

Cherry Hill Mortgage Investment Corp  
Form 10-K  
March 16, 2018  
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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549**

**FORM 10-K**

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF  
1934**

**For the fiscal year ended December 31, 2017**

**OR**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934**

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission File Number: 001-36099**

**CHERRY HILL MORTGAGE INVESTMENT CORPORATION  
(Exact name of registrant as specified in its charter)**

**Maryland**

**46-1315605**

**(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)**

**1451 Route 34, Suite 303  
Farmingdale, New Jersey**

**07727**

**(Address of principal executive offices)**

**(Zip Code)**

**(877) 870 – 7005**

**(Registrant's telephone number, including area code)**

**Securities registered pursuant to Section 12(b) of the Act:**

**Title of Each Class**

**Name of Each Exchange on Which  
Registered**

**Common Stock, \$0.01 par value  
8.20% Series A Cumulative Redeemable Preferred Stock, \$0.01 par  
value**

**New York Stock Exchange  
New York Stock Exchange**

**Securities registered pursuant to Section 12(g) of the Act:  
None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  
Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the  
Exchange Act. Yes  No

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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  No

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 (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of large accelerated filer, accelerated filer, smaller reporting company, and emerging growth company in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer   
Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company   
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

The aggregate market value of the registrant's common stock, \$0.01 par value per share, at June 30, 2017, held by those persons deemed by the registrant to be non-affiliates (based upon the closing sale price of the common stock on the New York Stock Exchange on June 30, 2017) was approximately \$214.6 million. Shares of the registrant's common stock held by each executive officer and director and by each entity or person that, to the registrant's knowledge, owned 10% or more of the registrant's outstanding common stock as of June 30, 2017, have been excluded from this number in that these persons may be deemed affiliates of the registrant. The determination of affiliate status for this purpose is not necessarily a conclusive determination for other purposes.

On March 16, 2018, the registrant had a total of 12,721,464 shares of common stock, \$0.01 par value, outstanding.

### **DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the registrant's Definitive Proxy Statement on Schedule 14A relating to its 2018 Annual Meeting of Stockholders, to be filed with the Securities and Exchange Commission by no later than April 30, 2018, are incorporated by reference into Part III, Items 10 through 14, inclusive, of this Annual Report on Form 10-K as indicated herein.

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**GLOSSARY**

This glossary defines some of the terms that we use elsewhere in this Annual Report on Form 10-K and is not a complete list of all of the defined terms used herein. In this Annual Report on Form 10-K, unless specifically stated otherwise or the context otherwise indicates, references to we, us, our, the Company or CHMI refer to Cherry Hill Mortgage Investment Corporation, a Maryland corporation, together with its consolidated subsidiaries; references to the Manager refer to Cherry Hill Mortgage Management, LLC, a Delaware limited liability company; and references to the Operating Partnership refer to Cherry Hill Operating Partnership, LP, a Delaware limited partnership.

**Agency** means a U.S. Government agency, such as Ginnie Mae, or a GSE.

**Agency RMBS** means RMBS issued by an Agency or for which an Agency guarantees payments of principal and interest on the securities.

**ASC** means an Accounting Standards Codification.

**ARM** means an adjustable-rate residential mortgage loan.

**CFTC** means the U.S. Commodity Futures Trading Commission.

**CMO** means a collateralized mortgage obligation. CMOs are structured debt instruments representing interests in specified pools of mortgage loans subdivided into multiple classes, or tranches, of securities, with each tranche having different maturities or risk profiles.

**credit enhancement** means techniques to improve the credit ratings of securities, including overcollateralization, creating retained spread, creating subordinated tranches and insurance.

**Excess MSR** means an interest in an MSR, representing a portion of the interest payment collected from a pool of mortgage loans, net of a basic servicing fee paid to the mortgage servicer.

**Fannie Mae** means the Federal National Mortgage Association.

**FHA** means the Federal Housing Administration.

**Freddie Mac** means the Federal Home Loan Mortgage Corporation.

**FRM** means a fixed-rate residential mortgage loan.

**Ginnie Mae** means the Government National Mortgage Association, a wholly-owned corporate instrumentality of the United States of America within HUD.

**GSE** means a government-sponsored enterprise. When we refer to GSEs, we mean Fannie Mae or Freddie Mac.

**HUD** means the U.S. Department of Housing and Urban Development.

**hybrid ARM** means a residential mortgage loan that has an interest rate that is fixed for a specified period of time (typically three, five, seven or ten years) and thereafter adjusts to an increment over a specified interest rate index.

**inverse IO** means an inverse interest-only security, which is a type of stripped security. These debt securities receive no principal payments and have a coupon rate which has an inverse relationship to its reference index.

**IO** means an interest-only security, which is a type of stripped security. IO strips receive a specified portion of the interest on the underlying assets.

**MBS** means mortgage-backed securities.

**MSR** means a mortgage servicing right. An MSR provides a mortgage servicer with the right to service a mortgage loan or a pool of mortgages in exchange for a portion of the interest payments made on the mortgage or the underlying mortgages. An MSR is made up of two components: a basic servicing fee and an Excess MSR. The basic servicing fee is the amount of compensation for the performance of servicing duties.

**mortgage loan** means a loan secured by real estate together with the right to receive the payment of principal and interest on the loan (including the servicing fee).

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**non-Agency RMBS** means RMBS that are not issued or guaranteed by an Agency, including investment grade (AAA through BBB rated) and non-investment grade (BB rated through unrated) classes.

**non-conforming loan** means a residential mortgage loan that does not conform to the Agency underwriting guidelines and does not meet the funding criteria of Fannie Mae and Freddie Mac.

**non-QM loan** means a mortgage loan that does not satisfy the requirements for a qualified mortgage.

**prime mortgage loan** means a mortgage loan that generally conforms to GSE underwriting guidelines or is a non-QM loan with a FICO score generally above 700.

**qualified mortgage** means a mortgage that complies with the ability to repay rule and related requirements in Regulation Z.

**REIT** means a real estate investment trust.

**residential mortgage pass-through certificate** is a MBS that represents an interest in a pool of mortgage loans secured by residential real property where payments of both interest and principal (including principal prepayments) on the underlying residential mortgage loans are made monthly to holders of the security, in effect passing through monthly payments made by the individual borrowers on the mortgage loans that underlie the security, net of fees paid to the issuer/guarantor and servicer.

**RMBS** means a residential MBS.

**Servicing Related Assets** means Excess MSR and MSRs.

**SIFMA** means the Securities Industry and Financial Markets Association.

**stripped security** is an RMBS structured with two or more classes that receives different distributions of principal or interest on a pool of RMBS. Stripped securities include IOs and inverse IOs.

**TBA** means a forward-settling Agency RMBS where the pool is to-be-announced. In a TBA, a buyer will agree to purchase, for future delivery, Agency RMBS with certain principal and interest terms and certain types of underlying collateral, but the particular Agency RMBS to be delivered is not identified until shortly before the TBA settlement date.

**TRS** means a taxable REIT subsidiary.

**UPB** means unpaid principal balance.

**U.S. Treasury** means the U.S. Department of Treasury.

**VA** means the Department of Veterans Affairs.

**VA mortgage loan** means a mortgage loan that is partially guaranteed by the VA in accordance with its regulations.

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**FORWARD-LOOKING INFORMATION**

We make forward-looking statements in this Annual Report on Form 10-K within the meaning of Section 27A of the Securities Act of 1933, as amended (the Securities Act ), and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act ). For these statements, we claim the protections of the safe harbor for forward-looking statements contained in such Sections. Forward-looking statements are subject to substantial risks and uncertainties, many of which are difficult to predict and are generally beyond our control. These forward-looking statements include information about possible or assumed future results of our business, financial condition, liquidity, results of operations, plans and objectives. When we use the words believe, expect, anticipate, estimate, plan, continue, should, could, would, may, potential or the negative of these terms or other comparable terminology, we intend to identify forward-looking statements. Statements regarding the following subjects, among others, may be forward-looking:

- the Company's investment objectives and business strategy;
- the Company's ability to raise capital through the sale of its equity and debt securities and to invest the net proceeds of any such offering in the target assets identified at the time of the offering;
- the Company's ability to obtain future financing arrangements and refinance existing financing arrangements as they mature;
- the Company's expected leverage;
- the Company's expected investments;
- the Company's ability to acquire servicing-related assets and mortgage and real estate-related securities; estimates and statements relating to, and the Company's ability to make, future distributions to holders of the Company's securities;
- the Company's ability to compete in the marketplace;
- market, industry and economic trends;
- recent market developments and actions taken and to be taken by the U.S. Government, the U.S. Treasury and the Board of Governors of the Federal Reserve System, Fannie Mae, Freddie Mac, Ginnie Mae and the U.S. Securities and Exchange Commission ( SEC );
- mortgage loan modification programs and future legislative actions;
- the Company's ability to maintain its qualification as a REIT under the Internal Revenue Code of 1986, as amended (the Code ), and limitations on the Company's business due to compliance with requirements for maintaining its qualification as a REIT under the Code;
- the Company's ability to maintain its exclusion from regulation as an investment company under the Investment Company Act of 1940, as amended (the Investment Company Act );
- projected capital and operating expenditures;
- availability of qualified personnel; and
- projected prepayment and/or default rates.

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The Company's beliefs, assumptions and expectations can change as a result of many possible events or factors, not all of which are known to it or are within its control. If any such change occurs, the Company's business, financial condition, liquidity and results of operations may vary materially from those expressed in, or implied by, the Company's forward-looking statements. These risks, along with, among others, the following factors, could cause actual results to vary from the Company's forward-looking statements:

the factors referenced in this Annual Report on Form 10-K, including those set forth under Item 1. Business and Item 1A. Risk Factors ;

general volatility of the capital markets;

changes in the Company's investment objectives and business strategy;

availability, terms and deployment of capital;

availability of suitable investment opportunities;

the Company's dependence on the Manager and the Company's ability to find a suitable replacement if the Company or the Manager were to terminate the management agreement the Company has entered into with the Manager;

changes in the Company's assets, interest rates or the general economy;

increased rates of default and/or decreased recovery rates on the Company's investments;

changes in interest rates, interest rate spreads, the yield curve, prepayment rates or recapture rates;

limitations on the Company's business due to compliance with requirements for maintaining its qualification as a REIT under the Code and its exclusion from regulation as an investment company under the Investment Company Act;

the degree and nature of the Company's competition, including competition for the residential mortgage assets in which the Company invests; and

other risks associated with acquiring, investing in and managing residential mortgage assets.

Although the Company believes that the expectations reflected in the forward-looking statements are reasonable, it cannot guarantee future results, levels of activity, performance or achievements. These forward-looking statements apply only as of the date of this Annual Report on Form 10-K. The Company is not obligated, and does not intend, to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. See Item 1A. Risk Factors of this Annual Report on Form 10-K.



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### **PART I**

#### **Item 1. Business**

Cherry Hill Mortgage Investment Corporation is a publicly traded residential real estate finance company focused on acquiring, investing in and managing residential mortgage assets in the United States. We were incorporated in Maryland on October 31, 2012, and we commenced operations on October 9, 2013, following the completion of our initial public offering ( IPO ) and a concurrent private placement. Our common stock is listed and traded on the New York Stock Exchange under the symbol CHMI. We are externally managed by Cherry Hill Mortgage Management, LLC, an SEC-registered investment adviser established by Stanley Middleman. Our Manager is a party to a services agreement with Freedom Mortgage Corporation ( Freedom Mortgage ), which is owned and controlled by Mr. Middleman. Our Manager is owned by a blind trust for the benefit of Mr. Middleman.

We operate so as to continue to qualify to be taxed as a REIT under the Code. To qualify as a REIT, we must distribute annually to our stockholders an amount at least equal to 90% of our REIT taxable income, determined without regard to the deduction for dividends paid and excluding any net capital gain. We currently expect to distribute substantially all of our REIT taxable income to our stockholders. We will be subject to income tax on our taxable income that is not distributed and to an excise tax to the extent that certain percentages of our taxable income are not distributed by specified dates. CHMI Solutions, Inc. ( Solutions ), our TRS, and its wholly owned subsidiary, Aurora Financial Group, Inc. ( Aurora ), are subject to regular corporate U.S. federal, state and local income taxes on their taxable income.

Our principal objective is to generate attractive current yields and risk-adjusted total returns for our stockholders over the long term, primarily through dividend distributions and secondarily through capital appreciation. We attempt to attain this objective by selectively constructing and actively managing a portfolio of Servicing Related Assets and RMBS. Subject to market conditions, we may also invest in prime residential mortgage loans and other cash flowing residential mortgage assets.

We operate our business through the following segments: (i) investments in RMBS; (ii) investments in Servicing Related Assets; and (iii) All Other. For information regarding the segments in which we operate, see Item 8. Consolidated Financial Statements and Supplementary Data—Note 3—Segment Reporting.

#### **Our Targeted Asset Classes**

Our primary targeted asset classes currently include:

RMBS, including Agency RMBS, residential mortgage pass-through certificates, CMOs (IOs and inverse IOs) and TBAs; and  
Servicing Related Assets consisting of MSRMs and Excess MSRMs.

#### **Our Strategy**

Our strategy, which may change due to the availability and terms of capital and as market conditions warrant, involves:

allocating a substantial portion of our equity capital to the acquisition of Servicing Related Assets through bulk and flow purchases;  
the creation of intercompany Excess MSRMs from MSRMs acquired by our mortgage servicing subsidiary, Aurora;  
acquiring RMBS on a leveraged basis; and  
opportunistically mitigating our prepayment and interest rate and, to a lesser extent, credit risk by using a variety of hedging instruments and, where applicable and available, recapture agreements.

*Servicing Related Asset Strategy.* We currently expect that the primary method by which we will invest in Excess MSR's will be through the creation of intercompany Excess MSR's from MSR's acquired by Aurora. We plan to acquire MSR's from servicers, which may include Freedom Mortgage, on a bulk and/or flow purchase basis on terms to be negotiated in the future.

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Our ability to acquire MSR is subject to the applicable REIT qualification tests. We have to hold our MSR through Aurora, which is subject to corporate income tax. In certain cases, we will create Excess MSR from those MSR which will be transferred to one of our subsidiaries which function as qualified REIT subsidiaries. These intercompany transfers are eliminated in consolidation for financial statement purposes. The portion of the interest payments represented by the Excess MSR will not be subject to an entity level tax as long as we comply with the REIT qualification tests. The tax liability of Aurora negatively impacts our returns from the MSR that it holds. In addition, our investments in MSR will expose us to default risk and the potential for credit losses.

We do not directly service the mortgage loans underlying the MSR we acquire; rather, we contract with third-party subservicers to handle servicing functions for the loans underlying the MSR.

*RMBS Strategy.* Our RMBS strategy focuses primarily on the acquisition and ownership of Agency RMBS that are whole-pool, residential mortgage pass-through certificates. However, from time to time, we invest in CMOs, including IOs and inverse IOs, primarily to take advantage of particularly attractive prepayment-related or structural opportunities in the RMBS markets. In addition to investing in specific pools of Agency RMBS, we utilize forward-settling purchases and sales of Agency RMBS where the underlying pools of mortgage loans are to-be-announced (TBA's). Pursuant to these TBA transactions, we agree to purchase or sell, for future delivery, Agency RMBS with certain principal and interest terms and certain types of underlying collateral, but the particular Agency RMBS to be delivered is not identified until shortly before the TBA settlement date. Generally, we do not take delivery of the specified pool but instead enter into an offsetting transaction before the date when we would be required to take delivery. Our ability to engage in TBA transactions is limited by the gross income and asset tests applicable to REITs.

Our RMBS strategy includes selective investments in GSE risk-sharing securities. GSE risk-sharing securities are general obligations of Fannie Mae and Freddie Mac that provide credit protection with respect to defaults on reference pools of loans. We currently expect to expand our participation in that market. However, the extent of our investments in GSE risk-sharing securities is limited by the gross income and asset tests applicable to REITs. We also may invest opportunistically in legacy non-Agency RMBS issued during or after 2010. To date, the GSE risk-sharing securities are the only non-Agency RMBS in which we have invested. If and when market conditions permit us to execute our prime mortgage loan acquisition and financing strategy, we expect that we will retain certain bonds collateralized by the prime mortgage loans we securitize. We also may selectively invest across the entire capital structure of non-Agency RMBS that are newly issued by third parties. Non-Agency RMBS are subject to risk of default, among other risks, and could result in greater losses.

*Prime Mortgage Loans.* We believe that the market for non-conforming loans including, in particular, prime non-conforming mortgage loans, will grow. While our interest in this asset class is undiminished, we do not currently anticipate that either market conditions or available long-term financing will result in our execution of this strategy in 2018. The prime mortgage loans may be ARMs, hybrid ARMs or FRMs with original terms to maturity of not more than 30 years and will be either fully amortizing or interest-only for up to ten years, and fully amortizing thereafter. We expect that these loans may include both qualified mortgages and, if and when market conditions permit, non-QM loans.

Our overall strategy, and each category of assets within that strategy, is adaptable to changing market environments, subject to compliance with the income and other tests that we must satisfy to maintain our qualification as a REIT and maintain our exclusion from regulation as an investment company under the Investment Company Act. As a result, our acquisition and management decisions will depend on prevailing market conditions, and our targeted asset classes and strategy may vary over time in response to market conditions.

## **Our Manager**

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We are externally managed by our Manager and, with the exception of Aurora, our licensed mortgage servicing subsidiary, which has a nominal amount of employees, we have no employees. We have entered into a management agreement with our Manager, pursuant to which our Manager is responsible for our investment strategies and decisions and our day-to-day operations, subject to the supervision and oversight of our board of directors. Our Manager is a Delaware limited liability company originally established by Mr. Middleman. The

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Manager is party to a services agreement with Freedom Mortgage, which is owned and controlled by Mr. Middleman. The sole member of the Manager is a blind trust for the benefit of Mr. Middleman. We rely on our Manager to provide or obtain on our behalf the personnel and services necessary for us to conduct our business.

The executive offices of our Manager are located at 907 Pleasant Valley Ave., Mount Laurel, New Jersey 08054, and the telephone number of our Manager's executive offices is (877) 870-7005.

We have an Investment Committee to monitor our investment policies, portfolio holdings, financing and hedging strategies and compliance with our investment guidelines. The members of our Investment Committee are Mr. Lown, our President and Chief Executive Officer; Mr. Evans, our Chief Investment Officer; Mr. Levine, our Chief Financial Officer, Treasurer and Secretary; and the MSR portfolio manager.

Our Manager is registered as an investment adviser under the Investment Advisers Act of 1940, as amended, and is subject to the regulatory oversight of the Investment Management Division of the SEC.

### **Our Investment Guidelines; Transactions with Freedom Mortgage**

The investment guidelines for our assets and borrowings are as follows:

• No investment will be made if it causes us to fail to qualify as a REIT under the Code.

• No investment will be made if it causes us to be regulated as an investment company under the Investment Company Act.

• We will not enter into principal transactions or split price executions with Freedom Mortgage or any of its affiliates unless such transaction is otherwise in accordance with our investment guidelines and the management agreement between us and our Manager and the terms of such transaction are at least as favorable to us as to Freedom Mortgage or its affiliate.

• Any proposed material investment that is outside our targeted asset classes must be approved by at least a majority of our independent directors.

Our Manager makes the determinations as to the percentage of assets that are invested in each of our targeted asset classes, consistent with our investment guidelines. Our Manager's acquisition decisions depend on prevailing market conditions and may change over time in response to opportunities available in different interest rate, economic and credit environments. In addition, our investment guidelines may be changed from time to time by our board of directors without the approval of our stockholders. Changes to our investment guidelines may include, without limitation, modification or expansion of the types of assets which we may acquire.

Our board of directors receives a report of our investments each quarter in conjunction with its review of our quarterly results. The Nominating and Corporate Governance Committee, which is comprised solely of our independent directors, reviews the material terms of any transaction between us and Freedom Mortgage, including the pricing terms, to determine if the terms of those transactions are fair and reasonable. We also retain two independent valuation services to assist our management and our independent directors in making pricing determinations on any Servicing Related Assets we may purchase from Freedom Mortgage.

In 2013 and 2014, we acquired Excess MSRs from Freedom Mortgage and entered into recapture agreements with Freedom Mortgage. For reporting purposes, these Excess MSRs were aggregated into three pools: Excess MSR Pool 1, Excess MSR Pool 2 and Excess MSR Pool 2014. On November 15, 2016, we sold the Excess MSRs in Excess MSR Pool 1 and the Excess MSRs in Excess MSR Pool 2014 to Freedom Mortgage. We sold the Excess MSRs in Excess MSR Pool 2 to Freedom Mortgage on February 1, 2017. In connection with the sale of the Excess MSRs in Excess MSR Pool 2 to Freedom Mortgage, Freedom Mortgage transferred to Aurora Ginnie Mae MSRs on mortgage loans that had an aggregate UPB of approximately \$4.5 billion as of January 31, 2017. In connection with these sales,

we repaid the outstanding borrowings drawn on our \$25 million term loan with NexBank SSB (the NexBank term loan ). In addition, the Acknowledgment Agreement that we and Freedom Mortgage entered into with Ginnie Mae at the time of our IPO was terminated. In connection with the sale transactions, Freedom Mortgage made 12 monthly yield maintenance payments aggregating \$3.0 million to the Company from December 2016 to November 2017.

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### **Our Financing Strategies and Use of Leverage**

We finance our RMBS with what we believe to be a prudent amount of leverage, which will vary from time to time based upon the particular characteristics of our portfolio, availability of financing and market conditions. Our borrowings for RMBS consist of repurchase transactions under master repurchase agreements. These agreements represent uncommitted financing provided by the counterparties. Our repurchase transactions are collateralized by our RMBS. In a repurchase transaction, we sell an asset to a counterparty at a discounted value, or the loan amount, and simultaneously agree to repurchase the same asset from such counterparty at a price equal to the loan amount plus an interest factor. Despite being legally structured as sales and subsequent repurchases, repurchase transactions are generally accounted for as debt secured by the underlying assets. During the term of a repurchase transaction, we generally receive the income and other payments distributed with respect to the underlying assets. While the proceeds of our repurchase financings often will be used to purchase additional RMBS subject to the same master repurchase agreement, our repurchase financing arrangements do not restrict our ability to use proceeds from these arrangements to support our other liquidity needs. Our master repurchase agreements are documented under the standard form master repurchase agreement published by SIFMA.

We have entered into repurchase agreements with 30 counterparties as of December 31, 2017. From time to time, we expect to negotiate and enter into additional master repurchase agreements with other counterparties that could produce opportunities to acquire certain RMBS that may not be available from our existing counterparties. See Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources in this Annual Report on Form 10-K.

Aurora has entered into two separate MSR financing facilities, one of which is a term loan for \$20.0 million and secured by all Ginnie Mae MSRs owned by Aurora and one of which is a revolving loan for up to \$25.0 million and secured by all Fannie Mae MSRs owned by Aurora. See Item 8. Consolidated Financial Statements and Supplementary Data—Note 12—Notes Payable. We may utilize other types of borrowings in the future, including corporate debt, securitization, or other more complex financing structures. Additionally, we may take advantage of available borrowings, if any, under new programs established by the U.S. Government to finance our assets. We also may raise capital by issuing unsecured debt or preferred or common stock.

### **Interest Risk Hedging**

Subject to maintaining our qualification as a REIT and maintaining our exclusion from regulation as an investment company under the Investment Company Act, we use certain derivative financial instruments and other hedging instruments to mitigate interest rate risk we expect to arise from our repurchase agreement financings associated with our RMBS. We also attempt to mitigate duration and basis risk arising from our RMBS portfolio. The interest rate hedging instruments that we currently use include: interest rate swaps, TBAs and swaptions. Our overall hedging strategy takes into account the natural hedging effect of our Servicing Related Assets, which tend to increase in value as interest rates rise. See Item 8. Consolidated Financial Statements and Supplementary Data—Note 2—Basis of Presentation and Significant Accounting Policies—Derivatives and Hedging Activities.

### **Policies with Respect to Certain Other Activities**

If our board of directors determines that additional funding is required, we may raise such funds through additional offerings of equity or debt securities, the retention of cash flow and other funds from debt financing, or a combination of these methods. In the event that our board of directors determines to raise additional equity capital, it has the authority, without stockholder approval, to issue additional shares of common stock or preferred stock in any manner and on such terms and for such consideration as it deems appropriate, at any time. We may, in the future, offer equity or debt securities in exchange for assets. We have not in the past and will not in the future underwrite the securities of

other companies. Our board of directors may change any of these policies without prior notice to you or a vote of our stockholders.

**Competition**

We compete with other mortgage REITs, specialty finance companies, savings and loan associations, banks, mortgage bankers, insurance companies, mutual funds, institutional investors, investment banking firms, financial institutions, governmental bodies and other entities for investment opportunities in general. See Item 1A. Risk Factors—We operate in a highly competitive market.



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### **Employees**

We do not have any employees other than those of our licensed mortgage servicing subsidiary, Aurora, which has four employees.

### **Our Tax Status**

We have elected to be taxed as a REIT under the Code. Provided that we maintain our qualification as a REIT, we generally will not be subject to U.S. federal income tax on our REIT taxable income that is currently distributed to our stockholders. REITs are subject to a number of organizational and operational requirements, including a requirement that they currently distribute at least 90% of their annual REIT taxable income excluding net capital gains. We cannot assure you that we will be able to comply with such requirements in the future. Failure to qualify as a REIT in any taxable year would cause us to be subject to U.S. federal income tax on our taxable income at regular corporate rates (and any applicable state and local taxes). Even if we qualify for taxation as a REIT, we may be subject to certain federal, state, local and non-U.S. taxes on our income. For example, the income generated by our TRS and its subsidiary, Aurora, is subject to U.S. federal, state and local income tax. See Item 1A. Risk Factors—U.S. Federal Income Tax Risks for additional tax status information.

### **Our Exclusion from Regulation as an Investment Company**

We are organized as a holding company and conduct business primarily through our subsidiaries. We believe we have conducted and intend to conduct our operations so that neither we nor any of our subsidiaries are required to register as an investment company under the Investment Company Act.

Section 3(a)(1)(A) of the Investment Company Act defines an investment company as any issuer that is or holds itself out as being engaged primarily in the business of investing, reinvesting or trading in securities. Section 3(a)(1)(C) of the Investment Company Act defines an investment company as any issuer that is engaged or proposes to engage in the business of investing, reinvesting, owning, holding or trading in securities and owns or proposes to acquire investment securities having a value exceeding 40% of the value of the issuer's total assets (exclusive of U.S. Government securities and cash items) on an unconsolidated basis, which we refer to as the 40% test. Excluded from the term investment securities, among other things, are U.S. Government securities and securities issued by majority-owned subsidiaries that are not themselves investment companies and are not relying on the exclusion from the definition of investment company set forth in Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act.

We believe neither we nor our Operating Partnership is considered an investment company under Section 3(a)(1)(A) of the Investment Company Act because neither we nor our Operating Partnership engage primarily or hold ourselves out as being engaged primarily in the business of investing, reinvesting or trading in securities. Rather, through our Operating Partnership's wholly-owned or majority-owned subsidiaries, we and our Operating Partnership are primarily engaged in the non-investment company businesses of these subsidiaries, namely the business of purchasing or otherwise acquiring mortgages and other interests in real estate.

We rely upon certain exemptions from registration as an investment company under the Investment Company Act, including, in the case of our subsidiary, Cherry Hill QRS I, LLC, Section 3(c)(5)(C) of the Investment Company Act. Section 3(c)(5)(C), as interpreted by the staff of the SEC, requires an entity to invest at least 55% of its assets in mortgages and other liens on and interests in real estate, which we refer to as qualifying real estate interests, and at least 80% of its assets in qualifying real estate interests plus real estate-related assets. In satisfying the 55% requirement, the entity may treat securities issued with respect to an underlying pool of mortgage loans in which it holds all of the certificates issued by the pool as qualifying real estate interests. We treat the Agency whole-pool pass-through securities in which we have invested as qualifying real estate interests for purposes of the 55%

requirement. The Servicing Related Assets and Agency CMOs we have acquired are not treated as qualifying real estate interests for purposes of the 55% requirement, but are treated as real estate-related assets that qualify for the 80% test. In addition, Cherry Hill QRS I, LLC will treat its investments in Cherry Hill QRS II, LLC, Cherry Hill QRS III, LLC and Cherry Hill QRS IV, LLC ( QRS IV ) as real estate-related assets because substantially all of the assets held by those subsidiaries are real estate-related assets.

We monitor our compliance with the 40% test and the holdings of our subsidiaries to ensure that each of our subsidiaries is in compliance with an applicable exemption or exclusion from registration as an investment

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company under the Investment Company Act. In the event that we or our Operating Partnership were to acquire assets that could make either entity fall within the definition of an investment company under Section 3(a)(1)(A) or Section 3(a)(1)(C) of the Investment Company Act, we believe that we would still qualify for an exclusion from registration pursuant to Section 3(c)(5)(C).

Qualification for exclusion from registration under the Investment Company Act limits our ability to make certain investments. In addition, complying with the tests for exclusion from registration could restrict the time at which we can acquire and sell assets. To the extent that the SEC or its staff provides more specific guidance regarding any of the matters bearing upon such exclusions, we may be required to adjust our strategy accordingly. Any additional guidance from the SEC or its staff could further inhibit our ability to pursue the strategies we have chosen.

### **Website Access to Reports**

We maintain a website at [www.chmireit.com](http://www.chmireit.com). We are providing the address to our website solely for the information of investors. The information on our website is not a part of, nor is it incorporated by reference, into this report. Through our website, we make available, free of charge, our annual proxy statement, annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. The SEC maintains a website that contains these reports at [www.sec.gov](http://www.sec.gov).

### **Corporate Information**

Our principal executive offices are located at 1451 Route 34, Suite 303, Farmingdale, New Jersey 07727. Our telephone number is (877) 870-7005. The offices of our Manager are located at 907 Pleasant Valley Ave., Mount Laurel, New Jersey, 08054.

### **Item 1A. Risk Factors**

*The Company's business and operations are subject to a number of risks and uncertainties, the occurrence of which could adversely affect its business, financial condition, results of operations and ability to make distributions to stockholders and could cause the value of the Company's capital stock to decline. Please refer to the section entitled Forward-Looking Information.*

### **Risks Related to Our Business**

*We may not be able to continue to operate our business successfully or generate sufficient revenue to make or sustain distributions to our stockholders.*

We commenced operations on October 9, 2013. We cannot assure you that we will be able to continue to operate our business successfully or implement our strategies. There can be no assurance that we will be able to continue to generate sufficient returns to pay our operating expenses and make satisfactory distributions to our stockholders. The results of our operations depend on several factors, including the availability of opportunities for the acquisition of target assets, the level and volatility of interest rates, the availability of adequate short and long-term financing, conditions in the financial markets and general economic conditions.

*Difficult conditions in the mortgage and residential real estate markets as well as general market concerns may adversely affect the value of the assets in which we invest, and these conditions may persist for the foreseeable future.*

Our business is materially affected by conditions in the residential mortgage market, the residential real estate market, the financial markets and the economy in general. In particular, the residential mortgage market in the United States has experienced a variety of difficulties and changed economic conditions, including defaults, credit losses and liquidity concerns. Over the past several years, certain commercial banks, investment banks and insurance companies have announced extensive losses from exposure to the residential mortgage market. These factors have impacted investor perception of the risk associated with RMBS, other real estate-related securities and various other asset classes in which we may invest. As a result, values of our target assets have experienced

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volatility. Deterioration of the mortgage market and investor perception of the risks associated with RMBS and other residential mortgage assets that we acquire could materially adversely affect our business, financial condition and results of operations and our ability to make distributions to our stockholders.

### ***We are dependent on mortgage servicers and subservicers to service the mortgage loans relating to our Servicing Related Assets.***

Our investments in Servicing Related Assets are dependent on the entity performing the actual servicing of the mortgage loans, called the mortgage servicer, to perform its servicing obligations. As a result, we could be materially and adversely affected if a mortgage servicer is terminated by the applicable Agency. The duties and obligations of mortgage servicers are defined through contractual agreements, which generally provide for the possibility for termination of the mortgage servicer in the absolute discretion of the applicable Agency. In addition, the termination of a mortgage servicer could take effect across all mortgages being serviced by that mortgage servicer. We have three mortgage servicers for the MSRs held by Aurora, one of which is Freedom Mortgage.

We could also be materially and adversely affected if a mortgage servicer is unable to adequately service the underlying mortgage loans due to the following reasons, among others:

- its failure to comply with applicable laws and regulation;
- its failure to perform its loss mitigation obligations;
- a downgrade in its servicer rating;
- its failure to perform adequately in its external audits;
- a failure in or poor performance of its operational systems or infrastructure;
- regulatory or legal scrutiny, enforcement proceedings, consent orders or similar actions regarding any aspect of its operations, including, but not limited to, servicing practices and foreclosure processes lengthening foreclosure timelines; or
- the transfer of servicing to another party.

MSRs are subject to numerous federal, state and local laws and regulations and may be subject to various judicial and administrative decisions imposing various requirements and restrictions on the servicer's business. If any mortgage servicer that we use actually or allegedly fails to comply with applicable laws, rules or regulations, that mortgage servicer could be exposed to fines, penalties or other costs, or the mortgage servicer could be terminated by the applicable Agency. If these laws, regulations and decisions change, we could be exposed to similar fines, penalties or costs. In addition, if a mortgage servicer that we use experiences any of the failures or regulatory scrutiny described above, then we could become subject to heightened regulatory or legal scrutiny by virtue of being a counterparty of these entities. Such scrutiny could result in our incurring meaningful additional costs or fines or being subject to material operational requirements or restrictions, each of which could adversely affect our business and results of operations.

In addition, a bankruptcy by any mortgage servicer that services the mortgage loans for us could result in:

- payments made by such mortgage servicer to us, or obligations incurred by it, being voided by a court under federal or state preference laws or federal or state fraudulent conveyance laws; or
  - any agreement between us and the mortgage servicer being rejected in a bankruptcy proceeding.
- Because we do not and in the future may not have the employees, servicing platforms, or technical resources necessary to service mortgage loans, upon a discontinuance or bankruptcy of any mortgage servicer that we use, we would need to engage an alternate mortgage servicer, which may not be readily available on acceptable terms or at all.

Any of the foregoing events could have a material and adverse effect on us.

***The performance of loans underlying our MSR's may be adversely affected by the performance of the related mortgage servicer.***

The performance of the loans underlying our MSR's is subject to risks associated with inadequate or untimely servicing. If our mortgage servicers commit a material breach of their obligations as a servicer, we may

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be subject to damages if the breach is not cured within a specified period of time following notice. Poor performance by a mortgage servicer may result in greater than expected delinquencies and foreclosures and losses on the mortgage loans underlying our MSR. A substantial increase in our delinquency or foreclosure rate or the inability to process claims could adversely affect our ability to access the capital and secondary markets for our financing needs.

***Our ability to invest in, and dispose of, our investments in Servicing Related Assets may be subject to the receipt of third-party consents.***

The Agencies may require that we submit ourselves to costly or burdensome conditions as a prerequisite to their consent to our investments in Servicing Related Assets. These conditions may diminish or eliminate the investment potential of certain of those assets by making such investments too expensive for us or by severely limiting the potential returns available or otherwise imposing unacceptable conditions. The potential costs, issues or restrictions associated with receiving any such Agency's consent for any such acquisitions or dispositions by us cannot be determined with any certainty. To the extent we are unable to acquire or dispose of Servicing Related Assets when we determine it would be beneficial to do so, our results of operations may be adversely impacted.

***The value of our Servicing Related Assets may vary substantially with changes in interest rates.***

The values of Servicing Related Assets are highly sensitive to changes in interest rates. The value of Servicing Related Assets typically increases when interest rates rise and decreases when interest rates decline due to the effect those changes in interest rates have on prepayment estimates. Subject to qualifying and maintaining our qualification as a REIT, we may pursue various hedging strategies to seek to reduce our exposure to adverse changes in interest rates. Our hedging activity will vary in scope based on the level and volatility of interest rates, the type of assets held and other changing market conditions. Interest rate hedging may fail to protect or could adversely affect us. To the extent we do not utilize derivatives to hedge against changes in the fair value of our Servicing Related Assets, our balance sheet, results of operations and cash flows would be susceptible to significant volatility due to changes in the fair value of, or cash flows from, those assets as interest rates change.

***If delinquencies increase, the value of our Servicing Related Assets may decline significantly.***

Delinquency rates have a significant impact on the value of our Servicing Related Assets. An increase in delinquencies will generally result in lower revenue because, typically, servicers will only collect servicing fees from GSEs or mortgage owners for performing loans. Our expectation of delinquencies is a significant assumption underlying the cash flow projections on the related pools of mortgage loans. If delinquencies are significantly greater than expected, the actual fair value of the Servicing Related Assets could be diminished. As a result, we could suffer a loss.

***Prepayment rates can change, adversely affecting the performance of our assets.***

The frequency at which prepayments (including voluntary prepayments by borrowers, loan buyouts and liquidations due to defaults and foreclosures) occur on mortgage loans is affected by a variety of factors, including the prevailing level of interest rates as well as economic, demographic, tax, social, legal, and other factors. Generally, borrowers tend to prepay their mortgage loans when prevailing mortgage rates fall below the interest rates on their mortgage loans. If borrowers prepay their mortgage loans at rates that are faster or slower than expected, it may adversely affect our results.

We record our Servicing Related Assets on our balance sheet at fair value, and changes in their fair value are reflected in our consolidated results of operations. The determination of the fair value of Servicing Related Assets requires our management to make numerous estimates and assumptions that could materially differ from actual results. Such

estimates and assumptions include, among other things, prepayment rates, as well as estimates of the future cash flows from the Servicing Related Assets, interest rates, delinquencies and foreclosure rates of the underlying mortgage loans. The ultimate realization of the value of the Servicing Related Assets, which are measured at fair value on a recurring basis, may be materially different than the fair values of such assets as may be reflected in our consolidated financial statements as of any particular date. The use of different estimates or assumptions in connection with the valuation of these assets could produce materially different fair values for such assets. Our failure to make accurate assumptions regarding prepayment rates or the other factors



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examined in determining fair value could cause the fair value of our Servicing Related Assets to materially vary, which could have a material adverse effect on our financial position, results of operations and cash flows. If the fair value of our Servicing Related Assets decreases, we would be required to record a non-cash charge, which would have a negative impact on our financial results. Furthermore, a significant increase in prepayment speeds could materially reduce the ultimate cash flows we receive from the Servicing Related Assets, and we could ultimately receive substantially less than what we paid for such assets.

Prepayment rates also affect the fair values of our RMBS. Voluntary prepayment rates generally increase when interest rates fall and decrease when interest rates rise, but changes in prepayment rates are difficult to predict. Prepayments can also occur when borrowers sell the property and use the sale proceeds to prepay the mortgage as part of a physical relocation or when borrowers default on their mortgages and the mortgages are prepaid from the proceeds of a foreclosure sale of the property. Fannie Mae and Freddie Mac will generally purchase mortgages that are 120 days or more delinquent from mortgage-backed securities trusts when the cost of guaranteed payments to security holders, including advances of interest at the security coupon rate, exceeds the cost of holding the nonperforming loans in their portfolios. Ginnie Mae provides the issuer the option to buy loans that are 90 days or more delinquent out of the mortgage-backed securities that it services, which may also contribute to an increase in prepayment rates. Consequently, prepayment rates also may be affected by conditions in the housing and financial markets, which may result in increased delinquencies on mortgage loans. Additionally, changes in the GSEs decisions as to when to repurchase delinquent loans can materially impact prepayment rates.

***Interest rate mismatches between our assets and any borrowings used to fund purchases of our assets may reduce our income during periods of changing interest rates.***

Some of our assets will be fixed-rate securities or have a fixed rate component (such as RMBS backed by hybrid ARMs). This means that the interest we earn on these assets will not vary over time based upon changes in a short-term interest rate index. Although the interest we would earn on any RMBS backed by ARMs generally will adjust for changing interest rates, such interest rate adjustments may not occur as quickly as the interest rate adjustments to any related borrowings, and such interest rate adjustments will generally be subject to interest rate caps, which potentially could cause such RMBS to acquire many of the characteristics of fixed-rate securities if interest rates were to rise above the cap levels. We generally fund our fixed-rate target assets with short-term borrowings. Therefore, there will be an interest rate mismatch between our assets and liabilities. Although we hedge to minimize interest rate exposure, the use of interest rate hedges also introduces the risk of other interest rate mismatches and exposures. During periods of changing interest rates, these mismatches could cause our business, financial condition and results of operations and ability to make distributions to our stockholders to be materially adversely affected.

Ordinarily, short-term interest rates are lower than long-term interest rates. If short-term interest rates rise disproportionately relative to long-term interest rates (a flattening of the yield curve), our borrowing costs may increase more rapidly than the interest income earned on our assets. Because we expect that our investments in RMBS, on average, will bear interest based on longer-term rates than our borrowings, a flattening of the yield curve would tend to decrease our net income and the market value of our assets. Additionally, to the extent cash flows from RMBS are reinvested in new RMBS, the spread between the yields of the new RMBS and available borrowing rates may decline, which could reduce our net interest margin or result in losses. Any one of the foregoing risks could materially adversely affect our business, financial condition and results of operations and our ability to pay distributions to our stockholders. It is also possible that short-term interest rates may exceed long-term interest rates, in which event our borrowing costs may exceed our interest income and we could incur operating losses.

***We cannot predict the impact future actions by regulators or U.S. government bodies, including the U.S. Federal Reserve, will have on our business, and any such actions may negatively impact us.***

Regulators and U.S. government bodies have a major impact on our business. The U.S. Federal Reserve is a major participant in, and its actions significantly impact, the residential mortgage market. For example, quantitative easing, a program implemented by the U.S. Federal Reserve to keep long-term interest rates low and stimulate the U.S. economy, has had the effect of reducing the difference between short-term and long-term interest rates. As a result of the reduction in long-term interest rates, prepayment speeds increased. The U.S. Federal Reserve's purchases of Agency RMBS have resulted in a narrowing of the spread earned by Agency

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RMBS investors. While the U.S. Federal Reserve has discontinued quantitative easing, the effects on the Agency RMBS market have not completely dissipated as the U.S. Federal Reserve continues to reinvest paydowns of its holdings in Agency RMBS. The U.S. Federal Reserve has announced that it expects to cease reinvesting paydowns in April 2018. We cannot predict or control the impact future actions by regulators or U.S. government bodies such as the U.S. Federal Reserve will have on our business. Accordingly, future actions by regulators or U.S. government bodies, including the U.S. Federal Reserve, could have a material and adverse effect on our business, financial condition and results of operations and our ability to pay distributions to our stockholders.

***Interest rate caps on the ARMs and hybrid ARMs that may back our RMBS may reduce our net interest margin during periods of rising interest rates.***

ARMs and hybrid ARMs are typically subject to periodic and lifetime interest rate caps. Periodic interest rate caps limit the amount an interest rate can increase during any given period. Lifetime interest rate caps limit the amount an interest rate can increase through the maturity of the loan. We generally fund our RMBS with borrowings that typically are not subject to similar restrictions. Accordingly, in a period of rapidly increasing interest rates, our financing costs could increase without limitation while caps could limit the interest we earn on the ARMs and hybrid ARMs that will back our RMBS. This problem is magnified for ARMs and hybrid ARMs that are not fully indexed because such periodic interest rate caps prevent the coupon on the security from fully reaching the specified rate in one reset. Further, some ARMs and hybrid ARMs may be subject to periodic payment caps that result in a portion of the interest being deferred and added to the principal outstanding. As a result, we may receive less cash income on RMBS backed by ARMs and hybrid ARMs than necessary to pay interest on our related borrowings. Interest rate caps on RMBS backed by ARMs and hybrid ARMs could reduce our net interest margin if interest rates were to increase beyond the level of the caps, which could materially adversely affect our business, financial condition and results of operations and our ability to pay distributions to our stockholders.

***Our Manager relies on analytical models and other data to analyze potential asset acquisition and disposition opportunities and to manage our portfolio. These models are based on assumptions and the results may differ significantly from actual experience.***

Our Manager relies on analytical models and information and data supplied by third parties. These models and data may be used to value assets or potential asset acquisitions and dispositions and also in connection with our asset management activities. If these models and data prove to be incorrect, misleading or incomplete, any decisions made in reliance thereon could expose us to potential risks. In addition, models are only as accurate as the assumptions that go into building the models. Our Manager's use of models and data may induce it to purchase certain assets at prices that are too high, sell certain other assets at prices that are too low or miss favorable opportunities altogether. Similarly, any hedging activities that are based on faulty models and data may prove to be unsuccessful.

Some models, such as prepayment models or mortgage default models, may be predictive in nature. The use of predictive models has inherent risks. For example, such models may incorrectly forecast future behavior, leading to potential losses. In addition, the predictive models used by our Manager may differ substantially from those models used by other market participants, with the result that valuations based on these predictive models may be substantially higher or lower for certain assets than actual market prices. Furthermore, because predictive models are usually constructed based on historical data supplied by third parties, the success of relying on such models may depend heavily on the accuracy and reliability of the supplied historical data, and, in the case of predicting performance in scenarios with little or no historical precedent (such as extreme broad-based declines in home prices, or deep economic recessions or depressions), such models must employ greater degrees of extrapolation, and are therefore more speculative and of more limited reliability.

All valuation models rely on correct market data inputs. If incorrect market data is entered into even a well-founded valuation model, the resulting valuations will be incorrect. However, even if market data is input correctly, model prices will often differ substantially from market prices, especially for securities with complex characteristics or whose values are particularly sensitive to various factors. If our market data inputs are incorrect or our model prices differ substantially from market prices, our business, financial condition and results of operations and our ability to make distributions to our stockholders could be materially adversely affected.

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***Valuations of some of our assets will be inherently uncertain, may be based on estimates, may fluctuate over short periods of time and may differ from the values that would have been used if a ready market for these assets existed.***

While in many cases our determination of the fair value of our assets is based on valuations provided by third-party dealers and pricing services, we value assets based upon our judgment, and such valuations may differ from those provided by third-party dealers and pricing services. Valuations of certain assets are often difficult to obtain or unreliable. Depending on the complexity and illiquidity of an asset, valuations of the same asset can vary substantially from one dealer or pricing service to another. The valuation process has been particularly difficult recently because market events have made valuations of certain assets unpredictable, and the disparity of valuations provided by third-party dealers has widened. Our business, financial condition and results of operations and our ability to make distributions to our stockholders could be materially adversely affected if our fair value determinations of these assets are materially higher than actual market values.

***An increase in interest rates may cause a decrease in the volume of certain of our target assets, which could adversely affect our ability to acquire target assets that satisfy our investment objectives and to make distributions to our stockholders.***

Rising interest rates generally reduce the demand for mortgage loans due to the higher cost of borrowing. A reduction in the volume of mortgage loans originated may affect the volume of target assets available to us, which could adversely affect our ability to acquire assets that satisfy our investment objectives. Rising interest rates may also cause our target assets that were issued prior to an interest rate increase to provide yields that are below prevailing market interest rates. If rising interest rates cause us to be unable to acquire a sufficient volume of our target assets with a yield that is above our borrowing cost, our ability to satisfy our investment objectives and to make distributions to our stockholders could be materially adversely affected.

***The lack of liquidity of our assets may adversely affect our business, including our ability to sell our assets.***

Mortgage-related assets generally experience periods of illiquidity, including the period of delinquencies and defaults with respect to residential and commercial mortgage loans during the financial crisis. In addition, validating third-party pricing for illiquid assets may be more subjective than with respect to more liquid assets. Any illiquidity of our assets makes it difficult for us to sell such assets if the need or desire arises. In addition, if we are required to liquidate all or a portion of our portfolio quickly, we may realize significantly less than the value at which we previously recorded our assets. Assets that are illiquid are more difficult to finance, and to the extent that we use leverage to finance assets that become illiquid we may lose that leverage or have it reduced. Assets tend to become less liquid during times of financial stress, which is often the time that liquidity is most needed. As a result, our ability to sell assets or vary our portfolio in response to changes in economic and other conditions may be limited by liquidity constraints, which could adversely affect our results of operations and financial condition.

***We use leverage in executing our business strategy, which may adversely affect the return on our assets and may reduce cash available for distribution to our stockholders, as well as increase losses when economic conditions are unfavorable.***

We use leverage to finance our investments in certain of our target assets and to enhance our financial returns. Our primary source of leverage is short-term borrowings under master repurchase agreements collateralized by our RMBS assets. Other sources of leverage include MSR financings and, in the future, may include other credit facilities.

Through the use of leverage, we acquire positions with market exposure significantly greater than the amount of capital committed to the transaction. Although we are not required to maintain any particular minimum or maximum target debt-to-equity leverage ratio with respect to our RMBS assets, the amount of leverage we may employ for this

asset class will depend upon the availability of particular types of financing and our Manager's assessment of the credit, liquidity, price volatility, financing counterparty risk and other factors. Our Manager has discretion, without the need for further approval by our board of directors, to change the amount of leverage we utilize for our RMBS. We do not have a targeted debt-to-equity ratio for our RMBS. We use leverage for the primary purpose of financing our RMBS portfolio and not for the purpose of speculating on changes in interest rates. We may, however, be limited or restricted in the amount of leverage we may employ by the terms and provisions of any financing or other agreements that we may enter into in the future, and we are subject to margin calls as a result of our financing activity.

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Our ability to achieve our investment and leverage objectives depends on our ability to borrow money in sufficient amounts and on favorable terms. In particular, our ability to execute on our prime mortgage loan strategy and our ability to build a significant servicing portfolio is dependent on obtaining sufficient financing on attractive terms. In addition, we must be able to renew or replace our maturing borrowings on a continuous basis. In recent years, investors and financial institutions that lend in the securities repurchase market have tightened lending standards in response to the difficulties and changed economic conditions that have materially adversely affected the RMBS market. These market disruptions have been most pronounced in the non-Agency RMBS market, but the impact has also extended to Agency RMBS, which has made the value of these assets unstable and relatively illiquid compared to prior periods. This could potentially increase our financing costs and reduce our liquidity. In addition, because we rely on short-term financing, we are exposed to changes in the availability of financing which may make it more difficult for us to secure continued financing.

Leverage magnifies both the gains and the losses of our positions. Leverage increases our returns as long as we earn a greater return on investments purchased with borrowed funds than our cost of borrowing such funds. However, if we use leverage to acquire an asset and the value of the asset decreases, the leverage may increase our loss. Even if the asset increases in value, if the asset fails to earn a return that equals or exceeds our cost of borrowing, the leverage will decrease our returns.

We are required to post large amounts of cash as collateral or margin to secure our leveraged RMBS positions. In the event of a sudden, precipitous drop in value of our financed assets, we might not be able to liquidate assets quickly enough to repay our borrowings, further magnifying losses. Even a small decrease in the value of a leveraged asset may require us to post additional margin or cash collateral. Our debt service payments and posting of margin or cash collateral will reduce cash flow available for distribution to stockholders. We may not be able to meet our debt service obligations. To the extent that we cannot meet our debt service obligations, we risk the loss of some or all of our assets to sale to satisfy our debt obligations.

To the extent we might be compelled to liquidate qualifying real estate assets to repay debts, our compliance with the REIT rules regarding our assets and our sources of income could be negatively affected, which could jeopardize our qualification as a REIT. Failing to qualify as a REIT would cause us to be subject to U.S. federal income tax (and any applicable state and local taxes) on all of our income and decrease profitability and cash available for distributions to stockholders.

***Adverse market developments generally will cause our lenders to require us to pledge cash as additional collateral. If our assets were insufficient to meet these collateral requirements, we might be compelled to liquidate particular assets at inopportune times and at unfavorable prices.***

Adverse market developments, including a sharp or prolonged rise in interest rates, a change in prepayment rates or increasing market concern about the value or liquidity of one or more types of our target assets, might reduce the market value of our portfolio, which generally will cause our lenders to initiate margin calls. A margin call means that the lender requires us to pledge cash as additional collateral to re-establish the ratio of the value of the collateral to the amount of the borrowing. If we are unable to satisfy margin calls, our lenders may foreclose on our collateral. The liquidation of collateral may jeopardize our ability to qualify as a REIT. Our failure to qualify as a REIT would cause us to be subject to U.S. federal income tax (and any applicable state and local taxes) on all of our income and decrease profitability and cash available for distribution to our stockholders.

***Our use of repurchase transactions gives our lenders greater rights in the event that we file for bankruptcy, which may make it difficult for us to recover our collateral in the event of a bankruptcy filing.***

Our borrowings under master repurchase agreements are intended to qualify for special treatment under the bankruptcy code, giving our lenders the ability to void the automatic stay provisions of the bankruptcy code and take possession of and liquidate collateral pledged in our repurchase transactions without delay if we file for bankruptcy. Furthermore, the special treatment of repurchase agreements under the bankruptcy code may make it difficult for us to recover our pledged assets in the event that any of our lenders files for bankruptcy. Thus, the use of repurchase transactions exposes our pledged assets to risk in the event of a bankruptcy filing by either our lenders or us.



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***If our lenders default on their obligations to resell the RMBS back to us at the end of the repurchase transaction term, the value of the RMBS has declined by the end of the repurchase transaction term or we default on our obligations under the repurchase transaction, we will lose money on these transactions, which, in turn, may materially adversely affect our business, financial condition and results of operations and our ability to pay distributions to our stockholders.***

When we engage in a repurchase transaction, we initially sell securities to the financial institution in exchange for cash, and our counterparty is obligated to resell the securities to us at the end of the term of the transaction, which is typically from 30 to 180 days, but which may be up to 364 days or more. The cash we receive when we initially sell the securities is less than the value of those securities. This difference is referred to as the haircut. If these haircuts are increased, we will be required to post additional cash collateral for our RMBS. If our counterparty defaults on its obligation to resell the securities to us, we would incur a loss on the transaction equal to the amount of the haircut (assuming there was no change in the value of the securities). See Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources for information regarding borrowings under the Company's repurchase agreements.

If we default on one of our obligations under a repurchase transaction, the counterparty can terminate the transaction and cease entering into any other repurchase transactions with us. Such a default also would constitute a default under many of our financing agreements with other counterparties. In that case, there is no assurance we would be able to establish a suitable replacement facility on acceptable terms or at all.

***Hedging against interest rate changes and other risks may materially adversely affect our business, financial condition and results of operations and our ability to make distributions to our stockholders.***

Subject to maintaining our qualification as a REIT and exemption from registration under the Investment Company Act, we pursue various hedging strategies to seek to reduce our exposure to adverse changes in interest rates. Our hedging activity varies in scope based on the level and volatility of interest rates, the types of liabilities and assets held and other changing market conditions. Interest rate hedging may fail to protect or could adversely affect us because, among other things:

- interest rate hedging can be expensive, particularly during periods of rising and volatile interest rates;
  - available interest rate hedges may not correspond directly with the interest rate risk for which protection is sought;
  - the duration of the hedge may not match the duration of the related assets or liabilities being hedged;
    - to the extent hedging transactions do not satisfy certain provisions of the Code, and are not made through a TRS, the amount of income that a REIT may earn from hedging transactions to offset interest rate losses is limited by U.S. federal tax provisions governing REITs;
  - the value of derivatives used for hedging may be adjusted from time to time in accordance with accounting rules to reflect changes in fair value. Downward adjustments or mark-to-market losses would reduce our total stockholders' equity;
  - the credit quality of the hedging counterparty owing money on the hedge may be downgraded to such an extent that it impairs our ability to sell or assign our side of the hedging transaction; and
  - the hedging counterparty owing money in the hedging transaction may default on its obligation to pay.
- Our hedging transactions, which are intended to limit losses, may actually adversely affect our earnings, which could reduce our cash available for distribution to our stockholders.

***Changes in regulations relating to swaps activities may cause us to limit our swaps activity or subject us and our Manager to additional disclosure, recordkeeping, and other regulatory requirements.***

The enforceability of agreements underlying hedging transactions may depend on compliance with applicable statutory and commodity and other regulatory requirements and, depending on the identity of the counterparty, applicable international requirements. Recently, new regulations have been promulgated by U.S. and foreign regulators attempting to strengthen oversight of derivative contracts. Any actions taken by regulators could constrain our strategy and could increase our costs, either of which could materially and adversely affect our business, financial condition and results of operations and our ability to make distributions to our stockholders. In particular, the Dodd-Frank Act requires most derivatives to be executed on a regulated market and cleared through a central counterparty, which has resulted in increased margin requirements and costs. On

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December 7, 2012, the CFTC issued a no-action letter that provides mortgage REITs relief from such registration, or the MREIT No-Action Letter, if they meet certain conditions and submit a claim for such no-action relief. We believe we meet the conditions set forth in the MREIT No-Action Letter, and we have filed our claim with the CFTC to perfect the use of the no-action relief from registration. However, if in the future we do not meet the conditions set forth in the MREIT No-Action Letter or the relief provided by the MREIT No-Action Letter becomes unavailable for any other reason, we may need to seek to obtain another exemption from registration or we may be required to register as a commodity pool operator with the CFTC. If we are required to register with the CFTC as a commodity pool operator, we would become subject to additional disclosure, recordkeeping and reporting requirements, which may increase our expenses or otherwise limit our ability to conduct our business as contemplated.

***We may change our investment strategy, investment guidelines and asset allocation without notice or stockholder consent, which may result in riskier investments. In addition, our charter provides that our board of directors may authorize us to revoke or otherwise terminate our REIT election, without the approval of our stockholders.***

Our board of directors has the authority to change our investment strategy or asset allocation at any time without notice to or consent from our stockholders. To the extent that our investment strategy changes in the future, we may make investments that are different from, and possibly riskier than, the investments described in this Annual Report and the other documents we file with the SEC from time to time. A change in our investment or leverage strategy may increase our exposure to interest rate and real estate market fluctuations or require us to sell a portion of our existing investments, which could result in gains or losses and therefore increase our earnings volatility. Decisions to employ additional leverage in executing our investment strategies could increase the risk inherent in our asset acquisition strategy. Furthermore, a change in our asset allocation could result in our allocating assets in a different manner than as described in this Annual Report.

In addition, our charter provides that our board of directors may authorize us to revoke or otherwise terminate our REIT election, without the approval of our stockholders, if it determines that it is no longer in our best interests to qualify as a REIT. These changes could adversely affect our financial condition, results of operations, the market value of our common or preferred stock, and our ability to make distributions to our stockholders.

***We operate in a highly competitive market.***

Our profitability depends, in large part, on our ability to acquire targeted assets at favorable prices. We compete with a number of entities when acquiring our targeted assets, including other mortgage REITs, financial companies, public and private funds, commercial and investment banks and residential and commercial finance companies. We may also compete with the U.S. Federal Reserve and the U.S. Treasury to the extent they purchase assets in our targeted asset classes. Many of our competitors are substantially larger and have considerably greater access to capital and other resources than we do. Furthermore, new companies with significant amounts of capital have recently been formed or have raised additional capital, and may continue to be formed and raise additional capital in the future, and these companies may have objectives that overlap with ours, which may create competition for assets we wish to acquire. Some competitors may have a lower cost of funds and access to funding sources that are not available to us. In addition, some of our competitors may have higher risk tolerances or different risk assessments, which could allow them to consider a wider variety of assets to acquire and establish more relationships than us. We also may have different operating constraints from those of our competitors including, among others, (i) tax-driven constraints such as those arising from our qualification as a REIT, (ii) restraints imposed on us by our efforts to comply with certain exclusions or exemptions from the definition of an investment company and (iii) restraints and additional costs arising from our status as a public company. Furthermore, competition for assets in our targeted asset classes may lead to the price of such assets increasing, which may further limit our ability to generate desired returns. We cannot assure you that the competitive pressures we face will not have a material adverse effect on our business, financial condition and results of operations.

***Our ability to make distributions to our stockholders depends on our operating results, our financial condition and other factors, and we may not be able to make regular cash distributions at a fixed rate or at all under certain circumstances.***

We intend to continue to distribute to our stockholders all or substantially all of our REIT taxable income in each year (subject to certain adjustments). This distribution policy will enable us to avoid being subject to U.S.

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federal income tax on our taxable income that we distribute to our stockholders. However, our ability to make distributions will depend on our earnings, applicable law, our financial condition and such other factors as our board of directors may deem relevant from time to time. We will declare and make distributions to our stockholders only to the extent approved by our board of directors.

### ***Residential whole mortgage loans are subject to increased risks.***

We may acquire and manage pools of residential whole mortgage loans. Residential whole mortgage loans are subject to increased risks of loss. Unlike Agency RMBS, whole mortgage loans generally are not guaranteed by the U.S. Government or any GSE, though in some cases they may benefit from private mortgage insurance. Additionally, by directly acquiring whole mortgage loans, we do not receive the structural credit enhancements that benefit senior tranches of CMOs. A whole mortgage loan is directly exposed to losses resulting from default. Therefore, the value of the underlying property, the creditworthiness and financial position of the borrower and the priority and enforceability of the lien will significantly impact the value of such mortgage loan. In the event of a foreclosure, we may assume direct ownership of the underlying real estate. The liquidation proceeds upon sale of such real estate may not be sufficient to recover our cost basis in the loan, and any costs or delays involved in the foreclosure or liquidation process may increase losses.

Whole mortgage loans are also subject to special hazard risk (property damage caused by hazards, such as earthquakes or environmental hazards, not covered by standard property insurance policies), and to bankruptcy risk (reduction in a borrower's mortgage debt by a bankruptcy court). In addition, claims may be assessed against us on account of our position as a mortgage holder or property owner, including assignee liability, responsibility for tax payments, environmental hazards and other liabilities. In some cases, these liabilities may be recourse liabilities or may otherwise lead to losses in excess of the purchase price of the related mortgage or property.

### **Risks Related to Our Relationship with our Manager and Freedom Mortgage**

#### ***Our Manager has limited experience operating a REIT, and we cannot assure you that our Manager's past experience will be sufficient to successfully manage our business as a REIT.***

Our Manager has limited experience operating a REIT. The REIT provisions of the Code are complex, and any failure to comply with those provisions in a timely manner could prevent us from qualifying as a REIT or force us to pay unexpected taxes and penalties. In such event, our net income would be reduced, and we could incur a loss.

#### ***Our Manager has limited experience operating a public company or complying with regulatory requirements, including the Sarbanes-Oxley Act, which may hinder its ability to achieve our objectives.***

Prior to our commencement of operations in October 2013, our Manager had no experience operating a public company or complying with regulatory requirements, including the Sarbanes-Oxley Act. Our Manager's inexperience may hinder our Manager's ability to achieve our objectives, and we cannot assure you that we will be able to successfully execute our business strategies as a public company or comply with regulatory requirements applicable to public companies.

#### ***We are dependent on our Manager and certain key personnel that are or will be provided to us through our Manager and may not find a suitable replacement if our Manager terminates the management agreement or such key personnel are no longer available to us.***

We do not have any employees of our own other than four employees of our licensed mortgage servicing subsidiary, Aurora. We are completely reliant on our Manager, which has significant discretion as to the implementation of our

operating policies and execution of our business strategies and risk management practices. The departure of Messrs. Lown or Levine or other senior officers could have a material adverse effect on our ability to achieve our objectives.

We can offer no assurance that our Manager will remain our manager or that we will continue to have access to our Manager's senior management. We are subject to the risk that our Manager will terminate the management agreement or that we may deem it necessary to terminate the management agreement or prevent certain individuals from performing services for us and that no suitable replacement will be found to manage us.

If our management agreement is terminated and no suitable replacement is found to manage us or we are unable to find a suitable replacement on a timely basis, we may not be able to continue to execute our business

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strategy. No assurances can be given that our Manager will act in our best interests with respect to the allocation of personnel, services and resources to our business. The failure of any of the key personnel of our Manager to service our business with the requisite time and dedication could materially and adversely affect our ability to execute our business plan.

***The management fee payable to our Manager is payable regardless of the performance of our portfolio, which may reduce our Manager's incentive to devote the time and effort to seeking profitable opportunities for our portfolio.***

We pay our Manager a management fee, which may be substantial, based on our stockholders' equity (as defined in the management agreement) regardless of the performance of our portfolio. The management fee takes into account the net issuance proceeds of both common and preferred stock offerings, as well as issuances of equity securities by our Operating Partnership. Our Manager's entitlement to non-performance-based compensation might reduce its incentive to devote the time and effort of its professionals to seeking profitable opportunities for our portfolio, which could result in a lower performance of our portfolio and materially adversely affect our business, financial condition and results of operations.

***Our investment guidelines are very broad, and our board of directors will not approve each decision made by our Manager to acquire, dispose of, or otherwise manage an asset.***

Our Manager is authorized to follow very broad guidelines in pursuing our strategy. Our board of directors will periodically review our portfolio and asset-management decisions. However, it generally will not review all of our proposed acquisitions, dispositions and other management decisions. In addition, in conducting periodic reviews, our board of directors will rely primarily on information provided to it by our Manager. Furthermore, our Manager may arrange for us to use complex strategies or to enter into complex transactions that may be difficult or impossible to unwind by the time they are reviewed by our board of directors. Our Manager has great latitude within the broad guidelines in determining the types of assets it may decide are proper for us to acquire and other decisions with respect to the management of those assets subject to our maintaining our qualification as a REIT. Poor decisions could have a material adverse effect on our business, financial condition and results of operations and our ability to make distributions to our stockholders.

***There will be conflicts of interest in our relationships with our Manager and Freedom Mortgage, which could result in decisions that are not in the best interests of our stockholders.***

Our Manager is a Delaware limited liability company established by Mr. Middleman. The Manager is a party to a services agreement with Freedom Mortgage, which is wholly owned and controlled by Mr. Middleman. The Manager is owned by a blind trust for the benefit of Mr. Middleman.

We are dependent on our Manager for our day-to-day management and operations. In turn, the Manager is dependent on the performance of Freedom Mortgage under the services agreement. Various potential and actual conflicts of interest may arise from the activities of Freedom Mortgage and its affiliates by virtue of this relationship. The ability of our Manager's officers and personnel, with the exception of those officers that are dedicated to us, to engage in other business activities may reduce the time our Manager and certain of its officers and personnel spend managing us.

Our management agreement with our Manager was negotiated between related parties, and its terms may not be as favorable to us as if it had been negotiated on an arm's-length basis with an unrelated third party. Furthermore, we may choose not to enforce, or to enforce less vigorously, our rights under this or other agreements with Freedom Mortgage because of our desire to maintain our ongoing relationships with Freedom Mortgage and our Manager. In the future, Freedom Mortgage may sponsor other vehicles that invest in Excess MSR's or prime loans or other investments, and there may be situations where we compete with Freedom Mortgage or its affiliates for opportunities to acquire MSR's

or prime mortgage loans or other assets. Freedom Mortgage is a separate and distinct company with its own business interests and will be under no obligation to maintain its current business strategy. Freedom Mortgage will be under no obligation to offer MSR's or other assets to us, and Freedom Mortgage may offer those assets to third parties without offering such assets to us.

In addition, there may be conflicts of interest inherent in our relationship with Freedom Mortgage through our Manager to the extent Freedom Mortgage or our Manager invests in or creates new vehicles to invest in assets in which we may invest or whose investment objectives overlap with our investment objectives. Certain



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investments appropriate for us may also be appropriate for one or more of these other investment vehicles. Members of our board of directors may serve as officers and/or directors of these other entities. In addition, in the future, our Manager or its affiliates may have investments in and/or earn fees from such other investment vehicles that are higher than their economic interests in us and which may therefore create an incentive to allocate investments to such other investment vehicles.

Our management agreement with our Manager generally does not limit or restrict our Manager or its affiliates from engaging in any business or managing other pooled investment vehicles that invest in investments that meet our investment objectives, except that under our management agreement neither our Manager nor any entity controlled by or under common control with our Manager is permitted to raise or sponsor any new pooled investment vehicle whose investment policies, guidelines or plans target as its primary investment category investments in Excess MSRs.

The ability of our Manager and its officers and employees to engage in other business activities, subject to the terms of our management agreement with our Manager, may reduce the amount of time our Manager, its officers or other employees spend managing us. In addition, we may engage (subject to our investment guidelines) in material transactions with Freedom Mortgage or our Manager, including, but not limited to, certain financing arrangements, co-investments in, or purchases of, MSRs or other assets, that present an actual, potential or perceived conflict of interest. It is possible that actual, potential or perceived conflicts could give rise to investor dissatisfaction, litigation or regulatory enforcement actions. Appropriately dealing with conflicts of interest is complex and difficult, and our reputation could be damaged if we fail, or appear to fail, to deal appropriately with one or more potential, actual or perceived conflicts of interest. Regulatory scrutiny of, or litigation in connection with, conflicts of interest could have a material adverse effect on our reputation, which could materially adversely affect our business in a number of ways, including causing an inability to raise additional funds, a reluctance of counterparties to do business with us, a decrease in the prices of our common or preferred securities and a resulting increased risk of litigation and regulatory enforcement actions.

***The management agreement with our Manager was not negotiated on an arm's-length basis and may not be as favorable to us as if it had been negotiated with an unaffiliated third party and may be costly and difficult to terminate.***

The management agreement that we have entered into with our Manager was negotiated between related parties, and its terms, including fees payable, may not be as favorable to us as if it had been negotiated with an unaffiliated third party. Various potential and actual conflicts of interest may arise from the activities of Freedom Mortgage and its affiliates.

Termination of our management agreement without cause is subject to several conditions which may make such a termination difficult and a significant termination fee could be payable by us. That fee will increase the effective cost to us of terminating the management agreement, thereby adversely affecting our ability to terminate our Manager without cause.

Pursuant to the management agreement, our Manager will not assume any responsibility other than to render the services called for thereunder and will not be responsible for any action of our board of directors in following or declining to follow the Manager's advice or recommendations. Under the terms of the management agreement, our Manager, Freedom Mortgage, and their affiliates and each of their officers, directors, trustees, members, stockholders, partners, managers, Investment Committee members, employees, agents, successors and assigns, will not be liable to us for acts or omissions performed in accordance with and pursuant to the management agreement, except because of acts constituting bad faith, willful misconduct, gross negligence, fraud or reckless disregard of their duties under the management agreement. In addition, we will indemnify our Manager, Freedom Mortgage, and their affiliates and each of their officers, directors, trustees, members, stockholders, partners, managers, Investment Committee members,

employees, agents, successors and assigns, with respect to all expenses, losses, damages, liabilities, demands, charges and claims arising from acts of our Manager not constituting bad faith, willful misconduct, gross negligence, fraud or reckless disregard of duties, performed in good faith in accordance with and pursuant to the management agreement.

***If our Manager ceases to be our Manager pursuant to the management agreement, our lenders and our derivative counterparties may cease doing business with us.***

If our Manager ceases to be our Manager, it would constitute an event of default or early termination event under many of our financing and hedging agreements, upon which our counterparties would have the right to

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terminate their agreements with us. If our Manager ceases to be our Manager for any reason, including upon the non-renewal of our management agreement, and we are unable to obtain financing or enter into or maintain derivative transactions, our business, financial condition and results of operations and our ability to make distributions to our stockholders may be materially adversely affected.

### **Risks Related to Our Organizational Structure**

#### ***Maintenance of our exclusion from regulation as an investment company under the Investment Company Act imposes significant limitations on our operations.***

We intend to continue to conduct our operations so that neither we nor any of our subsidiaries is required to register as an investment company under the Investment Company Act. We conduct our business primarily through our Operating Partnership and its wholly-owned subsidiaries. The securities issued by our subsidiaries that are excluded from the definition of investment company under Section 3(c)(7) of the Investment Company Act, together with other investment securities we may own, cannot exceed 40% of the value of all of our assets (excluding U.S. Government securities and cash) on an unconsolidated basis. This requirement limits the types of businesses in which we may engage and the assets we may hold. Certain of our subsidiaries rely on the exclusion provided by Section 3(c)(5)(C) under the Investment Company Act which is designed for entities primarily engaged in the business of purchasing or otherwise acquiring mortgages and other liens on and interests in real estate. This exclusion generally requires that at least 55% of the entity's assets on an unconsolidated basis consist of qualifying real estate interests and at least 80% of the entity's assets consist of qualifying real estate interests or real estate-related assets. These requirements limit the assets those subsidiaries can own and the timing of sales and purchases of those assets.

To classify the assets held by our subsidiaries as qualifying real estate interests or real estate-related assets, we rely on no-action letters and other guidance published by the SEC staff regarding those kinds of assets, as well as upon our analyses (in consultation with outside counsel) of guidance published with respect to other types of assets. There can be no assurance that the laws and regulations governing the Investment Company Act status of companies similar to ours, or the guidance from the SEC or its staff regarding the treatment of assets as qualifying real estate interests or real estate-related assets, will not change in a manner that adversely affects our operations. To the extent that the SEC staff provides more specific guidance regarding any of the matters bearing upon our exemption from the need to register under the Investment Company Act, we may be required to adjust our strategy accordingly. Any additional guidance from the SEC staff could further inhibit our ability to pursue the strategies that we have chosen. Furthermore, although we intend to monitor the assets of our subsidiaries regularly, there can be no assurance that our subsidiaries will be able to maintain their exclusion from registration. Any of the foregoing could require us to adjust our strategy, which could limit our ability to make certain investments or require us to sell assets in a manner, at a price or at a time that we otherwise would not have chosen. This could negatively affect the value of our common or preferred stock, the sustainability of our business model and our ability to make distributions.

#### ***The ownership limits in our charter may discourage a takeover or business combination that may have benefited our stockholders.***

To assist us in qualifying as a REIT, among other purposes, our charter generally limits, unless waived by our board of directors, the beneficial or constructive ownership of any class of our stock by any person, other than Mr. Middleman, to no more than 9.0% in value or the number of shares, whichever is more restrictive, of the outstanding shares of any class or series of our stock. This and other restrictions on ownership and transfer of our shares of stock contained in our charter may discourage a change of control of us and may deter individuals or entities from making tender offers for our common stock on terms that might be financially attractive to you or which may cause a change in our management. In addition to deterring potential transactions that may be favorable to our stockholders, these provisions may also decrease your ability to sell our common stock.

*Our stockholders ability to control our operations is severely limited.*

Our board of directors approves our major strategies, including our strategies regarding investments, financing, growth, debt capitalization, REIT qualification and distributions. Our board of directors may amend or revise these and other strategies without a vote of our stockholders.

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***Certain provisions of Maryland law could inhibit a change in our control.***

Certain provisions of the Maryland General Corporation Law, or the MGCL, may have the effect of inhibiting a third party from making a proposal to acquire us or impeding a change of control under circumstances that otherwise could provide our stockholders with the opportunity to realize a premium over the then-prevailing market price of our common stock, including:

business combination provisions that, subject to limitations, prohibit certain business combinations between us and an interested stockholder (defined generally as any person who beneficially owns 10% or more of the voting power of our outstanding voting stock or an affiliate or associate of ours who, at any time within the two-year period immediately prior to the date in question, was the beneficial owner of 10% or more of the voting power of our then-outstanding stock) or an affiliate of an interested stockholder for five years after the most recent date on which the stockholder became an interested stockholder, and thereafter require two supermajority stockholder votes to approve any such combination; and

control share provisions that provide that a holder of control shares of the Company (defined as voting shares of stock which, when aggregated with all other shares of stock owned by the acquiror or in respect of which the acquiror is able to exercise or direct the exercise of voting power (except solely by virtue of a revocable proxy), entitle the acquiror to exercise one of three increasing ranges of voting power in electing directors) acquired in a control share acquisition (defined as the direct or indirect acquisition of ownership or control of issued and outstanding control shares, subject to certain exceptions) generally has no voting rights with respect to the control shares except to the extent approved by our stockholders by the affirmative vote of two-thirds of all the votes entitled to be cast on the matter, excluding all interested shares.

We have elected to opt-out of these provisions of the MGCL, in the case of the business combination provisions, by resolution of our board of directors exempting any business combination between us and any other person (provided that such business combination is first approved by our board of directors, including a majority of our directors who are not affiliates or associates of such person), and, in the case of the control share provisions, pursuant to a provision in our bylaws. However, our board of directors may by resolution elect to repeal the foregoing opt-out from the business combination provisions of the MGCL, and we may, by amendment to our bylaws, opt in to the control share provisions of the MGCL in the future.

***Our authorized but unissued common and preferred stock may prevent a change in our control.***

Our charter authorizes us to issue additional authorized but unissued common stock and preferred stock without stockholder approval. In addition, our board of directors may, without stockholder approval, (i) amend our charter to increase or decrease the aggregate number of our shares of stock or the number of shares of any class or series of stock that we have authority to issue, (ii) classify or reclassify any unissued common stock or preferred stock and set the preferences, rights and other terms of the classified or reclassified shares. As a result, among other things, our board may establish a class or series of common stock or preferred stock that could delay or prevent a transaction or a change in our control that might involve a premium price for our common stock or otherwise be in the best interests of our stockholders.

***Our rights and the rights of our stockholders to take action against our directors and officers are limited, which could limit your recourse in the event of actions not in your best interest.***

Our charter limits the liability of our present and former directors and officers to us and our stockholders for money damages to the maximum extent permitted under Maryland law. Under current Maryland law, our present and former directors and officers will not have any liability to us or our stockholders for money damages other than liability resulting from:

• actual receipt of an improper benefit or profit in money, property or services; or  
• active and deliberate dishonesty by the director or officer that was established by a final judgment and is material to the cause of action.

In addition, our charter authorizes us to indemnify our present and former directors and officers for actions taken by them in those and other capacities to the maximum extent permitted by Maryland law and our bylaws require us to indemnify our present and former directors and officers, to the maximum extent permitted by

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Maryland law, in the defense of any proceeding to which he or she is made, or threatened to be made, a party by reason of his or her service to us as a director or officer in these and other capacities. In addition, we may be obligated to pay or reimburse the expenses incurred by our present and former directors and officers without requiring a preliminary determination of their ultimate entitlement to indemnification. As a result, we and our stockholders may have more limited rights against our present and former directors and officers than might otherwise exist absent the current provisions in our charter and bylaws or that might exist with other companies, which could limit your recourse in the event of actions not in your best interests.

***Our charter contains provisions that make removal of our directors difficult, which could make it difficult for our stockholders to effect changes to our management.***

Our charter provides that, subject to the rights of holders of one or more classes or series of preferred stock to elect or remove one or more directors, a director may be removed only for cause (as defined in our charter), and then only by the affirmative vote of at least two-thirds of the votes entitled to be cast generally in the election of directors. Vacancies may be filled only by a majority of the remaining directors in office, even if less than a quorum, for the full term of the directorship in which the vacancy occurred (other than vacancies among any directors elected by the holder or holders of any class or series of preferred stock, if such right exists). These requirements make it more difficult to change our management by removing and replacing directors and may prevent a change in our control that is in the best interests of our stockholders.

### **Risks Related to Our Common Stock**

***The market price and trading volume of our common stock may be volatile.***

The market price of our common stock may be highly volatile and subject to wide fluctuations. In addition, the trading volume in our common stock may fluctuate and cause significant price variations to occur. The stock market has experienced price and volume fluctuations that have affected the market price of many companies in industries similar or related to ours and that have been unrelated to these companies' operating performances. If the market price of our common stock declines significantly, you may be unable to resell your shares at a gain. Further, fluctuations in the trading price of our common stock may adversely affect the liquidity of the trading market for our common stock and, in the event that we seek to raise capital through future equity financings, our ability to raise such equity capital.

We cannot assure you that the market price of our common stock will not fluctuate or decline significantly in the future. Some of the factors that could negatively affect our share price or result in fluctuations in the price or trading volume of our common stock include:

- actual or anticipated variations in our quarterly operating results;
- increases in market interest rates that lead purchasers of our common stock to demand a higher yield or to seek alternative investments;
- changes in market valuations of similar companies;
- adverse market reaction to any increased indebtedness we incur in the future;
- additions or departures of key personnel;
- actions by stockholders;
- speculation in the press or investment community;
- general market, economic and political conditions and the impact of these conditions on the global credit markets;
- the operating performance of other similar companies;
- changes in accounting principles; and
- passage of legislation or other regulatory developments that adversely affect us or our industry.





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***For as long as we are an emerging growth company, we will not be required to comply with certain reporting requirements, including those relating to accounting standards and disclosure about our executive compensation, that apply to other public companies.***

We are an emerging growth company, as defined in Section 2(a) of the Securities Act, as modified by the Jumpstart Our Business Startups Act (the JOBS Act). As such, we are eligible to take advantage of certain exemptions from various reporting requirements that are applicable to other public companies that are not emerging growth companies, including, but not limited to, not being required to comply with the auditor attestation requirements of Section 404(b) of the Sarbanes-Oxley Act, reduced disclosure obligations regarding executive compensation in our periodic reports and proxy statements and exemptions from the requirements of holding a non-binding advisory vote on executive compensation and of stockholder approval of any golden parachute payments not previously approved. To the extent we continue to take advantage of any of these exemptions, we do not know if some investors will find our common stock less attractive as a result. The result may be a less active trading market for our common stock, and our stock price may be more volatile.

We could remain an emerging growth company until December 31, 2018, which is the last day of the fiscal year following the fifth anniversary of the IPO, or until the earliest of (a) the last day of the first fiscal year in which our annual gross revenues exceed \$1.07 billion, (b) the date that we become a large accelerated filer as defined in Rule 12b-2 under the Exchange Act, which would occur if the market value of our common stock that is held by non-affiliates exceeds \$700 million as of the last business day of our most recently completed second fiscal quarter, or (c) the date on which we have issued more than \$1 billion in non-convertible debt securities during the preceding three-year period.

In addition, pursuant to Section 107 of the JOBS Act, as an emerging growth company, we are permitted to take advantage of the extended transition period provided in Section 7(a)(2)(B) of the Securities Act for complying with new or revised accounting standards, which would allow us to delay the adoption of certain accounting standards until those standards would otherwise apply to private companies. We have elected to take advantage of the benefits of this extended transition period. This election is irrevocable. As a result of our election to utilize the extended transition period, our financial statements may not be comparable to those of other public companies that comply with such new or revised accounting standards. Please refer to Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations—Critical Accounting Policies and Use of Estimates—Emerging Growth Company Status for further discussion of our election to utilize the extended transition period for complying with new or revised accounting standards.

***Future sales of our common stock or securities convertible into our common stock could cause the market value of our common stock to decline and could result in dilution of your shares.***

Sales of substantial amounts of shares of our common stock or securities convertible into our common stock could cause the market price of our common stock to decrease significantly. We cannot predict the effect, if any, of future sales of our common stock or securities convertible into our common stock, or the availability of shares of our common stock for future sales, on the value of our common stock. Sales of substantial amounts of shares of our common stock or securities convertible into our common stock, or the perception that such sales could occur, may adversely affect prevailing market values for our common stock.

***Future offerings of debt securities, which would rank senior to our common stock upon our liquidation, and future offerings of equity securities, which would dilute the common stock holdings of our existing stockholders and may be senior to our common stock for the purposes of dividend and liquidating distributions, may adversely affect the market price of our common stock.***

In the future, we may attempt to increase our capital resources by making offerings of debt or additional offerings of equity securities, including commercial paper, medium-term notes, senior or subordinated notes and classes of preferred stock or common stock. Upon liquidation, holders of our debt securities and shares of preferred stock and lenders with respect to other borrowings will receive a distribution of our available assets prior to the holders of our common stock. Additional equity offerings may dilute the holdings of our existing stockholders or reduce the market price of our common stock, or both. Our preferred stock could have a preference on liquidating distributions or a preference on dividend payments that could limit our ability to make a dividend distribution to the holders of our common stock. Because our decision to issue securities in any future offering will depend on market conditions and other factors beyond our control, we cannot predict or estimate the amount, timing or nature of our future offerings. Thus, holders of our common stock bear the risk of our future offerings reducing the market price of our common stock and diluting their stock holdings in us.

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### ***Broad market fluctuations could negatively impact the market price of our common stock.***

The stock market has experienced extreme price and volume fluctuations that have affected the market price of many companies in industries similar or related to ours and that have been unrelated to these companies' operating performances. These broad market fluctuations could reduce the market price of our common stock. Furthermore, our operating results and prospects may be below the expectations of public market analysts and investors or may be lower than those of companies with comparable market capitalizations, which could lead to a material decline in the market price of our common stock.

### ***We have not established a minimum distribution payment level with respect to our common stock, and we cannot assure you of our ability to make distributions in the future.***

We expect to make regular distributions to holders of our common stock and preferred stock in amounts such that we distribute all or substantially all of our REIT taxable income in each year. We have not established a minimum distribution payment level with respect to our common stock, and our ability to make distributions may be adversely affected by a number of factors, including the risk factors described in this report. All distributions will be made at the discretion of our board of directors and will depend on our earnings, our financial condition, debt covenants, maintenance of our REIT qualification, applicable law and other factors as our board of directors may deem relevant from time to time.

No assurance can be given that the level of any distributions we make to our stockholders will achieve a market yield or increase or even be maintained over time, any of which could materially and adversely affect the market price of our common stock. In addition, some of our distributions may include a return of capital, which would reduce the amount of capital available to operate our business.

Distributions that we make to our stockholders will generally be taxable to our stockholders as ordinary income. However, a portion of our distributions may be designated by us as long-term capital gains to the extent that they are attributable to capital gain income recognized by us or may constitute a return of capital to the extent that they exceed our earnings and profits as determined for U.S. federal income tax purposes. A return of capital is not taxable, but has the effect of reducing the tax basis of a stockholder's investment in our common stock.

### ***Common stock eligible for future sales may depress the market price of our common stock.***

We cannot predict the effect, if any, of future sales of shares of our common stock or securities that are convertible into or exchangeable or exercisable for shares of our common stock, or the availability of such securities for future sales, on the value of our common stock. Sales of substantial amounts of our common stock or securities that are convertible into or exchangeable or exercisable for shares of our common stock, or the perception that such sales could occur, may adversely affect prevailing market prices for our common stock.

We have registered for public resale 1,000,000 shares of our common stock held by Mr. Middleman. Mr. Middleman could sell, or indicate an intention to sell, any or all of these shares in the public market. As a result, the trading price of our common stock could decline. In addition, the perception in the market that these sales may occur could also cause the trading price of our common stock to decline.

## **Risks Related to Our Series A Preferred Stock**

***Our 8.20% Series A Cumulative Redeemable Preferred Stock (the "Series A Preferred Stock") ranks junior to our existing and future indebtedness and will rank junior to any class or series of stock we may issue in the future with terms specifically providing that such stock ranks senior to the Series A Preferred Stock with respect to the***

***payment of dividends and the distribution of assets in the event of our liquidation, dissolution or winding up ( Senior Stock ), and your interests could be diluted by the issuance of additional shares of preferred stock and by other transactions.***

Our Series A Preferred Stock ranks junior to all of our existing and future indebtedness and any Senior Stock we may issue in the future and to other non-equity claims on us and our assets available to satisfy claims against us, including claims in bankruptcy, liquidation or similar proceedings. In the event of our bankruptcy, liquidation or dissolution or the winding-up of our affairs, our assets will be available to pay obligations on our Series A Preferred Stock only after all of our indebtedness and other liabilities have been paid. In addition, our Series A Preferred Stock would effectively rank junior to all indebtedness and other liabilities of any existing or

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future subsidiaries. Such subsidiaries are or would be separate legal entities and have or will have no legal obligation to pay any amounts to us in respect of dividends due on our Series A Preferred Stock. If we are forced to liquidate our assets to pay our creditors, we may not have sufficient assets to pay amounts due on any or all of our Series A Preferred Stock then outstanding. We may in the future incur substantial amounts of debt and other obligations that will rank senior to our Series A Preferred Stock.

Our charter currently authorizes the issuance of up to 100,000,000 shares of preferred stock in one or more classes or series. Subject to limitations prescribed by Maryland law and our charter, our board of directors is authorized to issue, from our authorized but unissued shares of stock, preferred stock in such classes or series as our board of directors may determine and to establish from time to time the number of shares of preferred stock to be included in any such class or series. The issuance of additional shares of our Series A Preferred Stock or any class or series of stock we may issue in the future with terms specifically providing that such stock ranks on parity with our Series A Preferred Stock with respect to the payment of dividends and the distribution of assets in the event of our liquidation, dissolution or winding up ( Parity Stock ) would dilute the interests of the holders of our Series A Preferred Stock, and the issuance of any Senior Stock or the incurrence of additional indebtedness could affect our ability to pay dividends on, redeem or pay the liquidation preference on our Series A Preferred Stock. Other than the limited conversion rights afforded to holders of our Series A Preferred Stock that may become exercisable in connection with certain changes of control, none of the provisions relating to our Series A Preferred Stock contain any terms relating to or limiting our indebtedness or affording the holders of our Series A Preferred Stock protection in the event of a highly leveraged or other transaction, including a merger or the sale, lease or conveyance of all or substantially all our assets, so long as the rights of the holders of our Series A Preferred Stock are not materially and adversely affected.

### ***The Series A Preferred Stock has not been rated.***

We have not sought to obtain a rating for our Series A Preferred Stock, and the Series A Preferred Stock may never be rated. It is possible, however, that one or more rating agencies might independently determine to assign a rating to our Series A Preferred Stock or that we may elect to obtain a rating of our Series A Preferred Stock in the future. Furthermore, we may elect to issue other securities for which we may seek to obtain a rating. If any ratings are assigned to our Series A Preferred Stock in the future or if we issue other securities with a rating, such ratings, if they are lower than market expectations or are subsequently lowered or withdrawn, could adversely affect the market for or the market value of the Series A Preferred Stock.

Ratings only reflect the views of the issuing rating agency or agencies, and such ratings could at any time be revised downward or withdrawn entirely at the discretion of the issuing rating agency. Further, a rating is not a recommendation to purchase, sell or hold any particular security, including our Series A Preferred Stock. In addition, ratings do not reflect market prices or suitability of a security for a particular investor, and any future rating of our Series A Preferred Stock may not reflect all risks related to the Company and its business, or the structure or market value of our Series A Preferred Stock.

### ***We may not be able to pay dividends or other distributions on the Series A Preferred Stock.***

Under Maryland law, no distributions on stock may be made if, after giving effect to the distribution, (i) the corporation would not be able to pay the indebtedness of the corporation as such indebtedness becomes due in the usual course of business or (ii) except in certain limited circumstances when distributions are made from net earnings, the corporation's total assets would be less than the sum of the corporation's total liabilities plus, unless the charter provides otherwise (which our charter does, with respect to our Series A Preferred Stock), the amount that would be needed, if the corporation were to be dissolved at the time of the distribution, to satisfy the preferential rights upon dissolution of stockholders whose preferential rights on dissolution are superior to those receiving the distribution. There can be no guarantee that we will have sufficient cash to pay dividends on our Series A Preferred Stock. Our

ability to pay dividends may be impaired if any of the risks described in this Annual Report on Form 10-K were to occur. In addition, payment of our dividends depends upon our earnings, our financial condition, maintenance of our REIT qualification and other factors as our board of directors may deem relevant from time to time. We cannot assure you that our business will generate sufficient cash flow from operations or that future borrowings will be available to us in an amount sufficient to enable us to make distributions on our Series A Preferred Stock and on our common stock, to pay our indebtedness or to fund our other liquidity needs.

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***Holders of our Series A Preferred Stock may not be able to exercise conversion rights upon a change of control. If exercisable, the change of control conversion rights applicable to our Series A Preferred Stock may not adequately compensate holders of our Series A Preferred Stock. These change of control conversion rights may also make it more difficult for a party to acquire us or discourage a party from acquiring us.***

Upon the occurrence of certain changes of control, each holder of our Series A Preferred Stock will have the right (unless, prior to the Change of Control Conversion Date (as defined below), we have provided notice of our election to redeem some or all of the shares of Series A Preferred Stock held by such holder, in which case such holder will have the right only with respect to shares of Series A Preferred Stock that are not called for redemption) to convert some or all of such holder's Series A Preferred Stock into shares of our common stock (or, under specified circumstances, certain alternative consideration). Notwithstanding that we generally may not redeem our Series A Preferred Stock prior to August 17, 2022, we have a special optional redemption right to redeem our Series A Preferred Stock in the event of certain changes of control, and holders of our Series A Preferred Stock will not have the right to convert any shares that we have elected to redeem prior to the date the Series A Preferred Stock is to be converted, which will be a business day selected by us that is no fewer than 20 days nor more than 35 days after the date on which we provide notice to the holders of Series A Preferred Stock (the Change of Control Conversion Date).

If we do not elect to redeem the Series A Preferred Stock prior to the Change of Control Conversion Date, then upon an exercise of the conversion rights provided to the holders of our Series A Preferred Stock, the holders of Series A Preferred Stock will be limited to a maximum number of shares of our common stock (or, if applicable, certain alternative conversion consideration) equal to 2.62881 multiplied by the number of shares of Series A Preferred Stock converted. If the Common Stock Price (as defined in the articles supplementary designating the Series A Preferred Stock) is less than \$9.51 per share, subject to adjustment in certain circumstances, the holders of Series A Preferred Stock will receive a maximum of 2.62881 shares of our common stock per share of Series A Preferred Stock, which may result in a holder receiving shares of common stock (or alternative conversion consideration, as applicable) with a value that is less than the liquidation preference of our Series A Preferred Stock.

In addition, the change of control conversion feature of the Series A Preferred Stock may have the effect of discouraging a third party from making an acquisition proposal for us or of delaying, deferring or preventing a change of control transaction under circumstances that otherwise could provide the holders of Series A Preferred Stock with the opportunity to realize a premium over the then-current market price of such stock or that stockholders may otherwise believe is in their best interests.

***Our charter, including the articles supplementary designating the Series A Preferred Stock, contains restrictions upon transfer and ownership of our stock, which may impair the ability of holders to acquire the Series A Preferred Stock or convert Series A Preferred Stock into our common stock.***

Our charter, including the articles supplementary designating the Series A Preferred Stock, contains restrictions on transfer and ownership of our stock intended to, among other purposes, assist us in maintaining our qualification as a REIT for U.S. federal income tax purposes. Our charter provides that generally no person, other than certain exempted holders, may own, or be deemed to own by virtue of the attribution provisions of the Code, more than 9.0% in value or in number of shares, whichever is more restrictive, of the outstanding shares of any class or series of our stock. No holder of Series A Preferred Stock will be entitled to convert such stock into our common stock to the extent that receipt of shares of our common stock would cause the holder to exceed any of the limitations on ownership and transfer contained in our charter. In addition, these restrictions could have anti-takeover effects and could reduce the possibility that a third party will attempt to acquire control of us, which could adversely affect the market price of our Series A Preferred Stock.

***Holders of our Series A Preferred Stock have limited voting rights.***

Our common stock is the only class of our securities that carries full voting rights. Holders of Series A Preferred Stock may vote only (i) to elect two additional directors to our board of directors in the event that six full quarterly dividends (whether or not consecutive) payable on the Series A Preferred Stock are in arrears, (ii) on amendments to our charter, including the articles supplementary designating the Series A Preferred Stock, that materially and adversely affect the rights of the holders of Series A Preferred Stock or (iii) to authorize, increase or create additional classes or series of Senior Stock. Other than these limited circumstances, holders of Series A Preferred Stock generally do not have any voting rights.



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***The market price of our Series A Preferred Stock could be substantially affected by various factors.***

The market price of our Series A Preferred Stock will depend on many factors, which may change from time to time, including:

• prevailing interest rates, increases in which may have an adverse effect on the market price of the Series A Preferred Stock;

• trading prices of common and preferred equity securities issued by REITs and other similar companies;

• the annual yield from distributions on the Series A Preferred Stock as compared to yields on other financial instruments;

• general economic and financial market conditions;

• government action or regulation;

• our financial condition, performance and prospects and those of our competitors;

• changes in financial estimates or recommendations by securities analysts with respect to us, our competitors or our industry;

• our issuance of additional preferred equity securities or the incurrence of debt; and

• actual or anticipated variations in our quarterly operating results and those of our competitors.

As a result of these and other factors, holders of our Series A Preferred Stock may experience a decrease, which could be substantial and rapid, in the market price of the Series A Preferred Stock, including decreases unrelated to our operating performance or prospects.

***Future offerings of debt or equity securities may adversely affect the market price of our Series A Preferred Stock.***

Future issuances and sales of Parity Stock, or the perception that such issuances and sales could occur, may cause prevailing market prices for our Series A Preferred Stock and our common stock to decline and may adversely affect our ability to raise additional capital in the financial markets at times and prices favorable to us.

If we decide to issue debt or Senior Stock in the future, it is possible that these securities will be governed by an indenture or other instrument containing covenants or other provisions that will restrict our operating flexibility. Additionally, any convertible or exchangeable securities that we issue in the future may have rights, preferences and privileges more favorable than those of our Series A Preferred Stock and may result in dilution to owners of our Series A Preferred Stock. We and, indirectly, our stockholders, will bear the cost of issuing and servicing such securities. Because our decision to issue debt or equity securities in any future offering will depend on market conditions and other factors beyond our control, we cannot predict or estimate the amount, timing or nature of our future offerings. Thus, holders of our Series A Preferred Stock bear the risk of our future offerings reducing the market price of our Series A Preferred Stock and diluting the value of their holdings in us.

***If our common stock is delisted, the ability to transfer or sell shares of our Series A Preferred Stock may be limited and the market value of our Series A Preferred Stock will likely be materially adversely affected.***

Other than in connection with certain changes of control, our Series A Preferred Stock does not contain provisions that are intended to protect holders of our Series A Preferred Stock if our common stock is delisted from the New York Stock Exchange (the "NYSE"). Since our Series A Preferred Stock has no stated maturity date, holders of our Series A Preferred Stock may be forced to hold their shares of Series A Preferred Stock and receive stated dividends on the Series A Preferred Stock when, as and if authorized by our board of directors and declared and paid by us with no assurance as to ever receiving the liquidation value thereof. In addition, if our common stock is delisted from the NYSE, it is likely that our Series A Preferred Stock will be delisted from the NYSE as well. Accordingly, if our common stock is delisted from the NYSE, the ability to transfer or sell shares of our Series A Preferred Stock may be limited and the market value of our Series A Preferred Stock will likely be materially adversely affected.



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### **U.S. Federal Income Tax Risks**

***Our failure to qualify as a REIT would subject us to U.S. federal, state and local income taxes, which could adversely affect the value of our common stock and would substantially reduce the cash available for distribution to our stockholders.***

We operate in a manner that is intended to cause us to qualify as a REIT for U.S. federal income tax purposes. However, the U.S. federal income tax laws governing REITs are complex, and interpretations of the U.S. federal income tax laws governing qualification as a REIT are limited. Moreover, our qualification and taxation as a REIT depend upon our ability to meet on a continuing basis, through actual annual operating results, certain qualification tests set forth in the U.S. federal income tax laws. Although we intend to operate so that we continue to qualify as a REIT, given the complex nature of the rules governing REITs, the ongoing importance of factual determinations, including the potential tax treatment of the investments we make, and the possibility of future changes in our circumstances, no assurance can be given that our actual results of operations for any particular taxable year will satisfy such requirements.

If we fail to qualify as a REIT in any calendar year, and do not qualify for certain statutory relief provisions, we would be required to pay U.S. federal income tax (and any applicable state and local taxes), including any applicable alternative minimum tax, on our taxable income at regular corporate rates, and dividends paid to our stockholders would not be deductible by us in computing our taxable income. Further, if we fail to qualify as a REIT, we might need to borrow money or sell assets in order to pay any resulting tax. Our payment of income tax would decrease the amount of our income available for distribution to our stockholders. Furthermore, if we fail to qualify or maintain our qualification as a REIT, we no longer would be required under U.S. federal tax laws to distribute substantially all of our REIT taxable income to our stockholders. Unless our failure to qualify as a REIT was subject to relief under U.S. federal tax laws, we could not re-elect to qualify as a REIT until the fifth calendar year following the year in which we failed to qualify.

***Complying with REIT requirements may cause us to forego or liquidate otherwise attractive investments.***

To qualify as a REIT, we must continually satisfy various tests regarding the sources of our income, the nature and diversification of our assets, the amounts we distribute to our stockholders and the ownership of our common stock. In order to meet these tests, we may be required to forego investments we might otherwise make. We may be required to make distributions to stockholders at disadvantageous times or when we do not have funds readily available for distribution, and may be unable to pursue investments that would be otherwise advantageous to us in order to satisfy the source of income or asset diversification requirements for qualifying as a REIT. Thus, compliance with the REIT requirements may hinder our investment performance.

***Failure to make required distributions would subject us to tax, which would reduce the cash available for distribution to our stockholders.***

To qualify as a REIT, we must distribute to our stockholders each calendar year at least 90% of our REIT taxable income (including certain items of non-cash income), determined without regard to the deduction for dividends paid and excluding net capital gain. To the extent that we satisfy the 90% distribution requirement, but distribute less than 100% of our taxable income, we will be subject to U.S. federal corporate income tax on our undistributed income. In addition, we will incur a 4% nondeductible excise tax on the amount, if any, by which our distributions in any calendar year are less than the sum of:

- 85% of our REIT ordinary income for that year;
- 95% of our REIT capital gain net income for that year; and

any undistributed taxable income from prior years.

We intend to distribute our taxable income to our stockholders in a manner intended to satisfy the 90% distribution requirement and to avoid both corporate income tax and the 4% nondeductible excise tax. However, there is no requirement that TRSs distribute their after tax net income to their parent REIT or its stockholders.

Our taxable income may substantially exceed our net income as determined based on generally accepted accounting principles ( GAAP ), because, for example, realized capital losses will be deducted in determining our GAAP net income, but may not be deductible in computing our taxable income. In addition, we may invest in assets that generate taxable income in excess of economic income or in advance of the corresponding cash

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flow from the assets. As a result of the foregoing, we may generate less cash flow than taxable income in a particular year. To the extent that we generate such non-cash taxable income in a taxable year, we may incur corporate income tax and the 4% nondeductible excise tax on that income if we do not distribute such income to stockholders in that year. In that event, we may be required to use cash reserves, incur debt, sell assets, make taxable distributions of our shares or debt securities or liquidate non-cash assets at rates or at times that we regard as unfavorable to satisfy the distribution requirement and to avoid corporate income tax and the 4% nondeductible excise tax in that year.

We may satisfy the 90% distribution test with taxable distributions of our stock or debt securities. On August 11, 2017, the IRS issued Revenue Procedure 2017-45 authorizing elective cash/stock dividends to be made by publicly held REITs (e.g., REITs that are required to file annual and periodic reports with the SEC under the Exchange Act). Pursuant to Revenue Procedure 2017-45, effective for distributions declared on or after August 11, 2017, the IRS will treat the distribution of stock pursuant to an elective cash/stock dividend as a distribution of property under Section 301 of the Code (e.g., a dividend), as long as at least 20% of the total dividend is available in cash and certain other parameters detailed in the Revenue Procedure are satisfied. Although we have no current intention of paying dividends in our own stock, if in the future we choose to pay dividends in our own stock, our stockholders may be required to pay tax in excess of the cash that they receive.

### ***Despite qualification as a REIT, we may face other tax liabilities that reduce our cash flows.***

Despite qualification as a REIT, we may be subject to certain U.S. federal, state and local taxes on our income and assets, including taxes on any undistributed income, tax on income from some activities conducted as a result of a foreclosure, and state or local income, property and transfer taxes. In addition, Solutions, Aurora and any other TRSs we form will be subject to regular corporate U.S. federal, state and local taxes. Any of these taxes would decrease cash available for distributions to our stockholders.

### ***We may lose our REIT qualification or be subject to a penalty tax if the U.S. Internal Revenue Service, or IRS, successfully challenges our characterization of our investments in Excess MSR.***

We may create Excess MSR from the MSR held by Aurora. The IRS has issued two private letter rulings to other REITs holding that Excess MSR are qualifying assets for purposes of the 75% asset test and produce qualifying income for purposes of the 75% gross income test. Any income that is qualifying income for the 75% gross income test is also qualifying income for the 95% gross income test. A private letter ruling may be relied upon only by the taxpayer to whom it is issued, and the IRS may revoke a private letter ruling. Based on these private letter rulings and other IRS guidance regarding excess mortgage servicing fees, we generally intend to treat our investments in Excess MSR as qualifying assets for purposes of the 75% asset test and as producing qualifying income for purposes of the 95% and 75% gross income tests. However, we have not sought, and we do not intend to seek, our own private letter ruling. Thus, it is possible that the IRS could successfully take the position that our Excess MSR are not qualifying assets or do not produce qualifying income, presumably by recharacterizing Excess MSR as an interest in servicing compensation, in which case we may fail one or more of the income and asset requirements for REIT qualification. If we failed one of those tests, we would either be required to pay a penalty tax, which could be material, to maintain REIT status, or we would fail to qualify as a REIT.

### ***The failure of RMBS subject to a repurchase agreement to qualify as real estate assets would adversely affect our ability to qualify as a REIT.***

We have entered into repurchase agreements under which we nominally sell certain of our RMBS to a counterparty and simultaneously agree to repurchase the sold assets. We believe that, for U.S. federal income tax purposes, these transactions will be treated as secured debt and we will be treated as the owner of the RMBS that are the subject of any such repurchase agreement notwithstanding that such agreements may transfer record ownership of such assets to

the counterparty during the term of the agreement. It is possible, however, that the IRS could successfully assert that we do not own the RMBS during the term of the repurchase agreement, in which case we could fail to qualify as a REIT.

***Our ability to engage in TBA transactions could be limited by the requirements necessary to qualify as a REIT, and we could fail to qualify as a REIT as a result of these investments.***

We purchase and sell TBAs for purposes of managing interest related risks associated with our liabilities under repurchase agreements, including duration and basis risks. We generally treat such TBA purchases and sales as hedging transactions that hedge indebtedness incurred to acquire or carry real estate assets, or

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qualifying liability hedges for REIT purposes. From time to time, we also opportunistically engage in TBA transactions because we find them attractive on their own. The law is unclear regarding whether income and gains from TBAs that are not qualifying liability hedges are qualifying income for the 75% gross income test and w