Altisource Asset Management Corp
Form 10-Q
July 22, 2014

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 JUNE 30, 2014

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: 000-54809

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

UNITED STATES VIRGIN ISLANDS	66-0783125
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

402 Strand Street
Frederiksted, United States Virgin Islands 00840-3531
(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	o		Accelerated Filer	x
Non-Accelerated Filer	o	(Do not check if a smaller reporting company)	Smaller Reporting Company	o

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

As of July 18, 2014, 2,242,672 shares of our common stock were outstanding (excluding 194,198 shares held as treasury stock).

Altisource Asset Management Corporation
June 30, 2014
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References in this report to "we," "our," "us," or the "Company" refer to Altisource Asset Management Corporation and its consolidated subsidiaries, unless otherwise indicated. References in this report to “Residential” refer to Altisource Residential Corporation, unless otherwise indicated. References in this report to “Altisource” refer to Altisource Portfolio Solutions S.A. and its consolidated subsidiaries, unless otherwise indicated. References in this report to “Ocwen” refer to Ocwen Financial Corporation 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 quarterly 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 and the business strategy of Residential;
- our ability to retain and maintain our strategic relationships with related parties;
- the ability of Residential to generate cash available for distribution to its stockholders under our management;
- our ability to effectively compete with our competitors;
- Residential's ability to complete future or pending transactions;
- our ability to retain Residential as a client;
- the failure of Altisource and Ocwen to effectively perform their obligations under their agreements with us and Residential;
- general economic and market conditions; and
- governmental regulations, taxes and policies.

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 the risk factors set forth in our annual report on Form 10-K for the year ended December 31, 2013 and in our quarterly report on Form 10-Q for the first quarter of 2014

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Part I

Item 1. Financial statements (unaudited)

Certain information contained herein is presented as of July 18, 2014, 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 Asset Management Corporation
Consolidated Balance Sheets
(In thousands, except share and per share amounts)
(Unaudited)

	June 30, 2014	December 31, 2013
Assets:		
Real estate held for use:		
Land (from consolidated VIE)	$3,875	$478
Rental residential properties (net of accumulated depreciation of $172 and $24, respectively - from consolidated VIE)	14,917	3,092
Real estate owned (from consolidated VIE)	231,013	32,332
Total real estate held for use, net	249,805	35,902
Real estate assets held for sale (from consolidated VIE)	27,572	1,186
Mortgage loans (from consolidated VIE)	2,024,028	1,207,163
Mortgage loans held for investment (from consolidated VIE)	144,009	—
Cash and cash equivalents (including from consolidated VIE $130,758 and $115,988, respectively)	204,642	140,000
Restricted cash	10,269	5,878
Accounts receivable (including from consolidated VIE $631 and $1,428, respectively)	955	1,428
Related party receivables (from consolidated VIE)	12,608	9,260
Deferred leasing and financing costs, net (from consolidated VIE)	3,457	2,293
Prepaid expenses and other assets (including from consolidated VIE $260 and $1,542, respectively)	1,678	1,994
Total assets	$2,679,023	$1,405,104
Liabilities:		
Repurchase agreements (from consolidated VIE)	$1,271,483	$602,382
Accounts payable and accrued liabilities (including from consolidated VIE $7,459 and $4,952, respectively)	10,679	6,872
Related party payables (including from consolidated VIE $4,078 and $1,409, respectively)	4,911	2,883
Total liabilities	1,287,073	612,137
Commitments and contingencies (Note 6)	—	—
Mezzanine Equity		
Preferred stock, $0.01 par value, 250,000 shares issued and outstanding as of June 30, 2014 and none issued or outstanding as of December 31, 2013; redemption value $250,000	248,824	—
Equity:		
Common stock, $.01 par value, 5,000,000 authorized shares; 2,436,870 and 2,242,672 shares issued and outstanding, respectively as of June 30, 2014 and 2,354,774 shares issued and outstanding as of December 31, 2013	24	24
Additional paid-in capital	15,610	12,855
Retained earnings (accumulated deficit)	14,657	(5,339)
Treasury stock, at cost, 194,198 shares as of June 30, 2014 and none as of December 31, 2013	(197,673)	—
Total stockholders' equity	(167,382)	7,540
Noncontrolling interest in consolidated affiliate	1,310,508	785,427

Total equity	1,143,126	792,967
Total liabilities and equity	$2,679,023	$1,405,104

See accompanying notes to Consolidated Financial Statements.

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

	Three months ended June 30, 2014	Three months ended June 30, 2013	Six months ended June 30, 2014	Six months ended June 30, 2013
Rental revenues and net gain on mortgage loans:				
Rental revenues	$181	$—	$250	$—
Net unrealized gain on mortgage loans	105,042	7,165	170,172	8,293
Net realized gain on mortgage loans	10,819	1,719	20,140	2,106
Total rental revenues and net gain on mortgage loans	116,042	8,884	190,562	10,399
Expenses:				
Residential property operating expenses	3,253	84	4,303	84
Real estate depreciation and amortization	103	—	151	—
Mortgage loan servicing costs	16,925	1,242	28,362	1,634
Interest expense	6,945	654	12,653	696
General and administrative	7,421	3,369	13,376	6,067
Related party general and administrative	2,675	—	3,598	207
Total expenses	37,322	5,349	62,443	8,688
Other income	2,101	193	2,209	193
Income before income taxes	80,821	3,728	130,328	1,904
Income tax (benefit) expense	(191)	—	575	—
Net income	81,012	3,728	129,753	1,904
Net income attributable to noncontrolling interest in consolidated affiliate	(67,782)	(5,227)	(109,695)	(4,243)
Net income (loss) attributable to common stockholders	$13,230	$(1,499)	$20,058	$(2,339)
Earnings (loss) per share of common stock – basic:				
Earnings (loss) per basic share	$5.87	$(0.64)	$8.68	$(1.00)
Weighted average common stock outstanding – basic	2,255,278	2,343,462	2,310,931	2,343,338
Earnings (loss) per share of common stock – diluted:				
Earnings (loss) per diluted share	$4.60	$(0.64)	$7.00	$(1.00)
Weighted average common stock outstanding – diluted	2,874,906	2,343,462	2,865,185	2,343,338

See accompanying notes to consolidated financial statements.

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Altisource Asset Management Corporation
Consolidated Statements of Equity
(In thousands, except share amounts)
(Unaudited)

	Common stock						
	Number of shares	Amount	Additional paid-in capital	Retained earnings (accumulated deficit)	Treasury stock	Noncontrolling interest in consolidated affiliate	Total equity
December 31, 2013	2,354,774	$24	$12,855	$(5,339)	$—	$785,427	$792,967
Issuance of common stock, including option exercises	82,096	—	20	—	—	—	20
Treasury shares repurchased	—	—	—	—	(197,673)	—	(197,673)
Capital contribution from noncontrolling interest	—	—	—	—	—	468,391	468,391
Distribution from noncontrolling interest	—	—	—	—	—	(53,118)	(53,118)
Amortization of preferred stock issuance costs	—	—	—	(62)	—	—	(62)
Share-based compensation	—	—	2,735	—	—	113	2,848
Net income	—	—	—	20,058	—	109,695	129,753
June 30, 2014	2,436,870	$24	$15,610	$14,657	$(197,673)	$1,310,508	$1,143,126

	Common stock						
	Number of shares	Amount	Additional paid-in capital	Accumulated deficit	Treasury stock	Noncontrolling interest in consolidated affiliate	Total equity
December 31, 2012	2,343.213	$23	$4,993	$(46)	$—	$99,911	$104,881
Issuance of common stock, including option exercises	2,212	—	2	—	—	—	2
Capital contribution from noncontrolling interest	—	—	—	—	—	309,591	309,591
Share-based compensation	—	—	1,294	—	—	—	1,294
Net income (loss)	—	—	—	(2,339)	—	4,243	1,904
June 30, 2013	2,345,425	$23	$6,289	$(2,385)	$—	$413,745	$417,672

See accompanying notes to consolidated financial statements.

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Altisource Asset Management Corporation
Consolidated Statements of Cash Flows
(In thousands)
(Unaudited)

	Six months ended June 30, 2014	Six months ended June 30, 2013
Operating activities:		
Net income	$129,753	$1,904
Adjustments to reconcile net income to net cash used in operating activities:		
Net unrealized gain on mortgage loans	(170,172)	(8,293)
Net realized gain on mortgage loans	(20,140)	(2,106)
Net realized gain on sale of real estate	(1,293)	—
Real estate depreciation, amortization and other non-cash charges	3,373	—
Share-based compensation	2,848	1,294
Amortization of deferred financing costs	1,109	322
Changes in operating assets and liabilities:		
Accounts receivable	473	—
Related party receivables	4,952	724
Prepaid expenses and other assets	(1,008)	(280)
Accounts payable and accrued liabilities	2,234	1,012
Related party payables	2,028	234
Net cash used in operating activities	(45,843)	(5,189)
Investing activities:		
Investment in mortgage loans	(1,056,493)	(168,165)
Investment in real estate	(27,569)	(278)
Investment in renovations	(1,700)	(22)
Real estate tax advances	(14,368)	—
Mortgage loan dispositions	70,379	5,940
Mortgage loan payments	7,951	1,122
Disposition of real estate	3,466	—
Acquisition-related deposits	—	(20,142)
Change in restricted cash	(4,391)	—
Net cash used in investing activities	(1,022,725)	(181,545)
Financing activities:		
Proceeds from issuance of preferred stock	250,000	—
Cost of issuance of preferred stock	(1,176)	—
Issuance of common stock, including stock option exercises	3,155	123
Repurchase of common stock	(197,673)	—
Payment of tax withholdings on exercise of stock options	(3,135)	(121)
Cost of issuance of common stock	—	—
Capital contribution from noncontrolling interest	468,391	310,254
Distribution to noncontrolling interest	(53,118)	—
Proceeds from repurchase agreement	749,240	79,761
Repayments of repurchase agreement	(80,139)	(79,289)
Payment of deferred financing costs	(2,335)	(1,162)
Net cash provided by financing activities	1,133,210	309,566
Net increase in cash and cash equivalents	64,642	122,832
Cash and cash equivalents as of beginning of the period	140,000	105,014

Cash and cash equivalents as of end of the period	$204,642	$227,846
Supplemental disclosure of cash flow information		
Cash paid for interest	$10,496	$375
Transfer of mortgage loans to real estate owned	$220,971	$4,399
Transfer of real estate owned to mortgage loans	$3,594	$—
Changes in accrued equity issuance costs	$1,746	$663
Changes in receivables from mortgage loan dispositions, payments and real estate tax advances to borrowers, net	$4,796	$3,583

See accompanying notes to consolidated financial statements.

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Altisource Asset Management Corporation
Notes to Consolidated Financial Statements
June 30, 2014
(Unaudited)

1. Organization and basis of presentation

We were incorporated in the United States Virgin Islands on March 15, 2012, which we refer to as “inception.” Subsequent to our separation from Altisource Portfolio Solutions S.A. ("Altisource") on December 21, 2012, we immediately commenced operations. In October 2013, we applied for and were granted registration by the SEC as a registered investment adviser under section 203(c) of the Investment Advisers Act of 1940. Our primary business is to provide asset management and certain corporate governance services to Altisource Residential Corporation, which we refer to as “Residential” under a 15-year asset management agreement beginning December 21, 2012, which we refer to as the “Residential asset management agreement.” Residential is a Maryland corporation that acquires and manages single-family rental properties by acquiring sub-performing and non-performing mortgages throughout the United States.

Residential is currently our primary source of revenue and will drive our potential future growth. The Residential asset management agreement entitles us to incentive fees, which we refer to as our “incentive management fees,” that gives us a share of Residential’s cash flow available for distribution to its stockholders as well as reimbursement for certain overhead and operating expenses. Accordingly, our operating results are highly dependent on Residential's ability to achieve positive operating results.

We have concluded that Residential is a variable interest entity (“VIE”) because Residential’s equity holders lack the ability through voting rights to make decisions about Residential’s activities that have a significant effect on the success of Residential. We have also concluded that we are the primary beneficiary of Residential because under the Residential asset management agreement we have the power to direct the activities of Residential that most significantly impact Residential’s economic performance including establishing Residential’s investment and business strategy. As a result, we consolidate Residential in our consolidated financial statements.

Additionally, we provide management services to NewSource Reinsurance Company Ltd., which we refer to as “NewSource,” a title insurance and reinsurance company in Bermuda. In October 2013, we invested $2.0 million in 100% of the common stock of NewSource and Residential invested $18.0 million in the non-voting preferred stock of NewSource. On December 2, 2013, NewSource became registered as a licensed reinsurer with the Bermuda Monetary Authority (“BMA”). Because we own 100% of voting common stock of NewSource and there are no substantive kick-out rights granted to other equity owners, we consolidate NewSource in our consolidated financial statements.

Since its separation from Altisource, Residential has completed three public equity offerings with aggregate net proceeds of approximately $1.1 billion. On May 1, 2013, Residential completed a public offering of 17,250,000 shares of common stock at $18.75 per share and received net proceeds of approximately $309.5 million. On October 1, 2013, Residential completed its second public offering of 17,187,000 shares of common stock at $21.00 per share and received net proceeds of $349.4 million. On January 22, 2014, Residential completed its third public offering of 14,200,000 shares of common stock at $34.00 per share and received net proceeds of approximately $467.6 million.

On March 22, 2013, September 12, 2013 and September 23, 2013, Residential entered into three separate repurchase agreements to finance the acquisition and ownership of residential mortgage loans and REO properties. The maximum aggregate funding available under each of these repurchase agreements was increased at least one time.

For the repurchase agreement entered into on March 22, 2013, Residential amended it on April 21, 2014 to initially increase the aggregate maximum borrowing capacity from $100.0 million to $200.0 million. The maturity date of the repurchase agreement was also extended to April 20, 2015 subject to an additional one-year extension with the approval of the lender. On June 11, 2014, Residential further amended this repurchase agreement to increase the aggregate maximum borrowing capacity from $200.0 million to $375.0 million, subject to certain sublimits, for the period from June 11, 2014 through October 11, 2014. The aggregate borrowing capacity under the repurchase agreement will revert to $200.0 million after October 11, 2014.

The repurchase agreement dated September 12, 2013, as amended on December 18, 2013, has an aggregate funding capacity of $250.0 million and matures on March 11, 2016. This agreement includes a provision that, beginning in the nineteenth month, Residential will not be able to finance mortgage loans in excess of amounts outstanding under the facility at the end of the eighteenth month.

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For the repurchase agreement dated September 23, 2013, Residential amended it on December 23, 2013 to initially increase the aggregate maximum borrowing capacity from $200.0 million to $400.0 million. On June 25, 2014, Residential further amended this repurchase agreement to increase the aggregate maximum borrowing capacity from $400.0 million to $1.0 billion, subject to certain sublimits. The maturity date of the repurchase agreement is March 23, 2015. Residential has the option to extend this agreement for an additional year with no additional funding.

Following the amendments to Residential's repurchase agreements, the maximum aggregate funding available to Residential under these repurchase agreements as of June 30, 2014 was $1.7 billion, subject to certain sublimits, eligibility requirements and conditions precedent to each funding. As of June 30, 2014, an aggregate of $1.3 billion was outstanding under Residential's repurchase agreements. All obligations under the repurchase agreements are fully guaranteed by Residential.

On March 18, 2014, we closed a private placement for the issuance and sale of 250,000 shares of our Series A Convertible Preferred Stock to Luxor Capital Group, LP, a New York based investment manager, and other institutional investors for proceeds of $250.0 million. We used a portion of the proceeds from this transaction to repurchase shares of our common stock and for other corporate purposes. We intend to use the remaining proceeds to repurchase from time to time additional shares of our common stock and for other corporate purposes. Such stock repurchases may be made in the open market, block trades or privately-negotiated transactions. In connection with the foregoing, the Company's Board of Directors has approved a share repurchase program that authorizes us to repurchase up to $300.0 million of our common stock.

We ceased to be a development stage enterprise in the second quarter of 2013.

Basis of presentation and use of estimates

The accompanying 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 necessary for a fair presentation of our financial position, results of operations and cash flows. 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 2013 annual report on Form 10-K.

Preferred stock

During the first quarter of 2014, we issued $250.0 million of convertible preferred stock. All of the outstanding shares of preferred stock are redeemable by us in March 2020, the sixth anniversary of the date of issuance, and every five years thereafter. On these same redemption dates, each holder of preferred stock may cause us to redeem all the shares of preferred stock held by such holder at a redemption price equal to $1,000 per share. Accordingly, we classify these shares as mezzanine equity, outside of permanent stockholders' equity.

The holders of shares of Series A Preferred Stock will not be entitled to receive dividends with respect to the Series A Preferred Stock. The shares of Series A Preferred Stock are convertible into shares of our common stock at a conversion price of $1,250 per share, subject to certain anti-dilution adjustments.

Upon a change of control or upon a liquidation, dissolution or winding up of the Company, holders of the Series A Preferred Stock will be entitled to receive an amount in cash per Series A Preferred Stock equal to the greater of:

(i) $1,000 plus the aggregate amount of cash dividends paid on the number of shares of Common Stock into which such share of Series A Preferred Stock was convertible on each ex-dividend date for such dividends; and
(ii) the number of shares of Common Stock into which the Series A Preferred Stock is then convertible multiplied by the then current market price of the Common Stock.

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The Series A Preferred Stock confers no voting rights to holders, except with respect to matters that materially and adversely affect the voting powers, rights or preferences of the Series A Preferred Stock or as otherwise required by applicable law.

With respect to the distribution of assets upon the liquidation, dissolution or winding up of the Company, the Series A Preferred Stock ranks senior to our common stock and on parity with all other classes of preferred stock that may be issued by us in the future.

Treasury Stock

We account for repurchased common stock under the cost method and include such treasury stock as a component of total shareholders' equity. We have repurchased shares of our common stock (i) under our Board approval to repurchase up to $300.0 million in shares of our common stock and (ii) upon our withholding of shares of our common stock to satisfy tax withholding obligations in connection with the vesting of our restricted stock.

Loans held for investment

Loans held for investment consist of re-performing residential mortgage loans acquired from others. We do not originate loans. Each acquired loan is evaluated at acquisition to determine if the loan is impaired.

Acquired distressed re-performing residential mortgage loans that have evidence of deteriorated credit quality at the time of acquisition are accounted for in accordance with the provisions of ASC Topic 310-30, Receivables - Loans and Debt Securities Acquired with Deteriorated Credit Quality. 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. Under ASC Topic 310-30, Residential estimates cash flows expected to be collected, adjusted for expected prepayments and defaults. At each balance sheet date, Residential evaluates the pool of loans to determine whether the present value derived using the effective interest rate has decreased and, if so, recognizes a provision for loan loss. For any significant increases in cash flows expected to be collected, Residential adjusts the amount of accretable yield recognized on a prospective basis over the pool's remaining life.

Recently issued accounting standards

In January 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-04, Troubled Debt Restructurings by Creditors. It provides that a repossession or foreclosure has occurred, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendment requires disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in mortgage loans collateralized by residential real estate property that are in the process of foreclosure. The amended guidance may be applied using either a prospective transition method or a modified retrospective transition method and is effective for fiscal years, and interim periods within those years, beginning after December 15, 2014, with early adoption permitted. We do not expect this amendment to have a significant effect on our financial position or results of operations since our accounting policies and disclosures are currently consistent with the requirements set forth in the amendment.

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 and is effective for fiscal years, and interim periods within those years, beginning after December 15, 2016, and early adoption is not permitted. We are currently evaluating the impact of this amendment on our financial position and results of operations.

2. Mortgage loans

Acquisitions of non-performing residential mortgage loans

During the quarter ended June 30, 2014, Residential agreed to acquire an aggregate of 3,269 non-performing loans with an aggregate market value of underlying properties of $900.3 million. On June 27, 2014, Residential acquired 1,116 of these non-performing loans with an aggregate market value of underlying properties of $375.3 million for an aggregate purchase price of

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$235.0 million. On May 1, 2014, Residential also completed the acquisition of a portfolio of 664 non-performing mortgage loans and REO properties with an aggregate property value of $126.6 million for an aggregate purchase price of $92.7 million. Residential had previously agreed to purchase an aggregate of 915 non-performing mortgage loans and REO properties in this portfolio in March 2014. Subject to satisfactory due diligence results and final agreement on terms, Residential anticipates completing the acquisition of the remaining portions of these portfolios in the third quarter of 2014.

During the six months ended June 30, 2014, Residential's total completed acquisitions consisted of an aggregate of 5,797 residential mortgage loans, substantially all of which were non-performing, and 190 REO properties having an aggregate UPB of approximately $1.6 billion and an aggregate market value of underlying properties of $1.4 billion. The aggregate purchase price for these acquisitions was $940.5 million.

During the three and six months ended June 30, 2014, Residential recognized $2.4 million and $2.9 million, respectively, for due diligence costs related to these and other transactions in general and administrative and related party general and administrative expense.

During the six months ended June 30, 2013, Residential completed the acquisition of the following portfolios of non-performing residential mortgage loans:

- On February 14, 2013, a portfolio of first lien residential mortgage loans, substantially all of which were non-performing, having an aggregate market value of underlying properties of $94 million.
- On March 21, 2013, a portfolio of first lien residential mortgage loans, substantially all of which were non-performing, having an aggregate market value underlying properties of $39 million.
- On April 5, 2013, a portfolio of first lien residential mortgage loans, substantially all of which were non-performing, having an aggregate market value of underlying properties of $122 million.

During the three and six months ended June 30, 2013, Residential expensed $0.1 million and $0.4 million, respectively, for due diligence costs related to these and other transactions.

Throughout this quarterly report, all unpaid principal balance and market value amounts for the portfolios Residential has 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.

Acquisition of loans held for investment

During the three and six months ended June 30, 2014, Residential agreed to acquire an aggregate of 1,105 re-performing loans with an aggregate market value of underlying properties of $327.9 million. On June 27, 2014, Residential acquired 879 of these re-performing loans with an aggregate market value of underlying properties of $271.1 million for an aggregate purchase price of $144.6 million. Subject to satisfactory due diligence results and final agreement on terms, Residential anticipates completing the acquisition of the remaining portions of this portfolio in the third quarter of 2014.

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. The re-performing residential mortgage loans acquired in June 2014 have common risk characteristics and are being accounted for as a single loan pool. Under ASC 310-30 Residential estimates cash flows expected to be collected, adjusted for expected prepayments and defaults. For the three and six months ended June 30, 2014, Residential recognized no provision for loan loss nor any adjustments to the amount of the accretable yield.

The purchase price of the loans acquired during the three months ended June 30, 2014 is considered to be the fair value at the time of acquisition. The following table presents information regarding the estimates of the contractually required payments and the cash flows expected to be collected ($ in thousands):

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	June 30, 2014
Contractually required principal and interest	$ 325,000
Non-accretable yield	(96,263)
Expected cash flows to be collected	228,737
Accretable yield	(84,728)
Fair value at the date of acquisition	$ 144,009

Transfer of mortgage loans to real estate owned

During the three months ended June 30, 2014 and 2013, Residential transferred 907 and 33 mortgage loans, respectively, to REO at an aggregate fair value based on broker price opinions ("BPOs"), of $124.4 million and $4.2 million respectively. Such transfers occur when the foreclosure sale is complete.

During the six months ended June 30, 2014 and 2013, Residential transferred 1,544 and 34 mortgage loans, respectively, to REO at an aggregate fair value based on BPOs, of $221.0 million and $4.4 million respectively.

Dispositions

During the three months ended June 30, 2014 and 2013, Residential disposed of 135 and 28 mortgage loans, respectively, primarily through short sales, refinancing, and foreclosure sales. In connection with these dispositions, Residential recorded $10.8 million and $1.7 million, respectively, of net realized gains on mortgage loans.

During the six months ended June 30, 2014 and 2013, Residential disposed of 251 and 38 mortgage loans, respectively, primarily through short sales, refinancing, and foreclosure sales. In connection with these dispositions, Residential recorded $20.1 million and $2.106 million, respectively, of net realized gains on mortgage loans.

3. Real estate assets, net

Acquisitions

During the three and six months ended June 30, 2014, Residential acquired 190 REO properties as part of their portfolio acquisitions. During the six months ended June 30, 2013, Residential acquired six REO properties. Residential acquired no REO properties during the three months ended June 30, 2013. The aggregate purchase price attributable to these acquired REO properties was $27.6 million in the first six months of 2014 and $0.3 million in the first six months of 2013.

Real estate held for use

As of June 30, 2014, Residential had 1,766 REO properties held for use. Of these properties, 102 of these properties had been rented, 40 were being listed for rent and 140 were in varying stages of renovation. With respect to the remaining 1,484 REO properties, we will make a final determination whether each property meets Residential’s rental profile after (a) applicable state redemption periods have expired, (b) the foreclosure sale has been ratified (c) Residential has recorded the deed for the property, (d) utilities have been activated and (e) Residential has secured access for interior inspection. A majority of the REO properties are subject to state regulations which require Residential to await the expiration of a redemption period before a foreclosure can be finalized. Residential includes these redemption periods in its portfolio pricing which generally reduces the price Residential pays for the mortgage loans. Once the redemption period expires, Residential immediately proceeds to record the new deed, take possession of the property, activate utilities, and start the inspection process in order to make its final determination. As of December 31, 2013, Residential had 246 REO properties held for use. Of these properties, 14 had been rented, 11 were being listed for rent and 18 were in various stages of renovation. With respect to the remaining 203 REO properties, we were in the process of determining whether these properties would meet Residential's rental profile. As of June 30, 2013, Residential had 40 REO properties held for use, for all of which we were in the process of determining whether the properties would meet the rental profile. If a REO property meets Residential's rental profile, we determine the extent of renovations that are needed to generate an optimal rent and maintain consistency of renovation specifications for future branding. If we determine that the REO property will not meet Residential's rental profile, we list the property for sale, in certain instances after renovations are made to optimize the sale proceeds.

Real estate held for sale

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As of June 30, 2014, Residential classified 192 properties having carrying value of $27.6 million as real estate held for sale as they do not meet its residential rental property investment criteria. As of December 31, 2013, Residential had 16 REO properties having an aggregate carrying value of $1.2 million held for sale, and as of June 30, 2013, Residential had eight REO properties having a aggregate carrying value of $0.9 million held for sale. None of these REO properties have any operations; therefore, we are not presenting discontinued operations related to these properties.

Dispositions

During the three and six months ended June 30, 2014, Residential disposed of 22 and 24 residential properties, respectively. Residential did not dispose of any residential properties during the six months ended June 30, 2013.

4. Fair value of financial instruments

The following table sets forth the financial assets and liabilities that Residential measures at fair value by level within the fair value hierarchy as of June 30, 2014 and December 31, 2013 ($ in thousands):

	Level 1 Quoted prices in active markets	Level 2 Observable inputs other than Level 1 prices	Level 3 Unobservable inputs
June 30, 2014			
Recurring basis (assets)			
Mortgage loans	$—	$—	$2,024,028
Nonrecurring basis (assets)			
Real estate assets held for sale	$—	$—	$28,710
Transfer of real estate owned to mortgage loans	$—	$—	$3,594
Transfer of mortgage loans to real estate owned	$—	$—	$220,971
Not recognized on consolidated balance sheets at fair value (assets)			
Mortgage loans held for investment	$—	$—	$144,009
Not recognized on consolidated balance sheets at fair value (liabilities)			
Repurchase agreements at fair value	—	$1,271,483	$—
December 31, 2013			
Recurring basis (assets)			
Mortgage loans	$—	$—	$1,207,163
Nonrecurring basis (assets)			
Real estate assets held for sale	$—	$—	$1,520
Transfer of mortgage loans to real estate owned	$—	$—	$31,014
Not recognized on consolidated balance sheets at fair value (liabilities)			
Repurchase agreements at fair value	$—	$602,382	$—

Residential has not transferred any assets from one level to another level during the three or six months ended June 30, 2014. Additionally there have been no transfers between levels for the year ended December 31, 2013.

The carrying values of Residential's and our cash and cash equivalents, restricted cash, related party receivables, accounts payable and accrued liabilities, related party payables, preferred stock, and investment in New Source are equal to or approximate fair value. The fair value of mortgage loans is estimated using our proprietary pricing model. The fair value of transfers of mortgage loans to real estate owned is estimated using BPOs. The purchase price of mortgage loans held for investment which were acquired with evidence of deteriorated credit quality is considered to be the fair value at the time of acquisition. The fair value of the repurchase agreements is estimated using the income approach based on credit spreads available currently in the market for similar floating rate debt.

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The following table sets forth the changes in Residential's level 3 assets that are measured at fair value on a recurring basis ($ in thousands):

	Three months ended June 30, 2014	Three months ended June 30, 2013	Six months ended June 30, 2014	Six months ended June 30, 2013
Mortgage loans				
Beginning balance	$1,766,142	$87,670	$1,207,163	$—
Investment in mortgage loans	300,503	79,908	913,011	168,165
Net unrealized gain on mortgage loans	105,042	7,165	170,172	8,293
Net realized gain on mortgage loans	10,819	1,719	20,140	2,106
Mortgage loan dispositions and payments	(44,314)	(8,699)	(83,772)	(10,645)
Real estate tax advances to borrowers	4,716	—	12,722	—
Transfer of real estate owned to mortgage loans	5,563	—	5,563	—
Transfer of mortgage loans to real estate owned	(124,443)	(4,243)	(220,971)	(4,399)
Ending balance at June 30	$2,024,028	$163,520	$2,024,028	$163,520
Net unrealized gain on mortgage loans held	$70,623	$7,165	$108,820	$8,293

The following table sets forth the fair value of Residential's mortgage loans, the related unpaid principal balance and market value of underlying properties by delinquency status as of June 30, 2014 and December 31, 2013 ($ in thousands):

	Number of loans	Carrying Value	Unpaid principal balance	Market value of underlying properties
June 30, 2014				
Current	659	$85,322	$152,956	$146,861
30	43	7,100	11,177	11,420
60	32	4,875	7,007	8,117
90	2,312	384,350	635,463	587,819
Foreclosure	9,024	1,542,381	2,465,697	2,097,710
Mortgage loans	12,070	$2,024,028	$3,272,300	$2,851,927
December 31, 2013				
Current	238	$31,649	$60,051	$52,506
30	26	2,087	4,492	3,763
60	23	3,376	5,683	4,738
90	1,555	245,024	419,836	355,451
Foreclosure	6,212	925,027	1,609,546	1,310,439
Mortgage Loans	8,054	$1,207,163	$2,099,608	$1,726,897

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The following table sets forth the carrying value of Residential's re-performing mortgage loans held for investment, the related unpaid principal balance and market value of underlying properties by delinquency status as of June 30, 2014.

	Number of loans	Carrying value	Unpaid principal balance	Market value of underlying properties
June 30, 2014				
Current	866	$142,283	$204,963	$268,161
30	9	1,374	1,656	2,286
60	3	161	217	239
90	1	191	229	391
Mortgage loans held for investment	879	$144,009	$207,065	$271,077

The significant unobservable inputs used in the fair value measurement of Residential's mortgage loans are discount rates, forecasts of future home prices, alternate loan resolution probabilities, resolution timelines and the value of underlying properties. Significant changes in any of these inputs in isolation could result in a significant change to the fair value measurement. A decline in the discount rate in isolation would increase the fair value. A decrease in the housing pricing index in isolation would decrease the fair value. Individual loan characteristics such as location and value of underlying collateral affect the loan resolution probabilities and timelines. An increase in the loan resolution timeline in isolation would decrease the fair value. A decrease in the value of underlying properties in isolation would decrease the fair value. The following table sets forth quantitative information about the significant unobservable inputs used to measure the fair value of Residential's mortgage loans as of June 30, 2014 and December 31, 2013:

Input	June 30, 2014	December 31, 2013
Equity discount rate	15.0%	15.0%
Debt to asset ratio	65.0%	55.0%
Cost of funds	3.5% over 1 month LIBOR	3.5% over 1 month LIBOR
Annual change in home pricing index	-0.2% to 7.6%	-0.3% to 7.6%
Loan resolution probabilities — modification	0% to 22.3%	0% to 22.3%
Loan resolution probabilities — rental	0% to 100.0%	0% to 100.0%
Loan resolution probabilities — liquidation	0% to 100.0%	0% to 100.0%
Loan resolution timelines (in years)	0.1 to 5.3	0.1 - 5.8
Value of underlying properties	$3,000 - $4,100,000	$3,000 - $3,550,000

5. Repurchase agreements

Residential's operating partnership has entered into master repurchase agreements with major financial institutions. The purpose of these repurchase agreements is to finance the acquisition and ownership of mortgage loans and REO properties in its portfolio. Residential has effective control of the assets associated with these agreements and therefore it has concluded these are financing arrangements. As of June 30, 2014, the weighted average annualized interest rate on borrowing under Residential's repurchase agreements was 3.03%. The following table sets forth data with respect to Residential's repurchase agreements as of June 30, 2014 and December 31, 2013 ($ in thousands):

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	Maximum borrowing capacity	Book value of collateral	Amount outstanding
June 30, 2014			
Repurchase agreement due April 20, 2015 (1)	$375,000	$608,977	$324,381
Repurchase agreement due March 23, 2015	1,030,000	1,145,345	731,415
Repurchase agreement due March 11, 2016	250,000	405,348	215,687
	$1,655,000	$2,159,670	$1,271,483
December 31, 2013			
Repurchase agreement due April 21, 2014	$100,000	$166,350	$85,364
Repurchase agreement due March 23, 2015	400,000	634,234	398,602
Repurchase agreement due March 11, 2016	250,000	205,328	118,416
	$750,000	$1,005,912	$602,382

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(1) The aggregate borrowing capacity under the repurchase agreement will revert to $200.0 million after October 11, 2014.

Under the terms of the repurchase agreements, as collateral for the funds Residential draws thereunder, subject to certain conditions, Residential's operating partnership will sell to the applicable lender equity interests in its Delaware statutory trust subsidiaries that owns the applicable underlying assets on its behalf, or the trust will sell directly such underlying mortgage assets. In the event the lender determines the value of the collateral has decreased, it has the right to initiate a margin call and require Residential, or the applicable trust subsidiary, to post additional collateral or to repay a portion of the outstanding borrowings. The price paid by the lender for each mortgage asset Residential finances under the repurchase agreements is based on a percentage of the market value of the mortgage asset and may depend on its delinquency status. With respect to funds drawn under the repurchase agreements, Residential's operating partnership is required to pay the lender interest based on LIBOR or at the lender's cost of funds plus a spread calculated based on the type of applicable mortgage assets collateralizing the funding, as well as certain other customary fees, administrative costs and expenses to maintain and administer the repurchase agreements. Residential does not collateralize any of its repurchase facilities with cash.

The repurchase agreements require Residential to maintain various financial and other covenants, including maintaining a minimum adjusted tangible net worth, a maximum ratio of indebtedness to adjusted tangible net worth and specified levels of unrestricted cash as well. In addition, the repurchase agreements contain customary events of default. Residential is restricted by the terms of its repurchase agreements from paying dividends greater than its REIT taxable income in a calendar year.

Residential is currently in compliance with the covenants and other requirements with respect to its repurchase agreements. We monitor Residential's banking partners' ability to perform under the repurchase agreements and have concluded there is currently no reason to doubt that they will continue to perform under the repurchase agreements as contractually obligated.

6. Commitments and Contingencies

Litigation, claims and assessments

We are not currently the subject of any material legal or regulatory proceedings, and no material legal or regulatory proceedings have been threatened against us.

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7. Related party transactions

Our Consolidated Statements of Operations included the following significant related party transactions ($ in thousands):

	Three months ended June 30, 2014	Six months ended June 30, 2014	Counter-party	Consolidated Statements of Operations location
2014				
Residential property operating expenses	$3,169	$4,219	Altisource	Residential property operating expenses
Mortgage loan servicing costs	14,942	25,432	Ocwen	Mortgage loan servicing costs
Due diligence and unsuccessful deal costs	1,655	1,766	Altisource	Related party general and administrative expenses
Office and occupancy costs	69	143	Ocwen	Related party general and administrative expenses
Salaries and benefits	612	1,129	Altisource/Ocwen	Related party general and administrative expenses
Expense reimbursements	1,999	3,779	Residential/NewSource	Net loss (income) attributable to noncontrolling interest in consolidated affiliate
Management incentive fee	13,715	24,626	Residential	Net loss (income) attributable to noncontrolling interest in consolidated affiliate

	Three months ended June 30, 2013	Six months ended June 30, 2013	Counter-party	Consolidated Statements of Operations location
2013				
Mortgage loan servicing costs	$1,242	$1,634	Ocwen	Mortgage loan servicing costs
Due diligence and unsuccessful deal costs	—	183	Altisource	Related party general and administrative expenses
Office and occupancy costs	55	79	Ocwen	Related party general and administrative expenses
Expense reimbursements	1,156	2,057	Residential/NewSource	Net loss (income) attributable to noncontrolling interest in consolidated affiliate

During the six months ended June 30, 2013, Residential acquired a portfolio from Ocwen Financial Corporation ("Ocwen") of non-performing first lien residential mortgage loans having aggregate market value of underlying properties of $94 million. The aggregate purchase price for this portfolio was $64 million.

8. Share-based payments

During the six months ended June 30, 2014 and 2013, we granted 8,765 and 32,197 shares, respectively, of market-based restricted stock to certain members of executive management under our 2012 Equity Incentive Plan with a weighted average grant date fair value per share of $791.27 and $63.98, respectively.

Our directors each receive annual grants of restricted stock equal to $45,000 based on the market value of our common stock at the time of the annual stockholders meeting. This restricted stock vests and is issued after a one-year service period subject to each director attending at least 75% of the Board and committee meetings. No dividends are paid on the shares until the award is issued. During the six months ended June 30, 2014 and 2013, we granted 205 and 1,470 shares of stock, respectively, pursuant to our 2013 Director Equity Plan with a weighted average grant date fair value per share of $1,090.26 and $205.27, respectively.

We recorded $(0.5) million and $2.7 million of compensation expense related to these grants for the three and six months ended June 30, 2014, respectively, and recorded $1.1 million and $1.3 million for the three and six months ended June 30, 2013, respectively. As of June 30, 2014 and 2013, we had an aggregate $22.3 million and $9.5 million, respectively, of total unrecognized share-based compensation cost to be recognized over a weighted average remaining estimated term of 3.08 years and 3.50 years, respectively.

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9. Income taxes

We are domiciled in the United States Virgin Islands and under current United States Virgin Islands law are obligated to pay taxes in the United States Virgin Islands on income and/or capital gains. We applied for tax benefits from the United States Virgin Islands Economic Development Commission and received our certificate of benefits, effective as of February 1, 2013. Under the certificate of benefits, so long as we comply with the provisions of the certificate, we will receive a 90% exemption on our income taxes until 2043. From inception to December 31, 2012 we had future taxable income deductions (deferred tax assets) related to initial year expenditures, including the results of operations attributable to noncontrolling interest in consolidated affiliates. Previously, we had recorded a valuation allowance equal to 100% of the resulting gross deferred tax asset; however, due to year-to-date actual activity and forecasted income, management believes it is more likely than not that the majority of the deferred tax asset will be realized and therefore the valuation allowance was substantially eliminated.

As of June 30, 2014 and 2013, neither Residential nor we accrued interest or penalties associated with any unrecognized tax benefits, nor was any interest expense or penalty recognized during the six months ended June 30, 2014 and 2013. Residential recorded nominal state and local tax expense on income and property for the three and six months ended June 30, 2014. Our subsidiaries and we remain subject to tax examination for the period from inception to December 31, 2013.

10. Earnings per share

The following table sets forth the components of diluted earnings per share (in thousands, except share and per share amounts):

	Three months ended June 30, 2014	Three months ended June 30, 2013	Six months ended June 30, 2014	Six months ended June 30, 2013
Numerator				
Net income (loss) attributable to common stockholders	$13,230	$(1,499)	$20,058	$(2,339)
Denominator				
Weighted average common stock outstanding – basic	2,255,278	2,343,462	2,310,931	2,343,338
Stock options using treasury method	250,287	—	262,033	—
Restricted stock	169,341	—	176,665	—
Preferred shares if converted	200,000	—	115,556	—
Weighted average common stock outstanding – diluted	2,874,906	2,343,462	2,865,185	2,343,338
Earnings (loss) per basic share	$5.87	$(0.64)	$8.68	$(1.00)
Earnings (loss) per diluted share	$4.60	$(0.64)	$7.00	$(1.00)

Because we incurred a net loss attributable to common stockholders for the three and six months ended June 30, 2013, basic and diluted earnings per share are equivalent for the period. For the three and six months ended June 30, 2013, there were 293,760 stock options and 224,944 units of restricted stock excluded from the calculation of diluted earnings per share because inclusion would have been anti-dilutive.

11. Segment information

Our primary business is to provide asset management and certain corporate governance services to Residential. Residential's primary business is the acquisition and ownership of single-family rental assets. Residential's primary sourcing strategy is to acquire these assets by purchasing sub-performing and non-performing mortgage loans. As a result, we operate in a single segment focused on the management of Residential's resolution of sub-performing and non-performing mortgages with the intent to modify as many loans as possible to keep borrowers in their homes or own the collateral which is suitable as long-term rental properties.

12. Subsequent events

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On July 10, 2014, Residential acquired a portfolio of 46 first lien residential mortgage loans, substantially all of which were non-performing loans in advanced stages of foreclosure, having an aggregate UPB of $7.0 million and an aggregate market value of underlying properties of $5.0 million for an aggregate purchase price of $3.7 million.

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Item 2. Management's discussion and analysis of financial condition and results of operations

Overview

Our primary business is to provide asset management and certain corporate governance services to Residential and NewSource. In October 2013, we applied for and were granted registration by the SEC as a registered investment adviser under section 203(c) of the Investment Advisers Act of 1940.

We have a capital light operating strategy. Residential is currently our primary source of revenue and will drive our potential future growth. The asset management agreement with Residential entitles us to “incentive management fees,” that give us a share of Residential’s cash flow available for distribution to its stockholders, as well as reimbursement for certain overhead and operating expenses. Accordingly, our operating results are highly dependent on Residential's ability to achieve positive operating results.

On March 18, 2014, we closed a private placement for the issuance and sale of 250,000 shares of our Series A Convertible Preferred Stock, to Luxor Capital Group, LP, a New York based investment manager, and other institutional investors for proceeds of $250.0 million. We used a portion of the proceeds from this transaction to repurchase shares of our common stock and for other corporate purposes. We intend to use the remaining proceeds to repurchase from time to time additional shares of our common stock and for other corporate purposes. Such stock repurchases may be made in the open market, block trades or privately-negotiated transactions. In connection with the foregoing, the Company's Board of Directors has approved a share repurchase program that authorizes us to repurchase up to $300.0 million in shares of our common stock.

We have concluded that Residential is a variable interest entity because Residential’s equity holders lack the ability through voting rights to make decisions about Residential’s activities that have a significant effect on the success of Residential. We have also concluded that we are the primary beneficiary of Residential’s financial condition and results of operations because under the Residential asset management agreement we have the power to direct the activities of Residential that most significantly impact Residential’s economic performance including establishing Residential’s investment and business strategy. As a result, we consolidate Residential’s financial results in our consolidated financial statements.

Additionally, we provide management services to NewSource. On December 2, 2013, NewSource became registered as a licensed reinsurer with the BMA. Because we own 100% of voting common stock of NewSource and there are no substantive kick-out rights granted to other equity owners, we consolidate NewSource in our consolidated financial statements.

In its initial eighteen months of operations, we advised Residential and conducted portfolio analysis and the bidding process to facilitate the acquisition and growth of Residential’s portfolio of residential mortgage loans as follows:

In 2013, Residential acquired portfolios consisting of an aggregate of 8,491 residential mortgage loans and 40 REO properties, substantially all of which were non-performing, having an aggregate unpaid principal balance (“UPB”) of approximately $2.2 billion and an aggregate market value of underlying properties of $1.8 billion. The aggregate purchase price for these portfolios was $1.2 billion.

During the quarter ended June 30, 2014, Residential agreed to acquire an aggregate of 4,374 residential mortgage loans, of which 3,269 were non-performing loans and 1,105 were re-performing loans, with an aggregate market value of underlying properties of $1.23 billion. On June 27, 2014, Residential acquired 1,116 of the non-performing loans and 879 of the re-performing loans with an aggregate market value of underlying properties of $646.4 million for an aggregate purchase price of $379.1 million. On July 10, 2014, Residential acquired 46 non-performing loans with an aggregate market value of underlying properties of $5.0 million for an aggregate purchase price of $3.7 million. Subject to satisfactory due diligence results and final agreement on terms, Residential anticipates completing the acquisition of the remainder of these portfolios in the third quarter of 2014. There can be no assurance that Residential will complete these transactions in whole or in part on a timely basis or at all.

On May 1, 2014, Residential also completed the acquisition of a portfolio of 664 non-performing mortgage loans and REO properties with an aggregate property value of $126.6 million for an aggregate purchase price of $92.7 million. Residential had previously agreed to purchase an aggregate of 915 non-performing mortgage loans and REO properties in this portfolio in March 2014. There can be no assurance that Residential will complete this transaction in whole or in part on a timely basis or at all.

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During the six months ended June 30, 2014, Residential's total completed acquisitions consisted of an aggregate of 5,797 residential mortgage loans, substantially all of which were non-performing, 879 re-performing mortgage loans and 190 REO properties having an aggregate UPB of approximately $1.8 billion and an aggregate market value of underlying properties of $1.7 billion. The aggregate purchase price for these acquisitions was $1.1 billion.

During 2013 and the six months ended June 30, 2014, Residential modified an aggregate of 272 mortgage loans, converted an aggregate of 1,756 mortgage loans into REO properties and disposed of an aggregate of 462 mortgage loans and REO properties through short sale, refinancing or other liquidation events.

Following the above-referenced transactions, as of June 30, 2014, Residential's portfolio consisted of 12,070 residential mortgage loans, substantially all of which were non-performing, having an aggregate UPB of approximately $3.3 billion and an aggregate market value of underlying properties of $2.9 billion. We also had 1,958 REO properties with an aggregate carrying value of $277.4 million, of which 102 REO properties were rented and 40 were being listed for rent or prepared for rental. Residential also had 879 re-performing mortgage loans having an aggregate UPB of approximately $207.1 million and an aggregate market value of underlying properties of $271.1 million.

To date, Residential has acquired its non-performing loan portfolios through direct acquisitions from institutions such as banks, HUD and private equity funds.

NewSource commenced its reinsurance activities during the second quarter of 2014, and generated approximately $400,000 of title reinsurance premiums in Florida. We expect to expand the product mix and geographic scope of NewSource's title reinsurance activities in the coming quarters in seeking to grow NewSource's business opportunities.

In addition, as part of our plan to launch an additional managed vehicle, we have dedicated additional resources to develop and implement a strategy to launch NewSource as a separate company that focuses on housing-related reinsurance products with limited catastrophe risk and high operational intensity, such as title insurance and home warranty. Our strategic plan is intended to provide NewSource with increased access to risk capital required to take advantage of this opportunity which we believe has stable economics and attractive underwriting margins. There can be no assurance that we will be able to complete the launch of NewSource as a separate company or grow its business as planned on a timely basis or at all.

Observations on Current Market Opportunities

We believe there is currently a significant market opportunity to acquire single-family rental properties through the distressed loan channel and expect the supply of non-performing loans, sub-performing loans, properties in foreclosure and REO to remain steady over the next several years as banks and other mortgage lenders seek to dispose of their distressed inventories. We continue to see substantial volumes of distressed residential mortgage loan portfolios offered for sale by banks, HUD and private equity funds, among others. We believe that the distressed loan channel gives Residential a cost advantage over other acquisition channels such as foreclosure auctions and REO acquisitions, involves less competition and positions Residential to be selected as the buyer of diverse portfolios of such loans since Residential is not geographically constrained. Residential's preferred resolution methodology is to modify the sub-performing and non-performing loans. We believe modification followed by refinancing generates near-term cash flows, provides the highest possible economic outcome for Residential and is a socially responsible business strategy because it keeps more families in their homes.

Metrics Affecting Our Consolidated Results

As described above, our operating results depend heavily on Residential’s operating results. Residential’s results are affected by various factors, some of which are beyond our control, including the following:

Revenues

Residential’s revenues primarily consist of the following:

i. Net unrealized gains from the conversion of loans to REO. Upon conversion of loans to REO, Residential marks the properties to the most recent market value (less estimated selling costs in the case of REO properties held for sale). The difference between the carrying value of the asset at the time of conversion and the most recent market value, based on BPOs, is recorded in Residential's statement of operations as net unrealized gain on mortgage loans. We expect the timeline to convert acquired loans into REO will vary significantly by loan, which could result in fluctuations in Residential's revenue recognition and its operating performance from period to period. The factors that

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may affect the timelines to foreclose upon a residential mortgage loan include, without limitation, state foreclosure timelines and deferrals associated therewith; unauthorized parties occupying the property; federal, state or local legislative action or initiatives designed to provide homeowners with assistance in avoiding residential mortgage loan foreclosures and continued declines in real estate values and/or sustained high levels of unemployment that increase the number of foreclosures and which place additional pressure and/or delays on the already overburdened judicial and administrative proceedings.

ii. Net unrealized gains from the change in fair value of loans. After our sub-performing and non-performing mortgage loans are acquired, the fair value of each loan is adjusted in each subsequent reporting period as the loan proceeds to a particular resolution (i.e., modification, or conversion to real estate owned). As a loan approaches resolution, the resolution timeline for that loan decreases and costs embedded in the discounted cash flow model for loan servicing, foreclosure costs and property insurance are incurred and removed from future expenses. The shorter resolution timelines and reduced future expenses each increase the fair value of the loan. The increase in the value of the loan is recognized in net unrealized gain on mortgage loans in our consolidated statements of operations The exact nature of resolution will be dependent on a number of factors that are beyond our control, including borrower willingness to pay, property value, availability of refinancing, interest rates, conditions in the financial markets, the regulatory environment and other factors.

iii. Net realized gain on mortgage loans. Residential records net realized gains, including the reclassification of previously accumulated net unrealized gains, upon the liquidation of a loan which may consist of short sale, third party sale of the underlying property, refinancing or full debt pay-off of the loan. We expect the timeline to liquidate loans will vary significantly by loan, which could result in fluctuations in revenue recognition and operating performance from period to period. Additionally, the proceeds from loan liquidations may vary significantly depending on the resolution methodology. Residential generally expects to collect proceeds of loan liquidations in cash and, thereafter, have no continuing involvement with the asset.

As a greater number of Residential's REO properties are renovated and deemed suitable for rental, we expect a greater portion of its revenues will be rental revenues. We believe the key variables that will affect Residential's rental revenues over the long term will be average occupancy and rental rates. We anticipate that a majority of Residential's leases of single-family rental properties to tenants will be for a term of two years or less. As these leases permit the residents to leave at the end of the lease term without penalty, we anticipate Residential's rental revenues will be affected by declines in market rents more quickly than if its leases were for longer terms. Short-term leases may result in high turnover, which involves expenses such as renovation costs and marketing costs, or reduced rental revenues.

Although we generally seek to lease the REO properties Residential acquires on foreclosure, we may determine to sell the properties that do not meet Residential's rental criteria. The real estate market and home prices will determine proceeds from any sale of real estate. In addition, while we seek to track real estate price trends and estimate the effects of those trends on the valuations of Residential's portfolios of residential mortgage loans, future real estate values are subject to influences beyond our control.

Expenses

Residential's expenses primarily consist of loan servicing fees and advances, rental property operating expenses, depreciation and amortization, general and administrative expenses, expense reimbursement, incentive management fees and interest expense. From time to time, expenses also may include impairments of assets. Loan servicing fees and advances are expenses paid to Ocwen to service Residential's acquired loans and for real estate insurance and other corporate advances. Rental property operating expenses are expenses associated with Residential's ownership and operation of rental properties including expenses such as Altisource's inspection, property preservation and renovation fees, property management fees, turnover costs, property taxes, insurance and HOA dues. Depreciation and amortization is a non-cash expense associated with the ownership of real estate and generally remains relatively consistent each year in relation to Residential’s asset levels since it depreciate its properties on a straight-line basis over a fixed life. Interest expense consists of the costs to borrow money in connection with Residential’s debt financing of our portfolios. General and administrative expenses consist of the costs related to the general operation and overall administration of our business, including estimated selling costs of REO held for sale. Expense reimbursement consists primarily of our employee salaries in direct correlation to the services they provide on Residential’s behalf and other personnel costs and corporate overhead. We are not reimbursed by Residential for certain general and administrative expenses pertaining to stock-based compensation and our expenditures that are not for the benefit of Residential. The incentive management fees consist of compensation due to us, based on the amount of cash available for distribution to

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Residential's stockholders for each period. The expense reimbursement and incentive management fee are eliminated in consolidation but increase our net income by reducing the amount of net income attributable to noncontrolling interest.

Other factors affecting our consolidated results

We expect Residential's results of operations to be affected by various additional factors, many of which are beyond our control, including the following:

Acquisitions

Residential's operating results will depend on our ability to source sub-performing and non-performing loans, as well as other residential mortgage loans and REO property assets. We believe that there is currently a large supply of sub-performing and non-performing mortgage loans available to Residential for acquisition. We believe the available supply provides for a steady acquisition pipeline of assets since we plan on targeting just a small percentage of the population.

Generally, we expect that Residential's mortgage loan portfolio may grow at an uneven pace, as opportunities to acquire distressed residential mortgage loans may be irregularly timed and may at times involve large portfolios of loans, and the timing and extent of our success in acquiring such loans cannot be predicted.

Financing

Our ability to grow Residential's business is dependent on the availability of adequate financing including additional equity financing, debt financing or both in order to meet Residential's objectives. We intend to leverage Residential's investments with debt, the level of which may vary based upon the particular characteristics of its portfolio and on market conditions. To the extent available at the relevant time, Residential's financing sources may include bank credit facilities, warehouse lines of credit, structured financing arrangements and repurchase agreements, among others. We may also seek to raise additional capital for Residential through public or private offerings of debt or equity securities, depending upon market conditions. To qualify as a REIT under the Code, Residential will need to distribute at least 90% of its taxable income each year to its stockholders. This distribution requirement limits its ability to retain earnings and thereby replenish or increase capital to support its activities.

Residential's taxable income is triggered primarily by material charges in the economic status of loans, such as a sale of the loan, modification of the loan from a non-performing status to a performing status or conversion of the loan to REO. We expect Residential to convert its taxable gains on REO dispositions and loan modifications within a short period to cash gains, which can be used to fund the distribution requirements from the corresponding taxable gains. Distribution requirements from the taxable gains on Residential's remaining loans that it expects to convert to rental properties can be funded through a higher advance rate on the increased value when a property becomes rented.

Resolution Activities

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	First quarter 2013	Second quarter 2013	Six months ended June 30, 2013	First quarter 2014	Second quarter 2014	Six months ended June 30, 2014
Mortgage Loans [1]						
Beginning balance	—	673	—	8,054	11,509	8,054
Acquisitions	684	720	1,404	4,207	1,590	