

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

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2016

OR

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

For the transition period from _____ to _____
Commission file number 001-36099

CHERRY HILL MORTGAGE INVESTMENT CORPORATION
(Exact name of registrant as specified in its charter)

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

Maryland 46-1315605
(State or Other Jurisdiction of Incorporation or Organization) (I.R.S. Employer Identification No.)

301 Harper Drive, Suite 110 08057
Moorestown, New Jersey
(Address of Principal Executive Offices) (Zip Code)

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

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was

Edgar Filing: Cherry Hill Mortgage Investment Corp - Form 10-Q

required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

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

Large accelerated filer

Accelerated filer

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

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

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

CHERRY HILL MORTGAGE INVESTMENT CORPORATION
TABLE OF CONTENTS

| | Page |
|--|------|
| <u>FORWARD-LOOKING INFORMATION</u> | 2 |
| PART I. <u>FINANCIAL INFORMATION</u> | 4 |
| Item 1. <u>Consolidated Financial Statements (Unaudited)</u> | 4 |
| <u>Consolidated Balance Sheets</u> | 4 |
| <u>Consolidated Statements of Income (Loss)</u> | 5 |
| <u>Consolidated Statements of Comprehensive Income (Loss)</u> | 6 |
| <u>Consolidated Statements of Changes in Stockholders' Equity</u> | 7 |
| <u>Consolidated Statements of Cash Flows</u> | 8 |
| <u>Notes to Consolidated Financial Statements</u> | 9 |
| Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 44 |
| Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u> | 67 |
| Item 4. <u>Controls and Procedures</u> | 72 |
| PART II. <u>OTHER INFORMATION</u> | 73 |
| Item 1. <u>Legal Proceedings</u> | 73 |
| Item 1A. <u>Risk Factors</u> | 73 |
| Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | 73 |
| Item 3. <u>Defaults Upon Senior Securities</u> | 73 |
| Item 4. <u>Mine Safety Disclosures</u> | 73 |
| Item 5. <u>Other Information</u> | 73 |

Item 6.

Exhibits

73

Table of Contents

FORWARD-LOOKING INFORMATION

Cherry Hill Mortgage Investment Corporation (together with its consolidated subsidiaries, the “Company”, “we”, “our” or “us”) makes forward-looking statements in this Quarterly Report on Form 10-Q within the meaning of Section 27A of the Securities Act of 1933, as amended (the “Securities Act”), and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). For these statements, the Company claims the protections of the safe harbor for forward-looking statements contained in such Sections. Forward-looking statements are subject to substantial risks and uncertainties, many of which are difficult to predict and are generally beyond the Company’s control. These forward-looking statements include information about possible or assumed future results of the Company’s business, financial condition, liquidity, results of operations, plans and objectives. When the Company uses the words “believe,” “expect,” “anticipate,” “estimate,” “plan,” “continue,” “intend,” “should,” “could,” “would,” “may,” “potential” or the negative or other comparable terminology, the Company intends to identify forward-looking statements. Statements regarding the following subjects, among others, may be forward-looking:

- the Company’s investment objectives and business strategy;
- the Company’s ability to raise capital through the sale of its equity and debt securities;
- the Company’s ability to obtain future financing arrangements and refinance existing financing arrangements as they mature;
- the Company’s expected leverage;
- the Company’s expected investments;
- the Company’s ability to execute its prime mortgage loan strategy and its ability to finance this asset class;
- the Company’s ability to acquire Servicing Related Assets;
- estimates or statements relating to, and the Company’s ability to make, future distributions;
- the Company’s ability to compete in the marketplace;
- market, industry and economic trends;
- recent market developments and actions taken and to be taken by the U.S. Government, the U.S. Treasury and the Board of Governors of the Federal Reserve System, Fannie Mae, Freddie Mac, Ginnie Mae and the U.S. Securities and Exchange Commission (“SEC”);
- mortgage loan modification programs and future legislative actions;
- the Company’s ability to maintain its qualification as a real estate investment trust (“REIT”) under the Internal Revenue Code of 1986, as amended (the “Code”);
- the Company’s ability to maintain its exclusion from registration as an investment company under the Investment Company Act of 1940, as amended (the “Investment Company Act”);

Table of Contents

projected capital and operating expenditures;

availability of investment opportunities in mortgage-related, real estate-related and other securities;

availability of qualified personnel;

prepayment rates; and

projected default rates.

The Company's beliefs, assumptions and expectations can change as a result of many possible events or factors, not all of which are known to it or are within its control. If any such change occurs, the Company's business, financial condition, liquidity and results of operations may vary materially from those expressed in, or implied by, the Company's forward-looking statements. These risks, along with, among others, the following factors, could cause actual results to vary from the Company's forward-looking statements:

the factors discussed under "Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations" in this Quarterly Report on Form 10-Q and "Item 1A. Risk Factors" in the Company's Annual Report on Form 10-K for the year ended December 31, 2015;

general volatility of the capital markets;

changes in the Company's investment objectives and business strategy;

availability, terms and deployment of capital;

availability of suitable investment opportunities;

the Company's dependence on its external manager, Cherry Hill Mortgage Management, LLC ("the Manager"), and the Company's ability to find a suitable replacement if the Company or the Manager were to terminate the management agreement the Company has entered into with the Manager;

changes in the Company's assets, interest rates or the general economy;

increased rates of default and/or decreased recovery rates on the Company's investments;

changes in interest rates, interest rate spreads, the yield curve, prepayment rates or recapture rates;

limitations on the Company's business due to compliance with requirements for maintaining its qualification as a REIT under the Code and its exclusion from registration as an investment company under the Investment Company Act; and

the degree and nature of the Company's competition, including competition for its targeted assets.

Although the Company believes that the expectations reflected in the forward-looking statements are reasonable, it cannot guarantee future results, levels of activity, performance or achievements. These forward-looking statements apply only as of the date of this Quarterly Report on Form 10-Q. The Company is not obligated, and does not intend, to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

Cherry Hill Mortgage Investment Corporation and Subsidiaries

Consolidated Balance Sheets

June 30, 2016 (Unaudited) and December 31, 2015

(in thousands — except share data)

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

See accompanying notes to consolidated financial statements.

Table of Contents

Cherry Hill Mortgage Investment Corporation and Subsidiaries

Consolidated Statements of Income (Loss)

(Unaudited)

(in thousands — except per share data)

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

See accompanying notes to consolidated financial statements.

Table of Contents

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

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

See accompanying notes to consolidated financial statements.

Table of Contents

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

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

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

See accompanying notes to consolidated financial statements.

Table of Contents

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

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

Edgar Filing: Cherry Hill Mortgage Investment Corp - Form 10-Q

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

See accompanying notes to consolidated financial statements.

8

Table of Contents

Cherry Hill Mortgage Investment Corporation and Subsidiaries

Notes to Consolidated Financial Statements

June 30, 2016

(Unaudited)

Note 1 — Organization and Operations

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

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

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

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

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

Note 2 — Basis of Presentation and Significant Accounting Policies

Basis of Accounting

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

Table of Contents

Emerging Growth Company Status

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

Use of Estimates

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

Risks and Uncertainties

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

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

Investments in RMBS

Classification – The Company classifies its investments in RMBS as securities available for sale. Although the Company generally intends to hold most of its securities until maturity, it may, from time to time, sell any of its securities as part of its overall management of its portfolio. Securities available for sale are carried at fair value with

the net unrealized gains or losses reported as a separate component of other comprehensive income, to the extent impairment losses, if any, are considered temporary. Unrealized losses on securities are charged to earnings if they reflect a decline in value that is other-than-temporary, as described below.

Table of Contents

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

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

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

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

Investments in Excess MSRs

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

Table of Contents

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

Investments in MSR

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

Revenue Recognition – Mortgage servicing fee income represents revenue earned for servicing mortgage loans. The servicing fees are based on a contractual percentage of the outstanding principal balance and recognized as revenue as the related mortgage payments are collected. Corresponding costs to service are charged to expense as incurred. Approximately \$728,000 in reimbursable servicing advances was receivable at June 30, 2016, and has been classified within “Receivables and other assets” on the consolidated balance sheets. For further discussion on Receivables and other assets, see Note 14.

Servicing fee income received and servicing costs incurred are reported on the consolidated statements of comprehensive income. The change in fair value from period to period is recorded on the income statement as “Unrealized gain (loss) on investments in MSR.” Fair value is generally determined by discounting the expected future cash flows using discount rates that incorporate the market risks and liquidity premium specific to the MSR and, therefore, may differ from their effective yields.

Derivatives and Hedging Activities

Derivative transactions include swaps, swaptions, Treasury futures and “to-be-announced” securities (“TBAs”). Swaps and swaptions are entered into by the Company solely for interest rate risk management purposes. TBAs and Treasury futures are used to manage duration risk and basis risk. The decision of whether or not a given transaction/position (or

portion thereof) is economically hedged is made on a case-by-case basis, based on the risks involved and other factors as determined by senior management, including restrictions imposed by the Code on REITs. In determining whether to economically hedge a risk, the Company may consider whether other assets, liabilities, firm commitments and anticipated transactions already offset or reduce the risk. All transactions undertaken as economic hedges are entered into with a view towards minimizing the potential for economic losses that could be incurred by the Company. Generally, derivatives entered into are not intended to qualify as hedges under GAAP, unless specifically stated otherwise.

Table of Contents

Derivative financial instruments could expose the Company to counterparty risk if the Company's counterparties become unable to satisfy their respective obligations under the terms of these instruments. The Company reduces, but does not eliminate, its exposure to counterparty risk by limiting its counterparties to major financial institutions. In addition, the potential risk of loss with any one counterparty is monitored by the Company. Finally, the Company's interest rate swaps are required to be cleared on an exchange, which further mitigates, but does not eliminate, the Company's exposure to counterparty risk.

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

Revenue Recognition – With respect to derivatives that have not been designated as hedges, any net payments under, or fluctuations in the fair value of, such derivatives have been recognized currently in “Realized and unrealized gains (losses) on derivatives, net” in the consolidated statements of income.

Cash and Cash Equivalents and Restricted Cash

The Company considers all highly liquid short-term investments with maturities of 90 days or less when purchased to be cash equivalents. Substantially all amounts on deposit with major financial institutions exceed insured limits. Restricted cash represents the Company's cash held by counterparties as collateral against the Company's derivatives (approximately \$11.3 million and \$4.6 million at June 30, 2016 and December 31, 2015, respectively), borrowings under its repurchase agreements (approximately \$3.5 million and \$4.2 million at June 30, 2016 and December 31, 2015, respectively) as well as cash held that relates to outstanding borrowings on a term loan (“Term Loan”) (approximately \$1.1 million at both June 30, 2016 and December 31, 2015). For further information on the restricted cash as it relates to the Term Loan, see Note 13.

Due to Affiliates

“Due to Affiliates” on the balance sheets represents amounts due to the Manager pursuant to the Management Agreement. For further information on the Management Agreement, see Note 7.

Income Taxes

The Company has elected to be taxed as a REIT under the Code commencing with its short taxable year ended December 31, 2013. As long as the Company qualifies as a REIT, the Company generally will not be subject to U.S. federal income taxes on its taxable income to the extent it annually distributes at least 90% of its REIT taxable income to stockholders and does not engage in prohibited transactions. The Company's taxable REIT subsidiaries (“TRSs”), CHMI Solutions and Aurora, are subject to U.S. federal income taxes on their taxable income.

Table of Contents

The Company accounts for income taxes in accordance with ASC 740, Income Taxes. ASC 740 requires the recording of deferred income taxes that reflect the net tax effect of temporary differences between the carrying amounts of the Company's assets and liabilities for financial reporting purposes and the amounts used for income tax purposes, including operating loss carry forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect of a change in tax rates on deferred tax assets and liabilities is recognized in earnings in the period that includes the enactment date. The Company assesses its tax positions for all open tax years and determines if it has any material unrecognized liabilities in accordance with ASC 740. The Company records these liabilities to the extent it deems them more-likely-than-not to be incurred. The Company records interest and penalties related to income taxes within the provision for income taxes in the consolidated statements of income (loss). The Company has not incurred any interest or penalties.

Realized Gain (Loss) on RMBS and Derivatives, Net

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

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|-----------------------------|----------|---------------------------|-----------|
| | 2016 | 2015 | 2016 | 2015 |
| Realized gain (loss) on RMBS, net | | | | |
| Gain on RMBS | \$ 235 | \$ 16 | \$ 555 | \$ 323 |
| Loss on RMBS | - | (131) | - | (131) |
| Net realized gain (loss) on RMBS | 235 | (115) | 555 | 192 |
| Realized gain (loss) on derivatives, net | (299) | (52) | (1,760) | (1,294) |
| Unrealized gain (loss) on derivatives, net | (1,228) | 2,835 | (6,426) | 293 |
| Total | \$ (1,292) | \$ 2,668 | \$ (7,631) | \$ (809) |

The gain and loss on RMBS presented above represent the amounts reclassified from other comprehensive income (loss) in earnings.

Repurchase Agreements and Interest Expense

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

Federal Home Loan Bank of Indianapolis Advances

Advances from the Federal Home Loan Bank of Indianapolis ("FHLBI") were secured by the pledge of Agency RMBS, had varying amortization structures and maturities and bore interest at rates set by FHLBI based on market conditions and a number of criteria, including the size of the transaction and the FHLBI's cost of funds. Advances were treated as collateralized financing transactions and were carried at their contractual amounts. Interest was recorded at the contractual amount on an accrual basis. See Note 12 for information regarding the regulatory change eliminating our ability to obtain further advances from FHLBI.

Table of Contents

Dividends Payable

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

Comprehensive Income

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

Business Combinations

Business combinations are accounted for under the acquisition method of accounting in accordance with ASC 805, Business Combinations. Under the acquisition method the acquiring entity in a business combination recognizes 100 percent of the acquired assets and assumed liabilities, regardless of the percentage owned, at their estimated fair values as of the date of acquisition. Any excess of the purchase price over the fair value of net assets and other identifiable intangible assets acquired is recorded as goodwill. To the extent the fair value of net assets acquired, including other identifiable assets, exceeds the purchase price, a bargain purchase gain is recognized. Assets acquired and liabilities assumed from contingencies must also be recognized at fair value, if the fair value can be determined during the measurement period. Results of operations of an acquired business are included in the consolidated statement of income (loss) from the date of acquisition. Acquisition-related costs, including conversion and restructuring charges, are expensed as incurred. We applied this guidance to the Aurora acquisition.

Recent Accounting Pronouncements

Business Combinations – In September 2015, the Financial Accounting Standards Board (“FASB”) issued ASU 2015-16, Simplifying the Accounting for Measurement-Period Adjustments, which amends ASC 805, Business Combinations. ASU 2015-16 requires that an acquirer recognize adjustments to previously identified provisional amounts in the reporting period in which the adjustment amounts are determined. ASU 2015-16 requires an entity to present separately on the face of the income statement or disclose in the notes the portion of the amount recorded in current-period earnings by line item that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date. For public business entities, ASU 2015-16 is effective for fiscal years beginning after December 15, 2015, including interim periods within those fiscal years. Adoption of ASU 2015-16 did not have a material impact on the consolidated statement of income (loss) or earnings per share.

Revenue Recognition – In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers, which supersedes the revenue recognition requirements in ASC 606, Revenue Recognition, and most industry-specific guidance throughout the Industry Topics of the Codification. The core principle of ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 is effective for fiscal years and interim periods beginning after December 15, 2017. Entities have the option of using either a full retrospective or a modified approach to adopt the guidance in ASU 2014-09. Management is currently evaluating the impact ASU 2014-09 may have on its consolidated financial statements.

Table of Contents

Transfers and Servicing – In June 2014, the FASB issued ASU 2014-11, Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures, which amends ASC 860, Transfers and Servicing. ASU 2014-11, which affects all entities that enter into repurchase-to-maturity transactions or repurchase financings, requires two accounting changes. First, ASU 2014-11 changes the accounting for repurchase-to-maturity transactions to secured borrowing accounting. Second, for repurchase financing arrangements, ASU 2014-11 requires separate accounting for a transfer of a financial asset executed contemporaneously with a repurchase agreement with the same counterparty, which will result in secured borrowing accounting for the repurchase agreement. ASU 2014-11 also requires disclosures for certain transactions comprising (1) a transfer of a financial asset accounted for as a sale and (2) an agreement with the same transferee entered into in contemplation of the initial transfer that results in the transferor retaining substantially all of the exposure to the economic return on the transferred financial asset throughout the term of the transaction. For those transactions outstanding at the reporting date, the transferor is required to disclose additional information by type of transaction. ASU 2014-11 also requires certain disclosures for repurchase agreements, securities lending transactions, and repurchase-to-maturity transactions that are accounted for as secured borrowings. The accounting changes in ASU 2014-11 are effective for public business entities for the first interim or annual period beginning after December 15, 2014. For public business entities, the disclosure for certain transactions accounted for as a sale is required to be presented for interim and annual periods beginning after December 15, 2014, and the disclosure for repurchase agreements, securities lending transactions, and repurchase-to-maturity transactions accounted for as secured borrowings is required to be presented for annual periods beginning after December 15, 2014, and for interim periods beginning after March 15, 2015, with early adoption prohibited. Adoption of ASU 2014-11 did not have a material impact on the consolidated balance sheet, statement of income (loss), or earnings per share.

Stock Compensation – In June 2014, the FASB issued ASU 2014-12, Accounting for Share-Based Payments When the Terms of an Award Provide that a Performance Target Could be Achieved After the Requisite Service Period, which amends ASC 718, Compensation – Stock Compensation. ASU 2014-12 requires that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. A reporting entity should apply existing guidance in ASC 718 as it relates to awards with performance conditions that affect vesting to account for such awards. As such, the performance target should not be reflected in estimating the grant-date fair value of the award. Compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the period(s) for which the requisite service has already been rendered. If the performance target becomes probable of being achieved before the end of the requisite service period, the remaining unrecognized compensation cost should be recognized prospectively over the remaining requisite service period. The total amount of compensation cost recognized during and after the requisite service period should reflect the number of awards that are expected to vest and should be adjusted to reflect those awards that ultimately vest. The requisite service period ends when the employee can cease rendering service and still be eligible to vest in the award if the performance target is achieved. As indicated in the definition of vest, the stated vesting period (which includes the period in which the performance target could be achieved) may differ from the requisite service period. ASU 2014-12 is effective for annual periods and interim periods within those annual periods beginning after December 15, 2015, with early adoption permitted. Adoption of ASU 2014-12 did not have a material impact on the consolidated balance sheet, statement of income (loss), or earnings per share.

Going Concern – In August 2014, the FASB issued ASU 2014-15, Disclosures of Uncertainties about an Entity's Ability to Continue as a Going Concern, which amends ASC Subtopic 205-40, Presentation of Financial Statements – Going Concern. ASU 2014-15 provides guidance in GAAP about management's responsibility to evaluate whether there are conditions or events that raise substantial doubt about an entity's ability to continue as a going concern within one year after the date that the financial statements are issued and to provide related footnote disclosures of the relevant facts and circumstances. ASU 2014-15 is effective for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter, with early adoption permitted. Management does not expect the adoption of ASU 2014-15 to have an impact on its consolidated financial statements.

Changes in Presentation

Certain prior period amounts have been reclassified to conform to current period presentation.

16

Table of Contents

Note 3 — Segment Reporting

The Company conducts its business through the following segments: (i) investments in RMBS; (ii) investments in Servicing Related Assets; and (iii) “All Other” which consists primarily of general and administrative expenses, including fees to the directors and management fees pursuant to the Management Agreement (See Note 7). For segment reporting purposes, the Company does not allocate interest income on short-term investments.

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

| | Servicing Related Assets | RMBS | All Other | Total |
|---|-----------------------------|-------------|-------------|------------|
| Income Statement | | | | |
| Three Months Ended June 30, 2016 | | | | |
| Interest income | \$ 3,085 | \$4,050 | \$ - | \$7,135 |
| Interest expense | 333 | 1,552 | - | 1,885 |
| Net interest income | 2,752 | 2,498 | - | 5,250 |
| Servicing fee income | 1,574 | - | - | 1,574 |
| Servicing costs | 501 | - | - | 501 |
| Net servicing income | 1,073 | - | - | 1,073 |
| Other income | (3,225 |) (1,292) | - | (4,517) |
| Other operating expenses | - | - | 1,512 | 1,512 |
| (Benefit from) provision for corporate business taxes | 10 | - | - | 10 |
| Net income (loss) | \$ 590 | \$1,206 | \$ (1,512) | \$284 |
| Three Months Ended June 30, 2015 | | | | |
| Interest income | \$ 4,935 | \$3,153 | \$ - | \$8,088 |
| Interest expense | 19 | 1,327 | - | 1,346 |
| Net interest income | 4,916 | 1,826 | - | 6,742 |
| Servicing fee income | 156 | - | - | 156 |
| Servicing costs | 94 | - | - | 94 |
| Net servicing income | 62 | - | - | 62 |
| Other income | 3,090 | 2,668 | - | 5,758 |
| Other operating expenses | - | - | 1,324 | 1,324 |
| (Benefit from) provision for corporate business taxes | (70 |) - | - | (70) |
| Net income (loss) | \$ 8,138 | \$4,494 | \$ (1,324) | \$11,308 |
| Six Months Ended June 30, 2016 | | | | |
| Interest income | \$ 4,529 | \$7,794 | \$ - | \$12,323 |
| Interest expense | 673 | 2,869 | - | 3,542 |
| Net interest income | 3,856 | 4,925 | - | 8,781 |
| Servicing fee income | 3,069 | - | - | 3,069 |
| Servicing costs | 903 | - | - | 903 |
| Net servicing income | 2,166 | - | - | 2,166 |
| Other income | (7,764 |) (7,631) | - | (15,395) |
| Other operating expenses | - | - | 3,010 | 3,010 |
| (Benefit from) provision for corporate business taxes | (580 |) - | - | (580) |
| Net income (loss) | \$ (1,162 |) \$(2,706) | \$ (3,010) | \$(6,878) |
| Six Months Ended June 30, 2015 | | | | |
| Interest income | \$ 7,510 | \$6,405 | \$ - | \$13,915 |
| Interest expense | 19 | 2,562 | - | 2,581 |
| Net interest income | 7,491 | 3,843 | - | 11,334 |

Edgar Filing: Cherry Hill Mortgage Investment Corp - Form 10-Q

| | | | | |
|---|----------|---------|-------------|---------|
| Servicing fee income | 156 | - | - | 156 |
| Servicing costs | 94 | - | - | 94 |
| Net servicing income | 62 | - | - | 62 |
| Other income | 973 | (809) | - | 164 |
| Other operating expenses | - | - | 2,756 | 2,756 |
| (Benefit from) provision for corporate business taxes | (70 |) - | - | (70) |
| Net income (loss) | \$ 8,596 | \$3,034 | \$ (2,756) | \$8,874 |

Balance Sheet

June 30, 2016

| | | | | |
|-------------------|----------|-----------|---------|-----------|
| Investments | \$97,342 | \$522,151 | \$- | \$619,493 |
| Other assets | 4,476 | 19,794 | 11,638 | 35,908 |
| Total assets | 101,818 | 541,945 | 11,638 | 655,401 |
| Debt | 22,853 | 456,075 | - | 478,928 |
| Other liabilities | 5,811 | 15,381 | 5,109 | 26,301 |
| Total liabilities | 28,664 | 471,456 | 5,109 | 505,229 |
| GAAP book value | \$73,154 | \$70,489 | \$6,529 | \$150,172 |

December 31, 2015

| | | | | |
|-------------------|----------|-----------|---------|-----------|
| Investments | \$97,803 | \$508,242 | \$- | \$606,045 |
| Other assets | 3,562 | 13,984 | 12,749 | 30,295 |
| Total assets | 101,365 | 522,226 | 12,749 | 636,340 |
| Debt | 24,313 | 447,810 | - | 472,123 |
| Other liabilities | 1,883 | 4,903 | 5,094 | 11,880 |
| Total liabilities | 26,196 | 452,713 | 5,094 | 484,003 |
| GAAP book value | \$75,169 | \$69,513 | \$7,655 | \$152,337 |

Table of Contents

Note 4 — Investments in RMBS

All of the Company's RMBS are classified as available for sale and are, therefore, reported at fair value with changes in fair value recorded in other comprehensive income except for securities that are OTTI. There were no OTTI securities as of June 30, 2016 and December 31, 2015 (dollars in thousands):

Summary of RMBS Assets

As of June 30, 2016

| Asset Type | Original Face Value | Book Value | Gross Unrealized | | Carrying Value ^(A) | Number of Securities | Weighted Average Rating | Coupon | Yield ^(C) | Maturity (Years) ^(D) |
|------------------------|---------------------|------------|------------------|----------|-------------------------------|----------------------|-------------------------|--------|----------------------|---------------------------------|
| | | | Gains | Losses | | | | | | |
| RMBS | | | | | | | | | | |
| Fannie Mae | \$349,283 | \$314,051 | \$7,280 | \$(22) | \$321,309 | 49 | (B) | 3.73 % | 3.44 % | 23 |
| Freddie Mac | 202,601 | 186,823 | 4,594 | - | 191,417 | 24 | (B) | 3.61 % | 3.25 % | 25 |
| CMOs | 19,896 | 9,614 | 66 | (255) | 9,425 | 5 | Unrated | 4.55 % | 4.14 % | 11 |
| Total/Weighted Average | \$571,780 | \$510,488 | \$11,940 | \$(277) | \$522,151 | 78 | | 3.70 % | 3.39 % | 24 |

As of December 31, 2015

| Asset Type | Original Face Value | Book Value | Gross Unrealized | | Carrying Value ^(A) | Number of Securities | Weighted Average Rating | Coupon | Yield ^(C) | Maturity (Years) ^(D) |
|------------------------|---------------------|------------|------------------|------------|-------------------------------|----------------------|-------------------------|--------|----------------------|---------------------------------|
| | | | Gains | Losses | | | | | | |
| RMBS | | | | | | | | | | |
| Fannie Mae | \$329,767 | \$308,367 | \$1,961 | \$(1,556) | \$308,772 | 44 | (B) | 3.77 % | 3.59 % | 24 |
| Freddie Mac | 208,154 | 193,567 | 821 | (977) | 193,411 | 24 | (B) | 3.61 % | 3.48 % | 24 |
| CMOs | 16,646 | 6,493 | - | (434) | 6,059 | 4 | Unrated | 4.55 % | 7.39 % | 10 |
| Total/Weighted Average | \$554,567 | \$508,427 | \$2,782 | \$(2,967) | \$508,242 | 72 | | 3.72 % | 3.60 % | 23 |

(A) See Note 9 regarding the estimation of fair value, which approximates carrying value for all securities.

(B) The Company used an implied AAA rating for the Fannie Mae and Freddie Mac securities.

(C) The weighted average yield is based on the most recent annualized monthly interest income, divided by the Book Value. Prior period amounts have been reclassified to conform to current period presentation.

(D) The weighted average stated maturity.

Table of Contents

Summary of RMBS Assets by Maturity

As of June 30, 2016

| Asset Type | Original Face Value | Book Value | Gross Unrealized | | Carrying Value ^(A) | Number of Securities | Weighted Average Rating | Weighted Average | | Maturity (Years) ^(D) | |
|---------------------------|---------------------------|---------------|---------------------|----------|----------------------------------|----------------------------|-------------------------------|------------------|----------------------|------------------------------------|---|
| | | | Gains | Losses | | | | Coupon | Yield ^(C) | | |
| Less than 1 Year | \$- | \$- | \$- | \$- | \$- | - | - | % | - | % | - |
| 1-5 Years | - | - | - | - | - | - | - | % | - | % | - |
| 5-10 Years | 3,500 | 3,500 | 34 | (6) | 3,528 | 2 | (B) | 4.69 % | 5.00 % | 9 | |
| Over 10 Years | 568,280 | 506,988 | 11,906 | (271) | 518,623 | 76 | (B) | 3.69 % | 3.38 % | 24 | |
| Total/Weighted Average | \$571,780 | \$510,488 | \$11,940 | \$(277) | \$522,151 | 78 | | 3.70 % | 3.39 % | 24 | |

As of December 31, 2015

| Asset Type | Original Face Value | Book Value | Gross Unrealized | | Carrying Value ^(A) | Number of Securities | Weighted Average Rating | Weighted Average | | Maturity (Years) ^(D) |
|---------------------------|---------------------------|---------------|------------------|------------|----------------------------------|----------------------------|-------------------------------|------------------|----------------------|------------------------------------|
| | | | Gains | Losses | | | | Coupon | Yield ^(C) | |
| Less than 1 Year | \$- | \$- | \$- | \$- | \$- | - | - | - | - | - |
| 1-5 Years | - | - | - | - | - | - | - | - | - | - |
| 5-10 Years | 5,500 | 5,553 | - | (216) | 5,337 | 3 | (B) | 4.76 % | 4.96 % | 9 |
| Over 10 Years | 549,067 | 502,874 | 2,782 | (2,751) | 502,905 | 69 | (B) | 3.71 % | 3.59 % | 24 |
| Total/Weighted Average | \$554,567 | \$508,427 | \$2,782 | \$(2,967) | \$508,242 | 72 | | 3.72 % | 3.60 % | 23 |

(A) See Note 9 regarding the estimation of fair value, which approximates carrying value for all securities.

(B) The Company used an implied AAA rating for the Fannie Mae and Freddie Mac securities.

(C) The weighted average yield is based on the most recent annualized monthly interest income, divided by the Book Value. Prior period amounts have been reclassified to conform to current period presentation.

(D) The weighted average stated maturity.

At June 30, 2016 and December 31, 2015, the Company pledged Agency RMBS investments with a carrying value of approximately \$480.5 million and \$399.8 million, respectively, as collateral for repurchase agreements. At June 30, 2016, the Company pledged no Agency RMBS investments as collateral for FHLBI advances. At December 31, 2015, the Company pledged Agency RMBS investments with a carrying value of approximately \$83.2 million as collateral for FHLBI advances. At June 30, 2016 and December 31, 2015, the Company did not have any securities purchased from and financed with the same counterparty that did not meet the conditions of ASC 860, Transfers and Servicing, to be considered linked transactions and, therefore, classified as derivatives.

Unrealized losses that are considered other-than-temporary are recognized currently in earnings. During the three and six month periods ended June 30, 2016 and 2015, the Company did not record any OTTI charges. Based on management's analysis of these securities, the performance of the underlying loans and changes in market factors, management determined that unrealized losses as of the balance sheet date on the Company's securities were primarily the result of changes in market factors, rather than issuer-specific credit impairment. The Company performed analyses in relation to such securities, using management's best estimate of their cash flows, which support its belief that the carrying values of such securities were fully recoverable over their expected holding period. Such market

factors include changes in market interest rates and credit spreads, or certain macroeconomic events, which did not directly impact the Company's ability to collect amounts contractually due. Management continually evaluates the credit status of each of the Company's securities and the collateral supporting those securities. This evaluation includes a review of the credit of the issuer of the security (if applicable), the credit rating of the security (if applicable), the key terms of the security (including credit support), debt service coverage and loan to value ratios, the performance of the pool of underlying loans and the estimated value of the collateral supporting such loans, including the effect of local, industry and broader economic trends and factors. In connection with the above, the Company weighs the fact that all of its investments in Agency RMBS are guaranteed by U.S. government agencies or U.S. government sponsored entities.

Table of Contents

These factors include underlying loan default expectations and loss severities, which are analyzed in connection with a particular security's credit support, as well as prepayment rates. The result of this evaluation is considered when determining management's estimate of cash flows and in relation to the amount of the unrealized loss and the period elapsed since it was incurred. Significant judgment is required in this analysis. The following tables summarize the Company's securities in an unrealized loss position as of the dates indicated (dollars in thousands):

RMBS Unrealized Loss Positions

As of June 30, 2016

| Asset Type | Original | | Gross | | Number of Securities | Weighted Average | | | Maturity (Years) ^(D) |
|----------------------------|---------------|---------------|----------------------|----------------------------------|----------------------------|------------------|--------|----------------------|------------------------------------|
| | Face Value | Book Value | Unrealized Losses | Carrying Value ^(A) | | Rating | Coupon | Yield ^(C) | |
| Less than Twelve Months | \$8,132 | \$8,408 | \$ (92) | \$8,316 | 2 | (B) | 4.25 % | 1.72 % | 22 |
| Twelve or More Months | 13,146 | 2,877 | (185) | 2,692 | 2 | (B) | 4.07 % | 10.93 % | 11 |
| Total/Weighted Average | \$21,278 | \$11,285 | \$ (277) | \$11,008 | 4 | | 4.21 % | 4.07 % | 19 |

As of December 31, 2015

| Asset Type | Original | | Gross | | Number of Securities | Weighted Average | | | Maturity (Years) ^(D) |
|----------------------------|---------------|---------------|----------------------|----------------------------------|----------------------------|------------------|--------|----------------------|------------------------------------|
| | Face Value | Book Value | Unrealized Losses | Carrying Value ^(A) | | Rating | Coupon | Yield ^(C) | |
| Less than Twelve Months | \$271,585 | \$274,996 | \$ (2,749) | \$272,247 | 39 | (B) | 3.65 % | 3.48 % | 24 |
| Twelve or More Months | 11,146 | 940 | (218) | 722 | 1 | (B) | 3.00 % | 25.37 % | 17 |
| Total/Weighted Average | \$282,731 | \$275,936 | \$ (2,967) | \$272,969 | 40 | | 3.65 % | 3.55 % | 24 |

(A) See Note 9 regarding the estimation of fair value, which is equal to carrying value for all securities.

(B) The Company used an implied AAA rating for the Fannie Mae and Freddie Mac securities, other than CMOs, which are unrated.

(C) The weighted average yield is based on the most recent annualized monthly interest income, divided by the Book Value. Prior period amounts have been reclassified to conform to current period presentation.

(D) The weighted average stated maturity. The Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost bases which may be maturity.

Note 5 — Investments in Servicing Related Assets

Excess MSRs

In October 2013, the Company entered into an agreement ("Excess MSR Agreement 1") with Freedom Mortgage to invest in Excess MSRs with Freedom Mortgage. Freedom Mortgage originated the mortgage servicing rights on the

related pool of residential fixed rate Ginnie Mae-eligible FHA and VA mortgage loans with an aggregate unpaid principal balance (“UPB”) of approximately \$10.0 billion (“Excess MSR Pool 1”). Freedom Mortgage is entitled to receive an initial weighted average total mortgage servicing amount of approximately 28 basis points (“bps”) on the performing UPB, as well as any ancillary income from Excess MSR Pool 1. Pursuant to Excess MSR Agreement 1, Freedom Mortgage performs all servicing functions and advancing functions related to Excess MSR Pool 1 for a basic fee (the amount representing reasonable compensation for performing the servicing duties) of 8 bps. The remainder, or “excess mortgage servicing amount,” is initially equal to a weighted average of 20 bps.

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

Table of Contents

The value, and absolute amount, of recapture activity tends to vary inversely with the direction of interest rates. When interest rates are falling, recapture rates tend to be higher due to increased opportunities for borrowers to refinance. As interest rates increase, however, there is likely to be less recapture activity.

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

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

Upon completion of the IPO and the concurrent private placement, the Company also entered into a flow and bulk Excess MSR purchase agreement related to future purchases of Excess MSR from Freedom Mortgage. On February 28, 2014, pursuant to the flow and bulk Excess MSR purchase agreement, the Company purchased from Freedom Mortgage Excess MSR on mortgage loans originated by Freedom Mortgage during the first quarter of 2014 with an UPB of approximately \$76.8 million. The Company acquired an approximate 85% interest in the Excess MSR for approximately \$567,000. The terms of the purchase include recapture provisions that are the same as those in the Excess MSR acquisition agreements the Company entered into with Freedom Mortgage in October 2013.

On March 31, 2014, pursuant to the flow and bulk Excess MSR purchase agreement, the Company purchased from Freedom Mortgage Excess MSR on mortgage loans originated by a third party originator with an aggregate UPB of approximately \$159.8 million. Freedom Mortgage purchased the MSR on these mortgage loans from a third party on January 31, 2014. The Company acquired an approximate 71% interest in the Excess MSR for approximately \$946,000. The terms of the purchase include recapture provisions that are the same as those in the Excess MSR acquisition agreements the Company entered into with Freedom Mortgage in October 2013.

On June 30, 2014, pursuant to the flow and bulk Excess MSR purchase agreement, the Company purchased from Freedom Mortgage Excess MSR on mortgage loans originated by Freedom Mortgage during the second quarter of 2014 with an aggregate UPB of approximately \$98.1 million. The Company acquired an approximate 85% interest in the Excess MSR for approximately \$661,000. The terms of the purchase include recapture provisions that are the same as those in the Excess MSR acquisition agreements the Company entered into with Freedom Mortgage in October 2013.

Table of Contents

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

MSRs

On May 29, 2015, in conjunction with the acquisition of Aurora, the Company acquired MSRs on conventional mortgage loans with an aggregate UPB of approximately \$718.4 million. On June 10, 2015, the Company agreed to transfer the direct servicing of the MSR portfolio to Freedom Mortgage pursuant to a subservicing agreement with Freedom Mortgage. The transfer occurred on September 1, 2015. Pending the transfer, the former servicing employees of Aurora, now employees of Freedom Mortgage, directly serviced the MSR portfolio for Aurora and the servicing was provided at cost pursuant to the Management Agreement with the Manager and the Services Agreement between the Manager and Freedom Mortgage. The cost for such services was included in servicing costs on the consolidated statements of income (loss).

Aurora subsequently acquired three portfolios of MSRs on loans owned or securitized by Fannie Mae or Freddie Mac with an aggregate UPB of approximately \$3.0 billion as of June 30, 2016.

In June 2016, Aurora entered into a joint marketing recapture agreement with Freedom Mortgage. Pursuant to this agreement, Freedom Mortgage will attempt to refinance certain mortgage loans underlying Aurora's MSR portfolio as directed by Aurora. If a loan is refinanced, Aurora will pay Freedom Mortgage a fee for its origination services. Freedom Mortgage will be entitled to sell the loan for its own benefit and will transfer the related MSR to Aurora. The agreement has an initial term of one year, subject to automatic renewals of one year each and subject to termination by either party upon 60 days prior notice. All new loans must qualify for sale to Fannie Mae or Freddie Mac and meet other conditions set forth in the agreement. No refinances or fees were paid during the three month period ended June 30, 2016.

The following is a summary of the Company's Servicing Related Assets (dollars in thousands):

Servicing Related Assets Summary

As of June 30, 2016

| | Unpaid Principal Balance | Amortized Cost Basis ^(A) | Carrying Value ^(B) | Weighted Average Coupon | Weighted Average Maturity (Years) ^(C) | Changes in Fair Value Recorded in Other Income (Loss) ^(D) |
|--|--------------------------------|---|----------------------------------|-------------------------------|---|--|
| Excess MSR Pool 1 | \$6,807,065 | \$ 34,550 | \$34,721 | 3.51 | % 25.6 | \$(3,183) |
| Excess MSR Pool 1 - Recapture Agreement | - | 1,841 | 1,744 | | | 1,467 |
| Excess MSR Pool 2 | 6,661,764 | 20,964 | 28,958 | 2.84 | % 26.6 | (1,228) |
| Excess MSR Pool 2 - Recapture Agreement | - | 1,484 | 973 | | | 553 |
| Excess MSR Pool 2014 | 238,805 | 1,440 | 1,196 | 3.63 | % 26.9 | (65) |
| Excess MSR Pool 2014 - Recapture Agreement | - | - | - | | | - |
| MSRs ^(E) | 3,600,130 | 35,058 | 29,750 | 3.82 | 24.1 | (5,308) |

Edgar Filing: Cherry Hill Mortgage Investment Corp - Form 10-Q

| | | | | | | | |
|-------|--------------|-----------|----------|------|---|------|------------|
| Total | \$17,307,764 | \$ 95,337 | \$97,342 | 3.32 | % | 25.7 | \$(7,764) |
|-------|--------------|-----------|----------|------|---|------|------------|

22

Table of Contents

As of December 31, 2015

| | Unpaid Principal Balance | Amortized Cost Basis ^(A) | Carrying Value ^(B) | Weighted Average Coupon | Weighted Average Maturity (Years) ^(C) | Changes in Fair Value Recorded in Other Income (Loss) ^(D) |
|---|--------------------------------|---|----------------------------------|-------------------------------|---|--|
| Excess MSR Pool 1 | \$7,416,465 | \$ 39,483 | \$42,837 | 3.51 | % 26.0 | \$(2,822) |
| Excess MSR Pool 1 - Recapture Agreement | - | 2,209 | 645 | - | - | 331 |
| Excess MSR Pool 2 | 7,279,706 | 23,116 | 32,338 | 2.78 | % 27.1 | 2,626 |
| Excess MSR Pool 2 - Recapture Agreement | - | 1,780 | 716 | - | - | (324) |
| Excess MSR Pool 2014 | 265,890 | 1,685 | 1,506 | 3.65 | % 27.4 | 170 |
| Excess MSR Pool 2014 - Recapture Agreement | - | - | - | - | - | - |
| MSRs ^(E) | 2,016,351 | 20,884 | 19,761 | 3.76 | % 22.7 | (1,123) |
| Total | \$16,978,412 | \$ 89,157 | \$97,803 | 3.23 | % 26.1 | \$(1,142) |

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

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

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

(D) The portion of the change in fair value of the recapture agreement relating to loans recaptured as of June 30, 2016 and December 31, 2015 is reflected in the respective pool.

(E) MSR cost basis consists of the carrying value of the prior period, adjusted for any acquisitions made during the current period.

The tables below summarize the geographic distribution for the states representing 5% or greater of the underlying residential mortgage loans of the Servicing Related Assets:

Geographic Concentration of Servicing Related Assets

As of June 30, 2016

| | Percentage of Total Outstanding Unpaid Principal Balance | |
|------------|---|---|
| California | 11.5 | % |
| Texas | 8.8 | % |
| Florida | 6.4 | % |
| Virginia | 5.5 | % |
| All other | 67.8 | % |
| Total | 100.0 | % |

Table of Contents

As of December 31, 2015

| | Percentage of Total Outstanding Unpaid Principal Balance | |
|----------------|---|---|
| California | 12.3 | % |
| Texas | 9.4 | % |
| Florida | 6.5 | % |
| Virginia | 6.0 | % |
| North Carolina | 5.2 | % |
| Washington | 5.1 | % |
| Georgia | 5.0 | % |
| All other | 50.5 | % |
| Total | 100.0 | % |

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

Note 6 — Equity and Earnings per Share

Equity Incentive Plan

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

The following tables present certain information about the Company's 2013 Plan as of the dates indicated:

Equity Incentive Plan Information

As of June 30, 2016

| | Number of Securities Issued or to be Issued Upon Exercise | Number of Securities Remaining Available For Future Issuance Under Equity Compensation Plans |
|--|--|---|
| Equity compensation Plans Approved By Shareholders | | 1,332,063 |
| LTIP-OP Units | 140,350 | |
| Forfeited LTIP-OP Units | (916) | |
| Shares of Common Stock | 28,503 | |
| Equity Compensation Plans Not Approved By Shareholders | | - |

Table of Contents

As of December 31, 2015

| | Number of Securities Issued or to be Issued Upon Exercise | Number of Securities Remaining Available For Future Issuance Under Equity Compensation Plans |
|--|--|---|
| Equity compensation Plans Approved By Shareholders | | 1,377,112 |
| LTIP-OP Units | 103,850 | |
| Shares of Common Stock | 19,038 | |
| Equity Compensation Plans Not Approved By Shareholders | | - |

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

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

The table below sets forth certain information regarding the LTIP-OP Units that have been granted by the board of directors (dollars in thousands, except per share data):

LTIP-OP Unit Grant Information

| Grant Date | Number of Grantees | Stock Price on Grant Date | Number of Units Granted | Aggregate Fair Market Value |
|---------------|-----------------------|------------------------------|----------------------------|--------------------------------|
| June 15, 2016 | 14 | \$ 15.85 | 36,500 | \$ 579 |
| | 12 | \$ 15.80 | 35,000 | \$ 553 |

September 9,
2015

| | | | | |
|-----------------|----|----------|--------|--------|
| June 10, 2014 | 10 | \$ 19.33 | 31,350 | \$ 606 |
| October 9, 2013 | 11 | \$ 20.00 | 37,500 | \$ 750 |

Except for 7,500 LTIP-OP Units that were granted to the Company's independent directors at the time of the IPO, which vested immediately, LTIP-OP Units vest ratably over the first three year anniversaries of the grant date. The fair value of each LTIP-OP Unit was determined based on the initial offering price of the Company's common stock in the case of the grant to the independent directors and based on the closing price of the Company's common stock on the applicable grant date in all other cases.

25

Table of Contents

As of June 30, 2016, 48,289 LTIP-OP Units have vested. The Company recognized approximately \$135,200 and \$100,500 in share-based compensation expense in the three month periods ended June 30, 2016 and 2015, respectively. The Company recognized approximately \$282,000 and \$200,100 in share-based compensation expense in the six month periods ended June 30, 2016 and 2015, respectively. There was approximately \$1.2 million of total unrecognized share-based compensation expense as of June 30, 2016, related to the 91,145 non-vested LTIP-OP Units. This unrecognized share-based compensation expense is expected to be recognized ratably over the remaining vesting period of up to three years. The aggregate expense related to the LTIP-OP Unit grants is presented as “General and administrative expense” in the Company’s consolidated income statement.

On January 27, 2014, pursuant to the 2013 Plan, the Company granted each of the independent directors 530 shares of common stock (for a total of 1,590 shares), which were fully vested on the date of grant, and 2,651 restricted shares of common stock (for a total of 7,953 shares) which were subject to forfeiture in certain circumstances within one year from the grant date. This unrecognized share-based compensation expense is expected to be recognized ratably over the vesting period.

On September 9, 2015, pursuant to the 2013 Plan, the Company granted each of the independent directors 3,165 restricted shares of common stock (for a total of 9,495 shares) which were subject to forfeiture in certain circumstances within one year from the grant date. This unrecognized share-based compensation expense is expected to be recognized ratably over the vesting period.

On June 15, 2016, pursuant to the 2013 Plan, the Company granted each of the independent directors 3,155 restricted shares of common stock (for a total of 9,465 shares) which were subject to forfeiture in certain circumstances within one year from the grant date. This unrecognized share-based compensation expense is expected to be recognized ratably over the vesting period.

As of June 30, 2016, 1,332,063 shares of common stock remain available for future issuance under the 2013 Plan.

Non-Controlling Interests in Operating Partnership

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

As of June 30, 2016, the non-controlling interest holders in the Operating Partnership owned 139,434 LTIP-OP Units, or approximately 1.9% of the Operating Partnership. Pursuant to ASC 810, Consolidation, changes in a parent’s ownership interest (and transactions with non-controlling interest unit holders in the Operating Partnership) while the parent retains its controlling interest in its subsidiary should be accounted for as equity transactions. The carrying amount of the non-controlling interest will be adjusted to reflect the change in its ownership interest in the subsidiary, with the offset to equity attributable to the Company.

Earnings per Share

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

Table of Contents

The following table presents basic earnings per share of common stock for the periods indicated (dollars in thousands, except per share data):

Earnings per Share Information

| | Three Months Ended June 30, 2016 | 2015 | Six Months Ended June 30, 2016 | 2015 |
|---|-------------------------------------|-----------|-----------------------------------|-----------|
| Numerator: | | | | |
| Net income attributable to common stockholders and participating securities | \$ 284 | \$ 11,308 | \$ (6,878) | \$ 8,874 |
| Net income allocable to common stockholders | \$ 283 | \$ 11,205 | \$ (6,780) | \$ 8,793 |
| Denominator: | | | | |
| Weighted average common shares outstanding | 7,509,543 | 7,509,543 | 7,509,543 | 7,509,543 |
| Weighted average diluted shares outstanding | 7,520,616 | 7,509,543 | 7,519,827 | 7,509,543 |
| Basic and Dilutive: | | | | |
| Basic earnings per share | \$ 0.04 | \$ 1.49 | \$ (0.90) | \$ 1.17 |
| Diluted earnings per share | \$ 0.04 | \$ 1.49 | \$ (0.90) | \$ 1.17 |

There were no participating securities or equity instruments outstanding that were anti-dilutive for purposes of calculating earnings per share for the periods presented.

Note 7 — Transactions with Affiliates and Affiliated Entities

Manager

The Company has entered into the Management Agreement with the Manager, pursuant to which the Manager provides for the day-to-day management of the Company's operations. The Management Agreement requires the Manager to manage the Company's business affairs in conformity with the policies that are approved and monitored by the Company's board of directors. The Management Agreement terminates on October 22, 2020, subject to automatic renewal for successive one-year terms and to certain termination rights. The Manager's performance is reviewed prior to any renewal and may be terminated by the Company for cause without payment of a termination fee, or may be terminated without cause with payment of a termination fee, as defined in the Management Agreement, equal to three times the average annual management fee amount earned by the Manager during the two four-quarter periods ending as of the end of the most recently completed fiscal quarter prior to the effective date of the termination, upon either the affirmative vote of at least two-thirds of the members of the board of directors or the affirmative vote of the holders of at least a majority of the outstanding common stock. Pursuant to the Management Agreement, the Manager, under the supervision of the Company's board of directors, formulates investment strategies, arranges for the acquisition of assets, arranges for financing, monitors the performance of the Company's assets and provides certain advisory, administrative and managerial services in connection with the operations of the Company. For performing these services, the Company pays the Manager a quarterly management fee equal to the product of one quarter of the 1.5% Management Fee Annual Rate and the Stockholders' Equity, adjusted as set forth in the Management Agreement, calculated and payable quarterly in arrears.

The Manager is a party to a services agreement (the "Services Agreement") with Freedom Mortgage, pursuant to which Freedom Mortgage provides to the Manager the personnel, services and resources as needed by the Manager to enable the Manager to carry out its obligations and responsibilities under the Management Agreement. The Company is a named third-party beneficiary to the Services Agreement and, as a result, has, as a non-exclusive remedy, a direct right of action against Freedom Mortgage in the event of any breach by the Manager of any of its duties, obligations or agreements under the Management Agreement that arise out of or result from any breach by Freedom Mortgage of its obligations under the Services Agreement. The Services Agreement will terminate upon the termination of the

Management Agreement. Pursuant to the Services Agreement, the Manager will make certain payments to Freedom Mortgage in connection with the services provided. The Management Agreement between the Company and the Manager was negotiated between related parties, and the terms, including fees payable, may not be as favorable to the Company as if it had been negotiated with an unaffiliated third party. Both the Manager and Freedom Mortgage are controlled by Mr. Stanley Middleman, who is also a shareholder of the Company.

Table of Contents

The Management Agreement provides that the Company will reimburse the Manager for various expenses incurred by the Manager or its officers, and agents on the Company’s behalf, including costs of software, legal, accounting, tax, administrative and other similar services rendered for the Company by providers retained by the Manager. “Due to affiliates” consisted of the following for the periods indicated (dollars in thousands):

Management Fee to Affiliate

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|-----------------------|-----------------------------|--------|---------------------------|----------|
| | 2016 | 2015 | 2016 | 2015 |
| Management fees | \$ 560 | \$ 560 | \$ 1,120 | \$ 1,120 |
| Expense reimbursement | 130 | 130 | 260 | 260 |
| Total | \$ 690 | \$ 690 | \$ 1,380 | \$ 1,380 |

Subservicing Agreement

Freedom Mortgage is directly servicing the Company’s portfolio of Fannie Mae and Freddie Mac MSR’s pursuant to a subservicing agreement entered into on June 10, 2015. The agreement has an initial term of three (3) years, expiring on September 1, 2018, and is subject to automatic renewal for additional three year terms unless either party chooses not to renew. The agreement may be terminated without cause by either party by giving notice as specified in the agreement. Under that agreement, Freedom Mortgage agrees to service the applicable mortgage loans in accordance with applicable law and the requirements of the applicable agency. The Company pays fees for specified services, which are included in “Servicing costs” on the consolidated statement of income (loss).

Other Transactions with Affiliated Entities

The Company, through one of its subsidiaries, has entered into an uncommitted master repurchase agreement with Freedom Mortgage pursuant to which the Company may, from time to time, purchase a newly issued Ginnie Mae RMBS, subject to Freedom Mortgage’s agreement to repurchase the security at a future date, generally no more than 120 days later. The Company simultaneously re-hypothecates the security to one of its counterparties with whom it has a repurchase agreement, for an identical term. For the three and six month periods ended June 30, 2016, the Company earned approximately \$518,000 in income and had a corresponding expense of \$127,000, which are included in “Interest income” and “Interest expense”, respectively, on the consolidated statement of income (loss). No such related income or expense was earned or incurred during the three and six month periods ended June 30, 2015. There were no such assets, or related liabilities, as of June 30, 2016 and December 31, 2015.

See Note 5 for a discussion of the co-investments in Excess MSR’s with Freedom Mortgage, the services provided by Freedom Mortgage during the period prior to transfer to Freedom Mortgage of the direct servicing obligations for the MSR’s and the MSR recapture agreement between Aurora and Freedom Mortgage. See Note 10 for a discussion of the Acknowledgement Agreement among the Company, Freedom Mortgage and Ginnie Mae entered into in connection with the co-investments in Excess MSR’s.

Note 8 — Derivative Instruments

Interest Rate Swap Agreements, Swaptions, TBAs and Treasury Futures

In order to help mitigate exposure to higher short-term interest rates in connection with its repurchase agreements, the Company enters into interest rate swap agreements. These agreements establish an economic fixed rate on related borrowings because the variable-rate payments received on the interest rate swap agreements largely offset interest accruing on the related borrowings, leaving the fixed-rate payments to be paid on the interest rate swap agreements as the Company’s effective borrowing rate, subject to certain adjustments including changes in spreads between variable

rates on the interest rate swap agreements and actual borrowing rates. A swaption is an option granting its owner the right but not the obligation to enter into an underlying swap. The Company's interest rate swap agreements and swaptions have not been designated as hedging instruments for GAAP purposes.

Table of Contents

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

The following table summarizes the outstanding notional amounts of derivative instruments as of the dates indicated (dollars in thousands):

| Non-hedge derivatives | June 30, 2016 | December 31, 2015 |
|--|---------------|-------------------|
| Notional amount of interest rate swaps | \$ 321,250 | \$ 300,300 |
| Notional amount of swaptions | 85,000 | 85,000 |
| Notional amount of TBAs, net | 1,000 | - |
| Notional amount of Treasury Futures | 45,600 | - |
| Total notional amount | \$ 452,850 | \$ 385,300 |

The following table presents information about the Company's interest rate swap agreements as of the dates indicated (dollars in thousands):

| | Notional Amount | Weighted Average Pay Rate | Weighted Average Receive Rate | Weighted Average Years to Maturity |
|-------------------|-----------------|---------------------------|-------------------------------|------------------------------------|
| June 30, 2016 | \$321,250 | 1.53 % | 0.64 % | 3.4 |
| December 31, 2015 | \$300,300 | 1.71 % | 0.37 % | 4.3 |

The following table presents information about derivatives realized gain (loss), which is included on the consolidated statement of income (loss) for the periods indicated (dollars in thousands):

Realized Gains (Losses) on Derivatives

| | | Three Months Ended June 30, | | Six Months Ended June 30, | |
|-----------------------|---|-----------------------------|-----------|---------------------------|-------------|
| Non-Hedge Derivatives | Income Statement Location | 2016 | 2015 | 2016 | 2015 |
| Interest rate swaps | Realized gain/(loss) on derivative assets | \$ (398) | \$ (149) | \$ (1,748) | \$ (937) |
| Swaptions | Realized gain/(loss) on derivative assets | (140) | 64 | (140) | 64 |
| TBAs | Realized gain/(loss) on derivative assets | 56 | 33 | (26) | (76) |
| Treasury futures | Realized gain/(loss) on derivative assets | 183 | - | 154 | (345) |
| Total | | \$ (299) | \$ (52) | \$ (1,760) | \$ (1,294) |

Offsetting Assets and Liabilities

The Company has netting arrangements in place with all of its derivative counterparties pursuant to standard documentation developed by the International Swap and Derivatives Association, or ISDA. Under GAAP, if the Company has a valid right of offset, it may offset the related asset and liability and report the net amount. The Company presents interest rate swaps, swaptions and Treasury futures assets and liabilities on a gross basis in its consolidated balance sheets. The Company presents TBA assets and liabilities on a net basis in its consolidated balance sheets. The Company presents repurchase agreements subject to master netting arrangements on a gross basis.

Additionally, the Company does not offset financial assets and liabilities with the associated cash collateral on the consolidated balance sheets.

Table of Contents

The following tables present information about the Company's assets and liabilities that are subject to master netting arrangements or similar agreements and can potentially be offset on the Company's consolidated balance sheets as of the dates indicated (dollars in thousands):

Offsetting Assets and Liabilities

As of June 30, 2016

| | Gross Amounts of Recognized Assets or Liabilities | Gross Amounts Offset in the Consolidated Balance Sheet | Net Amounts of Assets Presented in the Consolidated Balance Sheet | Gross Amounts Not Offset in the Consolidated Balance Sheet | Cash Collateral Received (Pledged) | Net Amount |
|-----------------------|---|---|---|--|---|------------|
| Assets | | | | | | |
| Interest rate swaps | \$ - | \$ - | \$ - | \$- | \$- | \$ - |
| Swaptions | 24 | - | 24 | (24) | - | - |
| TBAs | 1 | - | 1 | (1) | - | - |
| Treasury futures | 288 | - | 288 | (288) | (645) | - |
| Total Assets | \$ 313 | \$ - | \$ 313 | \$(313) | \$(645) | \$ - |
| Liabilities | | | | | | |
| Repurchase agreements | \$ 456,075 | \$ - | \$ 456,075 | \$(452,625) | \$(3,450) | \$ - |
| Interest rate swaps | 10,666 | - | 10,666 | - | (10,666) | - |
| Swaptions | - | - | - | - | - | - |
| TBAs | - | - | - | - | - | - |
| Treasury futures | - | - | - | - | - | - |
| Total Liabilities | \$ 466,741 | \$ - | \$ 466,741 | \$(452,625) | \$(14,116) | \$ - |

Table of Contents

As of December 31, 2015

| | Gross Amounts of Recognized Assets or Liabilities | Gross Amounts Offset in the Consolidated Balance Sheet | Net Amounts of Assets Presented in the Consolidated Balance Sheet | Gross Amounts Not Offset in the Consolidated Balance Sheet | Cash Collateral Received (Pledged) | Net Amount |
|-----------------------|--|---|---|--|---|------------|
| Assets | | | | | | |
| Interest rate swaps | \$ 51 | \$ - | \$ 51 | \$ (51) | \$ - | \$ - |
| Swaptions | 371 | - | 371 | (371) | - | - |
| TBAs | - | - | - | - | - | - |
| Treasury futures | - | - | - | - | (84) | - |
| Total Assets | \$ 422 | \$ - | \$ 422 | \$ (422) | \$ (84) | \$ - |
| Liabilities | | | | | | |
| Repurchase agreements | \$ 385,560 | \$ - | \$ 385,560 | \$ (381,386) | \$ (4,174) | \$ - |
| Interest rate swaps | 4,595 | - | 4,595 | - | (4,595) | - |
| Swaptions | - | - | - | - | - | - |
| TBAs | - | - | - | - | - | - |
| Treasury futures | - | - | - | - | - | - |
| Total Liabilities | \$ 390,155 | \$ - | \$ 390,155 | \$ (381,386) | \$ (8,769) | \$ - |

Note 9 – Fair Value

Fair Value Measurements

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

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

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

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

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

31

Table of Contents

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

RMBS

The Company holds a portfolio of RMBS that are classified as available for sale and are carried at fair value in the consolidated balance sheets. The Company determines the fair value of its RMBS based upon prices obtained from third-party pricing providers. The third-party pricing providers use pricing models that generally incorporate such factors as coupons, primary and secondary mortgage rates, rate reset period, issuer, prepayment speeds, credit enhancements and expected life of the security. As a result, the Company classified 100% of its RMBS as Level 2 fair value assets at June 30, 2016 and December 31, 2015.

Excess MSRs

The Company holds a portfolio of Excess MSRs that are reported at fair value in the consolidated balance sheets. Although Excess MSR transactions are observable in the marketplace, the valuation includes unobservable market data inputs (prepayment speeds, delinquency levels and discount rates). As a result, the Company classified 100% of its Excess MSRs as Level 3 fair value assets at June 30, 2016 and December 31, 2015.

MSRs

The Company holds a portfolio of MSRs that are reported at fair value in the consolidated balance sheets. Although MSR transactions are observable in the marketplace, the valuation includes unobservable market data inputs (prepayment speeds, delinquency levels, costs to service and discount rates). As a result, the Company classified 100% of its MSRs as Level 3 fair value assets at June 30, 2016 and December 31, 2015.

Derivative Instruments

The Company enters into a variety of derivative financial instruments as part of its economic hedging strategies. The Company executes interest rate swaps, swaptions, TBAs and treasury futures. The Company utilizes third-party pricing providers to value its financial derivative instruments. The Company classified 100% of the derivative instruments as Level 2 fair value assets and liabilities at June 30, 2016 and December 31, 2015.

Both the Company and the derivative counterparties under their netting arrangements are required to post cash collateral based upon the net underlying market value of the Company's open positions with the counterparties. Posting of cash collateral typically occurs daily, subject to certain dollar thresholds. Due to the existence of netting arrangements, as well as frequent cash collateral posting at low posting thresholds, credit exposure to the Company and/or counterparties is considered materially mitigated. The Company's interest rate swaps are required to be cleared on an exchange, which further mitigates, but does not eliminate, credit risk. Based on the Company's assessment, there is no requirement for any additional adjustment to derivative valuations specifically for credit.

Table of Contents

Recurring Fair Value Measurements

The following tables present the Company's assets and liabilities measured at fair value on a recurring basis as of the dates indicated (dollars in thousands).

Recurring Fair Value Measurements

As of June 30, 2016

| | Level 1 | Level 2 | Level 3 | Carrying Value |
|------------------------------|---------|-----------|----------|----------------|
| Assets | | | | |
| RMBS | | | | |
| Fannie Mae | \$ - | \$321,309 | \$- | \$ 321,309 |
| Freddie Mac | - | 191,417 | - | 191,417 |
| CMOs | - | 9,425 | - | 9,425 |
| RMBS total | - | 522,151 | - | 522,151 |
| Derivative assets | | | | |
| Interest rate swaps | - | - | - | - |
| Interest rate swaptions | - | 24 | - | 24 |
| TBAs | - | 1 | - | 1 |
| Treasury Futures | - | 288 | - | 288 |
| Derivative assets total | - | 313 | - | 313 |
| Servicing Related Assets | - | - | 97,342 | 97,342 |
| Total Assets | \$ - | \$522,464 | \$97,342 | \$ 619,806 |
| Liabilities | | | | |
| Derivative liabilities | | | | |
| Interest rate swaps | - | 10,666 | - | 10,666 |
| TBAs | - | - | - | - |
| Treasury Futures | - | - | - | - |
| Derivative liabilities total | - | 10,666 | - | 10,666 |
| Total Liabilities | \$ - | \$10,666 | \$- | \$ 10,666 |

As of December 31, 2015

| | Level 1 | Level 2 | Level 3 | Carrying Value |
|--------------------------|---------|-----------|----------|----------------|
| Assets | | | | |
| RMBS | | | | |
| Fannie Mae | \$ - | \$308,772 | \$- | \$ 308,772 |
| Freddie Mac | - | 193,411 | - | 193,411 |
| CMOs | - | 6,059 | - | 6,059 |
| RMBS total | - | 508,242 | - | 508,242 |
| Derivative assets | | | | |
| Interest rate swaps | - | 51 | - | 51 |
| Interest rate swaptions | - | 371 | - | 371 |
| TBAs | - | - | - | - |
| Treasury Futures | - | - | - | - |
| Derivative assets total | - | 422 | - | 422 |
| Servicing related assets | - | - | 97,803 | 97,803 |
| Total Assets | \$ - | \$508,664 | \$97,803 | \$ 606,467 |
| Liabilities | | | | |

| | | | | |
|------------------------------|------|---------|-----|----------|
| Derivative liabilities | | | | |
| Interest rate swaps | - | 4,595 | - | 4,595 |
| TBAs | - | - | - | - |
| Treasury Futures | - | - | - | - |
| Derivative liabilities total | - | 4,595 | - | 4,595 |
| Total Liabilities | \$ - | \$4,595 | \$- | \$ 4,595 |

The Company may be required to measure certain assets or liabilities at fair value from time to time. These periodic fair value measures typically result from application of certain impairment measures under GAAP. These items would constitute nonrecurring fair value measures under ASC 820. As of June 30, 2016 and December 31, 2015, the Company did not have any assets or liabilities measured at fair value on a nonrecurring basis in the periods presented.

Table of Contents

Level 3 Assets and Liabilities

The valuation of Level 3 instruments requires significant judgment by the third-party pricing providers and management. The third-party pricing providers and management rely on inputs such as market price quotations from market makers (either market or indicative levels), original transaction price, recent transactions in the same or similar instruments, and changes in financial ratios or cash flows to determine fair value. Level 3 instruments may also be discounted to reflect illiquidity and/or non-transferability, with the amount of such discount estimated by third-party pricing providers and management in the absence of market information. Assumptions used by third-party pricing providers and management due to lack of observable inputs may significantly impact the resulting fair value and, therefore, the Company's consolidated financial statements. The Company's management reviews all valuations that are based on pricing information received from third-party pricing providers. As part of this review, prices are compared against other pricing or input data points in the marketplace, along with internal valuation expertise, to ensure the pricing is reasonable.

In connection with the above, the Company estimates the fair value of its Servicing Related Assets based on internal pricing models rather than quotations, and compares the results of these internal models against the results from models generated by third-party valuation specialists. The determination of estimated cash flows used in pricing models is inherently subjective and imprecise.

Changes in market conditions, as well as changes in the assumptions or methodology used to determine fair value, could result in a significant change to estimated fair values. It should be noted that minor changes in assumptions or estimation methodologies can have a material effect on these derived or estimated fair values, and that the fair values reflected below are indicative of the interest rate and credit spread environments as of June 30, 2016 and December 31, 2015 and do not take into consideration the effects of subsequent changes in market or other factors.

The tables below present the reconciliation for the Company's Level 3 assets (Servicing Related Assets) measured at fair value on a recurring basis as of the dates indicated (dollars in thousands):

Level 3 Fair Value Measurements

As of June 30, 2016

| | Level 3 ^(A) | | | | |
|---|------------------------|----------|-----------|------------|------------|
| | Pool 1 | Pool 2 | Pool 2014 | MSRs | Total |
| Balance at December 31, 2015 | \$43,482 | \$33,054 | \$1,506 | \$19,761 | \$97,803 |
| Purchases and principal paydowns | | | | | |
| Purchases | - | - | - | 15,297 | 15,297 |
| Proceeds from principal paydowns | (5,301) | (2,448) | (245) | - | (7,994) |
| Changes in fair value due to: | | | | | |
| Mark to market gain (loss) | (1,716) | (675) | (65) | (3,702) | (6,158) |
| Amortization of MSRs | - | - | - | (1,606) | (1,606) |
| Unrealized gain (loss) included in Net Income | \$(1,716) | \$(675) | \$(65) | \$(5,308) | \$(7,764) |
| Balance at June 30, 2016 | \$36,465 | \$29,931 | \$1,196 | \$29,750 | \$97,342 |

As of December 31, 2015

| | Level 3 ^(A) | | | | |
|--|------------------------|--------|-----------|------|-------|
| | Pool 1 | Pool 2 | Pool 2014 | MSRs | Total |

Edgar Filing: Cherry Hill Mortgage Investment Corp - Form 10-Q

| | | | | | |
|---|------------|----------|---------|------------|------------|
| Balance at December 31, 2014 | \$54,798 | \$34,938 | \$1,586 | \$- | \$91,322 |
| Purchases and principal paydowns | | | | | |
| Purchases | - | - | - | 20,884 | 20,884 |
| Proceeds from principal paydowns | (8,825) | (4,186) | (250) | - | (13,261) |
| Changes in fair value due to: | | | | | |
| Mark to market gain (loss) | (2,491) | 2,302 | 170 | (567) | (586) |
| Amortization of MSR's | - | - | - | (556) | (556) |
| Unrealized gain (loss) included in Net Income | \$(2,491) | \$2,302 | \$170 | \$(1,123) | \$(1,142) |
| Balance at December 31, 2015 | \$43,482 | \$33,054 | \$1,506 | \$19,761 | \$97,803 |

(A) Includes the recapture agreement for each respective pool.

Edgar Filing: Cherry Hill Mortgage Investment Corp - Form 10-Q

Table of Contents

The tables below present information about the significant unobservable inputs used in the fair value measurement of the Company's Servicing Related Assets classified as Level 3 fair value assets as of the dates indicated (dollars in thousands except per loan figures):

Fair Value Measurements

As of June 30, 2016

| | Fair Value | Valuation Technique | Unobservable Input ^(A) | Range | Weighted Average | |
|-----------|------------|----------------------|-----------------------------------|---------------|------------------|---|
| Pool 1 | \$ 36,465 | Discounted cash flow | Constant prepayment speed | 4.0% - 25.2 % | 13.3 | % |
| | | | Uncollected Payments | 4.2% - 7.0 % | 6.4 | % |
| | | | Discount rate | | 12.3 | % |
| Pool 2 | \$ 29,931 | Discounted cash flow | Constant prepayment speed | 7.6% - 44.7 % | 16.7 | % |
| | | | Uncollected Payments | 9.2% - 13.6 % | 12.4 | % |
| | | | Discount rate | | 16.5 | % |
| Pool 2014 | \$ 1,196 | Discounted cash flow | Constant prepayment speed | 3.9% - 29.0 % | 14.3 | % |
| | | | Uncollected Payments | 6.9% - 8.6 % | 8.2 | % |
| | | | Discount rate | | 11.9 | % |
| MSRs | \$ 29,750 | Discounted cash flow | Constant prepayment speed | 6.2% - 20.6 % | 14.4 | % |
| | | | Uncollected payments | 0.7% - 1.4 % | 1.2 | % |
| | | | Discount rate | | 9.3 | % |
| | | | Annual cost to service, per loan | | \$ 63 | |
| TOTAL | \$ 97,342 | Discounted cash flow | | | | |

As of December 31, 2015

| | Fair Value | Valuation Technique | Unobservable Input ^(A) | Range | Weighted Average | |
|-----------|------------|----------------------|-----------------------------------|----------------|------------------|---|
| Pool 1 | \$ 43,482 | Discounted cash flow | Constant prepayment speed | 4.0% - 19.0 % | 10.5 | % |
| | | | Uncollected Payments | 2.9% - 7.0 % | 6.2 | % |
| | | | Discount rate | | 12.3 | % |
| Pool 2 | \$ 33,054 | Discounted cash flow | Constant prepayment speed | 8.3% - 42.3 % | 14.9 | % |
| | | | Uncollected Payments | 10.4% - 13.9 % | 13.0 | % |
| | | | Discount rate | | 16.7 | % |
| Pool 2014 | \$ 1,506 | Discounted cash flow | Constant prepayment speed | 3.9% - 22.3 % | 11.2 | % |
| | | | Uncollected Payments | 5.9% - 7.1 % | 6.8 | % |
| | | | Discount rate | | 11.9 | % |
| MSRs | \$ 19,761 | Discounted cash flow | Constant prepayment speed | 0.0% - 13.8 % | 9.7 | % |
| | | | Uncollected payments | 1.2% - 3.4 % | 1.6 | % |
| | | | Discount rate | | 8.3 | % |
| | | | Annual cost to service, per loan | | \$ 73 | |
| TOTAL | \$ 97,803 | Discounted cash flow | | | | |

Significant increases (decreases) in any of the inputs in isolation may result in significantly lower (higher) fair value measurement. A change in the assumption used for discount rates may be accompanied by a directionally similar change in the assumption used for the probability of uncollected payments and a directionally opposite change in the assumption used for prepayment rates.

Table of Contents

Fair Value of Financial Instruments

In accordance with ASC 820, the Company is required to disclose the fair value of financial instruments, both assets and liabilities recognized and not recognized in the consolidated balance sheet, for which fair value can be estimated. The following describes the Company's methods for estimating the fair value for financial instruments.

RMBS available for sale securities, Servicing Related Assets, derivative assets and derivative liabilities are recurring fair value measurements; carrying value equals fair value. See discussion of valuation methods and assumptions within the "Fair Value Measurements" section of this footnote.

Cash and cash equivalents and restricted cash have a carrying value which approximates fair value because of the short maturities of these instruments.

The carrying value of repurchase agreements that mature in less than one year generally approximates fair value due to the short maturities. The Company does not hold any repurchase agreements that are considered long-term.

Note 10 — Commitments and Contingencies

The following represents commitments and contingencies of the Company as of June 30, 2016 and December 31, 2015:

Management Agreement

The Company pays the Manager a quarterly management fee, calculated and payable quarterly in arrears, equal to the product of one quarter of the 1.5% Management Fee Annual Rate and the Stockholders' Equity, adjusted as set forth in the Management Agreement as of the end of such fiscal quarter. The Company relies on resources of Freedom Mortgage to provide the Manager with the necessary resources to conduct Company operations. For further discussion regarding the Management Fee, see Note 7.

Legal and Regulatory

From time to time the Company may be subject to potential liability under laws and government regulations and various claims and legal actions arising in the ordinary course of business. Liabilities are established for legal claims when payments associated with the claims become probable and the costs can be reasonably estimated. The actual costs of resolving legal claims may be substantially higher or lower than the amounts established for those claims. Based on information currently available, management is not aware of any legal or regulatory claims that would have a material effect on the Company's consolidated financial statements, and, therefore, no accrual is required as of June 30, 2016 and December 31, 2015.

Commitments to Purchase/Sell RMBS

As of June 30, 2016 and December 31, 2015, the Company held forward TBA purchase and sale commitments, respectively, with counterparties, which are forward RMBS trades, whereby the Company committed to purchasing a pool of securities at a particular interest rate. As of the date of the trade, the mortgage-backed securities underlying the pool that will be delivered to fulfill a TBA trade are not yet designated. The securities are typically "to be announced" 48 hours prior to the established trade settlement date. As of June 30, 2016, the Company was obligated to purchase approximately \$4.4 million of Fannie Mae securities and was not obligated to sell any securities. As of December 31, 2015, the Company was not obligated to buy any securities and was obligated to sell less than \$1,000 of Fannie Mae securities.

Table of Contents

Acknowledgement Agreement

In order to have Ginnie Mae acknowledge our interest in Excess MSR's related to FHA and VA mortgage loans that have been pooled into securities guaranteed by Ginnie Mae, the Company entered into an acknowledgment agreement with Ginnie Mae and Freedom Mortgage. Under that agreement, if Freedom Mortgage fails to make a required payment to the holders of the Ginnie Mae-guaranteed RMBS, the Company would be obligated to make that payment even though the payment may relate to loans for which the Company does not own any Excess MSR's. The Company's failure to make that payment could result in liability to Ginnie Mae for any losses or claims that it suffers as a result.

Management has determined, as of June 30, 2016, the risk of material loss to be remote and thus no liability has been accrued.

Note 11 – Repurchase Agreements

The Company had outstanding approximately \$456.1 million and \$385.6 million of repurchase agreements as of June 30, 2016 and December 31, 2015, respectively. The Company's obligations under these agreements had weighted average remaining maturities of 73 days and 47 days as of June 30, 2016 and December 31, 2015, respectively. RMBS and cash have been pledged as collateral under these repurchase agreements (see Note 4).

The repurchase agreements had the following remaining maturities and weighted average rates as of the dates indicated (dollars in thousands):

Repurchase Agreement Characteristics

As of June 30, 2016

| | Repurchase Agreements | Weighted Average Rate | |
|---------------------------|-----------------------|-----------------------|---|
| Less than one month | \$ 140,677 | 0.73 | % |
| One to three months | 129,968 | 0.71 | % |
| Greater than three months | 185,430 | 0.77 | % |
| Total/Weighted Average | \$ 456,075 | 0.74 | % |

As of December 31, 2015

| | Repurchase Agreements | Weighted Average Rate | |
|---------------------------|-----------------------|-----------------------|---|
| Less than one month | \$ 93,926 | 0.55 | % |
| One to three months | 284,687 | 0.56 | % |
| Greater than three months | 6,947 | 0.52 | % |
| Total/Weighted Average | \$ 385,560 | 0.56 | % |

Note 12 – FHLBI Advances

The Company had no outstanding advances from the FHLBI as of June 30, 2016. The Company had approximately \$62.3 million of FHLBI advances, with a weighted average borrowing rate of 0.54%, as of December 31, 2015. The Company's obligations under those advances had a weighted average remaining maturity of 94 days as of December 31, 2015.

Table of Contents

As a result of Federal Housing Finance Agency (“FHFA”) rulemaking relating to captive insurance companies and their ability to maintain membership in the Federal Home Loan Bank system, the Company’s captive insurance subsidiary is not able to obtain additional advances from the FHLBI as of the date of these financial statements.

The outstanding FHLBI advances had the following remaining maturities and weighted average rates as of December 31, 2015 (dollars in thousands):

Federal Home Loan Bank Advance Characteristics

As of December 31, 2015

| | Federal Home Loan Bank advances | Weighted Average Rate | |
|--|------------------------------------|-----------------------|---|
| Less than one month | \$ 15,000 | 0.44 | % |
| One to three months | - | - | |
| Greater than three months | 47,250 | 0.57 | % |
| Total/Weighted Average Federal Home Loan Bank advances | \$ 62,250 | 0.54 | % |

Note 13 – Notes Payable

At June 30, 2016 and December 31, 2015 the Company had outstanding borrowings of \$22.9 million and \$24.3 million, respectively, on a \$25 million Term Loan. The \$25 million Term Loan was fully drawn as of June 30, 2016. The outstanding borrowings bear interest at a weighted average interest rate of 5.57% per annum and are secured by the pledge of the Company’s existing portfolio of Excess MSR. The principal payments on the borrowings are due monthly, beginning in September 2015, based on a 10-year amortization schedule with a maturity date in April 2020. Prior to September 2015, only interest was payable monthly.

The outstanding long-term borrowings had the following remaining maturities as of the dates indicated (dollars in thousands):

Long-Term Borrowings Repayment Characteristics

As of June 30, 2016

| | 2016 | 2017 | 2018 | 2019 | 2020 | Total |
|-------------------------------------|---------|---------|---------|---------|----------|----------|
| Term Loan | | | | | | |
| Borrowings under Term Loan facility | \$1,007 | \$2,100 | \$2,219 | \$2,346 | \$15,235 | \$22,907 |

As of December 31, 2015

| | 2016 | 2017 | 2018 | 2019 | 2020 | Total |
|-------------------------------------|---------|---------|---------|---------|----------|----------|
| Term Loan | | | | | | |
| Borrowings under Term Loan facility | \$1,958 | \$2,074 | \$2,192 | \$2,317 | \$15,762 | \$24,303 |

Table of Contents

Note 14 – Receivables and Other Assets

The assets comprising “Receivables and other assets” as of June 30, 2016 and December 31, 2015 are summarized in the following table (dollars in thousands):

Receivables and Other Assets

| | June 30, 2016 | December 31, 2015 |
|------------------------------------|---------------|-------------------|
| Excess servicing income receivable | \$ 2,033 | \$ 2,159 |
| Servicing advances | 728 | 787 |
| Interest receivable | 1,497 | 1,497 |
| Federal Home Loan Bank stock | 3,261 | 3,261 |
| Deferred tax receivable | 787 | 203 |
| Other receivables | 1,618 | 1,421 |
| Total other assets | \$ 9,924 | \$ 9,328 |

As a condition to membership in the FHLBI, CHMI Insurance was required to purchase and hold a certain amount of FHLBI stock, which was based, in part, upon the outstanding principal balance of advances from the FHLBI. At June 30, 2016, CHMI Insurance had stock in the FHLBI totaling approximately \$3.3 million, which is included in Other Assets on the consolidated balance sheet. FHLBI stock is considered a non-marketable, long-term investment, is carried at cost and is subject to recoverability testing under applicable accounting standards. This stock can only be redeemed or sold at its par value, and only to the FHLBI. Accordingly, when evaluating FHLBI stock for impairment, the Company considers the ultimate recoverability of the par value rather than recognizing temporary declines in value. As of June 30, 2016, the Company had not recognized an impairment charge related to its FHLBI stock.

Note 15 – Income Taxes

The Company has elected to be taxed as a REIT under Code Sections 856 through 860 beginning with its short taxable year ended December 31, 2013. As a REIT, the Company generally will not be subject to U.S. federal income tax to the extent that it distributes its taxable income to its stockholders. To maintain qualification as a REIT, the Company must distribute at least 90% of its annual REIT taxable income to its stockholders and meet certain other requirements such as assets it may hold, income it may generate and its stockholder composition. It is the Company’s policy to distribute all or substantially all of its REIT taxable income. To the extent there is any undistributed REIT taxable income at the end of a year, the Company can elect to distribute such shortfall within the next year as permitted by the Code.

Effective January 1, 2014, CHMI Solutions has elected to be taxed as a corporation for U.S. federal income tax purposes; prior to this date, CHMI Solutions was a disregarded entity for U.S. federal income tax purposes. CHMI Solutions has jointly elected with the Company, the ultimate beneficial owner of CHMI Solutions, to be treated as a taxable REIT subsidiary (“TRS”) of the Company, and all activities conducted through CHMI Solutions and its wholly owned subsidiary, Aurora, are subject to federal and state income taxes. CHMI Solutions files a consolidated tax return with Aurora Financial Group Inc., its wholly owned subsidiary, and is fully taxed as a U.S. C-Corporation.

The state and local tax jurisdictions for which the Company is subject to tax-filing obligations recognize the Company’s status as a REIT, and therefore, the Company generally does not pay income tax in such jurisdictions. CHMI Solutions and Aurora are subject to U.S. federal, state and local income taxes.

Table of Contents

The components of the Company's income tax expense (benefit) are as follows for the periods indicated below (dollars in thousands):

| | Six Months Ended June 30, | |
|---|---------------------------|----------|
| | 2016 | 2015 |
| Current federal income tax expense | \$ - | \$ - |
| Current state income tax expense | - | - |
| Deferred federal income tax expense (benefit) | (522) | (59) |
| Deferred state income tax expense (benefit) | (58) | (11) |
| Total Income Tax Expense | \$ (580) | \$ (70) |

The following is a reconciliation of the statutory federal rate to the effective rate, for the periods indicated below (dollars in thousands):

| | Six Months Ended June 30, | | | |
|---|---------------------------|---------|----------|---------|
| | 2016 | | 2015 | |
| Computed income tax (benefit) expense at federal rate | \$ (2,610) | 35.0 % | \$ 3,081 | 35.0 % |
| State taxes, net of federal benefit, if applicable | (58) | 0.8 % | 9 | 0.1 % |
| Permanent differences in taxable income from GAAP pre-tax income | - | % | - | % |
| REIT income not subject to tax | 2,088 | (28.0)% | (3,160) | (35.9)% |
| (Benefit from) Provision for Income Taxes/Effective Tax Rate ^(A) | \$(580) | 7.8 % | \$(70) | (0.8)% |

(A) The provision for income taxes is recorded at the TRS level.

The Company's consolidated balance sheets, at June 30, 2016 and December 31, 2015, contain the following current and deferred tax liabilities and assets, which are recorded at the TRS level (dollars in thousands):

| | Six Months Ended June 30, | |
|---|---------------------------|------|
| | 2016 | 2015 |
| Income taxes (payable) receivable | | |
| Federal income taxes (payable) receivable | \$ - | \$ - |
| State and local income taxes (payable) receivable | - | - |
| Income taxes (payable) receivable, net | \$ - | \$ - |

| | June 30, | December 31, 2015 |
|--|----------|-------------------|
| | 2016 | |
| Deferred tax assets (liabilities) | | |
| Deferred tax asset - organizational expenses | \$ 63 | \$ 72 |
| Deferred tax asset - mortgage servicing rights | 414 | (121) |
| Deferred tax asset - net operating loss | 310 | 252 |
| Total net deferred tax assets (liabilities) | \$ 787 | \$ 203 |

CHMI Solutions' federal and state net operating loss carryforwards at June 30, 2016 and December 31, 2015 were approximately \$839,000 and \$693,000, respectively, and are available to offset future taxable income and expire in 2036 and 2035, respectively. Management has determined that it is more likely than not that all of CHMI Solutions' deferred tax assets will be realized in the future. Accordingly, no valuation allowance has been established at June 30, 2016 and December 31, 2015. The deferred tax asset is included in "Receivables and other assets" in the consolidated balance sheets.

Edgar Filing: Cherry Hill Mortgage Investment Corp - Form 10-Q

Based on the Company's evaluation, the Company has concluded that there are no significant uncertain tax positions requiring recognition in the Company's consolidated financial statements. Additionally, there were no amounts accrued for penalties or interest as of or during the periods presented in these consolidated financial statements.

The Company's 2014, 2013 and 2012 federal, state and local income tax returns remain open for examination by the relevant authorities.

40

Table of Contents

Note 16 – Business Combinations

On May 29, 2015 (the acquisition date), CHMI Solutions acquired 100% of the outstanding voting stock of Aurora. The results of Aurora's operations have been included in the consolidated financial statements since that date. Aurora is a licensed mortgage origination and servicing company. Aurora is a seller/servicer for Fannie Mae and Freddie Mac.

Aurora's pipeline of mortgage loans was not closed out as of the acquisition date. As a result, CHMI Solutions agreed to maintain Aurora's existing warehouse facility pending funding and disposition of the mortgage loans in the pipeline which occurred prior to the end of the third quarter of 2015. All proceeds of the disposition of the mortgage loans, net of all costs and expenses related hereto, including the costs of the warehouse facility, were for the benefit of Aurora's former owners. The warehouse facility expired on August 31, 2015.

The acquisition-date fair value of the consideration transferred totaled approximately \$3.9 million, which consisted of cash. Twenty percent (20%) of the consideration was deposited in an escrow account to provide a source of funds for the seller's indemnification obligations. Transaction-related costs of approximately \$95,400 were expensed as incurred, and are included in "General and administrative expenses" on the consolidated income statement.

In the Aurora acquisition agreement, the parties agreed to fix the valuation of the MSR portfolio, as a percentage of par, based on third party appraisals obtained at the end of January 2015. The agreement also provided that the UPB of the portfolio would be fixed 90 days after the agreement was signed. Due to the increase in interest rates between January and the closing date at the end of May 2015, the value of the MSR portfolio increased. In addition, the UPB of the portfolio declined between the end of April and the closing date in May. Valuation adjustments for intangible assets and loan loss reserves also contributed to bargain purchase in the amount of approximately \$734,000.

Table of Contents

The following table summarizes the final fair values of the assets acquired and liabilities assumed at the acquisition date (dollars in thousands):

| | |
|--|---|
| | Preliminary Fair value of consideration transferred |
| Cash | \$ 80 |
| Mortgage receivables | 2,772 |
| Servicing escrow advances | 410 |
| Capital leases | 46 |
| Deposits held and prepaid items | 28 |
| License approvals | 120 |
| MSRs | 7,069 |
| Total identifiable assets acquired | \$ 10,525 |
| | |
| Current liabilities | 1,643 |
| Settlement liability | 260 |
| Assumed debt | 3,969 |
| Total liabilities assumed | \$ 5,872 |
| | |
| Net identifiable assets acquired | 4,653 |
| Cash consideration transferred | (3,919) |
| Gain on bargain purchase | \$ 734 |
| Deferred tax liability - bargain purchase | (285) |
| Realized gain (loss) on acquired assets, net | \$ 449 |

The amounts of revenue and earnings of Aurora included in the Company's consolidated income statement for the three and six month periods ended June 30, 2016 and June 30, 2015 are as follows (dollars in thousands):

| | Revenue and earnings included in the consolidated income statement | | | |
|----------|--|--------|---------------------------|--------|
| | Three Months Ended June 30, | | Six Months Ended June 30, | |
| | 2016 | 2015 | 2016 | 2015 |
| Revenue | \$ 1,574 | \$ 156 | \$ 3,069 | \$ 156 |
| Earnings | (2,055) | 213 | (2,633) | 213 |

Table of Contents

The following represents the pro forma consolidated income statement as if Aurora had been included in the consolidated results of the Company for the three and six month periods ended June 30, 2015 and for the three and six month periods ending June 30, 2016. The unaudited pro forma information is intended for informational purposes only and is not necessarily indicative of the Company's future operating results or operating results that would have occurred had the Aurora acquisition been completed at the beginning of 2015. No assumptions have been applied to the pro forma results of operations regarding possible revenue enhancements, expense efficiencies or asset dispositions (dollars in thousands):

Pro Forma Consolidated Income Statement

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|-----------------------------|-----------|---------------------------|-----------|
| | 2016 | 2015 | 2016 | 2015 |
| Revenue | \$ 1,806 | \$ 12,554 | \$ (4,448) | \$ 11,548 |
| Earnings (loss) | \$ 283 | \$ 11,345 | \$ (6,780) | \$ 8,963 |
| Earnings (Loss) Per Share of Common Stock | | | | |
| Basic | \$ 0.04 | \$ 1.51 | \$ (0.90) | \$ 1.19 |
| Diluted | \$ 0.04 | \$ 1.51 | \$ (0.90) | \$ 1.19 |
| Weighted Average Number of Shares of Common Stock | | | | |
| Outstanding | | | | |
| Basic | 7,509,543 | 7,509,543 | 7,509,543 | 7,509,543 |
| Diluted | 7,520,616 | 7,509,543 | 7,519,827 | 7,509,543 |

These amounts have been calculated after applying the Company's accounting policies and adjusting the results of Aurora primarily to reflect the exclusion of the bargain purchase and transaction costs together with the consequential tax effects.

Note 17 – Subsequent Events

Events subsequent to June 30, 2016, were evaluated and no additional events were identified requiring further disclosure in these interim consolidated financial statements.

Table of Contents

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

The following discussion and analysis should be read in conjunction with our interim consolidated financial statements and the accompanying notes included in "Item 1. Consolidated Financial Statements" of this Quarterly Report on Form 10-Q.

All currency amounts are presented in thousands, except per share amounts or otherwise noted.

General

Cherry Hill Mortgage Investment Corporation (the "Company", "we", "our" or "us") is a public residential real estate finance company focused on acquiring, investing in and managing residential mortgage assets in the United States. We were incorporated in Maryland on October 31, 2012, and we commenced operations on or about October 9, 2013 following the completion of our initial public offering ("IPO") and a concurrent private placement. Our common stock is listed and traded on the New York Stock Exchange under the symbol "CHMI." We are externally managed by Cherry Hill Mortgage Management, LLC (the "Manager"), an SEC-registered investment adviser and an affiliate of Freedom Mortgage Corporation, or Freedom Mortgage ("Freedom Mortgage").

Our principal objective is to generate attractive current yields and risk-adjusted total returns for our stockholders over the long term, primarily through dividend distributions and secondarily through capital appreciation. We intend to attain this objective by selectively constructing and actively managing a portfolio of Servicing Related Assets and RMBS, and subject to market conditions, prime mortgage loans and other cashflowing residential mortgage assets.

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

We elected to be treated as a real estate investment trust ("REIT") under the Internal Revenue Code of 1986, as amended (the "Code") commencing with our short taxable year ended December 31, 2013. We operate so as to continue to qualify to be taxed as a REIT. Our asset acquisition strategy focuses on acquiring a diversified portfolio of residential mortgage assets that balances the risk and reward opportunities our Manager observes in the marketplace. Since our IPO we have been, and we currently intend to continue as, a servicing-centric REIT with a substantial portion of our equity capital allocated to Servicing Related Assets. Prior to our acquisition of Aurora Financial Group, Inc. ("Aurora") in May 2015, these assets were limited to Excess MSR. The acquisition of Aurora included a portfolio of Fannie Mae and Freddie Mac MSR with an aggregate unpaid principal balance ("UPB") of approximately \$718.4 million as of May 29, 2015. Aurora subsequently acquired three additional portfolios of Fannie Mae and Freddie Mac MSR with an aggregate UPB of approximately \$3.0 billion as of June 30, 2016.

Aurora has the licenses necessary to service mortgage loans on a nationwide basis and is an approved Fannie Mae and Freddie Mac servicer. Although we continue to discuss the conditions under which Ginnie Mae will approve the change in control, it is not clear at this time that such conditions will be resolved. No assurance can be given that Ginnie Mae will approve the change of control.

We invest in whole pool Agency RMBS, primarily those backed by 30-, 20- and 15-year fixed rate mortgages ("FRMs") that offer, what we believe to be, favorable prepayment and duration characteristics. We finance our RMBS with leverage, the amount of which will vary from time to time depending on the particular characteristics of our portfolio, the availability of financing and market conditions. We do not have a targeted leverage ratio for our RMBS. Our borrowings for RMBS consist of short-term borrowings under master repurchase agreements. During the second half of 2015, we also used advances from the FHLBI to finance our Agency RMBS. We have also invested in Agency CMOs consisting of interest-only securities as well as credit risk transfer securities issued by Fannie Mae and Freddie

Mac.

44

Table of Contents

In January 2016, the FHFA released a final rule that amends regulations governing membership in the Federal Home Loan Bank (“FHLB”) system. The final rule, which largely adopts the provisions included in the proposed rule issued by the FHFA in September 2014, prevents captive insurance companies from obtaining and maintaining membership in the FHLB system and, consequently, accessing low-cost funding through the FHLB system. The final rule became effective on February 19, 2016. Since CHMI Insurance, our captive insurance subsidiary, became a member of the FHLBI after publication of the proposed rule, CHMI Insurance is required to terminate its membership in the FHLBI within one year following the effective date of the final rule. Under the final rule, CHMI Insurance has until the end of the one-year transition period (or until the date of termination, if earlier) to repay its existing advances to the FHLBI. In addition, the final rule prohibits CHMI Insurance from taking new advances from the FHLBI or renewing existing advances.

Subject to maintaining our qualification as a REIT, we utilize derivative financial instruments (or hedging instruments) to hedge our exposure to potential interest rate mismatches between the interest we earn on our assets and our borrowing costs caused by fluctuations in short-term interest rates. In utilizing leverage and interest rate hedges, our objectives include, where desirable, locking in, on a long-term basis, a spread between the yield on our assets and the cost of our financing in an effort to improve returns to our stockholders.

We also operate our business in a manner that permits us to maintain our exclusion from registration as an investment company under the Investment Company Act.

Factors Impacting our Operating Results

Our income is generated primarily by the net spread between the income we earn on our assets and the cost of our financing and hedging activities as well as the amortization of any purchase premiums or the accretion of discounts. Our net income includes the actual interest payments we receive on our Excess MSR and RMBS, the net servicing fee we receive on our MSR and the accretion/amortization of any purchase discounts/premiums. Changes in various factors such as market interest rates, prepayment speeds, estimated future cash flows, servicing costs and credit quality could affect the amount of premium to be amortized or discount to be accreted into interest income for a given period. Market interest rates and prepayment rates vary according to the type of investment, conditions in the financial markets, competition and other factors, none of which can be predicted with any certainty. The Company’s operating results may also be affected by credit losses in excess of initial anticipations or unanticipated credit events experienced by borrowers whose mortgage loans underly the MSR held by the Company.

Table of Contents

Set forth below is the positive gross spread between the yield on our invested assets and our costs of funding those assets at the end of the periods indicated below:

Average Net Yield Spread at Period End

| Quarter Ended | Average Asset Yield | Average Cost of Funds | Average Net Interest Rate Spread |
|--------------------|------------------------|--------------------------|-------------------------------------|
| June 30, 2016 | 3.39 % | 1.62 % | 1.77 % |
| March 31, 2016 | 3.56 % | 1.70 % | 1.86 % |
| December 31, 2015 | 3.60 % | 1.89 % | 1.71 % |
| September 30, 2015 | 3.01 % | 1.93 % | 1.08 % |
| June 30, 2015 | 3.63 % | 1.96 % | 1.67 % |
| March 31, 2015 | 3.83 % | 1.92 % | 1.91 % |
| December 31, 2014 | 3.70 % | 1.99 % | 1.71 % |
| September 30, 2014 | 3.61 % | 2.00 % | 1.61 % |
| June 30, 2014 | 3.62 % | 2.00 % | 1.62 % |
| March 31, 2014 | 3.56 % | 2.10 % | 1.46 % |
| December 31, 2013 | 3.48 % | 2.10 % | 1.38 % |

The Average Cost of Funds also includes the benefits of related swaps.

Changes in the Market Value of Our Assets

We hold our Servicing Related Assets as long-term investments. Our Excess MSR and MSR are carried at their fair value with changes in their fair value recorded in other income or loss in our consolidated statements of income (loss). Those values may be affected by events or headlines that are outside of our control, such as Brexit, other events impacting the U.S. or global economy generally or the U.S. residential market specifically, and events or headlines impacting the parties with which we do business. See “Item 1A. Risk Factors – Risks Related to our Business” in our Annual Report on Form 10-K for the year ended December 31, 2015 for a discussion of certain risks affecting our business that could materially and adversely affect the fair value of our Servicing Related Assets.

Our RMBS are carried at their fair value, as available-for-sale in accordance with ASC 320, Accounting for Certain Investments in Debt or Equity Securities, with changes in fair value recorded through accumulated other comprehensive income or loss, a component of stockholders’ equity. As a result, we do not expect that changes in the market value of our RMBS will normally impact our operating results. However, at least on a quarterly basis, we assess both our ability and intent to continue to hold our RMBS as long-term investments. As part of this process, we monitor our RMBS for other-than-temporary impairment. A change in our ability and/or intent to continue to hold any of our RMBS could result in our recognizing an impairment charge or realizing losses while holding these assets.

Impact of Changes in Market Interest Rates on Servicing Related Assets

Our Servicing Related Assets are subject to interest rate risk. Generally, in a declining interest rate environment, prepayment speeds tend to increase. Conversely, in an increasing interest rate environment, prepayment speeds tend to decrease. Prepayment speed is the measurement of how quickly borrowers pay down the unpaid principal balance (“UPB”) of their loans or how quickly loans are otherwise liquidated or charged off. Prepayment speeds significantly affect the value of the Servicing Related Assets. The price we pay to acquire Servicing Related Assets is based on, among other things, our projection of the cash flows from the related pool of mortgage loans. Our expectation of prepayment speeds is a significant assumption underlying those cash flow projections. If prepayment speeds are significantly greater than expected, the carrying value of the Servicing Related Assets could exceed their estimated fair value. If the fair value of the Servicing Related Assets decreases, we would be required to record a non-cash

charge, which would have a negative impact on our financial results. Furthermore, a significant increase in prepayment speeds could materially reduce the ultimate cash flows we receive from the Servicing Related Assets and we could ultimately receive substantially less than what we paid for such assets. We do not utilize derivatives to hedge against changes in the fair value of the Servicing Related Assets. As a result, our balance sheet, results of operations and cash flows are susceptible to significant volatility due to changes in the fair value of, or cash flows from, the Servicing Related Assets as interest rates change.

Table of Contents

Voluntary and involuntary prepayment rates may be affected by a number of factors including, but not limited to, the availability of mortgage credit, the relative economic vitality of the area in which the related properties are located, the servicing of the mortgage loans, possible changes in tax laws, other opportunities for investment, homeowner mobility and other economic, social, geographic, demographic and legal factors, none of which can be predicted with any certainty.

We have attempted to reduce the exposure of our Excess MSR to voluntary prepayments through the structuring of our investments. For example, we have entered into recapture agreements whereby we will receive a new Excess MSR with respect to a loan that was originated by Freedom Mortgage and used to repay a loan underlying an Excess MSR that we previously acquired from Freedom Mortgage. In lieu of receiving an Excess MSR with respect to the loan used to repay a prior loan, Freedom Mortgage may supply a similar Excess MSR. To the extent Freedom Mortgage is unable to achieve anticipated recapture rates, we may not benefit from the terms of the recapture agreements we have entered into, and the value of our Excess MSRs could decline. For a summary of the recapture terms related to our existing investments in Excess MSRs, see “—Our Portfolio—Excess MSRs.”

In June 2016, Aurora entered into a joint marketing recapture agreement with Freedom Mortgage. Pursuant to this agreement, Freedom Mortgage will attempt to refinance certain mortgage loans underlying Aurora’s servicing MSR portfolio as directed by Aurora. If a loan is refinanced, Aurora will pay Freedom Mortgage a fee for its origination services. Freedom will be entitled to sell the loan for its own benefit and will transfer the related MSR to Aurora. The agreement has an initial term of one year, subject to automatic renewals of one year each and subject to termination by either party upon 60 days prior notice. All new loans must qualify for sale to Fannie Mae or Freddie Mac and meet other conditions set forth in the agreement.

Impact of Interest Rates on Recapture Activity

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

Impact of Changes in Market Interest Rates on Assets Other than Servicing Related Assets

With respect to our business operations, increases in interest rates, in general, may over time cause:

- the interest expense associated with our borrowings to increase;
- the value of our assets to fluctuate;
- the coupons on any adjustable-rate and hybrid RMBS we may own to reset, although on a delayed basis, to higher interest rates;
- prepayments on our RMBS to slow, thereby slowing the amortization of our purchase premiums and the accretion of our purchase discounts; and
- an increase in the value of any interest rate swap agreements we may enter into as part of our hedging strategy.

Table of Contents

Conversely, decreases in interest rates, in general, may over time cause:

• prepayments on our RMBS to increase, thereby accelerating the amortization of our purchase premiums and the accretion of our purchase discounts;

• the interest expense associated with our borrowings to decrease;

• the value of our assets to fluctuate;

• to the extent we enter into interest rate swap agreements as part of our hedging strategy, the value of these agreements to decrease; and

• coupons on any adjustable-rate and hybrid RMBS assets we may own to reset, although on a delayed basis, to lower interest rates.

Prepayment speed also affects the value of our RMBS and any prime mortgage loans we may acquire. When we acquire RMBS, we anticipate that the underlying mortgage loans will prepay at a projected rate generating an expected yield. If we purchase assets at a premium to par value, when borrowers prepay their mortgage loans faster than expected, the corresponding prepayments on our RMBS may reduce the expected yield on such securities because we will have to amortize the related premium on an accelerated basis. Conversely, if we purchase assets at a discount to par value, when borrowers prepay their mortgage loans slower than expected, the decrease in corresponding prepayments on our RMBS may reduce the expected yield on such securities because we will not be able to accrete the related discount as quickly as originally anticipated. Based on our experience, we expect that over time any adjustable-rate and hybrid RMBS and mortgage loans that we own will experience higher prepayment rates than do fixed-rate RMBS and mortgage loans, as we believe that homeowners with adjustable-rate and hybrid mortgage loans exhibit more rapid housing turnover levels or refinancing activity compared to fixed-rate borrowers. In addition, we anticipate that prepayments on adjustable-rate mortgage loans accelerate significantly as the coupon reset date approaches.

Effects of Spreads on our Assets

The spread between the yield on our assets and our funding costs affects the performance of our business. Wider spreads imply greater income on new asset purchases but may have a negative impact on our stated book value. Wider spreads may also negatively impact asset prices. In an environment where spreads are widening, counterparties may require additional collateral to secure borrowings which may require us to reduce leverage by selling assets. Conversely, tighter spreads imply lower income on new asset purchases but may have a positive impact on stated book value of our existing assets. In this case we may be able to reduce the amount of collateral required to secure borrowings.

Credit Risk

We are subject to varying degrees of credit risk in connection with our assets. Although we expect relatively low credit risk with respect to our portfolios of Excess MSR and Agency RMBS, we are subject to the credit risk of the borrowers under the loans for which we hold MSR. Through loan level due diligence we attempt to mitigate this risk by seeking to acquire high quality assets at appropriate prices given anticipated and unanticipated losses. We also conduct ongoing monitoring of acquired assets. Nevertheless, unanticipated credit losses could occur which could adversely impact our operating results.

Table of Contents

Critical Accounting Policies and Use of Estimates

Our financial statements are prepared in accordance with U.S. GAAP, which requires the use of estimates that involve the exercise of judgment and the use of assumptions as to future uncertainties. In accordance with SEC guidance, the following discussion addresses the accounting policies that we apply with respect to our initial and continuing operations. Our most critical accounting policies involve decisions and assessments that could affect our reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, as well as our reported amounts of revenues and expenses. We believe that all of the decisions and assessments upon which our financial statements are based were reasonable at the time made and based upon information available to us at that time. Our critical accounting policies and accounting estimates will be expanded over time as we diversify our portfolio. The material accounting policies and estimates that we expect to be most critical to an investor's understanding of our financial results and condition and require complex management judgment are discussed below.

Classification of Investment Securities and Impairment of Financial Instruments

ASC 320-10, Debt and Equity Securities, requires that at the time of purchase, we designate a security as either trading, available-for-sale, or held-to-maturity depending on our ability and intent to hold such security to maturity. Securities available-for-sale will be reported at fair value, while securities held-to-maturity will be reported at amortized cost. Although we may hold most of our securities until maturity, we may, from time to time, sell any of our securities as part of our overall management of our asset portfolio. Accordingly, we will elect to classify substantially all of our securities as available-for-sale. All assets classified as available-for-sale will be reported at fair value, with unrealized gains and losses excluded from earnings and reported as a separate component of stockholders' equity to the extent they are not other than temporarily impaired. See "Valuation of Financial Instruments."

When the estimated fair value of a security is less than amortized cost, we consider whether there is an other-than-temporary impairment, or OTTI, in the value of the security. An impairment is deemed an OTTI if (i) we intend to sell the security, (ii) it is more likely than not that we will be required to sell the security before recovering our cost basis, or (iii) we do not expect to recover the entire amortized cost basis of the security even if we do not intend to sell the security or believe it is more likely than not that we will be required to sell the security before recovering our cost basis. If the impairment is deemed to be an OTTI, the resulting accounting treatment depends on the factors causing the OTTI. If the OTTI has resulted from (i) our intention to sell the security, or (ii) our judgment that it is more likely than not that we will be required to sell the security before recovering our cost basis, an impairment loss is recognized in current earnings equal to the difference between our amortized cost basis and fair value. Whereas, if the OTTI has resulted from our conclusion that we will not recover our cost basis even if we do not intend to sell the security, the credit loss portion of the impairment is recorded in current earnings and the portion of the loss related to other factors, such as changes in interest rates, continues to be recognized in accumulated other comprehensive income. Determining whether there is an OTTI may require management to exercise significant judgment and make significant assumptions, including, but not limited to, estimated cash flows, estimated prepayments, loss assumptions, and assumptions regarding changes in interest rates. As a result, actual impairment losses could differ from reported amounts. Such judgments and assumptions are based upon a number of factors, including (i) credit of the issuer or the borrower, (ii) credit rating of the security, (iii) key terms of the security, (iv) performance of the loan or underlying loans, including debt service coverage and loan-to-value ratios, (v) the value of the collateral for the loan or underlying loans, (vi) the effect of local, industry, and broader economic factors, and (vii) the historical and anticipated trends in defaults and loss severities for similar securities.

Valuation of Financial Instruments

ASC 820, Fair Value Measurements and Disclosure, ("ASC 820") defines fair value as the price that would be received upon the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC 820 clarifies that fair value should be based on the assumptions market participants would

use when pricing an asset or liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. The fair value hierarchy gives the highest priority to quoted prices available in active markets (i.e., observable inputs) and the lowest priority to data lacking transparency (i.e., unobservable inputs). Additionally, ASC 820 requires an entity to consider all aspects of nonperformance risk, including the entity's own credit standing, when measuring fair value of a liability.

Table of Contents

ASC 820 establishes a three level hierarchy to be used when measuring and disclosing fair value. Following is a description of the three levels:

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

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

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

The level in the fair value hierarchy within which a fair value measurement in its entirety falls is based on the lowest level input that is significant to the fair value measurement in its entirety. We have used Level 2 for our RMBS and for our derivative assets and liabilities and Level 3 for our Servicing Related Assets.

When available, we use quoted market prices to determine the fair value of an asset or liability. If quoted market prices are not available, we will consult independent pricing services or third party broker quotes, provided that there is no ongoing material event that affects the issuer of the securities being valued or the market. If there is such an ongoing event, or if quoted market prices are not available, we will determine the fair value of the securities using valuation techniques that use, when possible, current market-based or independently-sourced market parameters, such as interest rates.

Investments in Excess MSR

Upon acquisition, we elect to record our investments in Excess MSR at fair value. We make this election in order to provide the users of the financial statements with better information regarding the effects of prepayment risk and other market factors on the Excess MSR. Under this election, we will record a valuation adjustment on our Excess MSR investments on a quarterly basis to recognize the changes in fair value in net income as described in "Revenue Recognition on Investments in Excess MSR" below.

The fair values of Excess MSR are determined by projecting net servicing cash flows, which are then discounted to estimate the fair value. The fair values of Excess MSR are impacted by a variety of factors, including prepayment assumptions, discount rates, delinquency rates, contractually specified servicing fees, and underlying portfolio characteristics. The underlying assumptions and estimated values are corroborated by values received from independent third parties. Changes in fair value of our Excess MSR will be reported in other income or loss in our consolidated statements of income (loss). For additional information on our fair value methodology, see "Item 1. Consolidated Financial Statements — Note 9. Fair Value."

Revenue Recognition on Investments in Excess MSR

Investments in Excess MSR are aggregated into pools as applicable and each pool of Excess MSR is accounted for in the aggregate. Income for Excess MSR is accreted into income on an effective yield or "interest" method, based upon the expected excess servicing amount through the expected life of the underlying mortgages. Changes to expected cash flows result in a cumulative retrospective adjustment, which will be recorded in the period in which the change in expected cash flows occurs. Under the retrospective method, the income recognized for a reporting period is

measured as the difference between the amortized cost basis at the end of the period and the amortized cost basis at the beginning of the period, plus any cash received during the period. The amortized cost basis is calculated as the present value of estimated future cash flows using an effective yield, which is the yield that equates all past actual and current estimated future cash flows to the initial investment. In addition, our policy is to recognize income only on Excess MSR in existing eligible underlying mortgages. The difference between the fair value of Excess MSR and their amortized cost basis are recorded as “Unrealized gain (loss) on investments in excess mortgage servicing rights.” Fair value is generally determined by discounting the expected future cash flows using discount rates that incorporate the market risks and liquidity premium specific to the Excess MSR, and therefore may differ from their effective yields.

Investments in MSRs

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

Revenue Recognition on Investments in MSRs

Mortgage servicing fee income represents revenue earned for servicing mortgage loans. The servicing fees are based on a contractual percentage of the outstanding principal balance and recognized as revenue as the related mortgage payments are collected. Corresponding costs to service are charged to expense as incurred. Approximately \$728,000 in reimbursable servicing advances was receivable at June 30, 2016, and has been classified within “Receivables and other assets” on the consolidated balance sheet.

Servicing fee income received and servicing expenses incurred are reported on the consolidated statements of comprehensive income. The change in fair value from period to period is recorded on the income statement as “Unrealized gain (loss) on investments in MSR.” Fair value is generally determined by discounting the expected future cash flows using discount rates that incorporate the market risks and liquidity premium specific to the MSR and, therefore, may differ from their effective yields.

Table of Contents

Revenue Recognition on Securities

Interest income from coupon payments is accrued based on the outstanding principal amount of the RMBS and their contractual terms. Premiums and discounts associated with the purchase of the RMBS are amortized into interest income over the projected lives of the securities using the interest method. Our policy for estimating prepayment speeds for calculating the effective yield is to evaluate historical performance, consensus prepayment speeds, and current market conditions. Adjustments are made for actual prepayment activity.

Repurchase Transactions

We finance the acquisition of our RMBS for our portfolio through repurchase transactions under master repurchase agreements. Repurchase transactions are treated as collateralized financing transactions and are carried at their contractual amounts as specified in the respective transactions. Accrued interest payable is included in “Accrued expenses and other liabilities” on the consolidated balance sheet. Securities financed through repurchase transactions remain on our consolidated balance sheet as an asset and cash received from the purchaser is recorded on our consolidated balance sheet as a liability. Interest paid in accordance with repurchase transactions is recorded in interest expense.

Income Taxes

Our financial results are generally not expected to reflect provisions for current or deferred income taxes. We believe that we operate in a manner that allows us to qualify for taxation as a REIT. As a result of our expected REIT qualification, we do not generally expect to pay federal corporate level taxes, although CHMI Solutions, Inc. (formerly Cherry Hill TRS, LLC) and any other taxable REIT subsidiaries we form in the future will be required to pay federal corporate level taxes on their income. Many of the REIT requirements, however, are highly technical and complex. If we were to fail to meet the REIT requirements, we would be subject to federal, state and local income taxes.

Emerging Growth Company Status

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

Table of Contents

Results of Operations

Presented below is a comparison of the periods indicated (dollars in thousands):

Results of Operations

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|-----------------------------|-----------|---------------------------|-----------|
| | 2016 | 2015 | 2016 | 2015 |
| Income | | | | |
| Interest income | \$ 7,135 | \$ 8,088 | \$ 12,323 | \$ 13,915 |
| Interest expense | 1,885 | 1,346 | 3,542 | 2,581 |
| Net Interest Income | 5,250 | 6,742 | 8,781 | 11,334 |
| Servicing fee income | 1,574 | 156 | 3,069 | 156 |
| Servicing costs | 501 | 94 | 903 | 94 |
| Net servicing income | 1,073 | 62 | 2,166 | 62 |
| Other Income (Loss) | | | | |
| Realize gain (loss) on RMBS, net | 235 | (115) | 555 | 192 |
| Realized gain (loss) on derivatives, net | (299) | (52) | (1,760) | (1,294) |
| Realized gain (loss) on acquired assets, net | - | 174 | - | 174 |
| Unrealized gain (loss) on derivatives, net | (1,228) | 2,835 | (6,426) | 293 |
| Unrealized gain (loss) on Excess MSR's | (149) | 2,938 | (2,456) | 821 |
| Unrealized gain (loss) on investments in MSR's | (3,076) | (22) | (5,308) | (22) |
| Total Income | 1,806 | 12,562 | (4,448) | 11,560 |
| Expenses | | | | |
| General and administrative expense | 822 | 634 | 1,630 | 1,376 |
| Management fee to affiliate | 690 | 690 | 1,380 | 1,380 |
| Total Expenses | 1,512 | 1,324 | 3,010 | 2,756 |
| Income (Loss) Before Income Taxes | 294 | 11,238 | (7,458) | 8,804 |
| (Benefit from) provision for corporate business taxes | 10 | (70) | (580) | (70) |
| Net Income (Loss) | 284 | 11,308 | (6,878) | 8,874 |
| Net income allocated to LTIP - OP Units | (1) | (103) | 98 | (81) |
| Net income (loss) Applicable to Common Stockholders | \$ 283 | \$ 11,205 | \$ (6,780) | \$ 8,793 |

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

Segment Summary Data

for

| | Three Months Ended June 30, 2016 | | | |
|----------------------|----------------------------------|---------|-----------|---------|
| | Servicing Related | | | |
| | Assets | RMBS | All Other | Total |
| Interest income | \$3,085 | \$4,050 | \$ - | \$7,135 |
| Interest expense | 333 | 1,552 | - | 1,885 |
| Net interest income | 2,752 | 2,498 | - | 5,250 |
| Servicing fee income | 1,574 | - | - | 1,574 |
| Servicing costs | 501 | - | - | 501 |
| Net servicing income | 1,073 | - | - | 1,073 |

Edgar Filing: Cherry Hill Mortgage Investment Corp - Form 10-Q

| | | | | |
|--------------------------|---------|---------|-----------|---------|
| Other income | (3,225) | (1,292) | - | (4,517) |
| Other operating expenses | - | - | 1,512 | 1,512 |
| Corporate business taxes | 10 | - | - | 10 |
| Net income (loss) | \$590 | \$1,206 | \$(1,512) | \$284 |

52

Table of Contents

Three Months Ended June 30, 2015

Servicing

Related

| | Assets | RMBS | All Other | Total |
|--------------------------|---------|---------|-------------|----------|
| Interest income | \$4,935 | \$3,153 | \$ - | \$8,088 |
| Interest expense | 19 | 1,327 | - | 1,346 |
| Net interest income | 4,916 | 1,826 | - | 6,742 |
| Servicing fee income | 156 | - | - | 156 |
| Servicing costs | 94 | - | - | 94 |
| Net servicing income | 62 | - | - | 62 |
| Other income | 3,090 | 2,668 | - | 5,758 |
| Other operating expenses | - | - | 1,324 | 1,324 |
| Corporate business taxes | (70) | - | - | (70) |
| Net income (loss) | \$8,138 | \$4,494 | \$ (1,324) | \$11,308 |

Six Months Ended June 30, 2016

Servicing

Related

| | Assets | RMBS | All Other | Total |
|--------------------------|-----------|-----------|------------|------------|
| Interest income | \$4,529 | \$7,794 | \$ - | \$12,323 |
| Interest expense | 673 | 2,869 | - | 3,542 |
| Net interest income | 3,856 | 4,925 | - | 8,781 |
| Servicing fee income | 3,069 | - | - | 3,069 |
| Servicing costs | 903 | - | - | 903 |
| Net servicing income | 2,166 | - | - | 2,166 |
| Other income | (7,764) | (7,631) | - | (15,395) |
| Other operating expenses | - | - | 3,010 | 3,010 |
| Corporate business taxes | (580) | - | - | (580) |
| Net income (loss) | \$(1,162) | \$(2,706) | \$(3,010) | \$(6,878) |

Six Months Ended June 30, 2015

Servicing

Related

| | Assets | RMBS | All Other | Total |
|--------------------------|---------|---------|------------|----------|
| Interest income | \$7,510 | \$6,405 | \$ - | \$13,915 |
| Interest expense | 19 | 2,562 | - | 2,581 |
| Net interest income | 7,491 | 3,843 | - | 11,334 |
| Servicing fee income | 156 | - | - | 156 |
| Servicing costs | 94 | - | - | 94 |
| Net servicing income | 62 | - | - | 62 |
| Other income | 973 | (809) | - | 164 |
| Other operating expenses | - | - | 2,756 | 2,756 |
| Corporate business taxes | (70) | - | - | (70) |
| Net income (loss) | \$8,596 | \$3,034 | \$(2,756) | \$8,874 |

Interest Income

Interest income for the three month period ended June 30, 2016, was \$7.1 million as compared to \$8.1 million for the three month period ended June 30, 2015. Interest income for the six month period ended June 30, 2016, was \$12.3 million as compared to \$13.9 million for the six month period ended June 30, 2015. For the three month period ended

June 30, 2016, the \$953,000 decrease was driven primarily by a decrease of approximately \$1.9 million related to the Excess MSR's which was primarily a function of the application of the retrospective method which looks back using the current, rather than historical, estimates of prepayments to measure amortization of the Excess MSR's. The decrease in interest income was also offset by an increase of approximately \$897,000 related to RMBS.

Table of Contents

Interest Expense

Interest expense for the three month period ended June 30, 2016, was \$1.9 million as compared to \$1.3 million for the three month period ended June 30, 2015. Interest expense for the six month period ended June 30, 2016, was \$3.5 million as compared to \$2.6 million for the six month period ended June 30, 2015. For the three month period ended June 30, 2016, the \$539,000 increase was comprised of an increase of \$314,000 from Servicing Related Assets and an increase of \$225,000 from RMBS. The increase associated with the Servicing Related Assets was primarily due to borrowings on our \$25 million Term Loan and the increase associated with the RMBS was primarily due to an overall increase in repurchase rates which were in part offset by swap hedges.

Change in Fair Value of Investments in Servicing Related Assets

The fair value of our investments in Servicing Related Assets decreased by approximately \$3.2 million and \$7.8 million for the three and six month periods ended June 30, 2016, primarily due to fluctuations in the modeled prepayment speeds. The fair values of Excess MSR Pool 1, Excess MSR Pool 2, Excess MSR Pool 2014 and the MSRs decreased by approximately \$373,000, increased by approximately \$236,000, decreased by approximately \$13,000 and decreased by approximately \$3.1 million, respectively, for the three month period ended June 30, 2016. The fair values of Excess MSR Pool 1, Excess MSR Pool 2, Excess MSR Pool 2014 and the MSRs decreased by approximately \$1.7 million, decreased by approximately \$675,000, decreased by approximately \$65,000 and decreased by approximately \$5.3 million, respectively, for the six month period ended June 30, 2016.

Change in Fair Value of Derivatives

The fair value of derivatives for the three month period ended June 30, 2016 decreased by \$1.2 million due to a decrease in interest rates during the period. The fair value of derivatives for the six month period ended June 30, 2016 decreased by \$6.4 million due to a decrease in interest rates during the period.

General and Administrative Expense

General and administrative expense for the three and six month periods ended June 30, 2016, increased by approximately \$188,000 and \$254,000, respectively, as compared to the three and six month periods ended June 30, 2015 primarily due to costs associated with CHMI Solutions and CHMI Insurance.

Management Fees to Affiliate

Management fees for the three and six month periods ended June 30, 2016 remained unchanged as compared to the three and six month periods ended June 30, 2015.

Net Income Allocated to LTIP - OP Units

Net income allocated to LTIP—OP Units, which are owned by directors and officers of the Company and by certain employees of Freedom Mortgage who provide services to us through the Manager, represents approximately 1.9% of net income as of June 30, 2016.

Table of Contents

Accumulated Other Comprehensive Income (Loss)

For the period indicated below, our accumulated other comprehensive income (loss) changed due to the following factors (dollars in thousands):

Accumulated Other Comprehensive Income (Loss)

| | Three Months Ended June 30, 2016 |
|---|-------------------------------------|
| Accumulated other comprehensive gain (loss), March 31, 2016 | \$ 7,135 |
| Other comprehensive income (loss) | 4,495 |
| Accumulated other comprehensive gain (loss), June 30, 2016 | \$ 11,630 |

| | Six Months Ended June 30, 2016 |
|--|-----------------------------------|
| Accumulated other comprehensive gain (loss), December 31, 2015 | \$ (197) |
| Other comprehensive income (loss) | 11,827 |
| Accumulated other comprehensive gain (loss), June 30, 2016 | \$ 11,630 |

Our GAAP equity changes as the values of our RMBS are marked to market each quarter, among other factors. The primary causes of mark to market changes are changes in interest rates and credit spreads. During the three months ended June 30, 2016, a 29 basis point decrease in the 10 Year US Treasury rate caused a net unrealized gain on our RMBS of approximately \$4.5 million, recorded in accumulated other comprehensive income.

Non-GAAP Financial Measures

This Management Discussion and Analysis section contains analysis and discussion of non-GAAP measurements. The non-GAAP measurements include the following:

• core earnings; and

• core earnings attributable to common stockholders, per share.

Core earnings is a non-GAAP measure of the Company's operating performance and is defined by us as GAAP net income (loss), excluding realized gain (loss) on RMBS, realized gain (loss) on derivatives, unrealized gain (loss) on derivatives and unrealized gain (loss) on investments in Excess MSR and MSR, and as adjusted to exclude net income (loss) allocable to non-controlling interest attributable to outstanding LTIP-OP units in our operating partnership. Additionally, core earnings excludes (1) any tax (benefit) expense on unrealized (gain) loss on MSR, (2) any estimated "catch up" premium amortization (benefit) cost due to the use of current rather than historical estimates of prepayment speeds for the amortization of Excess MSR and (3) the amortization of MSR. Core earnings are provided for purposes of comparability to other issuers that invest in residential mortgage-related assets. The Company believes providing investors with core earnings, in addition to related GAAP financial measures, gives investors greater transparency into the Company's ongoing operational performance. The concept of core earnings does have significant limitations, including the exclusion of realized and unrealized gains (losses), among other things, and may not be comparable to similarly-titled measures of other companies that invest in residential mortgage-related assets those may calculate core earnings differently than we do. As a result, core earnings should not be considered a substitute for the Company's GAAP net income (loss) or as a measure of the Company's liquidity.

Core Earnings Summary

Core earnings for the three month period ended June 30, 2016, as compared to the three month period ended June 30, 2015, increased by approximately \$414,000, or \$0.05 per average common share. Core earnings for the six month period ended June 30, 2016, as compared to the six month period ended June 30, 2015, increased by approximately \$675,000, or \$0.09 per average common share. This increase was driven primarily by uncommitted master repurchase agreement with Freedom Mortgage in the period. For a further discussion of the agreement, see Note 7.

Table of Contents

The following table provides GAAP measures of net income (loss) and details with respect to reconciling the line items excluded for purposes of calculating core earnings and related per average common share amounts, for the periods indicated (dollars in thousands):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|-----------------------------|-----------|---------------------------|----------|
| | 2016 | 2015 | 2016 | 2015 |
| Net income (loss) | \$ 284 | \$ 11,308 | \$ (6,878) | \$ 8,874 |
| Realized (gain) loss on RMBS, net | (235) | 115 | (555) | (192) |
| Realized (gain) loss on derivatives, net | 299 | 52 | 1,760 | 1,294 |
| Realized (gain) loss on acquired assets, net | - | (174) | - | (174) |
| Unrealized (gain) loss on derivatives, net | 1,228 | (2,835) | 6,426 | (293) |
| Unrealized (gain) loss on investments in Excess MSR | 149 | (2,938) | 2,456 | (821) |
| Unrealized (gain) loss on investments in MSR | 3,076 | 22 | 5,308 | 22 |
| Tax (benefit) expense on unrealized (gain) loss on MSR | 96 | (60) | (533) | (60) |
| Estimated "catch up" premium amortization (benefit) cost | 134 | (1,889) | 1,751 | (1,244) |
| Amortization of MSR | (990) | - | (1,606) | - |
| Total core earnings: | \$ 4,041 | \$ 3,601 | \$ 8,129 | \$ 7,406 |
| Core earnings attributable to noncontrolling interests | (59) | (33) | (115) | (68) |
| Core Earnings Attributable to Common Stockholders | \$ 3,982 | \$ 3,568 | \$ 8,014 | \$ 7,338 |
| Core Earnings Attributable to Common Stockholders, per Share | \$ 0.53 | \$ 0.48 | \$ 1.07 | \$ 0.98 |
| GAAP Net income (Loss) Per Share of Common Stock | \$ 0.04 | \$ 1.49 | \$ (0.90) | \$ 1.17 |

Our Portfolio

Excess MSR

As of June 30, 2016 and December 31, 2015, we had approximately \$67.6 million and \$78.0 million, respectively, estimated carrying value of Excess MSR. Our investments represents between a 50% and 85% interest in the Excess MSR on three pools of mortgage loans with an aggregate UPB at June 30, 2016 and December 31, 2015, of approximately \$13.7 billion and \$15.0 billion, respectively. Freedom Mortgage is the servicer of the loans underlying these Excess MSR, and it earns a basic fee and all ancillary income associated with the portfolios in exchange for providing all servicing functions. In addition, Freedom Mortgage retains the remaining interest in the Excess MSR. We do not have any servicing duties, liabilities or obligations associated with the servicing of the portfolios underlying these Excess MSR. These investments in Excess MSR are subject to recapture agreements with Freedom Mortgage. Under the recapture agreements, we are generally entitled to our percentage interest in the Excess MSR on any initial or subsequent refinancing by Freedom Mortgage of a loan in the original portfolio. In other words, we are generally entitled to our percentage interest in the Excess MSR on both (i) a loan resulting from a refinancing by Freedom Mortgage of a loan in the original portfolio, and (ii) a loan resulting from a refinancing by Freedom Mortgage of a previously recaptured loan.

Upon completion of our IPO and the concurrent private placement, we entered into two separate Excess MSR acquisition and recapture agreements with Freedom Mortgage related to our investments in Excess MSR. We also entered into a flow and bulk purchase agreement related to future purchases of Excess MSR from Freedom Mortgage. In three separate transactions in 2014, we purchased from Freedom Mortgage Excess MSR on mortgage loans originated by Freedom Mortgage during the first quarter of 2014 with an aggregate UPB of approximately \$334.7 million. We acquired an interest between 71% and 85% interest in the Excess MSR for an aggregate purchase price of approximately \$2.174 million. The terms of the purchase include recapture provisions that are the same as those in the Excess MSR acquisition agreements we entered into with Freedom Mortgage in October 2013.

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

Table of Contents

The following tables summarize the collateral characteristics of the loans underlying our Excess MSR investments as of the dates indicated (dollars in thousands):

Excess MSR Collateral Characteristics

As of June 30, 2016

| | Collateral Characteristics | | | | | | | | Weighted Average Loan Age (months) | ARMs % ^(A) |
|---------------------------|-------------------------------|----------------------------------|---------------------------------|-----------------------|--------------|----------------------------|----------------------------|----------------------------|--|--------------------------|
| | Current Carrying Amount | Original Principal Balance | Current Principal Balance | Number of Loans | WA Coupon | WA Maturity (months) | WA Maturity (months) | WA Maturity (months) | | |
| <u>Pool 1</u> | | | | | | | | | | |
| Original Pool | \$ 30,092 | \$ 10,026,722 | \$ 6,137,091 | 33,944 | 3.48 % | 304 | 43 | 0.8 | % | |
| Recaptured Loans | 4,629 | - | 669,974 | 3,504 | 3.72 % | 327 | 9 | 0.3 | % | |
| Recapture Agreement | 1,744 | - | - | - | - | - | - | - | - | |
| Pool 1 Total/WA | 36,465 | 10,026,722 | 6,807,065 | 37,448 | 3.51 % | 307 | 39 | 0.8 | % | |
| <u>Pool 2</u> | | | | | | | | | | |
| Original Pool | 14,620 | 10,704,024 | 4,392,715 | 30,409 | 2.40 % | 310 | 48 | 100.0 | % | |
| Recaptured Loans | 14,338 | - | 2,269,049 | 14,315 | 3.70 % | 338 | 12 | 0.1 | % | |
| Recapture Agreement | 973 | - | - | - | - | - | - | - | - | |
| Pool 2 Total/WA | 29,931 | 10,704,024 | 6,661,764 | 44,724 | 2.84 % | 320 | 36 | 66.0 | % | |
| <u>Pool 2014</u> | | | | | | | | | | |
| Original Pool | 678 | 334,672 | 167,513 | 1,092 | 3.64 % | 319 | 38 | 0.0 | % | |
| Recaptured Loans | 518 | - | 71,292 | 346 | 3.63 % | 330 | 11 | 0.0 | % | |
| Recapture Agreement | - | - | - | - | - | - | - | - | - | |
| Pool 2014 Total/WA | 1,196 | 334,672 | 238,805 | 1,438 | 3.63 % | 323 | 30 | 0.0 | % | |
| Total/Weighted Average | \$ 67,592 | \$ 21,065,418 | \$ 13,707,634 | 83,610 | 3.19 % | 313 | 37 | 32.4 | % | |

As of December 31, 2015

| | Collateral Characteristics | | | | | | | | Weighted Average Loan Age (months) | ARMs % ^(A) |
|---------------------|-------------------------------|----------------------------------|---------------------------------|-----------------------|--------------|----------------------------|----------------------------|----------------------------|--|--------------------------|
| | Current Carrying Amount | Original Principal Balance | Current Principal Balance | Number of Loans | WA Coupon | WA Maturity (months) | WA Maturity (months) | WA Maturity (months) | | |
| <u>Pool 1</u> | | | | | | | | | | |
| Original Pool | \$ 38,633 | \$ 10,026,722 | \$ 6,865,916 | 37,204 | 3.49 % | 311 | 36 | 0.9 | % | |
| Recaptured Loans | 4,204 | - | 550,549 | 2,834 | 3.77 % | 331 | 7 | 0.5 | % | |
| Recapture Agreement | 645 | - | - | - | - | - | - | - | - | |
| Pool 1 Total/WA | 43,482 | 10,026,722 | 7,416,465 | 40,038 | 3.51 % | 312 | 34 | 0.8 | % | |
| <u>Pool 2</u> | | | | | | | | | | |
| Original Pool | 17,967 | 10,704,024 | 5,041,239 | 34,109 | 2.35 % | 318 | 41 | 100.0 | % | |
| Recaptured Loans | 14,371 | - | 2,238,467 | 13,832 | 3.74 % | 342 | 9 | 0.1 | % | |
| Recapture Agreement | 716 | - | - | - | - | - | - | - | - | |
| Pool 2 Total/WA | 33,054 | 10,704,024 | 7,279,706 | 47,941 | 2.78 % | 325 | 31 | 69.3 | % | |
| <u>Pool 2014</u> | | | | | | | | | | |

Edgar Filing: Cherry Hill Mortgage Investment Corp - Form 10-Q

| | | | | | | | | | |
|---------------------|----------|--------------|--------------|--------|--------|-----|----|------|---|
| Original Pool | 947 | 334,672 | 197,900 | 1,242 | 3.65 % | 327 | 30 | 0.0 | % |
| Recaptured Loans | 559 | - | 67,990 | 321 | 3.65 % | 335 | 9 | 0.0 | % |
| Recapture Agreement | - | - | - | - | - | - | - | - | |
| Pool 2014 Total/WA | 1,506 | 334,672 | 265,890 | 1,563 | 3.65 % | 329 | 25 | 0.0 | % |
| Total/Weighted | | | | | | | | | |
| Average | \$78,042 | \$21,065,418 | \$14,962,061 | 89,542 | 3.16 % | 319 | 32 | 34.1 | % |

(A) ARMs % represents the percentage of the total principal balance of the pool that corresponds to ARMs and hybrid ARMs.

Table of Contents

MSRs

By virtue of our acquisition of Aurora on May 29, 2015, we acquired its portfolio of Fannie Mae and Freddie Mac MSR. On October 30, 2015, Aurora acquired a portfolio of MSRs on Fannie Mae and Freddie Mac mortgage loans with an aggregate UPB of approximately \$1.4 billion. On January 29, 2016, Aurora acquired a portfolio of MSRs on mortgage loans owned or securitized by Fannie Mae with an aggregate unpaid principal balance of approximately \$463 million. In addition, on June 30, 2016, Aurora acquired a portfolio of MSRs on mortgage loans owned or securitized by Fannie Mae with an aggregate unpaid principal balance of approximately \$1.3 billion. The following tables set forth certain characteristics of the mortgage loans underlying those MSRs as of the dates indicated (dollars in thousands):

MSR Collateral Characteristics

As of June 30, 2016

| | Collateral Characteristics | | | | | | | Weighted | |
|--------------|----------------------------|---------------------------|-----------|------------------|----------------------|------------------|----------------------|---------------------------|-----------------------|
| | Current Carrying Amount | Current Principal Balance | WA Coupon | WA Servicing Fee | WA Maturity (months) | WA Servicing Fee | WA Maturity (months) | Average Loan Age (months) | ARMs % ^(A) |
| <u>MSRs</u> | | | | | | | | | |
| Conventional | \$29,750 | \$3,600,130 | 3.82 % | 0.25 % | 290 | 25 | 0.2 | % | |
| MSR Total/WA | 29,750 | 3,600,130 | 3.82 % | 0.25 % | 290 | 25 | 0.2 | % | |

As of December 31, 2015

| | Collateral Characteristics | | | | | | | Weighted | |
|--------------|----------------------------|---------------------------|-----------|------------------|----------------------|------------------|----------------------|---------------------------|-----------------------|
| | Current Carrying Amount | Current Principal Balance | WA Coupon | WA Servicing Fee | WA Maturity (months) | WA Servicing Fee | WA Maturity (months) | Average Loan Age (months) | ARMs % ^(A) |
| <u>MSRs</u> | | | | | | | | | |
| Conventional | \$19,761 | \$2,016,351 | 3.76 % | 0.25 % | 273 | 31 | 0.2 | % | |
| MSR Total/WA | 19,761 | 2,016,351 | 3.76 % | 0.25 % | 273 | 31 | 0.2 | % | |

(A) ARM's % represents the percentage of the total principal balance of the pool that corresponds to ARM's and hybrid ARM's.

RMBS

The following tables summarize the characteristics of our RMBS portfolio and certain characteristics of the collateral underlying our RMBS as of the dates indicated (dollars in thousands):

RMBS Characteristics

As of June 30, 2016

| Original | Gross Unrealized | Number | Weighted Average |
|----------|------------------|--------|------------------|
|----------|------------------|--------|------------------|

Edgar Filing: Cherry Hill Mortgage Investment Corp - Form 10-Q

| Asset Type | Face Value | Book Value | Gains | Losses | Carrying Value ^(A) | of Securities | Rating | Coupon | Yield ^(C) | Maturity (Years) ^(D) |
|------------------------|------------|------------|----------|---------|-------------------------------|---------------|---------|--------|----------------------|---------------------------------|
| RMBS | | | | | | | | | | |
| Fannie Mae | \$349,283 | \$314,051 | \$7,280 | \$(22) | \$321,309 | 49 | (B) | 3.73 % | 3.44 % | 23 |
| Freddie Mac | 202,601 | 186,823 | 4,594 | - | 191,417 | 24 | (B) | 3.61 % | 3.25 % | 25 |
| CMOs | 19,896 | 9,614 | 66 | (255) | 9,425 | 5 | Unrated | 4.55 % | 4.14 % | 11 |
| Total/Weighted Average | \$571,780 | \$510,488 | \$11,940 | \$(277) | \$522,151 | 78 | | 3.70 % | 3.39 % | 24 |

58

Table of Contents

As of December 31, 2015

| Asset Type | Original | Book Value | Gross Unrealized | | Carrying Value ^(A) | Number of Securities | Weighted Average | | | Maturity (Years) ^(D) |
|------------------------|------------|------------|------------------|-----------|-------------------------------|----------------------|------------------|--------|----------------------|---------------------------------|
| | Face Value | | Gains | Losses | | | Rating | Coupon | Yield ^(C) | |
| RMBS | | | | | | | | | | |
| Fannie Mae | \$329,767 | \$308,367 | \$1,961 | \$(1,556) | \$308,772 | 44 | (B) | 3.77 % | 3.59 % | 24 |
| Freddie Mac | 208,154 | 193,567 | 821 | (977) | 193,411 | 24 | (B) | 3.61 % | 3.48 % | 24 |
| CMOs | 16,646 | 6,493 | - | (434) | 6,059 | 4 | Unrated | 4.55 % | 7.39 % | 10 |
| Total/Weighted Average | \$554,567 | \$508,427 | \$2,782 | \$(2,967) | \$508,242 | 72 | | 3.72 % | 3.60 % | 23 |

(A) See “Item 1. Consolidated Financial Statements — Note 9. Fair Value” regarding the estimation of fair value, which is equal to carrying value for all securities.

(B) We used an implied AAA rating for the Fannie Mae and Freddie Mac securities, other than CMOs, which are unrated.

(C) The weighted average yield is based on the most recent annualized monthly interest income, divided by the Book Value. Prior period amounts have been reclassified to conform to current period presentation.

(D) The weighted average maturity is based on the timing of expected principal reduction on the assets.

The following table summarizes the net interest spread of our RMBS portfolio as of the dates indicated:

Net Interest Spread

| | June 30, 2016 | | December 31, 2015 | |
|-----------------------------------|---------------|---|-------------------|---|
| Weighted Average Asset Yield | 3.08 | % | 2.61 | % |
| Weighted Average Interest Expense | 1.36 | % | 1.15 | % |
| Net Interest Spread | 1.72 | % | 1.46 | % |

Liquidity and Capital Resources

Liquidity is a measurement of our ability to meet potential cash requirements, including ongoing commitments to repay borrowings, fund and maintain investments and other general business needs. Additionally, to maintain our status as a REIT under the Code, we must distribute annually at least 90% of our REIT taxable income. In future years, a portion of this requirement may be able to be met through stock dividends, rather than cash, subject to limitations based on the value of our stock.

Our primary sources of funds for liquidity consist of cash provided by operating activities (primarily income from our investments in Excess MSR and RMBS and net servicing income from our MSR) and sales or repayments of RMBS and borrowings under repurchase agreements. In the future, sources of funds for liquidity may include potential MSR financing, warehouse agreements, securitizations and the issuance of equity or debt securities, when feasible. As a result of FHFA rulemaking activity, we no longer have access to FHLBI advances and do not expect to have access to this source of capital in the future. Our primary uses of funds are the payment of interest, management fees, outstanding commitments, other operating expenses, investments in new or replacement assets and other operating expenses and the repayment of borrowings, as well as dividends.

We seek to maintain adequate cash reserves and other sources of available liquidity to meet any margin calls resulting from decreases in value related to a reasonably possible (in the opinion of management) change in interest rates.

As of the date of this filing, we have sufficient liquid assets to satisfy all of our short-term recourse liabilities. With respect to the next twelve months, we expect that our cash on hand combined with our cash flow provided by operations will be sufficient to satisfy our anticipated liquidity needs with respect to our current investment portfolio, including related financings, potential margin calls and operating expenses. While it is inherently more difficult to forecast beyond the next twelve months, we currently expect to meet our long-term liquidity requirements through our cash on hand and, if needed, additional borrowings, proceeds received from repurchase agreements and similar financings, proceeds from equity offerings and the liquidation or refinancing of our assets.

Table of Contents

Our operating cash flow differs from our net income due primarily to: (i) accretion of discount or premium on our RMBS and Excess MSRs, (ii) unrealized gains or losses on our Servicing Related Assets, and (iii) other-than-temporary impairment on our securities, if any.

Repurchase Agreements

As of June 30, 2016, we had repurchase agreements with 22 counterparties and approximately \$456.1 million of outstanding repurchase agreement borrowings from 16 of those counterparties, which were used to finance RMBS. As of June 30, 2016, the Company's exposure (defined as the amount of cash and securities pledged as collateral, less the borrowing under the repurchase agreement) to any of the counterparties under the repurchase agreements did not exceed five percent of the Company's equity. Under these agreements, which are uncommitted facilities, we sell a security to a counterparty and concurrently agreed to repurchase the same security at a later date plus the interest charged. The sale price represents financing proceeds and the difference between the sale and repurchase prices represents interest on the financing. The price at which the security is sold generally represents the market value of the security less a discount or "haircut". The weighted average haircut on our repurchase debt at June 30, 2016, was approximately 5.0%. During the term of the repurchase agreement, which can be as short as 30 days, the counterparty holds the security and posted margin as collateral. The counterparty monitors and calculates what it estimates to be the value of the collateral during the term of the agreement. If this value declines by more than a de minimis threshold, the counterparty requires us to post additional collateral (or "margin") in order to maintain the initial haircut on the collateral. This margin is typically required to be posted in the form of cash and cash equivalents. Furthermore, we are, from time to time, a party to derivative agreements or financing arrangements that may be subject to margin calls based on the value of such instruments.

Set forth below is the average aggregate balance of borrowings under the Company's repurchase agreements for each of the periods shown and the aggregate balance as of the end of each such period (dollars in thousands):

Repurchase Agreement Average and Maximum Amounts

| Quarter Ended | Average Monthly Amount | Maximum Month-End Amount | Ending Amount |
|--------------------|------------------------|--------------------------|---------------|
| June 30, 2016 | \$ 485,476 | \$ 544,862 | \$456,075 |
| March 31, 2016 | \$ 406,360 | \$ 414,153 | \$398,374 |
| December 31, 2015 | \$ 408,227 | \$ 443,446 | \$385,560 |
| September 30, 2015 | \$ 396,013 | \$ 440,727 | \$440,727 |
| June 30, 2015 | \$ 382,333 | \$ 384,386 | \$384,386 |
| March 31, 2015 | \$ 376,083 | \$ 377,361 | \$373,868 |
| December 31, 2014 | \$ 354,878 | \$ 363,493 | \$362,126 |
| September 30, 2014 | \$ 315,830 | \$ 329,239 | \$329,239 |
| June 30, 2014 | \$ 288,881 | \$ 293,747 | \$293,747 |
| March 31, 2014 | \$ 263,505 | \$ 269,982 | \$269,982 |
| December 31, 2013 | \$ 267,038 | \$ 270,555 | \$261,302 |
| September 30, 2013 | \$ - | \$ - | \$- |

The increases in the Company's borrowings under its repurchase agreements were primarily due to the temporary investment of funds borrowed in the fourth quarter of 2015 under the Term Loan and amortization of the Excess MSRs, in advance of the redeployment into MSRs. In addition, maturing advances from the FHLBI have been replaced by borrowings under the Company's repurchase agreements.

Table of Contents

These short-term borrowings were used to finance certain of our investments in RMBS. The RMBS repurchase agreements are guaranteed by the Company. The weighted average difference between the market value of the assets and the face amount of available financing for the RMBS repurchase agreements, or the haircut, was 5.0% and 5.0% as of June 30, 2016 and December 31, 2015, respectively. The following tables provide additional information regarding our repurchase agreements (dollars in thousands):

Repurchase Agreement Characteristics

As of June 30, 2016

| | Repurchase Agreements | Weighted Average Rate | |
|---------------------------|-----------------------|-----------------------|---|
| Less than one month | \$ 140,677 | 0.73 | % |
| One to three months | 129,968 | 0.71 | % |
| Greater than three months | 185,430 | 0.77 | % |
| Total/Weighted Average | \$ 456,075 | 0.74 | % |

As of December 31, 2015

| | Repurchase Agreements | Weighted Average Rate | |
|---------------------------|-----------------------|-----------------------|---|
| Less than one month | \$ 93,926 | 0.55 | % |
| One to three months | 284,687 | 0.56 | % |
| Greater than three months | 6,947 | 0.52 | % |
| Total/Weighted Average | \$ 385,560 | 0.56 | % |

The amount of collateral as of June 30, 2016 and December 31, 2015, including cash, was \$484.0 million and \$404.1 million, respectively.

The weighted average term to maturity of our borrowings under repurchase agreements as of June 30, 2016 and December 31, 2015 was 73 days and 47 days, respectively.

FHLBI Advances

As of June 30, 2016, we had FHLBI no advances. At June 30, 2016, CHMI Insurance held FHLBI Stock of approximately \$3.3 million as required by the FHLBI.

In January 2016, the FHFA released a final rule that amends regulations governing membership in the Federal Home Loan Bank ("FHLB") system. The final rule, which largely adopts the provisions included in the proposed rule issued by the FHFA in September 2014, prevents captive insurance companies from obtaining and maintaining membership in the FHLB system and, consequently, accessing low-cost funding through the FHLB system. The final rule became effective on February 19, 2016. Since CHMI Insurance became a member of the FHLBI after publication of the proposed rule, CHMI Insurance is required to terminate its membership in the FHLBI within one year following the effective date of the final rule. Under the final rule, CHMI Insurance has until the end of the one-year transition period (or until the date of termination, if earlier) to repay its existing advances. In addition, the final rule prohibits CHMI Insurance from taking new advances from the FHLBI or renewing existing advances.

Table of Contents

Prior to January 2016, these short-term borrowings were used to finance certain of our investments in RMBS. The FHLBI Advances were guaranteed by the Company. The following tables provide additional information regarding FHLBI Advances outstanding as of December 31, 2015 (dollars in thousands):

Federal Home Loan Bank Advance Characteristics

As of December 31, 2015

| | Federal Home Loan Bank advances | Weighted Average Rate | |
|--|------------------------------------|-----------------------|---|
| Less than one month | \$ 15,000 | 0.44 | % |
| One to three months | - | - | |
| Greater than three months | 47,250 | 0.57 | % |
| Total/Weighted Average Federal Home Loan Bank advances | \$ 62,250 | 0.54 | % |

The amount of collateral as of December 31, 2015, including FHLBI stock and securities pledged but not being backed by any advances, was \$86.4 million.

The weighted average term to maturity of our borrowings under FHLBI advances as of December 31, 2015 was 94 days.

Cash Flows

Operating and Investing Activities

Our operating activities provided cash of approximately \$15.1 million and \$18.4 million and our investing activities used cash of approximately \$18.8 million and \$12.7 million for the three and six month periods ended June 30, 2016, respectively. The cash provided by operating activities and the cash used in investing activities is a result of the execution of our ongoing investment strategy.

Dividends

We conduct our operations in a manner intended to satisfy the requirements for qualification as a REIT for U.S. federal income tax purposes. U.S. federal income tax law generally requires that a REIT distribute annually at least 90% of its REIT taxable income, without regard to the deduction for dividends paid and excluding net capital gains, and that it pay tax at regular corporate rates to the extent that it annually distributes less than 100% of its taxable income. We intend to make regular quarterly distributions of all or substantially all of our REIT taxable income to holders of our common stock out of assets legally available for this purpose, if and to the extent authorized by our board of directors. Before we pay any dividend, whether for U.S. federal income tax purposes or otherwise, we must first meet both our operating requirements and debt service on our repurchase agreements and other debt payable. If our cash available for distribution is less than our REIT taxable income, we could be required to sell assets or borrow funds to make cash distributions, or we may make a portion of the required distribution in the form of a taxable stock distribution or distribution of debt securities. We will make distributions only upon the authorization of our board of directors. The amount, timing and frequency of distributions will be authorized by our board of directors based upon a variety of factors, including:

- actual results of operations;

- our level of retained cash flows;

Table of Contents

- our ability to make additional investments in our target assets;
- restrictions under Maryland law;
- any debt service requirements;
- our taxable income;
- the annual distribution requirements under the REIT provisions of the Code; and
- other factors that our board of directors may deem relevant

Our ability to make distributions to our stockholders will depend upon the performance of our investment portfolio, and, in turn, upon our Manager's management of our business. Distributions will be made quarterly in cash to the extent that cash is available for distribution. We may not be able to generate sufficient cash available for distribution to pay distributions to our stockholders. In addition, our board of directors may change our distribution policy in the future.

We make distributions based on a number of factors, including an estimate of taxable earnings per common share. Dividends distributed and taxable and GAAP earnings will typically differ due to items such as fair value adjustments, differences in premium amortization and discount accretion, and nondeductible general and administrative expenses. Our dividend per share may be substantially different than our taxable earnings and GAAP earnings per share. Our GAAP earnings per share for the three month periods ended June 30, 2016 and 2015 were \$0.04 and \$1.49, respectively. Our GAAP loss per share for the six month period ended June 30, 2016 was \$0.90. Our GAAP earnings per share for the six month period ended June 30, 2015 was \$1.17.

Our long term view of the attractiveness of the investment opportunities in our target asset classes has not changed. However, the current levels of asset pricing has reduced the available returns. We intend to expand the scope of our investments in our target assets with the goal of creating a more diversified and stable revenue profile. We believe a more stable source of income should provide value to our stockholders over time. Our diversification strategy involves execution risks and requires capital. There is no assurance as to when we will be able to raise that capital, if at all.

Off-balance Sheet Arrangements

As of June 30, 2016, we did not have any off-balance sheet arrangements. We did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured investment vehicles, or special purpose or variable interest entities, established to facilitate off-balance sheet arrangements or other contractually narrow or limited purposes. Further, we have not guaranteed any obligations of unconsolidated entities or entered into any commitment or intend to provide additional funding to any such entities.

Contractual Obligations

Our contractual obligations as of June 30, 2016 and December 31, 2015, included repurchase agreements and as of December 31, 2015 only, FHLBI advances on certain RMBS, borrowings under a fully drawn \$25 million Term Loan and no amounts outstanding on an MSR Facility, our management agreement with our Manager, our subservicing agreement with Freedom Mortgage and our joint marketing recapture agreement with Freedom Mortgage. Pursuant to our management agreement, our Manager is entitled to receive a management fee and the reimbursement of certain expenses.

Table of Contents

The following table summarizes our contractual obligations as of the dates indicated (dollars in thousands):

Contractual Obligations Characteristics

As of June 30, 2016

| | Less than 1 year | 1 to 3 years | 3 to 5 years | More than 5 years | Total |
|--|---------------------|-----------------|-----------------|----------------------|-----------|
| Repurchase agreements | | | | | |
| Borrowings under repurchase agreements | \$456,075 | \$- | \$- | \$- | \$456,075 |
| Interest on repurchase agreement borrowings ^(A) | \$400 | \$- | \$- | \$- | \$400 |
| Term Loan | | | | | |
| Borrowings under Term Loan facility | \$2,042 | \$6,853 | \$14,021 | \$- | \$22,907 |
| Interest on Term Loan borrowings | \$1,224 | \$2,944 | \$65 | \$- | \$4,233 |

As of December 31, 2015

| | Less than 1 year | 1 to 3 years | 3 to 5 years | More than 5 years | Total |
|--|---------------------|-----------------|-----------------|----------------------|-----------|
| Repurchase agreements | | | | | |
| Borrowings under repurchase agreements | \$385,560 | \$- | \$- | \$- | \$385,560 |
| Interest on repurchase agreement borrowings ^(A) | \$263 | \$- | \$- | \$- | \$263 |
| Federal Home Loan Bank advances | | | | | |
| Borrowings under FHLBI advances | \$62,250 | \$- | \$- | \$- | \$62,250 |
| Interest on FHLBI advance borrowings ^(A) | \$92 | \$- | \$- | \$- | \$92 |
| Term Loan | | | | | |
| Borrowings under Term Loan facility | \$1,958 | \$6,583 | \$15,762 | \$- | \$24,303 |
| Interest on Term Loan borrowings | \$1,308 | \$3,215 | \$493 | \$- | \$5,016 |

Interest expense is calculated based on the interest rate in effect at June 30, 2016 and includes all interest expense (A) incurred and expected to be incurred in the future through the contractual maturity of the associated repurchase agreement.

The table above does not include amounts due under the management agreement with our Manager. Those payments are discussed below.

In addition, the table above does not include amounts payable to Freedom Mortgage pursuant to the subservicing agreement or the joint marketing recapture agreement.

Management Agreement

The management agreement with our Manager provides that our Manager is entitled to receive a management fee, the reimbursement of certain expenses and, in certain circumstances, a termination fee. The management fee is an amount equal to 1.5% per annum of our stockholders' equity, adjusted as set forth in the management agreement, and calculated and payable quarterly in arrears. We will also be required to pay a termination fee equal to three times the average annual management fee earned by our Manager during the two four-quarter periods ending as of the end of the fiscal quarter preceding the date of termination. Such termination fee will be payable upon termination of the management agreement by us without cause or by our Manager if we materially breach the management agreement.

Table of Contents

We pay all of our direct operating expenses, except those specifically required to be borne by our Manager under the management agreement. Our Manager is responsible for all costs incident to the performance of its duties under the management agreement. Our Manager uses the proceeds from its management fee in part to pay Freedom Mortgage for services provided under the Services Agreement between the Manager and Freedom Mortgage. Our officers, will receive no cash compensation directly from us. Our Manager provides us with a chief financial officer, a controller and a general counsel. Our Manager is entitled to be reimbursed for a pro rata portion of the costs of the wages, salary and other benefits with respect to these officers, based on the percentages of their working time and efforts spent on matters related to our company. The amount of the wages, salary and benefits reimbursed with respect to these officers our Manager provides to us is subject to the approval of the compensation committee of our board of directors.

The term of the management agreement will expire on October 22, 2020 and will be automatically renewed for a one-year term on such date and on each anniversary of such date thereafter unless terminated or not renewed as described below. Either we or our Manager may elect not to renew the management agreement upon expiration of its initial term or any renewal term by providing written notice of non-renewal at least 180 days, but not more than 270 days, before expiration. In the event we elect not to renew the term, we will be required to pay our Manager the termination fee described above. We may terminate the management agreement at any time for cause effective upon 30 days prior written notice of termination from us to our Manager, in which case no termination fee would be due. Our board of directors will review our Manager's performance prior to the automatic renewal thereof and, as a result of such review, upon the affirmative vote of at least two-thirds of the members of our board of directors or of the holders of a majority of our outstanding common stock, we may terminate the management agreement based upon unsatisfactory performance by our Manager that is materially detrimental to us or a determination by our independent directors that the management fees payable to our Manager are not fair, subject to the right of our Manager to prevent such a termination by agreeing to a reduction of the management fees payable to our Manager. Upon any termination of the management agreement based on unsatisfactory performance or unfair management fees, we are required to pay our Manager the termination fee described above. Our Manager may terminate the management agreement, without payment of the termination fee, in the event we become regulated as an investment company under the Investment Company Act. Our Manager may also terminate the management agreement upon 60 days' written notice if we default in the performance of any material term of the management agreement and the default continues for a period of 30 days after written notice to us, whereupon we would be required to pay our Manager the termination fee described above.

Subservicing Agreement

Freedom Mortgage is directly servicing the Company's portfolio of Fannie Mae and Freddie Mac MSR's pursuant to a subservicing agreement entered into on June 10, 2015. The agreement has an initial term of three years, expiring on September 1, 2018, and is subject to automatic renewal for additional three year terms unless either party chooses not to renew. The agreement may be terminated without cause by either party by giving notice as specified in the agreement. If the agreement is not renewed by the Company or terminated by the Company without cause, market rate de-boarding fees will be due to the subservicer. Under that agreement, Freedom Mortgage agrees to service the applicable mortgage loans in accordance with applicable law and the requirements of the applicable agency. The Company pays fees for specified services.

Joint Marketing Recapture Agreement

In June 2016, Aurora entered into a joint marketing recapture agreement with Freedom Mortgage. Pursuant to this agreement, Freedom Mortgage will attempt to refinance certain mortgage loans underlying Aurora's servicing MSR portfolio as directed by Aurora. If a loan is refinanced, Aurora will pay Freedom Mortgage a fee for its origination services. Freedom will be entitled to sell the loan for its own benefit and will transfer the related MSR to Aurora. The agreement has an initial term of one year, subject to automatic renewals of one year each and subject to termination by either party upon 60 days prior notice. All new loans must qualify for sale to Fannie Mae or Freddie Mac and meet

other conditions set forth in the agreement.

65

Table of Contents

Inflation

Virtually all of our assets and liabilities are financial in nature. As a result, interest rates and other factors affect our performance more so than inflation, although inflation rates can often have a meaningful influence over the direction of interest rates. Furthermore, our financial statements are prepared in accordance with GAAP and our distributions are determined by our board of directors primarily based on our REIT taxable income, and, in each case, our activities and balance sheet are measured with reference to historical cost and/or fair market value without considering inflation.

66

Table of Contents

Item 3. Quantitative and Qualitative Disclosures about Market Risk

We seek to manage our risks related to the credit quality of our assets, interest rates, liquidity, prepayment speeds and market value while, at the same time, seeking to provide an opportunity to stockholders to realize attractive risk-adjusted returns through ownership of our capital stock. While we do not seek to avoid risk completely, we believe the risk can be quantified from historical experience and seek to actively manage that risk, to earn sufficient compensation to justify taking those risks and to maintain capital levels consistent with the risks we undertake.

Interest Rate Risk

Interest rates are highly sensitive to many factors, including fiscal and monetary policies and domestic and international economic and political considerations, as well as other factors beyond our control. We are subject to interest rate risk in connection with our assets and our related financing obligations. In general, we finance the acquisition of certain of our assets through financings in the form of repurchase agreements and bank facilities. We expect to make use of MSR financing, warehouse facilities, securitizations, re-securitizations, and public and private equity and debt issuances in addition to transaction or asset specific funding arrangements. In addition, the values of our Servicing Related Assets are highly sensitive to changes in interest rates, historically increasing when rates rise and decreasing when rates decline. Subject to maintaining our qualification as a REIT, we attempt to mitigate interest rate risk through utilization of hedging instruments, primarily interest rate swap agreements. We may also use financial futures, options, interest rate cap agreements, and forward sales. These instruments are intended to serve as a hedge against future interest rate changes on our borrowings.

Interest Rate Effect on Net Interest Income

Our operating results depend in large part on differences between the income earned on our assets and our cost of borrowing and hedging activities. The cost of our borrowings are generally based on prevailing market interest rates. During a period of rising interest rates, our borrowing costs generally will increase (1) while the yields earned on our leveraged fixed-rate mortgage assets will remain static and (2) at a faster pace than the yields earned on our leveraged adjustable-rate and hybrid adjustable-rate RMBS, which could result in a decline in our net interest spread and net interest margin. The severity of any such decline would depend on our asset/liability composition at the time as well as the magnitude and duration of the interest rate increase. Further, an increase in short-term interest rates could also have a negative impact on the market value of our assets, other than our Servicing Related Assets. A decrease in interest rates could have a negative impact on the market value of our Servicing Related Assets. If any of these events happen, we could experience a decrease in net income or incur a net loss during these periods, which could adversely affect our liquidity and results of operations.

During the three months ended June 30, 2016, yields earned remained consistent with the prior quarter but the weighted average borrowing expense under repurchase agreements advances increased from 71 bps to 74 bps, respectively. During the six months ended June 30, 2016, yields earned remained consistent with the prior quarter but the weighted average borrowing expense under repurchase agreements advances increased from 56 bps to 74 bps, respectively.

Hedging techniques are partly based on assumed levels of prepayments of our assets, specifically our RMBS. If prepayments are slower or faster than assumed, the life of the investment will be longer or shorter, which would reduce the effectiveness of any hedging strategies we may use and may cause losses on such transactions. Hedging strategies involving the use of derivatives are highly complex and may produce volatile returns.

Table of Contents

Interest Rate Cap Risk

Any adjustable-rate RMBS that we acquire will generally be subject to interest rate caps, which potentially could cause such RMBS to acquire many of the characteristics of fixed-rate securities if interest rates were to rise above the cap levels. This issue will be magnified to the extent we acquire adjustable-rate and hybrid adjustable-rate RMBS that are not based on mortgages which are fully indexed. In addition, adjustable-rate and hybrid adjustable-rate RMBS may be subject to periodic payment caps that result in some portion of the interest being deferred and added to the principal outstanding. This could result in our receipt of less cash income on such assets than we would need to pay the interest cost on our related borrowings. To mitigate interest rate mismatches, we may utilize the hedging strategies discussed above under “—Interest Rate Risk.” Actual economic conditions or implementation of decisions by our Manager may produce results that differ significantly from the estimates and assumptions used in our models.

Prepayment Risk; Extension Risk

The value of our assets may be affected by prepayment rates on mortgage loans. We anticipate that the mortgage loans underlying our Servicing Related Assets and RMBS will prepay at a projected rate generating an expected yield. If we purchase assets at a premium to par value, when borrowers prepay their mortgage loans faster than expected, the corresponding prepayments may reduce the expected yield on such assets because we will have to amortize the related premium on an accelerated basis. Conversely, if we purchase assets at a discount to par value, when borrowers prepay their mortgage loans slower than expected, the decrease in corresponding prepayments may reduce the expected yield on such assets because we will not be able to accrete the related discount as quickly as originally anticipated. A slower than anticipated rate of prepayment also will cause the life of the related RMBS to extend beyond that which was projected. As a result we would have a lower yielding asset for a longer period of time. In addition, if we have hedged our interest rate risk, extension may cause the security to be outstanding longer than the related hedge thereby reducing the protection intended to be provided by the hedge. With respect to our Servicing Related Assets, if prepayment speeds are significantly greater than expected, the carrying value of our Servicing Related Assets may change. If the fair value of our Servicing Related Assets decreases, we would be required to record a non-cash charge. Significant increases in prepayment speeds could also materially reduce the ultimate cash flows we receive from Servicing Related Assets, and we could ultimately receive substantially less than what we paid for such assets.

The following tables summarize the estimated change in fair value of our interests in the Excess MSR as of the dates indicated given several parallel changes in the discount rate and voluntary prepayment rate (dollars in thousands):

Excess MSR Fair Value Changes

As of June 30, 2016

| | (20)% | (10)% | -% | 10% | 20% |
|--------------------------------------|----------|----------|----------|------------|------------|
| Discount Rate Shift in % | | | | | |
| Estimated FV | \$74,297 | \$70,792 | \$67,592 | \$64,714 | \$62,064 |
| Change in FV | \$6,705 | \$3,200 | \$- | \$(2,878) | \$(5,528) |
| % Change in FV | 10 % | 5 % | - | (4)% | (8)% |
| Voluntary Prepayment Rate Shift in % | | | | | |
| Estimated FV | \$74,760 | \$71,064 | \$67,592 | \$64,395 | \$61,402 |
| Change in FV | \$7,168 | \$3,472 | \$- | \$(3,197) | \$(6,190) |
| % Change in FV | 11 % | 5 % | - | (5)% | (9)% |
| Recapture Rate Shift in % | | | | | |
| Estimated FV | \$67,067 | \$67,340 | \$67,592 | \$67,884 | \$68,157 |
| Change in FV | \$(525) | \$(252) | \$- | \$292 | \$565 |
| % Change in FV | (1)% | (0)% | - | 0 % | 1 % |

Edgar Filing: Cherry Hill Mortgage Investment Corp - Form 10-Q

Table of Contents

As of December 31, 2015

| | (20)% | (10)% | -% | 10% | 20% |
|--------------------------------------|----------|----------|----------|-----------|-----------|
| Discount Rate Shift in % | | | | | |
| Estimated FV | \$86,063 | \$81,859 | \$78,042 | \$74,577 | \$71,406 |
| Change in FV | \$8,016 | \$3,812 | \$- | \$(3,470) | \$(6,642) |
| % Change in FV | 10 % | 5 % | - | (4)% | (9)% |
| Voluntary Prepayment Rate Shift in % | | | | | |
| Estimated FV | \$85,033 | \$81,428 | \$78,042 | \$74,886 | \$71,919 |
| Change in FV | \$6,986 | \$3,380 | \$- | \$(3,162) | \$(6,128) |
| % Change in FV | 9 % | 4 % | - | (4)% | (8)% |
| Recapture Rate Shift in % | | | | | |
| Estimated FV | \$77,775 | \$77,911 | \$78,042 | \$78,184 | \$78,320 |
| Change in FV | \$(272) | \$(136) | \$- | \$136 | \$272 |
| % Change in FV | (0)% | (0)% | - | 0% | 0% |

The following tables summarize the estimated change in fair value of our interests in the MSR as of the dates indicated given several parallel shifts in the discount rate and voluntary prepayment rate (dollars in thousands):

MSR Fair Value Changes

As of June 30, 2016

| | (20)% | (10)% | -% | 10% | 20% |
|--------------------------------------|----------|----------|----------|-----------|-----------|
| Discount Rate Shift in % | | | | | |
| Estimated FV | \$31,890 | \$30,782 | \$29,750 | \$28,786 | \$27,883 |
| Change in FV | \$2,140 | \$1,032 | \$- | \$(964) | \$(1,867) |
| % Change in FV | 7 % | 3 % | - | (3)% | (6)% |
| Voluntary Prepayment Rate Shift in % | | | | | |
| Estimated FV | \$33,903 | \$31,724 | \$29,750 | \$27,958 | \$26,325 |
| Change in FV | \$4,153 | \$1,974 | \$- | \$(1,793) | \$(3,425) |
| % Change in FV | 14 % | 7 % | - | (6)% | (12)% |
| Servicing Cost Shift in % | | | | | |
| Estimated FV | \$30,672 | \$30,211 | \$29,750 | \$29,289 | \$28,828 |
| Change in FV | \$922 | \$461 | \$- | \$(461) | \$(922) |
| % Change in FV | 3 % | 2 % | - | (2)% | (3)% |

As of December 31, 2015

| | (20)% | (10)% | -% | 10% | 20% |
|--------------------------------------|----------|----------|----------|----------|-----------|
| Discount Rate Shift in % | | | | | |
| Estimated FV | \$21,261 | \$20,486 | \$19,761 | \$19,084 | \$18,450 |
| Change in FV | \$1,500 | \$724 | \$- | \$(677) | \$(1,312) |
| % Change in FV | 8 % | 4 % | - | (3)% | (7)% |
| Voluntary Prepayment Rate Shift in % | | | | | |
| Estimated FV | \$21,656 | \$20,672 | \$19,761 | \$18,916 | \$18,130 |
| Change in FV | \$1,894 | \$911 | \$- | \$(845) | \$(1,631) |
| % Change in FV | 10 % | 5 % | - | (4)% | (8)% |
| Servicing Cost Shift in % | | | | | |
| Estimated FV | \$20,490 | \$20,126 | \$19,761 | \$19,397 | \$19,033 |

Edgar Filing: Cherry Hill Mortgage Investment Corp - Form 10-Q

| | | | | | |
|----------------|-------|-------|-----|----------|----------|
| Change in FV | \$728 | \$364 | \$- | \$(364) | \$(728) |
| % Change in FV | 4 | % 2 | % - | (2)% | (4)% |

69

Table of Contents

The following tables summarize the estimated change in fair value of our RMBS as of the dates indicated given several parallel shifts in interest rates (dollars in thousands):

RMBS Fair Value Changes

As of June 30, 2016

| | June 30, 2015 | Fair Value Change | | | | |
|--|---------------|-------------------|-----------|-----------|-----------|------------|
| | | +25 Bps | +50 Bps | +75 Bps | +100 Bps | +150 Bps |
| RMBS Portfolio | | | | | | |
| RMBS, available-for-sale, net of swaps | \$ 512,301 | | | | | |
| RMBS Total Return (%) | | (0.23)% | (0.58)% | (1.07)% | (1.68)% | (3.19)% |
| RMBS Dollar Return | | \$(1,161) | \$(2,897) | \$(5,344) | \$(8,366) | \$(15,896) |

As of December 31, 2015

| | December 31, 2015 | Fair Value Change | | | | |
|--|----------------------|-------------------|-----------|-----------|------------|------------|
| | | +25 Bps | +50 Bps | +75 Bps | +100 Bps | +150 Bps |
| RMBS Portfolio | | | | | | |
| RMBS, available-for-sale, net of swaps | \$ 503,697 | | | | | |
| RMBS Total Return (%) | | (0.49)% | (1.07)% | (1.74)% | (2.47)% | (4.04)% |
| RMBS Dollar Return | | \$(2,444) | \$(5,406) | \$(8,785) | \$(12,456) | \$(20,353) |

The sensitivity analysis is hypothetical and is presented solely to assist an analysis of the possible effects on the fair value under various scenarios. It is not a prediction of the amount or likelihood of a change in any particular scenario. In particular, the results are calculated by stressing a particular economic assumption independent of changes in any other assumption. In practice, changes in one factor may result in changes in another, which might counteract or amplify the sensitivities. In addition, changes in the fair value based on a 10% variation in an assumption generally may not be extrapolated because the relationship of the change in the assumption to the change in fair value may not be linear.

Counterparty Risk

When we engage in repurchase transactions, we generally sell securities to lenders (i.e., repurchase agreement counterparties) and receive cash from the lenders. The lenders are obligated to resell the same securities back to us at the end of the term of the transaction. Because the cash we receive from the lender when we initially sell the securities to the lender is less than the value of those securities (this difference is the haircut), if the lender defaults on its obligation to resell the same securities back to us we would incur a loss on the transaction equal to the amount of the haircut (assuming there was no change in the value of the securities). As of June 30, 2016, the Company's exposure (defined as the amount of cash and securities pledged as collateral, less the borrowing under the repurchase agreement) to any of the counterparties under the repurchase agreements did not exceed five percent of the Company's equity.

Our interest rate swaps are required to be cleared on an exchange which greatly mitigates, but does not entirely eliminate, counterparty risk.

Our investments in Servicing Related Assets are dependent on the mortgage servicer, Freedom Mortgage, to perform its servicing and subservicing obligations. If the mortgage servicer fails to perform its obligations and is terminated, our investments in the related Excess MSR could lose all their value, and the value of the related MSR may be adversely affected. In addition, many servicers also rely on subservicing arrangements with third parties, and the failure of subservicers to adequately perform their services may negatively impact the servicer and, as a result, the performance of the Excess MSR we acquired from Freedom Mortgage. In addition, should Freedom Mortgage fail to make required payments, under our acknowledgment agreement with Ginnie Mae, we could be exposed to potential liabilities. To the extent Freedom Mortgage loses its ability to serve as a servicer for one or more of the agencies we could face significant adverse consequences. Similarly, if Freedom Mortgage is unable to successfully execute its business strategy or no longer maintains its financial viability, our business strategy would be materially adversely affected and our results of operations would suffer.

Table of Contents

Funding Risk

To the extent available on desirable terms, we expect to continue to finance our RMBS with repurchase agreement financing. We also anticipate financing our MSRs with revolving bank loans secured by a pledge of those MSRs. Over time, as market conditions change, in addition to these financings, we may use other forms of leverage. We may also seek to finance other mortgage-related assets, such as prime mortgage loans. Weakness in the financial markets, the residential mortgage markets and the economy generally could adversely affect one or more of our potential lenders and could cause one or more of our potential lenders to be unwilling or unable to provide us with financing or to increase the costs of that financing.

Liquidity Risk

Our Excess MSRs and MSRs, as well as some of the assets that may in the future comprise our portfolio, are not publicly traded. A portion of these assets may be subject to legal and other restrictions on resale or will otherwise be less liquid than publicly-traded securities. The illiquidity of these assets may make it difficult for us to sell such assets if the need or desire arises, including in response to changes in economic and other conditions.

Credit Risk

Although we expect relatively low credit risk with respect to our portfolios of Excess MSRs and our Agency RMBS, our investment in MSRs exposes us to the credit risk of borrowers. To the extent we invest in non-Agency RMBS and prime mortgage loans we expect to encounter credit risk related to these asset classes.

To date, our only investments in non-Agency RMBS have been credit risk transfer securities issued by Fannie Mae and Freddie Mac.

Table of Contents

Item 4. Controls and Procedures

Disclosure Controls and Procedures. The Company's President and its Chief Financial Officer, have evaluated the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended ("Exchange Act")) as of the end of the period covered by this report. The Company's disclosure controls and procedures are designed to provide reasonable assurance that information is recorded, processed, summarized and reported accurately and on a timely basis. Based on such evaluation, the Company's President and the Company's Chief Financial Officer have concluded that, as of the end of such period, the Company's disclosure controls and procedures are effective.

Changes in Internal Control Over Financial Reporting. There have been no changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the most recently completed fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Table of Contents

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, the Company may be involved in various claims and legal actions in the ordinary course of business. As of June 30, 2016, the Company was not involved in any legal proceedings.

Item 1A. Risk Factors

There have been no material changes to the risk factors previously disclosed in our Annual Report on Form 10-K filed with the SEC on March 15, 2016, as updated in our Current Report on Form 10-Q filed with the SEC on May 10, 2016.

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

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not Applicable.

Item 5. Other Information

None.

Item 6. Exhibits

| Exhibit Number | Description |
|----------------|--|
| 31.1* | Certification of Principal Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934. |
| 31.2* | Certification of Principal Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934. |
| 32.1* | Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2* | Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to 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.

73

Table of Contents

SIGNATURES

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

CHERRY HILL
MORTGAGE
INVESTMENT
CORPORATION

August 9, 2016 By: /s/ Jeffrey Lown II
Jeffrey Lown II
President (Principal
Executive Officer)

August 9, 2016 By: /s/ Martin J. Levine
Martin J. Levine
Chief Financial Officer,
Secretary and Treasurer
(Principal Financial
Officer)

Table of Contents

CHERRY HILL MORTGAGE INVESTMENT CORPORATION

FORM 10-Q

June 30, 2016

INDEX OF EXHIBITS

| Exhibit Number | Description |
|----------------|--|
| <u>31.1*</u> | Certification of Principal Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934. |
| <u>31.2*</u> | Certification of Principal Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934. |
| <u>32.1*</u> | Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| <u>32.2*</u> | Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to 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.