

Great Ajax Corp.  
Form 10-Q  
August 13, 2015

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-Q**

**(Mark One)**

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

**For the quarterly period ended June 30, 2015**

**OR**

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

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

**001-36844**

**(Commission file number)**

**GREAT AJAX CORP.**

**(Exact name of registrant as specified in its charter)**

Maryland  
**State or other jurisdiction of incorporation or organization**      47-1271842  
**(I.R.S. Employer Identification No.)**

9400 SW Beaverton-Hillsdale Hwy,  
Suite 131  
Beaverton, OR 97005  
**(Address of principal executive offices)**      97005  
**(Zip Code)**

503-505-5670

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

Indicate by check mark whether the Registrant (1) has filed all reports 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 report(s), 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 Website, 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 "

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 definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (check one):

Edgar Filing: Great Ajax Corp. - Form 10-Q

Large accelerated filer

Accelerated filer

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

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

As of August 12, 2015, 15,909,634 shares of the Registrant's common stock, par value \$0.01 per share, were outstanding which includes 624,106 of operating partnership units that are redeemable on a one-for-one basis into shares of the registrant's common stock.

**Table of Contents**

	<b>Page</b>
<u>PART I. Financial Information</u>	1
<u>Item 1. Consolidated Interim Financial Statements</u>	1
<u>Cautionary Statement Regarding Forward-Looking Statements</u>	23
<u>Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	24
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	42
<u>Item 4. Controls and Procedures</u>	43
<u>PART II. Other Information</u>	45
<u>Item 1. Legal Proceedings</u>	45
<u>Item 1A. Risk Factors</u>	45
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	45
<u>Item 3. Defaults Upon Senior Securities</u>	45
<u>Item 4. Mine Safety Disclosures</u>	45
<u>Item 5. Other Information</u>	45
<u>Item 6. Exhibits</u>	45

Table of Contents

## PART I. FINANCIAL INFORMATION

## Item 1. Consolidated Interim Financial Statements

## GREAT AJAX CORP. AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

**(Dollars in thousands except shares and per share data)**

	<b>June 30, 2015</b> <b>(unaudited)</b>	<b>December 31, 2014</b>
<b>ASSETS</b>		
Cash and cash equivalents	\$ 36,240	\$ 53,099
Mortgage loans, net <sup>(1)</sup>	444,408	211,159
Property held-for-sale	9,018	1,316
Rental property, net	121	290
Receivable from servicer	3,538	1,340
Investment in affiliate	2,445	2,237
Prepaid expenses and other assets	6,068	3,317
Total Assets	\$ 501,838	\$ 272,758
<b>LIABILITIES AND EQUITY</b>		
Liabilities:		
Secured borrowings <sup>(1)</sup>	\$ 116,349	\$ 84,679
Borrowings under repurchase agreement	153,804	15,249
Management fee payable	441	258
Accrued expenses and other liabilities	2,794	1,292
Total liabilities	273,388	101,478
Commitments and contingencies – see Note 7		
Equity:		
Preferred stock \$.01 par value; 25,000,000 shares authorized, none issued or outstanding	-	-
Common stock \$.01 par value; 125,000,000 shares authorized, 15,253,998 shares at June 30, 2015 and 11,223,984 shares at December 31, 2014 issued and outstanding	152	112
Additional paid-in capital	211,361	158,951
Retained earnings	7,279	2,744
Equity attributable to common stockholders	218,792	161,807
Noncontrolling interests	9,658	9,473

Edgar Filing: Great Ajax Corp. - Form 10-Q

Total equity	228,450	171,280
Total Liabilities and Equity	\$ 501,838	\$ 272,758

Mortgage loans includes \$179,808 and \$127,559 of loans at June 30, 2015 and December 31, 2014, respectively, transferred to securitization trusts that are variable interest entities (“VIEs”); these loans can only be used to settle (1) obligations of the VIEs. Secured borrowings consist of notes issued by VIEs that can only be settled with the assets and cash flows of the VIEs. The creditors do not have recourse to the primary beneficiary (Great Ajax Corp.). See Note 8—Debt.

The accompanying notes are an integral part of the consolidated interim financial statements.

Table of Contents

## GREAT AJAX CORP. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

**(Dollars in thousands except shares and per share data)**

	<b>Three months ended June 30, 2015</b>		<b>Six months ended June 30, 2015</b>	
<b>INCOME</b>				
Loan interest income	\$ 10,793		\$ 17,677	
Interest expense	(2,269)	)	(3,344)	)
Net interest income	8,524		14,333	
Other income	232		446	
Total income	8,756		14,779	
<b>EXPENSE</b>				
Related party expense – management fee	856		1,602	
Related party expense – loan servicing fees	851		1,507	
Loan transaction expense	729		989	
Professional fees	356		741	
Other expense	289		450	
Total expense	3,081		5,289	
Income before provision for income taxes	5,675		9,490	
Provision for income taxes	16		16	
Consolidated net income	5,659		9,474	
Less: consolidated net income attributable to the non-controlling interest	223		398	
	\$ 5,436		\$ 9,076	

Edgar Filing: Great Ajax Corp. - Form 10-Q

Consolidated net  
income attributable to  
common stockholders

Basic earnings per common share	\$	0.36	\$	0.64
Diluted earnings per common share	\$	0.36	\$	0.64
Weighted average shares - basic		15,237,739		14,129,162
Weighted average shares - diluted		15,909,634		14,801,319

The accompanying notes are an integral part of the consolidated interim financial statements.



Table of Contents

## GREAT AJAX CORP. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

**(Dollars in thousands)**

	<b>Six months ended June 30, 2015</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>	
Consolidated net income	\$9,474
Adjustments to reconcile net income to net cash from operating activities	
Stock-based management fee and compensation expense	921
Non-cash interest income accretion	(11,850 )
Loss on sale of property	9
Depreciation of property	1
Amortization of prepaid financing costs	435
Net change in operating assets and liabilities	
Prepaid expenses and other assets	(3,186 )
Receivable from servicer	(2,198 )
Undistributed income from investment in affiliate	(275 )
Accrued expenses and other liabilities	1,685
Net cash from operating activities	(4,984 )
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>	
Purchase of mortgage loans and related balances	(233,626)
Principal paydowns on mortgage loans	7,260
Purchase of property held-for-sale and related balances	(2,794 )
Proceeds from sale of property held-for-sale	357
Distribution from affiliate	67
Renovations of rental property and property held for sale	(139 )
Net cash from investing activities	(228,875)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>	
Proceeds from repurchase agreement	153,841
Proceeds from sale or issuance of secured notes	35,213
Repayments on repurchase agreement	(15,286 )
Repayments on secured notes	(3,543 )
Sale of common stock, net of offering costs	51,529
Distribution to non-controlling interest	(213 )
Dividends paid on common stock	(4,541 )
Net cash from financing activities	217,000

Edgar Filing: Great Ajax Corp. - Form 10-Q

NET CHANGE IN CASH AND CASH EQUIVALENTS	(16,859 )
CASH AND CASH EQUIVALENTS, beginning of period	53,099
CASH AND CASH EQUIVALENTS, end of period	\$36,240
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION	
Cash paid for interest	\$2,544
Cash paid for income taxes	\$-
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES	
Transfer of loans to rental property or property held for sale	\$4,965
Transfer of rental property to property held for sale	\$168
Issuance of common stock for management fees	\$814

The accompanying notes are an integral part of the consolidated interim financial statements.

Table of ContentsGREAT AJAX CORP. AND SUBSIDIARIES  
CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

(Unaudited)

(Dollars in thousands)

	<b>Common Stock</b>	<b>Additional Paid-in Capital</b>	<b>Retained Earnings</b>	<b>Total Stockholders' Equity</b>	<b>Noncontrolling Interest</b>	<b>Total Equity</b>
Balance at December 31, 2014	\$ 112	\$ 158,951	\$ 2,744	\$ 161,807	\$ 9,473	\$ 171,280
Issuance of shares	40	51,489	-	51,529	-	51,529
Net income	-	-	9,076	9,076	398	9,474
Stock-based management fee expense	-	814	-	814	-	814
Stock-based compensation expense	-	107	-	107	-	107
Dividends and distributions	-	-	(4,541 )	(4,541 )	(213 )	(4,754 )
Balance at June 30, 2015	\$ 152	\$ 211,361	\$ 7,279	\$ 218,792	\$ 9,658	\$ 228,450

The accompanying notes are an integral part of the consolidated interim financial statements.

Table of Contents

**GREAT AJAX CORP. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**June 30, 2015**

**(Unaudited)**

Note 1 — Organization and basis of presentation

Great Ajax Corp., a Maryland corporation (the “Company”), is an externally managed real estate company formed on January 30, 2014 and capitalized on March 28, 2014 by its then sole stockholder, Aspen Yo LLC (“Aspen Yo”), a company affiliated with the Aspen Capital companies (“Aspen Capital”). The Company was formed to facilitate capital raising activities and to operate as a mortgage real estate investment trust. The Company focuses primarily on acquiring, investing in and managing a portfolio of re-performing and non-performing mortgage loans secured by single-family residences and, to a lesser extent, single-family properties. Re-performing loans are loans on which at least five of the seven most recent payments have been made, or the most recent payment has been made and accepted pursuant to an agreement, or the full dollar amount to cover at least five payments has been paid in the last seven months. Non-performing loans are those loans on which the most recent three payments have not been made. The Company also invests in loans secured by smaller multi-family residential and commercial mixed use retail/residential properties, as well as in the properties directly. The Company’s manager is Thetis Asset Management LLC (the “Manager” or “Thetis”), an affiliated company. The Company owns 19.8% of the Manager. The Company’s mortgage loans and real properties are serviced by Gregory Funding LLC (“Gregory” or “Servicer”), also an affiliated company. The Company expects to qualify and will elect to be taxed as a real estate investment trust, or REIT, under the Internal Revenue Code of 1986, as amended (the “Code”), commencing with the year ended December 31, 2014.

The Company conducts substantially all of its business through its operating partnership, Great Ajax Operating Partnership L.P., a Delaware limited partnership, and its subsidiaries. The Company, through a wholly owned subsidiary, is the sole general partner of the operating partnership. GA-TRS LLC, or Thetis TRS, is a wholly owned subsidiary of the operating partnership that owns the equity interest in the Manager. The Company elected to treat Thetis TRS as a “taxable REIT subsidiary” (“TRS”) under the Code. In September 2014, the Company formed Great Ajax Funding LLC, a wholly owned subsidiary of the operating partnership, to act as the depositor of mortgage loans into securitization trusts and to hold the subordinated securities issued by such trusts and any additional trusts the Company may form for additional securitizations. The Company generally securitizes its mortgage loans and retains subordinated securities from the securitizations. In November 2014, the Company formed AJX Mortgage Trust I, a wholly owned subsidiary of the operating partnership, in connection with a repurchase facility. In addition, the Company, through its operating partnership, holds real estate owned properties (“REO”) acquired upon the foreclosure or other settlement of its owned non-performing loans, as well as through outright purchases. On February 1, 2015, the Company formed GAJX Real Estate LLC, as a wholly owned subsidiary of the operating partnership, to own, maintain, improve and sell REO properties. The Company has elected to treat GAJX Real Estate LLC as a TRS under the Code.

The Company commenced its operations following the completion of its initial private offering in July 2014. On July 8, 2014, the Company closed a private offering, pursuant to which the Company sold 8,213,116 shares of common stock and 453,551 Class A Units of the operating partnership (the “OP Units”), which are redeemable on a 1-for-1 basis into shares of its common stock after one year of ownership. On August 1, 2014, the Company closed the sale of an additional 263,570 shares of common stock and 14,555 OP Units pursuant to the exercise of the option to purchase additional shares granted to the initial purchaser and placement agent. The purchase price per share and per OP Unit was \$15.00. In these offerings, which are referred to collectively as the “Original Private Placement,” the net proceeds, including from the additional shares purchased pursuant to the option to purchase additional shares and OP Units, after deducting the initial purchaser’s discount and placement fee and estimated offering expenses payable, was approximately \$128.4 million. The Original Private Placement was made in reliance on the exemptions from registration set forth in Section 4(a)(2) of the Securities Act of 1933, as amended (the “Securities Act”), and Rule 506 of Regulation D thereunder and Rule 144A under the Securities Act.

Upon the closing of the Original Private Placement, the Company used \$48.8 million of the proceeds to acquire its initial mortgage portfolio through the acquisition of 82% of the equity interests in Little Ajax II, LLC

Table of Contents

(“Little Ajax II”). Little Ajax II was an affiliated entity that acquired primarily re-performing mortgage loans and a number of non-performing mortgage loans in a series of transactions between December 1, 2013 and July 7, 2014. In September 2014, the Company completed a transaction to acquire the remaining interests in this initial mortgage-related asset portfolio. The transaction initially had Little Ajax II redeem the 82% membership interest of the operating partnership by distributing to the operating partnership 82% of all Little Ajax II loans, participation interests and real property. The operating partnership then purchased for cash the remaining 18% interest in such real estate assets for an aggregate purchase price of approximately \$11.4 million. The operating partnership also purchased from Gregory its 5% interest in the 43 loans in which Little Ajax II held a 95% participation interest for approximately \$0.2 million.

On December 16, 2014, the Company closed an additional private placement (the “Second Private Placement”), pursuant to which it sold 2,725,326 shares of common stock and 156,000 OP Units. The purchase price per share was \$15.00. The net proceeds from the private placement after deducting the placement fee and offering expenses paid by the Company, was approximately \$41.2 million. The Company used the proceeds of the Original Private Placement and the Second Private Placement, referred to collectively as the Private Placements, to purchase re-performing and non-performing loans. The Company completed its initial public offering, or IPO, in February 2015 in which the Company and selling stockholders sold an aggregate of 5,276,797 shares of common stock, including shares sold pursuant to exercise of the option to purchase additional shares granted to the underwriters. The Company sold 3,976,464 shares of common stock and selling stockholders sold 1,300,333 shares of common stock, in each case, including shares sold pursuant to exercise of the option to purchase additional shares granted to the underwriters. The Company used the approximately \$53.9 million of proceeds (after deducting the underwriting discount but before deducting estimated offering expenses) to acquire additional mortgage loans and mortgage-related assets.

Basis of presentation and use of estimates

These interim consolidated financial statements should be read in conjunction with the Company’s consolidated financial statements and the notes thereto for the period ended December 31, 2014 included in the Annual Report on Form 10-K filed with the Securities and Exchange Commission (the “SEC”) on March 26, 2015.

Interim financial statements are prepared in accordance with accounting principles generally accepted in the United States (“U.S. GAAP”) for interim financial information and pursuant to the requirements for reporting on Form 10-Q and Regulation S-X. In the opinion of management, all adjustments, consisting solely of normal recurring accruals considered necessary for the fair presentation of financial statements for the interim period presented, have been included. The current period’s results of operations will not necessarily be indicative of results that ultimately may be achieved for the fiscal year ending December 31, 2015.

The consolidated financial statements have been prepared in accordance with U.S. GAAP, as contained within the Accounting Standards Codification (“ASC”) of the Financial Accounting Standards Board (“FASB”) and the rules and

regulations of the SEC, as applied to interim financial statements. Comparative income statement periods have been omitted as the Company had no operations prior to July 8, 2014.

All controlled subsidiaries are included in the consolidated financial statements and all intercompany accounts and transactions have been eliminated in consolidation. The operating partnership is a majority owned partnership that has a non-controlling ownership interest that is included in non-controlling interests on the consolidated balance sheet. As of June 30, 2015, the Company owned 96.1% of the outstanding OP Units and the remaining 3.9% of the OP Units were owned by an unaffiliated holder.

The Company's 19.8% investment in the Manager is accounted for using the equity method because it exercises significant influence on the operations of the Manager through common officers and directors. There is no traded or quoted price for the interests in the Manager since it is privately held.

The preparation of consolidated financial statements in conformity with U.S. GAAP requires the Company 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. The Company considers significant estimates to include expected cash flows from mortgage loans and fair value measurements.

Table of Contents

Note 2 — Summary of significant accounting policies

Cash and cash equivalents

Highly liquid investments with an original maturity of three months or less when purchased are considered cash equivalents. The Company maintains cash and cash equivalents at insured banking institutions. Certain account balances exceed Federal Deposit Insurance Corporation (“FDIC”) insurance coverage and, as a result, there is a concentration of credit risk related to amounts on deposit in excess of FDIC insurance coverage.

Organizational expenses

Organizational expenses are expensed as incurred or when they become reimbursable. Organizational expenses consisted mainly of legal fees.

Offering costs

Costs associated with the Company’s completed offering of shares of common stock have been netted against, and are reflected as a reduction in additional paid-in capital.

Earnings per share

Basic earnings per share is computed by dividing consolidated net income attributable to common stockholders by the weighted average common stock outstanding during the period. The Company treats unvested restricted stock issued under its stock-based compensation plan, which are entitled to non-forfeitable dividends, as participating securities and applies the two-class method in calculating basic earnings per share. Diluted earnings per share is computed by dividing consolidated net income attributable to common stockholders by the weighted average common stock outstanding for the period plus other potentially dilutive securities, such as stock grants, shares that would be issued in the event that OP Units are redeemed for shares of common stock of the Company and shares issued in respect of the stock-based portion of the base fee payable to the Manager and directors’ fees.



## Stock-based payments

The Management Agreement (as defined below) provides for the payment to the Manager of a management fee. The Company pays half of the management fee in cash, and half of the management fee in shares of the Company's common stock, which are issued to the Manager in a private placement and are restricted securities under the Securities Act. Shares issued to the Manager are determined based on the higher of the most recently reported book value or the average of the closing prices of our common stock on the NYSE on the five business days after the date on which the most recent regular quarterly dividend to holders of our common stock is paid. Management fees paid in common stock are expensed in the quarter incurred and recorded in equity at quarter end.

Pursuant to the Company's 2014 Director Equity Plan (the "Director Plan"), the Company may make stock-based awards. The Company has issued to each of the independent directors restricted stock awards of 2,000 shares of its common stock, which are subject to a one-year vesting period. In addition, each of the Company's independent directors receives an annual retainer of \$50,000, payable quarterly, half of which is paid in shares of the Company's common stock on the same basis as the stock portion of the management fee payable to the Manager, and half in cash. Stock-based expense for the directors' annual retainer is expensed as earned, in equal quarterly amounts during the year, and recorded in equity at quarter end.

## Directors' fees

The expense related to directors' fees is accrued and reflected in stockholders' equity in the period in which it is incurred.

Table of Contents

Management fee and expense reimbursement

Under the management agreement with the Manager, the Company pays a quarterly base management fee based on its stockholders' equity and a quarterly incentive management fee based on its cash distributions to its stockholders. Manager fees are expensed in the quarter incurred and the portion payable in common stock is included in stockholders' equity at quarter-end. See "Note 9 — Related party transactions."

Servicing fees

Under the servicing agreement, Gregory receives servicing fees ranging from 0.65% – 1.25% annually of unpaid principal balance ("UPB") (or the fair market value or purchase price of REO that the Company owns or acquires). Gregory is reimbursed for all customary, reasonable and necessary out-of-pocket costs and expenses incurred in the performance of its obligations, including the actual cost of any repairs and renovations undertaken on the Company's behalf. The total fees incurred by the Company for these services will be dependent upon the UPB and type of mortgage loans that Gregory services, property values, previous UPB of the relevant loan, and the number of REO properties. The agreement will automatically renew for successive one-year terms, subject to prior written notice of non-renewal. In certain cases, the Company may be obligated to pay a termination fee. The Management Agreement will automatically terminate at the same time as the servicing agreement if the servicing agreement is terminated for any reason. See "Note 9 — Related party transactions."

Fair value of financial instruments

Fair value is defined 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. A fair value hierarchy has been established which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

**Level 1** — Quoted prices in active markets for identical assets or liabilities.

**Level 2** — Observable inputs other than Level 1 prices, such as quoted prices for similar assets and liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

**Level 3** — Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The degree of judgment utilized in measuring fair value generally correlates to the level of pricing observability. Assets and liabilities with readily available actively quoted prices or for which fair value can be measured from actively quoted prices generally will have a higher degree of pricing observability and a lesser degree of judgment utilized in measuring fair value. Conversely, assets and liabilities rarely traded or not quoted will generally have little or no pricing observability and a higher degree of judgment utilized in measuring fair value. Pricing observability is impacted by a number of factors, including the type of asset or liability, whether it is new to the market and not yet established, and the characteristics specific to the transaction.

Property held-for-sale is measured at cost at acquisition and subsequently measured at the lower of cost or fair value less cost to sell on a nonrecurring basis. The fair value of property held-for-sale is generally based on estimated market prices from an independently prepared appraisal, an independent broker price opinion (“BPO”), or management’s judgment as to the selling price of similar properties.

#### Income taxes

The Company intends to elect REIT status upon the filing of its 2014 income tax return, and has conducted its operations in order to satisfy and maintain eligibility for REIT status. Accordingly, the Company does not believe it will be subject to U.S. federal income tax from the year ended December 31, 2014 forward on the portion of the Company’s REIT taxable income that is distributed to the Company’s stockholders as long as certain asset, income and stock ownership tests are met. If after electing to be taxed as a REIT, the Company subsequently fails to qualify as a REIT in any taxable year, it generally will not be permitted to qualify for treatment as a REIT for U.S. federal

Table of Contents

income tax purposes for the four taxable years following the year during which qualification is lost. The Company may also be subject to state or local income or franchise taxes.

Thetis TRS, GAJX Real Estate LLC and any other TRS that the Company forms, will be subject to U.S. federal and state income taxes. On January 13, 2015, the Company applied for a private letter ruling from the Internal Revenue Service that would allow it to exclude its proportionate share of gross income from the Manager if it held its interest in the Manager through the operating partnership. If the Company receives such a ruling, it expects that it will hold its interest in the Manager through the operating partnership, instead of through Thetis TRS; however, there is no assurance that such a ruling will be issued. Income taxes are provided for using the asset and liability method. A provision for income taxes of \$16,400 was recorded for both the three- and six-month periods ended June 30, 2015. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted rates expected to apply to taxable income in the years in which management expects those temporary differences to be recovered or settled. The effect on deferred taxes of a change in tax rates is recognized in income in the period in which the change occurs. Subject to the Company's judgment, it reduces a deferred tax asset by a valuation allowance if it is "more-likely-than-not" that some or all of the deferred tax asset will not be realized. Tax laws are complex and subject to different interpretations by the taxpayer and respective governmental taxing authorities. Significant judgment is required in evaluating tax positions, and the Company recognizes tax benefits only if it is more likely than not that a tax position will be sustained upon examination by the appropriate taxing authority.

The Company evaluates tax positions taken in its consolidated financial statements under the interpretation for accounting for uncertainty in income taxes. As a result of this evaluation, the Company may recognize a tax benefit from an uncertain tax position only if it is "more-likely-than-not" that the tax position will be sustained on examination by taxing authorities.

The Company's tax returns remain subject to examination and consequently, the taxability of the distributions and other tax positions taken by the Company may be subject to change. Distributions to stockholders generally will be taxable as ordinary income, although a portion of such distributions may be designated as long-term capital gain or qualified dividend income, or may constitute a return of capital. The Company will furnish annually to each stockholder a statement setting forth distributions paid during the preceding year and their U.S. federal income tax treatment.

Mortgage loans

Purchased mortgage loans are initially recorded at the purchase price, net of any acquisition fees or costs at the time of acquisition and are considered asset acquisitions. As part of the determination of the purchase price for mortgage loans, the Company uses a discounted cash flow valuation model to model expected cash flows, and which considers alternate loan resolution probabilities, including liquidation or conversion to real estate owned. Observable inputs to

the model include current interest rates, loan amounts, status of payments and property types. Unobservable inputs to the model include discount rates, forecast of future home prices, alternate loan resolution probabilities, resolution timelines, the value of underlying properties and other economic and demographic data.

Under ASC 310-30, acquired loans may be aggregated and accounted for as a pool of loans if the loans being aggregated have some degree of credit quality deterioration since origination and have common risk characteristics. A pool is accounted for as a single asset with a single composite interest rate and an aggregate expectation of cash flows. Re-performing mortgage loans have been determined to have common risk characteristics and are accounted for as a single loan pool for loans acquired within each three-month fiscal quarter. Similarly, non-performing mortgage loans have been determined to have common risk characteristics and are accounted for as a single non-performing pool for loans acquired within each three-month fiscal quarter. Under ASC 310-30, the Company estimates cash flows expected to be collected, adjusted for expected prepayments and defaults expected to be incurred over the life of the loan pool. The Company determines the excess of the loan pool's contractually required principal and interest payments over the expected cash flows as an amount that should not be accreted, referred to as the non-accretable yield. The difference between expected cash flows and the purchase price (at acquisition) or the present value of the expected cash flows is referred to as the accretable yield, which represents the amount that is expected to be recorded as interest income over the remaining life of the loan pool. For the three-

Table of Contents

and six-months ended June 30, 2015, the Company recognized no provision for loan loss. For the three- and six-months ended June 30, 2015, the Company accreted \$10.8 million and \$17.7 million, respectively, into interest income with respect to its loan portfolio. As of June 30, 2015, the Company's loan portfolio had a UPB of \$596.3 million and a carrying value of \$444.4 million and at December 31, 2014, a UPB of \$298.6 million and carrying value of \$211.2 million, which excludes one loan in which it holds a 40.5% beneficial interest through an equity method investee.

Generally, the Company acquires loans at a discount associated with some degree of credit impairment. The Company elects to aggregate certain pools of loans with common risk characteristics and accrue interest income thereon at a composite interest rate, based on expectations of cash flows to be collected for the pool. Expectations of pool cash flow are reviewed quarterly. Adjustments to a pool's prospective composite interest rate or an allowance for impairment are made to the extent revised expectations differ from original estimates.

For loans that do not qualify for pool aggregation treatment, including performing loans that are not purchased at discounts resulting from credit-related issues, interest is recognized using the simple-interest method on daily balances of the principal amount outstanding, adjusted for the amortization or accretion of the loan premium or discount over the contractual life of the loan.

Accrual of interest on individual loans is discontinued when management believes that, after considering economic and business conditions and collection efforts, the borrower's financial condition is such that collection of interest is doubtful. The Company's policy is to stop accruing interest when a loan's delinquency exceeds 90 days. All interest accrued but not collected for loans that are placed on non-accrual status or subsequently charged-off are reversed against interest income. Income is subsequently recognized on the cash basis until, in management's judgment, the borrower's ability to make periodic principal and interest payments returns and future payments are reasonably assured, in which case the loan is returned to accrual status.

An individual loan is considered to be impaired when, based on current events and conditions, it is probable the Company will be unable to collect all amounts due (both principal and interest) according to the contractual terms of the loan agreement. Impaired loans are carried at the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's market price, or the fair value of the collateral if the loan is collateral dependent.

For individual loans, a troubled debt restructuring is a formal restructuring of a loan where, for economic or legal reasons related to the borrower's financial difficulties, a concession that would not otherwise be considered is granted to the borrower. The concession may be granted in various forms, including providing a below-market interest rate, a reduction in the loan balance or accrued interest, an extension of the maturity date, or a combination of these. An individual loan that has had a troubled debt restructuring is considered to be impaired and is subject to the relevant accounting for impaired loans.

The allowance for loan losses is established through a provision for loan losses charged to expenses. The allowance is an amount that management believes will be adequate to absorb probable losses on existing loans that may become uncollectible, based on evaluations of the collectability of loans.

Purchased non-performing loans that are accounted for as individual loans are recorded at fair value, which is generally the purchase price. Interest income is recognized on a cash basis and loan purchase discount is accreted to income in proportion to the actual principal paid. Loans are tested quarterly for impairment and impairment reserves are recorded to the extent the fair market value of the underlying collateral falls below net book value.

While the Company generally intends to hold its assets as long-term investments, it may sell certain of its loans in order to manage its interest rate risk and liquidity needs, meet other operating objectives and adapt to market conditions. The timing and impact of future sales of loans, if any, cannot be predicted with any certainty. Since the Company expects that its assets will generally be financed, it expects that a significant portion of the proceeds from sales of its assets (if any), prepayments and scheduled amortization will be used to repay balances under its financing sources.

## Table of Contents

### Residential properties

Property is recorded at cost if purchased, or at fair value of the asset less estimated selling costs if obtained through foreclosure by the Company. Property that is currently unoccupied and actively marketed for sale is classified as held-for-sale. Property held-for-sale is carried at the lower of cost or fair market value. Net unrealized losses due to changes in market value are recognized through a valuation allowance by charges to income.

No depreciation or amortization expense is recognized on properties held-for-sale, while holding costs are expensed as incurred. Rental property is property not held-for-sale. Rental properties are intended to be held as long-term investments but may eventually be held-for-sale. Depreciation is provided for using the straight-line method over the estimated useful lives of the assets of three to 27.5 years.

With respect to residential rental properties not held-for-sale, the Company performs an impairment analysis using estimated cash flows if events or changes in circumstances indicate that the carrying value may be impaired, such as prolonged vacancy, identification of materially adverse legal or environmental factors, changes in expected ownership period or a decline in market value to an amount less than cost. This analysis is performed at the property level. These cash flows are estimated based on a number of assumptions that are subject to economic and market uncertainties including, among others, demand for rental properties, competition for customers, changes in market rental rates, costs to operate each property and expected ownership periods.

If the carrying amount of a held-for-investment asset exceeds the sum of its undiscounted future operating and residual cash flows, an impairment loss is recorded for the difference between estimated fair value of the asset and the carrying amount. The Company generally estimates the fair value of assets held for use by using BPOs. In some instances, appraisal information may be available and is used in addition to BPOs.

The Company performs property renovations to maximize the value of the property for its rental strategy. Such expenditures are part of its initial investment in a property and, therefore, are capitalized as part of the basis of the property. Subsequently, the residential property, including any renovations that improve or extend the life of the asset, are accounted for at cost. The cost basis is depreciated using the straight-line method over an estimated useful life of three to 27.5 years. Interest and other carrying costs incurred during the renovation period are capitalized until the property is ready for its intended use. Expenditures for ordinary maintenance and repairs are charged to expense as incurred.

### Segment information



The Company's primary business is acquiring, investing in and managing a portfolio of mortgage loans. The Company operates in a single segment focused on non-performing mortgages and re-performing mortgages.

#### Emerging growth company

Section 107 of the Jumpstart Our Business Startups Act (the "JOBS Act") provides that an emerging growth company can take advantage of the extended transition period provided in Section 7(a)(2)(B) of the Securities Act for complying with new or revised accounting standards. In other words, an emerging growth company can delay the adoption of certain accounting standards until those standards would otherwise apply to private companies. The Company has elected to take advantage of the benefits of this extended transition period. Its consolidated financial statements may, therefore, not be comparable to those of companies that comply with such new or revised accounting standards.

#### Reclassifications

The December 31, 2014 amounts included in the delinquency table in Note 3 – Mortgage loans have been reclassified from delinquent to current to reflect a correction of an error in the presentation of the disclosure that is immaterial to the consolidated financial statements taken as a whole. Such reclassifications did not affect cash flows, net revenues, net income, total assets, total liabilities or total equity.

Table of Contents

Recently issued accounting standards

In January 2014, FASB issued Accounting Standards Update (“ASU”) 2014-04, Troubled Debt Restructurings by Creditors. It provides that if a repossession or foreclosure has occurred, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendment requires disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in mortgage loans collateralized by residential real estate property that are in the process of foreclosure. The amended guidance may be applied using either a prospective transition method or a modified retrospective transition method and is effective for fiscal years, and interim periods within those years, beginning after December 15, 2014, with early adoption permitted. We adopted this standard in the first quarter of 2015 and it did not have a material impact on our financial statements.

In May 2014, the FASB issued ASU 2014-09 Revenue from Contracts with Customers. ASU 2014-09 is a comprehensive new revenue recognition model requiring a company to recognize revenue to depict the transfer of goods or services to a customer at an amount reflecting the consideration it expects to receive in exchange for those goods or services. While ASU 2014-09 specifically references contracts with customers, it may apply to certain other transactions such as the sale of real estate or equipment. ASU 2014-09 may be applied using either a full retrospective or a modified retrospective approach and is effective for fiscal years, and interim periods within those years, beginning after December 15, 2016, and early adoption is not permitted. On April 29, 2015, the FASB proposed a one-year deferral of the effective date for ASU 2014-09. The Company is evaluating the impact of this amendment on its financial position and results of operations.

In February 2015, the FASB issued ASU 2015-02 Amendments to the Consolidation Analysis. These amendments: (1) modify the evaluation of whether limited partnerships and similar legal entities are variable interest entities (“VIEs”) or voting interest entities; (2) eliminate the presumption that a general partner should consolidate a limited partnership; (3) affect the consolidation analysis of reporting entities that are involved with VIEs, particularly those that have fee arrangements and related party relationships; and (4) provide a scope exception from consolidation guidance for reporting entities with interests in legal entities that are required to comply with or operate in accordance with requirements that are similar to those in Rule 2a-7 of the Investment Company Act of 1940 for registered money market funds. ASU 2015-02 is effective for interim and annual reporting periods beginning after December 15, 2015. The Company is evaluating the impact of this amendment on its financial position and results of operations.

In April 2015, the FASB issued ASU 2015-03 Interest – Imputation of Interest. The amendments in this update require that debt issuance costs be presented in the balance sheet as a direct deduction from the carrying amount of a debt liability, consistent with debt discounts. This guidance is effective for interim and annual reporting periods beginning after December 15, 2015, with early adoption permitted. This guidance may be adopted retrospectively or under a modified retrospective method where the cumulative effect is recognized at the date of initial application. The

Company is evaluating the impact of this amendment on its financial position and results of operations.

Note 3 — Mortgage loans

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

12

Table of Contents

	Three months ended June 30, 2015		Six months ended June 30, 2015		Period from inception to December 31, 2014	
	Re-performing loans	Non-performing loans	Re-performing loans	Non-performing loans	Re-performing loans	Non-performing loans
Contractually required principal and interest	\$ 332,571	\$ 31,827	\$ 486,603	\$ 65,675	\$ 393,657	\$ 257,790
Non-accretable yield	(132,557)	(18,598)	(198,704)	(38,317)	(173,502)	(184,096)
Expected cash flows to be collected	200,014	13,229	287,899	27,358	220,155	73,694
Accretable yield	(49,626)	(4,185)	(73,680)	(8,038)	(60,495)	(22,071)
Fair value at acquisition	\$ 150,388	\$ 9,044	\$ 214,219	\$ 19,320	\$ 159,660	\$ 51,623
Accretable yield	Three months ended <b>June 30, 2015</b>		Six months ended <b>June 30, 2015</b>		Period from inception to <b>December 31, 2014</b>	
	Re-performing loans	Non-performing loans	Re-performing loans	Non-performing loans	Re-performing loans	Non-performing loans
Balance at beginning of period	\$ 74,045	\$ 22,604	\$ 54,940	\$ 20,686	\$ –	\$ –
Accretable yield additions	49,626	4,185	73,680	8,038	60,495	22,071
Accretion	(7,739)	(3,054)	(12,688)	(4,989)	(5,555)	(1,385)
Balance at end of period	\$ 115,932	\$ 23,735	\$ 115,932	\$ 23,735	\$ 54,940	\$ 20,686

During the three- and six-months ended June 30, 2015, the Company recognized \$0.7 million and \$1.0 million, respectively, for due diligence costs related to these and other transactions in loan transaction expense.

The following table sets forth the carrying value of its mortgage loans, and related UPB by delinquency status as of June 30, 2015 and December 31, 2014 (\$ in thousands):

	June 30, 2015			December 31, 2014		
	Number loans	Carrying value	Unpaid principal balance	Number loans	Carrying value	Unpaid principal balance
Current	1,123	\$ 209,046	\$ 267,983	439	\$ 72,727	\$ 94,993
30	406	66,969	87,292	237	36,954	53,739
60	194	29,611	39,647	99	13,849	17,766
90	534	77,407	107,345	352	53,987	76,691
Foreclosure	362	61,375	94,021	212	33,642	55,384
Mortgage loans	2,619	\$ 444,408	\$ 596,288	1,339	\$ 211,159	\$ 298,573

These balances do not include one loan in which we hold a 40.5% beneficial interest through an equity method investee.

As of June 30, 2015, the Company held 34 residential properties with a carrying value of \$5.1 million that had been foreclosed.

The Company's mortgage loans are secured by real estate. As such, the Company believes that the credit quality indicators for each of its mortgage loans are the timeliness of payments and the value of the underlying real estate. The Company categorizes mortgage loans as "re-performing" and as "non-performing." The Company monitors the credit quality of the mortgage loans in its portfolio on an ongoing basis, principally by considering loan payment activity or delinquency status. In addition, the Company assesses the expected cash flows from the mortgage loans, the fair value of the underlying collateral and other factors, and evaluates whether and when it becomes probable that all amounts contractually due will not be collected.

Table of Contents

## Note 4 — Real estate assets, net

## Real estate held for use

As of June 30, 2015, the Company had two REO properties having an aggregate carrying value of \$0.1 million held for use as rentals. Both of these properties had been rented.

## Real estate held-for-sale

As of June 30, 2015, the Company classified 54 REO properties having an aggregate carrying value of \$9.0 million as real estate held for sale as they do not meet its residential rental property investment criteria.

## Dispositions

During the three-months ended June 30, 2015, the Company disposed of two held-for-sale residential properties and recognized a loss of \$7,000. During the six-months ended June 30, 2015, the Company disposed of three held-for-sale residential properties and recognized a loss of \$9,000.

**Note 5 — Fair value of financial instruments**

The following tables set forth the fair value of financial assets and liabilities by level within the fair value hierarchy as of June 30, 2015 and December 31, 2014 (\$ in thousands):

	<b>Carrying Value</b>	<b>Level 1 Quoted prices in active markets</b>	<b>Level 2 Observable inputs other than Level 1 prices</b>	<b>Level 3 Unobservable inputs</b>
<b>June 30, 2015</b>				
Not recognized on consolidated balance sheet at fair value (assets)				
Mortgage loans	\$444,408	—	—	\$ 501,369

Edgar Filing: Great Ajax Corp. - Form 10-Q

Not recognized on consolidated balance sheet at fair value  
(liabilities)

Borrowings under repurchase agreement	153,804	—	\$ 153,804	—
Secured borrowings	116,349	—	116,349	—

	Carrying Value	Level 1 Quoted prices in active markets	Level 2 Observable inputs other than Level 1 prices	Level 3 Unobservable inputs
<b>December 31, 2014</b>				
Not recognized on consolidated balance sheet at fair value (assets)				
Mortgage loans	\$211,159	—	—	\$ 235,623
Not recognized on consolidated balance sheet at fair value (liabilities)				
Borrowings under repurchase agreement	15,249	—	\$ 15,249	—
Secured borrowings	84,679	—	84,679	—

The Company has not transferred any assets from one level to another level during the three or six months ended June 30, 2015.

The carrying values of its cash and cash equivalents, related party receivables, accounts payable and accrued liabilities, related party payables and investments in the Manager and affiliate are equal to or approximate

Table of Contents

fair value. Property held-for-sale is measured at cost at acquisition and subsequently measured at the lower of cost or fair value less cost to sell on a nonrecurring basis. The fair value of property held-for-sale is generally based on estimated market prices from an independently prepared appraisal, an independent BPO, or management's judgment as to the selling price of similar properties. No properties held-for-sale were measured at fair value at June 30, 2015.

The fair value of mortgage loans is estimated using the Manager's proprietary pricing model which estimates expected cash flows with the discount rate used in the present value calculation representing the estimated effective yield of the loan. The value of transfers of mortgage loans to real estate owned is estimated using BPOs.

The significant unobservable inputs used in the fair value measurement of the Company's mortgage loans are the same as those used to calculate the acquisition price, including discount rates and loan resolution timelines. Significant changes to any of these inputs in isolation could result in a significant change to the fair value measurement. A decline in the discount rate in isolation would increase the fair value. An increase in the loan resolution timeline in isolation would decrease the fair value. The following table sets forth quantitative information about the significant unobservable inputs used to measure the fair value of the Company's mortgage loans as of June 30, 2015:

<b>Input</b>	<b>Range of Values</b>
Equity discount rate – Re-performing loans	8% - 14%
Equity discount rate – Non-performing loans	10% - 18%
Cost of debt	4.25%
Loan resolution timelines – Re-performing loans (in years)	4 - 7
Loan resolution timelines – Non-performing loans (in years)	1.4 - 4

Note 6 — Unconsolidated affiliates

On December 5, 2014, the Company acquired a 40.5% interest in GA-E 2014-12, a Delaware trust, for \$2.2 million. GA-E 2014-12 holds an economic interest in a single small-balance commercial loan secured by a commercial property in Portland, Oregon. At December 31, 2014, GA-E 2014-12 had a basis in the loan of \$5.4 million. At June 30, 2015, GA-E 2014-12 had a basis in the loan of \$5.6 million, and net income of \$0.2 million for the three months ended, and \$0.4 million for the six months ended June 30, 2015, of which 40.5% is the Company's share. The Company accounts for this investment using the equity method.

Upon the closing of the Original Private Placement, the Company received a 19.8% equity interest in Thetis. At December 31, 2014, Thetis had total assets of \$2.2 million and liabilities of \$0.2 million. At June 30, 2015, Thetis had total assets of \$2.8 million, liabilities of \$0.3 million, and net income of \$0.3 million for the three months ended, and \$0.5 million for the six months ended June 30, 2015, of which 19.8% is the Company's share. The Company accounts for its investment in Thetis using the equity method. Thetis is a privately held company and there is no public market



for its securities.

Note 7 — Commitments and contingencies

The Company regularly enters into agreements to acquire additional mortgage loans and mortgage-related assets, subject to continuing diligence on such assets and other customary closing conditions. There can be no assurance that the Company will acquire any or all of the mortgage loans identified in any acquisition agreement as of the date of these consolidated financial statements, and it is possible that the terms of such acquisitions may change.

At June 30, 2015, we had commitments to purchase 158 re-performing mortgage loans secured by single and one-to-four family residences with aggregate UPB of \$46.8 million and an estimated purchase price of \$36.0 million.

Litigation, claims and assessments

From time to time, the Company may be involved in various claims and legal actions arising in the ordinary course of business. As of June 30, 2015, the Company was not a party to, and its properties were not

Table of Contents

subject to, any pending or threatened legal proceedings that individually or in the aggregate, are expected to have a material impact on its financial condition, results of operations or cash flows.

Note 8 — Debt

Repurchase agreement

On November 25, 2014, the Company entered into a repurchase facility pursuant to which a newly formed Delaware statutory trust wholly owned by the operating partnership, AJX Mortgage Trust I, the “Seller,” will acquire, from time to time, pools of mortgage loans that are primarily secured by first liens on one-to-four family residential properties from its affiliates and/or third party sellers. The facility was amended on May 13, 2015 to increase the transaction limit. These mortgage loans will generally be sold from time to time by the operating partnership as the “Guarantor” to the Seller pursuant to the terms of a mortgage loan purchase agreement by and between the Guarantor, as seller, and the Seller, as purchaser, in accordance with the terms thereof. Pursuant to the Master Repurchase Agreement (the “MRA”), these mortgage loans, together with the Seller’s 100% ownership interests in its wholly owned subsidiary, a newly formed Delaware limited liability company (“REO I”), and any future REO subsidiaries wholly owned by the Seller and certain other property of the Seller, will be sold by the Seller to Nomura Corporate Funding Americas, LLC, as Buyer, from time to time, pursuant to one or more transactions, not exceeding \$200 million, with a simultaneous agreement by the Seller to repurchase such mortgage loans and other property, as provided in the MRA. The obligations of the Seller are guaranteed by the operating partnership. Repurchases under this facility carry interest calculated based on a spread to one-month LIBOR and are fixed for the term of the borrowing. The purchase price for each mortgage loan or REO is generally equal to 65% of the acquisition price for such asset or the then current BPO for the asset. The difference between the market value of the asset and the amount of the repurchase agreement is the amount of equity the Company has in the position and is intended to provide the lender some protection against fluctuations of value in the collateral and/or the failure by the Company to repay the borrowing at maturity. The Company has effective control over the assets associated with this agreement and therefore it is accounted for as a financing arrangement. The facility termination date is November 24, 2015.

Gregory services these mortgage loans and the REO properties pursuant to the terms of a servicing agreement by and among the Servicer, the Seller, REO I and any other REO Subsidiary, which servicing agreement has the same fees and expenses terms as the Company’s servicing agreement described under Note 9 — Related Party Transactions. The operating partnership as Guarantor will provide to the Buyer a limited guaranty of certain losses incurred by the Buyer in connection with certain events and/or the Seller’s obligations under the MLPA, following the breach of certain covenants by the Seller or an REO Subsidiary related to their status as a special purpose entity, the occurrence of certain bad acts by the Seller Parties, the occurrence of certain insolvency events of the Seller or an REO Subsidiary or other events specified in the Guaranty. As security for its obligations under the Guaranty, the Guarantor will pledge the Trust Certificate representing the Guarantor’s 100% beneficial interest in the Seller. While the Guaranty establishes a master netting arrangement, the arrangement does not meet the criteria for offsetting. The amount outstanding on the Company’s repurchase facility and the carrying value of the Company’s loans pledged as collateral are presented as gross amounts in the Company’s balance sheets at June 30, 2015 and December 31, 2014. The following table sets

forth the details of the repurchase agreement (\$ in thousands):

Maturity Date	Maximum borrowing capacity	June 30, 2015			December 31, 2014		
		Amount outstanding	Carrying value of collateral	Interest rate	Amount outstanding	Carrying value of collateral	Interest rate
November 24, 2015	\$ 200,000	\$ 153,804	\$ 241,689	4.00 %	\$ 15,249	\$ 23,460	4.00 %

Secured borrowings

From the commencement of operations to June 30, 2015, the Company has completed three securitizations pursuant to Rule 144A under the Securities Act. The securitizations are structured as debt financings and not REMIC sales, and the loans included in the securitizations remain on the Company's balance sheet as the Company is the primary beneficiary of the securitization trusts, which are variable interest entities ("VIEs"). The securitization VIEs are structured as pass through entities that receive principal and interest on the underlying mortgages and distribute those payments to the holders of the notes. The Company's exposure to the obligations of the VIEs is

Table of Contents

generally limited to its investments in the entities. The notes that are issued by the securitization trusts are secured solely by the mortgages held by the applicable trusts and not by any of the Company's other assets. The mortgage loans of the applicable trusts are the only source of repayment and interest on the notes issued by such trusts. The Company does not guarantee any of the obligations of the trusts under the terms of the agreement governing the notes or otherwise.

The Company's securitizations are structured with Class A notes, Class B notes, and a trust certificate representing the residual interests in the mortgages. For each of the Company's three securitizations, the Company has retained the Class B notes and the trust certificate. The Class A notes are senior, sequential pay, fixed rate notes. The Class B notes are subordinate, sequential pay, fixed rate notes with Class B-2 notes subordinate to the Class B-1 notes. If the Class A notes have not been redeemed by the payment date 36 months after issue, or otherwise paid in full by that date, an amount equal to the aggregate interest payment amount that accrued and would otherwise be paid to the Class B-1 and the Class B-2 notes will be paid as principal to the Class A notes on that date and each subsequent payment date until the Class A notes are paid in full. After the Class A notes are paid in full, the Class B-1 and Class B-2 notes will resume receiving their respective interest payment amounts and any interest that accrued but was not paid to the Class B notes while the Class A notes were outstanding. As the holder of the trust certificates, the Company is entitled to receive any remaining amounts in the trust after the Class A notes and Class B notes have been paid in full.

The following table sets forth the original terms of all securitization notes at their respective cutoff dates as of June 30, 2015:

Issuing Trust/Issue Date	Security	Original Principal	Interest Rate
Ajax Mortgage Loan Trust 2014-A/ October 2014	Class A notes due 2057 <sup>(1)</sup>	\$45 million	4.00 %
	Class B-1 notes due 2057 <sup>(2)</sup>	\$8 million	5.19 %
	Class B-2 notes due 2057 <sup>(2)</sup>	\$8 million	5.19 %
	Trust certificates <sup>(3)</sup>	\$20.4 million	–
Ajax Mortgage Loan Trust 2014-B / November 2014	Class A notes due 2054 <sup>(1)</sup>	\$41.2 million	3.85 %
	Class B-1 notes due 2054 <sup>(2)</sup>	\$13.7 million	5.25 %
	Class B-2 notes due 2054 <sup>(2)</sup>	\$13.7 million	5.25 %
	Trust certificates <sup>(3)</sup>	\$22.9 million	–
Ajax Mortgage Loan Trust 2015-A / May 2015	Class A notes due 2054 <sup>(1)</sup>	\$35.6 million	3.88 %
	Class B-1 notes due 2054 <sup>(2)</sup>	\$8.7 million	5.25 %
	Class B-2 notes due 2054 <sup>(2)</sup>	\$8.7 million	5.25 %
	Trust certificates <sup>(3)</sup>	\$22.8 million	–

(1) The Class A notes are senior, sequential pay, fixed rate notes.

(2) The Class B notes are subordinate, sequential pay, fixed rate notes with Class B-2 notes subordinate to the Class B-1 notes. We have retained the Class B notes.

The trust certificate issued by the trust and the beneficial ownership of the trust are retained by Great Ajax Funding (3)LLC as the depositor. As the holder of the trust certificate, we are entitled to receive any remaining amounts in the trust after the Class A notes and Class B notes have been paid in full.

Table of Contents

Servicing for the mortgage loans in 2014-A, 2014-B and 2015-A is provided by the Servicer at a servicing fee rate of 0.65% annually of UPB for re-performing loans and 1.25% annually of UPB for non-performing loans, and is paid monthly by us. The following table sets forth the status of the 2014-A, 2014-B and 2015-A notes held by others at the securitization cutoff date, at December 31, 2014 and at June 30, 2015 (\$ in thousands):

Class of Notes	Balances at June 30, 2015		Balances at December 31, 2014		Original balances at securitization cutoff date	
	Carrying value of mortgages	Bond principal balance	Carrying value of mortgages	Bond principal balance	Mortgage UPB	Bond principal balance
2014-A	\$ 58,313	\$ 41,681	\$ 58,905	\$ 44,016	\$ 81,405	\$ 45,000
2014-B	68,379	39,344	68,654	40,663	91,535	41,191
2015-A	53,116	35,324	—	—	75,835	35,643
	\$ 179,808	\$ 116,349	\$ 127,559	\$ 84,679	\$ 248,775	\$ 121,834

The Company's obligations under its secured borrowings are not fixed, and the payments on these borrowings are predicated upon cash flows received on the underlying mortgage loans. Accordingly, a projection of contractual maturities over the next five years is inapplicable.

## Note 9 — Related party transactions

Our consolidated statement of income included the following significant related party transactions (\$ in thousands):

	Three months ended June 30, 2015			Six months ended June 30, 2015		
	Amount	Counterparty	Consolidated Statement of Income location	Amount	Counterparty	Consolidated Statement of Income location
Management fee	\$856	Thetis	Related party expense – management fee	\$1,602	Thetis	Related party expense – management fee
Loan servicing fees	851	Gregory	Related party expense – loan servicing fees	1,507	Gregory	Related party expense – loan servicing fees
Due diligence and related loan acquisition costs	1	Gregory	Loan transaction expense	19	Gregory	Loan transaction expense
Expense reimbursements	-	Aspen Yo	Professional fees	3	Aspen Yo	Professional fees

Management Agreement

On July 8, 2014, the Company entered into a 15-year management agreement (the “Management Agreement”) with the Manager. Under the Management Agreement, the Manager implements the Company’s business strategy and manages the Company’s business and investment activities and day-to-day operations, subject to oversight by the Company’s board of directors. Among other services, the Manager, directly or through Aspen affiliates, provides the Company with a management team and necessary administrative and support personnel. The Company does not currently have any employees and does not expect to have any employees in the foreseeable future. Each of the Company’s executive officers is an employee or officer, or both, of the Manager or the Company’s Servicer.

Under the Management Agreement, the Company pays both a base management fee and an incentive fee to the Manager.

The Base Management Fee equals 1.5% of our stockholders’ equity per annum and calculated and payable quarterly in arrears. For purposes of calculating the management fee, the Company’s stockholders’ equity means: (a) the sum of (i) the net proceeds from any issuances of common stock or other equity securities issued by the Company or the operating partnership (without double counting) since inception (allocated on a pro rata daily basis

Table of Contents

for such issuances during the fiscal quarter of any such issuance), and (ii) the Company's and the operating partnership's (without double counting) retained earnings calculated in accordance with U.S. GAAP at the end of the most recently completed fiscal quarter (without taking into account any non-cash equity compensation expense incurred in current or prior periods), less (A) any amount that the Company or the operating partnership pays to repurchase shares of common stock or OP Units since inception, (B) any unrealized gains and losses and other non-cash items that have affected consolidated stockholders' equity as reported in the Company's financial statements prepared in accordance with U.S. GAAP, and (C) one-time events pursuant to changes in U.S. GAAP, and certain non-cash items not otherwise described above, in each case after discussions between the Manager and the Company's independent directors and approval by a majority of the Company's independent directors. As a result, the Company's stockholders' equity, for purposes of calculating the management fee, could be greater or less than the amount of stockholders' equity shown on the Company's consolidated financial statements. 50% of the base management fee is payable in shares of the Company's common stock so long as the ownership of such additional number of shares by the Manager would not violate the 9.8% stock ownership limit set forth in the Company's charter, and the balance is payable in cash. The common stock will be determined using the higher of the most recently reported book value or the average of the closing prices of our common stock on the NYSE on the five business days after the date on which the most recent regular quarterly dividend to holders of our common stock is paid. The Manager has agreed to hold any shares of common stock received by it as payment of the base management fee for at least three years from the date such shares of common stock are received by it.

The Manager is also entitled to an incentive management fee that is payable quarterly in arrears in cash in an amount equal to one-fourth of 20% of the dollar amount by which (i) the sum of (A) the aggregate cash dividends, if any, declared out of the REIT taxable income of the Company by the Company's Board of Directors payable to the holders of the Company's common stock and (B) the aggregate cash distributions, if any, declared out of the REIT taxable income of the operating partnership (without duplication) by the operating partnership payable to holders of OP Units (other than any OP Units held by the Company as a limited partner) annualized, or the Annualized Dividends and Distributions, in respect of such calendar quarter exceeds (ii) the product of (1) the book value per share of the Company's common stock as of the end of each such quarter multiplied by the number of shares of the Company's common stock and OP Units (other than any OP Units held by the Company as a limited partner) outstanding as of the end of such calendar quarter and (2) 8%. Notwithstanding the foregoing, no incentive fee will be payable to the Manager with respect to any calendar quarter unless its cumulative core earnings, as defined in the agreement, is greater than zero for the most recently completed eight calendar quarters, or the number of completed calendar quarters since the closing date of the Original Private Placement, whichever is less.

The Company also reimburses the Manager for all third-party, out-of-pocket costs incurred by the Manager for managing its business, including third-party diligence and valuation consultants, legal expenses, auditors and other financial services. The Company will not reimburse the Manager for lease costs or salaries and expenses of employees of the Manager. The reimbursement obligation is not subject to any dollar limitation. Expenses will be reimbursed in cash on a monthly basis.

The Company will be required to pay the Manager a termination fee in the event that the Management Agreement is terminated as a result of (i) a termination by the Company without cause, (ii) its decision not to renew the Management Agreement upon the determination of at least two thirds of the Company's independent directors for



reasons including the failure to agree on revised compensation, (iii) a termination by the Manager as a result of the Company becoming regulated as an “investment company” under the Investment Company Act of 1940 (other than as a result of the acts or omissions of the Manager in violation of investment guidelines approved by the Company’s board of directors), or (iv) a termination by the Manager if we default in the performance of any material term of the Management Agreement (subject to a notice and cure period). The termination fee will be equal to twice the combined base fee and incentive fees payable to the Manager during the 12-month period ended as of the end of the most recently completed fiscal quarter prior to the date of termination.

#### Servicing Agreement

On July 8, 2014, the Company entered into a 15-year servicing agreement (the “Servicing Agreement”) with the Servicer. The Company’s overall servicing costs under the servicing agreement will vary based on the types of assets serviced.

Table of Contents

Servicing fees range from 0.65% to 1.25% annually of UPB (or the fair market value or purchase price of REO the Company owns or acquires), and are paid monthly. The total fees incurred by us for these services depend upon the UPB and type of mortgage loans that Gregory services pursuant to the terms of the servicing agreement. The fees are determined based on the loan's status at acquisition and do not change if a performing loan becomes non-performing or vice versa.

The Company will also reimburse Gregory for all customary, reasonable and necessary out-of-pocket costs and expenses incurred in the performance of its obligations, including the actual cost of any repairs and renovations to REO properties. The total fees incurred by us for these services will be dependent upon the property value, previous UPB of the relevant loan, and the number of REO properties.

If the Management Agreement has been terminated other than for cause and/or the Servicer terminates the servicing agreement, the Company will be required to pay a termination fee equal to the aggregate servicing fees payable under the servicing agreement for the immediate preceding 12-month period.

Trademark Licenses

Aspen Yo has granted the Company a non-exclusive, non-transferable, non-sublicensable, royalty-free license to use the name "Great Ajax" and the related logo. The Company also has a similar license to use the name "Thetis." The agreement has no specified term. If the Management Agreement expires or is terminated, the trademark license agreement will terminate within 30 days. In the event that this agreement is terminated, all rights and licenses granted thereunder, including, but not limited to, the right to use "Great Ajax" in its name will terminate. Aspen Yo also granted to the Manager a substantially identical non-exclusive, non-transferable, non-sublicensable, royalty-free license to use of the name "Thetis."

Note 10 — Stock-based payments and director fees

Pursuant to the terms of the Management Agreement, the Company pays 50% of the base fee to the Manager in shares of its common stock with the number of shares determined based on the higher of the most recently reported book value or the average of the closing prices of our common stock on the NYSE on the five business days after the date on which the most recent regular quarterly dividend to holders of our common stock is paid. The Company paid the Manager a base fee for the quarter ended June 30, 2015 of \$0.9 million of which the Company paid half, or \$0.4 million, in 29,790 shares of its common stock. The shares issued to the Manager are restricted securities subject to transfer restrictions, and were issued in a private placement transaction on July 28, 2015.

In addition, each of the Company's independent directors receives an annual retainer of \$50,000, payable quarterly, half of which is paid in shares of the Company's common stock on the same basis as the stock portion of the management fee payable to the Manager and half in cash. The following table sets forth the Company's stock-based management fees and independent director fees (\$ in thousands except share amounts):

**Management fees and director fees**

	<b>For the three months ended June 30, 2015</b>		<b>For the six months ended June 30, 2015</b>	
	<b>Number of shares</b>	<b>Amount of expense recognized<sup>(1)</sup></b>	<b>Number of shares</b>	<b>Amount of expense recognized<sup>(1)</sup></b>
Management fees	29,790	\$ 441	55,877	\$ 814
Independent director fees	1,740	25	3,488	50
	31,530	\$ 466	59,365	\$ 864

(1) All management fees and independent director fees are fully expensed in the period in which they are incurred.

Table of Contents

The Director Plan is designed to promote the Company's interests by attracting and retaining qualified and experienced individuals for service as non-employee directors. The Director Plan is administered by the Company's board of directors. The total number of shares of common stock or other stock-based award, including grants of long term incentive plan ("LTIP") units from the operating partnership, available for issuance under the Director Plan is 100,000 shares. At the closing of the Original Private Placement, the Company issued to each of its three independent directors restricted stock awards of 2,000 shares of its common stock, which are subject to a one-year vesting period. At the time of the IPO in February 2015, the Company added an additional independent director who was also granted a restricted stock award of 2,000 shares of its common stock, subject to a one-year vesting period.

The following table sets forth the activity in its restricted stock plan (\$ in thousands, except share and per share amounts):

## Restricted Stock

	<b>Number of shares</b>	<b>Per share value</b>	<b>Total cost of grant</b>	<b>Grant expense recognized for the three months ended June 30, 2015</b>	<b>Grant expense recognized for the six months ended June 30, 2015</b>
July 8, 2014, Directors' Grants <sup>(1)</sup>	6,000	\$ 15.00	\$ 90	\$ 23	\$ 45
February 19, 2015 Director Grant <sup>(1)</sup>	2,000	14.25	29	7	12
	8,000		\$ 119	\$ 30	\$ 57

(1) Vesting period is one year from grant date.

## Note 11 — Income taxes

As a REIT, the Company must meet certain organizational and operational requirements including the requirement to distribute at least 90% of its annual REIT taxable income to its stockholders. As a REIT, the Company generally will not be subject to U.S. federal income tax to the extent the Company distributes its REIT taxable income to its stockholders and provided the Company satisfies the REIT requirements including certain asset, income, distribution and stock ownership tests. If the Company fails to qualify as a REIT, and does not qualify for certain statutory relief provisions, it will be subject to U.S. federal, state and local income taxes and may be precluded from qualifying as a REIT for the subsequent four taxable years following the year in which it lost its REIT qualification.

## Edgar Filing: Great Ajax Corp. - Form 10-Q

The Company's consolidated financial statements include the operations of Thetis TRS and GAJX Real Estate LLC, which are subject to U.S. federal, state and local income taxes on the Company's taxable income.

For the three- and six-months ended June 30, 2015, the Company's taxable income was \$3.6 million and \$5.2 million, respectively. The Company recorded \$16,400 of income tax expense for both the three- and six-months ended June 30, 2015 and the Company recognized no deferred income tax assets or liabilities on its consolidated balance sheet at June 30, 2015 or December 31, 2014 due to immateriality. The Company also recorded no interest or penalties for the three- or six- month periods ended June 30, 2015.

The Company's 2014 U.S. federal, state and local tax returns remain open for examination. The Company has concluded that it had no uncertain tax positions for its 2014 tax year.

### Note 12 — Earnings per share

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

Table of Contents

	Three months ended June 30, 2015			Six months ended June 30, 2015		
	Income	Shares	Per Share	Income	Shares	Per Share
	(Numerator)	(Denominator)	Amount	(Numerator)	(Denominator)	Amount
<b>Basic EPS</b>						
Income attributable to common stockholders	\$ 5,436	15,237,739		9,076	14,129,162	
Allocation of earnings to participating restricted shares	(17 )			(31 )		
Income attributable to unrestricted common stockholders	\$ 5,419	15,237,739	\$ 0.36	\$ 9,045	14,129,162	\$ 0.64
<b>Effect of dilutive securities</b>						
Operating partnership units	223	624,106		398	624,106	
Restricted stock grants and Manager and director fee shares	17	47,789		31	48,051	
<b>Diluted EPS</b>						
Income attributable to common stockholders and dilutive securities	\$ 5,659	15,909,634	\$ 0.36	\$ 9,474	14,801,319	\$ 0.64

Note 13 — Subsequent events

#### Dividend Declaration

On August 3, 2015, the Company declared a dividend of \$0.22 per share, to be paid on August 28, 2015, to stockholders of record as of August 14, 2015.

#### Management Fees

On July 28, 2015, we issued 29,790 shares of our common stock to the Manager in payment of 50% of the management fee due for the second quarter of 2015 in a private transaction. The management fee expense associated with these shares was recorded as an expense in the second quarter of 2015.

#### Directors' Retainer

On July 28, 2015, we issued each of Jonathan Bradford Handley, Jr., Daniel Hoffman, J. Kirk Ogren Jr. and John Condas 435 shares of our common stock in payment of half of their quarterly director fees for the second quarter of 2015.

#### Securitization

On July 2, 2015, we closed on our fourth securitization. An aggregate of \$87.2 million of senior securities and \$15.9 million of subordinated securities were issued in private offerings to institutional investors with respect to \$158.5 million UPB of mortgage loans.

Table of Contents

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

Some of the statements under “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and elsewhere in this report constitute forward-looking statements. Forward-looking statements relate to expectations, beliefs, projections, future plans and strategies, anticipated events or trends and similar expressions concerning matters that are not historical facts. In some cases, you can identify forward-looking statements by terms such as “anticipate,” “believe,” “could,” “estimate,” “expect,” “intend,” “may,” “plan,” “potential,” “should,” “will” and “would” or the negatives of these terms or other comparable terminology.

The forward-looking statements are based on our beliefs, assumptions and expectations of our future performance, taking into account all information currently available to us. These beliefs, assumptions and expectations can change as a result of many possible events or factors, not all of which are known to us or are within our control. If a change occurs, our business, financial condition, liquidity and results of operations may vary materially from those expressed in our forward-looking statements. You should carefully consider these risks, along with the following factors that could cause actual results to vary from our forward-looking statements:

the factors referenced in this report, including those set forth under “Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations”;

- our ability to implement our business strategy;
- difficulties in identifying re-performing and non-performing loans and properties to acquire;
- the impact of changes to the supply of, value of and the returns on re-performing and non-performing loans;
- our ability to convert non-performing loans into performing loans, or to modify or otherwise resolve such loans;
- our ability to convert non-performing loans to properties that can generate attractive returns either through sale or rental;
- our ability to compete with our competitors;
- our ability to control our costs;



Edgar Filing: Great Ajax Corp. - Form 10-Q

the impact of changes in interest rates and the market value of the collateral underlying our re-performing and non-performing loan portfolios or of our other real estate assets;

- our ability to obtain financing arrangements on favorable terms, or at all;
- our ability to retain our engagement of our Manager;
- the failure of the Servicer to perform its obligations under the servicing agreement;
- general volatility of the capital markets;
- the impact of adverse real estate, mortgage or housing markets and changes in the general economy;
- changes in our business strategy;
- our failure to qualify or maintain qualification as a real estate investment trust (“REIT”);
- our expectations regarding the time during which we will be an emerging growth company under the JOBS Act;
- our failure to maintain our exemption from registration under the Investment Company Act of 1940, as amended (the “Investment Company Act”); and
- the impact of adverse legislative or regulatory tax changes.

Table of Contents

**Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations**

In this quarterly report on Form 10-Q (“report”), unless the context indicates otherwise, references to “Great Ajax,” “we,” “the company,” “our” and “us” refer to the activities of and the assets and liabilities of the business and operations of Great Ajax Corp.; “operating partnership” refers to Great Ajax Operating Partnership L.P., a Delaware limited partnership; “our Manager” refers to Thetis Asset Management LLC, a Delaware limited liability company; “Aspen Capital” refers to the Aspen Capital group of companies; “Aspen” and “Aspen Yo” refers to Aspen Yo LLC, an Oregon limited liability company that is part of Aspen Capital; “the Servicer” and “Gregory” refer to Gregory Funding LLC, an Oregon limited liability company and our affiliate, and an indirect subsidiary of Aspen Yo.

Our Management’s Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the unaudited interim Consolidated Financial Statements and related notes included in Item 1. Consolidated Interim Financial Statements of this report and in Item 8. Financial Statements and Supplementary Data in our most recent Annual Report on Form 10-K, as well as the sections entitled “Risk Factors” in Item 1A. of our most recent Annual Report on Form 10-K and Part II, Item 1A. of this report, as well as other cautionary statements and risks described elsewhere in this report and our most recent Annual Report on Form 10-K.

Overview

Great Ajax Corp. is a Maryland corporation that focuses primarily on acquiring, investing in and managing a portfolio of re-performing and non-performing mortgage loans secured by single-family residences and, to a lesser extent, single-family properties. We also invest in loans secured by multi-family residential and commercial mixed use retail/residential properties, as well as in the properties directly. The multi-family and commercial mixed-use properties generally will have loan values of up to approximately \$5 million. We refer to these as “smaller commercial properties.” On July 8, 2014, we closed a private offering of shares of our common stock and limited partnership units of our operating partnership, or OP Units. On August 1, 2014, we closed the sale of additional shares of our common stock and OP Units pursuant to the exercise of the additional allotment option we granted to the initial purchaser and placement agent in connection with the July placement and we refer to these closings as the Original Private Placement. The Original Private Placement resulted in net proceeds to us of approximately \$128.4 million. We commenced operations on July 8, 2014. In December 2014, we closed an additional private placement, or the Second Private Placement, of shares of our common stock and OP Units, which resulted in net proceeds to us of approximately \$41.2 million. We completed our IPO in February 2015, in which we and selling stockholders sold an aggregate of 5,276,797 shares of common stock, including shares sold pursuant to exercise of the option to purchase additional shares granted to the underwriters. We sold 3,976,464 shares of common stock and selling stockholders sold 1,300,333 shares of common stock, in each case, including shares sold pursuant to exercise of the option to purchase additional shares granted to the underwriters. We used the approximately \$53.9 million of proceeds (after deducting the underwriting discount but before deducting estimated offering expenses) to acquire additional mortgage loans and mortgage-related assets.

We are externally managed by Thetis Asset Management LLC, an affiliated entity. We own a 19.8% interest in the Manager. Our mortgage loans and other real estate assets are serviced by Gregory Funding LLC, an affiliated entity. We conduct substantially all of our business through our operating partnership, Great Ajax Operating Partnership L.P., a Delaware limited partnership, and its subsidiaries. We, through a wholly owned subsidiary, are the general partner of our operating partnership. GA-TRS LLC, or Thetis TRS, is a wholly owned subsidiary of the operating partnership that owns the equity interest in the Manager. We elected to treat Thetis TRS as a TRS under the Code. In January 2015, we applied for a private letter ruling from the Internal Revenue Service that would permit us to hold our interest in the Manager through the operating partnership. In September 2014, we formed Great Ajax Funding LLC, a wholly owned subsidiary of the operating partnership, to act as the depositor of mortgage loans into securitization trusts and to hold the subordinated securities issued by such trusts and any additional trusts we may form for additional securitizations. In November 2014, we formed AJX Mortgage Trust I, a wholly owned subsidiary of the operating partnership, in connection with a repurchase agreement. On February 1, 2015, we formed GAJX Real Estate LLC, as a wholly owned subsidiary of the operating partnership, to own, maintain, improve and sell REO purchased by us. We have elected to treat GAJX Real Estate LLC as a TRS under the Code.

## Table of Contents

We expect to qualify and have elected to be taxed as a REIT for U.S. federal income tax purposes beginning with our taxable year ended December 31, 2014. Our qualification as a REIT will depend upon our ability to meet, on a continuing basis, various complex requirements under the Code relating to, among other things, the sources of our gross income, the composition and values of our assets, our distribution levels and the diversity of ownership of our capital stock. We believe that we are organized in conformity with the requirements for qualification as a REIT under the Code, and that our current intended manner of operation will enable us to meet the requirements for taxation as a REIT for U.S. federal income tax purposes.

## **Recent Developments**

Through June 30, 2015, we have acquired mortgage loans and other mortgage related assets with an aggregate unpaid principal balance, or UPB, of \$598.9 million, which includes one loan in which we hold a 40.5% beneficial interest through an equity method investee. During July 2015, we completed the acquisition of 158 re-performing mortgage loans secured by single and one-to-four family residences with aggregate UPB of \$46.8 million. The loans were acquired at 77.0% of UPB and the estimated market value of the underlying collateral is \$60.5 million. The purchase price equaled 59.6% of the estimated market value of the underlying collateral.

## Market Trends and Outlook

The U.S. Federal Reserve estimates that as of March 31, 2015, there was approximately \$9.9 trillion of mortgage loans outstanding on U.S. one-to-four family residential properties and approximately \$1.02 trillion of mortgage loans outstanding on U.S. multi-family residential properties.

While housing starts increased in 2014 over 2013, the number of building permits issued in the first quarter of 2015 indicates that starts may be leveling off for single-family homes (a decrease of 2.5% compared to the fourth quarter of 2014). Construction starts on single-family homes were down 8% from the previous quarter and up 6% from the first quarter of 2014, they remain significantly below historical levels. In addition to the leveling of housing starts, a persistent price gap exists between newly built homes and existing homes with sales of existing homes showing improvements while sales of new homes continued to lag in the first quarter of 2015. While new homes are almost always more expensive, on average, than their older comparables, that gap has widened since the last recession. Furthermore, the U.S. Department of Housing and Urban Development, or HUD, has noted that the listed inventories of new and of existing homes at the end of the first quarter 2015 would support 5.1 months and 4.6 months, respectively, of sales at the current sales pace, while historical average supply of homes on the market is 6.0 months. The Mortgage Bankers Association estimates that total one-to-four family mortgage loan originations (including both purchase and refinance transactions) will increase from \$1.4 trillion in 2015 to \$1.3 trillion in 2016.

Cyclical trends are prompting a significant realignment within the mortgage sector. These trends and their effects include:

continuing sales of residential mortgage assets by banks and other mortgage lenders due to elevated operating costs resulting from new regulatory requirements, delinquencies and impairments;

the continuing decline in home ownership that, conversely, has increased the demand for single-family and multi-family residential rental properties and associated rents;

the dislocations in the residential mortgage loan origination market and the limited availability of financing for non-government sponsored enterprise mortgages since 2008, which have made qualifying for a mortgage loan more difficult. These factors, combined with shifting demographic trends and the need for families pushed out of their homes through foreclosure or the inability to continue to pay their mortgage loans, are driving increased demand for loan modifications, non-GSE mortgage financing and single-family rental properties;

the changing regulatory landscape, leading to the reduction of the government's role in, and the return of private capital, including non-bank participants, to the housing finance market; some of the changes have begun to be implemented, as evidenced by the tightening of conforming loan limits and increases in guarantee fees; and

Table of Contents

unemployment remaining relatively high, under-employment continuing to be a concern and real wages continuing to be stagnant, which means that the ability of borrowers to continue to pay their existing mortgage loans will likely remain under pressure.

The current market landscape is also generating new opportunities in residential mortgage-related whole loan strategies. The origination of subprime and alternative residential mortgage loans has dramatically declined since 2008 and the new QM and ATR Rule requirements will also put pressure on new originations. Additionally, many banks and other mortgage lenders have increased their credit standards and down payment requirements for originating new loans.

The combination of these factors has also resulted in a significant number of families that cannot qualify to obtain new residential mortgage loans. We believe new U.S. federal regulations addressing “qualified mortgages” based, among other factors on employment status, debt-to-income level, impaired credit history or lack of savings, will continue to limit mortgage loan availability from traditional mortgage lenders. In addition, we believe that many homeowners displaced by foreclosure or who either cannot afford to own or cannot be approved for a mortgage will prefer to live in single-family rental properties with similar characteristics and amenities to owned homes as well as smaller multi-family residential properties. In certain demographic areas, new households are being formed at a rate that exceeds the new homes being added to the market, which we believe favors future demand for non-federally guaranteed mortgage financing for single-family and smaller multi-family rental properties. For all these reasons, we believe that demand for single-family and smaller multi-family rental properties will increase in the near term and remain at heightened levels in the foreseeable future.

We expect the availability of pools of re-performing and non-performing loans, properties in foreclosure and REO to increase and remain elevated over the next several years. The single family mortgage delinquency rate at December 31, 2014 is 6.71%, according to the Federal Reserve Board. Overall housing values have rebounded since 2012; however, CoreLogic®, a leading global property information, analytics and data-enabled services provider, has reported that approximately 5.4 million homes, or 10.8% of all residential properties with a mortgage, were in a negative position as of the end of the fourth quarter 2014. Negative equity, often referred to as “underwater” or “upside down,” means that borrowers owe more on their mortgages than their homes are worth. Negative equity can occur because of a decline in value, an increase in mortgage debt or a combination of both. For the homes in negative equity status, the national aggregate value of negative equity was \$349 billion at the end of the fourth quarter of 2014, up \$7 billion from approximately \$342 billion at the end of the third quarter 2014. In addition, Corelogic® reports that of the 49.9 million residential properties with equity, approximately 10 million have less than 20% equity. Borrowers with less than 20% equity, referred to as “under-equited,” may have a more difficult time refinancing their existing home or obtaining new financing to sell and buy another home due to underwriting constraints. Under-equited mortgages accounted for 20% of all residential properties with a mortgage nationwide in the fourth quarter of 2014, with more than 1.4 million residential properties at less than 5% equity, referred to as near-negative equity. Properties that are near-negative equity are considered at risk if home prices fall. Further, a portion of the 800,000 borrowers with low interest rates under the HAMP for the past five years will begin seeing mortgage payment increases in 2014. Generally, their interest rates will increase by one percentage point each year until their rate equals the average 30-year, fixed-rate mortgage rate at the time of modification. 11% of HAMP borrowers have already missed at least one payment, and we believe that wages and home prices have not improved enough for many of these borrowers to afford the monthly payment increase. In June, September and November 2014 and July 2015, the FHA held note sales

under the Distressed Asset Stabilization Program of 2014, or DASP, as part of a broad effort by the FHA to decrease losses and market and sell non-performing loans in bulk. Further such sales are expected. In addition, in July 2014 and February, March, April and May of 2015, Freddie Mac sold \$659 million, \$392 million, \$1,038 million, \$267 million and \$624 million respectively, of non-performing loans, and in April 2015 Fannie Mae sold \$762 million of non-performing loans. Fannie Mae and Freddie Mac have indicated that they will have ongoing non-performing loan sales programs.

We also believe that banks and other mortgage lenders have strengthened their capital bases and are more aggressively foreclosing on delinquent borrowers or selling these loans to dispose of their inventory. Additionally, many non-performing loan buyers are now interested in reducing their investment duration and have begun selling re-performing loans.

## Table of Contents

We also believe there are significant attractive investment opportunities in the smaller commercial mortgage loan and property markets. We focus on densely populated urban areas where we expect positive economic change based on certain demographic, economic and social statistical data. The primary lenders for smaller multi-family and mixed retail/residential properties are community banks and not regional and national banks and large institutional lenders. We believe the primary lenders and loan purchasers are less interested in these assets because they typically require significant commercial and residential mortgage credit and underwriting expertise, special servicing capability and active property management. It is also more difficult to create the large pools that these primary banks, lenders and portfolio acquirers typically desire. Many community banks also remain under financial and regulatory pressure since the financial crisis and are now beginning to sell smaller commercial mortgage loans as property values have begun to increase.

### Factors That May Affect Our Operating Results

*Acquisitions.* Our operating results depend heavily on sourcing re-performing and non-performing loans. We believe that there is currently a large supply of re-performing and non-performing loans available to us for acquisition. We believe the available supply provides for a steady acquisition pipeline of assets since we plan on targeting just a small percentage of the population. We further believe that we will be able to purchase residential mortgage loans at lower prices than “real estate owned” properties, or REO, for the following reasons.

We believe that buying re-performing loans is more efficient and lower risk than acquiring REO rentals directly because the net cash flow from the re-performing loans is typically greater than rent cash flow. Re-performing loans are typically purchased at significant discounts from UPB and underlying property values, but the borrower pays interest on the full UPB, leading to a higher current yield. The borrower is also responsible for property taxes, insurance and maintenance, which are all costs that the owner of the REO would otherwise have to pay. In addition, to the extent that the UPB exceeds the home’s value, the lender will receive all appreciation until such time as the HPA exceeds the UPB. While the return to the mortgage loan owner is thus capped, conversely, there is also risk mitigation if the REO value decreases, until the value is less than the price the lender paid for the loan.

If a re-performing loan becomes a non-performing loan, or we purchase a non-performing loan, which is purchased at a deeper discount than re-performing loans, we, through the Servicer, have a number of ways to mitigate our loss. These loss mitigation techniques include working with the borrower to achieve performance, including through modification of the mortgage loan terms as well as short sale, assisted deed-in-lieu of foreclosure, assisted deed-for-lease, foreclosure and other loss mitigation activities. With each REO acquired, we assess the best potential return—either through rental, sale with carryback financing, which we believe will increase the potential pool of purchasers, or sale without our financing the purchase.

We believe that we will be able to purchase residential mortgage loans at lower prices than REO properties because sellers of such loans will be able to avoid paying the costs typically associated with sales of real estate, whether single-family residences or smaller commercial properties, such as broker commissions and closing costs of up to 10% of gross proceeds of the sale. We believe this will motivate the sellers to accept a lower price for the



re-performing and non-performing loans than they would if selling REO.

We believe there are fewer participants in the re-performing and non-performing loan marketplace than in the foreclosure auction and other REO acquisition channels due to the large size of portfolios offered for sale on an “all or none” basis and the required operational infrastructure and expertise involved in servicing loans and managing single-family rental properties across various states. Additionally, as the acquirer of loans, we take the risk of delays in the foreclosure process for non-performing loans. We will focus on smaller pools of mortgage loan assets that we can analyze on a loan-by-loan basis, and we believe that we will be able to aggregate these smaller pools often at a greater discount than would be available for larger pools. We believe the relatively lower level of competition for re-performing and non-performing loans, combined with growing supply, provides buyers with the opportunity for a higher discount rate relative to the foreclosure auction and other REO acquisition channels and therefore a relatively lower cost to acquire REO.

## Table of Contents

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

*Financing.* Our ability to grow our business by acquiring re-performing and non-performing loans depends on the availability of adequate financing, including additional equity financing, debt financing or both in order to meet our objectives. We intend to leverage our investments with debt, the level of which may vary based upon the particular characteristics of our portfolio and on market conditions. We securitize our whole loan portfolios, primarily as a financing tool, when economically efficient to create long-term, fixed rate, non-recourse financing with moderate leverage, while retaining one or more tranches of the subordinate MBS so created. The securitizations are structured as debt financings and not REMIC sales, and the loans included in the securitizations remain on the Company's balance sheet. In October 2014, November 2014 and May 7, 2015, we completed securitization transactions pursuant to Rule 144A under the Securities Act of 1933, as amended, or the Securities Act, in which we issued notes primarily secured by seasoned, performing and non-performing mortgage loans primarily secured by first liens on one-to-four family residential properties. In November 2014, we entered into a repurchase financing facility under which we nominally sell certain of our assets to a counterparty and simultaneously enter into an agreement to repurchase the sold assets at a price equal to the loan amount plus an interest factor. Despite being legally structured as sales and subsequent repurchases, repurchase transactions are generally accounted for as debt secured by the underlying assets. We describe the securitizations and the repurchase financing facility below under "—Liquidity and Capital Resources." To the extent appropriate at the relevant time, our financing sources may also include bank credit facilities, warehouse lines of credit, structured financing arrangements and additional repurchase agreements, among others. See "—Liquidity and Capital Resources." We may also seek to raise additional capital through public or private offerings of debt or equity securities, depending upon market conditions.

To qualify as a REIT under the Code, we generally will need to distribute at least 90% of our taxable income each year (subject to certain adjustments) to our stockholders. This distribution requirement limits our ability to retain earnings and thereby replenish or increase capital to support our activities.

*Resolution Methodologies.* We, through the Servicer, or our affiliates, employ various loan resolution methodologies with respect to our residential mortgage loans, including loan modification, collateral resolution and collateral disposition. The manner in which a non-performing loan is resolved will affect the amount and timing of revenue we will receive. Our preferred resolution methodology is to modify non-performing loans. Once successfully modified and there is a period of continued performance, we expect that borrowers will typically refinance these loans either with other lenders or by the Servicer at or near the estimated value of the underlying property. We believe modification followed by refinancing generates near-term cash flows, provides the highest possible economic outcome for us and is a socially responsible business strategy because it keeps more families in their homes. In certain circumstances, we may also consider selling these modified loans. Though we do not actively seek to acquire REO or rental properties, through historical experience, we expect that many of our non-performing residential mortgage loans

will enter into foreclosure or similar proceedings, ultimately becoming REO that we can convert into single-family rental properties that we believe will generate long-term returns for our stockholders. REO property can be converted into single-family rental properties or they may be sold through REO liquidation and short sale processes. We expect the timelines for each of the different processes to vary significantly, and final resolution could take up to 48 months or longer from the loan acquisition date. The exact nature of resolution will depend on a number of factors that are beyond our control, including borrower willingness, property value, availability of refinancing, interest rates, conditions in the financial markets, regulatory environment and other factors. To avoid the 100% prohibited transaction tax on the sale of dealer property by a REIT, we intend to dispose of any asset that may be treated as held “primarily for sale to customers in the ordinary course of a trade or business” by contributing or selling the asset to a TRS prior to marketing the asset for sale.

The state of the real estate market and home prices will determine proceeds from any sale of real estate. We will opportunistically and on an asset-by-asset basis determine whether to rent any REO we acquire, whether upon

Table of Contents

foreclosure or otherwise, we may determine to sell such assets if they do not meet our investment criteria. In addition, while we seek to track real estate price trends and estimate the effects of those trends on the valuations of our portfolios of residential mortgage loans, future real estate values are subject to influences beyond our control. Generally, rising home prices are expected to positively affect our results. Conversely, declining real estate prices are expected to negatively affect our results.

*Conversion to rental property.* The key variables that will affect our residential rental revenues over the long-term will be the extent to which we acquire REO, which, in turn, will depend on the amount of our capital invested, average occupancy and rental rates in our owned rental properties. We expect the timeline to convert acquired loans into rental properties will vary significantly by loan, which could result in variations in our revenue and our operating performance from period to period. There are a variety of factors that may inhibit our ability, through the Servicer, to foreclose upon a residential mortgage loan and get access to the real property within the time frames we model as part of our valuation process. These factors include, without limitation: state foreclosure timelines and the associated deferrals (including from litigation); unauthorized occupants of the property; U.S. federal, state or local legislative action or initiatives designed to provide homeowners with assistance in avoiding residential mortgage loan foreclosures that may delay the foreclosure process; U.S. federal government programs that require specific procedures to be followed to explore the non-foreclosure outcome of a residential mortgage loan prior to the commencement of a foreclosure proceeding; and declines in real estate values and high levels of unemployment and underemployment that increase the number of foreclosures and place additional pressure on the already overburdened judicial and administrative systems.

*Expenses.* Our expenses primarily consist of the fees and expenses payable by us under the management agreement and the servicing agreement. Our Manager incurs direct, out-of-pocket costs related to managing our business, which are contractually reimbursable by us. Depreciation and amortization is a non-cash expense associated with the ownership of real estate and generally remains relatively consistent each year at an asset level since we depreciate our properties on a straight-line basis over a fixed life. Interest expense consists of the costs to borrow money.

*Changes in home prices.* As discussed above, generally, rising home prices are expected to positively affect our results, particularly as it should result in greater levels of re-performance of mortgage loans, faster refinancing of those mortgage loans, more re-capture of principal on greater than 100% LTV (loan-to-value) mortgage loans and increased recovery of the principal of the mortgage loans upon sale of any REO. Conversely, declining real estate prices are expected to negatively affect our results, particularly if the price should decline below our purchase price for the loans and especially if borrowers determine that it is better to strategically default as their equity in their homes decline. While home prices have risen to nearly pre-Great Recession levels in many parts of the United States, there are still significant regions where values have not materially increased. When we analyze loan and property acquisitions we do not take HPA into account except for rural properties for which we model negative HPA related to our expectation of worse than expected property condition. We typically concentrate our investments in specific urban geographic locations in which we expect stable or better property markets, although we do not use any appreciation expectation in the performance modeling.

*Changes in market interest rates.* With respect to our business operations, increases in interest rates, in general, may over time cause: (1) the value of our mortgage loan and MBS portfolio to decline; (2) coupons on our ARM and hybrid ARM mortgage loans and MBS to reset, although on a delayed basis, to higher interest rates; (3) prepayments on our mortgage loans and MBS portfolio to slow, thereby slowing the amortization of our purchase premiums and the accretion of our purchase discounts; (4) the interest expense associated with our borrowings to increase; and (5) to the extent we enter into interest rate swap agreements as part of our hedging strategy, the value of these agreements to increase. Conversely, decreases in interest rates, in general, may over time cause: (a) prepayments on our mortgage loan and MBS portfolio to increase, thereby accelerating the amortization of our purchase premiums and the accretion of our purchase discounts; (b) the value of our mortgage loan and MBS portfolio to increase; (c) coupons on our ARM and hybrid ARM mortgage loans and MBS to reset, although on a delayed basis, to lower interest rates; (d) the interest expense associated with our borrowings to decrease; and (e) to the extent we enter into interest rate swap agreements as part of our hedging strategy, the value of these agreements to decrease.

*Market conditions.* Due to the dramatic repricing of real estate assets during the most recent financial crisis and the continuing uncertainty in the direction and continuing strength of the real estate markets, we believe a void

## Table of Contents

in the debt and equity capital available for investing in real estate has been created as many financial institutions, insurance companies, finance companies and fund managers face insolvency or have determined to reduce or discontinue investment in debt or equity related to real estate. We believe the dislocations in the residential real estate market have resulted or will result in an “over-correction” in the repricing of real estate assets, creating a potential opportunity for us to capitalize on these market dislocations and capital void.

We believe that in spite of the continuing uncertain market environment for mortgage-related assets, current market conditions offer potentially attractive investment opportunities for us, even in the face of a riskier and more volatile market environment, as the depressed trading prices of our target assets have caused a corresponding increase in available yields. We expect that market conditions will continue to impact our operating results and will cause us to adjust our investment and financing strategies over time as new opportunities emerge and risk profiles of our business change.

## Critical Accounting Policies and Estimates

Certain of our critical accounting policies require management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. We consider significant estimates to include expected cash flows from mortgage loans and fair value measurements. We believe that all of the decisions and assessments upon which our consolidated financial statements are and will be based were or will be reasonable at the time made based upon information available to us at that time. We have identified our most critical accounting policies to be the following:

*Mortgage loans, net.* Purchased mortgage loans are initially recorded at the purchase price, net of any acquisition fees or costs at the time of acquisition and are considered asset acquisitions. As part of the determination of the purchase price for mortgage loans, we use a discounted cash flow valuation model to model expected cash flows, and which considers alternate loan resolution probabilities, including liquidation or conversion to real estate owned. Observable inputs to the model include current interest rates, loan amounts, status of payments and property types. Unobservable inputs to the model include discount rates, forecast of future home prices, alternate loan resolution probabilities, resolution timelines, the value of underlying properties and other economic and demographic data.

Under ASC 310-30, acquired loans may be aggregated and accounted for as a pool of loans if the loans being aggregated have some degree of credit quality deterioration since origination and have common risk characteristics. A pool is accounted for as a single asset with a single composite interest rate and an aggregate expectation of cash flows. Re-performing mortgage loans have been determined to have common risk characteristics and are accounted for as a single loan pool for loans acquired within each three-month fiscal quarter. Similarly, non-performing mortgage loans have been determined to have common risk characteristics and are accounted for as a single non-performing pool for loans acquired within each three-month fiscal quarter. Under ASC 310-30, we estimate cash flows expected to be

collected, adjusted for expected prepayments and defaults expected to be incurred over the life of the loan pool. We determine the excess of the loan pool's contractually required principal and interest payments over the expected cash flows as an amount that should not be accreted, referred to as the non-accretable yield. The difference between expected cash flows and the purchase price (at acquisition) or the present value of the expected cash flows is referred to as the accretable yield, which represents the amount that is expected to be recorded as interest income over the remaining life of the loan pool. For the three- and six-months ended June 30, 2015, we recognized no provision for loan loss. For the three- and six-months ended June 30, 2015, we accreted \$10.8 million and \$17.7 million, respectively, into interest income with respect to our loan portfolio. As of June 30, 2015, our loan portfolio had a UPB of \$596.3 million and a carrying value of \$444.4 million, and at December 31, 2014, a UPB of \$298.6 million and carrying value of \$211.2 million, which excludes one loan in which we hold a 40.5% beneficial interest through an equity method investee.

Generally, we acquire loans at a discount associated with some degree of credit impairment. We elect to aggregate certain pools of loans with common risk characteristics and accrue interest income thereon at a composite interest rate, based on expectations of cash flows to be collected for the pool. Expectations of pool cash flow are reviewed quarterly. Adjustments to a pool's prospective composite interest rate or an allowance for impairment are made to the extent revised expectations differ from original estimates.

Table of Contents

For loans that do not qualify for pool aggregation treatment, including performing loans that are not purchased at discounts resulting from credit-related issues, interest is recognized using the simple-interest method on daily balances of the principal amount outstanding, adjusted for the amortization or accretion of the loan premium or discount over the contractual life of the loan.

Accrual of interest on individual loans is discontinued when management believes that, after considering economic and business conditions and collection efforts, the borrower's financial condition is such that collection of interest is doubtful. Our policy is to stop accruing interest when a loan's delinquency exceeds 90 days. All interest accrued but not collected for loans that are placed on non-accrual status or subsequently charged-off are reversed against interest income. Income is subsequently recognized on the cash basis until, in management's judgment, the borrower's ability to make periodic principal and interest payments returns and future payments are reasonably assured, in which case the loan is returned to accrual status.

An individual loan is considered to be impaired when, based on current events and conditions, it is probable we will be unable to collect all amounts due (both principal and interest) according to the contractual terms of the loan agreement. Impaired loans are carried at the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's market price, or the fair value of the collateral if the loan is collateral dependent.

For individual loans, a troubled debt restructuring is a formal restructuring of a loan where, for economic or legal reasons related to the borrower's financial difficulties, a concession that would not otherwise be considered is granted to the borrower. The concession may be granted in various forms, including providing a below-market interest rate, a reduction in the loan balance or accrued interest, an extension of the maturity date, or a combination of these. An individual loan that has had a troubled debt restructuring is considered to be impaired and is subject to the relevant accounting for impaired loans.

The allowance for loan losses is established through a provision for loan losses charged to expenses. The allowance is an amount that management believes will be adequate to absorb probable losses on existing loans that may become uncollectible, based on evaluations of the collectability of loans.

Purchased non-performing loans that are accounted for as individual loans are recorded at fair value, which is generally the purchase price. Interest income is recognized on a cash basis and loan purchase discount is accreted to income in proportion to the actual principal paid. Loans are tested quarterly for impairment and impairment reserves are recorded to the extent the fair market value of the underlying collateral falls below net book value.

While we generally intend to hold our assets as long-term investments, we may sell certain of our loans in order to manage our interest rate risk and liquidity needs, meet other operating objectives and adapt to market conditions. The



timing and impact of future sales of loans, if any, cannot be predicted with any certainty. Since we expect that our assets will generally be financed, we expect that a significant portion of the proceeds from sales of our assets (if any), prepayments and scheduled amortization will be used to repay balances under our financing sources.

*Residential properties.* Property is recorded at cost if purchased, or at fair value of the asset less estimated selling costs if obtained through foreclosure by us. Property that is currently unoccupied and actively marketed for sale is classified as held-for-sale. Property held-for-sale is carried at the lower of cost or fair market value. Net unrealized losses due to changes in market value are recognized through a valuation allowance by charges to income.

No depreciation or amortization expense is recognized on properties held-for-sale, while holding costs are expensed as incurred. Rental property is property not held-for-sale. Rental properties are intended to be held as long-term investments but may eventually be held-for-sale. Depreciation is provided for using the straight-line method over the estimated useful lives of the assets of three to 27.5 years.

With respect to residential rental properties not held-for-sale, we perform an impairment analysis using estimated cash flows if events or changes in circumstances indicate that the carrying value may be impaired, such as prolonged vacancy, identification of materially adverse legal or environmental factors, changes in expected ownership period or a decline in market value to an amount less than cost. This analysis is performed at the property

Table of Contents

level. These cash flows are estimated based on a number of assumptions that are subject to economic and market uncertainties including, among others, demand for rental properties, competition for customers, changes in market rental rates, costs to operate each property and expected ownership periods.

If the carrying amount of a held-for-investment asset exceeds the sum of its undiscounted future operating and residual cash flows, an impairment loss is recorded for the difference between estimated fair value of the asset and the carrying amount. We generally estimate the fair value of assets held for use by using broker pricing opinions, or BPOs. In some instances, appraisal information may be available and is used in addition to BPOs.

We perform property renovations to maximize the value of the property for our rental strategy. Such expenditures are part of our initial investment in a property and, therefore, are capitalized as part of the basis of the property. Subsequently, the residential property, including any renovations that improve or extend the life of the asset, are accounted for at cost. The cost basis is depreciated using the straight-line method over an estimated useful life of three to 27.5 years. Interest and other carrying costs incurred during the renovation period are capitalized until the property is ready for its intended use. Expenditures for ordinary maintenance and repairs are charged to expense as incurred.

*Fair value of financial instruments.* Fair value is defined 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. A fair value hierarchy has been established which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

**Level 1**—Quoted prices in active markets for identical assets or liabilities.

**Level 2**—Observable inputs other than Level 1 prices, such as quoted prices for similar assets and liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

**Level 3**—Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The degree of judgment utilized in measuring fair value generally correlates to the level of pricing observability. Assets and liabilities with readily available actively quoted prices or for which fair value can be measured from actively quoted prices generally will have a higher degree of pricing observability and a lesser degree of judgment

utilized in measuring fair value. Conversely, assets and liabilities rarely traded or not quoted will generally have little or no pricing observability and a higher degree of judgment utilized in measuring fair value. Pricing observability is impacted by a number of factors, including the type of asset or liability, whether it is new to the market and not yet established, and the characteristics specific to the transaction.

Property held-for-sale is measured at cost at acquisition and subsequently measured at the lower of cost or fair value less cost to sell on a nonrecurring basis. The fair value of property held-for-sale is generally based on estimated market prices from an independently prepared appraisal, an independent BPO, or management's judgment as to the selling price of similar properties.

*Income Taxes.* We intend to elect REIT status upon the filing of our 2014 income tax return, and have conducted our operations in order to satisfy and maintain eligibility for REIT status. Accordingly, we do not believe we will be subject to U.S. federal income tax from the year ended December 31, 2014 forward on the portion of our REIT taxable income that is distributed to our stockholders as long as certain asset, income and stock ownership tests are met. If after electing to be taxed as a REIT, we subsequently fail to qualify as a REIT in any taxable year, we generally will not be permitted to qualify for treatment as a REIT for U.S. federal income tax purposes for the four taxable years following the year during which qualification is lost. We may also be subject to state or local income or franchise taxes.

Thetis TRS, GAJX Real Estate LLC and any other TRS that we form, will be subject to U.S. federal and state income taxes. On January 13, 2015 we applied for a private letter ruling from the Internal Revenue Service that would allow us to exclude our proportionate share of gross income from the Manager if we held our interest in the

Table of Contents

Manager through our operating partnership. If we receive such a ruling, we expect that we will hold our interest in the Manager through our operating partnership, instead of through Thetis TRS; however, there is no assurance that such a ruling will be issued. Income taxes are provided for using the asset and liability method. A provision for income taxes of \$16,400 was recorded for both the three- and six-month periods ended June 30, 2015. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted rates expected to apply to taxable income in the years in which management expects those temporary differences to be recovered or settled. The effect on deferred taxes of a change in tax rates is recognized in income in the period in which the change occurs. Subject to our judgment, we reduce a deferred tax asset by a valuation allowance if it is “more-likely-than-not” that some or all of the deferred tax asset will not be realized. Tax laws are complex and subject to different interpretations by the taxpayer and respective governmental taxing authorities. Significant judgment is required in evaluating tax positions, and we recognize tax benefits only if it is more likely than not that a tax position will be sustained upon examination by the appropriate taxing authority.

We evaluate tax positions taken in our consolidated financial statements under the interpretation for accounting for uncertainty in income taxes. As a result of this evaluation, we may recognize a tax benefit from an uncertain tax position only if it is “more-likely-than-not” that the tax position will be sustained on examination by taxing authorities.

Our tax returns remain subject to examination and consequently, the taxability of the distributions and other tax positions taken by us may be subject to change. Distributions to stockholders generally will be taxable as ordinary income, although a portion of such distributions may be designated as long-term capital gain or qualified dividend income, or may constitute a return of capital. The Company will furnish annually to each stockholder a statement setting forth distributions paid during the preceding year and their U.S. federal income tax treatment.

*Emerging growth company.* Section 107 of the JOBS Act provides that an emerging growth company can take advantage of the extended transition period provided in Section 7(a)(2)(B) of the Securities Act for complying with new or revised accounting standards. In other words, an emerging growth company can delay the adoption of certain accounting standards until those standards would otherwise apply to private companies. We have elected to take advantage of the benefits of this extended transition period. Our consolidated financial statements may, therefore, not be comparable to those of companies that comply with such new or revised accounting standards.

Recent Accounting Pronouncements

Refer to the notes to our interim consolidated financial statements for a description of relevant recent accounting pronouncements.

Results of Operations for the three- and six-months ended June 30, 2015

We were formed on January 30, 2014 as a Maryland corporation and were capitalized on March 28, 2014 by our then sole stockholder, Aspen Yo. We commenced operations upon the closing of the Original Private Placement on July 8, 2014. Upon the closing of the Original Private Placement, the Company used \$48.8 million of the proceeds to acquire its initial mortgage portfolio through the acquisition of 82% of the equity interests in Little Ajax II, LLC. Little Ajax II was an affiliated entity that acquired primarily re-performing mortgage loans and a number of non-performing mortgage loans in a series of transactions between December 1, 2013 and July 7, 2014. In September 2014, we completed a transaction to acquire the remaining interests in this initial mortgage-related asset portfolio. The transaction initially had Little Ajax II redeem the 82% membership interest of the operating partnership by distributing to the operating partnership 82% of all Little Ajax II loans, participation interests and real property. The operating partnership then purchased for cash the remaining 18% interest in such real estate assets for an aggregate purchase price of approximately \$11.4 million. The operating partnership also purchased for cash from Gregory, its 5% interest in the 43 loans in which Little Ajax II held a 95% participation interest for approximately \$0.2 million.

As we commenced operations on July 8, 2014, a comparison of the results of operations for the three and six months ended June 30, 2015 and the corresponding periods ended June 30, 2014 is not available.

Table of Contents

During the three- and six- months ended June 30, 2015, we acquired 827 and 1,337 mortgage loans, respectively, secured by single and one-to-four family residences with an aggregate UPB of \$204.6 million and \$306.7 million, respectively. The aggregate purchase price for the mortgage loans was \$159.4 million and \$233.5 million, respectively. During the three months ended June 30, 2015, re-performing loans represented \$188.9 million UPB and \$150.4 million purchase price and non-performing loans represented \$15.7 million UPB and \$9.0 million purchase price. During the six months ended June 30, 2015, re-performing loans represented \$274.9 million UPB and \$213.8 million purchase price and non-performing loans represented \$31.8 million UPB and \$19.6 million purchase price. For the three months ended June 30, 2015, the purchase price for re-performing loans and non-performing loans equaled 66.3% and 58.9%, respectively, of the estimated market value of the underlying collateral. For the six months ended June 30, 2015, the purchase price as a percent of the underlying collateral for re-performing loans and non-performing loans was 65.0% and 52.4%, respectively. Mortgage loans purchased in the three months ended June 30, 2015 were on our balance sheet for a weighted average of 41.7 days, and 65.6 days for the six months ended June 30, 2015. During the three months ended June 30, 2015, we also purchased one REO property for \$0.1 million, which was 63.1% of the estimated market value. During the six months ended June 30, 2015, we purchased 12 REO properties for \$2.7 million, which was 64.7% of the estimated market value. Our average daily carrying values for RPLs and NPLs were \$283.1 million and \$72.7 million, respectively, during the three months ended June 30, 2015.

From inception through June 30, 2015, we aggregated a portfolio consisting primarily of 2,700 mortgage loans secured by single and one-to-four family residences with an aggregate UPB of \$615.1 million, which includes one loan in which we hold a 40.5% beneficial interest through an equity method investee. We acquired the loans at an aggregate purchase price of \$447.9 million. Re-performing loans represented \$498.8 million UPB and a \$377.7 million purchase price and non-performing loans represented \$116.3 million UPB and a \$70.2 million purchase price. The purchase price for re-performing loans and non-performing loans equaled 67.3% and 57.4%, respectively, of the estimated market value of the underlying collateral. The Company also purchased 12 REO properties at an average price to estimated market of 64.7%. The results of operations for the period presented below may not be indicative of our expected results in future periods.

As of June 30, 2015, our portfolio of mortgage-related assets consisted of the following:

**Portfolio as of June 30, 2015<sup>(1)</sup>**

No. of Loans	2,620	
Total UPB	\$598,908,668	
Interest-Bearing Balance	\$562,294,615	
Deferred Balance <sup>(2)</sup>	\$36,614,053	
Market Value of Collateral <sup>(3)</sup>	\$663,588,960	
Price/Total UPB <sup>(3)</sup>	73.4	%
Price/Market Value of Collateral	66.4	%
Weighted Average Coupon <sup>(4)</sup>	4.64	%
Weighted Average LTV <sup>(5)</sup>	106	%

Remaining Term (as of 6/30/2015)	316.2	
No. of first liens	2,597	
No. of second liens	23	
No. of Rental Properties	2	
Market Value of Rental Properties	\$ 144,900	
Capital Invested	\$ 122,199	
Price/Market Value of Rental Properties	84.3	%
Gross Rent/Month	\$ 1,950	
No. of Other REO	54	
Market Value of Other REO	\$ 11,377,800	

Information reflects one loan in which we hold a 40.5% beneficial interest through an equity method investee and (1) two loans in which we have a 95% participation interest and are owned by the Servicer because neither we nor our subsidiaries have the necessary licenses in certain states.

(2) Amounts that have been deferred in connection with a loan modification on which interest does not accrue. These amounts generally become payable at the time of maturity.

(3) As of date of acquisition.

(4) Our loan portfolio consists of fixed rate (47.6% of UPB), ARM (20.2% of UPB) and Hybrid ARM (32.2% of UPB) mortgage loans with original terms to maturity of not more than 40 years.

(5) UPB as of June 30, 2015 divided by market value of collateral as of date of acquisition.

Table of Contents

As of June 30, 2015, 42 mortgage loans, representing 1.3% of our ending UPB, had been repaid.

We closely monitor the status of our mortgage loans through our Servicer, as it works with our borrowers to improve their payment records. We have not experienced material write downs or impairments on the mortgage loans purchased since commencement of operations in July 2014. As of June 30, 2015, of the 2,620 loans in our portfolio, 80.3% were re-performing loans and 19.7% were non-performing loans. The following chart shows the percentages of our portfolio, based on UPB, represented by non-performing loans and re-performing loans at June 30, 2015.

**Loan Portfolio as of June 30, 2015**

The following table sets forth the years in which our mortgage loans were originated based upon UPB:

**Mortgage Loan Origination at June 30, 2015**

<b>Years of Origination</b>	<b>Percentage of UPB</b>	
Prior to 1990	0.2	%
1990 – 2000	1.8	%
2001 – 2005	21.7	%
2006 – 2008	71.2	%
After 2008	5.1	%



Table of Contents

The following table identifies the mortgage loans by state, number of loans, loan value and collateral value and percentages thereof for the assets acquired through June 30, 2015 identified above:

**Loans by State as of June 30, 2015**

State	Loan Count	UPB (\$)	% of UPB		Collateral Value <sup>(1)</sup>	% of Collateral Value	
CA	373	139,599,557	23.3	%	160,126,587	24.1	%
FL	427	94,598,302	15.8	%	91,185,064	13.7	%
NY	186	62,443,900	10.4	%	83,287,700	12.5	%
NJ	163	45,688,551	7.6	%	45,025,184	6.8	%
MD	123	33,208,960	5.5	%	34,665,329	5.2	%
IL	122	25,114,455	4.2	%	23,474,200	3.5	%
MA	75	20,986,104	3.5	%	22,957,100	3.5	%
TX	154	17,296,919	2.9	%	24,424,974	3.7	%
GA	103	14,969,394	2.5	%	14,577,600	2.2	%
AZ	64	13,835,986	2.3	%	12,760,589	1.9	%
VA	60	12,480,083	2.1	%	13,763,130	2.1	%
OR	33	10,221,496	1.7	%	13,172,000	2.0	%
PA	97	9,339,346	1.6	%	11,915,300	1.8	%
NC	69	8,949,493	1.5	%	10,129,800	1.5	%
WA	36	8,398,752	1.4	%	9,128,400	1.4	%
MI	47	7,266,833	1.2	%	7,933,960	1.2	%
OH	59	7,078,609	1.2	%	7,252,918	1.1	%
NV	27	6,414,234	1.1	%	6,291,250	0.9	%
CO	26	6,263,325	1.0	%	7,553,464	1.1	%
CT	28	5,932,541	1.0	%	6,361,020	1.0	%
UT	25	4,662,836	0.8	%	5,214,700	0.8	%
SC	36	4,310,518	0.7	%	4,343,958	0.7	%
AL	22	3,856,850	0.6	%	3,632,410	0.5	%
TN	35	3,485,758	0.6	%	3,985,400	0.6	%
MO	22	3,172,832	0.5	%	3,312,000	0.5	%
LA	22	3,050,883	0.5	%	3,366,593	0.5	%
IN	32	2,933,667	0.5	%	3,393,655	0.5	%
MN	17	2,856,319	0.5	%	3,535,800	0.5	%
RI	12	2,582,325	0.4	%	2,921,275	0.4	%
WI	17	2,419,764	0.4	%	2,468,550	0.4	%
HI	7	1,961,420	0.3	%	3,453,500	0.5	%
NM	7	1,721,861	0.3	%	2,475,300	0.4	%
DE	8	1,514,610	0.3	%	2,450,000	0.4	%

Edgar Filing: Great Ajax Corp. - Form 10-Q

MS	12	1,337,402	0.2	%	1,490,550	0.2	%
KY	12	1,275,565	0.2	%	1,477,500	0.2	%
DC	5	1,190,274	0.2	%	2,327,000	0.4	%
NH	4	1,067,981	0.2	%	1,405,900	0.2	%
ME	5	809,308	0.1	%	733,900	0.1	%
OK	10	781,286	0.1	%	898,500	0.1	%
ID	6	670,631	0.1	%	1,104,500	0.2	%
AR	7	598,967	0.1	%	697,600	0.1	%
IA	7	562,231	0.1	%	614,400	0.1	%
KS	5	454,043	0.1	%	461,500	0.1	%
WV	5	427,645	0.1	%	400,000	0.1	%
SD	2	359,038	0.1	%	445,900	0.1	%
PR	2	358,345	0.1	%	520,000	0.1	%
NE	3	264,716	0.0	%	258,000	0.0	%
MT	1	134,753	0.0	%	215,000	0.0	%
Total	<b>2 2,620</b>	598,908,668			663,588,960	100.0	%

\* Information reflects two loans in which we have a 95% participation interest and are owned by the Servicer because neither we nor our subsidiaries have the necessary licenses in certain states.

\*\* Information reflects one loan in which we hold a 40.5% beneficial interest through an equity method investee.

(1) As of date of acquisition.

## Income

For the three months ended June 30, 2015, our net interest income was \$8.5 million, our consolidated net income was \$5.7 million, and diluted earnings per share was \$0.36. For the six months ended June 30, 2015, our net interest income was \$14.3 million, our consolidated net income was \$9.5 million, and diluted earnings per share was \$0.64. Our primary source of income is interest earned on our loan portfolio. Other income primarily consists of the equity earnings of affiliates, including our Manager. Our operating income for the three- and six-months ended June 30, 2015 included \$7.6 million and \$11.9 million of non-cash interest income accretion, respectively.

Table of Contents

## Management Fee

We pay a quarterly base management fee based on our stockholders' equity and a quarterly incentive management fee based on our cash distributions to our stockholders. We paid the Manager a base fee for the quarter ended June 30, 2015 of \$0.9 million of which we paid half, or \$0.4 million, in 29,790 shares of our common stock. We paid the Manager a base fee for the six months ended June 30, 2014 of \$1.6 million of which we paid half, or \$0.8 million, in 55,877 shares of our common stock.

*Net Book Value*

Our net book value at June 30, 2015 and December 31, 2014 was \$14.36 and \$14.43, respectively, calculated by dividing equity by total adjusted shares outstanding, including OP Units (which are redeemable on a 1-for-1 basis into shares of our common stock after one year of ownership) and Manager and director shares not issued as of the date indicated.

	June 30, 2015	December 31, 2014
Outstanding shares	15,253,998	11,223,984
Adjustments for:		
Operating partnership units	624,106	624,106
Manager and director shares earned but not issued as of the date indicated	31,530	18,465
Total adjusted shares outstanding	15,909,634	11,866,555

## Loan Servicing Fee

Pursuant to the servicing agreement, we paid Gregory \$0.9 million and \$1.5 million for its servicing of our mortgage loan portfolio during the three- and six-months ended June 30, 2015, respectively.

## Other Expenses

Other expenses incurred during the period include loan transaction expense, professional fees, directors' fees, and other general and administrative expenses. For both the three- and six-month periods ended June 30, 2015, our loan transaction expense included approximately \$0.3 million of additional due diligence expenses related to approximately 550 mortgage loans from new sellers which were excluded from our purchases since these loans did

not meet our acquisition criteria or quality standards. For the three- and six-months ended June 30, 2015, other expenses, in aggregate, totaled approximately \$1.4 million and \$2.2 million, respectively.

## Liquidity and Capital Resources

As of June 30, 2015, substantially all of our invested capital was in re-performing and non-performing loans. We also held approximately \$36.2 million of cash and cash equivalents. Our average daily cash balance during the quarter was \$43.6 million.

Liquidity is a measure of our ability to meet potential cash requirements, including ongoing commitments to repay borrowings, fund and maintain our assets and operations, make distributions to our stockholders and other general business needs. Our primary sources of cash have consisted of proceeds from the Private Placements and our IPO. We anticipate that our primary sources of cash in the future will generally consist of payments of principal and interest we receive on our loan portfolio, cash generated from operations, including rental payments from our REO and other real estate assets and profits we may earn from the sale of REO, and unused borrowing capacity under our financing sources. Depending on market conditions, we expect that our primary sources of financing will include securitizations, warehouse and credit facilities (including term loans and revolving facilities), repurchase agreements and private and public equity and debt issuances in addition to transaction or asset specific funding arrangements. We expect that these sources of funds will be sufficient to meet our short-term and long-term liquidity needs.

We use cash to purchase mortgage-related assets, repay principal and interest on any borrowings, make distributions to our stockholders and fund operations.

Table of Contents

Cash flows from operating activities for the six months ended June 30, 2015 were negative \$5.0 million resulting primarily from consolidated net income of \$9.5 million offset by increases in accrued expenses and other operating activity of \$2.6 million, and non-cash interest income accretion of \$11.9 million. For the six months ended June 30, 2015, cash flows from investing activities were negative \$228.9 million, due to acquisitions of mortgage loans. Cash flows from financing activities for the six months ended June 30, 2015, were positive \$217.0 million due to proceeds from our repurchase agreement of \$153.8 million, proceeds from the sale of secured notes of \$35.2 million and cash from our IPO of \$51.5 million, offset by repayments on our repurchase agreement and secured notes of \$18.8 million and dividends and distributions of \$4.8 million.

On July 8, 2014, we used approximately \$48.8 million of the net proceeds from the Original Private Placement to acquire our initial portfolio of mortgage-related assets by acquiring 82% of the limited liability company interests of Little Ajax II held by certain affiliated holders. Little Ajax II owned a portfolio of mortgage-related assets consisting of 418 mortgage loans and two single-family rental properties, which it acquired in a series of transactions from unaffiliated parties between December 1, 2013 and July 7, 2014. The approximately \$48.8 million purchase price paid by us for these assets equaled 82% of (a) the original capital contributions of all of the members of Little Ajax II, minus (b) all cash distributions paid out to the members of Little Ajax II prior to the closing date of the acquisition of the interests, plus (c) an amount equal to all interest income received by Little Ajax II on its loans from the date of acquisition of the loan through the closing date, plus (d) an amount equal to all earned discount received by Little Ajax II on its loans from the date of acquisition of the loan through the closing date, plus (e) an amount equal to all accrued but unpaid interest on loans owned directly by Little Ajax II or in which Little Ajax II owned a participation interest that were not more than 60 days delinquent on a contractual basis, up to a maximum of 59 days of interest, minus (f) an amount equal to all servicing fees paid or owed to Little Ajax II in connection with its loans from the date of acquisition of the loan through the closing date.

In September 2014, we completed a transaction to acquire the remaining interests in this initial mortgage-related asset portfolio. The transaction initially had Little Ajax II redeem the 82% membership interest of our operating partnership by distributing to the operating partnership 82% of all Little Ajax II loans, participation interests and real property. Our operating partnership then purchased for cash the remaining 18% interest in such real estate assets for an aggregate purchase price of approximately \$11.4 million. Our operating partnership also purchased for cash from Gregory its 5% interest in the 43 loans in which Little Ajax II held a 95% participation interest for approximately \$0.2 million.

In December 2014, we closed the Second Private Placement, which resulted in net proceeds to us of approximately \$41.2 million. To date, we are using the proceeds of the Private Placements to purchase re-performing and non-performing loans, as described above. While we generally intend to hold our assets as long-term investments, we may sell certain of our investments in order to manage our interest rate risk and liquidity needs, meet other operating objectives and adapt to market conditions. The timing and impact of future sales of investment securities, if any, cannot be predicted with any certainty. Since we expect that our assets will generally be financed, we expect that a significant portion of the proceeds from sales of our assets (if any), prepayments and scheduled amortization will be used to repay balances under our financing sources. On January 21, 2015, in order to satisfy the REIT requirement that we have at least 100 stockholders as of January 30, 2015, we sold 5,250 shares of common stock to affiliated persons at a price of \$15.00 per share, the last price at which shares were sold to unaffiliated purchasers in the Second

Private Placement in December 2014, for an aggregate purchase price of \$0.1 million.

The Company completed its IPO in February 2015 in which we and selling stockholders sold an aggregate of 5,276,797 shares of common stock, including shares sold pursuant to exercise of the option to purchase additional shares granted to the underwriters. We sold 3,976,464 shares of common stock and selling stockholders sold 1,300,333 shares of common stock, in each case, including shares sold pursuant to exercise of the option to purchase additional shares granted to the underwriters. We used the approximately \$53.9 million of proceeds (after deducting

Table of Contents

the underwriting discount but before deducting estimated offering expenses) to acquire additional mortgage loans and mortgage-related assets.

From the commencement of operations to June 30, 2015, the Company has completed three securitizations pursuant to Rule 144A under the Securities Act. The securitizations are structured as debt financings and not REMIC sales, and the loans included in the securitizations remain on the Company's balance sheet as the Company is the primary beneficiary of the securitization trusts, which are variable interest entities ("VIEs"). The securitization VIEs are structured as pass through entities that receive principal and interest on the underlying mortgages and distribute those payments to the holders of the notes. Our exposure to the obligations of the VIEs is generally limited to our investments in the entities. The notes that are issued by the securitization trusts are secured solely by the mortgages held by the applicable trusts and not by any of our other assets. The mortgage loans of the applicable trusts are the only source of repayment and interest on the notes issued by such trusts. We do not guarantee any of the obligations of the trusts under the terms of the agreement governing the notes or otherwise.

Our securitizations are structured with Class A notes, Class B notes, and a trust certificate representing the residual interests in the mortgages. For each of our three securitizations the Company has retained the Class B notes and the trust certificate. The Class A notes are senior, sequential pay, fixed rate notes. The Class B notes are subordinate, sequential pay, fixed rate notes with Class B-2 notes subordinate to the Class B-1 notes. If the Class A notes have not been redeemed by the payment date 36 months after issue, or otherwise paid in full by that date, an amount equal to the aggregate interest payment amount that accrued and would otherwise be paid to the Class B-1 and the Class B-2 notes will be paid as principal to the Class A notes on that date and each subsequent payment date until the Class A notes are paid in full. After the Class A notes are paid in full, the Class B-1 and Class B-2 notes will resume receiving their respective interest payment amounts and any interest that accrued but was not paid to the Class B notes while the Class A notes were outstanding. As the holder of the trust certificates, the Company is entitled to receive any remaining amounts in the trust after the Class A notes and Class B notes have been paid in full.

The following table sets forth the original terms of all securitization notes at their respective cutoff dates as of June 30, 2015:

Issuing Trust/Issue Date	Security	Original		
		Principal	Interest Rate	
Ajax Mortgage Loan Trust 2014-A/ October 2014	Class A notes due 2057 <sup>(1)</sup>	\$45 million	4.00	%
	Class B-1 notes due 2057 <sup>(2)</sup>	\$8 million	5.19	%
	Class B-2 notes due 2057 <sup>(2)</sup>	\$8 million	5.19	%
	Trust certificates <sup>(3)</sup>	\$20.4 million	–	
Ajax Mortgage Loan Trust 2014-B / November 2014	Class A notes due 2054 <sup>(1)</sup>	\$41.2 million	3.85	%
	Class B-1 notes due 2054 <sup>(2)</sup>	\$13.7 million	5.25	%
	Class B-2 notes due 2054 <sup>(2)</sup>	\$13.7 million	5.25	%

Edgar Filing: Great Ajax Corp. - Form 10-Q

	Trust certificates <sup>(3)</sup>	\$22.9 million	–	
Ajax Mortgage Loan Trust 2015-A / May 2015	Class A notes due 2054 <sup>(1)</sup>	\$35.6 million	3.88	%
	Class B-1 notes due 2054 <sup>(2)</sup>	\$8.7 million	5.25	%
	Class B-2 notes due 2054 <sup>(2)</sup>	\$8.7 million	5.25	%
	Trust certificates <sup>(3)</sup>	\$22.8 million	–	

(1) The Class A notes are senior, sequential pay, fixed rate notes.

(2) The Class B notes are subordinate, sequential pay, fixed rate notes with Class B-2 notes subordinate to the Class B-1 notes. We have retained the Class B notes.

(3) The trust certificates issued by the trusts and the beneficial ownership of the trusts are retained by Great Ajax Funding LLC as the depositor. As the holder of the trust certificates, we are entitled to receive any remaining amounts in the trusts after the Class A notes and Class B notes have been paid in full.



Table of Contents

Servicing for the mortgage loans in 2014-A, 2014-B and 2015-A is provided by the Servicer at a servicing fee rate of 0.65% annually of UPB for re-performing loans and 1.25% annually of UPB for non-performing loans, and is paid monthly by us.

On November 25, 2014, we entered into a repurchase facility pursuant to which a newly formed Delaware statutory trust wholly owned by the operating partnership, AJX Mortgage Trust I, the “Seller,” will acquire, from time to time, pools of mortgage loans that are primarily secured by first liens on one-to-four family residential properties from its affiliates and/or third party sellers. The facility was amended on May 13, 2015 to increase the transaction limit. These mortgage loans will generally be sold from time to time by the operating partnership, as the “Guarantor” to the Seller pursuant to the terms of a mortgage loan purchase agreement by and between the Guarantor, as seller, and the Seller as purchaser, in accordance with the terms thereof. Pursuant to the Master Repurchase Agreement, or MRA, these mortgage loans, together with the Seller’s 100% ownership interests in its wholly owned subsidiary, a newly formed Delaware limited liability company (“REO I”), and any future REO subsidiaries wholly owned by the Seller (“REO Subsidiaries”) and certain other property of the Seller will be sold by the Seller to Nomura Corporate Funding Americas, LLC, as Buyer, from time to time pursuant to one or more transactions, not exceeding \$200 million, with a simultaneous agreement by the Seller to repurchase such mortgage loans and other property, as provided in the MRA. The obligations of the Seller are guaranteed by the operating partnership. Repurchases under this facility carry interest calculated based on a spread to one-month LIBOR and are fixed for the term of the borrowing. The purchase price for each mortgage loan or REO is generally equal to 65% of the acquisition price for such asset or the then current BPO for the asset. The difference between the market value of the asset and the amount of the repurchase agreement is the amount of equity we have in the position and is intended to provide the lender some protection against fluctuations of value in the collateral and/or the failure by us to repay the borrowing at maturity. We have effective control over the assets associated with this agreement and therefore has concluded this is a financing arrangement. The facility termination date is November 24, 2015.

As of June 30, 2015 and December 31, 2014, we had \$153.8 million and \$15.2 million outstanding under our repurchase agreement, respectively. The maximum balance outstanding during both the three- and six-month periods ended June 30, 2015 was \$153.8 million. The following table sets forth data with respect to our repurchase agreements as of and for the three- and six-months ended June 30, 2015 and the three months ended December 31, 2014 (\$ in thousands):

	<b>Three months ended June 30, 2015</b>	<b>Six months ended June 30, 2015</b>	<b>Three months ended December 31, 2014</b>
Balance at end of period	\$ 153,804	\$ 153,804	\$ 15,249
Maximum month-end balance outstanding during the period	\$ 153,804	\$ 153,804	\$ 15,249
Average balance	\$ 85,464	\$ 50,535	\$ 4,475

The average balances of \$85.5 million for the three months ended June 30, 2015 and \$50.5 million for the six months ended June 30, were due to the increase in borrowing through the repurchase agreement during the second quarter, culminating in our balance at June 30, 2015 of \$153.8 million. The average balance outstanding of \$4.5 million during the three months ended December 31, 2014 was due to the initial borrowing on the line of \$15.2 million outstanding for only 29 days of the quarter.

Gregory services these mortgage loans and the REO properties pursuant to the terms of a servicing agreement by and among the Servicer, the Seller, REO I and any other REO Subsidiary, which servicing agreement has the same fees and expenses terms as the Company's servicing agreement with Gregory. The operating partnership as Guarantor will provide to the Buyer a limited guaranty of certain losses incurred by the Buyer in connection with certain events and/or the Seller's obligations under the MLPA, following the breach of certain covenants by the Seller or an REO Subsidiary related to their status as a special purpose entity, the occurrence of certain bad acts by the Seller Parties, the occurrence of certain insolvency events of the Seller or an REO Subsidiary or other events specified in the Guaranty. As security for its obligations under the Guaranty, the Guarantor will pledge the Trust Certificate representing the Guarantor's 100% beneficial interest in the Seller.

As of June 30, 2015, we do not have any credit facilities or other outstanding debt obligations other than the repurchase facility and secured borrowings.

Table of Contents

We are not required by our investment guidelines to maintain any specific debt-to-equity ratio, and we believe that the appropriate leverage for the particular assets we hold depends on the credit quality and risk of those assets, as well as the general availability and terms of stable and reliable financing for those assets.

From inception through June 30, 2015, the Company aggregated a portfolio consisting primarily of 2,700 mortgage loans secured by single and one-to-four family residences with an aggregate UPB of \$615.1 million, which includes one loan in which we hold a 40.5% beneficial interest through an equity method investee. We acquired the loans at an aggregate purchase price of \$447.9 million. Re-performing loans represented \$498.8 million UPB and \$377.7 million purchase price and non-performing loans represented \$116.3 million UPB and \$70.2 million purchase price. The Company's mortgage loans are mortgage loans secured by real estate. As such, the Company believes that the credit quality indicators for each of its mortgage loans are the timeliness of payments and the value of the underlying real estate. The Company categorizes mortgage loans as "re-performing" and as "non-performing." The Company monitors the credit quality of the mortgage loans in its portfolio on an ongoing basis, principally by considering loan payment activity or delinquency status. In addition, the Company assesses the expected cash flows from the mortgage loans, the fair value of the underlying collateral and other factors. The Company conducts a similar assessment for non-performing loans and evaluates whether and when it becomes probable that all amounts contractually due will not be collected.

The following table presents certain characteristics about our mortgage loans at June 30, 2015:

	Year of Origination				
	After 2008	2006-2008	2001-2005	1990-2000	Prior to 1990
Portfolio Characteristics:					
Number of loans	158	1,617	676	148	21
Current unpaid principal balance	\$30,251	\$426,473	\$130,214	\$11,036	\$935
Loan Attributes:					
Weighted average loan age (months)	54.3	100.5	130.1	213.5	464.3
Weighted average loan-to-value (as of 6/30/15)	94.6 %	111.8 %	91.6 %	66.0 %	35.0 %
Delinquency Performance (as of 6/30/15):					
30 days delinquent	8.3 %	15.7 %	11.9 %	18.6 %	10.7 %
60 days delinquent	7.8 %	6.4 %	7.0 %	5.8 %	10.2 %
90+ days delinquent	12.9 %	17.9 %	18.7 %	22.8 %	30.0 %
Bankruptcy/foreclosure	11.5 %	15.1 %	18.0 %	21.6 %	20.7 %

We may declare dividends based on, among other things, our earnings, our financial condition, our working capital needs, new opportunities, and distribution requirements imposed on REITs. The declaration of dividends to our stockholders and the amount of such dividends are at the discretion of our board of directors. On January 16, 2015, we declared a dividend of \$0.16 per share, which was paid on January 30, 2015 to stockholders of record as of January 13, 2015.

On May 4, 2015, the Company declared a dividend of \$0.18 per share, to be paid on May 29, 2015, to stockholders of record as of May 15, 2015.

On August 3, 2015, the Company declared a dividend of \$0.22 per share, to be paid on August 28, 2015, to stockholders of record as of August 14, 2015.

We believe that our capital resources will be sufficient to enable us to meet anticipated short-term and long-term liquidity requirements.

#### Off-Balance Sheet Arrangements

Other than the securitization trusts and equity method investments discussed elsewhere in this report, we do not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. Further, we have not guaranteed any obligations of unconsolidated entities nor do we have any commitment or intent to provide funding to any such entities. As such, we are not materially exposed to any market, credit, liquidity or financing risk that could arise if we had engaged in such relationships.

Table of Contents

## Contractual Obligations

A summary of our contractual obligations as of June 30, 2015 and December 31, 2014 is as follows:

June 30, 2015	<b>Payments Due by Period</b>				
	<b>Total</b>	<b>Less than 1 Year</b>	<b>1 – 3 Years</b>	<b>3 – 5 Years</b>	<b>More than 5 Years</b>
	(in thousands)				
Borrowings under repurchase agreement	\$ 153,804	\$ 153,804	\$ -	\$ -	\$ -
Interest on repurchase agreement	3,076	3,076	-	-	-
<b>Total</b>	<b>\$ 156,880</b>	<b>\$ 156,880</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>
December 31, 2014	<b>Payments Due by Period</b>				
	<b>Total</b>	<b>Less than 1 Year</b>	<b>1 – 3 Years</b>	<b>3 – 5 Years</b>	<b>More than 5 Years</b>
	(in thousands)				
Borrowings under repurchase agreement	\$ 15,249	\$ 15,249	\$ -	\$ -	\$ -
Interest on repurchase agreement	610	610	-	-	-
<b>Total</b>	<b>\$ 15,859</b>	<b>\$ 15,859</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>

At June 30, 2015, we had securitized borrowings with a balance of \$116.3 million consisting of three tranches of \$41.7 million, \$39.3 million and \$35.3 million with contractual interest rates of 4.00%, 3.85% and 3.875%, respectively.

At December 31, 2014, we had securitized borrowings with a balance of \$84.7 million consisting of two tranches of \$44.0 million and \$40.7 million with contractual interest rates of 4.00% and 3.85%, respectively. Our securitized borrowings are not included in the table above, as such borrowings are non-recourse to us and are only paid to the extent that cash flows from mortgage loans (in the securitization trust) collateralizing the debt are received.

## Inflation

Virtually all of our assets and liabilities are interest-rate sensitive in nature. As a result, interest rates and other factors influence our performance far more so than does inflation. Changes in interest rates do not necessarily correlate with inflation rates or changes in inflation rates. Our activities and balance sheet are measured with reference to historical

cost and/or fair market value without considering inflation.

### Item 3. Quantitative and Qualitative Disclosures About Market Risk

The primary components of our market risk are related to real estate risk, interest rate risk, prepayment risk and credit risk. We seek to actively manage these and other risks and to acquire and hold assets at prices that we believe justify bearing those risks, and to maintain capital levels consistent with those risks.

#### **Real Estate Risk**

Residential property values are subject to volatility and may be affected adversely by a number of factors, including, but not limited to, national, regional and local economic conditions (which may be adversely affected by industry slowdowns and other factors); local real estate conditions (such as an oversupply of housing); construction quality, age and design; demographic factors; and retroactive changes to building or similar codes. Decreases in property values could cause us to suffer losses.

#### **Interest Rate Risk**

We expect to continue to securitize our whole loan portfolios, primarily as a financing tool, when economically efficient to create long-term, fixed rate, non-recourse financing with moderate leverage, while

## Table of Contents

retaining one or more tranches of the subordinate MBS so created. Interest rates are highly sensitive to many factors, including governmental monetary and tax policies, domestic and international economic and political considerations and other factors beyond our control. Changes in interest rates may affect the fair value of the mortgage loans and real estate underlying our portfolios as well as our financing interest rate expense.

We believe that a rising interest rate environment could have a positive net effect on our operations to the extent we will own rental real property or seek to sell real property. Rising interest rates could be accompanied by inflation and higher household incomes which generally correlate closely to higher rent levels and property values. Even if our interest and operating expenses rise at the same rate as rents, our operating profit could still increase. Despite our beliefs, it is possible that the value of our real estate assets and our net income could decline in a rising interest rate environment to the extent that our real estate assets are financed with floating rate debt and there is no accompanying increase in rental yield or property values.

### **Prepayment Risk**

Prepayment risk is the risk of change, whether an increase or a decrease, in the rate at which principal is returned in respect of the mortgage loans we will own as well as the mortgage loans underlying our retained MBS, including both through voluntary prepayments and through liquidations due to defaults and foreclosures. This rate of prepayment is affected by a variety of factors, including the prevailing level of interest rates as well as economic, demographic, tax, social, legal and other factors. Prepayment rates, besides being subject to interest rates and borrower behavior, are also substantially affected by government policy and regulation. Changes in prepayment rates will have varying effects on the different types of assets in our portfolio. We attempt to take these effects into account. We will generally purchase re-performing and non-performing loans at significant discounts from UPB and underlying property values. An increase in prepayments would accelerate the repayment of the discount and lead to increased yield on our assets while also causing re-investment risk that we can find additional assets with the same interest and return levels. A decrease in prepayments would likely have the opposite effects.

### **Credit Risk**

We are subject to credit risk in connection with our assets. While we will engage in diligence on assets we will acquire, such due diligence may not reveal all of the risks associated with such assets and may not reveal other weaknesses in such assets, which could lead us to misprice acquisitions. Property values are subject to volatility and may be affected adversely by a number of factors, including, but not limited to, national, regional and local economic conditions (which may be adversely affected by industry slowdowns and other factors), local real estate conditions (such as an oversupply of housing), changes or continued weakness in specific industry segments, construction quality, age and design, demographic factors and retroactive changes to building or similar codes.

There are many reasons borrowers will fail to pay including but not limited to, in the case of residential mortgage loans, reductions in personal income, job loss and personal events such as divorce or health problems, and in the case of commercial mortgage loans, reduction in market rents and occupancies and poor property management services by borrowers. We will rely on the Servicer to mitigate our risk. Such mitigation efforts may include loan modifications and prompt foreclosure and property liquidation following a default. If a sufficient number of re-performing borrowers default, our results of operations will suffer and we may not be able to pay our own financing costs.

#### Item 4. Controls and Procedures

##### Evaluation of Disclosure Controls and Procedures

We conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this report on Form 10-Q. The controls evaluation was conducted under the supervision and with the participation of management, including our Chief Executive Officer and Chief Financial Officer. Disclosure controls and procedures are controls and procedures designed to reasonably assure that information required to be disclosed in our reports filed under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), such as this Report on Form 10-Q, is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures are also designed to reasonably assure that such information is accumulated and communicated to our management, including the Chief



Table of Contents

Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Based on the controls evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of the period covered by this Form 10-Q, our disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified by the SEC, and that material information related to our company and our consolidated subsidiaries is made known to management, including the Chief Executive Officer and Chief Financial Officer, particularly during the period when our periodic reports are being prepared.

Internal Control Over Financial Reporting

There have been no changes in our internal control over financial reporting that occurred during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II. other information

Item 1. Legal Proceedings

Neither we nor any of our affiliates are the subject of any material legal or regulatory proceedings. We and our affiliates may be involved, from time to time, in legal proceedings that arise in the ordinary course of business.

Item 1A. Risk Factors

For information regarding factors that could affect our results of operations, financial condition, and liquidity, see the risk factors discussed under “Risk Factors” in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2014. There have been no material changes from these previously disclosed risk factors.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Unregistered Sales of Equity Securities

On April 28, 2015, we issued 26,087 shares of our common stock to the Manager in payment of half of its quarterly management fee for the first quarter of 2015. On July 28, 2015, we issued 29,790 shares of our common stock to the Manager in payment of half of its quarterly management fee for the second quarter of 2015. After our IPO, the management fee shares were and will be deemed to be the average of the closing prices of our common stock on the NYSE on the five business days after the date on which the most recent regular quarterly dividend to holders of our common stock were and is paid. These shares were issued in reliance on the exemption from registration set forth in Section 4(a)(2) of the Securities Act. The management fee expense associated with these shares was recorded as an expense in the first and second quarters of 2015.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures.

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

The exhibits listed in the accompanying Exhibit Index are filed or furnished as part of this Quarterly Report on Form 10-Q.

45

Table of Contents

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

GREAT AJAX CORP.

Date: August 13, 2015 By: /s/ Lawrence Mendelsohn  
Lawrence Mendelsohn  
Chairman and Chief Executive Officer

(Principal Executive Officer)

Date: August 13, 2015 By: /s/ Glenn J. Ohl  
Glenn J. Ohl  
Chief Financial Officer

(Principal Financial and Accounting Officer)

Table of Contents

**EXHIBIT INDEX**

**Exhibit**

<b>Number</b>	<b>Exhibit Description</b>
31.1*	Rule 13a-14(a) Certification of Chief Executive Officer of the Company in accordance with Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	Rule 13a-14(a) Certification of Chief Financial Officer of the Company in accordance with Section 302 of the Sarbanes-Oxley Act of 2002.
32.1*	Section 1350 Certification of Chief Executive Officer of the Company in accordance with Section 906 of the Sarbanes-Oxley Act of 2002.
32.2*	Section 1350 Certification of Chief Financial Officer of the Company in accordance with Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS**	XBRL Instance Document
101.SCH**	XBRL Taxonomy Extension Schema
101.CAL**	XBRL Taxonomy Extension Calculation Linkbase
101.DEF**	XBRL Taxonomy Definition Linkbase
101.LAB**	XBRL Taxonomy Extension Label Linkbase
101.PRE**	XBRL Taxonomy Extension Presentation Linkbase

\* Filed herewith.

\*\* Furnished herewith.