Altisource Asset Management Corp
Form 10-Q
November 09, 2015

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

FORM 10-Q

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

OR

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

COMMISSION FILE NUMBER: 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.)

36C Strand Street
Christiansted, United States Virgin Islands 00820
(Address of principal executive office)

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

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

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

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

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

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

As of October 30, 2015, 2,213,222 shares of our common stock were outstanding (excluding 302,475 shares held as treasury stock).

Altisource Asset Management Corporation
September 30, 2015
Table of Contents

(table of contents)

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.

Special note on forward-looking statements

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

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

- our ability to implement our business strategy and the business strategy of Residential;
- our ability to retain Residential as a client;
- our ability to attract and/or obtain new asset management clients;
- our ability to retain and maintain our strategic relationships with key vendors;
- the ability of Residential to pay acceptable dividends to its stockholders under our management;
- our ability to effectively compete with our competitors;
- Residential's ability to complete future or pending transactions;
- the failure of Altisource to effectively perform its obligations under their agreements with us and Residential;
- the failure of Residential’s mortgage loan servicers to effectively perform their services to 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, 2014.

(table of contents)

Part I

Item 1. Financial statements (unaudited)

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

(table of contents)

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

	September 30, 2015	December 31, 2014
Assets:		
Real estate held for use:		
Land (from consolidated VIE)	$49,518	$14,424
Rental residential properties (net of accumulated depreciation of $5,048 and $1,062, respectively - from consolidated VIE)	200,136	60,908
Real estate owned (from consolidated VIE)	567,228	457,045
Total real estate held for use, net	816,882	532,377
Real estate assets held for sale (from consolidated VIE)	133,154	92,230
Mortgage loans at fair value (from consolidated VIE)	1,380,575	1,959,044
Mortgage loans held for sale (from consolidated VIE)	254,835	12,535
Cash and cash equivalents (including from consolidated VIE $83,881 and $66,166, respectively)	152,634	116,782
Restricted cash (from consolidated VIE)	25,511	13,282
Accounts receivable (including from consolidated VIE $35,507 and $10,313, respectively)	35,514	11,068
Related party receivables (from consolidated VIE)	—	17,491
Deferred leasing and financing costs, net (from consolidated VIE)	9,806	4,251
Prepaid expenses and other assets (including from consolidated VIE $395 and $373, respectively)	1,790	1,638
Total assets	$2,810,701	$2,760,698
Liabilities:		
Repurchase and loan and security agreements (from consolidated VIE)	$929,478	$1,015,000
Other secured borrowings (from consolidated VIE)	513,049	324,082
Accounts payable and accrued liabilities (including from consolidated VIE $63,871 and $11,678, respectively)	68,585	16,726
Related party payables (including from consolidated VIE $0 and $4,879, respectively)	—	6,169
Total liabilities	1,511,112	1,361,977
Commitments and contingencies (Note 6)		
Redeemable preferred stock:		
Preferred stock, $0.01 par value, 250,000 shares issued and outstanding as of September 30, 2015 and December 31, 2014; redemption value $250,000	249,082	248,927
Equity:		
Common stock, $.01 par value, 5,000,000 authorized shares; 2,515,697 and 2,213,222 shares issued and outstanding, respectively, as of September 30, 2015 and 2,452,101 and 2,188,136 shares issued and outstanding, respectively, as of December 31, 2014	25	25
Additional paid-in capital	20,977	14,152
Retained earnings	59,670	54,174
Treasury stock, at cost, 302,475 shares as of September 30, 2015 and 263,965 shares as of December 31, 2014	(252,072)	(245,468)
Total stockholders' equity (deficit)	(171,400)	(177,117)

Noncontrolling interest in consolidated affiliate	1,221,907	1,326,911
Total equity	1,050,507	1,149,794
Total liabilities and equity	$2,810,701	$2,760,698

See accompanying notes to consolidated financial statements.

2

(table of contents)

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

	Three months ended September 30, 2015	Three months ended September 30, 2014	Nine months ended September 30, 2015	Nine months ended September 30, 2014
Revenues:				
Rental revenues	$4,021	$469	$7,561	$719
Net unrealized gain on mortgage loans	27,499	88,726	130,842	258,898
Net realized gain on mortgage loans	12,874	13,727	47,528	33,867
Net realized gain on mortgage loans held for sale	100	302	505	302
Net realized gain on real estate	13,914	3,310	36,926	4,544
Interest income	115	2,568	595	2,757
Total revenues	58,523	109,102	223,957	301,087
Expenses:				
Residential property operating expenses	16,574	9,247	45,890	13,550
Real estate depreciation and amortization	2,050	313	4,392	464
Real estate and mortgage loan selling costs and impairment	10,705	5,542	34,235	8,775
Mortgage loan servicing costs	13,477	21,226	47,989	49,588
Interest expense	14,194	11,699	38,914	24,352
General and administrative	8,935	5,435	26,465	15,578
Related party general and administrative	—	999	—	4,597
Total expenses	65,935	54,461	197,885	116,904
Other income	—	1,586	—	2,372
(Loss) income before income taxes	(7,412)	56,227	26,072	186,555
Income tax (benefit) expense	(97)	853	240	1,428
Net (loss) income	(7,315)	55,374	25,832	185,127
Net loss (income) attributable to noncontrolling interest in consolidated affiliate	5,335	(37,676)	(20,181)	(147,371)
Net (loss) income attributable to common stockholders	$(1,980)	$17,698	$5,651	$37,756
(Loss) earnings per share of common stock – basic:				
(Loss) earnings per basic share	$(0.92)	$7.91	$2.49	$16.51
Weighted average common stock outstanding – basic	2,208,658	2,238,225	2,210,448	2,286,451

(Loss) earnings per share of common stock – diluted:				
(Loss) earnings per diluted share	$(0.92)	$6.25	$2.07	$13.23
Weighted average common stock outstanding – diluted	2,208,658	2,831,617	2,733,747	2,853,751

See accompanying notes to consolidated financial statements.

(table of contents)

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

	Common stock						
	Number of shares	Amount	Additional paid-in capital	Retained earnings	Treasury stock	Noncontrolling interest in consolidated affiliate	Total equity
December 31, 2014	2,452,101	$25	$14,152	$54,174	$(245,468)	$1,326,911	$1,149,794
Issuance of common stock, including option exercises	63,596	—	20	—	—	—	20
Treasury shares repurchased	—	—	—	—	(6,604)	—	(6,604)
Capital contribution from noncontrolling interest	—	—	—	—	—	103	103
Distribution from noncontrolling interest	—	—	—	—	—	(98,123)	(98,123)
Repurchase of noncontrolling interest in subsidiaries by affiliate	—	—	—	—	—	(19,983)	(19,983)
Acquisition of noncontrolling interest in subsidiaries	—	—	2,314	—	—	(7,321)	(5,007)
Amortization of preferred stock issuance costs	—	—	—	(155)	—	—	(155)
Share-based compensation, net of tax	—	—	4,491	—	—	139	4,630
Net income	—	—	—	5,651	—	20,181	25,832
September 30, 2015	2,515,697	$25	$20,977	$59,670	$(252,072)	$1,221,907	$1,050,507

	Common stock						
	Number of shares	Amount	Additional paid-in capital	Retained earnings (accumulated deficit)	Treasury stock	Noncontrolling interest in consolidated affiliate	Total equity
December 31, 2013	2,354,774	$24	$12,855	$(5,339)	$—	$785,427	$792,967
Issuance of common stock, including option exercises	96,066	1	44	—	—	—	45
Treasury shares repurchased	—	—	—	—	(236,751)	—	(236,751)

Capital contribution from noncontrolling interest	—	—	—	—	—	468,416	468,416
Distribution from noncontrolling interest	—	—	—	—	—	(84,570)	(84,570)
Amortization of preferred stock issuance costs	—	—	—	(114)	—	—	(114)
Share-based compensation	—	—	4,347	—	—	170	4,517
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

See accompanying notes to consolidated financial statements.
4

(table of contents)

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

	Nine months ended September 30, 2015	Nine months ended September 30, 2014
Operating activities:		
Net income	$25,832	$185,127
Adjustments to reconcile net income to net cash used in operating activities:		
Net unrealized gain on mortgage loans	(130,842)	(258,898)
Net realized gain on mortgage loans	(47,528)	(33,867)
Net realized gain on sale of mortgage loans held for sale	(505)	(302)
Net realized gain on sale of real estate	(36,926)	(4,544)
Real estate depreciation and amortization	4,392	464
Real estate and mortgage loan selling costs and impairment	34,235	8,775
Accretion of interest on re-performing mortgage loans	(581)	(2,475)
Share-based compensation	4,461	4,517
Amortization of deferred financing costs	4,271	2,127
Loss on retirement of leasehold improvements	212	—
Changes in operating assets and liabilities:		
Accounts receivable	(998)	(1,137)
Related party receivables	—	6,421
Prepaid expenses and other assets	(355)	(6,315)
Deferred leasing costs	(1,287)	—
Accounts payable and accrued liabilities	15,071	1,786
Related party payables	—	4,024
Net cash used in operating activities	(130,548)	(94,297)
Investing activities:		
Investment in mortgage loans	—	(1,241,083)
Investment in real estate	(111,423)	(27,463)
Investment in renovations	(15,936)	(5,957)
Investment in subsidiary	(5,007)	—
Real estate tax advances	(18,438)	(20,244)
Mortgage loan dispositions	190,146	122,023
Mortgage loan payments	19,268	14,903
Disposition of real estate	119,368	11,771
Change in restricted cash	(12,229)	(6,155)
Net cash provided by (used in) investing activities	165,749	(1,152,205)
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	584	12,186
Repurchase of common stock	(6,604)	(236,751)
Payment of tax withholdings on exercise of stock options	(564)	(12,141)
Capital contribution from noncontrolling interest	103	468,416
Distribution to noncontrolling interest	(67,506)	(84,570)
Repurchase of noncontrolling interest in subsidiaries by affiliate	(19,983)	—
Proceeds from issuance of other secured debt	221,691	150,000
Repayments of secured notes	(32,298)	—
Proceeds from repurchase agreement	285,967	952,264

Repayments of repurchase agreement	(371,489)	(296,317)
Payment of deferred financing costs	(9,250)	(3,636)
Net cash (used in) provided by financing activities	651	1,198,326

See accompanying notes to consolidated financial statements.

(table of contents)

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

	Nine months ended September 30, 2015	Nine months ended September 30, 2014
Net increase in cash and cash equivalents	35,852	(48,176)
Cash and cash equivalents as of beginning of the period	116,782	140,000
Cash and cash equivalents as of end of the period	$152,634	$91,824
Supplemental disclosure of cash flow information		
Cash paid for interest	$34,152	$20,212
Transfer of mortgage loans to real estate owned	367,653	410,913
Transfer of mortgage loans at fair value to mortgage loans held for sale	250,346	—
Transfer of real estate owned to mortgage loans	8,275	5,367
Change in accrued capital expenditures	164	7,712
Changes in receivables from mortgage loan dispositions, payments and real estate tax advances, net	2,550	13,081
Changes in receivables from real estate owned dispositions	1,949	3,097

See accompanying notes to consolidated financial statements.

(table of contents)

Altisource Asset Management Corporation
Notes to Consolidated Financial Statements
September 30, 2015
(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.” Residential is a Maryland corporation that acquires and manages quality, affordable single-family rental properties throughout the United States.

Residential is currently our primary source of revenue and will drive our results. On March 31, 2015, we entered into a new asset management agreement with Residential (the “New AMA”) with an effective date of April 1, 2015. Our previous asset management agreement with Residential (the “Original AMA”) had a different incentive fee structure, which we refer to as our “incentive management fees,” that gave us a share of Residential’s cash flow available for distribution to its stockholders as well as reimbursement for certain overhead and operating expenses. Although the New AMA provides for a new fee structure in which we are entitled to a base management fee, an incentive management fee and a conversion fee for loans and real estate owned (“REO”) properties that become rental properties during each quarter, our operating results are highly dependent on Residential's operating results. For additional details on the New AMA, please see “Note 7. Related Party Transactions.”

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 AMA 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.

For entities that are consolidated, but not 100% owned, a portion of the income or loss and corresponding equity is allocated to noncontrolling interests. Historically, amounts recognized as noncontrolling interest in our consolidated financial statements were equivalent to Residential's net income and equity because we had no ownership interest in Residential. In the third quarter of 2015, we acquired 324,465, or approximately 0.58%, of Residential's outstanding shares. Subsequent to our acquisition of these shares, the noncontrolling interest in consolidated affiliate represents the remaining 99.42% ownership interest held by non-affiliated shareholders of Residential's common stock.

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. In September 2015, we contributed an additional $5.0 million to NewSource. In September 2015, Residential's taxable REIT subsidiary (“TRS”) repurchased the $15.0 million of ARLP 2014-1 Class M notes held by NewSource under a master repurchase agreement. These proceeds, along with existing cash balances, were used by NewSource to repurchase, at par value, the $18.0 million preferred stock held by Residential on September 14, 2015. In connection with the repurchase of its preferred stock, NewSource also paid to Residential the accrued but unpaid dividend on the preferred stock from January 1, 2015 through September 10, 2015, or $1.5 million.

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. NewSource commenced reinsurance activities during the second quarter of 2014. In December 2014, NewSource determined that the economics of the initial business did not warrant the continuation of its initial reinsurance quota share agreement with an unrelated third party. NewSource therefore transferred all of the risk of claims and future losses underwritten to an unrelated third party.

Since Residential commenced operations, it has financed its business through a combination of equity offerings and repurchase agreements, warehouse lines and securitizations. Since inception, it has completed three public equity offerings with aggregate net proceeds of approximately $1.1 billion. Residential also entered into three separate repurchase agreements to finance its

(table of contents)

acquisition and ownership of residential mortgage loans and REO properties. The maximum aggregate funding available under these repurchase agreements at December 31, 2014 was $1.2 billion. On April 10, 2015, Residential also entered into a loan and security agreement (the “Nomura loan agreement”) with Nomura Corporate Funding Americas, LLC (“Nomura”). The purpose of the Nomura loan agreement is to finance Residential's beneficial ownership of REO properties. The maximum aggregate funding available to Residential under the repurchase agreements and the Nomura loan agreement as of September 30, 2015 was $1.3 billion, subject to certain sublimits, eligibility requirements and conditions precedent to each funding. As of September 30, 2015, an aggregate of $929.5 million was outstanding under Residential's repurchase agreements and the Nomura loan agreement. All obligations of Residential’s subsidiaries under the repurchase agreements and the Nomura loan agreement are fully guaranteed by Residential.

Each of Residential's repurchase agreements and the Nomura loan agreement is described below:

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

- Deutsche Bank (“DB”) is the lender on the repurchase agreement entered into on September 12, 2013 (the “DB repurchase agreement”). The DB repurchase agreement matures on March 11, 2016 and includes a provision that after March 2015, Residential is not eligible for additional funding under the facility, thereby reducing Residential's aggregate funding capacity under the DB repurchase agreement to $91.2 million, which was the amount outstanding under the facility on September 30, 2015.

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

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

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

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

8

(table of contents)

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

- On June 29, 2015, Residential completed a securitization transaction in which ARLP Securitization Trust, Series 2015-1 ("ARLP 2015-1") issued $205.0 million in Class A Notes (the “ARLP 2015-1 Class A Notes”) with a weighted coupon of approximately 4.01% and $60.0 million in Class M Notes (the “ARLP 2015-1 Class M Notes”). Residential retained $34.0 million of the ARLP 2015-1 Class A Notes and all of the ARLP 2015-1 Class M Notes. No interest will be paid on any ARLP 2015-1 Class M Notes while any ARLP 2015-1 Class A Notes remain outstanding. The ARLP 2015-1 Class A Notes and ARLP 2015-1 Class M Notes are secured solely by the non-performing mortgage loans and REO properties of ARLP 2015-1 and not by any of Residential's other assets. The assets of ARLP 2015-1 are the only source of repayment and interest on the ARLP 2015-1 Class A Notes and the ARLP 2015-1 Class M Notes. The ARLP 2015-1 Class A Notes and the ARLP 2015-1 Class M Notes mature on May 25, 2055, and Residential does not guarantee any of the obligations of ARLP 205-1 under the terms of the indenture governing the notes or otherwise. As of September 30, 2015, the book value of the underlying securitized assets held by ARLP 2015-1 was $284.5 million.

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

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

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. 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 used substantially all of the proceeds from this transaction to repurchase shares of our common stock and for other corporate purposes.

Basis of presentation and use of estimates

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

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

(table of contents)

Residential properties

Purchases of real estate properties are evaluated by Residential to determine whether they meet the definition of an asset acquisition or of a business combination under U.S. GAAP. For asset acquisitions, Residential capitalizes pre-acquisition costs to the extent such costs would have been capitalized had Residential owned the asset when the cost was incurred and capitalizes closing and other direct acquisition costs. Residential then allocates the total cost of the property, including the acquisition costs, between land, building and any identified intangible assets and liabilities (including in-place leases and above and below-market leases). For acquisitions that qualify as business combinations, Residential expenses the acquisition costs in the period in which the costs were incurred and allocates the cost of the property among land, building and any identified intangible assets and liabilities. Lease intangibles are recorded at the estimated fair value, which is the estimated costs that would have been incurred to lease the property net of any above or below-market lease concessions, and are amortized on a straight-line basis over the remaining life of the related lease or, in the case of acquisitions of real estate pools, over the weighted average remaining life of the related pool of leases.

Upon the acquisition of real estate through the completion of foreclosure, Residential records the assets at fair value as of the acquisition date as a component of real estate owned based on information obtained from a broker's price opinion(“BPO”), a full appraisal or the price given in a current contract of sale of the property. Fair value measurements for assets where there exists limited or no observable market data and, therefore, are based primarily upon management's or other third-party estimates, are often calculated based on the characteristics of the asset, the economic environment and other such factors. Based on professional judgment and knowledge of the particular situation, management determines the appropriate fair value to be utilized for such property. Residential engages third party vendors, including Altisource, to obtain and evaluate BPOs prepared by other third party brokers for its ultimate use. BPOs are subject to judgments of a particular broker formed by visiting a property, assessing general home values in an area, reviewing comparable listings and reviewing comparable completed sales. These judgments may vary among brokers and may fluctuate over time based on housing market activities and the influx of additional comparable listings and sales. Our results could be materially and adversely affected if the judgments used by a broker prove to be incorrect or inaccurate. Residential has established validation procedures to confirm the values it receives from third party vendors are consistent with its observations of market values.

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

After an evaluation period, Residential may perform property renovations to those properties that meet its rental investment criteria in order to optimize its rental proceeds. In some instances, Residential may also perform renovations on REO properties that do not meet its rental investment criteria in order to optimize sale proceeds. Such expenditures are part of Residential's initial investment in a property and, therefore, are classified as investing activities in our consolidated statement of cash flows. Subsequently, residential rental properties, including any renovations that improve or extend the life of the asset, are accounted for at cost. R