Cherry Hill Mortgage Investment Corp
Form 10-Q
August 09, 2016

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

FORM 10-Q

(Mark One)
QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2016

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)

N/A
(Former name, former address and former fiscal year, if changed since last report)

Maryland (State or Other Jurisdiction of Incorporation or Organization)	46-1315605 (I.R.S. Employer Identification No.)
301 Harper Drive, Suite 110 Moorestown, New Jersey (Address of Principal Executive Offices)	08057 (Zip Code)

(877) 870 – 7005
(Registrant’s Telephone Number, Including Area Code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes 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 whether the registrant is a large accelerated filed, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

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

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

As of August 9, 2016, there were 7,528,503 outstanding shares of common stock, $0.01 par value per share, of Cherry Hill Mortgage Investment Corporation.

CHERRY HILL MORTGAGE INVESTMENT CORPORATION
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FORWARD-LOOKING INFORMATION

Cherry Hill Mortgage Investment Corporation (together with its consolidated subsidiaries, the “Company”, “we”, “our” or “us”) makes forward-looking statements in this Quarterly Report on Form 10-Q 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, the Company claims 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 the Company’s control. These forward-looking statements include information about possible or assumed future results of the Company’s business, financial condition, liquidity, results of operations, plans and objectives. When the Company uses the words “believe,” “expect,” “anticipate,” “estimate,” “plan,” “continue,” “intend,” “should,” “could,” “would,” “may,” “potential” or the negative or other comparable terminology, the Company intends 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;
- 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 execute its prime mortgage loan strategy and its ability to finance this asset class;
- the Company’s ability to acquire Servicing Related Assets;
- estimates or statements relating to, and the Company’s ability to make, future distributions;
- 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 real estate investment trust (“REIT”) under the Internal Revenue Code of 1986, as amended (the “Code”);
- the Company’s ability to maintain its exclusion from registration as an investment company under the Investment Company Act of 1940, as amended (the “Investment Company Act”);

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- projected capital and operating expenditures;
- availability of investment opportunities in mortgage-related, real estate-related and other securities;
- availability of qualified personnel;
- prepayment rates; and
- projected default rates.

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 discussed under "Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations" in this Quarterly Report on Form 10-Q and "Item 1A. Risk Factors" in the Company's Annual Report on Form 10-K for the year ended December 31, 2015;
- 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 its external manager, Cherry Hill Mortgage Management, LLC ("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 registration as an investment company under the Investment Company Act; and
- the degree and nature of the Company's competition, including competition for its targeted 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 Quarterly Report on Form 10-Q. 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.

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PART I. FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

Cherry Hill Mortgage Investment Corporation and Subsidiaries
Consolidated Balance Sheets
June 30, 2016 (Unaudited) and December 31, 2015
(in thousands — except share data)

	June 30, 2016	December 31, 2015
Assets		
RMBS, available-for-sale	$ 522,151	$ 508,242
Investments in Servicing Related Assets at fair value	97,342	97,803
Cash and cash equivalents	9,820	10,603
Restricted cash	15,851	9,942
Derivative assets	313	422
Receivables and other assets	9,924	9,328
Total Assets	$ 655,401	$ 636,340
Liabilities and Stockholders’ Equity		
Liabilities		
Repurchase agreements	$ 456,075	$ 385,560
Federal Home Loan Bank advances	-	62,250
Derivative liabilities	10,666	4,595
Notes payable	22,853	24,313
Dividends payable	3,689	3,684
Due to affiliates	1,132	998
Payables for unsettled trades	4,421	-
Accrued expenses and other liabilities	6,393	2,603
Total Liabilities	$ 505,229	$ 484,003
Stockholders’ Equity		
Preferred stock, $0.01 par value, 100,000,000 shares authorized, none issued and outstanding as of June 30, 2016 and December 31, 2015	$ -	$ -
Common stock, $0.01 par value, 500,000,000 shares authorized, and 7,528,503 shares issued and outstanding as of June 30, 2016, and 500,000,000 shares authorized, and 7,519,038 shares issued and outstanding as of December 31, 2015	75	75
Additional paid-in capital	148,407	148,332
Retained earnings (deficit)	(11,016)	3,133
Accumulated other comprehensive income (loss)	11,630	(197)
Total CHMI Stockholders’ Equity	$ 149,096	$ 151,343
Non-controlling interests in operating partnership	1,076	994
Total Stockholders’ Equity	$ 150,172	$ 152,337
Total Liabilities and Stockholders’ Equity	$ 655,401	$ 636,340

See accompanying notes to consolidated financial statements.

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Cherry Hill Mortgage Investment Corporation and Subsidiaries
Consolidated Statements of Income (Loss)
(Unaudited)
(in thousands — except per share data)

	Three Months Ended June 30, 2016	Three Months Ended June 30, 2015	Six Months Ended June 30, 2016	Six Months Ended June 30, 2015
Income				
Interest income	$ 7,135	$ 8,088	$ 12,323	$ 13,915
Interest expense	1,885	1,346	3,542	2,581
Net interest income	5,250	6,742	8,781	11,334
Servicing fee income	1,574	156	3,069	156
Servicing costs	501	94	903	94
Net servicing income (loss)	1,073	62	2,166	62
Other income (loss)				
Realized gain (loss) on RMBS, net	235	(115)	555	192
Realized gain (loss) on derivatives, net	(299)	(52)	(1,760)	(1,294)
Realized gain (loss) on acquired assets, net	-	174	-	174
Unrealized gain (loss) on derivatives, net	(1,228)	2,835	(6,426)	293
Unrealized gain (loss) on investments in Excess MSRs	(149)	2,938	(2,456)	821
Unrealized gain (loss) on investments in MSRs	(3,076)	(22)	(5,308)	(22)
Total Income	1,806	12,562	(4,448)	11,560
Expenses				
General and administrative expense	822	634	1,630	1,376
Management fee to affiliate	690	690	1,380	1,380
Total Expenses	1,512	1,324	3,010	2,756
Income (Loss) Before Income Taxes	294	11,238	(7,458)	8,804
Provision for corporate business taxes	10	(70)	(580)	(70)
Net Income (Loss)	284	11,308	(6,878)	8,874
Net (income) loss allocated to noncontrolling interests	(1)	(103)	98	(81)
Net Income (Loss) Applicable to Common Stockholders	$ 283	$ 11,205	$ (6,780)	$ 8,793
Net income (Loss) Per Share of Common Stock				
Basic	$ 0.04	$ 1.49	$ (0.90)	$ 1.17
Diluted	$ 0.04	$ 1.49	$ (0.90)	$ 1.17
Weighted Average Number of Shares of Common Stock Outstanding				
Basic	7,509,543	7,509,543	7,509,543	7,509,543
Diluted	7,520,616	7,509,543	7,519,827	7,509,543

See accompanying notes to consolidated financial statements.

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Cherry Hill Mortgage Investment Corporation and Subsidiaries
Consolidated Statements of Comprehensive Income (Loss)
(Unaudited)
(in thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Net income (loss)	$ 284	$ 11,308	$ (6,878)	$ 8,874
Other comprehensive income (loss):				
Net unrealized gain (loss) on RMBS	4,730	(6,280)	12,382	(3,489)
Reclassification of net realized (gain) loss on RMBS in earnings	(235)	115	(555)	(192)
Other comprehensive income (loss)	4,495	(6,165)	11,827	(3,681)
Comprehensive income (loss)	$ 4,779	$ 5,143	$ 4,949	$ 5,193
Comprehensive income (loss) attributable to noncontrolling interests	68	47	70	48
Comprehensive income (loss) attributable to common stockholders	$ 4,711	$ 5,096	$ 4,879	$ 5,145

See accompanying notes to consolidated financial statements.

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Cherry Hill Mortgage Investment Corporation and Subsidiaries
Consolidated Statements of Changes in Stockholders' Equity
For the three and six month periods ended June 30, 2016 and 2015
(Unaudited)
(in thousands — except share data)

	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings (Deficit)	Non-Controlling Interest in Operating Partnership	Total Stockholders' Equity
Balance, December 31, 2014	7,509,543	$ 75	$ 148,258	$ 6,641	$ 4,799	$ 545	$ 160,318
Issuance of common stock	-	-	-	-	-	-	-
Net income	-	-	-	-	8,793	81	8,874
Other comprehensive income	-	-	-	(3,681)	-	-	(3,681)
LTIP-OP Unit awards	-	-	-	-	-	204	204
Distribution paid on LTIP-OP Units	-	-	-	-	-	(70)	(70)
Common dividends declared, $1.00 per share	-	-	-	-	(7,511)	-	(7,511)
Balance, June 30, 2015	7,509,543	$ 75	$ 148,258	$ 2,960	$ 6,081	$ 760	$ 158,134
Balance, December 31, 2015	7,519,038	$ 75	$ 148,332	$ (197)	$ 3,133	$ 994	$ 152,337
Issuance of common stock	9,465	- (A)	75	-	-	-	75
Net income	-	-	-	-	(6,780)	(98)	(6,878)
Other comprehensive income	-	-	-	11,827	-	-	11,827
LTIP-OP Unit awards	-	-	-	-	-	282	282
Distribution paid on LTIP-OP Units	-	-	-	-	-	(102)	(102)
Common dividends declared, $0.98 per share	-	-	-	-	(7,369)	-	(7,369)
Balance, June 30, 2016	7,528,503	$ 75	$ 148,407	$ 11,630	$ (11,016)	$ 1,076	$ 150,172

(A) de minimis ($95.00 rounds to $0.00).

See accompanying notes to consolidated financial statements.

Cherry Hill Mortgage Investment Corporation and Subsidiaries
Consolidated Statements of Cash Flows
(Unaudited)
(in thousands)

	Six Months Ended June 30, 2016	2015
Cash Flows From Operating Activities		
Net income (loss)	$ (6,878)	$ 8,874
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Realized (gain) loss on RMBS, net	(555)	(192)
Realized gain on bargain purchase	-	(174)
Accretion of premium and other amortization	1,851	1,518
Change in fair value of investments in Servicing Related Assets	7,764	(799)
Unrealized (gain) loss on derivatives, net	6,426	(293)
Realized (gain) loss on derivatives, net	1,760	1,294
LTIP-OP Unit awards	282	204
Changes in:		
Receivables from unsettled trades	-	(4,668)
Receivables and other assets	(596)	915
Due to affiliate	134	98
Payables for unsettled trades	4,421	-
Accrued expenses and other liabilities	3,795	(740)
Net cash provided by (used in) operating activities	$ 18,404	$ 6,037
Cash Flows From Investing Activities		
Purchase of RMBS	(73,393)	(100,752)
Principal paydown of RMBS	24,514	19,575
Proceeds from sale of RMBS	45,501	59,127
Acquisition of Excess MSRs	-	-
Principal paydown of Excess MSRs	7,994	6,623
Aurora acquisition, net of cash received	-	(3,839)
Acquisition of MSRs	(15,297)	-
Purchase of derivatives	(2,006)	(1,449)
Sale of derivatives	-	206
Net cash provided by (used in) investing activities	$ (12,687)	$ (20,509)
Cash Flows From Financing Activities		
Changes in restricted cash	(5,909)	(4,137)
Borrowings under repurchase agreements	1,049,585	761,630
Repayments of repurchase agreements	(979,070)	(739,365)
Proceeds from Federal Home Loan Bank advances	7,000	-
Repayments of Federal Home Loan Bank advances	(69,250)	-
Proceeds from bank loans	-	6,732
Principal paydown of bank loans	(1,460)	-
Dividends paid	(7,369)	(7,660)
LTIP-OP Units distributions paid	(102)	(70)
Issuance of common stock, net of offering costs	75	-
Net cash provided by (used in) financing activities	$ (6,500)	$ 17,130
Net Increase (Decrease) in Cash and Cash Equivalents	$ (783)	$ 2,658
Cash and Cash Equivalents, Beginning of Period	10,603	12,447

Cash and Cash Equivalents, End of Period	$ 9,820	$ 15,105
Supplemental Disclosure of Cash Flow Information		
Cash paid during the period for interest expense	$ 3,653	$ 2,325
Dividends declared but not paid	$ 3,689	$ 3,680

See accompanying notes to consolidated financial statements.

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Cherry Hill Mortgage Investment Corporation and Subsidiaries

Notes to Consolidated Financial Statements

June 30, 2016

(Unaudited)
Note 1 — Organization and Operations

Cherry Hill Mortgage Investment Corporation (together with its consolidated subsidiaries, the "Company") was organized in the state of Maryland on October 31, 2012 to invest in residential mortgage assets in the United States.

The accompanying interim consolidated financial statements include the accounts of the Company's subsidiaries, Cherry Hill Operating Partnership LP, Cherry Hill QRS I, LLC, Cherry Hill QRS II, Cherry Hill QRS III, LLC, CHMI Insurance Company, LLC ("CHMI Insurance"), CHMI Solutions, Inc. ("CHMI Solutions") and Aurora Financial Group, Inc. ("Aurora").

On October 9, 2013, the Company completed an initial public offering (the "IPO") and a concurrent private placement of its common stock. The Company did not conduct any activity prior to the IPO and the concurrent private placement. Substantially all of the net proceeds from the IPO and the concurrent private placement were used to invest in excess mortgage servicing rights on residential mortgage loans ("Excess MSRs") and residential mortgage-backed securities ("RMBS" or "securities"), the payment of principal and interest on which is guaranteed by a U.S. government agency or a U.S. government sponsored enterprise ("Agency RMBS").

The Company is party to a management agreement (the "Management Agreement") with Cherry Hill Mortgage Management, LLC (the "Manager"), a Delaware limited liability company and an affiliate of Freedom Mortgage Corporation ("Freedom Mortgage"). The Manager and Freedom Mortgage are controlled by Mr. Middleman. For a further discussion of the Management Agreement, see Note 7.

The Company has elected to be taxed as a REIT, as defined under the Internal Revenue Code of 1986, as amended (the "Code"), commencing with its short taxable year ended December 31, 2013. As long as the Company continues to comply with a number of requirements under federal tax law and maintains its qualification as a REIT, the Company generally will not be subject to U.S. federal income taxes to the extent that the Company distributes its taxable income to its stockholders on an annual basis and does not engage in prohibited transactions. However, certain activities that the Company may perform may cause it to earn income that will not be qualifying income for REIT purposes.

Note 2 — Basis of Presentation and Significant Accounting Policies

Basis of Accounting

The accompanying interim consolidated financial statements are prepared in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial information and pursuant to the requirements for reporting on Form 10-Q and Article 10 of Regulation S-X. The interim consolidated financial statements include the accounts of the Company and its consolidated subsidiaries. All significant intercompany transactions and balances have been eliminated. The Company consolidates those entities in which it has an investment of 50% or more and has control over significant operating, financial and investing decisions of the entity. The interim consolidated financial statements reflect all necessary and recurring adjustments for fair presentation of the results for the interim periods presented herein.

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Emerging Growth Company Status

On April 5, 2012, the Jumpstart Our Business Startups Act (the "JOBS Act") was signed into law. The JOBS Act contains provisions that, among other things, reduce certain reporting requirements for qualifying public companies. Because the Company qualifies as an "emerging growth company," it may, under Section 7(a)(2)(B) of the Securities Act of 1933, delay adoption of new or revised accounting standards applicable to public companies until such standards would otherwise apply to private companies. The Company has elected to take advantage of this extended transition period until the first to occur of the date that it (i) is no longer an "emerging growth company" or (ii) affirmatively and irrevocably opts out of this extended transition period. As a result, the consolidated financial statements may not be comparable to those of other public companies that comply with such new or revised accounting standards. Until the date that the Company is no longer an "emerging growth company" or affirmatively and irrevocably opts out of the extended transition period, upon issuance of a new or revised accounting standard that applies to the consolidated financial statements and that has a different effective date for public and private companies, the Company will disclose the date on which adoption is required for non-emerging growth companies and the date on which it will adopt the recently issued accounting standard.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make a number of significant estimates and assumptions. These include estimates of fair value of Excess MSRs and MSRs (collectively, "Servicing Related Assets"), RMBS, derivatives and credit losses including the period of time during which the Company anticipates an increase in the fair values of securities sufficient to recover unrealized losses on those securities, and other estimates that affect the reported amounts of certain assets and liabilities and disclosure of contingent assets and liabilities as of the date of the interim consolidated financial statements and the reported amounts of certain revenues and expenses during the reporting period. It is likely that changes in these estimates (e.g., valuation changes due to supply and demand, credit performance, prepayments, interest rates, or other reasons) will occur in the near term. The Company's estimates are inherently subjective in nature. Actual results could differ from the Company's estimates and differences may be material.

Risks and Uncertainties

In the normal course of business, the Company encounters primarily two significant types of economic risk: credit and market. Credit risk is the risk of default on the Company's investments in RMBS, Servicing Related Assets and derivatives that results from a borrower's or derivative counterparty's inability or unwillingness to make contractually required payments. Market risk reflects changes in the value of investments in RMBS, Servicing Related Assets and derivatives due to changes in interest rates, spreads or other market factors. The Company is subject to the risks involved with real estate and real estate-related debt instruments. These include, among others, the risks normally associated with changes in the general economic climate, changes in the mortgage market, changes in tax laws, interest rate levels, and the availability of financing.

The Company also is subject to significant tax risks. If the Company were to fail to qualify as a REIT in any taxable year, the Company would be subject to U.S. federal income tax (including any applicable alternative minimum tax), which could be material. Unless entitled to relief under certain statutory provisions, the Company would also be disqualified from treatment as a REIT for the four taxable years following the year during which qualification is lost.

Investments in RMBS

Classification – The Company classifies its investments in RMBS as securities available for sale. Although the Company generally intends to hold most of its securities until maturity, it may, from time to time, sell any of its securities as part of its overall management of its portfolio. Securities available for sale are carried at fair value with the net unrealized gains or losses reported as a separate component of other comprehensive income, to the extent impairment losses, if any, are considered temporary. Unrealized losses on securities are charged to earnings if they reflect a decline in value that is other-than-temporary, as described below.

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Fair value is determined under the guidance of ASC 820, Fair Value Measurements and Disclosures. The Company determines fair value of its RMBS investments based upon prices obtained from third-party pricing providers. The third-party pricing providers use pricing models that generally incorporate such factors as coupons, primary and secondary mortgage rates, rate reset period, issuer, prepayment speeds, credit enhancements and expected life of the security. In determining the fair value of RMBS, management's judgment is used to arrive at fair value that considers prices obtained from third-party pricing providers and other applicable market data. The Company's application of ASC 820 guidance is discussed in further detail in Note 9.

Investment securities transactions are recorded on the trade date. At disposition, the net realized gain or loss is determined on the basis of the cost of the specific investment and is included in earnings. All RMBS sold in the year ended December 31, 2015, were settled prior to year-end. Approximately \$4.4 million in Agency RMBS purchased, but not yet settled, was payable at June 30, 2016.

Revenue Recognition – Interest income from coupon payments is accrued based on the outstanding principal amount of the RMBS and their contractual terms. Premiums and discounts associated with the purchase of the RMBS are accreted into interest income over the projected lives of the securities using the interest method. The Company's policy for estimating prepayment speeds for calculating the effective yield is to evaluate historical performance, consensus on prepayment speeds, and current market conditions. Adjustments are made for actual prepayment activity. Approximately \$1.5 million and \$1.5 million in interest income was receivable at June 30, 2016 and December 31, 2015, respectively, and has been classified within "Receivables and other assets" on the consolidated balance sheets.

Impairment – The Company evaluates its RMBS, on a quarterly basis, to assess whether a decline in the fair value below the amortized cost basis is an other-than-temporary impairment ("OTTI"). The presence of OTTI is based upon a fair value decline below a security's amortized cost basis and a corresponding adverse change in expected cash flows due to credit related factors as well as non-credit factors, such as changes in interest rates and market spreads. Impairment is considered other-than-temporary if an entity (i) intends to sell the security, (ii) will more likely than not be required to sell the security before it recovers in value, or (iii) does not expect to recover the security's amortized cost basis, even if the entity does not intend to sell the security. Under these scenarios, the impairment is other-than-temporary and the full amount of impairment should be recognized currently in earnings and the cost basis of the security is adjusted. However, if an entity does not intend to sell the impaired security and it is more likely than not that it will not be required to sell before recovery, the OTTI should be separated into (i) the estimated amount relating to credit loss, or the credit component, and (ii) the amount relating to all other factors, or the non-credit component. Only the estimated credit loss amount is recognized currently in earnings, with the remainder of the loss recognized in other comprehensive income. The difference between the new amortized cost basis and the cash flows expected to be collected is accreted into interest income in accordance with the effective interest method.

Investments in Excess MSRs

Classification – The Company has elected the fair value option to record its investments in Excess MSRs in order to provide users of the consolidated financial statements with better information regarding the effects of prepayment risk and other market factors on the Excess MSRs. Under this election, the Company records a valuation adjustment on its investments in Excess MSRs on a quarterly basis to recognize the changes in fair value in net income as described below. In determining the valuation of Excess MSRs, management uses internally developed models that are primarily based on observable market-based inputs but which also include unobservable market data inputs (see Note 9).

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Revenue Recognition – Excess MSRs are aggregated into pools as applicable. Each pool of Excess MSRs is accounted for in the aggregate. Interest income for each pool of Excess MSRs is accreted into interest income on an effective yield or "interest" method, based upon the pool's expected excess mortgage servicing amount over the expected life of the underlying mortgages. A change to expected cash flows results in a cumulative retrospective adjustment, which is recorded in the period in which the change occurs. Under the retrospective method, the interest income recognized for a reporting period is measured as the difference between the amortized cost basis at the end of the period and the amortized cost basis at the beginning of the period, plus any cash received during the period. The amortized cost basis is calculated as the present value of estimated future cash flows using an effective yield, which is the yield that equates all past actual and current estimated future cash flows to the initial investment. The difference between the fair value of Excess MSRs and their amortized cost basis is recorded on the income statement as "Unrealized gain (loss) on investments in Excess MSRs." Fair value is generally determined by discounting the expected future cash flows using discount rates that incorporate the market risks and liquidity premium specific to the Excess MSRs and, therefore, may differ from their effective yields. Approximately $2.0 million and $2.2 million in Excess MSR cashflow was receivable at June 30, 2016 and December 31, 2015, respectively, and has been classified within "Receivables and other assets" on the consolidated balance sheets.

Investments in MSRs

Classification – The Company has elected the fair value option to record its investments in MSRs in order to provide users of the financial statements with better information regarding the effects of prepayment risk and other market factors on the MSRs. Under this election, the Company records a valuation adjustment on its investments in MSRs on a quarterly basis to recognize the changes in fair value in net income as described below. The Company's MSRs represent the right to service mortgage loans. As an owner and manager of MSRs, the Company may be obligated to fund advances of principal and interest payments due to third-party owners of the loans, but not yet received from the individual borrowers. These advances are reported as servicing advances within the "Receivables and other assets" line item on the consolidated balance sheets. MSRs are reported at fair value on the consolidated balance sheets. Although transactions in MSRs are observable in the marketplace, the valuation includes unobservable market data inputs (prepayment speeds, delinquency levels, costs to service and discount rates). Changes in the fair value of MSRs as well as servicing fee income and servicing costs are reported on the consolidated statements of income. In determining the valuation of MSRs, management uses internally developed models that are primarily based on observable market-based inputs but which also include unobservable market data inputs (see Note 9).

Revenue Recognition – Mortgage servicing fee income represents revenue earned for servicing mortgage loans. The servicing fees are based on a contractual percentage of the outstanding principal balance and recognized as revenue as the related mortgage payments are collected. Corresponding costs to service are charge