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Altisource Asset Management Corp
Form 10-Q
November 05, 2014

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

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2014

OR

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

COMMISSION FILE NUMBER: 000-54809

Altisource Asset Management Corporation
(Exact name of registrant as specified in its charter)
UNITED STATES VIRGIN ISLANDS 66-0783125
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

402 Strand Street
Frederiksted, United States Virgin Islands 00840-3531
(Address of principal executive office)

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

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

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

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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 October 31, 2014, 2,189,875 shares of our common stock were outstanding (excluding 260,965 shares held as treasury stock).

Altisource Asset Management Corporation

September 30, 2014

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References in this report to "we," "our," "us," or the "Company" refer to Altisource Asset Management Corporation and its consolidated subsidiaries, unless otherwise indicated. References in this report to "Residential" refer to Altisource Residential Corporation, unless otherwise indicated. References in this report to "Altisource" refer to Altisource Portfolio Solutions S.A. and its consolidated subsidiaries, unless otherwise indicated. References in this report to "Ocwen" refer to Ocwen Financial Corporation and its consolidated subsidiaries, unless otherwise indicated.

Special note on forward-looking statements

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

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

- our ability to implement our business strategy and the business strategy of Residential;
- our ability to retain and maintain our strategic relationships with related parties;
- the ability of Residential to generate cash available for distribution to its stockholders under our management;
- our ability to effectively compete with our competitors;
- Residential's ability to complete future or pending transactions;
- our ability to retain Residential as a client;
- the failure of Altisource and Ocwen to effectively perform their obligations under their agreements with us and Residential;
- general economic and market conditions; and
- governmental regulations, taxes and policies.

While forward-looking statements reflect our good faith beliefs, assumptions and expectations, they are not guarantees of future performance. Such forward-looking statements speak only as of their respective dates, and we assume no obligation to update them to reflect changes in underlying assumptions or factors, new information or otherwise. For a further discussion of these and other factors that could cause our future results to differ materially from any forward-looking statements, please see the risk factors set forth in our annual report on Form 10-K for the year ended December 31, 2013 and in our quarterly reports on Form 10-Q for the first and second quarters of 2014

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Part I

Item 1. Financial statements (unaudited)

Certain information contained herein is presented as of October 31, 2014, which we have concluded is the latest practicable date for financial information prior to the filing of this quarterly report.

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

	September 30, 2014	December 31, 2013
Assets:		
Real estate held for use:		
Land (from consolidated VIE)	\$9,865	\$478
Rental residential properties (net of accumulated depreciation of \$484 and \$24, respectively - from consolidated VIE)	38,470	3,092
Real estate owned (from consolidated VIE)	370,733	32,332
Total real estate held for use, net	419,068	35,902
Real estate assets held for sale (from consolidated VIE)	40,985	1,186
Mortgage loans (from consolidated VIE)	2,071,505	1,207,163
Mortgage loans held for sale (from consolidated VIE)	143,197	—
Cash and cash equivalents (including from consolidated VIE \$76,027 and \$115,988, respectively)	91,824	140,000
Restricted cash	12,033	5,878
Accounts receivable (including from consolidated VIE \$871 and \$1,428, respectively)	1,493	1,428
Related party receivables (from consolidated VIE)	19,254	9,260
Deferred leasing and financing costs, net (from consolidated VIE)	3,688	2,293
Prepaid expenses and other assets (including from consolidated VIE \$5,304 and \$1,542, respectively)	6,847	1,994
Total assets	\$2,809,894	\$1,405,104
Liabilities:		
Repurchase agreements (from consolidated VIE)	\$1,258,329	\$602,382
Other secured borrowings	150,000	—
Accounts payable and accrued liabilities (including from consolidated VIE \$14,577 and \$4,952, respectively)	16,146	6,872
Related party payables (including from consolidated VIE \$6,489 and \$1,409, respectively)	6,907	2,883
Total liabilities	1,431,382	612,137
Commitments and contingencies (Note 6)		
Redeemable preferred stock:		
Preferred stock, \$0.01 par value, 250,000 shares issued and outstanding as of September 30, 2014 and none issued or outstanding as of December 31, 2013; redemption value \$250,000	248,875	—
Equity:		
Common stock, \$.01 par value, 5,000,000 authorized shares; 2,450,840 and 2,200,330 shares issued and outstanding, respectively as of September 30, 2014 and 2,354,774 shares issued and outstanding as of December 31, 2013	25	24
Additional paid-in capital	17,246	12,855
Retained earnings (accumulated deficit)	32,303	(5,339)
Treasury stock, at cost, 250,510 shares as of September 30, 2014 and none as of December 31, 2013	(236,751)	—
Total stockholders' equity	(187,177)	7,540

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Noncontrolling interest in consolidated affiliate	1,316,814	785,427
Total equity	1,129,637	792,967
Total liabilities and equity	\$2,809,894	\$1,405,104

See accompanying notes to Consolidated Financial Statements.

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

	Three months ended September 30, 2014	Three months ended September 30, 2013	Nine months ended September 30, 2014	Nine months ended September 30, 2013
Revenues:				
Rental revenues	\$469	\$6	\$719	\$6
Net unrealized gain on mortgage loans	88,726	17,670	258,898	25,963
Net realized gain on mortgage loans	13,727	1,909	33,867	4,015
Net realized gain on re-performing mortgage loans	302	—	302	—
Net realized gain on real estate	3,310	—	4,544	—
Interest income	2,568	156	2,757	368
Total revenues	109,102	19,741	301,087	30,352
Expenses:				
Residential property operating expenses	9,247	191	13,550	275
Real estate depreciation and amortization	313	4	464	4
Real estate selling costs and impairment	5,542	210	8,775	210
Mortgage loan servicing costs	21,226	2,154	49,588	3,788
Interest expense	11,699	467	24,352	1,163
General and administrative	5,435	4,895	15,578	10,798
Related party general and administrative	999	681	4,597	1,052
Total expenses	54,461	8,602	116,904	17,290
Other income (expense)	1,586	13	2,372	(6
Income before income taxes	56,227	11,152	186,555	13,056
Income tax expense	853	—	1,428	—
Net income	55,374	11,152	185,127	13,056
Net income attributable to noncontrolling interest in consolidated affiliate	(37,676	) (13,709	) (147,371	) (17,952
Net income (loss) attributable to common stockholders	\$17,698	\$(2,557	) \$37,756	\$(4,896
Earnings (loss) per share of common stock – basic:				
Earnings (loss) per basic share	\$7.91	\$(1.09	) \$16.51	\$(2.09
Weighted average common stock outstanding – basic	2,238,225	2,348,040	2,286,451	2,344,923
Earnings (loss) per share of common stock – diluted:				

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Earnings (loss) per diluted share	\$6.25	\$(1.09) \$13.23	\$(2.09)
Weighted average common stock outstanding – diluted	2,831,617	2,348,040	2,853,751	2,344,923	

See accompanying notes to consolidated financial statements.

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

	Common stock			Retained	Treasury	Noncontrolling	Total equity
	Number of	Amount	Additional	earnings	stock	interest in	
	shares		paid-in capital	(accumulated		consolidated	
				deficit)		affiliate	
December 31, 2013	2,354,774	\$24	\$12,855	\$(5,339	)\$—	\$785,427	\$792,967
Issuance of common							
stock, including	96,066	1	44	—	—	—	45
option exercises							
Treasury shares	—	—	—	—	(236,751	)—	(236,751)
repurchased							
Capital contribution	—	—	—	—	—	468,416	468,416
from noncontrolling							
interest							
Distribution from	—	—	—	—	—	(84,570	)(84,570)
noncontrolling							
interest							
Amortization of	—	—	—	(114	)—	—	(114)
preferred stock							
issuance costs							
Share-based	—	—	4,347	—	—	170	4,517
compensation							
Net income	—	—	—	37,756	—	147,371	185,127
September 30, 2014	2,450,840	\$25	\$17,246	\$32,303	\$(236,751	)\$1,316,814	\$1,129,637

	Common stock			Accumulated	Treasury	Noncontrolling	Total equity
	Number of	Amount	Additional	deficit	stock	interest in	
	shares		paid-in capital			consolidated	
						affiliate	
December 31, 2012	2,343,213	\$23	\$4,993	\$(46	)\$—	\$99,911	\$104,881
Issuance of common							
stock, including	7,333	1	12	—	—	—	13
option exercises							
Capital contribution	—	—	—	—	—	309,700	309,700
from noncontrolling							
interest							
Distribution from	—	—	—	—	—	(2,509	)(2,509)
noncontrolling							
interest							
Share-based	—	—	3,434	—	—	—	3,434
compensation							
Net income (loss)	—	—	—	(4,896)—	17,952	13,056

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September 30, 2013	2,350,546	\$24	\$8,439	\$(4,942)\$—	\$425,054	\$428,575
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See accompanying notes to consolidated financial statements.

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

	Nine months ended September 30, 2014	Nine months ended September 30, 2013	
Operating activities:			
Net income	\$185,127	\$13,056	
Adjustments to reconcile net income to net cash used in operating activities:			
Net unrealized gain on mortgage loans	(258,898	) (25,963)
Net realized gain on mortgage loans	(33,867	) (4,015)
Net realized gain on sale of re-performing mortgage loans	(302) —	
Net realized gain on sale of real estate	(4,544) —	
Real estate depreciation, amortization and other non-cash charges	9,239	4	
Accretion of interest on re-performing mortgage loans	(2,475) —	
Share-based compensation	4,517	3,434	
Amortization of deferred financing costs	2,127	630	
Changes in operating assets and liabilities:			
Accounts receivable	(1,137) —	
Related party receivables	6,421	(166)
Prepaid expenses and other assets	(6,315	) (363)
Accounts payable and accrued liabilities	1,786	2,063	
Related party payables	4,024	251	
Net cash used in operating activities	(94,297	) (11,069)
Investing activities:			
Investment in mortgage loans	(1,241,083	) (642,645)
Investment in real estate	(27,463	) (6,198)
Investment in renovations	(5,957	) (145)
Real estate tax advances	(20,244	) (547)
Mortgage loan dispositions	122,023	13,783	
Mortgage loan payments	14,903	2,659	
Disposition of real estate	11,771	—	
Change in restricted cash	(6,155	) (3,092)
Net cash used in investing activities	(1,152,205	) (636,185)
Financing activities:			
Proceeds from issuance of preferred stock	250,000	—	
Cost of issuance of preferred stock	(1,125) —	
Issuance of common stock, including stock option exercises	12,186	666	
Repurchase of common stock	(236,751) —	
Payment of tax withholdings on exercise of stock options	(12,141	) (653)
Cost of issuance of common stock	—	—	
Capital contribution from noncontrolling interest	468,416	310,250	
Distribution to noncontrolling interest	(84,570	) (2,509)
Proceeds from issuance of notes	150,000	—	
Proceeds from repurchase agreement	952,264	418,099	
Repayments of repurchase agreement	(296,317	) (79,299)
Payment of deferred financing costs	(3,636	) (2,254)
Net cash provided by financing activities	1,198,326	644,300	
Net decrease in cash and cash equivalents	(48,176) (2,954)
Cash and cash equivalents as of beginning of the period	140,000	105,014	

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Cash and cash equivalents as of end of the period	\$91,824	\$102,060
Supplemental disclosure of cash flow information		
Cash paid for interest	\$20,212	\$377
Transfer of mortgage loans to real estate owned	410,913	10,598
Transfer of real estate owned to mortgage loans	5,367	—
Change in accrued capital expenditures	7,712	—
Change in accrued equity issuance costs	—	1,242
Changes in receivables from mortgage loan dispositions, payments and real estate tax advances, net	13,081	5,745
Changes in receivables from real estate owned dispositions	3,097	—

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See accompanying notes to consolidated financial statements.

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

1. Organization and basis of presentation

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

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

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

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

Since Residential commenced operations, it has completed three public equity offerings with aggregate net proceeds of approximately \$1.1 billion. On March 22, 2013, September 12, 2013 and September 23, 2013, Residential entered into three separate repurchase agreements to finance the acquisition and ownership of residential mortgage loans and REO properties. The maximum aggregate funding available under these repurchase agreements initially was \$425.0 million. Residential subsequently increased the aggregate funding capacity under each repurchase agreement as follows:

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

period from June 11, 2014 through October 11, 2014, and on October 3, 2014, Residential extended the increase through December 10, 2014. The aggregate borrowing capacity under the repurchase agreement will revert to \$200.0 million after December 10, 2014.

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

For the repurchase agreement dated September 23, 2013, Residential amended it on December 23, 2013 to initially increase the aggregate maximum borrowing capacity from \$200.0 million to \$400.0 million. On June 25, 2014, Residential further amended this repurchase agreement to increase the aggregate maximum borrowing capacity from

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\$400.0 million to \$1.0 billion, subject to certain sublimits. The maturity date of the repurchase agreement is March 23, 2015. Residential has the option to extend this agreement for an additional year with no additional funding.

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

On September 25, 2014, Residential completed a securitization transaction in which ARLP Securitization Trust, Series 2014-1 ("ARLP 2014-1") issued \$150.0 million in Class A Notes (the "Class A Notes") with a weighted yield of approximately 3.5% and \$32.0 million in Class M Notes (the "Class M Notes") with a weighted yield of 4.25%. The Class A Notes and the Class M Notes are secured solely by the non-performing mortgage loans of ARLP 2014-1 and not by any of Residential's other assets. The assets of ARLP 2014-1 are the only source of repayment and interest on the Class A Notes and the Class M Notes. The Class A Notes and the Class M Notes mature on September 25, 2044, and Residential does not guaranty any of the obligations of ARLP 2014-1 under the terms of the Indenture governing the notes or otherwise. As of September 30, 2014, the book value of the underlying securitized assets held by ARLP 2014-1 was \$211.3 million.

Residential retained all of the Class M Notes in its taxable REIT subsidiary ("TRS"). On September 30, 2014, pursuant to a master repurchase agreement, the TRS sold \$15.0 million of the Class M Notes to NewSource Reinsurance Company Ltd, ("NewSource"), an entity in which Residential owns 100% of the outstanding preferred stock and in which we own 100% of the outstanding common stock, for a purchase price of \$15.0 million. The master repurchase agreement requires the TRS to repurchase the Class M Notes from NewSource at a 5.0% yield on December 28, 2014, subject to the parties' option to extend the master repurchase agreement for an additional 89 day period. In no event can the master repurchase agreement be extended beyond September 29, 2015.

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

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

Basis of presentation and use of estimates

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

The unaudited consolidated financial statements and accompanying unaudited consolidated financial information, in our opinion, contain all adjustments that are of a normal recurring nature and necessary for a fair presentation of our financial position, results of operations and cash flows for the interim periods. The interim results are not necessarily indicative of results for a full year. We have omitted certain notes and other information from the interim consolidated financial statements presented in this Quarterly Report as permitted by SEC rules and regulations. These consolidated financial statements should be read in conjunction with our 2013 annual report on Form 10-K.

Preferred stock

During the first quarter of 2014, we issued \$250.0 million of convertible preferred stock. All of the outstanding shares of preferred stock are redeemable by us in March 2020, the sixth anniversary of the date of issuance, and every five years thereafter. On these same redemption dates, each holder of preferred stock may cause us to redeem all the shares of preferred

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stock held by such holder at a redemption price equal to \$1,000 per share. Accordingly, we classify these shares as mezzanine equity, outside of permanent stockholders' equity.

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

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

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

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

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

Treasury Stock

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

Loans held for sale

Loans held for sale, which consist of re-performing residential mortgage loans acquired from others, are recorded at the lower of cost or fair value. Residential does not originate loans. During the third quarter 2014, Residential decided to sell these re-performing loans and as such they were reclassified as loans held for sale from loans held for investment. See Note 12 - "Subsequent events" for information on our dispositions of re-performing loans subsequent to September 30, 2014.

Recently issued accounting standards

In January 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-04, Troubled Debt Restructurings by Creditors. It provides that a repossession or foreclosure has occurred, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendment requires disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in mortgage loans collateralized by residential real estate property that are in the process of foreclosure. The amended guidance may be applied using either a prospective transition

method or a modified retrospective transition method and is effective for fiscal years, and interim periods within those years, beginning after December 15, 2014, with early adoption permitted. We do not expect this amendment to have a significant effect on our financial position or results of operations since our accounting policies and disclosures are currently consistent with the requirements set forth in the amendment.

In May 2014, the FASB issued ASU 2014-09 Revenue from Contracts with Customers. ASU 2014-09 is a comprehensive new revenue recognition model requiring a company to recognize revenue to depict the transfer of goods or services to a customer at an amount reflecting the consideration it expects to receive in exchange for those goods or services. ASU 2014-09 may be applied using either a full retrospective or a modified retrospective approach and is effective for fiscal years, and interim periods within those years, beginning after December 15, 2016, and early adoption is not permitted. We do not expect this amendment to have a significant effect on our financial position or results of operations since our accounting policies and disclosures are currently consistent with the requirements set forth in the amendment.

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2. Mortgage loans

During the nine months ended September 30, 2014, Residential acquired an aggregate of 8,155 mortgage loans and REO properties, consisting of the following:

Acquisitions of non-performing residential mortgage loans

During the nine months ended September 30, 2014, Residential acquired an aggregate of 7,086 residential mortgage loans, substantially all of which were non-performing, and 190 REO properties having an aggregate UPB of approximately \$1.9 billion and an aggregate market value of underlying properties of \$1.7 billion. The aggregate purchase price for these acquisitions was \$1.1 billion. During the quarter ended September 30, 2014, Residential agreed to acquire an aggregate of 246 residential mortgage loans, substantially all of which are non-performing, with an aggregate market value of underlying properties of \$29.7 million. There can be no assurance that Residential will complete this pending transaction in whole or in part on a timely basis or at all.

Acquisition of re-performing residential mortgage loans

On June 27, 2014, Residential acquired 879 re-performing mortgage loans with an aggregate market value of underlying properties of \$271.1 million for an aggregate purchase price of \$144.6 million. Under ASC 310-30, acquired loans may be aggregated and accounted for as a pool of loans if the loans being aggregated have common risk characteristics. A pool is accounted for as a single asset with a single composite interest rate and an aggregate expectation of cash flows. These 879 re-performing residential mortgage loans were determined to have common risk characteristics and have been accounted for as a single loan pool. Under ASC 310-30, Residential estimates cash flows expected to be collected, adjusted for expected prepayments and defaults expected to be incurred over the life of the loan pool. Residential determines the excess of the loan pool's contractually required principal and interest payments over the expected cash flows as an amount that should not be accreted, the nonaccretable yield. The difference between expected cash flows and the present value of the expected cash flows is referred to as the accretable yield, which represents the amount that is expected to be recorded as interest income over the remaining life of the loan pool. For the three and nine months ended September 30, 2014, Residential recognized no provision for loan loss and no adjustments to the amount of the accretable yield. For the three and nine months ended September 30, 2014, Residential accreted \$2.5 million into interest income with respect to these re-performing loans. As of September 30, 2014, these re-performing loans, having a UPB of \$204.3 million and a carrying value of \$143.2 million, were held for sale. During October 2014, Residential sold an aggregate of 934 re-performing loans to an unrelated third party for an aggregate purchase price of \$164 million. See Note 12 - "Subsequent events" for information on our dispositions of re-performing loans subsequent to September 30, 2014.

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

Contractually required principal and interest	\$325,000	
Non-accretable yield	(96,263)
Expected cash flows to be collected	228,737	
Accretable yield	(84,728)
Fair value at the date of acquisition	\$144,009	
Accretable Yield	Three months ended	
	September 30, 2014	
Balance at the beginning of the period	\$84,728	

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Accretion	(2,475)
Balance at the end of the period	\$82,253	

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Since the commencement of its operations, Residential has engaged in the acquisition of the following portfolios of non-performing and re-performing residential mortgage loans:

Portfolios Residential Agreed to Acquire			Acquisitions Completed in 2014		Acquisitions Completed in 2013		
Date of agreement in principle	Number of loans	Fair value of underlying property (in millions)	Date acquisition closed	Number of loans acquired	Fair value of underlying property (in millions)	Number of loans acquired	Fair value of underlying property (in millions)
January 23, 2013	460	\$94.2	February 14, 2013			460	\$94.2
February 12, 2013	244	40.1	March 21, 2013			230	38.7
February 14, 2013	762	128.9	April 5, 2013			720	122.1
June 25, 2013	321	73.9	August 26, 2013			292	67.3
June 27, 2013	2,377	296.1	August 6, 2013			1,562	185.2
			September 19, 2013			416	56.0
August 12, 2013	2,966	790.2	September 30, 2013			1,547	403.6
			October 21, 2013			1,100	298.0
November 12, 2013	993	137.3	January 2, 2014	650	\$93.6		
November 22, 2013	6,540	1,542.1	December 24, 2013			2,204	530.1
			January 31, 2014	3,421	791.7		
December 19, 2013	164	18.3	January 28, 2014	66	7.0		
			February 28, 2014	70	8.2		
March 11, 2014 ⁽¹⁾	915	180.0	May 1, 2014 ⁽²⁾	664	126.6		
May 2, 2014	78	8.7	July 10, 2014	46	5.0		
June 4, 2014	3,191	891.6	June 27, 2014	1,116	375.3		
			July 31, 2014	1,243	315.7		
June 4, 2014 ⁽³⁾	1,105	331.6	June 27, 2014 ⁽³⁾	879	271.1		
September 15, 2014	246	29.7	pending ⁽⁴⁾				
Totals	20,362	\$4,562.7	Totals	8,155	\$1,994.2	8,531	\$1,795.2

(1) The remaining portion of this acquisition, consisting of 159 mortgage loans and REO properties, closed in October 2014.

(2) Includes 190 REOs.

(3) This acquisition consisted of a portfolio of re-performing loans.

(4) This acquisition is expected to close in the fourth quarter of 2014.

During the three and nine months ended September 30, 2014, Residential recognized a nominal amount and \$2.9 million, respectively, for due diligence costs related to these and other transactions in both general and administrative expense and related party general and administrative expense. During the three and nine months ended September 30, 2013, Residential expensed \$0.9 million and \$1.3 million, respectively, for due diligence costs.

Generally, we expect that Residential's mortgage loan portfolio may grow at an uneven pace, as opportunities to acquire distressed residential mortgage loans may be irregularly timed and may involve large portfolios of loans, and the timing and extent of Residential's success in acquiring such loans cannot be predicted. In addition, for any given portfolio of loans that Residential agrees to acquire, it typically acquires fewer loans than originally expected, as certain loans may be resolved prior to the closing date or may fail to meet Residential's diligence standards. The number of unacquired loans typically constitutes a relatively small portion of a particular portfolio. In some cases, the number of loans Residential does not acquire could be significant. In any case where Residential does not acquire the full portfolio, appropriate adjustments are made to the applicable purchase price.

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

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Transfer of mortgage loans to real estate owned

During the three months ended September 30, 2014 and 2013, Residential transferred 1,113 and 43 mortgage loans, respectively, to REO at an aggregate fair value based on broker price opinions ("BPOs"), of \$189.9 million and \$6.2 million respectively. Such transfers occur when the foreclosure sale is complete. In connection with these transfers to REO, Residential recorded \$38.4 million and \$1.8 million, respectively, in net unrealized gains on mortgage loans.

During the nine months ended September 30, 2014 and 2013, Residential transferred 2,657 and 77 mortgage loans, respectively, to REO at an aggregate fair value based on BPOs, of \$410.9 million and \$10.6 million respectively. In connection with these transfers to REO, Residential recorded \$90.5 million and \$3.0 million, respectively, in net unrealized gains on mortgage loans.

Dispositions

During the three months ended September 30, 2014 and 2013, Residential disposed of 165 and 54 mortgage loans, respectively, primarily through short sales, refinancing and foreclosure sales. In connection with these dispositions, Residential recorded \$13.7 million and \$1.9 million, respectively, of net realized gains on mortgage loans.

During the nine months ended September 30, 2014 and 2013, Residential disposed of 416 and 92 mortgage loans, respectively, primarily through short sales, refinancing and foreclosure sales. In connection with these dispositions, Residential recorded \$33.9 million and \$4.0 million, respectively, of net realized gains on mortgage loans. During October 2014, Residential sold 934 re-performing loans to an unrelated third party. The sale included 770 loans from the re-performing mortgage loans held for sale, purchased in the second quarter of 2014, and 164 loans that have transitioned to re-performing status from prior non-performing loan acquisitions that have a clean pay history of at least six months. See Note 12 - "Subsequent events" for information on our dispositions of re-performing loans subsequent to September 30, 2014.

3. Real estate assets, net

Acquisitions

During the nine months ended September 30, 2014, Residential acquired 190 REO properties as part of their portfolio acquisitions. Residential acquired no REO properties during the three months ended September 30, 2014. During the three and nine months ended September 30, 2013, Residential acquired 34 and 40 REO properties, respectively. The aggregate purchase price attributable to these acquired REO properties was \$27.5 million for the nine months ended September 30, 2014 and was \$5.9 million and \$6.2 million, respectively, for the three and nine months ended September 30, 2013.

Real estate held for use

As of September 30, 2014, Residential had 2,660 REO properties held for use. Of these properties, 216 had been rented, 90 were being listed for rent and 270 were in varying stages of renovation. With respect to the remaining 2,084 REO properties, we will make a final determination whether each property meets Residential's rental profile after (a) applicable state redemption periods have expired, (b) the foreclosure sale has been ratified (c) Residential has recorded the deed for the property, (d) utilities have been activated and (e) Residential has secured access for interior inspection. A majority of the REO properties are subject to state regulations which require Residential to await the expiration of a redemption period before a foreclosure can be finalized. Residential includes these redemption periods in its portfolio pricing which generally reduces the price Residential pays for the mortgage loans. Once the redemption period expires, Residential immediately proceeds to record the new deed, take possession of the property, activate

utilities, and start the inspection process in order to make its final determination. As of December 31, 2013, Residential had 246 REO properties held for use. Of these properties, 14 had been rented, 11 were being listed for rent and 18 were in various stages of renovation. With respect to the remaining 203 REO properties, we were in the process of determining whether these properties would meet Residential's rental profile. As of September 30, 2013, Residential had 100 REO properties held for use. Of these properties, five had been rented, six were being listed for rent and three were in various stages of renovation. With respect to the remaining 86 REO properties, we were in the process of determining whether these properties would meet Residential's rental profile. If a REO property meets Residential's rental profile, we determine the extent of renovations that are needed to generate an optimal rent and maintain consistency of renovation specifications for future branding. If we determine that the REO property will not meet Residential's rental profile, we list the property for sale, in certain instances after renovations are made to optimize the sale proceeds.

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Real estate held for sale

As of September 30, 2014, Residential classified 324 properties having an aggregate carrying value of \$41.0 million as real estate held for sale as they do not meet its residential rental property investment criteria. As of December 31, 2013, Residential had 16 REO properties having an aggregate carrying value of \$1.2 million held for sale, and as of September 30, 2013, Residential had 14 REO properties having an aggregate carrying value of \$1.1 million held for sale. None of these REO properties have any operations; therefore, we are not presenting discontinued operations related to these properties.

Dispositions

During the three and nine months ended September 30, 2014, Residential disposed of 78 and 102 residential properties, respectively. Residential did not dispose of any residential properties during the nine months ended September 30, 2013. In connection with the dispositions for the three and nine months ended September 30, 2014, we recorded \$3.3 million and \$4.5 million, respectively, of net realized gains on real estate.

4. Fair value of financial instruments

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

	Level 1 Quoted prices in active markets	Level 2 Observable inputs other than Level 1 prices	Level 3 Unobservable inputs
September 30, 2014			
Recurring basis (assets)			
Mortgage loans	\$—	\$—	\$2,071,505
Nonrecurring basis (assets)			
Real estate assets held for sale	\$—	\$—	\$44,187
Transfer of real estate owned to mortgage loans	\$—	\$—	\$5,367
Transfer of mortgage loans to real estate owned	\$—	\$—	\$410,913
Not recognized on consolidated balance sheets at fair value (assets)			
Mortgage loans held for sale	\$—	\$—	\$143,197
Not recognized on consolidated balance sheets at fair value (liabilities)			
Repurchase agreements at fair value	\$—	\$1,258,329	\$—
Other secured borrowings	\$—	\$150,000	\$—
December 31, 2013			
Recurring basis (assets)			
Mortgage loans	\$—	\$—	\$1,207,163
Nonrecurring basis (assets)			
Real estate assets held for sale	\$—	\$—	\$1,520
Transfer of mortgage loans to real estate owned	\$—	\$—	\$31,014
Not recognized on consolidated balance sheets at fair value (liabilities)			
Repurchase agreements at fair value	\$—	\$602,382	\$—

Residential has not transferred any assets from one level to another level during the nine months ended September 30, 2014. Additionally there were no transfers between levels for the year ended December 31, 2013.

The carrying values of Residential's and our cash and cash equivalents, restricted cash, related party receivables, accounts payable and accrued liabilities, related party payables, preferred stock, and investment in NewSource are equal to or approximate fair value. The fair value of mortgage loans is estimated using our proprietary pricing model. The fair value of transfers of mortgage loans to real estate owned is estimated using BPOs. The fair value of re-performing mortgage loans held

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for sale is estimated using the present value of the future estimated principal and interest payments of the loan, with the discount rate used in the present value calculation representing the estimated effective yield of the loan. The fair value of the repurchase agreements is estimated using the income approach based on credit spreads available currently in the market for similar floating rate debt. The fair value of other secured borrowings is estimated using observable market data.

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

	Three months ended September 30, 2014	Three months ended September 30, 2013	Nine months ended September 30, 2014	Nine months ended September 30, 2013
Mortgage loans				
Beginning balance	\$2,024,028	\$163,520	\$1,207,163	\$—
Investment in mortgage loans	184,590	475,998	1,097,601	644,163
Net unrealized gain on mortgage loans	88,726	17,670	258,898	25,963
Net realized gain on mortgage loans	13,727	1,909	33,867	4,015
Mortgage loan dispositions and payments	(60,062)	(11,882)	(143,834)	(22,527)
Real estate tax advances to borrowers	6,397	887	19,119	887
Reclassification of realized gains on real estate sold from unrealized gains	3,322	—	4,237	—
Transfer of real estate owned to mortgage loans	719	—	5,367	—
Transfer of mortgage loans to real estate owned	(189,942)	(6,199)	(410,913)	(10,598)
Ending balance at September 30	\$2,071,505	\$641,903	\$2,071,505	\$641,903
Net unrealized gain on mortgage loans held at the end of the period	\$55,558	\$17,670	\$164,378	\$25,963

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

	Number of loans	Carrying Value	Unpaid principal balance	Market value of underlying properties
September 30, 2014				
Current	685	\$96,445	\$161,438	\$168,946
30	98	10,080	17,485	19,072
60	46	6,593	9,560	10,208
90	2,608	410,583	663,560	629,706
Foreclosure	8,653	1,547,804	2,362,326	2,086,407
Mortgage loans	12,090	\$2,071,505	\$3,214,369	\$2,914,339
December 31, 2013				

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Current	238	\$31,649	\$60,051	\$52,506
30	26	2,087	4,492	3,763
60	23	3,376	5,683	4,738
90	1,555	245,024	419,836	355,451
Foreclosure	6,212	925,027	1,609,546	1,310,439
Mortgage Loans	8,054	\$1,207,163	\$2,099,608	\$1,726,897

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

	Number of loans	Carrying value	Unpaid principal balance	Market value of underlying properties
September 30, 2014				
Current	818	\$136,814	\$194,861	\$257,491
30	23	2,587	3,867	4,114
60	7	1,062	1,552	1,703
90	24	2,734	4,066	4,436
Mortgage loans held for sale	872	\$143,197	\$204,346	\$267,744

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

Input	September 30, 2014	December 31, 2013
Equity discount rate	15.0%	15.0%
Debt to asset ratio	65.0%	55.0%
Cost of funds	3.5% over 1 month LIBOR	3.5% over 1 month LIBOR
Annual change in home pricing index	-0.2% to 7.6%	-0.3% to 7.6%
Loan resolution probabilities — modification	0% to 44.7%	0% to 22.3%
Loan resolution probabilities — rental	0% to 100.0%	0% to 100.0%
Loan resolution probabilities — liquidation	0% to 100.0%	0% to 100.0%
Loan resolution timelines (in years)	0.1 to 5.3	0.1 - 5.8
Value of underlying properties	\$3,000 - \$6,450,000	\$3,000 - \$3,550,000

5. Borrowings

Repurchase Agreements

Residential's operating partnership and certain of its Delaware Statutory Trust subsidiaries, as applicable, have entered into master repurchase agreements with major financial institutions. The purpose of these repurchase agreements is to finance the acquisition and ownership of mortgage loans and REO properties in its portfolio. Residential has effective control of the assets associated with these agreements and therefore it has concluded these are financing arrangements. As of September 30, 2014, the weighted average annualized interest rate on borrowing under Residential's repurchase agreements was 3.05%, excluding amortization of deferred financing costs. The following table sets forth data with respect to Residential's repurchase agreements as of September 30, 2014 and December 31, 2013 (\$ in thousands):

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	Maximum borrowing capacity	Book value of collateral	Amount outstanding
September 30, 2014			
Repurchase agreement due April 20, 2015 (1)	\$375,000	\$655,739	\$374,982
Repurchase agreement due March 23, 2015	1,030,000	1,076,441	669,452
Repurchase agreement due March 11, 2016	250,000	414,889	213,894
	\$1,655,000	\$2,147,069	\$1,258,328
December 31, 2013			
Repurchase agreement due April 21, 2014	\$100,000	\$166,350	\$85,364
Repurchase agreement due March 23, 2015	400,000	634,234	398,602
Repurchase agreement due March 11, 2016	250,000	205,328	118,416
	\$750,000	\$1,005,912	\$602,382

(1) The aggregate borrowing capacity under the repurchase agreement reverts to \$200.0 million after December 10, 2014.

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

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

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

Other Secured Debt

On September 25, 2014, Residential completed a securitization transaction in which ARLP 2014-1 issued \$150.0 million in Class A Notes with a weighted yield of approximately 3.5% and \$32.0 million in Class M Notes with a weighted yield of 4.25%. The Class A Notes and the Class M Notes are secured solely by the non-performing mortgage loans of ARLP 2014-1 and not by any of Residential's other assets. The assets of ARLP 2014-1 are the only source of repayment and interest on the Class A Notes and the Class M Notes. The Class A Notes and the Class M Notes mature on September 25, 2044, and Residential does not guaranty any of the obligations of ARLP 2014-1 under the terms of the Indenture governing the notes or otherwise. As of September 30, 2014, the book value of the

underlying securitized assets held by ARLP 2014-1 was \$211.3 million.

Residential retained all of the Class M Notes in its TRS. On September 30, 2014, pursuant to a master repurchase agreement, the TRS sold \$15.0 million of the Class M Notes to NewSource for a purchase price of \$15.0 million. The master repurchase agreement requires the TRS to repurchase the Class M Notes from NewSource at a 5.0% yield on December 28, 2014, with the parties having the option to extend the master repurchase agreement for an additional 89 day period. In no event can the master repurchase agreement be extended beyond September 29, 2015.

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The following table sets forth data with respect to these notes as of September 30, 2014 (\$ in thousands):

	Interest Rate	September 30, 2014
ARLP Securitization Trust, Series 2014-1		
ARLP 2014-1 Class A Notes due September 25, 2044 ⁽¹⁾	3.4747	% \$150,000
ARLP 2014-1 Class M Notes due September 25, 2044 ⁽²⁾	4.25	% 32,000
ARNS, Inc.		
Securities sold under agreement to repurchase due December 28, 2014	5.00	% 15,000
Elimination of intercompany debt		(47,000)
Total		\$ 150,000

(1) The expected redemption date for the Class A Notes is September 25, 2017.

(2) The expected redemption date for the Class M Notes is September 25, 2018.

6. Commitments and Contingencies

Litigation, claims and assessments

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

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7. Related party transactions

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

	Three months ended September 30, 2014	Nine months ended September 30, 2014	Counter-party	Consolidated Statements of Operations location
2014				
Residential property operating expenses	\$7,038	\$11,238	Ocwen/Altisource	Residential property operating expenses
Mortgage loan servicing costs	22,173	47,605	Ocwen	Mortgage loan servicing costs
Due diligence and unsuccessful deal costs	4	1,770	Altisource	Related party general and administrative expenses
Office and occupancy costs	91	234	Ocwen/Altisource	Related party general and administrative expenses
Salaries and benefits	485	1,614	Ocwen/Altisource	Related party general and administrative expenses
Expense reimbursements	1,801	5,580	Residential/NewSource	Net loss (income) attributable to noncontrolling interest in consolidated affiliate
Management incentive fee	19,503	44,129	Residential	Net loss (income) attributable to noncontrolling interest in consolidated affiliate
	Three months ended September 30, 2013	Nine months ended September 30, 2013	Counter-party	Consolidated Statements of Operations location
2013				
Residential property operating expenses	\$138	\$246	Ocwen/Altisource	Residential property operating expenses
Mortgage loan servicing costs	2,134	3,335	Ocwen	Mortgage loan servicing costs
Due diligence and unsuccessful deal costs	651	1,004	Altisource	Related party general and administrative expenses
Office and occupancy costs	74	153	Ocwen	Related party general and administrative expenses
Expense reimbursements	1,307	3,371	Residential/NewSource	Net loss (income) attributable to noncontrolling interest in consolidated affiliate
Management incentive fee	51	51	Residential	Net loss (income) attributable to noncontrolling interest in consolidated affiliate

On September 30, 2014, pursuant to a master repurchase agreement, Residential's TRS sold \$15.0 million of the Class M Notes to NewSource for a purchase price of \$15.0 million. The master repurchase agreement requires the TRS to repurchase the Class M Notes from NewSource at a 5.0% yield on December 28, 2014, with the parties having the option to extend the master repurchase agreement for an additional 89 day period. In no event can the master repurchase agreement be extended beyond September 29, 2015.

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

8. Share-based payments

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

Our directors each receive annual grants of restricted stock equal to \$45,000 based on the market value of our common stock at the time of the annual stockholders meeting. This restricted stock vests and is issued after a one-year service period subject to each director attending at least 75% of the Board and committee meetings. No dividends are paid on the shares until the award is issued. During the nine months ended September 30, 2014 and 2013, we granted 205 and 1,470 shares of stock, respectively,

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pursuant to our 2013 Director Equity Plan with a weighted average grant date fair value per share of \$1,090.26 and \$205.27, respectively.

We recorded \$1.6 million and \$4.3 million of compensation expense related to these grants for the three and nine months ended September 30, 2014, respectively, and recorded \$2.1 million and \$3.4 million for the three and nine months ended September 30, 2013, respectively. As of September 30, 2014 and 2013, we had an aggregate \$19.6 million and \$15.0 million, respectively, of total unrecognized share-based compensation cost to be recognized over a weighted average remaining estimated term of 2.83 years and 3.25 years, respectively.

9. Income taxes

We are domiciled in the United States Virgin Islands ("USVI") and under current USVI law are obligated to pay taxes in the United States Virgin Islands on income and/or capital gains. We applied for tax benefits from the United States Virgin Islands Economic Development Commission and received our certificate of benefits, effective as of February 1, 2013. Under the certificate of benefits, so long as we comply with the provisions of the certificate, we will receive a 90% exemption on our USVI sourced income taxes until 2043. NewSource is considered a controlled foreign corporation ("CFC") to AAMC. CFC Subpart F income generated is taxed currently in the USVI and does not receive the reduced tax rate under the certificate of benefits.

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

10. Earnings per share

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

	Three months ended September 30, 2014	Three months ended September 30, 2013	Nine months ended September 30, 2014	Nine months ended September 30, 2013
Numerator				
Net income (loss) attributable to common stockholders	\$17,698	\$(2,557)	\$37,756	\$(4,896)
Denominator				
Weighted average common stock outstanding – basic	2,238,225	2,348,040	2,286,451	2,344,923
Stock options using treasury method	244,543	—	256,203	—
Restricted stock	148,849	—	167,393	—
Preferred shares if converted	200,000	—	143,704	—
Weighted average common stock outstanding – diluted	2,831,617	2,348,040	2,853,751	2,344,923
Earnings (loss) per basic share	\$7.91	\$(1.09)	\$16.51	\$(2.09)
Earnings (loss) per diluted share	\$6.25	\$(1.09)	\$13.23	\$(2.09)

Because we incurred a net loss attributable to common stockholders for the three and nine months ended September 30, 2013, basic and diluted earnings per share are equivalent for the period. For the three and nine months ended September 30, 2013, there were 284,597 and 288,245 stock options, respectively, and 224,944 units of restricted stock excluded from the calculation of diluted earnings per share because inclusion would have been anti-dilutive.

11. Segment information

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

12. Subsequent events

Sale of Re-performing Mortgage Loans

In October 2014, Residential sold an aggregate of 934 re-performing loans for an aggregate purchase price of \$164 million. Of the 934 loans sold in this transaction, 770 were from the re-performing loan pool Residential purchased in the second quarter of 2014 and 164 were from prior NPL acquisitions that had transitioned to re-performing status and had a clean pay history of at least six months. The gain on purchase price for the 770 loans Residential purchased in the second quarter of 2014 was 2%, and the gain on purchase price for the remaining 164 re-performing loans was 28%. Following such payment, the total outstanding borrowings under Residential's repurchase agreements was reduced from \$1.3 billion to \$1.1 billion.

Completed Portfolio Acquisition

On October 24, 2014, Residential acquired a portfolio of 159 first lien residential mortgage loans, substantially all of which were non-performing, and REO properties, having an aggregate UPB of \$42.8 million and an aggregate market value of properties of \$31.6 million for an aggregate purchase price of \$21.0 million. This transaction represented the second closing of the portfolio of 915 non-performing mortgage loans and REO properties that Residential had agreed to purchase in the second quarter of 2014.

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

Overview

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

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

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

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

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

Since Residential has commenced operations, we have advised Residential and conducted portfolio analysis and the bidding process to facilitate the acquisition and growth of Residential’s portfolio of residential mortgage loans as follows:

During the nine months ended September 30, 2014, Residential completed the acquisition of an aggregate of 7,086 residential mortgage loans, substantially all of which were non-performing, and 190 REO properties having an aggregate unpaid principal balance (“UPB”) of approximately \$1.9 billion and an aggregate market value of underlying properties of \$1.7 billion. The aggregate purchase price for these acquisitions was \$1.1 billion. During the quarter ended September 30, 2014, Residential agreed to acquire an aggregate of 246 residential mortgage loans, substantially all of which are non-performing, with an aggregate market value of underlying properties of \$29.7 million. There can be no assurance that Residential will complete this transaction in whole or in part on a timely basis or at all.

On June 27, 2014, Residential acquired 879 re-performing mortgage loans with an aggregate market value of underlying properties of \$271.1 million for an aggregate purchase price of \$144.6 million. During October 2014, Residential sold 770 of these re-performing mortgage loans. See Note 12 - "Subsequent events" for information on our dispositions of re-performing loans subsequent to September 30, 2014.

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

During 2013 and the nine months ended September 30, 2014, Residential modified an aggregate of 451 mortgage loans, converted an aggregate of 2,860 mortgage loans into REO properties and disposed of an aggregate of 627 mortgage loans through short sale, refinancing or other liquidation events.

Following the above-referenced transactions, as of September 30, 2014, Residential's portfolio consisted of 12,090 residential mortgage loans, substantially all of which were non-performing, having an aggregate UPB of approximately \$3.2 billion and an

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aggregate market value of underlying properties of \$2.9 billion. Residential also owned 2,984 REO properties with an aggregate carrying value of \$460.1 million, of which 2,660 were held for use and 324 were held for sale. Of the 2,660 REO properties held for use, 216 REO properties had been rented and were occupied by tenants, 90 were being listed for rent and 270 were in varying stages of renovation. With respect to the remaining 2,084 REO properties held for use, Residential will make a final determination whether each property meets its rental profile after (a) applicable state redemption periods have expired, (b) the foreclosure sale has been ratified, (c) Residential has recorded the deed for the property, (d) utilities have been activated and (e) Residential has secured access for interior inspection. Residential also owned 872 re-performing mortgage loans held for sale having an aggregate UPB of approximately \$204.3 million and an aggregate market value of underlying properties of approximately \$267.7 million as of September 30, 2014.

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

NewSource has generated approximately \$2.0 million of title reinsurance premiums for the nine months ended September 30, 2014. We expect to further expand the geographic scope of NewSource's title reinsurance activities in the coming quarters in seeking to grow NewSource's business opportunities.

Observations on Current Market Opportunities

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

Metrics Affecting Our Consolidated Results

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

Revenues

Residential's revenues primarily consist of the following:

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

ii.

Net unrealized gains from the conversion of loans to REO. Upon conversion of loans to REO, Residential marks the properties to the most recent market value (less estimated selling costs in the case of REO properties held for sale). The difference between the carrying value of the asset at the time of conversion and the most recent market value, based on BPOs, is recorded in Residential's statement of operations as net unrealized gain on mortgage loans. We expect the timeline to convert acquired loans into REO will vary significantly by loan, which could result in fluctuations in Residential's revenue recognition and its operating performance from period to period. The factors that may affect the timelines to foreclose upon a residential mortgage loan include, without limitation, state foreclosure timelines and deferrals associated therewith; unauthorized parties occupying the property; federal, state or local legislative action or initiatives designed to provide homeowners with assistance in avoiding residential mortgage loan foreclosures and continued declines in real estate values and/or sustained high levels of unemployment that increase

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the number of foreclosures and which place additional pressure and/or delays on the already overburdened judicial and administrative proceedings.

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

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

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

Expenses

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

Other factors affecting our consolidated results

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

Acquisitions

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

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Generally, we expect that Residential's mortgage loan portfolio may grow at an uneven pace, as opportunities to acquire distressed residential mortgage loans may be irregularly timed and may at times involve large portfolios of loans, and the timing and extent of Residential's success in acquiring such loans cannot be predicted. In addition, for any given portfolio of loans that we agree to acquire, we typically acquire fewer loans than originally expected, as certain loans may be resolved prior to the closing date or may fail to meet our diligence standards. The number of unacquired loans typically constitutes a relatively small portion of a particular portfolio. In some cases, the number of loans we do not acquire could be significant. In any case where we do not acquire the full portfolio, appropriate adjustments are made to the applicable purchase price.

Financing

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

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

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Resolution Activities

	First quarter 2013	Second quarter 2013	Third quarter 2013	Nine months ended September 30, 2013	First quarter 2014	Second quarter 2014	Third quarter 2014	Nine months ended September 30, 2014
Mortgage Loans ⁽¹⁾								
Beginning balance	—	673	1,332	—	8,054	11,509	12,070	8,054
Acquisitions	684	720	3,783	5,187	4,207	1,590	1,289	7,086
Dispositions	(10	)(28	)(54	)(92	)(116	)(135	)(165	)(416
Mortgage loan conversions to REO	(1	)(33	)(43	)(77	)(637))