Altisource Residential Corp
Form 10-Q
November 09, 2015

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

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2015

OR

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

COMMISSION FILE NUMBER: 001-35657

Altisource Residential Corporation
(Exact name of registrant as specified in its charter)

MARYLAND	46-0633510
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

c/o Altisource Asset Management Corporation
36C Strand Street
Christiansted, United States Virgin Islands 00820
(Address of principal executive office)

(340) 692-1055
(Registrant’s telephone number, including area code)

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

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

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

Large Accelerated Filer	x		Accelerated Filer	o
Non-Accelerated Filer	o	(Do not check if a smaller reporting company)	Smaller Reporting Company	o

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

As of October 30, 2015, 55,990,853 shares of our common stock were outstanding (excluding 1,234,393 shares held as treasury stock).

Altisource Residential Corporation
September 30, 2015
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References in this report to "we," "our," "us," or the "Company" refer to Altisource Residential Corporation and its consolidated subsidiaries, unless otherwise indicated. References in this report to “AAMC” refer to Altisource Asset Management Corporation, unless otherwise indicated. References in this report to “Altisource” refer to Altisource Portfolio Solutions S.A. and its consolidated subsidiaries, unless otherwise indicated.

Special note on forward-looking statements

Our disclosure and analysis in this quarterly report on Form 10-Q contain “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended, which we refer to as the “Securities Act,” and Section 21E of the Securities Exchange Act of 1934, as amended, which we refer to as the “Exchange Act.” In some cases, you can identify forward-looking statements by the use of forward-looking terminology such as “may,” “will,” “should,” “expects,” “intends,” “plans,” “anticipates,” “believes,” “estimates,” “predicts,” or “potential” or the negative of thes and phrases or similar words or phrases which are predictions of or indicate future events or trends and which do not relate solely to historical matters. You can also identify forward-looking statements by discussions of strategy, plans or intentions.

The forward-looking statements contained in this report reflect our current views about future events and are subject to numerous known and unknown risks, uncertainties, assumptions and changes in circumstances that may cause our actual results to differ significantly from those expressed in any forward-looking statement. Factors that may materially affect such forward-looking statements include, but are not limited to:

- our ability to implement our business strategy;
- our ability to make distributions to our stockholders;
- our ability to acquire assets for our portfolio;
- the impact of changes to the supply of, value of and the returns on sub-performing and non-performing loans and single-family rental properties;
- our ability to convert loans to rental properties generating attractive returns;
- our ability to predict our costs;
- our ability to effectively compete with our competitors;
- our ability to apply the proceeds from financing activities to target assets in a timely manner;
- changes in interest rates and the market value of the collateral underlying our sub-performing and non-performing loan portfolios or acquired real estate owned and single-family rental properties;
- our ability to obtain and access financing arrangements on favorable terms, or at all;
- our ability to maintain adequate liquidity;
- our ability to retain our engagement of AAMC;
- the failure of Altisource to effectively perform its obligations under various agreements with us;
- the failure of our mortgage loan servicers to effectively perform their servicing obligations;
- our failure to maintain qualification as a REIT;
- our failure to maintain our exemption from registration under the Investment Company Act;
- the impact of adverse real estate, mortgage or housing markets;
- the impact of adverse legislative or regulatory tax changes; and
- general economic and market conditions.

While forward-looking statements reflect our good faith beliefs, assumptions and expectations, they are not guarantees of future performance. Such forward-looking statements speak only as of their respective dates, and we assume no obligation to update them to reflect changes in underlying assumptions or factors, new information or otherwise. For a further discussion of these and other factors that could cause our future results to differ materially from any forward-looking statements, please see "Item 1A. Risk factors” in our annual report on Form 10-K for the year ended

December 31, 2014.

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Part I

Item 1. Financial statements (unaudited)

Certain information contained herein is presented as of October 30, 2015, which we have concluded is the latest practicable date for financial information prior to the filing of this quarterly report.

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Altisource Residential Corporation
Consolidated Balance Sheets
(In thousands, except share and per share amounts)
(Unaudited)

	September 30, 2015	December 31, 2014
Assets:		
Real estate held for use:		
Land	$49,518	$14,424
Rental residential properties (net of accumulated depreciation of $5,048 and $1,062, respectively)	200,136	60,908
Real estate owned	567,228	457,045
Total real estate held for use, net	816,882	532,377
Real estate assets held for sale	133,154	92,230
Mortgage loans at fair value	1,380,575	1,959,044
Mortgage loans held for sale	254,835	12,535
Cash and cash equivalents	83,881	66,166
Restricted cash	25,511	13,282
Accounts receivable	35,507	10,313
Related party receivables	—	17,491
Investment in affiliate	—	18,000
Deferred leasing and financing costs, net	9,806	4,251
Prepaid expenses and other assets	395	373
Total assets	$2,740,546	$2,726,062
Liabilities:		
Repurchase and loan and security agreements	$929,478	$1,015,000
Other secured borrowings (including $14,991 repurchase agreement with NewSource at December 31, 2014)	513,049	339,082
Accounts payable and accrued liabilities	63,871	11,678
Related party payables	5,126	33,391
Total liabilities	1,511,524	1,399,151
Commitments and contingencies (Note 6)		
Equity:		
Common stock, $.01 par value, 200,000,000 authorized shares; 57,225,246 and 55,990,853 shares issued and outstanding, respectively, as of September 30, 2015 and 57,192,212 shares issued and outstanding as of December 31, 2014	572	572
Additional paid-in capital	1,227,334	1,227,091
Retained earnings	21,099	99,248
Treasury stock, at cost, 1,234,393 shares as of September 30, 2015 and 0 shares as of December 31, 2014	(19,983)	—
Total equity	1,229,022	1,326,911
Total liabilities and equity	$2,740,546	$2,726,062

See accompanying notes to consolidated financial statements.

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Altisource Residential Corporation
Consolidated Statements of Operations
(In thousands, except share and per share amounts)
(Unaudited)

	Three months ended September 30, 2015	Three months ended September 30, 2014	Nine months ended September 30, 2015	Nine months ended September 30, 2014
Revenues:				
Rental revenues	$4,021	$469	$7,561	$719
Net unrealized gain on mortgage loans	27,499	88,726	130,842	258,898
Net realized gain on mortgage loans	12,874	13,727	47,528	33,867
Net realized gain on mortgage loans held for sale	100	302	505	302
Net realized gain on real estate	13,914	3,310	36,926	4,544
Interest income	115	2,568	595	2,757
Total revenues	58,523	109,102	223,957	301,087
Expenses:				
Residential property operating expenses	16,574	9,247	45,890	13,550
Real estate depreciation and amortization	2,050	313	4,392	464
Real estate and mortgage loan selling costs and impairment	10,705	5,542	34,235	8,775
Mortgage loan servicing costs	13,477	21,226	47,989	49,588
Interest expense	14,436	11,699	39,477	24,352
General and administrative	3,147	1,819	9,497	5,665
Related party general and administrative	4,988	21,530	25,789	51,629
Total expenses	65,377	71,376	207,269	154,023
Other income	1,518	—	3,518	383
(Loss) income before income taxes	(5,336)	37,726	20,206	147,447
Income tax expense	27	50	53	76
Net (loss) income	$(5,363)	$37,676	$20,153	$147,371
(Loss) earnings per share of common stock – basic:				
(Loss) earnings per basic share	$(0.09)	$0.66	$0.35	$2.63
Weighted average common stock outstanding – basic	57,056,625	57,174,150	57,154,734	55,930,010
(Loss) earnings per share of common stock – diluted:				
(Loss) earnings per diluted share	$(0.09)	$0.66	$0.35	$2.62
Weighted average common stock outstanding – diluted	57,056,625	57,406,325	57,351,014	56,312,104

Dividends declared per common share	$0.55	$0.55	$1.73	$1.48

See accompanying notes to consolidated financial statements.

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Altisource Residential Corporation
Consolidated Statements of Stockholders' Equity
(In thousands, except share amounts)
(Unaudited)

	Common stock					
	Number of shares	Amount	Additional paid-in capital	Retained earnings	Treasury stock	Total equity
December 31, 2014	57,192,212	$572	$1,227,091	$99,248	$—	$1,326,911
Issuance of common stock, including stock option exercises	33,034	—	104	—	—	104
Treasury shares repurchased	—	—	—	—	(19,983)	(19,983)
Dividends on common stock ($1.73 per share)	—	—	—	(98,302)	—	(98,302)
Share-based compensation	—	—	139	—	—	139
Net income	—	—	—	20,153	—	20,153
September 30, 2015	57,225,246	$572	$1,227,334	$21,099	$(19,983)	$1,229,022

	Common stock					
	Number of shares	Amount	Additional paid-in capital	Retained earnings	Treasury stock	Total equity
December 31, 2013	42,286,669	$423	$758,584	$26,420	$—	$785,427
Issuance of common stock, including stock option exercises	14,899,918	149	483,557	—	—	483,706
Cost of issuance of common stock	—	—	(15,290)	—	—	(15,290)
Dividends on common stock ($1.48 per share)	—	—	—	(84,570)	—	(84,570)
Share-based compensation	—	—	170	—	—	170
Net income	—	—	—	147,371	—	147,371
September 30, 2014	57,186,587	$572	$1,227,021	$89,221	$—	$1,316,814

See accompanying notes to consolidated financial statements.
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Altisource Residential Corporation
Consolidated Statements of Cash Flows
(In thousands)(Unaudited)

	Nine months ended September 30, 2015	Nine months ended September 30, 2014
Operating activities:		
Net income	$20,153	$147,371
Adjustments to reconcile net income to net cash used in operating activities:		
Net unrealized gain on mortgage loans	(130,842)	(258,898)
Net realized gain on mortgage loans	(47,528)	(33,867)
Net realized gain on sale of mortgage loans held for sale	(505)	(302)
Net realized gain on sale of real estate	(36,926)	(4,544)
Real estate depreciation and amortization	4,392	464
Real estate selling costs and impairment	34,235	8,775
Accretion of interest on re-performing mortgage loans	(581)	(2,475)
Share-based compensation	139	170
Amortization of deferred financing costs	4,271	2,241
Changes in operating assets and liabilities:		
Accounts receivable	(1,746)	(518)
Related party receivables	—	6,421
Prepaid expenses and other assets	(22)	(5,225)
Deferred leasing costs	(1,287)	—
Accounts payable and accrued liabilities	15,584	2,137
Related party payables	(22,444)	49,337
Net cash used in operating activities	(163,107)	(88,913)
Investing activities:		
Investment in mortgage loans	—	(1,241,083)
Investment in real estate	(111,423)	(27,463)
Investment in renovations	(15,936)	(5,957)
Real estate tax advances	(18,438)	(20,244)
Mortgage loan dispositions	190,146	122,023
Mortgage loan payments	19,268	14,903
Disposition of real estate	119,368	11,771
Disposition of preferred stock of affiliate	18,000	—
Change in restricted cash	(12,229)	(6,155)
Net cash provided by (used in) investing activities	188,756	(1,152,205)
Financing activities:		
Issuance of common stock, including stock option exercises	204	491,337
Payment of tax withholdings on exercise of stock options	(100)	(7,631)
Cost of issuance of common stock	—	(15,290)
Repurchase of common stock	(19,983)	—
Dividends on common stock	(67,685)	(84,570)
Repurchase of notes under master repurchase agreement	(14,991)	—
Proceeds from issuance of other secured debt	221,691	165,000
Repayments of secured notes	(32,298)	—
Proceeds from repurchase agreement	285,967	952,264
Repayments of repurchase agreement	(371,489)	(296,317)
Payment of deferred financing costs	(9,250)	(3,636)

Net cash (used in) provided by financing activities	(7,934)	1,201,157
Net increase in cash and cash equivalents	17,715	(39,961)
Cash and cash equivalents as of beginning of the period	66,166	115,988
Cash and cash equivalents as of end of the period	$83,881	$76,027

See accompanying notes to consolidated financial statements.

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Altisource Residential Corporation
Consolidated Statements of Cash Flows (continued)
(In thousands)(Unaudited)

	Nine months ended September 30, 2015	Nine months ended September 30, 2014
Supplemental disclosure of cash flow information:		
Cash paid for interest	$34,879	$20,212
Transfer of mortgage loans to real estate owned	367,653	410,913
Transfer of mortgage loans at fair value to mortgage loans held for sale	250,346	—
Transfer of real estate owned to mortgage loans	8,275	5,367
Change in accrued capital expenditures	164	7,712
Changes in receivables from mortgage loan dispositions, payments and real estate tax advances, net	2,550	13,081
Changes in receivables from real estate owned dispositions	1,949	3,097
Dividends declared but not paid	30,617	—

See accompanying notes to consolidated financial statements.

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Altisource Residential Corporation
Notes to Consolidated Financial Statements
September 30, 2015
(Unaudited)

1. Organization and basis of presentation

Altisource Residential Corporation is a Maryland REIT focused on acquiring and managing quality, affordable single-family rental properties throughout the United States. We conduct substantially all of our activities through our wholly owned subsidiary Altisource Residential, L.P. and its subsidiaries. Initially, we acquired our rental properties primarily through the acquisition of sub-performing and non-performing mortgage loan portfolios and, commencing in the second quarter of 2015, we expanded our acquisition strategy to opportunistically acquire portfolios of single-family rental properties as an avenue to more quickly achieve scale in our rental portfolio where we believe the economics make sense. We also commenced a program to begin purchasing real estate owned ("REO") properties on a one-by-one basis sourcing listed properties from the Multiple Listing Service and alternative listing sources. Our first purchases of REO properties under this program occurred in the third quarter of 2015.

On December 21, 2012 we became a stand-alone publicly traded company with an initial capital contribution of $100 million. We have a long-term service agreement with Altisource Portfolio Solutions, SA ("Altisource"), a leading provider of real estate and mortgage portfolio management, asset recovery and customer relationship management services. We also have servicing agreements with three separate mortgage loan servicers.

We are managed by AAMC, which we rely on to administer our business and perform certain of our corporate governance functions. AAMC also provides portfolio management services in connection with our acquisition and management of our portfolio. AAMC was formed on March 15, 2012 as a wholly owned subsidiary of Altisource and was spun off from Altisource into a stand-alone publicly traded company concurrently with our separation from Altisource. On March 31, 2015, we entered into a new asset management agreement with AAMC (the "New AMA") with an effective date of April 1, 2015. Our previous asset management agreement with AAMC (the "Original AMA") had a different incentive fee structure, which we refer to as "incentive management fees," that gave AAMC a share of cash flow available for distribution to our stockholders as well as reimbursement for certain overhead and operating expenses. The New AMA provides for a new fee structure in which we pay AAMC a base management fee, an incentive management fee and a conversion fee for loans and REOs that become rental properties during each quarter versus the incentive management fee and expense reimbursement structure under the Original AMA. For additional details on the New AMA, please see "Note 7. Related Party Transactions."

Since we commenced operations, we have financed our business through a combination of equity offerings and repurchase agreements, warehouse lines and securitizations. Since inception, we have completed three public equity offerings with aggregate net proceeds of approximately $1.1 billion. We also entered into three separate repurchase agreements to finance our acquisition and ownership of residential mortgage loans and REO properties. The maximum aggregate funding available under these repurchase agreements at December 31, 2014 was $1.2 billion. On April 10, 2015, we also entered into a loan and security agreement (the "Nomura loan agreement") with Nomura Corporate Funding Americas, LLC ("Nomura"). The purpose of the Nomura loan agreement is to finance our beneficial ownership of REO properties. The maximum aggregate funding available to us under the repurchase agreements and the Nomura loan agreement as of September 30, 2015 was $1.3 billion, subject to certain sublimits, eligibility requirements and conditions precedent to each funding. As of September 30, 2015, an aggregate of $929.5 million was outstanding under our repurchase agreements and the Nomura loan agreement. All obligations of our subsidiaries under the repurchase agreements and the Nomura loan agreement are fully guaranteed by us.

Each of our repurchase agreements and the Nomura loan agreement is described below:

- Credit Suisse (“CS”) is the lender on the repurchase agreement entered into on March 22, 2013, (the “CS repurchase agreement”) with an initial aggregate maximum borrowing capacity of $100.0 million. During 2014 the CS repurchase agreement was amended on several occasions, ultimately increasing the aggregate maximum borrowing capacity to $225.0 million on December 31, 2014 with a maturity date of April 20, 2015, subject to an additional one-year extension with the approval of the lender. On April 20, 2015, we entered into an amended and restated repurchase agreement with CS that increased our aggregate borrowing capacity from $225.0 million to $275.0 million, increased the REO sublimit under the facility and extended the maturity date to April 18, 2016.

- Deutsche Bank (“DB”) is the lender on the repurchase agreement entered into on September 12, 2013 (the “DB repurchase agreement”). The DB repurchase agreement matures on March 11, 2016 and includes a provision that after

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March 2015, we are not eligible for additional funding under the facility, thereby reducing our aggregate funding capacity under the DB repurchase agreement to $91.2 million, which was the amount outstanding under the facility on September 30, 2015.

- Wells Fargo (“Wells”) is the lender on the repurchase agreement entered into on September 23, 2013 (the “Wells repurchase agreement”) with an initial aggregate maximum borrowing capacity of $200.0 million. Throughout 2013 and 2014 the Wells repurchase agreement was amended several times increasing the aggregate maximum borrowing capacity to a high of $1.0 billion, and on December 31, 2014 was reduced to $750.0 million, subject to certain sublimits, to reflect the securitization of a significant portion of our non-performing loans that previously had been financed under the Wells repurchase agreement. On February 20, 2015, we exercised our option to extend the termination date of this facility to March 23, 2016 without any additional funding than the $536.0 million that was outstanding at the time of the extension. On September 30, 2015, the Wells repurchase agreement was amended to extend the termination date of the facility to September 27, 2017, to re-increase the aggregate amount of available funding to $750.0 million and to further increase sublimits of REO properties that may collateralize the facility from 10% of the aggregate funding capacity to 40% of the aggregate funding capacity, or $300.0 million of the $750.0 million.

- Nomura is the lender on the Nomura loan agreement entered into on April 10, 2015 with an initial aggregate maximum funding capacity of $100.0 million. On May 12, 2015, we amended the terms of the Nomura loan agreement to increase the aggregate maximum funding capacity to $200.0 million, subject to certain sublimits, eligibility requirements and conditions precedent to each funding. The Nomura loan agreement terminates on April 8, 2016.

Since September 2014, we have also completed three securitization transactions, each of which is summarized below:

- On September 25, 2014, we completed a securitization transaction in which ARLP Securitization Trust, Series 2014-1 (“ARLP 2014-1”) issued $150.0 million in Class A Notes (the “ARLP 2014-1 Class A Notes”) with a weighted coupon of approximately 3.47% and $32.0 million in Class M Notes (the “ARLP 2014-1 Class M Notes”) with a weighted coupon of 4.25%. The ARLP 2014-1 Class A Notes and the ARLP 2014-1 Class M Notes are secured solely by the non-performing mortgage loans and REO properties of ARLP 2014-1 and not by any of our other assets. The assets of ARLP 2014-1 are the only source of repayment and interest on the ARLP 2014-1 Class A Notes and the ARLP 2014-1 Class M Notes. The ARLP 2014-1 Class A Notes and the ARLP 2014-1 Class M Notes mature on September 25, 2044, and we do not guarantee any of the obligations of ARLP 2014-1 under the terms of the indenture governing the notes or otherwise. As of September 30, 2015, the book value of the underlying securitized assets held by ARLP 2014-1 was $203.1 million.

- On November 25, 2014, we completed a securitization transaction in which ARLP Securitization Trust, Series 2014-2 ("ARLP 2014-2") issued $270.8 million in Class A Notes (the “ARLP 2014-2 Class A Notes”) with a weighted coupon of approximately 3.85% and $234.0 million in Class M Notes (the “ARLP 2014-2 Class M Notes”). We initially retained $95.8 million of the ARLP 2014-2 Class A Notes and all of the ARLP 2014-2 Class M Notes. On February 9, 2015, we sold $50.7 million of the retained ARLP 2014-2 Class A Notes to an unrelated third party. No interest will be paid on any ARLP 2014-2 Class M Notes while any ARLP 2014-2 Class A Notes remain outstanding. The ARLP 2014-2 Class A Notes and ARLP 2014-2 Class M Notes are secured solely by the non-performing mortgage loans and REO properties of ARLP 2014-2 and not by any of our other assets. The assets of ARLP 2014-2 are the only source of repayment and interest on the ARLP 2014-2 Class A Notes and the ARLP 2014-2 Class M Notes. The ARLP 2014-2 Class A Notes and the ARLP 2014-2 Class M Notes mature on January 26, 2054, and we do not guarantee any of the obligations of ARLP 2014-2 under the terms of the indenture governing the notes or otherwise. As of September 30, 2015, the book value of the underlying securitized assets held by ARLP 2014-2 was $325.0 million.

On June 29, 2015, we completed a securitization transaction in which ARLP Securitization Trust, Series 2015-1 ("ARLP 2015-1") issued $205.0 million in Class A Notes (the “ARLP 2015-1 Class A Notes”) with a weighted coupon of approximately 4.01% and $60.0 million in Class M Notes (the “ARLP 2015-1 Class M Notes”). We retained $34.0 million of the ARLP 2015-1 Class A Notes and all of the ARLP 2015-1 Class M Notes. No interest will be paid on any ARLP 2015-1 Class M Notes while any ARLP 2015-1 Class A Notes remain outstanding. The ARLP 2015-1 Class A Notes and ARLP 2015-1 Class M Notes are secured solely by the non-performing mortgage loans and REO properties of ARLP 2015-1 and not by any of our other assets. The assets of ARLP 2015-1 are the only source of repayment and interest on the ARLP 2015-1 Class A Notes and the ARLP 2015-1 Class M Notes. The ARLP 2015-1 Class A Notes and the ARLP 2015-1 Class M Notes mature on May 25, 2055, and we do not guarantee any of the obligations of

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ARLP 2015-1 under the terms of the indenture governing the notes or otherwise. As of September 30, 2015, the book value of the underlying securitized assets held by ARLP 2015-1 was $284.5 million.

We retained all of the ARLP 2014-1 Class M Notes in our taxable REIT subsidiary (“TRS”). On September 30, 2014, pursuant to a master repurchase agreement, the TRS sold $15.0 million of the ARLP 2014-1 Class M Notes to NewSource. On September 14, 2015, the TRS completed the repurchase of the ARLP 2014-1 Class M notes from NewSource at a 5.0% yield.

For a more complete description of our repurchase agreements, loan and security agreement and securitization transactions, please see “Note 5. Borrowings.”

Unconsolidated affiliate

On October 17, 2013, we invested $18.0 million in the non-voting preferred stock of NewSource, a title insurance and reinsurance company in Bermuda. On September 14, 2015, NewSource completed the repurchase of all of our shares of non-voting preferred stock for aggregate proceeds of $18.0 million, which was the aggregate par value of the shares being repurchased. Until September 10, 2015, we were eligible to receive a 12% annual cumulative preferred dividend on our investment. In connection with the repurchase of the preferred stock, NewSource also paid to us the accrued but unpaid dividend on our shares from January 1, 2015 through September 10, 2015, or $1.5 million. We accounted for our investment in NewSource using the cost method because we did not exercise significant influence over NewSource. As a result, we recognized preferred dividend income from this investment when received.

Basis of presentation and use of estimates

The accompanying unaudited interim consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States which we refer to as "U.S. GAAP." All wholly owned subsidiaries are included and all intercompany accounts and transactions have been eliminated. The preparation of consolidated financial statements in conformity with U.S. GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ materially from those estimates.

The unaudited consolidated financial statements and accompanying unaudited consolidated financial information, in our opinion, contain all adjustments that are of a normal recurring nature and necessary for a fair presentation of our financial position, results of operations and cash flows for the interim periods. The interim results are not necessarily indicative of results for a full year. We have omitted certain notes and other information from the interim consolidated financial statements presented in this Quarterly Report as permitted by SEC rules and regulations. These consolidated financial statements should be read in conjunction with our 2014 annual report on Form 10-K.

Residential properties

Purchases of real estate properties are evaluated to determine whether they meet the definition of an asset acquisition or of a business combination under U.S. GAAP. For asset acquisitions, we capitalize the pre-acquisition costs to the extent such costs would have been capitalized had we owned the asset when the cost was incurred and capitalize closing and other direct acquisition costs. We then allocate the total cost of the property, including the acquisition costs, between land, building and any identified intangible assets and liabilities (including in-place leases and above and below-market leases). For acquisitions that qualify as business combinations, we expense the acquisition costs in the period in which the costs were incurred and allocate the cost of the property among land, building and any identified intangible assets and liabilities. Lease intangibles are recorded at the estimated fair value, which is the

estimated costs that would have been incurred to lease the property net of any above or below-market lease concessions, and are amortized on a straight-line basis over the remaining life of the related lease or, in the case of acquisitions of real estate pools, over the weighted average remaining life of the related pool of leases.

Upon the acquisition of real estate through the completion of foreclosure, we record the assets at fair value as of the acquisition date as a component of real estate owned based on information obtained from a broker's price opinion (“BPO”), a full appraisal or the price given in a current contract of sale of the property. Fair value measurements for assets where there exists limited or no observable market data and, therefore, are based primarily upon management's or other third-party estimates, are often calculated based on the characteristics of the asset, the economic environment and other such factors. Based on professional judgment and knowledge of the particular situation, management determines the appropriate fair value to be utilized for such property. We engage third party vendors, including Altisource, to obtain and evaluate BPOs prepared by other third party

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brokers for our ultimate use. BPOs are subject to judgments of a particular broker formed by visiting a property, assessing general home values in an area, reviewing comparable listings and reviewing comparable completed sales. These judgments may vary among brokers and may fluctuate over time based on housing market activities and the influx of additional comparable listings and sales. Our results could be materially and adversely affected if the judgments used by a broker prove to be incorrect or inaccurate. We have established validation procedures to confirm the values we receive from third party vendors are consistent with our observations of market values.

These validation procedures include establishing thresholds to identify changes in value that require further analysis. Our current policies require that we update the fair value estimate of each financed REO property at least every 180 days by obtaining a new BPO, which is subject to the review processes of our third party vendors. We generally perform further analysis when the value of the property per the new BPO varies from the old BPO by 25%, or $75,000 per property. If a newly obtained BPO varies from the old BPO by this established threshold, we perform additional procedures to ensure the BPO accurately reflects the current fair value of the property. These procedures include engaging additional third party vendors to compare the old BPOs to the new BPOs and to assist us in evaluating the appropriateness of comparable properties and property-specific characteristics used in the valuation process. As part of this evaluation, our third party vendors often discuss the differing BPOs with the providing brokers to ensure that proper comparable properties have been identified. These third party vendors also compare the BPOs to past appraisals, if any, of the property to ensure the BPOs are in line with those appraisals. Following the consideration and reconciliation of the BPOs, the third party provider may provide us with a new property value reflecting the analysis they performed or confirm the BPO value we received, in which case we use the new property value or the validated BPO, respectively, for our fair value estimate of the property.

After an evaluation period, we may perform property renovations to those properties that meet our rental investment criteria in order to optimize our rental proceeds. In some instances, we may also perform renovations on REO properties that do not meet our rental investment criteria in order to optimize sale proceeds. Such expenditures are part of our initial investment in a property and, therefore, are classified as investing activities in our consolidated statement of cash flows. Subsequently, residential rental properties, including any renovations that improve or extend the life of the asset, are accounted for at cost. REO properties that do not meet our rental investment criteria that are held for sale are accounted for at the lower of carrying value or estimated fair value less cost to sell. The cost basis of residential rental properties is depreciated using the straight-line method over an estimated useful life of three years to 27.5 years based on the nature of the components. Interest and other carrying costs incurred during the renovation period are capitalized until the property is ready for its intended use. Expenditures for ordinary maintenance and repairs are charged to expense as incurred.

Expenditures directly related to successful leasing efforts, such as lease commissions, are included in deferred leasing and financing costs, net and are stated at amortized cost. Such expenditures are part of our operations and, therefore, are classified as operating activities in our consolidated statement of cash flows. Capitalized leasing costs are amortized on a straight-line basis over the lease term of the respective leases, which generally are from one year to two years.

Residential properties are classified either as held for use or held for sale. Residential properties are classified as real estate assets held for sale when sale of the assets has been formally approved and is expected to occur in the next twelve months. We record residential properties held for sale at the lower of the carrying amount or estimated fair value less costs to sell. The impairment loss, if any, is the amount by which the carrying amount exceeds the estimated fair value less costs to sell.

Treasury stock

As previously disclosed, in August 2015, our Board of Directors authorized a share repurchase plan of $100.0 million. During the third quarter of 2015, we repurchased an aggregate of approximately $20.0 million in shares of our common stock under this plan. We account for repurchased common stock under the cost method and include such treasury stock as a component of total shareholders' equity. Following our third quarter repurchases, we have an aggregate of $80.0 million remaining for repurchases under our Board-approved repurchase plan.

Recently issued accounting standards

In April 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2015-03, Interest - Imputation of Interest (Subtopic 835-30) - Simplifying the Presentation of Debt Issuance Costs. ASU 2015-03 requires that debt issuance costs are presented on the balance sheet as a deduction from the carrying amount of the related debt liability instead of being presented as an asset. Debt disclosures will include the face amount of the debt liability and the effective interest rate. In August 2015, the FASB issued ASU 2015-15, Interest - Imputation of Interest (Subtopic 835-30) - Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements. ASU 2015-15

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provides additional guidance to ASU 2015-03, which did not address presentation or subsequent measurement of debt issuance costs related to line of credit arrangements. ASU 2015-15 noted that the SEC staff would not object to an entity deferring and presenting debt issuance costs as an asset and subsequently amortizing the deferred debt issuance costs ratably over the term of the line of credit arrangement, regardless of whether there are any outstanding borrowings on the line of credit arrangement. These standards require retrospective application and represent a change in accounting principle. The standard is effective for fiscal years beginning after December 15, 2015. Early adoption is permitted. We do not expect the impact of adopting these standards to have a material impact on our consolidated financial statements.

In February 2015, the FASB issued ASU 2015-02, Consolidation (Topic 810) – Amendments to the Consolidation Analysis. ASU 2015-02 makes targeted amendments to the current consolidation guidance that change the analysis a reporting entity must perform to determine whether it should consolidate certain types of legal entities. This guidance addresses concerns that current accounting might require a reporting entity to consolidate another legal entity in situations in which the reporting entity's contractual rights do not give it the ability to act primarily on its own behalf, the reporting entity does not hold a majority of the legal entity's voting rights, or the reporting entity is not exposed to a majority of the legal entity's economic benefits or obligations. The standard is effective for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2015. Early application is permitted. We are evaluating the impact of ASU 2015-02 on our consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09 Revenue from Contracts with Customers. ASU 2014-09 is a comprehensive new revenue recognition model requiring a company to recognize revenue to depict the transfer of goods or services to a customer at an amount reflecting the consideration it expects to receive in exchange for those goods or services. ASU 2014-09 may be applied using either a full retrospective or a modified retrospective approach. In August 2015, FASB issued ASU No. 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date, which effectively delayed the adoption date of ASU 2014-09 by one year. ASU 2014-09 is therefore effective for fiscal years, and interim periods within those years, beginning after December 15, 2017. Early adoption is permitted for fiscal years, and interim periods within those years, beginning after December 15, 2016. We do not expect this amendment to have a significant effect on our consolidated financial statements.

2. Mortgage loans

Acquisitions of non-performing residential mortgage loans

During the nine months ended September 30, 2015, we did not acquire any portfolios of residential mortgage loans. During the nine months ended September 30, 2014, we acquired an aggregate of 7,086 residential mortgage loans, substantially all of which were non-performing, and 190 REO properties having an aggregate UPB of approximately $1.9 billion and an aggregate market value of underlying properties of approximately $1.7 billion. The aggregate purchase price for these acquisitions was approximately $1.1 billion.

During the three and nine months ended September 30, 2015, we recognized a nominal amount and $0.4 million, respectively, for due diligence costs related to a potential purchase of a portfolio of non-performing loans on which we bid but did not ultimately acquire. During the three and nine months ended September 30, 2014, we recognized a nominal amount and $2.9 million, respectively, for due diligence costs related to transactions in both general and administrative expense and related party general and administrative expense.

Generally, we expect that our residential mortgage loan and REO portfolios may grow at an uneven pace, as opportunities to acquire distressed residential mortgage loans and REO portfolios may be irregularly timed and may involve large portfolios of loans or REO, and the timing and extent of our success in acquiring such assets cannot be predicted. In addition, for any given portfolio of loans that we agree to acquire, we typically acquire fewer loans than

originally expected, as certain loans may be resolved prior to the closing date or may fail to meet our diligence standards. The number of loans or REO excluded from an acquisition typically constitutes a relatively small portion of a particular portfolio. In some cases, the number of loans or REO that we do not acquire could be significant. In any case where we do not acquire the full portfolio, appropriate reductions are made to the applicable purchase price.

Throughout this report, all unpaid principal balance and market value amounts for the portfolios we have acquired are provided as of “cut-off date” for each transaction unless otherwise indicated. The “cut-off date” for each acquisition is a date shortly before the closing used to identify the final loans being purchased and the related unpaid principal balance, market value of underlying properties and other characteristics of the loans.

Transfers of non-performing mortgage loans to real estate owned

During the three months ended September 30, 2015 and 2014, we transferred a net of 507 and 1,104 mortgage loans, respectively, to REO at an aggregate fair value based on broker price opinions ("BPOs") of $90.7 million and $188.2 million, respectively. Such transfers occur when the foreclosure sale is complete. In connection with these transfers to REO, we recorded an aggregate of $17.0 million and $41.0 million, respectively, in unrealized gains on mortgage loans.

During the nine months ended September 30, 2015 and 2014, we transferred a net of 1,918 and 2,634 mortgage loans, respectively, to REO at an aggregate fair value based on BPOs of $359.4 million and $405.5 million, respectively. Such transfers occur when the foreclosure sale is complete. In connection with these transfers to REO, we recorded an aggregate of $68.4 million and $93.6 million, respectively, in unrealized gains on mortgage loans. At September 30, 2015, we had 5,348 loans with a carrying value of $1.0 billion that were in the foreclosure process compared to 7,841 loans with a carrying value of $1.5 billion at December 31, 2014.

Dispositions of non-performing residential mortgage loans

During the three months ended September 30, 2015 and 2014, we disposed of 145 and 165 non-performing mortgage loans, respectively, primarily through short sales, refinancing, foreclosure sales, and sale of loans that had transitioned to re-performing loans from prior non-performing loan acquisitions. In connection with these dispositions, we recorded $12.9 million and $13.7 million, respectively, of net realized gains on mortgage loans.

During the nine months ended September 30, 2015 and 2014, we disposed of 565 and 416 non-performing mortgage loans, respectively, primarily through short sales, refinancing, foreclosure sales, and sale of loans that had transitioned to re-performing loans from prior non-performing loan acquisitions. In connection with these dispositions, we recorded $47.5 million and $33.9 million, respectively, of net realized gains on mortgage loans.

During the third quarter of 2015, 871 non-performing mortgage loans with a carrying value of $250.3 million were transferred to mortgage loans held for sale in connection with our agreement in principle to sell such non-performing loans to an unrelated third party. Subject to confirmatory due diligence and negotiation of a definitive purchase agreement, we expect this disposition to occur in the fourth quarter of 2015. No assurance can be given that we will consummate this sale on a timely basis or at all.

Acquisition and dispositions of re-performing residential mortgage loans

On June 27, 2014, we acquired 879 re-performing mortgage loans with an aggregate market value of underlying properties of $271.1 million for an aggregate purchase price of $144.6 million. Under ASC 310-30, acquired loans may be aggregated and accounted for as a pool of loans if the loans being aggregated have common risk characteristics. A pool is accounted for as a single asset with a single composite interest rate and an aggregate expectation of cash flows. These 879 re-performing residential mortgage loans were determined to have common risk characteristics and have been accounted for as a single loan pool.

During October 2014, we sold an aggregate of 934 re-performing loans to an unrelated third party for an aggregate purchase price of $164 million. The sale included 770 loans from the re-performing mortgage loans purchased in June 2014, and 164 loans that had transitioned to re-performing status from prior non-performing loan acquisitions.

During June 2015, we sold an aggregate of 189 re-performing loans to an unrelated third party for an aggregate purchase price of $34.6 million. The sale included 52 loans from the re-performing mortgage loans purchased in June 2014, and 137 loans that had transitioned to re-performing status from prior non-performing loan acquisitions. Approximately $2.0 million of the proceeds from the June 2015 re-performing loan sale were used to purchase the

loans out of our ARLP 2014-1 and ARLP 2014-2 securitizations and approximately $16.4 million of the proceeds were used to purchase the loans out of our Wells repurchase facility. Therefore, our net proceeds from the June 2015 re-performing loan sale were approximately $16.2 million.

Additionally, we disposed of 12 re-performing mortgage loans acquired in June 2014 through short sale, refinancing or other liquidation events, and two re-performing mortgage loans acquired in June 2014 were converted into REO properties.

Under ASC 310-30, we estimate cash flows expected to be collected, adjusted for expected prepayments and defaults expected to be incurred over the life of the loan pool. We determine the excess of the loan pool's contractually required principal and interest payments over the expected cash flows as an amount that should not be accreted, the nonaccretable yield. The difference between expected cash flows and the present value of the expected cash flows is referred to as the accretable yield, which represents the amount that is expected to be recorded as interest income over the remaining life of the loan pool. For the three

and nine months ended September 30, 2015, we recognized no provision for loan loss and no adjustments to the amount of the accretable yield. For the three and nine months ended September 30, 2015, we accreted $0.1 million and $0.6 million, respectively, into interest income with respect to our re-performing loans. As of September 30, 2015, these re-performing loans, having a UPB of $8.3 million and a carrying value of $5.7 million, were held for sale.

The following tables present information regarding the estimates of the contractually required payments and the cash flows expected to be collected as of the date of the acquisition and changes in the balance of the accretable yield ($ in thousands):

	Nine months ended September 30, 2015	
	Accretable Yield	Carrying Amount of Loans
Balance at the beginning of the period	$7,640	$