Cherry Hill Mortgage Investment Corp
Form 10-Q
May 13, 2014
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2014

OR

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

For the transition period from __________ to __________

Commission file number 001-36099

CHERRY HILL MORTGAGE INVESTMENT CORPORATION

(Exact name of registrant as specified in its charter)

N/A

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

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

(877) 870 7005

(Registrant s Telephone Number, Including Area Code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

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

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

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

As of May 13, 2014, there were 7,509,543 outstanding shares of common stock, $0.01 par value per share, of Cherry Hill Mortgage Investment Corporation.

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CHERRY HILL MORTGAGE INVESTMENT CORPORATION

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PART I. FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

Cherry Hill Mortgage Investment Corporation and Subsidiaries

Consolidated Balance Sheets

March 31, 2014 (Unaudited) and December 31, 2013

(in thousands except share data)

	March 31, 2014	December 31, 2013
Assets		
Agency RMBS, available-for-sale	$ 308,855	$ 286,979
Investments in excess mortgage servicing rights at fair value	107,887	110,306
Cash and cash equivalents	12,707	10,375
Restricted cash	3,139	3,744
Derivative assets	1,648	4,613
Receivables from unsettled trades		7,239
Receivables and other assets	3,974	4,142
Total Assets	**$ 438,210**	**$ 427,398**
Liabilities and Stockholders Equity		
Liabilities		
Repurchase agreements	$ 269,981	$ 261,302
Derivative liabilities	1,877	592
Dividends payable	3,755	3,375
Due to affiliates	685	616
Accrued expenses and other liabilities	355	391
Total Liabilities	**$ 276,653**	**$ 266,276**
Stockholders Equity		
Preferred stock, $0.01 par value, 100,000,000 shares authorized, none issued and outstanding as of March 31, 2014 and December 31, 2013	$	$
Common stock, $0.01 par value, 500,000,000 shares authorized, 7,509,543 shares issued and outstanding at March 31, 2014 and 7,500,000 shares issued and outstanding at December 31, 2013	75	75
Additional paid-in capital	148,145	148,078
Retained earnings (deficit)	14,670	17,695
Accumulated other comprehensive income (loss)	(1,678)	(5,033)
Total CHMI Stockholders Equity	**$ 161,212**	**$ 160,815**
Non-controlling interests in operating partnership	345	307

Total Stockholders Equity	**$**	**161,557**	**$**	**161,122**
Total Liabilities and Stockholders Equity	**$**	**438,210**	**$**	**427,398**

See accompanying notes to consolidated financial statements.

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Cherry Hill Mortgage Investment Corporation and Subsidiaries

Consolidated Statements of Income

(Unaudited)

(in thousands except per share data)

	Three Months Ended March 31, 2014		Three Months Ended March 31, 2013	
Income				
Interest income	$	6,011	$	
Interest expense		947		
Net interest income		5,064		
Other Income (Loss)				
Realized gain (loss) on Agency RMBS, net		(349)		
Realized gain (loss) on derivatives, net		(72)		
Unrealized gain (loss) on derivatives, net		(3,443)		
Unrealized gain (loss) on investments in excess mortgage servicing rights		670		
Total Income		**1,870**		
Expenses				
General and administrative expense		457		35
Management fee and expense reimbursement to affiliate		679		
Total Expenses		**1,136**		**35**
Net Income (Loss)		**734**		**(35)**
Net income allocated to LTIP - OP Units		(4)		
Net Income (Loss) Applicable to Common Stockholders	**$**	**730**	**$**	**(35)**
Net income (Loss) Per Share of Common Stock				
Basic	$	0.10	$	(35.00)
Diluted	$	0.10	$	(35.00)
Weighted Average Number of Shares of Common Stock Outstanding				
Basic		7,502,505		1,000
Diluted		7,506,680		1,000

See accompanying notes to consolidated financial statements.

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Cherry Hill Mortgage Investment Corporation and Subsidiaries

Consolidated Statements of Comprehensive Income

(Unaudited)

(in thousands except share data)

	Three Months Ended March 31, 2014		Three Months Ended March 31, 2013	
Net Income (Loss)	$	734	$	(35)
Other Comprehensive Income (Loss):				
Net unrealized gain (loss) on Agency RMBS		3,355		
Other comprehensive income (loss)		3,355		
Comprehensive Income (Loss)	**$**	**4,089**	**$**	**(35)**

See accompanying notes to consolidated financial statements.

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Cherry Hill Mortgage Investment Corporation and Subsidiaries

Consolidated Statements of Changes in Stockholders Equity

For the periods January 1, 2013 through December 31, 2013

and January 1, 2014 through March 31, 2014 (unaudited)

(in thousands except share data)

	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings (Deficit)	Non-Controlling Interest in Operating Partnership	Total Stockholders Equity (Deficit)
Balance, January 1, 2013	**1,000**	**$ (A)**	**$ 1**	**$**	**$ (25)**	**$**	**$ (24)**
Repurchase of common stock	(1,000)		(1)				(1)
Issuance of common stock, net of offering costs	7,500,000	75	148,078				148,153
Net Income					21,095	107	21,202
Other Comprehensive Loss				(5,033)			(5,033)
LTIP-OP Unit awards						200	200
Common dividends declared, $.45 per share					(3,375)		(3,375)
Balance, December 31, 2013	**7,500,000**	**75**	**148,078**	**(5,033)**	**17,695**	**307**	**161,122**
Issuance of common stock	9,543	(B)	67				67
Net Income					730	4	734
Other Comprehensive Income				3,355			3,355
LTIP-OP Unit awards						50	50
Distribution paid on LTIP-OP Units						(16)	(16)
Common dividends declared, $0.50 per share					(3,755)		(3,755)
Balance, March 31, 2014	**7,509,543**	**$ 75**	**$ 148,145**	**$ (1,678)**	**$ 14,670**	**$ 345**	**$ 161,557**

(A) de minimus ($10 rounds to $0)
(B) de minimus ($95 rounds to $0)
See accompanying notes to consolidated financial statements.

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Cherry Hill Mortgage Investment Corporation and Subsidiaries

Consolidated Statements of Cash Flows

(Unaudited)

(in thousands)

	Three Months Ended March 31, 2014	Three Months Ended March 31, 2013
Cash Flows From Operating Activities		
Net income	$ 734	$ (35)
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Change in fair value of investments in Excess MSRs	(670)	
Accretion of premium and other amortization	355	
Realized (gain) loss on Agency RMBS, net	349	
Unrealized (gain) loss on derivatives, net	3,443	
Realized (gain) loss on derivatives, net	72	
LTIP-OP unit awards	50	
Changes in:		
Receivables from unsettled trades	7,239	
Receivables and other assets	168	
Due to affiliate	69	
Accrued expenses and other liabilities	1,249	35
Net cash provided by (used in) operating activities	**$ 13,058**	**$**
Cash Flows From Investing Activities		
Purchase of Agency RMBS	(34,927)	
Acquisition of Excess MSRs	(1,513)	
Proceeds from sale of Agency RMBS	11,594	
Cost of sale of Derivatives	(72)	
Principal paydown of Excess MSRs	4,602	
Principal paydown of Agency RMBS	4,108	
Net cash provided by (used in) investing activities	**$ (16,208)**	**$**
Cash Flows From Financing Activities		
Repayments of repurchase agreements	(468,508)	
Margin deposits under repurchase agreements	605	
Purchase of derivatives	(478)	
Borrowings under repurchase agreements	477,187	
Issuance of common stock	67	
LTIP-OP distributions paid	(16)	
Dividends paid	(3,375)	

Net cash provided by (used in) financing activities	**$**	**5,482**	**$**
Net Increase (Decrease) in Cash and Cash Equivalents	**$**	**2,332**	**$**
Cash and Cash Equivalents, Beginning of Period		**10,375**	
Cash and Cash Equivalents, End of Period	**$**	**12,707**	**$**
Supplemental Disclosure of Cash Flow Information			
Cash paid during the period for interest expense	$	242	$
Dividends declared but not paid	$	3,755	$

See accompanying notes to consolidated financial statements.

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Cherry Hill Mortgage Investment Corporation

Notes to Consolidated Financial Statements

March 31, 2014

(unaudited)

Note 1 Organization and Operations

Cherry Hill Mortgage Investment Corporation (together with its consolidated subsidiaries, the Company , CHMI , we or our company) was organized in the state of Maryland on October 31, 2012 to invest in residential mortgage assets in the United States. Under the Company s charter, at December 31, 2012, CHMI was authorized to issue 1,000 shares of common stock. On June 6, 2013, the Company amended and restated its charter and increased its authorized capitalization. Accordingly, at March 31, 2014 and December 31, 2013, the Company was authorized to issue up to 500,000,000 shares of common stock and 100,000,000 shares of preferred stock, each with a par value of $0.01 per share. CHMI commenced operations on or about October 9, 2013.

The accompanying consolidated financial statements include the accounts of the Company s subsidiaries, Cherry Hill Operating Partnership LP, Cherry Hill QRS I, LLC, Cherry Hill QRS II, LLC and CHMI Solutions, LLC (formerly, Cherry Hill TRS, LLC).

On October 9, 2013, the Company completed an initial public offering (the IPO) of 6,500,000 shares of common stock and a concurrent private placement of 1,000,000 shares of common stock. The IPO and concurrent private placement resulted in the sale of 7,500,000 shares of common stock, at a price per share of $20.00. The net proceeds to the Company from the IPO and the concurrent private placement were approximately $148.1 million, after deducting offering-related expenses payable by the Company. The Company did not conduct any activity prior to the IPO and the concurrent private placement. Substantially all of the net proceeds from the IPO and the concurrent private placement were used to invest in excess mortgage servicing rights on residential mortgage loans (Excess MSRs) and residential mortgage-backed securities (RMBS or securities), the payment of principal and interest on which is guaranteed by a U.S. Government agency or a U.S. government sponsored enterprise (Agency RMBS).

Prior to the IPO, the Company was a development stage company that had not commenced operations other than the organization of the Company. The Company completed the IPO and concurrent private placement on October 9, 2013, at which time the Company commenced operations.

Prior to the IPO, the sole stockholder of the Company was Stanley Middleman. On December 4, 2012, Mr. Middleman made a $1,000 initial capital contribution to CHMI in exchange for 1,000 shares of common stock, and, on October 9, 2013, CHMI repurchased these shares from Mr. Middleman for $1,000.

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

The Company was taxed for U.S. federal income tax purposes as a Subchapter C corporation for the two month period from October 31, 2012 (date of inception) to December 31, 2012. On February 13, 2013, the Company elected to be taxed for U.S. federal income tax purposes as a Subchapter S corporation effective January 1, 2013, and, as such, all federal tax liabilities were the responsibility of the sole stockholder. In anticipation of the IPO, the Company elected

to revoke its Subchapter S election on October 2, 2013 and will elect to be taxed as a real estate investment trust (REIT), as defined under the Internal Revenue Service Code of 1986, as amended, (the Code) for U.S. federal income tax purposes commencing with the year ended December 31, 2013. As long as the Company continues to comply with a number of requirements under federal tax law and maintains its qualification as a REIT, the Company generally will not be subject to U.S. federal income taxes to the extent that the Company distributes its taxable income to its stockholders on an annual basis and does not engage in prohibited transactions. However, certain activities that the Company may perform may cause it to earn income that will not be qualifying income for REIT purposes.

Note 2 Basis of Presentation and Significant Accounting Policies

Basis of Accounting

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

Emerging Growth Company Status

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

Use of Estimates

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

Risks and Uncertainties

In the normal course of business, the Company encounters primarily two significant types of economic risk: market and credit. Market risk reflects changes in the value of investments in RMBS, Excess MSRs and derivatives due to changes in interest rates, spreads or other market factors. Credit risk is the risk of default on the Company s investments in RMBS, Excess MSRs and derivatives that results from a borrower s or derivative counterparty s

inability or unwillingness to make contractually required payments.

Additionally, the Company is subject to the risks involved with real estate and real estate-related debt instruments. These include, among others, the risks normally associated with changes in the general economic climate, changes in the mortgage market, changes in tax laws, interest rate levels, and the availability of financing.

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

Investments in RMBS

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

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

Investment securities transactions are recorded on the trade date. Purchases of newly-issued securities are recorded when all significant uncertainties regarding the characteristics of the securities are removed, generally shortly before settlement date. At disposition, the net realized gain or loss is determined on the basis of the cost of the specific investment and is included in earnings. Approximately $0 and $7.2 million in Agency RMBS sold but not yet settled is receivable at March 31, 2014, and December 31, 2013, respectively.

Revenue Recognition Interest income from coupon payments is accrued based on the outstanding principal amount of the Agency RMBS and their contractual terms. Premiums and discounts associated with the purchase of the RMBS are accreted into interest income over the projected lives of the securities using the interest method. The Company s policy for estimating prepayment speeds for calculating the effective yield is to evaluate historical performance, determine market consensus on prepayment speeds, and to factor in current market conditions. Adjustments are made for actual prepayment activity. Approximately $927,000 and $900,000 in interest income is receivable at March 31, 2014 and December 31, 2013, respectively, and is classified as Receivables and other assets on the consolidated balance sheet.

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

Investments in Excess MSRs

Classification Upon acquisition, the Company elected the fair value option to record its investments in Excess MSRs in order to provide users of the financial statements with better information regarding the effects of prepayment risk and other market factors on the Excess MSRs. Under this election, the Company records a valuation adjustment on its investments in Excess MSRs on a quarterly basis to recognize the changes in fair value in net income as described below. The valuation of Excess MSRs is not wholly based on listed price data; rather, the fair value is based upon internally developed models that are primarily based on observable market-based inputs, but which also include unobservable market data inputs (see Note 9).

Revenue Recognition Excess MSRs are aggregated into pools as applicable. Each pool of Excess MSRs is accounted for in the aggregate. Interest income for Excess MSRs is accreted into interest income on an effective yield or interest method, based upon the expected excess mortgage servicing amount over the expected life of the underlying mortgages. Changes to expected cash flows result in a cumulative retrospective adjustment, which will be recorded in the period in which the change in expected cash flows occurs. Under the retrospective method, the interest income recognized for a reporting period would be measured as the difference between the amortized cost basis at the end of the period and the amortized cost basis at the beginning of the period, plus any cash received during the period. The amortized cost basis is calculated as the present value of estimated future cash flows using an effective yield, which is the yield that equates all past actual and current estimated future cash flows to the initial investment. The difference between the fair value of Excess MSRs and their amortized cost basis is recorded on the income statement as Unrealized gain (loss) on investments in excess mortgage servicing rights. Fair value is generally determined by discounting the expected future cash flows using discount rates that incorporate the market risks and a liquidity premium specific to the Excess MSRs and, therefore, may differ from their effective yields. Approximately $2.7 million and $2.8 million in Excess MSR cashflow is receivable at March 31, 2014 and December 31, 2013, respectively, and is classified as Receivables and other assets on the consolidated balance sheet.

Derivatives and Hedging Activities

Derivative transactions include swaps, swaptions and to-be-announced securities (TBAs). Swaps and swaptions are entered into by the Company solely for interest rate risk management purposes. TBAs are used for duration risk and basis risk management purposes. The decision of whether or not a given transaction/position (or portion thereof) is economically hedged is made on a case-by-case basis, based on the risks involved and as determined by senior management, including, among other factors, restrictions imposed by the Code. In determining whether to economically hedge a risk, the Company may consider whether other assets, liabilities, firm commitments and anticipated transactions already offset or reduce the risk. All transactions undertaken as economic hedges are entered into with a view towards minimizing the potential for economic losses that could be incurred by the Company. Generally, derivatives entered into are not intended to qualify as hedges under GAAP, unless specifically stated otherwise.

The Company s derivative financial instruments contain credit risk to the extent that its bank counterparties may be unable to meet the terms of the agreements. The Company reduces such risk by limiting its counterparties to major financial institutions. In addition, the potential risk of loss with any one party resulting from this type of credit risk is monitored. Management does not expect any material losses as a result of default by other parties.

Classification All derivatives are recognized as either assets or liabilities on the consolidated balance sheet and measured at fair value. Due to the nature of these instruments, they may be in a receivable/asset position or a payable/liability position at the end of an accounting period. Derivative amounts payable to, and receivable from, the same party under a contract may be offset as long as the following conditions are met: (i) each of the two parties owes the other determinable amounts; (ii) the reporting party has the right to offset the amount owed with the amount owed by the other party; (iii) the reporting party intends to offset; and (iv) the right to offset is enforceable by law. The Company reports the fair value of derivative instruments gross of cash paid or received pursuant to credit support agreements, and fair value is reflected on a net counterparty basis when the Company believes a legal right of offset exists under an enforceable master netting agreement. For further discussion on offsetting assets and liabilities, see Note 8.

Revenue Recognition With respect to interest rate swaps and swaptions that have not been designated as hedges, any net payments under, or fluctuations in the fair value of, such derivatives have been recognized currently in Realized and unrealized gains (losses) on derivatives, net in the consolidated statements of income. These derivatives may, to some extent, be economically effective as hedges.

Cash and Cash Equivalents and Restricted Cash

The Company considers all highly liquid short-term investments with maturities of 90 days or less when purchased to be cash equivalents. Substantially all amounts on deposit with major financial institutions exceed insured limits. Restricted cash represents the Company s cash held by counterparties as collateral against the Company s derivatives and/or borrowings under its repurchase agreements.

Due to Affiliate

This represents amounts due to the Manager pursuant to the Management Agreement. For further information on the Management Agreement, see Note 7.

Realized Gain (Loss) on Agency RMBS and Derivatives, Net

The following table presents gains and losses on sales of Agency RMBS and derivatives for the periods indicated (dollars in thousands):

	Three Months Ended March 31, 2014	Three Months Ended March 31, 2013
Realized gain (loss) on Agency RMBS, net		
Gain on Agency RMBS	$	$
Loss on Agency RMBS	(349)	
Net realized gain (loss) on Agency RMBS	(349)	
Realized gain (loss) on derivatives, net	(72)	
Unrealized gain (loss) on derivatives, net	(3,443)	
Total	**$ (3,864)**	**$**

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Repurchase Agreements and Interest Expense

The Company finances its investments in RMBS with short-term borrowings under master repurchase agreements. The repurchase agreements are generally short-term debt, which expire within one year. Borrowings under repurchase agreements generally bear interest rates of a specified margin over one-month LIBOR and are generally uncommitted. The repurchase agreements are treated as collateralized financing transactions and are carried at their contractual amounts, as specified in the respective agreements. Interest is recorded at the contractual amount on an accrual basis.

Dividends Payable

Because the Company is organized as a REIT under the Code, it is required by law to distribute annually at least 90% of its REIT taxable income, which it does in the form of quarterly dividend payments. The Company accrues the dividend payable on the accounting date, which causes an offsetting reduction in retained earnings.

Comprehensive Income

Comprehensive income is defined as the change in equity of a business enterprise during a period from transactions and other events and circumstances, excluding those resulting from investments by and distributions to owners. For the Company s purposes, comprehensive income represents net income, as presented in the consolidated statements of income, adjusted for unrealized gains or losses on Agency RMBS, which are designated as available for sale.

During the three month period ended March 31, 2014, accumulated other comprehensive income (loss) changed due to the following factors (dollars in thousands):

	Total Accumulated Other Comprehensive Income
Accumulated other comprehensive loss, December 31, 2013	$ (5,033)
Net unrealized gain (loss) on Agency RMBS	3,355
Accumulated other comprehensive loss, March 31, 2014	$ (1,678)

Offering Costs

Offering costs of approximately $1.9 million incurred in connection with the Company s IPO and concurrent private placement were reflected as a reduction of additional paid-in-capital at December 31, 2013. Costs incurred during the three month period ended March 31, 2013, which were not directly associated with the completion of the IPO and concurrent private placement, were expensed as incurred. Offering costs incurred in connection with the IPO and concurrent private placement included, among others, the fees and disbursements of the Company s counsel, the costs of printing the prospectus for the IPO, the fees paid to apply to list the Company s common stock and all filing fees paid in connection with the IPO. However, the Manager agreed to pay the underwriting discounts and commissions and a structuring fee of 0.375% of the gross proceeds of the IPO and concurrent private placement without reimbursement from the Company.

Income Taxes

The Company will elect to be taxed as a REIT under the Code. To qualify as a REIT, the Company must distribute at least 90% of its annual REIT taxable income to stockholders within the time frame set forth in the Code, and the Company must also meet certain other requirements.

The Company assesses its tax positions for all open tax years and determines if it has any material unrecognized liabilities in accordance with ASC 740, *Income Taxes*. The Company records these liabilities to the extent it deems them more-likely-than-not to be incurred. The Company classifies interest and penalties on material uncertain tax positions, if any, as interest expense and operating expense, respectively, in its consolidated statements of income. The Company has not incurred any interest or penalties.

Recent Accounting Pronouncements

Comprehensive Income In February 2013, the FASB issued ASU No. 2013-02, which amends ASC 320, *Comprehensive Income*. ASU 2013-02 provides disclosure guidance on amounts reclassified out of Accumulated Other Comprehensive Income by component. The new guidance does not change the requirement to present items of net income and OCI and totals for net income, OCI and comprehensive income in a single continuous statement or two consecutive statements. ASU 2013-02 is effective for the first interim or annual period beginning on or after December 15, 2012. Adopting ASU 2013-02 did not have any impact on the Company s consolidated financial statements.

Liabilities In March 2013, the FASB issued ASU 2013-04, *Liabilities (Topic 405): Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation Is Fixed at the Reporting Date (a consensus of the FASB Emerging Issues Task Force)*. ASU 2013-04 requires additional disclosures about joint and several liability arrangements and requires the Company to measure obligations resulting from joint and several liability arrangements as the sum of the amount the Company agreed to pay on the basis of its arrangement among its co-obligors and any additional amount the Company expects to pay on behalf of its co-obligors. ASU 2013-04 is effective for the fiscal years and interim periods beginning after December 15, 2013. Adopting ASU 2013-04 did not have any impact on the Company s consolidated financial statements.

Presentation of an Unrecognized Tax Benefit In July 2013, the FASB issued ASU No. 2013-11, which requires an entity to present an unrecognized tax benefit as a reduction of a deferred tax asset for a net operating loss (NOL) carryforward or similar tax loss or tax credit carryforward, rather than as a liability when (1) the uncertain tax position would not reduce the NOL or other carryforward under the tax law of the applicable jurisdiction, and (2) the entity intends to use the deferred tax asset for that purpose. ASU 2013-11 does not require any new recurring disclosures. It is effective prospectively for fiscal years, and interim periods within those years, beginning on or after December 15, 2013, with early adoption permitted. Early adopting ASU 2013-11 did not have any impact on the Company s consolidated financial statements.

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Note 3 Segment Reporting

The Company conducts its business through the following segments: (i) investments in RMBS; and (ii) investments in Excess MSRs. In addition, as of March 31, 2014 and December 31, 2013, the Company has capitalized a taxable REIT subsidiary, CHMI Solutions, LLC (Solutions) (previously Cherry Hill TRS, LLC), for the purpose of obtaining mortgage servicing licenses. There have been no operations to date within Solutions, and the operations of Solutions are included in All Other until such time as Solutions becomes operational.

All Other consists primarily of general and administrative expenses including fees to the directors, and management fees pursuant to the Management Agreement (see Note 7). For segment reporting purposes, the Company does not allocate interest income on short-term investments or general and administrative expenses.

Summary financial data on the Company s segments is given below, together with a reconciliation to the same data for the Company as a whole (dollars in thousands):

	Excess MSRs	RMBS	All Other	Total
Income Statement Data:				
Three Months Ended March 31, 2014				
Interest income	$ 3,685	$ 2,326	$	$ 6,011
Interest expense		947		947
Net interest income	3,685	1,379		5,064
Other income	670	(3,864)		(3,194)
Other operating expenses			1,136	1,136
Net income (loss)	$ 4,355	$ (2,485)	$ (1,136)	$ 734
Three Months Ended March 31, 2013				
Interest income	$	$	$	$
Interest expense				
Net interest income				
Other income				
Other operating expenses			35	35
Net income (loss)	$	$	$ (35)	$ (35)
Balance Sheet Data:				
March 31, 2014				
Investments	$ 107,887	$ 308,855	$	$ 416,742
Other assets	2,733	5,713	13,022	21,468
Total assets	110,620	314,568	13,022	438,210
Debt		269,981		269,981
Other liabilities		1,979	4,693	6,672
Total liabilities		271,960	4,693	276,653

GAAP book value	$ 110,620	$ 42,608	$ 8,329	$ 161,557
December 31, 2013				
Investments	$ 110,306	$ 286,979	$	$ 397,285
Other assets	2,828	16,494	10,791	30,113
Total assets	113,134	303,473	10,791	427,398
Debt		261,302		261,302
Other liabilities		690	4,284	4,974
Total liabilities		261,992	4,284	266,276
GAAP book value	$ 113,134	$ 41,481	$ 6,507	$ 161,122

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Note 4 Investments in RMBS

The following is a summary of the Company s RMBS investments at March 31, 2014 and December 31, 2013, all of which are classified as available for sale and are, therefore, reported at fair value with changes in fair value recorded in other comprehensive income, except for securities that are other-than-temporarily impaired, for which there was none for the current quarter ended (dollars in thousands):

Summary of RMBS

At March 31, 2014

			Gross Unrealized					Weighted Average		
Asset Type	**Original Face Value**	**Book Value**	**Gains**	**Losses**	**Carrying Value (A)**	**Number of Securities**	**Rating**	**Coupon**	**Yield**	**Maturity (Years) (C)**
Agency RMBS										
Fannie Mae	$ 188,495	$ 193,227	$ 89	$ (1,025)	$ 192,291	22	(B)	3.87%	3.63%	24
Freddie Mac	114,386	116,306	28	(833)	115,501	13	(B)	3.67%	3.24%	22
Variable Rate CMO	1,000	1,000	63		1,063	1	Unrated	4.65%	6.36%	10
Total/Weighted Average	**$ 303,881**	**$ 310,533**	**$ 180**	**$ (1,858)**	**$ 308,855**	**36**		**3.80%**	**3.49%**	**23**

Summary of RMBS

At December 31, 2013

			Gross Unrealized					Weighted Average		
Asset Type	**Original Face Value**	**Book Value**	**Gains**	**Losses**	**Carrying Value (A)**	**Number of Securities**	**Rating**	**Coupon**	**Yield**	**Maturity (Years) (C)**
Agency RMBS										
Fannie Mae	$ 173,015	$ 179,556	$	$ (2,800)	$ 176,756	18	(B)	3.86%	3.61%	25
Freddie Mac	109,431	112,456		(2,233)	110,223	11	(B)	3.62%	3.22%	24
Total/Weighted Average	**$ 282,446**	**$ 292,012**	**$**	**$ (5,033)**	**$ 286,979**	**29**		**3.77%**	**3.46%**	**24**

(A) See Note 9 regarding the estimation of fair value, which is equal to carrying value for all securities.
(B) The Company used an implied AAA rating for the Fannie Mae and Freddie Mac securities.
(C) The weighted average maturity is based on the timing of expected principal reduction on the assets.

At March 31, 2014, and December 31, 2013, the Company pledged investments with a carrying value of approximately $270.0 million and $261.3 million, respectively, as collateral for repurchase agreements. At March 31, 2014 and December 31, 2013, the Company did not have any securities purchased from and financed with the same counterparty that met the conditions of ASC 860, *Transfers and Servicing*, to be considered linked transactions and, therefore, classified as derivatives.

Unrealized losses that are considered other-than-temporary are recognized currently in earnings. During the three month periods ended March 31, 2014 and March 31, 2013, the Company recorded other-than-temporary impairment charges (OTTI) of $0 and $0, respectively. Based on management s analysis of these securities, the performance of the underlying loans and changes in market factors, management determined that unrealized losses as of the balance sheet date on the Company s securities were primarily the result of changes in market factors, rather than issuer-specific credit impairment. The Company performed analyses in relation to such securities, using management s best estimate of their cash flows, which support its belief that the carrying values of such securities were fully recoverable over their expected holding period. Such market factors include changes in market interest rates and credit spreads, or certain macroeconomic events, which did not directly impact the Company s ability to collect amounts contractually due. Management continually evaluates the credit status of each of the Company s securities and the collateral supporting those securities. This evaluation includes a review of the credit of the issuer of the security (if applicable), the credit rating of the security, the key terms of the security (including credit support), debt service coverage and loan to value ratios, the performance of the pool of underlying loans and the estimated value of the collateral supporting such loans, including the effect of local, industry and broader economic trends and factors. In connection with the above, the Company weighs the fact that all of its investments in RMBS are Agency RMBS that are guaranteed by U.S. government sponsored enterprises.

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These factors include underlying loan default expectations and loss severities, where applicable, which are analyzed in connection with a particular security s credit support, as well as prepayment rates. The result of this evaluation is considered when determining management s estimate of cash flows and in relation to the amount of the unrealized loss and the period elapsed since it was incurred. Significant judgment is required in this analysis. The following tables summarize the Company s RMBS in an unrealized loss position, all of which are due to mark to market rather than default estimates, as of March 31, 2014 and December 31, 2013 (dollars in thousands):

Unrealized Loss Positions

At March 31, 2014

			Gross Unrealized					Weighted Average		
Asset Type	**Original Face Value**	**Book Value**	**Gains**	**Losses**	**Carrying Value (A)**	**Number of Securities**	**Rating**	**Coupon**	**Yield**	**Maturity (Years) (C)**
Less than Twelve Months	$ 303,881	$ 310,533	$ 180	$ (1,858)	$ 308,855	36	(B)	3.80%	3.49%	23
Twelve or More Months										
Total/Weighted Average	**$ 303,881**	**$ 310,533**	**$ 180**	**$ (1,858)**	**$ 308,855**	**36**		**3.80%**	**3.49%**	**23**

Unrealized Loss Positions

At December 31, 2013

			Gross Unrealized					Weighted Average		
Asset Type	**Original Face Value**	**Book Value**	**Gains**	**Losses**	**Carrying Value (A)**	**Number of Securities**	**Rating**	**Coupon**	**Yield**	**Maturity (Years) (C)**
Less than Twelve Months	$ 282,446	$ 292,012	$	$ (5,033)	$ 286,979	29	(B)	3.77%	3.46%	24
Twelve or More Months										
Total/Weighted Average	**$ 282,446**	**$ 292,012**	**$**	**$ (5,033)**	**$ 286,979**	**29**		**3.77%**	**3.46%**	**24**

(A) See Note 9 regarding the estimation of fair value, which is equal to carrying value for all securities.
(B) We used an implied AAA rating for the Fannie Mae and Freddie Mac securities.
(C) The weighted average maturity is based on the timing of expected principal reduction on the assets.

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Note 5 Investments in Excess MSRs

In October 2013, CHMI entered into an agreement (MSR Agreement 1) with Freedom Mortgage Corporation (Freedom Mortgage), a leading residential mortgage servicer wholly-owned by the sole shareholder of the Manager, to invest in Excess MSRs with Freedom Mortgage. Freedom Mortgage originated the mortgage servicing rights on a pool of residential fixed rate Ginnie Mae-eligible FHA and VA mortgage loans with an aggregate unpaid principal balance of approximately $10.0 billion (Pool 1). Freedom Mortgage is entitled to receive an initial weighted average total mortgage servicing amount of approximately 28 basis points (bps) on the performing unpaid principal balance, as well as any ancillary income from Pool 1. Pursuant to MSR Agreement 1, Freedom Mortgage performs all servicing functions and advancing functions related to Pool 1 for a basic fee (the contractual amount the servicer is entitled to for performing the servicing duties) of 8 bps. Therefore, the remainder, or excess mortgage servicing amount , is initially equal to a weighted average of 20 bps.

The Company acquired the right to receive 85% of the excess mortgage servicing amount on Pool 1 and, subject to certain limitations and pursuant to a loan replacement agreement (the Pool 1 Recapture Agreement), 85% of the Excess MSRs on certain future mortgage loans originated by Freedom Mortgage that represent refinancings of loans in Pool l (which loans then become part of Pool 1) for approximately $60.6 million. Freedom Mortgage has co-invested, pari passu with the Company, in 15% of the Excess MSRs. Freedom Mortgage, as servicer, also retains the ancillary income and the servicing obligations and liabilities. If Freedom Mortgage is terminated as the servicer, the Company s right to receive its portion of the excess mortgage servicing amount is also terminated. To the extent that Freedom Mortgage is terminated as the servicer and receives a termination payment, the Company is entitled to a pro rata share, or 85%, of such termination payment.

The value, and absolute amount, of recapture activity tends to vary inversely with the direction of interest rates. When interest rates are falling, recapture rates tend to be higher due to increased opportunities for borrowers to refinance. As interest rates increase, however, there is likely to be less recapture activity. For Pool 1, since we expect interest rates to rise relative to what they had been in the past, which is likely to reduce the level of voluntary prepayments, we expect recapture rates to be significantly lower than what they had been in the past and, thus, lower market value for the related recapture agreement than when we purchased the pool. However, since prepayment rates are likely to decline at the same time, we expect overall prepayment rates to remain roughly constant.

In October 2013, the Company entered into an agreement (MSR Agreement 2) with Freedom Mortgage to invest with Freedom Mortgage in another pool of Excess MSRs. Freedom Mortgage acquired the mortgage servicing rights from a third-party seller on a pool of residential Ginnie Mae-eligible VA hybrid adjustable rate mortgage loans with an outstanding principal balance of approximately $10.7 billion (Pool 2). Freedom Mortgage is entitled to receive an initial weighted average total mortgage servicing amount of 44 bps on the performing unpaid principal balance, as well as any ancillary income from Pool 2. Pursuant to MSR Agreement 2, Freedom Mortgage performs all servicing functions and advancing functions related to Pool 2 for a basic fee of 10 bps. Therefore, the remainder, or excess mortgage servicing amount is initially equal to a weighted average of 34 bps.

The Company acquired the right to receive 50% of the excess mortgage servicing amount on Pool 2 and, subject to certain limitations and pursuant to a loan replacement agreement (the Pool 2 Recapture Agreement), 50% of the Excess MSRs on certain future mortgage loans originated by Freedom Mortgage that represent refinancings of loans in Pool 2 (which loans then become part of Pool 2) for approximately $38.4 million. Freedom Mortgage has co-invested, pari passu with the Company, in 50% of the Excess MSRs. Freedom Mortgage, as servicer, also retains the ancillary income and the servicing obligations and liabilities. If Freedom Mortgage is terminated as the servicer, the Company s right to receive its portion of the excess mortgage servicing amount is also terminated. To the extent that Freedom Mortgage is terminated as the servicer and receives a termination payment, the Company is entitled to a

pro rata share, or 50%, of such termination payment.

Pool 2 consists of adjustable rate mortgage loans, which have a higher prepayment speed than the fixed rate mortgage loans in Pool 1. Our recapture percentage with respect to Pool 2 has been higher than anticipated. This has resulted in a rise in the market value of the recapture agreement related to Pool 2.

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In October 2013, we also entered into a flow and bulk Excess MSR purchase agreement with Freedom Mortgage. This agreement provides that Freedom Mortgage will offer to sell to us a participation interest (between 65% and 85%) in the Excess MSRs on the eligible mortgage loans originated by Freedom Mortgage on a flow basis. In addition, Freedom will offer to sell to us a participation interest (between 40% and 85%) in the Excess MSRs on mortgage loans for which Freedom Mortgage acquires the MSRs from third parties. The pricing of the transactions must be approved by a majority of our independent directors based on, among other things, a valuation from a third party valuation service. We are not obligated to accept any such offer.

On February 28, 2014, pursuant to the flow and bulk Excess MSR purchase agreement , we purchased from Freedom Mortgage Excess MSRs on mortgage loans originated by Freedom Mortgage during the first quarter of 2014 with an aggregate unpaid principal balance (UPB) of approximately $76.8 million. We acquired an approximate 85% interest in the Excess MSRs for approximately $567,129. The terms of the purchase include recapture provisions that are the same as those in the Excess MSR acquisition agreements we entered into with Freedom Mortgage in October 2013.

On March 31, 2014, pursuant to the flow and bulk Excess MSR purchase agreement, we purchased from Freedom Mortgage Excess MSRs on mortgage loans originated by a third party originator with an aggregate UPB of approximately $161.1 million. Freedom Mortgage purchased the MSRs on these mortgage loans from a third party on January 31, 2014. We acquired an approximate 70% interest in the Excess MSRs for approximately $967,000. The terms of the purchase include recapture provisions that are the same as those in the Excess MSR acquisition agreements we entered into with Freedom Mortgage in October 2013.

The mortgage loans underlying the Excess MSRs purchased in 2014 are collectively referred to as Pool 2014, and the recapture provisions, which are identical, are collectively referred to as the 2014 Recapture Agreement.

The following is a summary of the Company s Excess MSRs (dollars in thousands):

	Three Months Ended March 31, 2014					
	Unpaid Principal Balance	**Amortized Cost Basis (A)**	**Carrying Value (B)**	**Weighted Average Coupon**	**Weighted Average Maturity (Years) (C)**	**Changes in Fair Value Recorded in Other Income (Loss) (D)**
Pool 1	$ 9,638,587	$ 53,748	$ 65,929	3.51%	27.7	$ 2,845
Pool 1 - Recapture Agreement		2,900	95			(886)
Pool 2	$ 9,743,778	30,860	38,522	2.72%	28.2	24
Pool 2 - Recapture Agreement		2,554	1,838			(1,308)
Pool 2014	236,486	1,508	1,503	3.73%	29.0	(5)
Pool 2014 - Recapture Agreement						
Total	**$ 19,618,851**	**$ 91,570**	**$ 107,887**	**3.12%**	**28.0**	**$ 670**

Year Ended December 31, 2013

	Unpaid Principal Balance	Amortized Cost Basis (A)	Carrying Value (B)	Weighted Average Coupon	Weighted Average Maturity (Years) (C)	Changes in Fair Value Recorded in Other Income (Loss) (D)
Pool 1	$ 9,823,250	$ 55,793	$ 65,128	3.51%	27.9	$ 9,335
Pool 1 - Recapture Agreement		2,900	982			(1,918)
Pool 2	10,226,679	33,410	41,050	2.64%	28.3	7,640
Pool 2 - Recapture Agreement		2,554	3,146			590
Total	**$ 20,049,929**	**$ 94,657**	**$ 110,306**	**3.07%**	**28.1**	**$ 15,647**

(A) The amortized cost basis of the recapture agreements is determined based on the relative fair values of the recapture agreements and related Excess MSRs at the time they were acquired.

(B) Carrying value represents the fair value of the pools or recapture agreements, as applicable (see Note 9).

(C) The weighted average maturity represents the weighted average expected timing of the receipt of cash flows of each investment.

(D) The portion of the change in fair value of the recapture agreement relating to loans recaptured as of March 31, 2014 and December 31, 2013 is reflected in the respective pool.

The table below summarizes the geographic distribution for the top five states of the residential mortgage loans underlying the Excess MSRs:

	Percentage of Total Outstanding Unpaid Principal Balance	
State	**March 31, 2014**	**December 31, 2013**
California	14.1%	14.4%
Texas	10.3%	10.0%
Florida	6.9%	6.9%
Virginia	6.5%	6.6%
North Carolina	5.6%	5.6%

Geographic concentrations of investments expose the Company to the risk of economic downturns within the relevant states. Any such downturn in a state where the Company holds significant investments could affect the underlying borrower s ability to make the mortgage payment and, therefore, could have a meaningful, negative impact on the Company s Excess MSRs.

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Note 6 Equity and Earnings per Share

Equity Incentive Plan

During 2013, the Board of Directors approved and the Company adopted the Cherry Hill Mortgage Investment Corporation 2013 Equity Incentive Plan (2013 Plan). The 2013 Plan provides for the grant of options to purchase shares of the Company s common stock, stock awards, stock appreciation rights, performance units, incentive awards and other equity-based awards, including long term incentive plan units (LTIP-OP Units) of the Company s operating partnership, Cherry Hill Operating Partnership, LP (the Operating Partnership).

The following table presents certain information about the Company s 2013 Plan as of March 31, 2014:

	Number of securities issued or to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights
LTIP-OP Units	37,500	
Shares of Common Stock	9,543	

LTIP-OP Units (sometimes referred to as profits interest units) are a special class of partnership interest in the Operating Partnership. LTIP-OP Units may be issued to eligible participants for the performance of services to or for the benefit of the Operating Partnership. Initially, LTIP-OP Units do not have full parity with the Operating Partnership s common units of limited partnership interest (OP Units) with respect to liquidating distributions; however, LTIP-OP Units receive, whether vested or not, the same per-unit distributions as OP Units and are allocated their pro-rata share of the Company s net income or loss. Under the terms of the LTIP-OP Units, the Operating Partnership will revalue its assets upon the occurrence of certain specified events, and any increase in the Operating Partnership s valuation from the time of grant of the LTIP-OP Units until such event will be allocated first to the holders of LTIP-OP Units to equalize the capital accounts of such holders with the capital accounts of the holders of OP Units. Upon equalization of the capital accounts of the holders of LTIP-OP Units with the other holders of OP Units, the LTIP-OP Units will achieve full parity with OP Units for all purposes, including with respect to liquidating distributions. If such parity is reached, vested LTIP-OP Units may be converted into an equal number of OP Units at any time and, thereafter, enjoy all the rights of OP Units, including redemption/exchange rights. Each LTIP-OP Unit awarded is deemed equivalent to an award of one share under the 2013 Plan and reduces the 2013 Plan s share authorization for other awards on a one-for-one basis.

During 2013 the Board of Directors approved a grant of 37,500 LTIP-OP Units upon the completion of the Company s IPO on October 9, 2013 (the grant date). Of the total 37,500 LTIP-OP Units granted, 7,500 were granted to the Company s independent directors, which vested immediately, and 30,000 LTIP-OP Units were granted to the Company s executive officers and certain employees of Freedom Mortgage, which vest ratably over the first three year anniversaries of the grant date. The fair value of each LTIP-OP Unit was determined based on the offering price of the Company s common shares on the grant date (IPO date) of $20.00. The aggregate grant date fair value of the total 37,500 LTIP-OP Units was $750,000.

As of March 31, 2014, 7,500 LTIP-OP Units have vested, and the Company recognized $50,000 and $0 in share-based compensation expense in March 31, 2014 and March 31, 2013, respectively, which is included in general and

administrative expense. There were $500,000 and $0 of total unrecognized share-based compensation expense as of March 31, 2014 and March 31, 2013 respectively, related to the 30,000 non-vested LTIP-OP Units. This unrecognized share-based compensation expense is expected to be recognized ratably over the remaining vesting period of 2.5 years. The aggregate expense related to the LTIP-OP Unit grants is presented as General and administrative expense in the Company s consolidated income statement.

On January 27, 2014, the Company granted each of the independent directors pursuant to the 2013 Equity Incentive Plan 530 shares of common stock (for a total of 1,590 shares), which were fully vested on the date of grant, and 2,651 restricted shares of common stock (for a total of 7,953 shares). The restricted shares of common stock are subject to forfeiture in certain circumstances.

As of March 31, 2014, 1,452,957 shares remain for future issuance under the 2013 Plan.

Non-Controlling Interests in Operating Partnership

Non-controlling interests in the Operating Partnership in the accompanying consolidated financial statements relate to LTIP-OP Units in the Operating Partnership held by parties other than the Company.

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Certain individuals own LTIP-OP Units in the Operating Partnership. An LTIP-OP Unit and a share of common stock of the Company have substantially the same economic characteristics in as much as they effectively share equally in the net income or loss of the Operating Partnership. LTIP-OP Units holders have the right to redeem their LTIP-OP Units, subject to certain restrictions. The redemption is required to be satisfied in shares of common stock, cash, or a combination thereof, at the Company s option, calculated as follows: one share of the Company s common stock, or cash equal to the fair value of a share of the Company s common stock at the time of redemption, for each LTIP-OP Unit. When an LTIP-OP Units holder redeems an OP Unit (as described above), non-controlling interest in the Operating Partnership is reduced and the Company s equity is increased.

As of March 31, 2014, the non-controlling interest holders in the Operating Partnership owned 37,500 LTIP-OP Units, or 0.5% of the Operating Partnership. Pursuant to ASC 810, *Consolidation*, regarding the accounting and reporting for non-controlling interests and changes in ownership interests of a subsidiary, changes in a parent s ownership interest (and transactions with non-controlling interest unit holders in the Operating Partnership) while the parent retains its controlling interest in its subsidiary should be accounted for as equity transactions. The carrying amount of the non-controlling interest will be adjusted to reflect the change in its ownership interest in the subsidiary, with the offset to equity attributable to the Company.

Earnings per Share

The Company is required to present both basic and diluted earnings per share (EPS). Basic EPS is calculated by dividing net income (loss) applicable to common stockholders by the weighted average number of shares of common stock outstanding during each period. Diluted EPS is calculated by dividing net income (loss) applicable to common stockholders by the weighted average number of shares of common stock outstanding plus the additional dilutive effect of common stock equivalents during each period. In accordance with ASC 260, *Earnings Per Share*, if there is a loss from continuing operations, the common stock equivalents are deemed anti-dilutive and earnings (loss) per share is calculated excluding the potential common shares.

The following table presents basic net earnings per share of common stock for the three month periods ended March 31, 2014 and March 31, 2013 (dollars in thousands, except per share data):

	Three Months Ended March 31, 2014	Three Months Ended March 31, 2013
Numerator:		
Net income attributable to common stockholders and participating securities for basic earnings per share	$ 730	$ (35)
Net income allocable to common stockholders	$ 730	$ (35)
Denominator:		
Weighted average common shares	7,502,505	1,000
Basic Dilutive:		
Earnings per common share	$ 0.10	$ (35.00)

Common Stock Offerings

In October 2013, the Company issued 7,500,000 shares of its common stock in its initial public offering and a concurrent private placement at a price of $20.00 per share for net proceeds of approximately $148.1 million.

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Note 7 Transactions with Affiliates and Affiliated Entities

Manager

The Company has entered into a management agreement with the Manager, pursuant to which the Manager provides for the day-to-day management of the Company s operations (the Management Agreement). The Management Agreement requires the Manager to manage the Company s business affairs in conformity with the policies and the investment guidelines that are approved and monitored by the Company s Board of Directors. The Management Agreement will remain in full force until October 9, 2016 and provides for automatically renewing one-year terms thereafter subject to certain termination rights. The Manager s performance is reviewed annually and may be terminated by the Company for cause without payment of a termination fee, or may be terminated without cause with payment of a termination fee, as defined in the Management Agreement, equal to three times the average annual management fee amount earned by the Manager during the two four-quarter periods ending as of the end of the most recently completed fiscal quarter prior to the effective date of the termination, upon either the affirmative vote of at least two-thirds of the members of the Board of Directors or the affirmative vote of the holders of at least a majority of the outstanding common stock. Pursuant to the Management Agreement, the Manager, under the supervision of the Company s board of directors, formulates investment strategies, arranges for the acquisition of assets, arranges for financing, monitors the performance of the Company s assets and provides certain advisory, administrative and managerial services in connection with the operations of the Company. For performing these services, the Company pays the Manager a quarterly management fee equal to the product of one quarter of the 1.5% Management Fee Annual Rate and the Stockholders Equity as of the end of such fiscal quarter.

The Manager is a party to a services agreement (the Services Agreement) with Freedom Mortgage, pursuant to which Freedom Mortgage provides to the Manager the personnel, services and resources as needed by the Manager to enable the Manager to carry out its obligations and responsibilities under the Management Agreement. The Company is a named third-party beneficiary to the Services Agreement and, as a result, has, as a non-exclusive remedy, a direct right of action against Freedom Mortgage in the event of any breach by the Manager of any of its duties, obligations or agreements under the Management Agreement that arise out of or result from any breach by Freedom Mortgage of its obligations under the Services Agreement. The Services Agreement will terminate upon the termination of the Management Agreement. Pursuant to the Services Agreement, the Manager will make certain payments to Freedom Mortgage in connection with the services provided. All of the Company s executive officers and the officers of the Manager are also officers or employees of Freedom Mortgage. As a result, the Management Agreement between the Company and the Manager was negotiated between related parties, and the terms, including fees payable, may not be as favorable to the Company as if it had been negotiated with an unaffiliated third party. Both the Manager and Freedom Mortgage are controlled by Mr. Stanley Middleman.

From October 31, 2012 (date of inception) to December 31, 2012, and for the nine months ended September 30, 2013, the Company shared office space with Freedom Mortgage. In accordance with the Management Agreement between the Company and the Manager, for the period indicated above, the Manager did not allocate rent, overhead, reimbursable executives salaries, or other miscellaneous office expenses to the Company, as it had not commenced operations as of September 30, 2013 and had not generated revenue during the period. The Manager commenced allocating expenses to the Company in October 2013, the first month during which the Company commenced operations.

The Management Agreement provides that the Company will reimburse the Manager for various expenses incurred by the Manager or its officers, and agents on the Company s behalf, including costs of legal, accounting, tax, administrative and other similar services rendered for the Company by providers retained by the Manager or employees of Freedom Mortgage provided by the Manager, in amounts which are no greater than those which would

be payable to outside professionals or consultants engaged to perform such services pursuant to agreements negotiated on an arm s-length basis. For the periods indicated, Due to affiliates consisted of the following (dollars in thousands):

	Three Months Ended March 31, 2014	Three Months Ended March 31, 2013
Management fees	$ 604	$
Expense reimbursement	75	
Total	**$ 679**	**$**

Other Affiliated Entities

See Note 5 for a discussion of the co-investments in Excess MSRs with Freedom Mortgage.

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Note 8 Derivative Instruments

Interest Rate Swap Agreements, Swaptions and TBAs

In order to help mitigate exposure to higher short-term interest rates in connection with its repurchase agreements, the Company enters into interest rate swap agreements. These agreements establish an economic fixed rate on related borrowings because the variable-rate payments received on the interest rate swap agreements largely offset interest accruing on the related borrowings, leaving the fixed-rate payments to be paid on the interest rate swap agreements as the Company s effective borrowing rate, subject to certain adjustments including changes in spreads between variable rates on the interest rate swap agreements and actual borrowing rates. A swaption is an option granting its owner the right but not the obligation to enter into an underlying swap. The Company s interest rate swap agreements and swaptions have not been designated as hedging instruments.

In order to help mitigate duration risk and basis risk management, the Company utilizes forward-settling purchases and sales of Agency RMBS where the underlying pools of mortgage loans are TBAs. Pursuant to these TBA transactions, the Company agrees to purchase or sell, for future delivery, Agency RMBS with certain principal and interest terms and certain types of underlying collateral, but the particular Agency RMBS to be delivered is not identified until shortly before the TBA settlement date.

The following table summarizes the outstanding notional amounts of derivative instruments as of March 31, 2014 and December 31, 2013 (dollars in thousands):

Non-hedge derivatives	March 31, 2014	December 31, 2013
Notional amount of interest rate swaps	$ 175,100	$ 171,700
Notional amount of swaptions	125,000	125,000
Notional amount of TBAs, net		4,800
Total notional amount	**$ 300,100**	**$ 301,500**

The following table presents information about the Company s interest rate swap agreements as of March 31, 2014 and December 31, 2013 (dollars in thousands):

Weighted Average Maturity	Weighted Average Maturity	Notional Amount	Weighted Average Pay Rate	Weighted Average Receive Rate	Weighted Average Years to Maturity
March 31, 2014	2020	$ 175,100	1.96%	0.24%	6.3
December 31, 2013	2020	$ 171,700	1.95%	0.24%	6.7

Offsetting Assets and Liabilities

The Company has netting arrangements in place with all derivative counterparties pursuant to standard documentation developed by the International Swap and Derivatives Association, or ISDA. Under GAAP, if the Company has a valid right of offset, it may offset the related asset and liability and report the net amount. The Company presents all derivative assets and liabilities subject to such arrangements on a gross basis in its consolidated balance sheets. Additionally, the Company does not offset financial assets and liabilities with the associated cash collateral on the

consolidated balance sheets.

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The following table presents information about the Company s assets and liabilities that are subject to master netting arrangements or similar agreements and can potentially be offset on the Company s consolidated balance sheets as of March 31, 2014 and December 31, 2013 (dollars in thousands):

March 31, 2014				
	Designation	**Derivative Asset**	**Derivative Liability**	**Net Amount**
Interest rate swaps	Non-hedge derivative	$ 771	$ (1,399)	$ (628)
Swaptions	Non-hedge derivative	439		439
TBAs	Non-hedge derivative	438	(478)	(40)
Total		**$ 1,648**	**$ (1,877)**	**$ (229)**

December 31, 2013				
	Designation	**Derivative Asset**	**Derivative Liability**	**Net Amount**
Interest rate swaps	Non-hedge derivative	$ 2,531	$ (592)	$ 1,939
Swaptions	Non-hedge derivative	2,082		2,082
TBAs	Non-hedge derivative			
Total		**$ 4,613**	**$ (592)**	**$ 4,021**

The following table presents information about derivatives realized gain (loss), which is included on the consolidated statement of income as of March 31, 2014 and March 31, 2013 (dollars in thousands):

Non-hedge derivatives	**Income Statement Location**	**March 31, 2014**	**March 31, 2013**
Interest rate swaps	Realized gain/(loss) on derivative assets	$ (72)	$ 0
Total		**$ (72)**	**$ 0**

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Note 9 Fair Value

Fair Value Measurements

ASC 820, *Fair Value Measurements and Disclosure*, (ASC 820) defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC 820 clarifies that fair value should be based on the assumptions market participants would use when pricing an asset or liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. The fair value hierarchy gives the highest priority to quoted prices available in active markets (i.e., observable inputs) and the lowest priority to data lacking transparency (i.e., unobservable inputs). Additionally, ASC 820 requires an entity to consider all aspects of nonperformance risk, including the entity s own credit standing, when measuring fair value of a liability.

ASC 820 establishes a three level hierarchy to be used when measuring and disclosing fair value. An instrument s categorization within the fair value hierarchy is based on the lowest level of significant input to its valuation. Following is a description of the three levels:

Level 1 inputs are quoted prices in active markets for identical assets or liabilities as of the measurement date under current market conditions. Additionally, the entity must have the ability to access the active market and the quoted prices cannot be adjusted by the entity.

Level 2 inputs include quoted prices in active markets for similar assets or liabilities; quoted prices in inactive markets for identical or similar assets or liabilities; or inputs that are observable or can be corroborated by observable market data by correlation or other means for substantially the full-term of the assets or liabilities.

Level 3 unobservable inputs are supported by little or no market activity. The unobservable inputs represent the assumptions that market participants would use to price the assets and liabilities, including risk. Generally, Level 3 assets and liabilities are valued using pricing models, discounted cash flow methodologies, or similar techniques that require significant judgment or estimation.

Following are descriptions of the valuation methodologies used to measure material assets and liabilities at fair value and details of the valuation models, key inputs to those models and significant assumptions utilized.

Agency RMBS

The Company holds a portfolio of Agency RMBS that are classified as available for sale and are carried at fair value on the consolidated balance sheet. The Company determines the fair value of its Agency RMBS based upon prices obtained from third-party pricing providers. The third-party pricing providers use pricing models that generally incorporate such factors as coupons, primary and secondary mortgage rates, rate reset period, issuer, prepayment speeds, credit enhancements and expected life of the security. As a result, the Company classified 100% of its Agency RMBS as Level 2 fair value assets at March 31, 2014 and December 31, 2013.

Excess MSRs

The Company holds a portfolio of Excess MSRs that are reported at fair value on the consolidated balance sheet. Although Excess MSR transactions are observable in the marketplace, the valuation includes unobservable market data inputs (prepayment speeds, delinquency levels and discount rates). As a result, the Company classified 100% of its Excess MSRs as Level 3 fair value assets at March 31, 2014 and December 31, 2013.

Derivative Instruments

The Company may enter into a variety of derivative financial instruments as part of its economic hedging strategies. The Company principally executes over-the-counter derivative contracts, specifically interest rate swaps and swaptions. The Company utilizes third-party pricing providers to value its financial derivative instruments. The Company classified 100% of the interest rate swaps and swaptions as Level 2 fair value assets and liabilities at March 31, 2014 and December 31, 2013.

The Company also enters into certain other derivative financial instruments, such as TBAs. These instruments are similar in form to the Company s Agency RMBS available for sale securities, and the Company utilizes a pricing service to value TBAs. As a result, the Company classified 100% of its TBAs as Level 2 fair value assets at March 31, 2014 and December 31, 2013.

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The Company has netting arrangements in place with certain derivative counterparties pursuant to standard documentation developed by the ISDA. Additionally, both the Company and the counterparties are required to post cash collateral based upon the net underlying market value of the Company s open positions with the counterparties. Posting of cash collateral typically occurs daily, subject to certain dollar thresholds. Due to the existence of netting arrangements, as well as frequent cash collateral posting at low posting thresholds, credit exposure to the Company and/or counterparties is considered materially mitigated. Based on the Company s assessment, there is no requirement for any additional adjustment to derivative valuations specifically for credit.

Recurring Fair Value Measurements

The following tables present the Company s assets and liabilities measured at fair value on a recurring basis at March 31, 2014 and December 31, 2013 (dollars in thousands).

Recurring Fair Value Measurements

At March 31, 2014

	Level 1	Level 2	Level 3	Carrying Value
Assets				
Agency RMBS				
Fannie Mae	$	$ 192,292	$	$ 192,292
Freddie Mac		115,500		115,500
Agency RMBS total		307,792		307,792
Variable Rate CMO		1,063		1,063
Derivative assets				
Interest rate swaps		771		771
Interest rate swaptions		439		439
TBAs		438		438
Derivative assets total		1,648		1,648
Excess MSRs			107,887	107,887
Total Assets	**$**	**$ 310,503**	**$ 107,887**	**$ 418,390**
Liabilities				
Derivative liabilities				
Interest rate swaps	$	$ 1,399	$	$ 1,399
TBAs		478		478