Great Ajax Corp.
Form 10-K
March 29, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

FOR ANNUAL AND TRANSITION REPORTS PURSUANT TO SECTIONS 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
(Mark One)

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

For the fiscal year ended December 31, 2015
OR

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

For the transition period from to
001-36844
(Commission file number)

GREAT AJAX CORP.
(Exact name of registrant as specified in its charter)

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

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

503-505-5670
Registrant's telephone number, including area code
Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common stock, par value $0.01 per share	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

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

The aggregate market value of the shares of common stock held by non-affiliates of the registrant as of June 30, 2015 (the last business day of the registrant's most recently completed second fiscal quarter) was approximately $207,247,958 based on the price per share of $14.02, the average price on June 30, 2015.

As of March 18, 2016, 15,942,638 shares of the Registrant's common stock, par value $0.01 per share, were outstanding, which includes 624,106 operating partnership units that are exchangeable on a one-for-one basis into shares of the registrant's common stock.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Definitive Proxy Statement with respect to its 2016 Annual Meeting of Stockholders are incorporated by reference into this annual report on Form 10-K in response to Part III, Items #10, 11, 12, 13 and 14.

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

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

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

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

- the factors referenced in this annual report, including those set forth under "Item 1A. Risk Factors," "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Item 1. Business";
- our ability to implement our business strategy;
- difficulties in identifying re-performing ("RPL") and non-performing loans ("NPL") and properties to acquire;
- the impact of changes to the supply of, value of and the returns on re-performing and non-performing loans;
- our ability to convert non-performing loans into performing loans, or to modify or otherwise resolve such loans;
- our ability to convert non-performing loans to properties that can generate attractive returns either through sale or rental;
- our ability to compete with our competitors;
- our ability to control our costs;
- the impact of changes in interest rates and the market value of the collateral underlying our re-performing and non-performing loan portfolios or of our other real estate assets;

- our ability to obtain financing arrangements on favorable terms, or at all;
- our ability to retain our engagement of our Manager;
- the failure of the Servicer to perform its obligations under the servicing agreement;
- general volatility of the capital markets;
- the impact of adverse real estate, mortgage or housing markets and changes in the general economy;
- changes in our business strategy;

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- our failure to qualify or maintain qualification as a real estate investment trust (“REIT”);

- our expectations regarding the time during which we will be an emerging growth company under the Jumpstart Our Business Startups Act (the “JOBS Act”);

- our failure to maintain our exemption from registration under the Investment Company Act of 1940, as amended (the “Investment Company Act”); and

- the impact of adverse legislative or regulatory tax changes.

Item 1. Business

Overview

Great Ajax Corp. is a Maryland corporation that focuses primarily on acquiring, investing in and managing a portfolio of re-performing and non-performing mortgage loans secured by single-family residences and, to a lesser extent, single-family properties. Re-performing loans are loans on which at least five of the seven most recent payments have been made, or the most recent payment has been made and accepted pursuant to an agreement, or the full dollar amount, to cover at least five payments has been paid in the last seven months. Non-performing loans are loans on which the most recent three payments have not been made. We also invest in loans secured by multi-family residential and commercial mixed use retail/ residential properties, as well as in the properties directly. The multi-family and commercial mixed-use properties generally have loan values of up to approximately $5 million. We refer to these as “smaller commercial properties.” We are organized and operated in a manner intended to allow us to qualify as a REIT.
Our primary strategy is to acquire, own and manage re-performing and non-performing mortgage loans, which are serviced by Gregory Funding LLC (“Gregory”), our affiliated servicer. We seek to acquire loans at significant discounts to our estimates of the value of the underlying real estate and of the unpaid principal balance, or UPB, of the loan. Unlike other loan acquirers, who often rely on pooled estimates in analyzing and pricing portfolios, our Manager uses proprietary models and data developed by its affiliates to evaluate individual assets and to help determine cities, neighborhoods and properties that it believes will experience home price appreciation, or HPA. These proprietary analytics have inputs for economic and demographic data that include changes in unemployment rates, median household incomes, housing starts, crime rates, education, electoral participation and other variables that we believe closely correlate to property values. The proprietary models predict probabilistic future cash flows for each loan we seek to acquire. Factors affecting our cash flow projections include resolution method, resolution timeline, foreclosure costs, rehabilitation costs and eviction costs. The database for these proprietary models contains foreclosure timelines on an individual county basis and, in some instances, also on an individual judge basis. We believe that these proprietary models permit us to acquire loans at prices we and the Manager believe represent a discount to UPB and current property values in non-auction purchases.

We generally securitize our mortgage loans and retain subordinated securities from our securitizations. We also hold “real estate-owned” properties, or REO, acquired upon the foreclosure or other settlement of our owned non-performing loans, as well as through outright purchases. Our REO consists principally of single-family homes, although we also may own smaller commercial properties. Our resolution methods are tailored to each loan, based on our Servicer’s detailed analytics, and include, among others, loan modification, forbearance agreements, foreclosure, short sale and deed-in-lieu of foreclosure. In the event of foreclosure, our Manager determines, in part based on the information obtained from the Servicer regarding historical experience, whether to seek to sell any REO asset, including offering mortgage financing to the purchaser, or to hold the REO as a rental property. We conduct some of these activities through a taxable REIT subsidiary, or TRS. As part of our integrated approach, the Servicer focuses on understanding each borrower’s situation and working closely with the borrower to determine the most appropriate resolution for both parties. We believe that purchasing re-performing and non-performing mortgage loans at significant discounts to UPB and underlying property values, as well as working, through Gregory, to support continuing or new payments by borrowers, allows us to achieve our targeted returns. However, if actual results differ from our assumptions, particularly if the value of the underlying properties were to decrease significantly, we may not achieve our targeted returns.

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We are externally managed by Thetis Asset Management LLC, an affiliated entity. We own a 19.8% equity interest in our Manager through a TRS. In addition, at March 18, 2016, our Manager and the Servicer own in the aggregate 443,855 shares of our common stock. We believe that these ownership interests, combined with our paying a percentage of the base management fee to our Manager in shares of our common stock, align our Manager's interests with our interests and those of our stockholders. See "— The Management Agreement."

We believe that we benefit from the strategies employed by Aspen Capital, Gregory and our Manager. Aspen Capital and Gregory have successfully competed in the residential loan and property markets based on their ability to evaluate, acquire, manage and service loans on an individual basis rather than on a pooled basis. Using proprietary analytics and data tracking, our Manager and Gregory have the ability to evaluate large numbers of loans efficiently, determine individual valuations and develop resolution and cash flow paths. Consistent with Aspen's past residential asset acquisitions and our recent operations, we are able to purchase loans through privately negotiated transactions rather than in the auction market. Since January 1, 2012 through December 31, 2015, over 90% of Aspen's acquisitions have been through privately negotiated transactions.

Manager Experience

Since 2009 through December 31, 2015, the management team of our Manager, on behalf of Aspen Capital, has invested more than $847.6 million in more than 5,868 residential assets, including the assets in our portfolio, with an aggregate UPB and REO market value at time of purchase or conversion of approximately $1.3 billion. Aspen Capital's overall portfolios of loans and properties may differ significantly from the mortgage loans we acquire in terms of interest rates, principal balances, geographic distribution, types of properties, lien priority, origination and underwriting criteria, and other possibly relevant characteristics. In addition, Aspen Capital's past performance is not indicative of future results and its results were not achieved by a public company (subject to legal and regulatory expenses) nor by an entity organized as a REIT. Results are necessarily reflective of particular market conditions and current and future market conditions and economic factors beyond management's control, which may cause future results to vary.

The Servicer

Gregory was formed by the members of our Manager's management team to service "high-touch" assets, which are loans that require substantial and active interaction with the borrower for modification or other resolution. These loans are to less creditworthy borrowers or for properties the value of which has decreased and are more expensive to service because they require more frequent interaction with customers and greater monitoring and oversight. Gregory, or its wholly owned subsidiary, is licensed to service loans in all states in which it does business and has unsupervised Title II Mortgagee authorization from the Federal Housing Administration, or FHA. Gregory, or its wholly owned subsidiary, is also a licensed mortgage lender in 23 states, and currently has mortgage loan origination staff who are licensed in 11 of those states. As of December 31, 2015, Gregory, for our account, its own account and for affiliated entities comprised primarily of third-party investors, services a portfolio of residential and commercial mortgage loans and REO throughout the United States with UPB and REO principal balance of approximately $1.0 billion.

Our Manager and the Servicer are located in separate premises in the same building and share IT resources, which should lead to more effective oversight by our Manager. We also believe this close collaboration leads to better communication among our Manager, the Servicer and us and greater ability by our Manager and the Servicer to enhance IT systems and upgrade analytics with desired features, which should enable our Manager and the Servicer to determine the optimal resolution strategy for each loan more quickly. Our Manager communicates an initial pool level strategy to the Servicer and hosts a training session to review priorities and optimal solutions. During the training session, our Manager can discuss any exceptions found during the due diligence process and provide guidance to the Servicer on addressing any issues effectively. In addition to training sessions and informal discussions, both parties meet weekly to review individual modification requests. Every employee of our Manager is very familiar with all functions of the Servicer, which allows them to monitor performance at a granular level to maximize individual asset returns.

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The Servicer must comply with a wide array of U.S. federal, state and local laws and regulations that regulate, among other things, the manner in which it services our mortgage loans and manages our real property in accordance with the servicing agreement, including recent Consumer Financial Protection Bureau, or CFPB, mortgage servicing regulations promulgated pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act, or the Dodd-Frank Act. These laws and regulations cover a wide range of topics. The laws and regulations are complex and vary greatly among the states and localities. In addition, these laws and regulations often contain vague standards or requirements, which make compliance efforts challenging. From time to time, the Servicer may become party to certain regulatory inquiries or proceedings, which, even if unrelated to the residential mortgage servicing operation, may result in adverse findings, fines, penalties or other assessments and may affect adversely the Servicer's reputation.

Strategy

We are continuing the opportunistic strategy developed by our Manager's management team at Aspen in a REIT structure that we believe provides us access to capital and allows us to compete for more significant investment opportunities in the evolving mortgage markets. This strategy enables us to generate attractive current yields and risk-adjusted total returns for our stockholders. We intend to continue to distribute substantially all of our REIT taxable income to our stockholders in accordance with applicable REIT qualification requirements. Our strategy consists of:

- focusing our investments primarily in loans secured by single-family residences with opportunistic mortgage or direct investment in smaller commercial properties, such as smaller mixed-use commercial facilities with ground floor retail units and residences above them;
- constructing and owning a portfolio of re-performing and non-performing mortgage loans at significant discounts to UPB and underlying property values;
- concentrating our investments in geographic areas, cities and neighborhoods with certain demographic and economic trends and attributes;
- working, through Gregory, to (1) support the continued performance of re-performing loans; (2) convert a portion of our non-performing loans to performing status; (3) determine optimal loss mitigation strategy on an asset-by-asset basis for remaining loans; and (4) manage the process and timelines for converting non-performing loans to sale or rental REO, including potentially offering financing to REO purchasers;
- when economically efficient, securitizing our performing and re-performing whole loan portfolios to create long-term, fixed rate, non-recourse financing, while retaining one or more tranches of any subordinated securities we may create; and
- opportunistically mitigating our interest rate and prepayment risk by using a variety of hedging instruments.

We believe that purchasing re-performing and non-performing mortgage loans at significant discounts to UPB and underlying property values, as well as working, through Gregory, to support continuing or new payments by borrowers, allows us to achieve our targeted returns. However, if actual results differ from our assumptions, particularly if the value of the underlying properties were to decrease significantly, we may not achieve our targeted returns.

We price each loan portfolio on a loan-by-loan basis and focus on the acquisition of loans with the underlying property located in or in close proximity to urban centers where we believe that HPA will outpace the national market.

While we expect to purchase loans nationwide, we target urban centers (including densely populated suburbs) because we believe that an increasing number of families and young professionals prefer to live in areas that are in close proximity to employment centers, public transportation and retail and other amenities that are typically more common in such areas, which provides greater potential for HPA. By focusing on urban centers and targeted densely populated suburbs we are able to more efficiently manage our portfolio and scale our high-touch loan servicing platform. Gregory has compiled data that suggests that HPA can vary significantly from neighborhood to neighborhood even within the same city. Our proprietary analytics include inputs for economic and demographic data that includes unemployment rates, housing starts, crime rates, education, electoral

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participation and other variables that we believe closely correlate to property values. These analytics help us determine cities, neighborhoods and properties that we believe will experience HPA.

We seek to build clusters of loans backed by collateral in certain markets. These markets include, but are not limited to, Phoenix, Arizona; Los Angeles and San Diego, California; Miami, Ft. Lauderdale, West Palm Beach, Orlando and Tampa, Florida; Atlanta, Georgia; Chicago, Illinois; New York and New Jersey metropolitan area; Dallas and Houston, Texas; and Maryland and Virginia near Washington, DC. In addition to its experienced servicing staff, Gregory has contracted with local experts in areas where it services a significant number of loans that provide local area market intelligence, monitor properties and can manage rehabilitation projects for REO or repairs for rental properties. We believe having affiliated local experts and a centralized management team provides us a competitive advantage and leads to more informed decision-making and better execution.

Based on the experience of our Manager's management team, we believe that acquiring re-performing and non-performing mortgage loans results in higher risk-adjusted returns and provides us a cost advantage over other real property acquisition channels, such as foreclosure auctions and REO acquisitions.

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

- The histories of distressed mortgage loans often provide more insight into the likelihood of default than acquiring newly originated mortgage loans, which should allow our Manager to model default risk and price acquisitions more accurately.

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

- We believe that we are able to purchase mortgage loans at lower prices than REO properties because sellers of such loans are able to avoid paying the costs typically associated with sales of real estate, whether single-family residences or smaller commercial properties, such as broker commissions and closing costs of up to 10% of gross proceeds of the sale. We believe this motivates the sellers to accept a lower price for the re-performing and non-performing loans than they would if selling REO directly.

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

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We use proprietary models to predict probabilistic future cash flows for each loan. Factors affecting our cash flow projections include resolution method, resolution timeline, foreclosure costs, rehabilitation costs and eviction costs. We value each portfolio on a loan-by-loan and property-by-property basis and generate cash flow projections as if each non-performing loan was foreclosed and resolved according to the expected resolution method. Some of the variables used are the specific location of the underlying property, loan-to-value ratio, property age and condition, change and rate of change of borrower credit rating, servicing notes, interest rate, monthly payment amount and neighborhood rents. For loan pool acquisitions, we target a 9 – 18% return, without taking into account or giving effect to any borrowings, which we refer to as an unlevered return. We forecast the relative likelihood of each resolution method — foreclosure, deed-in-lieu, short sale and rental — for non-performing loans. For re-performing pool acquisitions, we analyze each loan for re-default probability, loan-to-value ratio, interest rate and structure of the loan and the likely resolution method in the event the loan stops performing. Each re-performing loan is analyzed through both a performing and non-performing path.

Our comprehensive loan and property history database and data tracking lead to a deep understanding of our markets. This understanding, coupled with our long-term relationships with loan sellers, allows us to purchase loans at significant discounts to UPB and current property values. Our database contains foreclosure timelines on an individual county basis and in some instances, also on an individual judge basis. In addition to resolution timeline data, we track data by state, MSA (Metropolitan Statistical Area) and zip code basis regarding crime rates, education, electoral participation and other variables that we believe closely correlate with property values.

Our strategy is adaptable to changing market environments, subject to compliance with the income and other tests that allows us to continue to qualify and maintain our qualification as a REIT for U.S. federal income tax purposes and to maintain our exclusion from regulation as an investment company under the Investment Company Act. As a result, our acquisition and management decisions depend on prevailing market conditions, and our targeted investments may vary over time in response to market conditions. We may change our strategy and policies without a vote of our stockholders. Moreover, although our independent directors will periodically review our investment guidelines and our portfolio, they generally will not review particular proposed asset acquisitions or asset management decisions. See "— Investment Guidelines."

Our Portfolio

We acquire, invest in and manage a portfolio of mortgage loan assets as well as single-family and smaller commercial properties. We focus on acquiring and owning re-performing and non-performing mortgage loans and subordinated MBS securities from our own securitizations. We also hold REO acquired upon the foreclosure or other settlement of our owned non-performing loans or that we acquire in the market, principally single-family homes although we may also own smaller commercial properties. We assess the allocation of investments across asset classes, and within asset classes, based on the risk-adjusted relative value of each asset and the overall contribution of each asset to the anticipated performance of our investment portfolio and the value to be added to our investment portfolio. Additional factors that may affect the allocation of our investments include profiles of borrowers, geographic and demographic information, security, structure, seniority, credit enhancement, and legal matters. Our investment allocations are subject to change based on market changes and our assessment of the factors described above. See also "— Financing Strategy and Use of Leverage."

We closely monitor the status of our mortgage loans and, through our Servicer, work with our borrowers to improve their payment records. We have not experienced material write downs or impairments on the mortgage loans we have purchased since we commenced operations in July 2014. As of December 31, 2015, of the 3,250 loans in our portfolio, 85.0% were re-performing loans and 15.0% were non-performing loans.

Gregory is the holder of record for one loan each in Georgia and Illinois because neither we nor our operating partnership holds the necessary licenses to hold those assets directly in such states. Gregory sells a 95% participation interest in the assets to our subsidiaries in exchange for 95% of the purchase price for the assets to be purchased by Gregory, which pays for the balance of such assets.

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Additional Investments

Set forth below is a description of the asset classes in which we make investments.

Residential Mortgage Loans

Residential mortgage loans are loans secured by single-family residential real properties. We generally focus our residential mortgage loan acquisition efforts on the purchase of loan portfolios that are first lien, single-family fixed rate mortgage loans, ARMs and Hybrid ARMs with original terms to maturity of not more than 40 years and that are either fully amortizing or are interest-only for up to ten years, and fully amortizing thereafter. While we focus on older distressed mortgage loans, we have the ability to invest in newly originated mortgage loans. In most cases, the loans we purchase are re-performing, and non-performing.

Commercial Mortgage Loans

We also acquire commercial mortgage loans secured by smaller unit multifamily residences, which are considered commercial mortgage loans, as well as smaller mixed use retail/residential/office properties, which will generally have property values of less than $5 million. As with the single-family residential mortgage loans, we will have the ability to invest in newly originated mortgage loans, but we currently expect to focus on older distressed mortgage loans.

REO and Other Real Property

We will acquire individual real properties primarily through workouts of existing loans and foreclosure on defaulted loans as well as, to a much lesser extent, purchases from original owners. These properties consist of single-family residential properties, smaller multifamily residences and commercial mixed use retail/residential properties, such as smaller commercial facilities with ground floor retail units and residences above them. We may acquire on an opportunistic basis portfolios of residential single-family and multi-family properties throughout the United States.

Investment Process

Our underwriting process for acquiring re-performing and non-performing loan portfolios relies on extensive research and analysis of the target portfolio’s loan and borrower characteristics, underlying property values, document integrity, local processes and timelines, and the use of our proprietary models to determine probabilistic future cash flows and returns from various resolution methodologies. Factors affecting our cash flow projections and related pricing include, but are not limited to, property location, property age and condition, resolution method, resolution timeline, foreclosure costs, rehabilitation costs, eviction costs, neighborhood rents, changes and rate of change of borrower credit ratings and targeted return. We value every portfolio on a loan-by-loan and property-by-property basis.

We generate and analyze multiple models that evaluate the following:

- loan cash flows as if every non-performing loan is foreclosed and also using deterministic resolution outcomes; and
- re-performing loans with risk-based cash flows and pricing based on payment history, time series credit scores, geography, effective loan-to-value ratios, likelihood of prepayment and predictive re-default probabilities.

For pool acquisitions, we target a 9 – 18% unlevered return. For non-performing loans, we forecast the relative likelihood of each resolution method — foreclosure, deed in lieu, short sale and rental. For re-performing pool acquisitions, we analyze each loan for re-default probability and resolution method. Each re-performing loan is analyzed through both a performing and non-performing path.

Purchase prices generally are at a significant discount to UPB and current property value, based in part on at least two unaffiliated broker price opinions for every property. Employees and agents of our Manager frequently visit the exteriors of properties prior to completion of due diligence and the information from such visits is incorporated into final loan pricing negotiations with the seller.

We estimate our resolution timelines using a combination of proprietary data, modeling and historical trends. Our analysis of the resolution or foreclosure timeline for a mortgage loan is based on its history to date with added time cushion. We have developed a robust database of foreclosure timelines on an individual county basis and in some instances, on an individual judge basis. We also use statistical models to determine the expected modification success probability and the expected short sale success probabilities. We have an extensive due diligence process to validate data consistency, accuracy and compliance and perform document and third-party lien reviews on all loan files.

The most important factors in analyzing re-performing loans are the level and duration of continued re-performance, the potential for HPA, prevailing interest rates and the potential for economic growth and the availability of financing for the borrower. For non-performing loans, the most important factors are the expected time to either re-performance or foreclosure, the condition of the real property, the potential for HPA (although we do not use an assumption of HPA in our acquisition loan models), whether the property is located in an urban or rural area and its actual geographic location and relative costs of owning versus renting the property. The analysis of all mortgage loan and REO acquisitions is also affected by the supply of existing housing and rate of housing starts as higher construction costs, particularly if replacement cost is greater than market price, can slow the rate of starts and new housing inventory and lead to rising rental rates relative to mortgage payments. We evaluate geographic location priorities based on many different factors and data including, but not limited to, employment rates and the local mismatch between employment rates and housing supply, demographic shifts, cost of new construction, social services, education, crime and voting participation rates.

The following graphic outlines the process the Manager generally uses for assessing re-performing and non-performing portfolio investment opportunities:

Gregory Funding — Loan Servicing and Loan Resolution; Property Management

Gregory Funding LLC, and in California, its subsidiary, Gregory Funding Inc., sister entities with our Manager and indirect subsidiaries of Aspen, service our mortgage loans, mortgage-backed securities, or MBS, REO and other real estate assets. Gregory is licensed to service loans or is exempt from licensing in all states in which it does business. Gregory is also an approved servicer for the FHA and the Veterans Administration, or VA. As of the date of this annual report, Gregory and its subsidiary have approximately 80 employees, agents and independent contractors in nine states engaged in servicing mortgage loans and property management, and is licensed in every state in which licensing is required for such activities.

The Servicer employs various loan resolution methodologies with respect to our residential mortgage loans, including loan modification, collateral resolution and collateral disposition. To help us achieve our business objective, the Servicer focuses on (1) supporting the continuing performance of our re-performing loans; (2) converting a portion of our re-performing and non-performing loans to performing status; and (3) managing the foreclosure process and timelines with respect to the remainder of those loans.

Our preferred resolution methodology is typically to cause the re-performing and non-performing loans to perform. Following a period of continued performance, we expect many borrowers will refinance these loans with us or other lenders at or near the estimated value of the underlying property, potentially generating attractive returns for us. We believe loan re-performance followed by refinancing generates near-term cash flows, provides the highest possible stable economic outcome for us and is a socially responsible business strategy because it keeps more families in their homes. In certain circumstances, we may also consider selling these newly re-performing loans. However, based on historical experience, we expect that many of our non-performing residential mortgage loans will enter into foreclosure, ultimately becoming REO that we can, based on our analysis of risk-adjusted returns, sell, often while offering purchase money mortgage financing, or convert into rental properties. If a REO property does not meet our investment criteria, we expect the Servicer to engage in REO liquidation and short sale processes to dispose of the property and generate cash for reinvestment in other acquisitions. We believe that our multifaceted resolution approach generally creates optimal stable returns, as all loans and REO may not be amenable to a single resolution strategy. To avoid the 100% prohibited transaction tax on the sale of dealer property by a REIT, we may dispose of assets that may be treated as held “primarily for sale to customers in the ordinary course of a trade or business” by contributing or selling the asset to a taxable REIT subsidiary, or TRS, prior to marketing the asset for sale.

The Servicer collects and remits mortgage loan payments, responds to borrower inquiries, accounts for principal and interest, holds custodial and escrow funds for payment of property taxes and insurance premiums, counsel or otherwise work with delinquent borrowers, supervises foreclosures and property dispositions and generally administers the loans. In return for these servicing functions, we pay servicing fees to the Servicer equal to specified percentages of the outstanding unpaid principal balance of the loans being serviced. We are entitled to other forms of servicing compensation, rather than the Servicer, such as late payment or modification fees and any prepayment penalties payable by borrowers. Servicing compensation also includes interest income, or the “float,” earned on collections that are deposited in various custodial accounts between their receipt and the scheduled or contractual distribution of the funds to investors. Generally, the Servicer does not advance delinquent monthly payments of interest or principal in respect of mortgage loans but will be obligated to make certain servicing advances.

The Servicer also services the mortgage loans underlying the MBS we create and sell to investors pursuant to customary agreements.

Under the servicing agreement, the Servicer also provides property management, lease management and renovation management services associated with the real properties we acquire upon conversion of mortgage loans that we own or that we acquire directly and assists in finding third party financing for such properties.

The compensation payable by us to the Servicer for servicing our mortgage loans and managing our REO is described in more detail under “— Gregory Servicing Agreement.”

When we determine to sell a particular REO asset through our Servicer, we have the capability in certain states to underwrite and offer mortgage financing to the purchaser. We rely on Gregory’s in-depth knowledge of the properties when we facilitate financing in connection with a sale of a property through an unaffiliated lender. Unlike more traditional lenders, which base their underwriting primarily on the FICO® credit risk score, Gregory focuses on the borrower’s cash flow and residual income after satisfaction of monthly requirements, including the expenses for any dependents, employment stability and the ability to make a cash down payment. We may choose to purchase the loan. We believe that our ability to offer financing tailored to the particular borrower provides another tool to maximize our return by converting REO to long-term significant net yield generating assets. Gregory receives no additional compensation from us for originating REO sale financing or other loans that we acquire.

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Investment Guidelines

All of our investment activities are conducted by our Manager on our behalf pursuant to the management agreement. Our principal objective is to generate attractive risk-adjusted returns for our stockholders over the long-term through dividends and capital appreciation.

Our board of directors has adopted an investment policy designed to facilitate the management of our capital and assets and the maintenance of an investment portfolio profile that meets our objectives. The investment policy will help the board of directors oversee our efforts to achieve a return on assets consistent with our business objectives and to maintain adequate liquidity to meet any financial covenants and regular cash requirements.

Our Manager has established an internal investment committee, consisting of Messrs. Mendelsohn and Schaub and three other Aspen investment professionals experienced in residential and/or smaller commercial real estate investments. Any purchase of re-performing or non-performing residential mortgage loans or of properties are analyzed by the capital markets group of our Manager and presented in written form to its investment committee for approval prior to purchase. Our Manager's investment committee's role is to act in accordance with the investment policy and guidelines approved by our board of directors for the investment of our capital. The investment committee may, without a vote of our stockholders, consider any investment, including investments in re-performing, non-performing and, as appropriate, performing residential and smaller commercial mortgage loans, consistent with our investment policy. We may also acquire single-family homes, smaller multi-family residential properties and smaller mixed use retail/residential/office properties either upon foreclosure or other settlement of our owned non-performing loans or in the market and opportunistically either sell such REO, including offering mortgage loans to the purchasers, or rent the REO for the short or long term.

Our Manager's investment committee is authorized to finance our investment positions through repurchase agreements, warehouse lines of credit, securitized debt and other financing arrangements provided such agreements are negotiated with counterparties approved by the investment committee. Our Manager believes it is critical to structure any financing facilities to significantly limit the risk to our business from falling collateral values and margin calls. We fund our asset acquisitions with non-recourse securitizations in which the underlying collateral is not marked-to-market and employ repurchase agreements without the obligation to mark to market the underlying collateral to the extent available. We may also hedge our interest rate exposure on our financing activities through the use of interest rate swaps, forwards, futures and options, subject to prior approval from the investment committee.

Our board of directors has adopted the following additional investment guidelines:

- investments and acquisitions that exceed 15% of our equity from time to time must be approved by the Investment Supervisory Committee of our board of directors;
- no investment shall be made that would cause us to fail to qualify as a REIT for U.S. federal income tax purposes;
- no investment shall be made that would cause us to be regulated as an investment company under the Investment Company Act;
- our assets will be invested within our target assets, as described above; and
- until appropriate investments can be identified, we may pay off short-term debt or invest the proceeds of any offering in interest-bearing, short-term investments, including funds that are consistent with qualifying and maintaining our qualification as a REIT.

Our investment policy and guidelines may be changed from time to time by our board of directors without the approval of our stockholders.

Broad Investment Policy Risks

Our investment policy is very broad and, therefore, our Manager has great latitude in determining the types of assets that are appropriate investments for us, as well as the individual investment decisions. In the future, our Manager may make investments on our behalf with lower rates of return than those anticipated

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under current market conditions and/or may make investments with greater risks to achieve those anticipated returns. Our board of directors periodically reviews our investment policy and guidelines and our investment portfolio but does not review or approve each proposed investment by our Manager unless it falls outside our previously approved investment policy or constitutes a related party transaction. In conducting periodic reviews, our board of directors relies primarily on information provided to it by our Manager. Transactions entered into by our Manager may be costly, difficult or impossible to unwind by the time they are reviewed by our board of directors.
In addition, we may change our business strategy and investment policy and targeted asset classes at any time without the consent of our stockholders, and this could result in our making investments that are different in type from, and possibly riskier, than our current investments or the investments currently contemplated. Changes in our investment strategy and investment policy and targeted asset classes may increase our exposure to interest rate risk, counterparty risk, default risk and real estate market fluctuations, which could materially and adversely affect us.
Policies with Respect to Certain Transactions
Other than (i) the transactions pursuant to which we acquired our initial portfolio from Little Ajax II LLC, a Delaware limited liability company, or Little Ajax II, and from Gregory (see “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations — Liquidity and Capital Resources”), (ii) transactions in which Gregory is the holder of record because we or our subsidiaries may not hold the necessary license to hold those assets directly, but where we are the beneficial owner of at least 95% of the participation rights in those assets, or (iii) as approved by a majority of the independent members of our board of directors, we will not purchase portfolio assets from, or sell them to, our directors or officers or to our Manager, Aspen or any of their affiliates, or engage in any transaction in which they have a direct or indirect pecuniary interest, including in connection with the securitization of any of our mortgage loan assets (other than our agreements with our Manager, the Servicer and Aspen described in more detail herein).
Policies with Respect to Certain Other Activities
We intend to raise additional funds through future offerings of equity or debt securities or the retention of cash flow (subject to REIT distribution requirements) or a combination of these methods. In the event that our board of directors determines to raise additional equity capital, it has the authority, without stockholder approval, to issue additional common stock or preferred stock in any manner and on such terms and for such consideration as it deems appropriate, at any time, subject to compliance with applicable regulatory requirements.
In addition, we expect to borrow money to finance or refinance the acquisition of re-performing and non-performing residential mortgage loans and REO and for general corporate purposes and we may borrow to finance the payment of dividends. Our investment pol