Glen/Ford and Flexpoint Partners to determine if we would be willing to increase the consideration payable for NLASCO. After several conversations among representatives of ARC, Hunter's Glen/Ford and Flexpoint Partners, ARC determined to increase its bid and communicated this increase to BAS. BAS informed ARC that NLASCO was willing to proceed with negotiations with ARC.

During July and August 2006, we, together with our advisors, conducted due diligence on NLASCO while negotiating the terms of the NLASCO Agreement.

At a meeting of our board of directors on July 27, 2006, a representative of Hunter's Glen/Ford and a representative of Flexpoint Partners, made a presentation regarding the status of the proposed acquisition and financing for the acquisition, including the use of a rights offering to raise cash for the acquisition. The board of directors discussed, among other things, ARC's strategic plans to expand its business and that NLASCO's business would be complementary to ARC's business. In addition, Mr. Ford raised to the board the possibility of Flexpoint Partners making an investment in ARC to support the contemplated acquisition. The board was advised that ARC had retained Haynes and Boone to represent it in the proposed acquisition and Skadden to represent it in its securities filings in connection with the proposed acquisition. In addition, the chairman of our audit committee approved the terms and fees of PricewaterhouseCoopers LLP's engagement in connection with the acquisition, and the full audit committee ratified this approval.

Over the course of July and August 2006, we engaged various professional advisors in connection with the proposed acquisition, including PricewaterhouseCoopers LLP, Tillinghast, an actuarial firm, and insurance regulatory counsel.

On August 8, 2006, NLASCO executed a confidentiality agreement pursuant to which NLASCO agreed to keep certain information provided by ARC to NLASCO confidential and NLASCO agreed to certain customary standstill provisions with respect to ARC's common stock.

On August 16, 2006, representatives of the Company, Hunter's Glen/Ford and Flexpoint Partners traveled to Waco, Texas to conduct onsite due diligence of NLASCO.

On August 30, 2006, ARC retained Sandler O'Neill to render a fairness opinion with respect to the consideration to be paid in the NLASCO acquisition.

During August and September 2006, the parties continued to negotiate the terms of the NLASCO Agreement and ancillary agreements. There were several conference calls between the parties to negotiate the terms of these agreements.

On September 15, 2006, ARC Insurance Holdings Inc. was incorporated as a subsidiary of ARC to enter into the NLASCO Agreement.

Over the course of September 2006, the legal representatives of ARC and NLASCO had several telephone calls to work on resolving open issues relating to the NLASCO Agreement. Additionally, during that same time period, representatives of ARC negotiated the terms of the Flexpoint Agreement with Flexpoint and Flexpoint Partners and also negotiated the terms of the Investment Agreement with Mr. Ford, ARC Diamond and Hunter's Glen/Ford.

On September 20, 2006, the board of the Company was briefed on the status of the transaction with NLASCO.

On October 5, 2006, the board of directors of ARC met to review the proposed acquisition of NLASCO, as well as the terms of the NLASCO Agreement and related ancillary agreements and the Flexpoint Agreement. In addition, Sandler O'Neill provided an oral fairness opinion, subsequently confirmed in writing, to our board in connection with the consideration paid by ARC in the NLASCO acquisition. The board was apprised of Mr. Ford's interests in Flexpoint. The board met by telephonic conference call on October 6, 2006 and reviewed the terms of the NLASCO Agreement and the Flexpoint Agreement and following that review, approved the NLASCO Agreement, related ancillary agreements and the Flexpoint Agreement with directors Gerald J. Ford, Carl B. Webb and J. Randy Staff abstaining from the vote on the Flexpoint Agreement.

On October 6, 2006, ARC publicly announced the NLASCO acquisition, the Flexpoint Agreement and the proposed rights offering through two press releases.

On October 10, 2006, ARC filed an 8-K regarding the proposed transaction and the Flexpoint Agreement.

On October 13, 2006, our board met to review the Investment Agreement, and after this review, our board approved the Investment Agreement, with directors Ford, Staff and Webb abstaining. On October 16, 2006, ARC filed an 8-K regarding the Investment Agreement.

Reasons for the Proposed Acquisition; Recommendation by the ARC Board of Directors

In approving the acquisition of NLASCO, our board of directors considered a number of factors concerning the benefits of the NLASCO acquisition. Without giving any relative or specific weight to the factors, our board considered, among others the following factors:

the information presented to our board by our management concerning the industry, business, operations, earnings and growth potential of NLASCO;

the financial terms of the transaction, including the relationship of the value of the consideration payable in the transaction to the net income and cash flow of NLASCO;

the attractiveness of the NLASCO franchise, NLASCO's management team, the position of NLASCO within its industry and the historical profitability of NLASCO;

the similar management philosophies of ARC and NLASCO, focusing on profitability rather than growth;

because both NLASCO and ARC do business in the manufactured home industry, with similarities in customer base, the possibility of selling NLASCO's insurance products to existing and future ARC customers;

the potential opportunity to utilize the NOLs currently held by ARC if NLASCO continues to operate on a profitable basis;

the potential that NLASCO's consistent operating performance could provide ARC with significant earnings;

the potential opportunity to integrate ARC's current consumer insurance business into NLASCO's operations and achieve additional economies and efficiencies;

the potential to grow NLASCO's business by providing a financial platform and stable cash flows for the business;

ARC's intent to maintain NLASCO's current operating strategy and capitalization;

the additional opportunities for NLASCO to assist or otherwise provide ARC with alternatives or solutions relating to ARC's other insurance needs; and

the opinion of Sandler O'Neill with respect to the consideration paid by ARC in the NLASCO acquisition.

Our board of directors also considered the following negative factors in connection with the acquisition. Without giving any relative or specific weight to the factors, our board considered, among others, the following:

the risks associated with the insurance industry and NLASCO's business;

our lack of experience in operating an insurance company like NLASCO;

the fact that the NLASCO Agreement does not contain a financing condition in favor of ARC; and

the fact that we would be required to obtain stockholder approval of certain matters in connection with the financing for the NLASCO acquisition, and that stockholder approval may not be obtained.

The foregoing discussion is not intended to be exhaustive, but includes the material reasons our board of directors considered with respect to the acquisition. Our board of directors believes that the terms of the NLASCO acquisition and the NLASCO Agreement are in the best interests of ARC.

Opinion of ARC's Financial Advisor

Opinion of Sandler O'Neill & Partners, L.P. By letter dated August 30, 2006, ARC retained Sandler O'Neill to provide a fairness opinion in connection with a possible business combination with NLASCO. Sandler O'Neill is a nationally recognized investment banking firm whose principal business specialty is financial institutions. In the ordinary course of its investment banking business, Sandler O'Neill is regularly engaged in the valuation of financial institutions and their securities in connection with mergers and acquisitions and other corporate transactions.

Sandler O'Neill provided a fairness opinion to ARC in connection with the proposed NLASCO acquisition. At the October 5, 2006 meeting at which ARC's board considered and approved the NLASCO Agreement, subject to satisfactory resolution of certain outstanding issues, Sandler O'Neill delivered to the board its oral opinion, that, as of such date, the purchase price was fair to ARC from a financial point of view.

The full text of Sandler O'Neill's opinion is attached as Appendix B to this Proxy Statement. The opinion outlines the procedures followed, assumptions made, matters considered and qualifications and limitations on the review undertaken by Sandler O'Neill in rendering its opinion in connection with the NLASCO acquisition. The description of the opinion set forth below is qualified in its entirety by reference to the opinion.

Sandler O'Neill's opinion speaks only as of the date of the opinion. The opinion was directed to the ARC board in connection with the NLASCO acquisition and is directed only to the fairness of the purchase price to ARC from a financial point of view. It does not address the underlying business decision of ARC to engage in the transaction, the relative merits of the transaction as compared to any other alternative business strategies that may exist for ARC, the methods of financing used by ARC, including the rights offering, or the effect of any other transaction in which ARC might engage or any other aspect of the transaction and is not a recommendation to any ARC stockholder as to how such stockholder should vote with respect to the rights offering.

In connection with rendering its October 6, 2006 opinion, Sandler O'Neill reviewed and considered, among other things:

- (1) the NLASCO Agreement;
- (2) certain publicly available financial statements and other historical financial information of ARC that Sandler O'Neill deemed relevant;

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- (3) certain audited and unaudited historical financial statements and other historical financial information of NLASCO and those subsidiaries of NLASCO involved in the transaction as provided to Sandler O'Neill by senior management of NLASCO;
- (4) earnings estimates for ARC for the years ending December 31, 2006 through 2011 as provided by, and reviewed with, senior management of ARC;
- (5) financial projections for NLASCO and those subsidiaries of NLASCO involved in the transaction for the years ending December 31, 2006 through 2011 as provided by and reviewed with senior management of ARC and NLASCO;
- (6) the pro forma financial impact of the NLASCO acquisition on ARC, based on assumptions relating to transaction expenses, purchase accounting adjustments and cost savings determined by the senior management of ARC;
- (7) the publicly reported historical price and trading activity for ARC's common stock, including a comparison of certain financial and stock market information for ARC and similar publicly available information for certain other companies the securities of which are publicly traded;
- (8) the financial terms of certain recent business combinations in the insurance industry, to the extent publicly available;
- (9) the current market environment generally and that of the insurance industry in particular; and
- (10) such other information, financial studies, analyses and investigations and financial, economic and market criteria as Sandler O'Neill considered relevant.

Sandler O'Neill also discussed with certain members of senior management of ARC, the business, financial condition, results of operations and prospects of ARC and held similar discussions with certain members of senior management of NLASCO regarding the business, financial condition, results of operations and prospects of NLASCO.

In performing its reviews and analyses and in rendering its opinion, Sandler O'Neill relied upon the accuracy and completeness of all the financial and other information that was available to them from public sources, that was provided to Sandler O'Neill by ARC or NLASCO or their respective representatives or that was otherwise reviewed by Sandler O'Neill and have assumed such accuracy and completeness for purposes of rendering this opinion. Sandler O'Neill further relied on the assurances of the management of each of ARC and NLASCO that they are not aware of any facts or circumstances that would make any of such information inaccurate or misleading. Sandler O'Neill has not been asked to undertake, and has not undertaken, an independent verification of any of such information and Sandler O'Neill does not assume any responsibility or liability for the accuracy or completeness thereof. Sandler O'Neill did not make an independent evaluation or appraisal of the specific assets, the collateral securing the assets or the liabilities (contingent or otherwise) of ARC or NLASCO or any of their subsidiaries, or the collectibility of any such assets, nor has Sandler O'Neill been furnished with any such evaluations or appraisals. Furthermore, Sandler O'Neill made no appraisal or evaluation of NLASCO's reserves.

The budgets and estimates for growth used and relied upon by Sandler O'Neill in its analyses for ARC were provided by ARC senior management who confirmed to Sandler O'Neill that those budgets and estimates reflected the best currently available estimates and judgments of the future financial performance of ARC. With respect to the financial projections for NLASCO, with ARC's consent, Sandler O'Neill used and relied on those financial projections provided by the senior management of ARC, as adjusted by and discussed with NLASCO's senior management, who confirmed those financial projections reflected the best currently available estimates and judgments of the future financial performance of NLASCO by ARC's senior management. All projections of transaction costs, purchase accounting adjustments and expected cost savings related to the NLASCO acquisition were provided by or reviewed with senior management of ARC and such management confirmed to Sandler O'Neill that

those projections reflected their best currently available estimates and judgments. Sandler O'Neill assumed that the financial performances reflected in all estimates and projections used by Sandler O'Neill in its analyses would be achieved. Sandler O'Neill expressed no opinion as to such budgets, estimates or projections or the assumptions on which they were based. Sandler O'Neill also assumed that there has been no material change in the assets, financial condition, results of operations, business or prospects of ARC or NLASCO since the date of the last financial statements made available to them and that ARC and NLASCO will remain as going concerns for all periods relevant to the analyses.

Sandler O'Neill further assumed that ARC and NLASCO will remain as going concerns for all periods relevant to our analyses, that all of the representations and warranties contained in the NLASCO Agreement and all related agreements are true and correct, that each party to the agreements will perform all of the covenants required to be performed by such party under the agreements and that ARC will be able finance the NLASCO acquisition as planned. Additionally, Sandler O'Neill expresses no opinion as to any proposed financing related to the NLASCO acquisition. Finally, with ARC's consent, Sandler O'Neill relied upon the advice received from ARC's legal, accounting and tax advisors as to all legal, accounting and tax matters relating to the NLASCO Agreement and the other transactions contemplated by the NLASCO Agreement.

Sandler O'Neill's opinion is necessarily based on financial, economic, market and other conditions as in effect on, and the information made available to us as of, the date of its opinion. Events occurring after the date of its opinion could materially affect its opinion. Sandler O'Neill has not undertaken to update, revise, reaffirm or withdraw its' opinion or otherwise comment upon events occurring after the date of its opinion. Sandler O'Neill is expressing no opinion herein as to what the value of ARC's common stock will be when issued to NLASCO's stockholders pursuant to the NLASCO Agreement or the prices at which ARC's common stock may trade at any time. Sandler O'Neill will receive a fee for rendering its opinion and ARC has agreed to indemnify Sandler O'Neill against certain liabilities arising out of its engagement.

In rendering its October 6, 2006 opinion, Sandler O'Neill performed a variety of financial analyses. The following is a summary of the material analyses performed by Sandler O'Neill, but is not a complete description of all the analyses underlying Sandler O'Neill's opinion. The summary includes information presented in tabular format. **In order to fully understand the financial analyses, these tables must be read together with the accompanying text. The tables alone do not constitute a complete description of the financial analyses.** The preparation of a fairness opinion is a complex process involving subjective judgments as to the most appropriate and relevant methods of financial analysis and the application of those methods to the particular circumstances. The process, therefore, is not necessarily susceptible to a partial analysis or summary description and Sandler O'Neill believes that its analyses must be considered as a whole and that selecting portions of the factors and analyses to be considered without considering all factors and analyses, or attempting to ascribe relative weights to some or all such factors and analyses, could create an incomplete view of the evaluation process underlying its opinion. Also, no company included in Sandler O'Neill's comparative analyses described below is identical to NLASCO and no transaction is identical to the transactions described in this Proxy Statement. Accordingly, an analysis of comparable companies or transactions involves complex considerations and judgments concerning differences in financial and operating characteristics of the companies and other factors that could affect the public trading values or transaction values, as the case may be, of NLASCO and the companies to which it is being compared.

In performing its analyses, Sandler O'Neill also made numerous assumptions with respect to industry performance, business and economic conditions and various other matters, many of which cannot be predicted and are beyond the control of ARC, NLASCO and Sandler O'Neill. The analysis performed by Sandler O'Neill is not necessarily indicative of actual values or future results, both of which may be significantly more or less favorable than suggested by such analyses. Sandler O'Neill

prepared its analyses solely for purposes of rendering its opinion and provided such analyses to ARC board at the board's October 5, 2006 meeting. Estimates on the values of each company do not purport to be appraisals or necessarily reflect the prices at such companies or their securities may actually be sold. Such estimates are inherently subject to uncertainty and actual values may be materially different. Accordingly, Sandler O'Neill's analyses do not necessarily reflect the value of ARC's common stock or NLASCO's common stock or the prices at which ARC's or NLASCO's common stock may be sold at any time. The analysis of Sandler O'Neill and its opinion were among a number of factors taken into consideration by ARC's board in making its determination to adopt the NLASCO Agreement and the analyses described below should not be viewed as determinative of the decision of ARC's board or management with respect to the fairness of the NLASCO acquisition.

In arriving at its opinion, Sandler O'Neill did not attribute any particular weight to any analysis or factor that it considered. Rather, Sandler O'Neill made qualitative judgments as to the significance and relevance of each analysis and factor. The financial analyses summarized below include information presented in tabular format. Sandler O'Neill did not form an opinion as to whether any individual analysis or factor (positive or negative) considered in isolation supported or failed to support their respective opinions; rather Sandler O'Neill made its determination as to the fairness of the purchase price on the basis of their experience and professional judgment after considering the results of all its analyses taken as a whole. Accordingly, Sandler O'Neill believes that the analysis and the summary of the analysis must be considered as a whole and that selecting portions of the analysis and factors or focusing on the information presented below in tabular format, without considering all analyses and factors or the full narrative description of the financial analyses, including methodologies and assumptions underlying the analyses, could create a misleading or incomplete view of the process underlying its analyses and opinions. The tables alone do not constitute complete descriptions of the financial analyses presented in such tables.

Summary of Proposal. Sandler O'Neill reviewed the financial terms of the proposed transaction. Sandler O'Neill calculated an aggregate transaction value of \$117.5 million. Based upon financial information for NLASCO as or for the twelve month period ended June 30, 2006, Sandler O'Neill calculated the following transaction ratios:

Transaction Ratios

Transaction Value/Last Twelve Months' Net Operating Income	7.8x
Transaction Value/Shareholders' Equity	1.7x
Transaction Value/2006 Projected Net Operating Income(1)	6.8x
Transaction Value/2007 Projected Net Operating Income(1)	8.7x

(1) Based on projections provided by ARC management for NLASCO. Net operating income based on net income after interest expense and income taxes less net realized capital gains.

Comparable Company Analysis. Sandler O'Neill used publicly available information to perform a comparison of selected financial and market trading information for NLASCO.

Sandler O'Neill also used publicly available information to compare selected financial and market trading information for a group of insurance companies selected by Sandler O'Neill. The NLASCO

peer group consisted of the following publicly-traded personal line insurance companies and non-standard auto insurance companies with market capitalizations less than \$1 billion.

Personal Line Insurance Companies

Non-Standard Auto Insurance Companies

21st Century Holding Company
 Donegal Group Inc.
 Horace Mann Educators Corporation
 Midland Company
 National Atlantic Holdings Corporation
 Safety Insurance Group, Inc.

Affirmative Insurance Holdings, Inc.
 Bristol West Holdings, Inc.
 Direct General Corporation
 First Acceptance Corporation
 Infinity Property and Casualty Corporation

The analysis compared publicly available financial information for NLASCO and the high, low, mean, and median financial and market trading data for the NLASCO peer group as of and for the twelve months ended June 30, 2006. The table below sets forth the data for the mean and median data for the NLASCO peer group as of and for the twelve months ended June 30, 2006, with pricing data as of October 4, 2006.

Comparable Group Analysis

	Comparable Group Mean Result	Comparable Group Median Result
Price/Last Twelve Months' Net Operating Income	12.4x	11.3x
Price/Estimated 2006 EPS(1)	10.9x	10.3x
Price/Estimated 2007 EPS(1)	10.1x	10.1x
Price/Book Value per Share	1.5x	1.4x
Debt/Total Capital	16.0%	13.2%

(1) Based on Thomson FirstCall estimates.

Discounted Dividend Stream and Terminal Value Analysis. Sandler O'Neill performed two sets of analyses that estimated the future stream of after-tax dividend flows of NLASCO through December 31, 2010 under various circumstances. In the first analysis, or Base Case, Sandler O'Neill assumed NLASCO performed in accordance with the 2006 - 2010 net income projection provided by management based on NLASCO's historical gross losses over the last 18 months. In the second analysis, or Down Case, Sandler O'Neill assumed NLASCO performed in accordance with the Base Case but increased gross historical loss ratios from the Base Case by 6% for each NLASCO product line. In both cases to approximate the terminal value of NLASCO's common stock at December 31, 2010, Sandler O'Neill applied price to last twelve months earnings multiples of 10.0x to 14.0x and multiples of book value ranging from 100% to 175%. The dividend income streams and terminal values were then discounted to present values using different discount rates ranging from 10.5% to 12.5% chosen to reflect different assumptions regarding required rates of return of holders or prospective buyers of NLASCO common stock.

As illustrated in the following tables, the Base Case indicated an imputed range of aggregate values for NLASCO's common stock of \$119.3 million to \$180.2 million when applying the price/earnings multiples to the matched budget and \$89.2 million to \$165.5 million when applying multiples of book value to the matched budget.

Earnings Multiples

Discount Rate	10.0x	11.0x	12.0x	13.0x	14.0x
10.5%	\$ 128.7	\$ 141.6	\$ 154.4	\$ 167.3	\$ 180.2
11.0%	126.3	138.9	151.5	164.1	176.8
11.5%	123.9	136.3	148.6	161.0	173.4
12.0%	121.5	133.7	145.8	158.0	170.2
12.5%	119.3	131.2	143.1	155.0	167.0

Tangible Book Value Multiples

Discount Rate	100%	125%	150%	175%
10.5%	\$ 94.6	\$ 118.2	\$ 141.9	\$ 165.5
11.0%	93.2	116.5	139.8	163.1
11.5%	91.9	114.8	137.8	160.8
12.0%	90.5	113.2	135.8	158.4
12.5%	89.2	111.6	133.9	156.2

As illustrated in the following tables, the Down Case indicated an imputed range of aggregate values for NLASCO's common stock of \$70.9 million to \$107.1 million when applying the price to earnings multiples to the down case budget and \$72.9 million to \$135.2 million when applying multiples of book value to the down case budget.

Earnings Multiples

Discount Rate	10.0x	11.0x	12.0x	13.0x	14.0x
10.5%	\$ 76.5	\$ 84.1	\$ 91.8	\$ 99.4	\$ 107.1
11.0%	75.0	82.5	90.0	97.5	105.0
11.5%	73.6	81.0	88.3	95.7	103.0
12.0%	72.2	79.4	86.7	93.9	101.1
12.5%	70.9	78.0	85.0	92.1	99.2

Tangible Book Value Multiples

Discount Rate	100%	125%	150%	175%
10.5%	\$ 77.3	\$ 96.6	\$ 115.9	\$ 135.2
11.0%	76.1	95.2	114.2	133.2
11.5%	75.0	93.8	112.5	131.3
12.0%	73.9	92.4	110.9	129.4
12.5%	72.9	91.1	109.3	127.6

In connection with its analyses, Sandler O'Neill considered and discussed with the ARC board how the present value analyses would be affected by changes in the underlying assumptions, including variations with respect to net income. Sandler O'Neill noted that the discounted dividend stream and terminal value analysis is a widely used valuation methodology, but the results of such methodology are highly dependent upon the numerous assumptions that must be made, and the results thereof are not necessarily indicative of actual values or future results.

Analysis of Selected Merger Transactions. Sandler O'Neill reviewed 12 merger transactions announced from January 1, 2001 through October 4, 2006 involving specialty insurance companies in the United States with announced transaction values greater than \$50.0 million and transaction values less than \$500.0 million. Sandler O'Neill reviewed the following multiples: transaction price to last twelve months' net operating income and transaction price to book value. As illustrated in the following table, Sandler O'Neill compared the proposed merger multiples to the mean and median multiples of comparable transactions.

Comparable Transaction Multiples

	Mean Group Multiple	Median Group Multiple
	<u> </u>	<u> </u>
Transaction Value/LTM Net Operating Income	17.7x	13.3x
Transaction Value/Book Value	1.2x	1.2x

Miscellaneous. Sandler O'Neill has provided certain other investment banking services to ARC in the past and has received compensation for such services.

Sandler O'Neill will receive a fee of \$350,000 for rendering its opinion and ARC has agreed to indemnify Sandler O'Neill against certain liabilities arising out of its engagement.

In the ordinary course of their respective broker and dealer businesses, Sandler O'Neill may purchase securities from and sell securities to ARC and NLASCO and their affiliates. Sandler O'Neill may also actively trade the debt and/or equity securities of ARC or its affiliates for their own accounts and for the accounts of their customers and, accordingly, may at any time hold a long or short position in such securities.

Accounting Treatment

This acquisition will be accounted for in accordance with Statement of Financial Accounting Standards No. 141, *Business Combinations*, or SFAS No. 141. In accordance with SFAS No. 141, ARC will use the purchase method to account for the acquisition of NLASCO. The aggregate purchase price of the businesses and assets of NLASCO will be allocated to tangible assets, intangible assets, goodwill and liabilities based on their respective fair values. We have made certain assumptions in this regard that may or may not prove to be correct. The final allocation of the purchase price could differ materially from the preliminary allocation depicted herein. See "Unaudited Pro Forma Combined Condensed Consolidated Financial Statements" in this Proxy Statement.

Federal or State Regulatory Filings or Approvals Required in Connection with the Acquisition

Various aspects of the transaction contemplated in the NLASCO Agreement are subject to the review and approval of the Texas Department of Insurance, or TDI. The TDI must approve the transfer of NLASCO to us because such transfer occasions a transfer of control of NLIC, ASIC and NALICO General Agency, Inc., and the TDI must approve the payment of pre-closing dividends by NLIC and ASIC to NLASCO associated with the transaction if such dividends are "extraordinary" under the TDI's regulations. Gerald J. Ford, ARC and ARC Insurance Holdings Inc. will file with the TDI an Acquisition Statement on Form A for the purpose of obtaining the approval of the transfer of control of NLIC and ASIC. It is expected that the processing of this filing will be completed in approximately sixty (60) days after the TDI deems the filing complete. Gerald J. Ford, ARC, ARC Insurance Holdings Inc. and NALICO General Agency, Inc. will also make a separate pre-acquisition filing with the TDI on Form LHL238 regarding the transfer of control of NALICO General Agency, Inc., an insurance agency licensed by the TDI. It is expected that the processing of this filing will be completed before or simultaneously with the processing of the Acquisition Statement on Form A. If required, NLIC and ASIC will file with the TDI extraordinary dividend requests on Form D for the purpose of obtaining approval of dividend amounts necessary to enable NLASCO to make the pre-closing dividend payment associated with that transaction. It is expected that the processing of these filings, if made, would also be completed before or simultaneously with the processing of the Acquisition Statement on Form A. After the consummation of the NLASCO acquisition, appropriate filings will be made with the Company Licensing Section of the TDI to reflect any new management personnel for NLIC and ASIC.

Interests of Certain Persons in the NLASCO Acquisition

We have agreed to take such action as is necessary to appoint C. Clifton Robinson, one of the Sellers, to our board of directors following the consummation of the NLASCO acquisition. ARC currently has a vacancy on its board and the board has the authority to fill any vacancy through the next annual stockholders meeting. C. Clifton Robinson, in his individual capacity and through entities he controls, will receive all of the consideration payable to Sellers under the NLASCO Agreement. The shares of our common stock to be issued under the NLASCO Agreement will be subject to a share lock-up agreement and will be placed in escrow pursuant to an escrow agreement. Each of these agreements is further described in " The NLASCO Agreement and the Related Agreements." We have agreed to register the resale of the shares of our common stock issued to Mr. Robinson pursuant to a registration rights agreement described below under " The NLASCO Agreement and Related Agreements Registration Rights Agreement."

In addition, in connection with the consummation of the acquisition of NLASCO, NLASCO will enter into employment agreements with each of C. Clifton Robinson, to serve as Chairman of NLASCO, Gordon Robinson, to serve as Senior Advisor of NLASCO, and Gregory Vanek, to serve as Chief Executive Officer of NLASCO. For further description of the employment agreements, please see " The NLASCO Agreement and the Related Agreements Employment Agreements."

NLIC and ASIC are each lessees under two lease agreements. The lessors under each of NLIC's leases are related parties. The lessor under one of ASIC's leases is a related party. These lease agreements will be amended but will continue after the closing. For further description of the lease agreements, please see " Certain Relationships and Related Transactions Leases."

In addition, it is contemplated that C. Clifton Robinson and his affiliates that are guarantors of NLASCO's debt owed to Central National Bank will be released from the guaranties upon the closing of the NLASCO acquisition.

The NLASCO Agreement and Related Agreements

The following summary describes material provisions of the NLASCO Agreement. This summary is not complete and is qualified in its entirety by reference to the complete text of the NLASCO Agreement, which is attached to this Proxy Statement as *Appendix A* and incorporated into this Proxy Statement by reference. We urge you to read carefully the NLASCO Agreement in its entirety because this summary may not contain all the information about the NLASCO Agreement that is important to you.

The NLASCO Agreement has been included to provide you with information regarding its terms. It is not intended to provide any other factual information about ARC. Such information can be found elsewhere in this document and in the other public filings we make with the SEC, which are available, without charge, at <http://www.sec.gov>.

The representations and warranties described below and included in the NLASCO Agreement were made by us to Sellers and by Sellers and NLASCO to us. These representations and warranties were made as of specific dates and are in some cases subject to important qualifications, limitations and supplemental information agreed to by the parties in connection with negotiating the terms of the NLASCO Agreement. In addition, the representations and warranties may have been included in the NLASCO Agreement for the purpose of allocating risk between us and Sellers rather than to establish matters as facts. The NLASCO Agreement is described herein, and included as *Appendix A* hereto, only to provide you with information regarding its terms and conditions, and not to provide any other factual information regarding us, NLASCO or our or NLASCO's business. Accordingly, the representations and warranties and other provisions of the NLASCO Agreement should not be read

alone, and you should read the information provided elsewhere in this document and the documents incorporated by reference into this document for information regarding us and our business.

Purchase of NLASCO Shares

ARC, Buyer and Sellers have entered into the NLASCO Agreement dated October 6, 2006 with respect to Buyer's purchase of all outstanding shares of capital stock of NLASCO and the acquisition of control of NLIC and ASIC. Subject to the terms and conditions of the NLASCO Agreement, at the closing Buyer will purchase from Sellers all of the outstanding shares of capital stock of NLASCO in exchange for cash in the amount of \$105,750,000 and 1,218,880 shares of our common stock, which shares will be issued to C. Clifton Robinson and placed in escrow pursuant to an escrow agreement described below. The purchase price will be subject to adjustments based on (1) the GAAP stockholders' equity of NLASCO as of the closing date as finally determined by the parties and (2) the amount of actual losses on NLASCO's insurance policies as of the 36-month anniversary of the closing date for claims arising out of events or circumstances that occurred or existed on or prior to the closing date, compared to the reserves for losses as reflected on the closing balance sheet for both reported claims and for incurred but not reported claims.

Immediately before the closing, and subject to any necessary regulatory approvals or third party consents, Sellers will cause NLASCO to make a dividend or distribution to Sellers in an aggregate amount equal to the excess of (1) the closing date stockholders' equity over (2) \$71,009,382. At closing, NLASCO will repay approximately \$5.6 million aggregate principal amount of outstanding debt.

Closing under the NLASCO Agreement

The closing under the NLASCO Agreement will take place on the last day of a calendar month in which all conditions to the obligations of the parties to consummate the transactions contemplated by the NLASCO Agreement are satisfied or waived by the appropriate party or such other appropriate date as the parties may mutually determine. Subject to the satisfaction or waiver of these conditions, we currently anticipate that the closing will occur on the last day of the calendar month in which the rights offering is completed. If we have not completed the rights offering but we are using our reasonable best efforts to obtain financing for the NLASCO acquisition, then we will not be forced to close the NLASCO acquisition, but after March 31, 2007, the Sellers may elect to terminate the NLASCO Agreement.

Representations and Warranties

Sellers made the following representations and warranties with respect to Sellers relating to, among other things:

due organization, good standing and qualification;

authority for transaction;

absence of conflicts;

brokers' fees;

ownership of NLASCO shares;

various investment representations, including an acknowledgement that the shares of our common stock issued pursuant to the NLASCO Agreement will be restricted securities bearing a restrictive legend; and

accredited investor status.

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Sellers made a number of representations and warranties in the NLASCO Agreement with respect to NLASCO and its subsidiaries, relating to, among other things:

due organization, good standing and qualification;

capitalization;

absence of conflicts;

brokers' fees;

title to tangible assets;

investments;

ownership of subsidiaries;

financial statements; regulatory statements;

no material adverse changes;

undisclosed liabilities;

reserves;

ratings;

compliance with law;

tax matters;

real property and other tangible assets;

proprietary assets, including software;

contracts;

reinsurance contracts;

powers of attorney;

litigation;

insurance;

employee benefits;

environmental matters;

affiliated transactions;

certain business practices;

actuarial reports;

regulatory filings;

insurance markets;

producer relationships;

insurance practices; and

full disclosure.

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ARC and Buyer made a number of representations and warranties in the NLASCO Agreement relating to, among other things;

due organization and good standing;

corporate authority;

absence of conflicts;

brokers' fees;

investment intent; and

financial statements and SEC filings.

Pre-Closing Covenants

Pending the closing under the NLASCO Agreement, each of the parties to the NLASCO Agreement agreed to use its reasonable best efforts to take all actions to consummate the purchase and sale of the NLASCO stock pursuant to the NLASCO Agreement, including the satisfaction, but not waiver, of the conditions to closing in the NLASCO Agreement. In addition, Sellers agreed to, and to cause NLASCO and its subsidiaries to, cooperate with us in our financing efforts for the acquisition. Each of the parties agreed to use their reasonable best efforts to obtain any governmental approvals necessary for the acquisition and to cooperate in obtaining any required governmental approvals.

Sellers agreed that prior to the closing, subject to certain exceptions for actions taken in the ordinary course of business, consistent with past practice or below certain dollar thresholds or as specified in the NLASCO Agreement or with ARC's written consent, Sellers will, and will cause NLASCO and its subsidiaries to, comply with specific restrictions relating to, among others:

the maintenance and preservation of assets and properties;

the preservation of the business and organization of NLASCO;

the incurrence of certain capital expenditures;

the incurrence of debt;

the amendment of the governing documents of NLASCO or any of its subsidiaries;

the declaration or payment of dividends or distributions;

the issuance of stock or convertible securities;

the taking of certain actions relating to stock option plans;

the reorganization of any labor union or the entry into any collective bargaining agreement;

the formation of any subsidiary or the acquisition of any equity interest in other persons;

the adoption or amendment of employee benefit plans;

the hiring or termination of employees;

a change in accounting methods;

the making of material tax elections;

the commencement or settlement of legal proceedings; and

the agreement or entry into a contract to do any of the foregoing.

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In addition, NLASCO agreed to certain other customary covenants, including covenants:

to maintain its books and records in the usual manner;

to comply in all material respects with all applicable laws;

to provide notices to third parties and obtain third party consents for the acquisition;

to provide us full access at reasonable times to NLASCO's premises, properties, personnel, books records, contracts and documents or pertaining to NLASCO; provided, that we do not have access to information that may not be provided to us under applicable laws and regulations;

to maintain confidentiality of information relating to ARC pursuant to a confidentiality agreement;

not to solicit proposals or offers from other persons relating to the acquisition of all or substantially all of the capital stock or assets of NLASCO; and

to take such actions as are necessary to cause a change of control of NLIC to occur on the closing date.

Before the closing, NLASCO will exercise complete control and supervision over its operations, consistent with the terms of the NLASCO Agreement.

Material Adverse Effect

Pursuant to the NLASCO Agreement, a material adverse effect with respect to NLASCO, or Material Adverse Effect, means the occurrence before closing of any effect, change, event, claim, circumstance or matter that is, or could reasonably be expected to be or to become, materially adverse to (1) the business, condition, assets, capitalization, intellectual property, liabilities (contingent or otherwise), results of operations or financial performance of NLASCO and its subsidiaries, taken as a whole; provided, however, without limiting the foregoing, the occurrence before closing of any single event, or any series of related events, or set of related circumstances, that could reasonably be expected to cause a loss or diminution in value of NLASCO or any of its subsidiaries of at least \$5,875,000 shall be deemed to be a Material Adverse Effect, (2) the ability of Sellers to consummate timely the transactions contemplated by the NLASCO Agreement, or (3) the ability of Sellers, NLASCO or its subsidiaries to perform their respective obligations under the stock purchase agreement.

However, an adverse change, event, development or effect arising from or relating to any of the following, in each case, to the extent that NLASCO demonstrates to Buyer's reasonable satisfaction that such change, event, development or effect does not have a disproportionate effect on NLASCO or any of its subsidiaries, in and of itself, shall not be deemed a Material Adverse Effect:

general business or economic conditions;

national or international political or social conditions;

financial, banking or securities markets, including any disruption thereof and any decline in the price of any security or any market index;

changes in GAAP or regulatory accounting principles including SAP;

changes in laws, rules, regulations, orders or other binding directives issued by any governmental entity; or

the taking of any action contemplated by the NLASCO Agreement, including the public announcement of the transaction contemplated by the NLASCO Agreement.

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In addition, an adverse change in or effect on the business of NLASCO and its subsidiaries shall not be deemed a Material Adverse Effect if such adverse change or effect is cured, to the reasonable satisfaction of Buyer, by NLASCO before the earlier of (1) three days prior to the closing date and (2) the date on which the NLASCO Agreement is terminated pursuant to the termination provisions of the NLASCO Agreement.

Conditions to Closing

The NLASCO Agreement includes several conditions to closing. ARC's and Buyer's obligation to close is subject to the satisfaction or waiver of the following conditions, among others:

the representations and warranties of Sellers are true and correct in all material respects on the closing date, except to the extent that such representations and warranties are qualified by materiality, such representations and warranties are true and correct in all respects on the closing date;

Sellers have complied with all of their covenants under the NLASCO Agreement;

there is not pending or threatened any legal proceeding in which a governmental authority is or has threatened to become a party, and none of the parties to the NLASCO Agreement has received a notice from a governmental authority indicating there is a reasonable likelihood of commencing any legal proceeding or taking certain other actions relating to the acquisition;

there is not pending any legal proceeding that would reasonably likely result in a Material Adverse Effect or a material adverse effect on Buyer;

NLIC and ASIC have maintained their A.M. Best ratings and A.M. Best has not communicated to NLASCO that there is a reasonable possibility that A.M. Best would downgrade or consider any downgrade of the ratings of NLIC or ASIC;

the net written premiums divided by the policyholders' statutory surplus of NLIC and ASIC as determined by NLASCO in good faith in accordance with statutory accounting principles does not exceed 1.75 as of the last business day of the month preceding the month in which the closing occurs;

the aggregate number of producers and the aggregate number of policies for insurance in force as of the last business day of the month preceding the month in which the closing occurs as determined by NLASCO in good faith has not declined by more than 5% and 5%, respectively, since August 31, 2006;

the waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, has expired or been terminated and the parties have obtained all governmental approvals and other third party consents necessary to complete the acquisition;

no Material Adverse Effect has occurred and there exists no fact, development or state of circumstances that individually or in the aggregate would be reasonably likely to result in a Material Adverse Effect or a material adverse effect on Buyer;

Sellers have delivered the following agreements, duly executed by Sellers: a noncompetition agreement, a release, a registration rights agreement, a share lock-up agreement, an escrow agreement, the termination of a joint personnel agreement and the termination of a tax sharing agreement and Sellers shall have caused each of C. Clifton Robinson, Gordon Robinson and Gregory Vanek to deliver duly executed employment agreements;

since June 30, 2006, no reinsurance contract to which NLIC or ASIC is a party has been cancelled, commuted or non-renewed by a reinsurer, nor has there been any notice regarding such an action, nor has, to the knowledge of Sellers, any such cancellation, commutation or

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non-renewal been threatened or contemplated, except where (1) renewals or replacements of the reinsurance contracts are not more than 120% of the cost of the reinsurance contract in place on the date of the stock purchase agreement, (2) the limits of the renewed or replaced reinsurance contracts are no less favorable to the NLIC or ASIC than the reinsurance contract in place on the date of the stock purchase agreement, (3) the renewed or replaced reinsurance contracts are with a reinsurer with an A.M. Best rating no less than A-, and (4) the retention levels of the renewed or replaced reinsurance contract, after taking into account reasonable increases in retention levels that may be agreed to by NLIC or ASIC in exchange for reductions in the cost of reinsurance, are reasonably comparable to the retention levels on the renewed or replaced reinsurance contract;

NLASCO has stockholders' equity of at least \$71,039,000 as of the day prior to the closing date;

each of the underwriters of NLIC designated by Buyer has resigned and withdrawn as underwriters of NLIC and have signed any documentation requested by Buyer to designate successor underwriters of NLIC;

Sellers have delivered the resignations requested by Buyer with respect to the officers and directors of NLASCO and its subsidiaries;

Sellers and Buyer have entered into mutually acceptable amendments to certain lease agreements;

NLIC and ASIC were eligible, as of the date of the NLASCO Agreement, for the small company exemption in Article 5.13-2C of the Texas Insurance Code in effect on the closing date;

Sellers have delivered to Buyer a certificate to the effect that each of the conditions set forth above have been satisfied;

Sellers have delivered a duly adopted resolution of the board of directors of NLASCO dated at least one business day before the closing terminating the NLASCO 401(k) Plan as in effect immediately prior to the closing date in accordance with the terms of the plan documents for such plan; and

Sellers and Buyer have set forth, in a writing signed by Sellers and Buyer, the methodology the parties will follow in determining the Reserve Deficiency or Excess Reserve (each, as defined in the NLASCO Agreement), as applicable.

Sellers' obligation to close is subject to the satisfaction or waiver of the following conditions, among others:

the representations and warranties of ARC and Buyer are true and correct in all material respects on the closing date, except to the extent that such representations and warranties are qualified by materiality, such representations and warranties are true and correct in all respects on the closing date;

Buyer has complied with all of its covenants under the NLASCO Agreement;

there is no injunction, judgment, order, decree, ruling or charge in effect preventing consummation of any of the transactions contemplated by the NLASCO Agreement;

Buyer has delivered a certificate to Sellers to the effect that each of the conditions above is satisfied in all respect and the purchase price;

the waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, has expired or been terminated and the parties have obtained all governmental approvals and other third party consents necessary to complete the acquisition;

ARC has delivered a duly executed registration rights agreement;

on the closing date, ARC has delivered the 1,218,880 shares of our common stock in partial payment of the purchase price and the shares shall be duly authorized, validly issued, fully paid and nonassessable and the shares are free of liens other than those under the securities laws and the escrow agreement;

since the date of the NLASCO Agreement, no material adverse effect with respect to ARC has occurred and there exists no fact, development or state of circumstances that, individually or in the aggregate, would be reasonably likely to result in a material adverse effect with respect to ARC; and

Buyer and Sellers have set forth, in a writing signed by buyer and Sellers, in the methodology the parties will follow in determining the Reserve Deficiency or Excess Reserve, as applicable.

Indemnification

Sellers, on the one hand, and ARC and Buyer, on the other hand, have agreed to indemnify the other in connection with certain losses arising in connection with the NLASCO Agreement. The representations and warranties of each party generally survive until the 36-month anniversary of the closing date except that certain representations and warranties will survive until the applicable statute of limitations.

Seller will indemnify the Buyer indemnitees for losses arising out of:

a breach of a representation or warranty of Sellers, except that losses from most of the representations and warranties are not indemnifiable except to the extent that the losses from such breach or series of related events exceed \$20,000 and then only if the recoverable losses exceed \$3 million in the aggregate;

a breach of a covenant of Sellers;

a violation of law in connection with the pre-closing distribution to Sellers;

certain matters relating to intellectual property rights; and

certain legal proceedings pending at the date of the closing.

Sellers' indemnity obligations for breaches of representations and warranties are limited to \$23.5 million except that liability for breaches of certain representations and warranties is not limited.

ARC and Buyer will indemnify Sellers for losses arising out of a breach of a representation, warranty or covenant in the stock purchase agreement to the extent that such losses exceed \$3 million.

Termination

The NLASCO Agreement may be terminated:

by the mutual written consent of the parties;

ARC or Buyer may terminate the NLASCO Agreement within 30 business days of receiving notice from Sellers of an update to the disclosure schedule to the NLASCO Agreement if the development updated could reasonably be expected to have a Material Adverse Effect;

ARC or Buyer may terminate the NLASCO Agreement if (1) any of Sellers' representations and warranties shall have been materially inaccurate as of the date of the NLASCO Agreement or have become materially inaccurate as of any subsequent date or if any of Sellers' covenants have been breached in any material respect subject to a cure period or (2) if the closing has not occurred on or before March 31, 2007 by reason of the failure of a condition precedent unless

the failure results from ARC or Buyer breaching any representation, warranty or covenant or if Buyer has been unable to obtain financing on terms acceptable to Buyer and the failure is not due to a Material Adverse Change of Sellers' failure to timely provide or certify to the information provided by NLASCO for ARC's securities filings in connection with the acquisition; and

Sellers may terminate the NLASCO Agreement (1) if ARC's or Buyer's representations and warranties were materially inaccurate as of the date of the NLASCO Agreement or have become materially inaccurate as of any subsequent date or if any of ARC's or Buyer's covenants have been breached in any material respect subject to a cure period or (2) if the closing has not occurred on or before March 31, 2007 by reason of the failure of any condition precedent unless the failure results primarily from any Seller breach and except that Buyer may rescind any termination by Sellers by reason of the failure of the condition precedent resulting from a Material Adverse Effect if Buyer elects to pay the entire purchase price in cash.

Expenses

Each of ARC, Buyer, Sellers, NLASCO and NLASCO's subsidiaries will bear its own costs and expenses in connection with the NLASCO Agreement and the transactions contemplated therein except that (1) all expenses, whether billed or unbilled, of NLASCO or any NLASCO subsidiary on or before the closing date must be properly recorded as liabilities of NLASCO as of the closing date, (2) Buyer will pay all regulatory filing fees in connection with the NLASCO Agreement and (3) Buyer will reimburse to Sellers any fees and expenses related to ARC's financing of the acquisition that are incurred after the date of the NLASCO Agreement, payable to a third-party accounting firm and incurred in connection with any audit of NLASCO's financial statements for the years ended prior to December 31, 2005. Buyer will pay all transfer, documentary, sales, use, stamp, registration and other such taxes and will file all necessary tax returns. All sales, use, transfer, documentary and other similar taxes will be borne 50% by Sellers and 50% by Buyer.

Escrow Agreement

At the closing ARC, Buyer and Sellers will enter into an escrow agreement with an independent escrow agent regarding the establishment and maintenance of an escrow account to secure any post-closing adjustments in the purchase price under the NLASCO Agreement and certain other obligations of Sellers under the NLASCO Agreement. Under the terms of the NLASCO Agreement, the parties will deposit the 1,218,880 shares of our common stock issued to C. Clifton Robinson in an escrow account at closing. Any claims by us under the NLASCO Agreement must be submitted to Sellers and the escrow agent pursuant to customary procedures specified in the escrow agreement.

The escrow agreement will terminate 20 months after the closing date. The termination of the escrow agreement will not limit Sellers' indemnification obligations under the NLASCO Agreement, which are described in the section of this proxy statement entitled " The NLASCO Agreement and Related Agreements-Indemnification."

Registration Rights Agreement

At the closing, ARC, Buyer and C. Clifton Robinson will enter into a registration rights agreement pursuant to which we have agreed to prepare and file with the Securities and Exchange Commission within 20 months after the closing date a registration statement with respect to the resale of 1,218,880 shares of common stock issued pursuant to the NLASCO Agreement. The registration rights agreement will include customary covenants and indemnification provisions.

Employment Agreements

At the closing, NLASCO will enter into employment agreements with C. Clifton Robinson, the current chairman and chief executive officer of NLASCO, Gordon Robinson, the current vice chairman and deputy executive officer of NLASCO, and Gregory Vanek, the current president and chief operating officer of NLASCO. C. Clifton Robinson's employment agreement will provide that he will serve as chairman of NLASCO and will be paid \$100,000 a year. Gordon Robinson's employment agreement will provide that he will serve as a senior advisor to NLASCO and will be paid \$100,000 a year. Both C. Clifton Robinson's and Gordon Robinson's employment agreements will be for a one-year term with automatic one-year extensions. Gregory Vanek's employment agreement will provide that he will serve as chief executive officer of NLASCO and will be paid a salary of \$225,000 per year. Gregory Vanek's employment agreement is for a three-year term with automatic one-year extensions. Each of the employment agreements will also include noncompetition and non-solicitation provisions similar to that in the noncompetition agreement but with a term until two years after the termination of employment.

Noncompetition Agreement

At the closing, ARC, Buyer and Sellers will enter into a noncompetition agreement pursuant to which Sellers will agree not to, directly or indirectly, engage or invest in, own, manage, operate, finance, control, or participate in the ownership, management, operation, financing, or control of, be employed by, lend such Sellers' credit to, or render services to any business whose products, services or activities compete with those of NLASCO or any of its subsidiaries within certain states. The noncompetition agreement also includes customary non-solicitation provisions. The term of the noncompetition agreement is five years.

Release

At the closing, Sellers will execute a release pursuant to which Sellers will release NLASCO and its subsidiaries from certain potential liabilities arising before or contemporaneously with the closing date that Sellers or any of their affiliates may have against NLASCO or any of its subsidiaries.

Share Lock-up Agreement

At the closing, C. Clifton Robinson will execute a share lock-up agreement pursuant to which he will agree not to offer, sell, contract to sell, hypothecate, pledge, sell or grant any option, right or warrant to purchase, or otherwise dispose of, or contract to dispose of, our common stock until 20 months after the closing date.

Business of NLASCO

Company Overview

NLASCO is an insurance holding company that operates through its subsidiaries and controlled affiliates, who are controlled through various management agreements. NLASCO's two insurance subsidiaries are NLIC and ASIC. NLIC is rated "A" (Excellent) by A.M. Best Company, and ASIC is rated "B++" (Very Good) by A.M. Best. NLASCO has an experienced management team, a high quality agency force and an established track record of growth and underwriting profitability.

NLASCO specializes in providing fire and homeowners insurance for low value dwellings and manufactured homes, primarily in Texas and other areas of the south, southeastern and southwestern United States. NLASCO targets underserved markets that require underwriting expertise that many larger carriers have been unwilling to develop given the relatively small volume of premiums produced by local agents. Within these markets, NLASCO capitalizes on its superior local knowledge to identify

profitable underwriting opportunities. NLASCO believes that it distinguishes itself from competitors by delivering products that are not provided by many larger carriers, providing a high level of customer service and responding quickly to the needs of its agents and policyholders. NLASCO applies a high level of selectivity in the risks it underwrites and uses a risk-adjusted return approach to capital allocation, which NLASCO believes allows it to consistently generate underwriting profits.

NLASCO's policies are typically written for actual cash value of up to \$250,000 in the low value dwelling market and replacement cost of up to \$125,000 in the manufactured home market. Liability on a homeowner's policy typically provides coverage up to \$100,000 with a maximum of \$300,000 issued by a few select agents. NLASCO has also capitalized on its local market knowledge and distribution presence by introducing complementary products such as small commercial property and liability, builders risk, vacancy and a "Write Your Own" flood coverage program. These complementary products accounted for 7% of 2005 direct premiums written and are a potential source of growth.

NLASCO currently distributes its products through approximately 6,600 independent agents in 23 states, including approximately 3,300 in Texas, and a small portion of its business through 12 MGAs. NLASCO built its agency force by providing a consistent market in its core products for over 40 years while offering competitive commissions and profit sharing and effectively employing technology to enhance customer service. Distribution is diversified with the top 10 agents accounting for only 11% of direct premiums written in 2005. As of June 30, 2006, the average tenure of the top 25 agencies was over 8 years.

NLASCO applies its regional expertise, underwriting discipline and a risk-adjusted, return-on-equity based approach to capital allocation to offer primarily short-tail insurance products in its target markets. NLASCO's underwriting process involves securing an adequate level of underwriting information from its independent agents, identifying and evaluating risk exposures and then pricing the risks it chooses to accept.

NLASCO employs a disciplined underwriting approach that incorporates the continuously refined segmentation of its target markets to permit it to tailor its policies to individual risks and adopt pricing structures that will be supported in the applicable market. NLASCO utilizes underwriting principles and processes that reflect the knowledge and experience it has acquired during its 40-year history of underwriting risks. NLASCO also draws on the input and expertise of its skilled underwriters, management and consulting actuaries to underwrite its personal and commercial policies. NLASCO believes that this comprehensive process capitalizes on its knowledge and expertise and results in better underwriting decisions.

Company History

NLIC traces its origin back to 1948, when the original Lloyds company was licensed in San Antonio, Texas. In 1964, Clifton Robinson, Mike Lanham and several other passive investors purchased NLIC, which at the time had no substantial operations, and moved the headquarters to Waco, Texas. Insurance agents by trade, Messrs. Robinson and Lanham saw local residents frustrated by the inability to insure their low value rental property and used NLIC to address this niche. NLIC wrote its first property policy in October 1964. As the business grew over the next four decades, Mr. Robinson acquired the equity of other investors to become the sole owner of the company in 1986.

In 1999, GuideOne Mutual Insurance Company, or GuideOne, approached Mr. Robinson with an offer to purchase NLIC. The sale of NLIC to GuideOne was closed on December 31, 1999. In 2000, Mr. Robinson repurchased NLIC and acquired ASIC as well, both from GuideOne. The Robinsons formed NLASCO to effect the acquisition of the companies which closed on December 31, 2000. James Murphy, the former owner of ASIC, was a 25% partner in NLASCO. In 2001, Mr. Murphy sold his share of NLASCO to the Robinson family, which continues to own 100% of NLASCO.

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NLASCO was incorporated in Delaware in 2000. Financial information for periods prior to January 1, 2005 is unaudited and reported on a historical GAAP basis of accounting. NLASCO occasionally refers to audited statutory financial information that has been prepared in accordance with the National Association of Insurance Commissioners Accounting Practices and Procedure Manual, or Manual. All domestic U.S. insurance companies are required to prepare audited statutory-based financial statements in accordance with the Manual.

Industry Overview

The property and casualty insurance industry provides protection from pre-specified loss events, such as damage to property or liability claims by third parties. Property and casualty insurance can be broadly classified into personal lines, in which insurance is provided to individuals, and commercial lines, in which insurance is provided to business enterprises. In the U.S., personal and commercial insurance products are written in admitted and non-admitted markets, also known as the excess and surplus lines market. NLASCO provides insurance products in the personal market and the commercial line market.

In the admitted market, insurance rates and forms are generally highly regulated and coverages tend to be standardized. Within the admitted market, NLASCO focuses on underserved segments that do not fit into the standard underwriting criteria of national insurance companies due to factors such as type of business, location and the amount of premium per policy. These segments tend to have limited competition. Therefore, NLASCO believes it has greater flexibility in pricing and product design relative to most admitted market risks.

The non-admitted market focuses on harder-to-place risks that admitted insurers typically do not write. In this market, risks are underwritten with more flexible policy forms and rates, resulting in more restrictive and expensive coverages. NLASCO writes in this market in its dwelling fire business in Louisiana.

The property and casualty industry historically has been subject to cyclical fluctuations in pricing and availability of insurance coverage. "Soft" markets are often characterized by excess underwriting capital and involve intense price competition, expanded policy terms and conditions, erosion of underwriting discipline and poor operating performance. These market conditions usually lead to a period of diminished underwriting capacity after insurance companies exit unprofitable lines and exhibit greater underwriting discipline, increase premium rates and implement more restrictive policy terms and conditions. This latter market condition is called a "hard" market. The insurance market may not always be hard or soft; rather, it could be hard for one line of business and soft for another. The market at the start of 2006 might be characterized as soft for property risks in NLASCO's operating area, however, in coastal areas, due to the recent hurricane activity, the market is considered hard.

Beginning in 2001, the insurance market in Texas was disrupted by losses related to property mold claims. At that time, many national insurance carriers elected to reduce their personal property insurance business in Texas, thereby reducing competition in many of NLASCO's target markets, particularly in rural markets. Furthermore, poor underwriting results, low interest rates and weak investment returns over the past several years caused many carriers to become more risk averse in their underwriting strategy. These factors resulted in higher premium rates, more selectivity in risks insured and a reduction in coverages offered. As a result, the Texas insurance market experienced increased premium rates and policy terms and conditions became more stringent for personal property insurance and other business lines. In 2003, in response to this rapid increase in the cost of personal property insurance following the mold crisis, the TDI issued an order requiring insurance company groups in Texas to lower their homeowner's rates by an industry average of 12.5%. In connection therewith, TDI ordered a 16.5% rate reduction for NLASCO's homeowner's business and a reduction of 26.5% for dwelling fire and allied lines. The impact of that rate action was fully absorbed in 2003 and 2004. As a

result of the Texas mold crisis, NLIC direct premiums written grew at a compound annual growth rate of 60.2% from 2000 to 2003.

The property insurance market was significantly impacted by major hurricanes in 2005 and 2004. Hurricanes Katrina and Rita significantly impacted NLASCO's operating area in 2005. The Florida hurricanes in 2005 and 2004 indirectly impacted NLASCO's operations by causing an overall surge in demand for claims products and services and increasing reinsurance rates for catastrophe and other coverages. The insurance industry recorded the highest level of hurricane losses ever in 2005, breaking the previous record set in 2004. To date, insurers and reinsurers have been able to absorb these losses by charging higher rates and raising additional capital.

Product Lines

Personal and Commercial Lines

The NLASCO companies specialize in writing fire and homeowners insurance coverage for low value dwellings and manufactured homes. The vast majority of NLASCO's property coverage is written on policies which provide actual cash value payments as opposed to replacement cost. Under actual cash value policies, the insured is entitled to receive only the cost of replacing or repairing damaged or destroyed property with comparable new property less depreciation. Additionally, most of NLASCO's property policies exclude coverage for water and mold damage.

The average annual premium per policy issued by NLIC and ASIC is \$480 and \$312, respectively. NLIC primarily focuses on the low value dwelling, limited homeowners markets, preferred small commercial risks and ASIC primarily focuses on the mobile home market.

Throughout the years, NLASCO has capitalized on its strong distribution relationships and shifts in market conditions to introduce complementary products. These products include vacancy, builders risk and a "Write Your Own" flood coverage program. In addition, NLASCO introduced a preferred commercial property and liability product in 1992 to take advantage of opportunities presented by its agency network. Finally, NLASCO acquired a small book of profitable sports liability business that it has maintained and expanded through introduction to select distribution partners.

NLASCO's business is conducted with two product lines, its personal lines and its commercial lines. Set forth below is certain financial data broken down by line of business:

	Six Months Ended June 30, 2006	Year Ended December 31,		
		2005	2004	2003
(in millions)				
Direct Premiums Written				
Personal lines	\$ 72.0	\$ 141.2	\$ 139.2	\$ 138.8
Commercial lines	3.1	5.3	6.5	6.0
Total	\$ 75.1	\$ 146.5	\$ 145.7	\$ 144.8
Net Operating Income				
Personal lines	\$ 14.3	\$ 25.6	\$ 24.0	\$ 18.1
Commercial lines	0.6	1.0	1.1	0.8
Total	\$ 14.9	\$ 26.6	\$ 25.1	\$ 18.9
Total Assets				
Personal lines	\$ 231.4	\$ 243.7	\$ 212.5	\$ 184.0
Commercial lines	10.0	9.3	10.0	8.0
Total	\$ 241.4	\$ 253.0	\$ 222.5	\$ 192.0

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The following table sets forth the direct premiums written by line of business:

	Six Months Ended June 30, 2006		Year Ended December 31,					
			2005		2004		2003	
	Dollar Value	%	Dollar Value	%	Dollar Value	%	Dollar Value	%
(in millions)								
Personal lines								
Homeowners	\$ 33.8	45.0%	\$ 68.8	47.0%	\$ 72.0	49.4%	\$ 71.1	49.1%
Dwelling fire	26.0	34.6%	48.4	33.0%	44.4	30.5%	44.4	30.7%
Manufactured homes	9.6	12.8%	18.2	12.4%	18.8	12.9%	19.9	13.7%
Flood	2.0	2.7%	3.9	2.7%	3.3	2.3%	2.8	1.9%
Vacant	0.3	0.4%	0.6	0.4%	0.2	0.1%	0.1	0.1%
Commercial lines								
Commercial	2.2	2.9%	4.2	2.9%	4.7	3.2%	4.4	3.0%
Builder's risk/builder's risk renovation	0.9	1.2%	1.7	1.2%	1.8	1.2%	1.6	1.1%
Sports liability	0.2	0.3%	0.4	0.3%	0.4	0.3%	0.4	0.3%
Other	0.1	0.1%	0.3	0.2%	0.1	0.1%	0.1	0.1%
Total	\$ 75.1	100.0%	\$ 146.5	100.0%	\$ 145.7	100.0%	\$ 144.8	100.0%

Personal Lines

Homeowner's. Homeowner's policies accounted for direct premiums written of \$33.8 million in the six months ended June 30, 2006, \$68.8 million in the year ended December 31, 2005 and \$72.0 million in the year ended December 31, 2004. NLASCO's homeowner's policies offer coverage on owner-occupied dwellings and personal property, including liability and theft. On the homeowner's policy, an insured may purchase up to \$100,000 of liability insurance for the property, although the average liability coverage is approximately \$50,000. Expanded policy coverage, which is offered only on a limited basis through preferred agents, includes replacement cost and accidental water discharge. For both NLIC and ASIC, the average value of an insured's property is approximately \$70,000 and policy limits are set at \$250,000 for the dwelling, and personal property limits are set at 40% of the dwelling value.

Dwelling Fire. Dwelling fire policies accounted for direct premiums written of \$26.0 million in the six months ended June 30, 2006, \$48.4 million in the year ended December 31, 2005 and \$44.4 million in the year ended December 31, 2004. The policies generally cover fire, lightning, internal explosion, damage from smoke, storm, aircraft and vehicles, riot and civil commotion and exclude glass coverage. All policies are sold on an actual cash value basis. The dwelling fire program is designed for owners, tenants, secondary or seasonal occupants of homes that may be considered low in value, generally less than \$250,000. Underwriting is based on prior loss history and condition and value of the home. Separate liability coverage may be added to the policy on either an owner or tenant occupied basis if the dwelling is greater than \$25,000 in value. Extended coverage, including vandalism, freezing of pipes, accidental discharge of water, renters' belongings and replacement cost is available on a limited basis through preferred agents. Recent product enhancements include a liability endorsement for owners of rental property. At NLIC, the average value of an insured property is approximately \$40,000 and policy limits are set at \$250,000 for the dwelling and \$80,000 for personal property. At ASIC, the average property value is approximately \$50,000 while policy limits are set at \$250,000 for the dwelling and \$100,000 for personal property.

Manufactured Home ASIC. Manufactured home policies accounted for direct premiums written of \$8.2 million in the six months ended June 30, 2006, \$15.7 million in the year ended December 31, 2005 and \$16.6 million in the year ended December 31, 2004. ASIC provides coverage to a wider array of manufactured homes than NLIC, targeting both older and newer homes. Comprehensive mobile home policies are written for actual cash value and include contents, adjacent structures, theft and liability. ASIC also offers extended coverage options which include replacement cost liability coverage. The average property policy size is approximately \$30,000 and policy limits are generally set at \$125,000. The average liability policy limit is approximately \$100,000, with a maximum of \$300,000.

Manufactured Home NLIC. NLIC wrote direct premiums written for manufactured home coverage of \$1.4 million in the six months ended June 30, 2006, \$2.5 million in the year ended December 31, 2005 and \$2.2 million in the year ended December 31, 2004. Fire and extended coverage through NLIC is provided on a named peril basis for older manufactured homes which typically have a value of \$50,000 or less and are often second or vacation homes. The average policy size is approximately \$20,000 and policy limits are set at \$75,000. Liability coverage up to \$100,000 is available on certain manufactured homeowners policies.

Flood. NLASCO wrote direct flood premiums, primarily through *FloodConnect*, its comprehensive flood insurance processing system, of \$2.0 million in the six months ended June 30, 2006, \$3.9 million in the year ended December 31, 2005, and \$3.3 million in the year ended December 31, 2004. NLIC and ASIC provide flood coverage as general agents through the National Flood Insurance Program, or NFIP. This program is designed to provide an insurance alternative to disaster assistance to reduce the escalating costs of repairing damage to buildings and their contents caused by floods. Flood coverage requires a 30 day waiting period before coverage begins, unless it is for a loan closing or a mortgage requirement. NLASCO acts only in an agent capacity for the NFIP, and as a result, does not retain any of the underwriting risk associated with this product. Policy limits at both NLIC and ASIC are \$250,000 for dwellings and \$100,000 for personal property for homeowners policies and \$500,000 for buildings and \$500,000 for contents for commercial policies.

Vacant. Vacant risk, introduced in 2004, accounted for direct premiums written of \$0.3 million in the six months ended June 30, 2006, \$0.6 million in the year ended December 31, 2005 and \$0.2 million in the year ended December 31, 2004. This policy is targeted at homeowners who have vacated a residence, usually due to a move, and have not yet sold the original residence. To avoid moral hazard risk, vacant homes are insured for up to 75% of their market value on three month policies which may only be up to a maximum of 12 months. The average policy size is approximately \$50,000 and policy limits are set at \$200,000.

Commercial Lines

Commercial. Commercial monoline and package policies, which were introduced in 1992 and are underwritten only by NLIC, accounted for direct premiums written of \$2.2 million in the six months ended June 30, 2006, \$4.2 million in the year ended December 31, 2005 and \$4.7 million in the year ended December 31, 2004. Commercial policies are available for higher end "Main Street" storefront businesses such as attorney and medical offices and gift stores. NLASCO has not written higher risk policies, such as those for contractors, fast food businesses or garages. Policy limits are set at \$500,000 for property and \$1.0 million for liability.

Builders Risk / Builders Risk Renovation. The builders risk program generated direct premiums written of \$0.9 million in the six months ended June 30, 2006, \$1.7 million in the year ended December 31, 2005 and \$1.8 million in the year ended December 31, 2004. Builders risk is an actual cash value policy which is written for a three, six or twelve month period on a fire and extended coverage basis. Builders risk is written only on new construction residential and commercial properties and all policies exclude theft, liability and vandalism, which eliminates the labor intensive process of

monitoring numerous small claims and potential fraud. Builders risk renovation coverage is identical to builders risk coverage with the exception of structures covered, residential homes or commercial buildings being renovated or remodeled. The average policy sizes at NLIC and ASIC are approximately \$120,000 and \$220,000, respectively. Policy limits are set at \$500,000.

Sports Liability. The sports liability product accounted for direct premiums written of \$0.2 million in the six months ended June 30, 2006, \$0.4 million in the year ended December 31, 2005 and \$0.4 million in the year ended December 31, 2004. Coverage includes little leagues, sports camps and other youth outings. While accident and health coverage is included, in most cases it is secondary coverage which is used only after the primary carrier is utilized. Additionally, all of the policies written include a sexual misconduct exclusion. Coverage for this product is currently limited to Arizona and Ohio and policy limits are set at \$1.0 million for liability.

Other. NLASCO provides inland marine coverage on a limited basis and only when accompanied by other supporting business. Inland marine coverage is written on scheduled items only and does not cover leased equipment or theft. Travel trailer coverage is written on a comprehensive form to include the travel trailer and personal effects. Additionally, ASIC writes a comprehensive personal effects policy for tenant occupied mobile homes on an actual cash value basis.

Geographic Markets

The following table sets forth the percentage of NLASCO's total gross written premiums by state for the periods shown:

		Gross Written Premiums			
		Six Months Ended June 30, 2006	Year Ended December 31,		
			2005	2004	2003
		(in millions)			
Texas Flood	\$	2.0	\$ 3.2	\$ 2.8	\$ 2.4
Texas North		13.1	26.2		