

## Section 1: 10-Q (10-Q)

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

### FORM 10-Q

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

For the quarterly period ended March 31, 2017

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: 001-31458

## Drive Shack Inc.

(Exact name of registrant as specified in its charter)

Maryland

(State or other jurisdiction of incorporation  
or organization)

81-0559116

(I.R.S. Employer Identification No.)

1345 Avenue of the Americas, New York, NY

(Address of principal executive offices)

10105

(Zip Code)

(212) 798-6100

(Registrant's telephone number, including area code)

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

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 S 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 Regulations 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).

S Yes No £

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

Large accelerated filer £ Accelerated filer S Non-accelerated filer £ (Do not check if a smaller reporting company)

Smaller reporting company £ Emerging growth company £

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. £

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes £ No S

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the last practicable date.

**Common stock, \$0.01 par value per share: 66,842,378 shares outstanding as of April 26, 2017.**

## CAUTIONARY NOTE REGARDING FORWARD LOOKING STATEMENTS

This report contains certain “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements relate to, among other things, the operating performance of our investments, the stability of our earnings, and our financing needs. Forward-looking statements are generally identifiable by use of forward-looking terminology such as “may,” “will,” “should,” “potential,” “intend,” “expect,” “endeavor,” “seek,” “anticipate,” “estimate,” “overestimate,” “underestimate,” “believe,” “could,” “project,” “predict,” “continue” or other similar words or expressions. Forward-looking statements are based on certain assumptions, discuss future expectations, describe future plans and strategies, contain projections of results of operations or of financial condition or state other forward-looking information. Our ability to predict results or the actual outcome of future plans or strategies is inherently uncertain. Although we believe that the expectations reflected in such forward-looking statements are based on reasonable assumptions, our actual results and performance could differ materially from those set forth in the forward-looking statements. These forward-looking statements involve risks, uncertainties and other factors that may cause our actual results in future periods to differ materially from forecasted results. Factors which could have a material adverse effect on our operations and future prospects include, but are not limited to:

- the ability to retain and attract members to our golf properties;
- changes in global, national and local economic conditions, including, but not limited to, changes in consumer spending patterns, a prolonged economic slowdown and a downturn in the real estate market;
- effects of unusual weather patterns and extreme weather events, geographical concentrations with respect to our operations and seasonality of our business;
- competition within the industries in which we operate or may pursue additional investments;
- material increases in our expenses, including but not limited to unanticipated labor issues or costs with respect to our workforce, and costs of goods, utilities and supplies;
- our inability to sell or exit certain properties, and unforeseen changes to our ability to develop, redevelop or renovate certain properties;
- difficulty monetizing our real estate debt investments;
- liabilities with respect to inadequate insurance coverage, accidents or injuries on our properties, adverse litigation judgments or settlements, or membership deposits;
- changes to and failure to comply with relevant regulations and legislation, including in order to maintain certain licenses and permits, and environmental regulations in connection with our operations;
- inability to execute on our growth and development strategy by successfully developing, opening and operating new venues;
- impacts of failures of our information technology and cybersecurity systems;
- the impact of any current or further legal proceedings and regulatory investigations and inquiries;
- the impact of any material transactions with FIG LLC (the “Manager”) or one of its affiliates, including the impact of any actual, potential or predicted conflicts of interest;
- effects of the pending merger of Fortress Investment Group LLC with affiliates of SoftBank Group Corp.; and
- other risks detailed from time to time below, particularly under the heading “Risk Factors,” and in our other reports filed with or furnished to the Securities and Exchange Commission (the “SEC”).

Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. The factors noted above could cause our actual results to differ significantly from those contained in any forward-looking statement.

Readers are cautioned not to place undue reliance on any of these forward-looking statements, which reflect our management’s views only as of the date of this report. We are under no duty to update any of the forward-looking statements after the date of this report to conform these statements to actual results.

## **SPECIAL NOTE REGARDING EXHIBITS**

In reviewing the agreements included as exhibits to this Quarterly Report on Form 10-Q, please remember they are included to provide you with information regarding their terms and are not intended to provide any other factual or disclosure information about Drive Shack Inc. (the "Company") or the other parties to the agreements. The agreements contain representations and warranties by each of the parties to the applicable agreement. These representations and warranties have been made solely for the benefit of the other parties to the applicable agreement and:

- should not in all instances be treated as categorical statements of fact, but rather as a way of allocating the risk to one of the parties if those statements prove to be inaccurate;
- have been qualified by disclosures that were made to the other party in connection with the negotiation of the applicable agreement, which disclosures are not necessarily reflected in the agreement;
- may apply standards of materiality in a way that is different from what may be viewed as material to you or other investors; and
- were made only as of the date of the applicable agreement or such other date or dates as may be specified in the agreement and are subject to more recent developments.

Accordingly, these representations and warranties may not describe the actual state of affairs as of the date they were made or at any other time. Additional information about the Company may be found elsewhere in this Quarterly Report on Form 10-Q and the Company's other public filings, which are available without charge through the SEC's website at <http://www.sec.gov>.

The Company acknowledges that, notwithstanding the inclusion of the foregoing cautionary statements, it is responsible for considering whether additional specific disclosures of material information regarding material contractual provisions are required to make the statements in this report not misleading.

DRIVE SHACK INC.  
FORM 10-Q

INDEX

PART I. FINANCIAL INFORMATION

PAGE

Item 1.	Financial Statements	
	<a href="#">Consolidated Balance Sheets as of March 31, 2017 (unaudited) and December 31, 2016</a>	<a href="#">1</a>
	<a href="#">Consolidated Statements of Operations (unaudited) for the three months ended March 31, 2017 and 2016</a>	<a href="#">2</a>
	<a href="#">Consolidated Statements of Comprehensive Income (Loss) (unaudited) for the three months ended March 31, 2017 and 2016</a>	<a href="#">3</a>
	<a href="#">Consolidated Statement of Equity (unaudited) for the three months ended March 31, 2017</a>	<a href="#">4</a>
	<a href="#">Consolidated Statements of Cash Flows (unaudited) for the three months ended March 31, 2017 and 2016</a>	<a href="#">5</a>
	<a href="#">Notes to Consolidated Financial Statements (unaudited)</a>	<a href="#">6</a>
	<a href="#">Note 1 Organization</a>	<a href="#">6</a>
	<a href="#">Note 2 Summary of Significant Accounting Policies</a>	<a href="#">6</a>
	<a href="#">Note 3 Segment Reporting</a>	<a href="#">14</a>
	<a href="#">Note 4 Real Estate Securities</a>	<a href="#">17</a>
	<a href="#">Note 5 Real Estate Related and Other Loans, Residential Mortgage Loans and Subprime Mortgage Loans</a>	<a href="#">19</a>
	<a href="#">Note 6 Investments in Real Estate, Net of Accumulated Depreciation</a>	<a href="#">21</a>
	<a href="#">Note 7 Intangibles, Net of Accumulated Amortization</a>	<a href="#">21</a>
	<a href="#">Note 8 Debt Obligations</a>	<a href="#">22</a>
	<a href="#">Note 9 Derivatives</a>	<a href="#">23</a>
	<a href="#">Note 10 Fair Value of Financial Instruments</a>	<a href="#">24</a>
	<a href="#">Note 11 Equity and Earnings per Share</a>	<a href="#">28</a>
	<a href="#">Note 12 Transactions with Affiliates and Affiliated Entities</a>	<a href="#">30</a>
	<a href="#">Note 13 Commitments and Contingencies</a>	<a href="#">31</a>
	<a href="#">Note 14 Income Taxes</a>	<a href="#">31</a>
	<a href="#">Note 15 Impairment</a>	<a href="#">33</a>
	<a href="#">Note 16 Subsequent Events</a>	<a href="#">33</a>
Item 2.	<a href="#">Management's Discussion and Analysis of Financial Condition and Results of Operations</a>	<a href="#">34</a>
	<a href="#">General</a>	<a href="#">34</a>
	<a href="#">Market Considerations</a>	<a href="#">34</a>
	<a href="#">Application of Critical Accounting Policies</a>	<a href="#">35</a>
	<a href="#">Results of Operations</a>	<a href="#">40</a>
	<a href="#">Liquidity and Capital Resources</a>	<a href="#">44</a>
	<a href="#">Contractual Obligations</a>	<a href="#">49</a>
Item 3.	<a href="#">Quantitative and Qualitative Disclosures About Market Risk</a>	<a href="#">52</a>
Item 4.	<a href="#">Controls and Procedures</a>	<a href="#">53</a>
<b>PART II. OTHER INFORMATION</b>		
Item 1.	<a href="#">Legal Proceedings</a>	<a href="#">55</a>

<u>Item 1A.</u>	<u>Risk Factors</u>	<u>55</u>
<u>Item 2.</u>	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>78</u>
<u>Item 3.</u>	<u>Defaults upon Senior Securities</u>	<u>78</u>
<u>Item 4.</u>	<u>Mine Safety Disclosures</u>	<u>78</u>
<u>Item 5.</u>	<u>Other Information</u>	<u>78</u>
<u>Item 6.</u>	<u>Exhibits</u>	<u>79</u>
<u>SIGNATURES</u>		<u>81</u>

**DRIVE SHACK INC. AND SUBSIDIARIES**

**CONSOLIDATED BALANCE SHEETS**

(dollars in thousands, except share data)

	<b>March 31, 2017</b>	<b>December 31, 2016</b>
	<b>(Unaudited)</b>	
<b>Assets</b>		
Real estate securities, available-for-sale	\$ 2,032	\$ 1,950
Real estate securities, available-for-sale - pledged as collateral	326,878	627,304
Real estate related and other loans, held-for-sale, net	59,043	55,612
Investments in real estate, net of accumulated depreciation	216,452	217,611
Intangibles, net of accumulated amortization	63,366	65,112
Other investments	19,636	19,256
Cash and cash equivalents	126,970	140,140
Restricted cash	7,213	6,404
Receivables from brokers, dealers and clearing organizations	—	552
Receivables and other assets	38,165	38,017
<b>Total Assets</b>	<b>\$ 859,755</b>	<b>\$ 1,171,958</b>
<b>Liabilities and Equity</b>		
<b>Liabilities</b>		
Repurchase agreements	310,630	600,964
Credit facilities and obligations under capital leases	114,851	115,284
Junior subordinated notes payable	51,214	51,217
Dividends payable	930	8,949
Membership deposit liabilities	90,570	89,040
Accounts payable, accrued expenses and other liabilities	87,720	88,437
<b>Total Liabilities</b>	<b>\$ 655,915</b>	<b>\$ 953,891</b>
<b>Commitments and contingencies</b>		
<b>Equity</b>		
Preferred stock, \$0.01 par value, 100,000,000 shares authorized, 1,347,321 shares of 9.75% Series B Cumulative Redeemable Preferred Stock, 496,000 shares of 8.05% Series C Cumulative Redeemable Preferred Stock, and 620,000 shares of 8.375% Series D Cumulative Redeemable Preferred Stock, liquidation preference \$25.00 per share, issued and outstanding as of March 31, 2017 and December 31, 2016	\$ 61,583	\$ 61,583
Common stock, \$0.01 par value, 1,000,000,000 shares authorized, 66,842,378 and 66,824,304 shares issued and outstanding at March 31, 2017 and December 31, 2016, respectively	668	668
Additional paid-in capital	3,172,795	3,172,720
Accumulated deficit	(3,032,421)	(3,018,072)
Accumulated other comprehensive income	1,215	1,168
<b>Total Drive Shack Inc. Stockholders' Equity</b>	<b>203,840</b>	<b>218,067</b>
Noncontrolling interest	—	—
<b>Total Equity</b>	<b>\$ 203,840</b>	<b>\$ 218,067</b>
<b>Total Liabilities and Equity</b>	<b>\$ 859,755</b>	<b>\$ 1,171,958</b>

See notes to Consolidated Financial Statements.

**DRIVE SHACK INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)**

(dollars in thousands, except share data)

	<b>Three Months Ended March 31,</b>	
	<b>2017</b>	<b>2016</b>
<b>Revenues</b>		
Golf course operations	\$ 46,296	\$ 48,597
Sales of food and beverages	12,845	13,561
Total revenues	59,141	62,158
<b>Operating costs</b>		
Operating expenses	54,431	58,219
Cost of sales - food and beverages	4,032	4,597
General and administrative expense	3,565	2,937
Management fee to affiliate	2,677	2,675
Depreciation and amortization	5,793	6,031
Impairment	—	2,308
Realized/unrealized loss on investments	3,389	2,007
Total operating costs	73,887	78,774
Operating loss	(14,746)	(16,616)
<b>Other income (expenses)</b>		
Interest and investment income	7,888	21,039
Interest expense	(5,434)	(13,534)
Gain on deconsolidation	—	82,130
Other income (loss), net	(123)	320
Total other income (expenses)	2,331	89,955
(Loss) Income before income tax	(12,415)	73,339
Income tax expense	539	44
Net (Loss) Income	(12,954)	73,295
Preferred dividends	(1,395)	(1,395)
Net loss attributable to noncontrolling interest	—	124
(Loss) Income Applicable to Common Stockholders	\$ (14,349)	\$ 72,024
<b>(Loss) Income Applicable to Common Stock, per share</b>		
Basic	\$ (0.21)	\$ 1.08
Diluted	\$ (0.21)	\$ 1.05
<b>Weighted Average Number of Shares of Common Stock Outstanding</b>		
Basic	66,841,977	66,654,598
Diluted	66,841,977	68,284,898
Dividends Declared per Share of Common Stock	\$ —	\$ 0.12

See notes to Consolidated Financial Statements.

**DRIVE SHACK INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) (Unaudited)**

(dollars in thousands, except share data)

	Three Months Ended March 31,	
	2017	2016
Net (loss) income	\$ (12,954)	\$ 73,295
Other comprehensive income (loss):		
Net unrealized (loss) gain on available-for-sale securities	47	5,301
Reclassification of net realized loss (gain) on securities into earnings	—	(5,863)
Reclassification of net realized gain on deconsolidation of CDO VI	—	(20,682)
Reclassification of net realized gain on derivatives designated as cash flow hedges into earnings	—	(20)
Other comprehensive income (loss)	47	(21,264)
Total comprehensive (loss) income	\$ (12,907)	\$ 52,031
Comprehensive (loss) income attributable to Drive Shack Inc. stockholders' equity	\$ (12,907)	\$ 52,155
Comprehensive loss attributable to noncontrolling interest	\$ —	\$ (124)

See notes to Consolidated Financial Statements.



**DRIVE SHACK INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENT OF EQUITY (Unaudited)**

FOR THE THREE MONTHS ENDED MARCH 31, 2017

(dollars in thousands, except share data)

	Drive Shack Inc. Stockholders											
	Preferred Stock		Common Stock				Additional Paid- in Capital	Accumulated Deficit	Accumulated Other Comp. Income (Loss)	Total Drive Shack Inc. Stockholders' Equity	Noncontrolling Interest	Total Equity (Deficit)
	Shares	Amount	Shares	Amount	Amount							
Equity (deficit) - December 31, 2016	2,463,321	\$61,583	66,824,304	\$ 668	\$3,172,720	\$ (3,018,072)	\$ 1,168	\$ 218,067	\$ —	\$ 218,067		
Dividends declared	—	—	—	—	—	(1,395)	—	(1,395)	—	(1,395)		
Issuance of common stock (directors)	—	—	18,074	—	75	—	—	75	—	75		
Comprehensive income (loss)												
Net loss	—	—	—	—	—	(12,954)	—	(12,954)	—	(12,954)		
Other comprehensive income	—	—	—	—	—	—	47	47	—	47		
Total comprehensive loss								(12,907)	—	(12,907)		
Equity (deficit) - March 31, 2017	<u>2,463,321</u>	<u>\$61,583</u>	<u>66,842,378</u>	<u>\$ 668</u>	<u>\$3,172,795</u>	<u>\$ (3,032,421)</u>	<u>\$ 1,215</u>	<u>\$ 203,840</u>	<u>\$ —</u>	<u>\$ 203,840</u>		

See notes to Consolidated Financial Statements.

**DRIVE SHACK INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)**

(dollars in thousands, except share data)

	<b>Three Months Ended March 31,</b>	
	<b>2017</b>	<b>2016</b>
<b>Cash Flows From Operating Activities</b>		
Net (loss) income	\$ (12,954)	\$ 73,295
Adjustments to reconcile net (loss) income to net cash used in operating activities:		
Depreciation and amortization	5,793	6,031
Amortization of discount and premium	620	463
Other amortization	2,614	2,635
Net interest income on investments accrued to principal balance	(3,431)	(7,931)
Amortization of revenue on golf membership deposit liabilities	(305)	(185)
Amortization of prepaid golf membership dues	(6,283)	(6,222)
Non-cash directors' compensation	75	—
Valuation allowance on loans	—	2,198
Other-than-temporary impairment on securities	—	110
Equity in earnings from equity method investments, net of distributions	(379)	(371)
Gain on deconsolidation	—	(82,130)
Loss on settlement of investments, net	473	1,725
Unrealized loss on securities, intent-to-sell	558	—
Unrealized loss on non-hedge derivatives	2,502	341
Loss on extinguishment of debt, net	146	232
Change in:		
Restricted cash	330	(482)
Receivables and other assets	(645)	(1,313)
Accounts payable, accrued expenses and other liabilities	1,474	2,250
Net cash used in operating activities	(9,412)	(9,354)
<b>Cash Flows From Investing Activities</b>		
Principal repayments from investments	10,707	5,444
Purchase of real estate securities	—	(364,072)
Proceeds from sale of investments	286,639	361,341
Net proceeds from (payments for) settlement of TBAs	2,474	(7,536)
Acquisition and additions of investments in real estate	(3,971)	(1,972)
Deposits paid on investments	(80)	—
Net cash provided by (used in) investing activities	295,769	(6,795)
<b>Cash Flows From Financing Activities</b>		
Borrowings under debt obligations	1,007	363,741
Repayments of debt obligations	(292,237)	(352,211)
Margin deposits under repurchase agreements and derivatives	(49,545)	(9,406)
Return of margin deposits under repurchase agreements and derivatives	50,156	9,636
Golf membership deposits received	695	679
Common stock dividends paid	(8,019)	(7,999)
Preferred stock dividends paid	(1,395)	(1,395)
Payment of deferred financing costs	(22)	(263)
Other financing activities	(167)	(158)
Net cash (used in) provided by financing activities	(299,527)	2,624
<b>Net Decrease in Cash and Cash Equivalents</b>	<b>(13,170)</b>	<b>(13,525)</b>
Cash and Cash Equivalents, Beginning of Period	140,140	45,651
Cash and Cash Equivalents, End of Period	\$ 126,970	\$ 32,126
<b>Supplemental Schedule of Non-Cash Investing and Financing Activities</b>		
Preferred stock dividends declared but not paid	\$ 930	\$ 930
Common stock dividends declared but not paid	\$ —	\$ 7,999
Additions to capital lease assets and liabilities	\$ 254	\$ 718

See notes to Consolidated Financial Statements.



## DRIVE SHACK INC. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

MARCH 31, 2017

(dollars in tables in thousands, except share data)

---

#### 1. ORGANIZATION

Drive Shack Inc. (and with its subsidiaries, “Drive Shack Inc.” or the “Company”), is a leading owner and operator of golf-related leisure and entertainment businesses. On December 28, 2016, the Company changed its name from Newcastle Investment Corp. to Drive Shack Inc. in connection with its transformation to a leisure and entertainment company. The Company, a Maryland corporation, was formed in 2002, and its common stock is traded on the NYSE under the symbol “DS.”

The Company conducts its business through the following segments: (i) Traditional Golf properties, (ii) Entertainment Golf venues, (iii) Debt Investments and (iv) corporate. For a further discussion of the reportable segments, see Note 3.

The Company’s Traditional Golf business is one of the largest owners and operators of golf properties in the United States. As of March 31, 2017, the Company owned, leased or managed 78 properties across 13 states. Additionally, the Company plans to open a chain of next-generation Entertainment Golf venues across the United States and internationally which combine golf, competition, dining and fun. The Company plans to monetize the remaining loans and securities in its Debt Investments segment as part of the transformation to a leisure and entertainment company.

On February 23, 2017, the Company revoked its election to be treated as a real estate investment trust (“REIT”), effective January 1, 2017. The Company operated in a manner intended to qualify as a REIT for federal income tax purposes through December 31, 2016.

#### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Basis of Presentation** — The accompanying Consolidated Financial Statements and related notes of the Company have been prepared in accordance with accounting principles generally accepted in the United States for interim financial reporting and the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, certain information and footnote disclosures normally included in financial statements prepared under U.S. generally accepted accounting principles (“GAAP”) have been condensed or omitted. In the opinion of management, all adjustments considered necessary for a fair presentation of the Company’s financial position, results of operations and cash flows have been included and are of a normal and recurring nature. The operating results presented for interim periods are not necessarily indicative of the results that may be expected for any other interim period or for the entire year. These financial statements should be read in conjunction with the Company’s Consolidated Financial Statements for the year ended December 31, 2016 and notes thereto included in the Company’s Annual Report on Form 10-K filed with the SEC on March 2, 2017. Capitalized terms used herein, and not otherwise defined, are defined in the Company’s Consolidated Financial Statements for the year ended December 31, 2016.

Certain prior period amounts have been reclassified to conform to the current period’s presentation. In connection with the Company’s continued transformation from a financial services company to a leisure and entertainment company, including the announcement of the new management team in September 2016, the revocation of its REIT election effective January 1, 2017, as well as the monetization and planned exit of our real estate related debt positions, the Company’s Consolidated Statements of Operations have been changed to reflect an operating company presentation. We have reclassified driving range revenue, including the monthly membership program offered at most of our public properties (“The Players Club”) and miscellaneous revenue associated with operations from “Other revenue” to “Golf course operations”. We have reclassified expenses associated with the cost of merchandise sold from “Cost of sales - golf” to “Operating expenses.” We have added “Loan and security servicing expense” to “General and administrative expense.” The gains and losses associated with derivative instruments have been reclassified from “Other income (loss), net” to “Realized/unrealized (gain) loss on investments” to include balances as part of our operating income (loss). The Company did not make changes to its Consolidated Balance Sheets given the carrying value of the real estate related investments, including agency FNMA/FHLMC securities, held by the Company still represents a significant amount on the Company’s Consolidated Balance Sheets at March 31, 2017.

As of March 31, 2017, the Company’s significant accounting policies for these financial statements are summarized below and should be read in conjunction with the Summary of Significant Accounting Policies detailed in the Company’s Annual Report on Form 10-K for the year ended December 31, 2016.

**DRIVE SHACK INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

MARCH 31, 2017

(dollars in tables in thousands, except share data)

**REVENUE RECOGNITION**

**Golf Course Operations** — Revenue from green fees, cart rentals, merchandise sales and other operating activities (consisting primarily of range income, banquets and club amenities) are generally recognized at the time of sale, when services are rendered and collection is reasonably assured.

Revenue from membership dues is recognized in the month earned. Membership dues received in advance are included in deferred revenues and recognized as revenue ratably over the appropriate period, which is generally twelve months or less. The membership dues are generally structured to cover the club operating costs and membership services.

Private country club members generally pay an advance initiation fee deposit upon their acceptance as a member to the respective country club. Initiation fee deposits are refundable 30 years after the date of acceptance as a member. The difference between the initiation fee deposit paid by the member and the present value of the refund obligation is deferred and recognized into revenue in the Consolidated Statements of Operations on a straight-line basis over the expected life of an active membership, which is estimated to be seven years. The present value of the refund obligation is recorded as a membership deposit liability in the Consolidated Balance Sheets and accretes over a 30-year nonrefundable term using the effective interest method. This accretion is recorded as interest expense in the Consolidated Statements of Operations.

**Realized/Unrealized Loss on Investments and Other Income (Loss), Net** — These items are comprised of the following:

	Three Months Ended March 31,	
	2017	2016
(Gain) on settlement of real estate securities	\$ —	\$ (5,917)
Loss on settlement of real estate securities	2,803	—
Unrealized loss on securities, intent-to-sell	558	—
Loss on repayment/disposition of loans held-for-sale	—	47
Realized (gain) loss on settlement of TBAs, net	(2,474)	7,536
Unrealized loss on non-hedge derivative instruments	2,502	341
Realized/unrealized loss on investments	<u>\$ 3,389</u>	<u>\$ 2,007</u>
Loss on lease modifications and terminations	\$ (158)	\$ (60)
Loss on extinguishment of debt, net	(146)	(232)
Collateral management fee income, net	122	232
Equity in earnings of equity method investees	379	371
Gain (loss) on disposal of long-lived assets	26	(6)
Other (loss) income	(346)	15
Other (loss) income, net	<u>\$ (123)</u>	<u>\$ 320</u>

**DRIVE SHACK INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

MARCH 31, 2017

(dollars in tables in thousands, except share data)

**Reclassification From Accumulated Other Comprehensive Income Into Net (Loss) Income** — The following table summarizes the amounts reclassified out of accumulated other comprehensive income into net (loss) income:

Accumulated Other Comprehensive Income ("AOCI") Components	Income Statement Location	Three Months Ended March 31,	
		2017	2016
<b>Net realized (gain) loss on securities</b>			
Impairment	Impairment	\$ —	\$ 54
(Gain) on settlement of real estate securities	Realized/unrealized (gain) loss on investments	—	(5,917)
Realized (gain) on deconsolidation of CDO VI	Gain on deconsolidation	—	(20,682)
		\$ —	\$ (26,545)
<b>Net realized (gain) loss on derivatives designated as cash flow hedges</b>			
Amortization of deferred hedge (gain)	Interest expense	\$ —	\$ (20)
		\$ —	\$ (20)
<b>Total reclassifications</b>		\$ —	\$ (26,565)

**EXPENSE RECOGNITION**

**Operating Expenses** — Operating expenses for Traditional Golf consist primarily of payroll, equipment and cart leases, utilities, repairs and maintenance, supplies, seed, soil and fertilizer, marketing and operating lease rent expense. Many of the Traditional Golf properties and related facilities are leased under long-term operating leases. In addition to minimum payments, certain leases require payment of the excess of various percentages of gross revenue or net operating income over the minimum rental payments. The leases generally require the payment of taxes assessed against the leased property and the cost of insurance and maintenance. The majority of lease terms range from 10 to 20 years, and typically, the leases contain renewal options. Certain leases include scheduled increases or decreases in minimum rental payments at various times during the term of the lease. These scheduled rent increases or decreases are recognized on a straight-line basis over the term of the lease. Increases result in an accrual, which is included in accounts payable, accrued expenses and other liabilities, and decreases result in a receivable, which is included in receivables and other assets, for the amount by which the cumulative straight-line rent differs from the contractual cash rent.

**Derivatives and Hedging Activities** — All derivatives are recognized as either assets or liabilities on the balance sheet and measured at fair value. The Company reports the fair value of derivative instruments gross of cash paid or received pursuant to credit support agreements and fair value is reflected on a net counterparty basis when the Company believes a legal right of offset exists under an enforceable netting agreement. Fair value adjustments affect either equity or net income depending on whether the derivative instrument qualifies as a hedge for accounting purposes and, if so, the nature of the hedging activity. For those derivative instruments that are designated and qualify as hedging instruments, the Company designates the hedging instrument, based upon the exposure being hedged, as a cash flow hedge or a fair value hedge.

Derivative transactions are entered into by the Company solely for risk management purposes in the ordinary course of business. In determining whether to 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 hedges are entered into with a view towards minimizing the potential for economic losses that could be incurred by the Company. As of March 31, 2017, the Company has no derivative instruments that qualify and are designated as hedging instruments, but has one interest rate cap with a fair value of \$0.4 million which is not designated as a hedge.

The Company transacts in the To Be Announced mortgage backed securities ("TBA") market. TBA contracts are forward contracts to purchase mortgage-backed securities that will be issued by a U.S. government sponsored enterprise in the future. The Company

## DRIVE SHACK INC. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

MARCH 31, 2017

(dollars in tables in thousands, except share data)

---

primarily engages in TBA transactions for purposes of managing interest rate risk and market risk associated with our Agency residential mortgage backed securities (“RMBS”) investments for which we have exposure to interest rate and market risk volatility.

The Company typically does not take delivery of TBAs, but rather settles the associated receivable and payable with its trading counterparties on a net basis. As part of its TBA activities, the Company may “roll” its TBA positions, whereby it may sell (buy) securities for delivery (receipt) in an earlier month and simultaneously contract to repurchase (sell) similar securities at an agreed-upon price on a fixed date in a later month. The Company accounts for its TBA transactions as non-hedge instruments, with changes in market value recorded in the Statement of Operations. As of March 31, 2017, the Company held two short TBA contracts totaling \$319.0 million in notional amount of Agency RMBS. As of March 31, 2017 and December 31, 2016, the Company funded approximately \$1.1 million and zero, respectively, for margin calls related to TBA contracts.

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

#### BALANCE SHEET MEASUREMENT

**Investments in Real Estate, Net** — Real estate and related improvements are recorded at cost less accumulated depreciation. Costs that both materially add value to an asset and extend the useful life of an asset by more than a year are capitalized. With respect to golf course improvements (included in buildings and improvements), costs associated with original construction, significant replacements, permanent landscaping, sand traps, fairways, tee boxes or greens are capitalized. All other asset-related costs that do not meet these criteria, such as minor repairs and routine maintenance, are expensed as incurred.

Long-lived assets to be disposed of by sale, which meet certain criteria, are reclassified to real estate held-for-sale and measured at the lower of their carrying amount or fair value less costs of sale. A disposal of a component of an entity or a group of components of an entity are reported in discontinued operations if the disposal represents a strategic shift that has or will have a major effect on the Company’s operations and financial results. Discontinued operations are retroactively reclassified to income (loss) from discontinued operations for all periods presented.

Traditional Golf leases certain golf carts and other equipment that are classified as capital leases. The value of capital leases is recorded as an asset on the balance sheet, along with a liability related to the associated payments. Depreciation of capital lease assets is calculated using the straight-line method over the shorter of the estimated useful lives and the expected lease terms. The cost of equipment under capital leases is included in investments in real estate in the Consolidated Balance Sheets. Payments under the leases are treated as reductions of the liability, with a portion being recorded as interest expense under the effective interest method.

Depreciation is calculated using the straight-line method based on the following estimated useful lives:

Buildings and improvements	10-30 years
Capital leases - equipment	3-7 years
Furniture, fixtures and equipment	3-7 years

**Intangibles** — Intangible assets and liabilities relating to Traditional Golf consist primarily of leasehold advantages (disadvantages), management contracts and membership base. A leasehold advantage (disadvantage) exists to the Company when it pays a contracted rent that is below (above) market rents at the date of the transaction. The value of a leasehold advantage (disadvantage) is calculated based on the differential between market and contracted rent, which is tax effected and discounted to present value based on an after-tax discount rate corresponding to each golf property and is amortized over the term of the underlying lease agreement. The management contract intangible represents the Company’s golf course management contracts for both leased and managed properties. The management contract intangible for leased and managed properties is valued utilizing a discounted cash flow methodology under the income approach and is amortized over the term of the underlying lease or management agreements, respectively. The membership base intangible represents the Company’s relationship with its private country club members. The membership base intangible is valued using the multi-period excess earnings method under the income approach, and is amortized over the expected life of an active membership.

## DRIVE SHACK INC. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

MARCH 31, 2017

(dollars in tables in thousands, except share data)

Amortization of leasehold intangible assets and liabilities is included within operating expenses and amortization of all other intangible assets is included within depreciation and amortization in the Consolidated Statements of Operations. Amortization of all intangible assets is calculated using the straight-line method based on the following estimated useful lives:

Trade name	30 years
Leasehold intangibles	1 -26 years
Management contracts	1 -26 years
Internally-developed software	5 years
Membership base	7 years

**Membership Deposit Liabilities** — Private country club members generally pay an advance initiation fee deposit upon their acceptance as a member to the respective country club. Initiation fee deposits are refundable 30 years after the date of acceptance as a member. The difference between the initiation fee deposit paid by the member and the present value of the refund obligation is deferred and recognized into Golf course operations revenue in the Consolidated Statements of Operations on a straight-line basis over the expected life of an active membership, which is estimated to be seven years. The present value of the refund obligation is recorded as a membership deposit liability in the Consolidated Balance Sheets and accretes over a 30-year nonrefundable term using the effective interest method. This accretion is recorded as interest expense in the Consolidated Statements of Operations.

**Other Investment** — The Company owns a 23% economic interest in a limited liability company which owns preferred equity secured by a commercial real estate project. The Company accounts for this investment as an equity method investment. As of March 31, 2017 and December 31, 2016, the carrying value of this investment was \$19.6 million and \$19.3 million, respectively. The Company evaluates its equity method investment for other than temporary impairment whenever events or changes in circumstances indicate that the carrying amount of the investment might not be recoverable. The evaluation of recoverability is based on management's assessment of the financial condition and near term prospects of the commercial real estate project, the length of time and the extent to which the market value of the investment has been less than cost, availability and cost of financing, demand for space, competition for tenants, changes in market rental rates, and operating costs. As these factors are difficult to predict and are subject to future events that may alter management's assumptions, the values estimated by management in its recoverability analyses may not be realized, and actual losses or impairment may be realized in the future.

**Impairment of Real Estate and Finite-lived Intangible Assets** — The Company periodically reviews the carrying amounts of its long-lived assets, including real estate and finite-lived intangible assets, to determine whether current events or circumstances indicate that such carrying amounts may not be recoverable. The assessment of recoverability is based on management's estimates by comparing the sum of the estimated undiscounted cash flows generated by the underlying asset, or other appropriate grouping of assets, to its carrying value to determine whether an impairment existed at its lowest level of identifiable cash flows. If the carrying amount of the asset is greater than the expected undiscounted cash flows to be generated by such asset, an impairment is recognized to the extent the carrying value of such asset exceeds its fair value. The Company generally measures fair value by considering sale prices for similar assets or by discounting estimated future cash flows using an appropriate discount rate. Assets to be disposed of are carried at the lower of their financial statement carrying amount or fair value less costs to sell.

**Investments in CDO Servicing Rights** — In February 2011, the Company, through one of its subsidiaries, purchased the management rights with respect to certain C-BASS Investment Management LLC ("C-BASS") Collateralized Debt Obligations ("CDOs") for \$2.2 million pursuant to a bankruptcy proceeding. The Company initially recorded the cost of acquiring the collateral management rights as a servicing asset and subsequently amortizes this asset in proportion to, and over the period of, estimated net servicing income. Servicing assets are assessed for impairment on a quarterly basis, with impairment recognized as a valuation allowance. Key economic assumptions used in measuring any potential impairment of the servicing assets include the prepayment speeds of the underlying collateral, default rates, loss severities and discount rates. During both the three months ended March 31, 2017 and 2016, the Company recorded \$0.1 million of servicing rights amortization and no servicing rights impairment. As of March 31, 2017 and December 31, 2016, the Company's servicing assets had a carrying value of \$0.3 million and \$0.4 million, respectively, recorded in receivables and other assets.

**Variable Interest Entities ("VIEs")** - There are no assets or liabilities of consolidated VIEs included in the Consolidated Balance Sheets as of March 31, 2017 and December 31, 2016. The Company sold its remaining variable interests in Newcastle CDO V and Newcastle CDO VI during 2016 but continue to receive servicing fees as collateral manager, which are not considered variable interests.



**DRIVE SHACK INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

MARCH 31, 2017

(dollars in tables in thousands, except share data)

**Supplemental Non-Cash Investing and Financing Activities Related to CDOs** - The Company considers all activity in its CDOs' restricted cash accounts to be non-cash activity for purposes of its Consolidated Statement of Cash Flows since transactions conducted with restricted cash have no effect on its cash and cash equivalents. Supplemental non-cash investing and financing activities relating to CDOs for the three months ended March 31, 2016 are disclosed below. There were no non-cash investing and financing activities relating to CDOs for the three months ended March 31, 2017.

	Three Months Ended March 31, 2016
Restricted cash generated from pay downs on securities and loans	2,310
Restricted cash used for repayments of CDO and other bonds payable	2,748
<b>CDO VI deconsolidation:</b>	
Real estate securities	43,889
Restricted cash	67
CDO and other bonds payable	105,423

**Receivables and Other Assets**

The following table summarizes the Company's receivables and other assets:

	March 31, 2017	December 31, 2016
Accounts receivable, net	\$ 7,657	\$ 8,047
Prepaid expenses	4,243	3,654
Interest receivable	932	1,697
Deposits	4,833	4,105
Inventory	5,010	4,496
Derivative assets	364	856
Residential mortgage loans, held-for-sale, net	228	231
Miscellaneous assets, net <sup>(A)</sup>	14,898	14,931
	<u>\$ 38,165</u>	<u>\$ 38,017</u>

(A) Includes one owned property in Annandale, New Jersey in the Traditional Golf segment classified as held-for-sale as of December 31, 2016. We expect to close on this property during 2017.

**Accounts Payable, Accrued Expenses and Other Liabilities**

The following table summarizes the Company's accounts payable, accrued expenses and other liabilities:

	March 31, 2017	December 31, 2016
Accounts payable and accrued expenses	\$ 24,849	\$ 26,249
Deferred revenue	30,255	36,107
Security deposits payable	9,392	6,073
Unfavorable leasehold interests	4,012	4,225
Derivative liabilities	2,010	—
Accrued rent	2,031	2,613
Due to affiliates	892	892
Miscellaneous liabilities	14,279	12,278
	<u>\$ 87,720</u>	<u>\$ 88,437</u>

## DRIVE SHACK INC. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

MARCH 31, 2017

(dollars in tables in thousands, except share data)

---

#### *Recent Accounting Pronouncements*

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2014-09 *Revenue from Contracts with Customers (Topic 606)*. The standard’s core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. In doing so, companies will need to use more judgment and make more estimates than under today’s guidance. These may include identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. In August 2015, the FASB issued ASU 2015-14 *Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date*, which defers the effective date by one year. The standard will be effective for annual and interim periods beginning after December 15, 2017; however, all entities are allowed to adopt the standard as early as the original effective date (annual periods beginning after December 15, 2016). Entities have the option of using either a full retrospective or a modified approach to adopt the guidance. In March 2016, the FASB issued ASU 2016-08 *Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations* which clarifies how an entity should identify the unit of accounting for the principal versus agent evaluation and how to apply the control principle to certain types of arrangements. In April 2016, the FASB issued ASU 2016-10 *Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing*, which clarifies when a promised good or service is separately identifiable. In May 2016, the FASB issued ASU 2016-12 *Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients* which amends the new revenue recognition guidance on transition, collectibility, noncash consideration and the presentation of sales and other similar taxes. In December 2016, the FASB issued ASU 2016-20 *Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers* which amends the new revenue recognition guidance on performance obligations and 12 additional technical corrections and improvements. The Company is evaluating potential impacts of adopting this standard, and is in the process of reviewing customer contracts and revenue streams, identifying contractual provisions that may result in a change in the timing or the amount of revenue recognized. The Company expects to adopt the requirements of the new standard in the first quarter of 2018, and anticipates using the modified retrospective transition method.

In January 2016, the FASB issued ASU 2016-01 *Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. The standard addresses certain aspects of recognition, measurement, presentation and disclosure of financial instruments. The effective date of the standard will be for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. The Company is currently evaluating the new guidance to determine the impact it may have on its Consolidated Financial Statements.

In February 2016, the FASB issued ASU 2016-02 *Leases (Topic 842)*. The standard requires lessees to recognize most leases on the balance sheet and addresses certain aspects of lessor accounting. The effective date of the standard will be for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018 and early adoption is permitted. Entities are required to use a modified retrospective approach for leases that exist or are entered into after the beginning of the earliest comparative period in the financial statements, with an option to use certain relief. The Company is currently evaluating the new guidance to determine the impact it may have on its Consolidated Financial Statements.

In June 2016, the FASB issued ASU 2016-13 *Financial Instruments - Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments*. The standard changes how entities will measure credit losses for most financial assets and certain other instruments that are not measured at fair value through net income. For available-for-sale debt securities, entities will be required to record allowances rather than reduce the carrying amount under the other-than-temporary impairment model. The effective date of the standard will be for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019 and early adoption is permitted for annual periods beginning after December 15, 2018. Entities will apply the standard’s provisions as a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective. The Company is currently evaluating the new guidance to determine the impact it may have on its Consolidated Financial Statements.

In August 2016, the FASB issued ASU 2016-15 *Statement of Cash Flows (Topic 230), Classification of Certain Cash Receipts and Cash Payments*. The standard provides specific guidance over eight identified cash flow issues in order to reduce diversity in practice over the presentation and classification of certain types of cash receipts and cash payments. The effective date of the standard will be for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017 and early adoption is permitted. Entities should apply the standard using a retrospective transition method to each period presented. The Company is currently evaluating the new guidance to determine the impact it may have on its Consolidated Financial Statements.

**DRIVE SHACK INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

MARCH 31, 2017

(dollars in tables in thousands, except share data)

---

In November 2016, the FASB issued ASU 2016-18 *Statement of Cash Flows (Topic 230), Restricted Cash*. The standard requires entities to show the changes in the total of cash, cash equivalents and restricted cash in the statement of cash flows and provide a reconciliation to the related line items in the balance sheet. The effective date of the standard will be for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017 and early adoption is permitted. Entities will be required to apply the guidance retrospectively when adopted and provide the relevant disclosures in ASC 250 in the first interim and annual periods in which the guidance is adopted. The Company is currently evaluating the new guidance to determine the impact it may have on its Consolidated Financial Statements.

In January 2017, the FASB issued ASU 2017-01 *Business Combinations (Topic 805), Clarifying the Definition of a Business*. The standard clarifies the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets of businesses. The effective date of the standard will be for interim and annual periods beginning after December 15, 2017 and early adoption is permitted. Entities will be required to apply the guidance on a prospective basis. The Company is currently evaluating the impact that this update will have on its consolidated financial statements and related disclosures.

The FASB has recently issued or discussed a number of proposed standards on topics such as financial statement presentation, financial instruments and hedging. Some of the proposed changes are significant and could have a material impact on the Company's reporting. The Company has not yet fully evaluated the potential impact of these proposals, but will make such an evaluation as the standards are finalized.

**DRIVE SHACK INC. AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

MARCH 31, 2017

(dollars in tables in thousands, except share data)

**3. SEGMENT REPORTING**

The Company currently has four reportable segments: (i) Traditional Golf properties, (ii) Entertainment Golf venues, (iii) Debt Investments, and (iv) corporate. The Company's Traditional Golf business is one of the largest owners and operators of golf properties in the United States. As of March 31, 2017, the Company owned, leased or managed 78 properties across 13 states. Additionally, the Company plans to open a chain of next-generation Entertainment Golf venues across the United States and internationally, which combine golf, competition, dining and fun.

The Debt Investment segment consists primarily of loans and securities which the Company plans to monetize as part of its transformation to a leisure and entertainment company. The corporate segment consists primarily of interest income on short-term investments, general and administrative expenses, interest expense on the junior subordinated notes payable (Note 8) and management fees pursuant to the Management Agreement (Note 12). Segment information for previously reported periods has been restated to reflect the change to the reportable segments in the fourth quarter of 2016.

Summary financial data on the Company's segments is given below, together with reconciliation to the same data for the Company as a whole:

	Traditional Golf	Entertainment Golf	Debt Investments (A)	Corporate	Total
<b>Three Months Ended March 31, 2017</b>					
<b>Revenues</b>					
Golf course operations	\$ 46,296	\$ —	\$ —	\$ —	\$ 46,296
Sales of food and beverages	12,845	—	—	—	12,845
Total revenues	59,141	—	—	—	59,141
<b>Operating costs</b>					
Operating expenses (B)	54,431	—	—	—	54,431
Cost of sales - food and beverages	4,032	—	—	—	4,032
General and administrative expense	700	65	1	1,145	1,911
General and administrative expense - acquisition and transaction expenses (C)	276	1,261	—	117	1,654
Management fee to affiliate	—	—	—	2,677	2,677
Depreciation and amortization	5,793	—	—	—	5,793
Realized/unrealized loss on investments	120	—	3,269	—	3,389
Total operating costs	65,352	1,326	3,270	3,939	73,887
Operating loss	(6,211)	(1,326)	(3,270)	(3,939)	(14,746)
<b>Other income (expenses)</b>					
Interest and investment income	39	—	7,802	47	7,888
Interest expense	(3,817)	—	(1,206)	(411)	(5,434)
Other (loss) income, net	(624)	—	501	—	(123)
Total other income (expenses)	(4,402)	—	7,097	(364)	2,331
Income tax expense (D)	—	—	—	539	539
Net (loss) income	(10,613)	(1,326)	3,827	(4,842)	(12,954)
Preferred dividends	—	—	—	(1,395)	(1,395)
(Loss) income applicable to common stockholders	\$ (10,613)	\$ (1,326)	\$ 3,827	\$ (6,237)	\$ (14,349)

**DRIVE SHACK INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

MARCH 31, 2017

(dollars in tables in thousands, except share data)

Summary segment financial data (continued).

	Traditional Golf	Entertainment Golf	Debt Investments (A)	Corporate	Total
<b>March 31, 2017</b>					
Investments	\$ 278,686	\$ 1,132	\$ 407,589	\$ —	\$ 687,407
Cash and restricted cash	13,681	1,254	1,545	117,703	134,183
Other assets	34,427	2,136	1,444	158	38,165
Total assets	326,794	4,522	410,578	117,861	859,755
Debt, net	114,851	—	310,630	51,214	476,695
Other liabilities	167,342	1,578	5,967	4,333	179,220
Total liabilities	282,193	1,578	316,597	55,547	655,915
Preferred stock	—	—	—	61,583	61,583
Noncontrolling interest	—	—	—	—	—
Equity attributable to common stockholders	\$ 44,601	\$ 2,944	\$ 93,981	\$ 731	\$ 142,257
Additions to investments in real estate during the three months ended March 31, 2017					
	\$ 3,496	\$ 138	\$ —	\$ —	\$ 3,634
<b>Three Months Ended March 31, 2016</b>					
<b>Revenues</b>					
Golf course operations	\$ 48,597	\$ —	\$ —	\$ —	\$ 48,597
Sales of food and beverages	13,561	—	—	—	13,561
Total revenues	62,158	—	—	—	62,158
<b>Operating costs</b>					
Operating expenses (B)	58,219	—	—	—	58,219
Cost of sales - food and beverages	4,597	—	—	—	4,597
General and administrative expense	839	2	37	1,883	2,761
General and administrative expense - acquisition and transaction expenses (C)	126	12	—	38	176
Management fee to affiliate	—	—	—	2,675	2,675
Depreciation and amortization	6,031	—	—	—	6,031
Impairment	—	—	2,308	—	2,308
Realized/unrealized loss on investments	1	—	2,006	—	2,007
Total operating costs	69,813	14	4,351	4,596	78,774
Operating loss	(7,655)	(14)	(4,351)	(4,596)	(16,616)
<b>Other income (expenses)</b>					
Interest and investment income	42	—	20,991	6	21,039
Interest expense	(2,665)	—	(9,924)	(945)	(13,534)
Gain on deconsolidation	—	—	82,130	—	82,130
Other (loss) income, net	(283)	—	603	—	320
Total other income (expenses)	(2,906)	—	93,800	(939)	89,955
Income tax expense	44	—	—	—	44
Net (loss) income	(10,605)	(14)	89,449	(5,535)	73,295
Preferred dividends	—	—	—	(1,395)	(1,395)
Net loss attributable to noncontrolling interest	124	—	—	—	124
(Loss) income applicable to common stockholders	\$ (10,481)	\$ (14)	\$ 89,449	\$ (6,930)	\$ 72,024

**DRIVE SHACK INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

MARCH 31, 2017

(dollars in tables in thousands, except share data)

(A) The following table summarizes the investments and debt in the Debt Investments segment:

	March 31, 2017			
	Investments		Debt	
	Outstanding Face Amount	Carrying Value	Outstanding Face Amount	Carrying Value
Unlevered real estate securities	\$ 4,000	\$ 2,032	\$ —	\$ —
Levered real estate securities	319,380	326,878	310,630	310,630
Real estate related and other loans (E)	78,125	59,043	—	—
Other investments	N/A	19,636	—	—
	<u>\$ 401,505</u>	<u>\$ 407,589</u>	<u>\$ 310,630</u>	<u>\$ 310,630</u>

(B) Operating expenses includes rental expenses recorded under operating leases for carts and equipment in the amount of \$0.8 million and \$1.0 million for the three months ended March 31, 2017 and 2016, respectively.

(C) Acquisition and transaction expense includes costs related to completed and potential acquisitions and transactions which may include advisory, legal, accounting, valuation and other professional or consulting fees. Transaction expense also includes personnel and other costs which do not qualify for capitalization associated with the development of new Entertainment Golf venues.

(D) Effective January 1, 2017, the Company revoked its election to be treated as a REIT. As a result, the Company is subject to U.S. federal corporate income tax and the provision for income taxes is recorded in the corporate segment.

(E) Excludes two mezzanine loans with zero carrying value, which had an aggregate face amount of \$17.8 million and two corporate loans with zero carrying value, which had an aggregate face amount of \$45.7 million.

**DRIVE SHACK INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

MARCH 31, 2017

(dollars in tables in thousands, except share data)

**4. REAL ESTATE SECURITIES**

The following is a summary of the Company's real estate securities at March 31, 2017, all of which are classified as available-for-sale and are, therefore, reported at fair value with changes in fair value recorded in other comprehensive income, except for securities that are other-than-temporarily impaired.

Asset Type	Outstanding Face Amount	Amortized Cost Basis			Gross Unrealized		Carrying Value (B)	Number of Securities	Weighted Average				
		Before Impairment	Other-Than-Temporary Impairment (A)	After Impairment	Gains	Losses			Rating (C)	Coupon	Yield	Life (Years) (D)	Principal Subordination (E)
ABS - Non-Agency RMBS	\$ 4,000	\$ 2,338	\$ (1,521)	\$ 817	\$ 1,215	\$ —	\$ 2,032	1	C	1.37%	25.44%	9.2	28.8%
Total Securities, Available-for-Sale (F)	\$ 4,000	\$ 2,338	\$ (1,521)	\$ 817	\$ 1,215	\$ —	\$ 2,032	1					
FNMA/FHLMC (A)	319,380	337,972	(11,094)	326,878	—	—	326,878	1	AAA	3.50%	3.13%	7.7	N/A
Total Securities, Pledged as Collateral (F)	\$ 319,380	\$ 337,972	\$ (11,094)	\$ 326,878	\$ —	\$ —	\$ 326,878	1					

(A) As of March 31, 2017, the Company reclassified gross unrealized losses of \$11.1 million from other comprehensive income into earnings on FNMA/FHLMC securities that the Company intends to sell and recorded in realized/unrealized (gain) loss on investments in the Consolidated Statements of Operations.

(B) See Note 10 regarding the estimation of fair value, which is equal to carrying value for all securities.

(C) Represents the weighted average of the ratings of all securities in each asset type, expressed as an S&P equivalent rating. For each security rated by multiple rating agencies, the lowest rating is used. The Company uses an implied AAA rating for the Fannie Mac/Freddie Mac ("FNMA/FHLMC") securities. Ratings provided were determined by third-party rating agencies, represent the most recent credit ratings available as of the reporting date and may not be current.

(D) The weighted average life is based on the timing of expected cash flows on the assets.

(E) Percentage of the outstanding face amount of securities and residual interests that is subordinate to the Company's investments.

(F) The total outstanding face amount was \$319.4 million for fixed rate securities and \$4.0 million for floating rate securities.

**DRIVE SHACK INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

MARCH 31, 2017

(dollars in tables in thousands, except share data)

Unrealized losses that are considered other-than-temporary are recognized currently in earnings. During the three months ended March 31, 2017, the Company recorded other-than-temporary impairment charges (“OTTI”) of \$0.6 million with respect to real estate securities (gross of \$0.0 million of other-than-temporary impairment recognized in other comprehensive income). Based on management’s analysis of the securities, the performance of the underlying loans and changes in market factors, the Company noted adverse changes in the expected cash flows on certain of these securities and concluded that they were other-than-temporarily impaired. Any remaining unrealized losses 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 that the carrying values of such securities were fully recoverable over their expected holding period. The following table summarizes the Company’s securities in an unrealized loss position as of March 31, 2017.

Securities in an Unrealized Loss Position	Outstanding Face Amount	Amortized Cost Basis			Gross Unrealized		Carrying Value	Number of Securities	Weighted Average			
		Before Impairment	Other-than-Temporary Impairment (A)	After Impairment	Gains	Losses			Rating	Coupon	Yield	Life (Years)
Less Than Twelve Months	\$ 319,380	\$ 337,972	\$ (11,094)	\$ 326,878	\$ —	\$ —	\$ 326,878	1	AAA	3.50%	3.13%	7.7
Twelve or More Months	—	—	—	—	—	—	—	—	—	—%	—%	—
<b>Total</b>	<b>\$ 319,380</b>	<b>\$ 337,972</b>	<b>\$ (11,094)</b>	<b>\$ 326,878</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ 326,878</b>	<b>1</b>	<b>AAA</b>	<b>3.50%</b>	<b>3.13%</b>	<b>7.7</b>

(A) As of March 31, 2017, the Company reclassified gross unrealized losses of \$11.1 million from other comprehensive income into earnings on FNMA/FHLMC securities that the Company intends to sell and recorded in realized/unrealized (gain) loss on investments in the Consolidated Statements of Operations.

The Company performed an assessment of all of its debt securities that are in an unrealized loss position (unrealized loss position exists when a security’s amortized cost basis, excluding the effect of OTTI, exceeds its fair value). The securities that the Company intends to sell have a fair value of \$326.9 million and amortized cost basis after impairment of \$326.9 million as of March 31, 2017.

The Company has no activity related to credit losses on debt securities for the three months ended March 31, 2017.

The table below summarizes the geographic distribution of the collateral securing the asset-backed securities (“ABS”) at March 31, 2017:

Geographic Location	ABS - Non-Agency RMBS	
	Outstanding Face Amount	Percentage
Western U.S.	\$ 1,295	32.4%
Northeastern U.S.	605	15.1%
Southeastern U.S.	1,065	26.6%
Midwestern U.S.	430	10.8%
Southwestern U.S.	605	15.1%
	<b>\$ 4,000</b>	<b>100.0%</b>

Geographic concentrations of investments expose the Company to the risk of economic downturns within the relevant regions, particularly given the current unfavorable market conditions. These market conditions may make regions more vulnerable to downturns in certain market factors. Any such downturn in a region where the Company holds significant investments could have a material, negative impact on the Company.

In March 2017, the Company sold \$289.7 million face amount of agency FNMA/FHLMC fixed-rate securities at an average price of 98.8% of par for total proceeds of \$286.1 million and recognized a loss on sale of securities of \$2.8 million. The Company repaid \$277.8 million of repurchase agreements associated with these securities.



**DRIVE SHACK INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

MARCH 31, 2017

(dollars in tables in thousands, except share data)

***Securities Pledged as Collateral***

These government agency securities were sold under agreements to repurchase which are treated as collateralized financing transactions. Although being pledged as collateral, securities financed through a repurchase agreement remains on the Company's Consolidated Balance Sheets as an asset and cash received from the purchaser is recorded on the Company's Consolidated Balance Sheets as a liability.

**5. REAL ESTATE RELATED AND OTHER LOANS, RESIDENTIAL MORTGAGE LOANS AND SUBPRIME MORTGAGE LOANS**

Loans are accounted for based on management's strategy for the loan, and on whether the loan was credit-impaired at the date of acquisition. Loans acquired with the intent to sell are classified as held-for-sale.

The following is a summary of real estate related and other loans and residential mortgage loans at March 31, 2017. The loans contain various terms, including fixed and floating rates, self-amortizing and interest only. They are generally subject to prepayment.

<u>Loan Type</u>	<u>Outstanding Face Amount</u>	<u>Carrying Value (A)</u>	<u>Loan Count</u>	<u>Weighted Average Yield</u>	<u>Weighted Average Coupon</u>	<u>Weighted Average Life (Years) (B)</u>	<u>Floating Rate Loans as % of Face Amount</u>	<u>Delinquent Face Amount (C)</u>
Mezzanine Loans	\$ 17,767	\$ —	2	0.00%	8.39%	0.0	100.0%	\$ 17,767
Corporate Loans	123,812	59,043	4	22.49%	15.40%	0.5	—%	59,384
Total Real Estate Related and other Loans Held-for-Sale, Net	\$ 141,579	\$ 59,043	6	22.49%	14.52%	0.5	12.5%	\$ 77,151
Residential Mortgage Loans Held-for-Sale, Net (D)	\$ 769	\$ 228	3	3.11%	3.42%	0.4	100.0%	\$ 628

(A) Carrying value includes negligible interest receivable for the residential housing loans.

(B) The weighted average maturity is based on the timing of expected cash flows on the assets.

(C) Includes loans that are 60 days or more past due (including loans that are in foreclosure and borrowers in bankruptcy) or considered real estate owned ("REO"). As of March 31, 2017, \$77.2 million face amount of real estate related and other loans was on non-accrual status.

(D) Loans acquired at a discount for credit quality. Residential mortgage loans held-for-sale, net is recorded in receivables and other assets on the Consolidated Balance Sheets.

**DRIVE SHACK INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

MARCH 31, 2017

(dollars in tables in thousands, except share data)

The following is a summary of real estate related and other loans by maturities at March 31, 2017:

Year of Maturity	Outstanding Face Amount	Carrying Value	Number of Loans
Delinquent (A)	\$ 77,151	\$ 147	5
Period from April 1, 2017 to December 31, 2017	—	—	—
2018	—	—	—
2019	64,428	58,896	1
2020	—	—	—
2021	—	—	—
2022	—	—	—
Thereafter	—	—	—
Total	\$ 141,579	\$ 59,043	6

(A) Includes loans that are non-performing, in foreclosure, or under bankruptcy

Activities relating to the carrying value of the Company's real estate related and other loans and residential mortgage loans are as follows:

	Held-for-Sale	
	Real Estate Related and Other Loans	Residential Mortgage Loans (A)
Balance at December 31, 2016	\$ 55,612	\$ 231
Purchases / additional fundings	—	—
Interest accrued to principal balance	3,431	—
Principal pay downs	—	(3)
Balance at March 31, 2017	\$ 59,043	\$ 228

(A) Recorded in receivables and other assets on the Consolidated Balance Sheets.

There was no change in the loss allowance on the Company's real estate related and other loans and residential mortgage loans during the three months ended March 31, 2017.

The table below summarizes the geographic distribution of real estate related and other loans and residential mortgage loans at March 31, 2017:

Geographic Location	Real Estate Related and Other Loans		Residential Mortgage Loans	
	Outstanding Face Amount	Percentage	Outstanding Face Amount	Percentage
Northeastern U.S.	\$ —	—%	\$ 523	68.0%
Southeastern U.S.	—	—%	246	32.0%
Foreign	63,454	100.0%	—	—%
	\$ 63,454	100.0%	\$ 769	100.0%
Other (A)	78,125			
	\$ 141,579			

(A) Includes corporate loans which are not directly secured by real estate assets.

**DRIVE SHACK INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

MARCH 31, 2017

(dollars in tables in thousands, except share data)

**6. INVESTMENTS IN REAL ESTATE, NET OF ACCUMULATED DEPRECIATION**

The following table summarizes the Company's investments in real estate related to its Traditional and Entertainment Golf businesses:

	March 31, 2017			December 31, 2016		
	Gross Carrying Amount	Accumulated Depreciation	Net Carrying Value	Gross Carrying Amount	Accumulated Depreciation	Net Carrying Value
Land	\$ 84,319	\$ —	\$ 84,319	\$ 84,319	\$ —	\$ 84,319
Buildings and improvements	145,243	(42,737)	102,506	144,690	(39,402)	105,288
Furniture, fixtures and equipment	29,900	(21,250)	8,650	29,132	(20,516)	8,616
Capital leases - equipment	20,945	(5,645)	15,300	20,844	(4,818)	16,026
Construction in progress	5,677	—	5,677	3,362	—	3,362
Total Investments in Real Estate	<u>\$ 286,084</u>	<u>\$ (69,632)</u>	<u>\$ 216,452</u>	<u>\$ 282,347</u>	<u>\$ (64,736)</u>	<u>\$ 217,611</u>

**7. INTANGIBLES, NET OF ACCUMULATED AMORTIZATION**

The following table summarizes the Company's intangible assets related to the Traditional and Entertainment Golf businesses:

	March 31, 2017			December 31, 2016		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value
Trade name	\$ 700	\$ (76)	\$ 624	\$ 700	\$ (70)	\$ 630
Leasehold intangibles (A)	48,107	(13,591)	34,516	48,107	(12,550)	35,557
Management contracts	35,207	(11,242)	23,965	35,207	(10,434)	24,773
Internally-developed software	800	(520)	280	800	(480)	320
Membership base	5,236	(2,431)	2,805	5,236	(2,244)	2,992
Nonamortizable liquor licenses	1,176	—	1,176	840	—	840
Total Intangibles	<u>\$ 91,226</u>	<u>\$ (27,860)</u>	<u>\$ 63,366</u>	<u>\$ 90,890</u>	<u>\$ (25,778)</u>	<u>\$ 65,112</u>

(A) The amortization expense for leasehold intangibles is reported in operating expenses in the Consolidated Statements of Operations.

**DRIVE SHACK INC. AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

MARCH 31, 2017

(dollars in tables in thousands, except share data)

**8. DEBT OBLIGATIONS**

The following table presents certain information regarding the Company's debt obligations at March 31, 2017:

Debt Obligation/Collateral	Month Issued	Outstanding Face Amount	Carrying Value	Final Stated Maturity	Weighted Average Coupon (A)	Weighted Average Funding Cost (B)	Weighted Average Life (Years)	Face Amount of Floating Rate Debt
<b>Repurchase Agreements (C)</b>								
FNMA/FHLMC Securities	Mar 2017	\$ 310,630	\$ 310,630	Apr 2017	1.02%	1.02%	0.1	\$ —
		310,630	310,630			1.02%	0.1	—
<b>Credit Facilities and Capital Leases</b>								
Traditional Golf Term Loan (D) (E)	June 2016	102,000	98,979	Jul 2019	LIBOR+4.70%	7.92%	2.3	102,000
Vineyard II	Dec 1993	200	200	Dec 2043	2.20%	2.20%	26.7	200
Capital Leases (Equipment)	May 2014 - Mar 2017	15,672	15,672	Sep 2018 - Sep 2022	3.00% to 16.16%	6.56%	3.9	—
		117,872	114,851			7.72%	2.5	102,200
<b>Corporate</b>								
Junior subordinated notes payable (F)	Mar 2006	51,004	51,214	Apr 2035	LIBOR+2.25%	3.26%	18.1	51,004
		51,004	51,214			3.26%	18.1	51,004
<b>Total debt obligations</b>		<b>\$ 479,506</b>	<b>\$ 476,695</b>			<b>2.88%</b>	<b>2.6</b>	<b>\$ 153,204</b>

(A) Weighted average, including floating and fixed rate classes.

(B) Including the effect of deferred financing costs.

(C) The repurchase agreement had \$0.2 million of accrued interest payable at March 31, 2017. The counterparty on the repurchase agreement is Jefferies. The Company has margin exposures on the repurchase agreement related to the financing of FNMA/FHLMC securities. The underlying collateral of the repurchase agreement is fixed rate FNMA/FHLMC securities with the following value at March 31, 2017: \$319.4 million outstanding face amount, \$326.9 million amortized cost basis, \$326.9 million carrying value and a weighted average life of 7.7 years. To the extent that the value of the collateral underlying the repurchase agreement declines, the Company may be required to post margin, which could significantly impact its liquidity.

(D) The golf term loan is collateralized by 22 golf properties. The carrying amount of the golf term loan is reported net of amortized deferred financing costs of \$3.0 million as of March 31, 2017.

(E) Interest rate based on 1 month LIBOR plus 4.70% with a LIBOR floor of 1.80%. At the time of closing, the Company purchased a co-terminus LIBOR interest rate cap of 1.80%.

(F) Interest rate based on 3 month LIBOR plus 2.25%.

See Note 4 for information about the FNMA/FHLMC repurchase agreement activity for the three months ended March 31, 2017.

Traditional Golf leases certain golf carts and other equipment under capital lease agreements. The agreements typically provide for minimum rentals plus executory costs. Lease terms range from 36 to 66 months. Certain leases include bargain purchase options at lease expiration.

The future minimum lease payments required under the capital leases and the present value of the net minimum lease payments as of March 31, 2017 are as follows:

**DRIVE SHACK INC. AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

MARCH 31, 2017

(dollars in tables in thousands, except share data)

April 1, 2017 - December 31, 2017	\$	3,521
2018		4,685
2019		4,540
2020		3,259
2021		1,684
2022		173
Thereafter		—
Total minimum lease payments		17,862
Less: imputed interest		(2,190)
Present value of net minimum lease payments	\$	15,672

The Company's credit facilities contain various customary loan covenants, including certain coverage ratios. The Company was in compliance with all of these covenants as of March 31, 2017.

**9. DERIVATIVES**

The Company's derivative instruments are comprised of an interest rate cap and TBAs. Derivative assets with a fair value of \$0.4 million and \$0.9 million as of March 31, 2017 and December 31, 2016, respectively, were recorded within receivables and other assets on the Consolidated Balance Sheets. Derivative liabilities with a fair value of \$2.0 million and zero as of March 31, 2017 and December 31, 2016, respectively, were recorded within accounts payable, accrued expenses and other liabilities on the Consolidated Balance Sheets.

The following table summarizes (gains) losses recorded in relation to derivatives:

	Income Statement Location	Three Months Ended March 31,	
		2017	2016
<b>Cash flow hedges</b>			
Deferred hedge gain reclassified from Accumulated Other Comprehensive Income ("AOCI") into earnings	Interest expense	—	—
<b>Non-hedge derivatives</b>			
Unrealized loss on interest rate derivatives	Realized/unrealized (gain) loss on investments	\$ 120	\$ —
Unrealized loss recognized related to TBAs	Realized/unrealized (gain) loss on investments	2,382	—
Realized (gain) loss on settlement of TBAs	Realized/unrealized (gain) loss on investments	(2,474)	7,500

As of both March 31, 2017 and December 31, 2016, the Company had zero expected reclassification of deferred hedges from AOCI into earnings over the next 12 months.

**DRIVE SHACK INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

MARCH 31, 2017

(dollars in tables in thousands, except share data)

**10. FAIR VALUE OF FINANCIAL INSTRUMENTS*****Fair Value Summary Table***

The following table summarizes the carrying values and estimated fair values of the Company's financial instruments at March 31, 2017:

	Carrying Value	Estimated Fair Value	Fair Value Method (A)
<b>Assets</b>			
Real estate securities, available-for-sale	\$ 2,032	\$ 2,032	Pricing models
Real estate securities, available-for-sale - pledged as collateral	326,878	326,878	Broker/counterparty quotations, pricing services
Real estate related and other loans, held-for-sale, net	59,043	64,575	Pricing models
Residential mortgage loans, held-for-sale, net (B)	228	259	Broker/counterparty quotations, pricing models
Cash and cash equivalents	126,970	126,970	
Restricted cash	7,213	7,213	
Non-hedge derivative assets (C)	364	364	Counterparty quotations, pricing services
<b>Liabilities</b>			
Repurchase agreements	310,630	310,630	Counterparty quotations, market comparables
Credit facilities and obligations under capital leases	114,851	117,872	Pricing models
Junior subordinated notes payable	51,214	26,714	Pricing models
Non-hedge derivative liabilities (C)	2,010	2,010	Counterparty quotations, pricing services

(A) Methods are listed in order of priority. In the case of real estate securities and real estate related and other loans, broker quotations are obtained if available and practicable, otherwise counterparty quotations or pricing service valuations are obtained or, finally, internal pricing models are used. Internal pricing models are only used for (i) securities and loans that are not traded in an active market, and, therefore, have little or no price transparency, and for which significant unobservable inputs must be used in estimating fair value, or (ii) loans or debt obligations which are private and untraded.

(B) Residential mortgage loans held-for-sale, net is recorded in receivables and other assets on the Consolidated Balance Sheets.

(C) Represents derivative assets and liabilities, including an interest rate cap and TBA forward contracts (Note 9).

**Fair Value Measurements*****Valuation Hierarchy***

The fair value of financial instruments is categorized based on the priority of the inputs to the valuation technique and categorized into a three-level fair value hierarchy. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). The Company follows this hierarchy for its financial instruments measured at fair value.

Level 1 - Quoted prices in active markets for identical instruments.

Level 2 - Valuations based principally on observable market parameters, including

- quoted prices for similar assets or liabilities in active markets,
- inputs other than quoted prices that are observable for the asset or liability (such as interest rates and yield curves observable at commonly quoted intervals, implied volatilities and credit spreads), and
- market corroborated inputs (derived principally from or corroborated by observable market data).

Level 3 - Valuations determined using unobservable inputs that are supported by little or no market activity, and that are significant to the overall fair value measurement. Level 3 assets and liabilities include financial instruments whose value is determined using non-binding market quotations, pricing models, discounted cash flow methodologies, or similar techniques where significant inputs are unobservable, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

**DRIVE SHACK INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

MARCH 31, 2017

(dollars in tables in thousands, except share data)

---

Fair value may be based upon broker quotations, counterparty quotations or pricing services quotations, which provide valuation estimates based upon reasonable market order indications or management's good faith estimate, and are subject to significant variability based on market conditions, such as interest rates, credit spreads and market liquidity. A significant portion of the Company's loans, securities and debt obligations are currently not traded in active markets and therefore have little or no price transparency. As a result, the Company has estimated the fair value of these illiquid instruments based on internal pricing models or quotations subject to the Company's controls described below.

The Company has various processes and controls in place to ensure that fair value measurements are reasonably estimated. With respect to broker and pricing service quotations, and in order to ensure these quotes represent a reasonable estimate of fair value, The Company's quarterly procedures include a comparison of such quotations to quotations from different sources, outputs generated from its internal pricing models and transactions completed, as well as on its knowledge and experience of these markets. With respect to fair value estimates generated based on the Company's internal pricing models, the Company's management validates the inputs and outputs of the internal pricing models by comparing them to available independent third-party market parameters and models, where available, for reasonableness. The Company believes its valuation methods and the assumptions used are appropriate and consistent with other market participants.

Fair value measurements categorized within Level 3 are sensitive to changes in the assumptions or methodology used to determine fair value and such changes could result in a significant increase or decrease in the fair value. For the Company's investments in real estate securities, real estate related and other loans and residential mortgage loans categorized within Level 3 of the fair value hierarchy, the significant unobservable inputs include the discount rates, assumptions relating to prepayments, default rates and loss severities. Significant increases (decreases) in any of the discount rates, default rates or loss severities in isolation would result in a significantly lower (higher) fair value measurement. The impact of changes in prepayment speeds would have differing impacts on fair value, depending on the seniority of the investment. Generally, a change in the default assumption is accompanied by directionally similar changes in the assumptions used for the loss severity and the prepayment speed.

**DRIVE SHACK INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

MARCH 31, 2017

(dollars in tables in thousands, except share data)

**Recurring Fair Value Measurements - Real Estate Securities and Derivatives**

The following table summarizes financial assets and liabilities measured at fair value on a recurring basis at March 31, 2017:

	Carrying Value	Fair Value			Total
		Level 2 Market Quotations (Observable)	Level 3 Market Quotations (Unobservable)		
<b>Assets</b>					
Real estate securities, available-for-sale:					
ABS - Non-Agency RMBS	\$ 2,032	\$ —	\$ —	\$ 2,032	\$ 2,032
Real estate securities, available-for-sale total	\$ 2,032	\$ —	\$ —	\$ 2,032	\$ 2,032
Real estate securities, available-for-sale - pledged as collateral:					
FNMA/FHLMC	\$ 326,878	\$ 326,878	\$ —	\$ —	\$ 326,878
Real estate securities, available-for-sale - pledged as collateral total	\$ 326,878	\$ 326,878	\$ —	\$ —	\$ 326,878
Derivative assets:					
Interest rate cap, not treated as hedge	\$ 364	\$ 364	\$ —	\$ —	\$ 364
Derivative assets total	\$ 364	\$ 364	\$ —	\$ —	\$ 364
<b>Liabilities</b>					
Derivative liabilities:					
TBAs, not treated as hedges	\$ 2,010	\$ 2,010	\$ —	\$ —	\$ 2,010
Derivative liabilities total	\$ 2,010	\$ 2,010	\$ —	\$ —	\$ 2,010

**Significant Unobservable Inputs**

The following table provides quantitative information regarding the significant unobservable inputs used by the Company for assets and liabilities measured at fair value on a recurring basis as of March 31, 2017.

Asset Type	Amortized Cost Basis	Fair Value	Weighted Average Significant Input			
			Discount Rate	Prepayment Speed	Cumulative Default Rate	Loss Severity
ABS - Non-Agency RMBS	\$ 817	\$ 2,032	12.0%	4.6%	4.2%	6
Total	\$ 817	\$ 2,032				

All of the inputs used have some degree of market observability, based on the Company's knowledge of the market, relationships with market participants, and use of common market data sources. Collateral prepayment, default and loss severity projections are in the form of "curves" or "vectors" that vary for each monthly collateral cash flow projection. Methods used to develop these projections vary by asset class (e.g., CMBS projections are developed differently than home equity ABS projections) but conform to industry conventions. The Company uses assumptions that generate its best estimate of future cash flows of each respective security.



**DRIVE SHACK INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

MARCH 31, 2017

(dollars in tables in thousands, except share data)

The discount rates the Company uses are derived from a range of observable pricing on securities backed by similar collateral and offered in a live market. As the markets in which the Company transacts have become less liquid, the Company has had to rely on fewer data points in this analysis.

Default rates are determined from the current “pipeline” of loans that are more than 90 days delinquent, in foreclosure, or are REO. These significantly delinquent loans determine the first 24 months of the default vector. Beyond month 24, the default vector transitions to a steady-state value that is generally equal to or greater than that given by the widely published investment bank model.

The prepayment speed vector specifies the percentage of the collateral balance that is expected to voluntarily pay off at each point in the future. The prepayment speed vector is based on projections from a widely published investment bank model which considers factors such as collateral FICO score, loan-to-value ratio, debt-to-income ratio, and vintage on a loan-level basis. This vector is scaled up or down to match recent collateral-specific prepayment experience, as obtained from remittance reports and market data services.

Loss severities are based on recent collateral-specific experience with additional consideration given to collateral characteristics. Collateral age is taken into consideration because severities tend to initially increase with collateral age before eventually stabilizing. The Company typically uses projected severities that are higher than the historic experience for collateral that is relatively new to account for this effect. Collateral characteristics such as loan size, lien position, and location (state) also affect loss severity. The Company considers whether a collateral pool has experienced a significant change in its composition with respect to these factors when assigning severity projections.

The Company’s investments in instruments measured at fair value on a recurring basis using Level 3 inputs changed during the three months ended March 31, 2017 as follows:

	ABS - Non-Agency RMBS	
Balance at December 31, 2016	\$	1,950
Total gains (losses) (A)		
Included in other comprehensive income (loss)		47
Amortization included in interest income		47
Purchases, sales and repayments (A)		
Proceeds		(12)
Balance at March 31, 2017	\$	<u>2,032</u>

(A) None of the gains (losses) recorded in earnings during the period is attributable to the change in unrealized gains (losses) relating to Level 3 assets still held at the reporting dates. There were no purchases or sales during the three months ended March 31, 2017. There were no transfers into or out of Level 3 during the three months ended March 31, 2017.

***Non-Recurring Fair Value Measurements - Loans***

Loans which the Company does not have the ability or intent to hold into the foreseeable future are classified as held-for-sale. Held-for-sale loans are carried at the lower of amortized cost or fair value and are therefore recorded at fair value on a non-recurring basis. These loans were written down to fair value at the time of the impairment, based on broker quotations, pricing service quotations or internal pricing models. All the loans were within Level 3 of the fair value hierarchy. For real estate related and other loans, the most significant inputs used in the valuations are the amount and timing of expected future cash flows, market yields and the estimated collateral value of such loan investments.

The following table summarizes certain information for real estate related and other loans as of March 31, 2017:

**DRIVE SHACK INC. AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

MARCH 31, 2017

(dollars in tables in thousands, except share data)

Loan Type	Carrying Value	Fair Value	Significant Input			
			Range		Weighted Average	
			Discount Rate	Loss Severity	Discount Rate	Loss Severity
Corporate Loans	59,043	64,575	0.0%-22.5%	0.0%-100.0%	22.5%	48.0%
Total Real Estate Related and Other Loans Held-for-Sale, Net (A)	<u>\$ 59,043</u>	<u>\$ 64,575</u>				

(A) Excludes \$17.8 million face amount of mezzanine loans which have a zero carrying value.

**Liabilities for Which Fair Value is Only Disclosed**

The following table summarizes the level of the fair value hierarchy, valuation techniques and inputs used for estimating each class of liabilities not measured at fair value in the statement of financial position but for which fair value is disclosed:

Type of Liabilities Not Measured At Fair Value for Which Fair Value Is Disclosed	Fair Value Hierarchy	Valuation Techniques and Significant Inputs
Repurchase agreements	Level 2	Valuation technique is based on market comparables. Significant inputs include: <ul style="list-style-type: none"> <li>• Amount and timing of expected future cash flows</li> <li>• Interest rates</li> <li>• Collateral funding spreads</li> </ul>
Credit facilities	Level 3	Valuation technique is based on discounted cash flows. Significant inputs include: <ul style="list-style-type: none"> <li>• Amount and timing of expected future cash flows</li> <li>• Interest rates</li> <li>• Market yields</li> </ul>
Junior subordinated notes payable	Level 3	Valuation technique is based on discounted cash flows. Significant inputs include: <ul style="list-style-type: none"> <li>• Amount and timing of expected future cash flows</li> <li>• Interest rates</li> <li>• Market yields and the credit spread of the Company</li> </ul>

**11. EQUITY AND EARNINGS PER SHARE**
**A. Equity**

The following is a summary of the changes in the Company's outstanding options for the three months ended March 31, 2017:

	Number of Options	Weighted Average Strike Price	Weighted Average Life Remaining (in years)
Balance at December 31, 2016	5,126,906	\$ 2.79	
Expired	(40,330)	14.44	
Balance at March 31, 2017	<u>5,086,576</u>	<u>\$ 2.70</u>	5.91
Exercisable at March 31, 2017	3,934,081	\$ 2.77	5.81

**DRIVE SHACK INC. AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

MARCH 31, 2017

(dollars in tables in thousands, except share data)

As of March 31, 2017, the Company's outstanding options were summarized as follows:

	Issued Prior to 2011	Issued in 2011 and thereafter	Total
Held by the Manager	71,915	3,857,748	3,929,663
Issued to the Manager and subsequently transferred to certain of the Manager's employees	4,085	1,152,495	1,156,580
Issued to the independent directors	—	333	333
Total	76,000	5,010,576	5,086,576
Weighted average strike price	\$ 12.44	\$ 2.55	\$ 2.70

On February 27, 2017, the Company declared dividends of \$0.609375, \$0.503125 and \$0.523438 per share on the 9.750% Series B, 8.050% Series C and 8.375% Series D preferred stock, respectively, for the period beginning February 1, 2017 and ending April 30, 2017. Dividends totaling \$1.4 million were paid on April 28, 2017.

In January 2017, the Company issued a total of 18,074 shares of its common stock to its independent directors as a component of their annual compensation.

**B. Earnings Per Share**

The Company is required to present both basic and diluted earnings per share ("EPS"). The following table shows the amounts used in computing basic and diluted EPS:

	Three Months Ended March 31,	
	2017	2016
Numerator for basic and diluted earnings per share:		
(Loss) Income Applicable to Common Stockholders	\$ (14,349)	\$ 72,024
Denominator:		
Denominator for basic earnings per share - weighted average shares	66,841,977	66,654,598
Effect of dilutive securities		
Options	—	1,630,300
Denominator for diluted earnings per share - adjusted weighted average shares	66,841,977	68,284,898
Basic earnings per share:		
(Loss) Income Applicable to Common Stock, per share	\$ (0.21)	\$ 1.08
Diluted earnings per share:		
(Loss) Income Applicable to Common Stock, per share	\$ (0.21)	\$ 1.05

Basic EPS is calculated by dividing (loss) income applicable to common stockholders by the weighted average number of shares of common stock outstanding during each period. Diluted EPS is calculated by dividing (loss) income 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. The Company's common stock equivalents are its outstanding stock options. During the three months ended March 31, 2017 and 2016, the Company had 151,234 and 455,115 antidilutive options, respectively. During the three months ended March 31, 2017, based on the treasury stock method, the Company had 1,941,409 potentially dilutive common stock equivalents which were excluded due to the Company's loss position. During the three months ended March 31, 2016, based on the treasury stock method, the Company had 1,630,300 dilutive common stock equivalents, resulting from its outstanding options. Income (loss) applicable to common stockholders is equal to net income (loss) less preferred dividends and net income (loss) attributable to noncontrolling interest.

## DRIVE SHACK INC. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

MARCH 31, 2017

(dollars in tables in thousands, except share data)

## 12. TRANSACTIONS WITH AFFILIATES AND AFFILIATED ENTITIES

### Management Agreement

The Company is party to a Management Agreement with FIG LLC, its Manager and an affiliate of Fortress, which provides for automatically renewing one-year terms subject to certain termination rights. The Manager's performance is reviewed annually and the Management Agreement may be terminated by the Company by payment of a termination fee, as defined in the Management Agreement, equal to the amount of management fees earned by the Manager during the 12 consecutive calendar months immediately preceding the termination, upon the affirmative vote of at least two-thirds of the independent directors, or by a majority vote of the holders of common stock. Pursuant to the Management Agreement, the Manager provides for a management team and other professionals who are responsible for implementing our business strategy, subject to the supervision of our board of directors. Our Manager is responsible for, among other things, (i) setting investment criteria in accordance with broad investment guidelines adopted by our board of directors, (ii) sourcing, analyzing and executing acquisitions, (iii) providing financial and accounting management services and (iv) performing other duties as specified in the Management Agreement. For performing these services, the Company pays the Manager an annual management fee equal to 1.5% of the gross equity of the Company, as defined, including adjustments for return of capital dividends.

The Management Agreement provides that the Company will reimburse the Manager for various expenses incurred by the Manager or its officers, employees and agents on the Company's behalf, including costs of legal, accounting, tax, auditing, administrative and other similar services rendered for the Company by providers retained by the Manager or, if provided by the Manager's employees, in amounts which are no greater than those which would be payable to outside professionals or consultants engaged to perform such services pursuant to agreements negotiated on an arm's-length basis. In addition to expense reimbursements for expenses incurred by the Manager, the Company is responsible for reimbursing the Manager for certain expenses incurred by the Company that are initially paid by the Manager on behalf of the Company.

To provide an incentive for the Manager to enhance the value of the common stock, the Manager is entitled to receive an incentive return (the "Incentive Compensation") on a cumulative, but not compounding, basis in an amount equal to the product of (A) 25% of the dollar amount by which (1) (a) the Funds from Operations (defined as the net income applicable to common stockholders before Incentive Compensation, excluding extraordinary items, plus depreciation of operating real estate and after adjustments for unconsolidated subsidiaries, if any) of the Company per share of common stock (based on the weighted average number of shares of common stock outstanding) plus (b) gains (or losses) from debt restructuring and from sales of property and other assets per share of common stock (based on the weighted average number of shares of common stock outstanding), exceed (2) an amount equal to (a) the weighted average of the price per share of common stock in the initial public offering ("IPO") and the value attributed to the net assets transferred to the Company by its predecessor, and in any subsequent offerings by the Company (adjusted for prior return of capital dividends or capital distributions) multiplied by (b) a simple interest rate of 10% per annum (divided by four to adjust for quarterly calculations) multiplied by (B) the weighted average number of shares of common stock outstanding.

	Amounts incurred under the Management Agreement	
	Three Months Ended March 31,	
	2017	2016
Management fees	\$ 2,552	\$ 2,550
Expense reimbursement to the Manager	125	125
Incentive compensation	—	—
Total Management fee to affiliate	\$ 2,677	\$ 2,675

At March 31, 2017, Fortress, through its affiliates, and principals of Fortress, owned 5.1 million shares of the Company's common stock and Fortress, through its affiliates, had options relating to an additional 3.9 million shares of the Company's common stock (Note 11).

At both March 31, 2017 and December 31, 2016, due to affiliates was comprised of \$0.9 million in management fees and expense reimbursements payable to the Manager.

## DRIVE SHACK INC. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

MARCH 31, 2017

(dollars in tables in thousands, except share data)

---

#### Other Affiliated Entities

In April 2006, the Company securitized Subprime Portfolio I and, through Securitization Trust 2006, entered into a servicing agreement with a subprime home equity mortgage lender (the "Subprime Servicer") to service this portfolio. In July 2006, private equity funds managed by an affiliate of the Company's Manager completed the acquisition of the Subprime Servicer. As compensation under the servicing agreement, the Subprime Servicer receives, on a monthly basis, a net servicing fee equal to 0.5% per annum on the unpaid principal balance of the portfolio. In March 2007, through Securitization Trust 2007, the Company entered into a servicing agreement with the Subprime Servicer to service Subprime Portfolio II under substantially the same terms. At March 31, 2017, the outstanding unpaid principal balances of Subprime Portfolios I and II were approximately \$227.3 million and \$338.4 million, respectively. The Company received negligible cash inflows from the retained interests of Subprime Portfolios I and II during the three months ended March 31, 2017 and 2016. The Company's exposure to loss is solely limited to the carrying amount of the residual interests and retained bonds which are issued by Subprime Portfolios I and II.

In April 2010, the Company, through two of its CDOs, made a cash investment of \$75.0 million in a corporate loan in the resorts industry ("the resorts-related loan") to a portfolio company of a private equity fund managed by an affiliate of the Company's Manager. The Company's chairman is a director of and has an indirect ownership interest in the borrower. This investment improved the applicable CDOs' results under some of their respective tests, and is expected to yield approximately 22.5%. The maturity of the resorts-related loan has been extended to June 2019. Interest on the loan will be accrued and deferred until maturity.

In September 2016, the Company received a \$109.9 million pay down on the loan. As of March 31, 2017, the Company held on its balance sheet total investments of \$64.4 million face amount of loans issued by affiliates of the Manager. The Company earned approximately \$3.4 million and \$8.1 million of interest on investments issued by affiliates of the Manager for the three months ended March 31, 2017 and 2016, respectively.

In each instance described above, affiliates of the Company's Manager have an investment in the applicable affiliated fund and receive from the fund, in addition to management fees, incentive compensation if the fund's aggregate investment returns exceed certain thresholds.

A principal of the Manager owned or leased aircraft that the Company chartered from a third-party aircraft operator for business purposes in the course of operations. The Company paid the aircraft operator market rates for the charters.

#### **13. COMMITMENTS AND CONTINGENCIES**

The Company is and may become, from time to time, involved in legal actions in the ordinary course of business, including governmental and administrative investigations, inquiries and proceedings concerning employment, labor, environmental and other claims. Although management is unable to predict with certainty the eventual outcome of any legal action, management believes the ultimate liability arising from such actions, individually and in the aggregate, which existed at March 31, 2017, will not materially affect the Company's consolidated results of operations, financial position or cash flow. Given the inherent unpredictability of these types of proceedings, however, it is possible that future adverse outcomes could have a material effect on our financial results.

**DRIVE SHACK INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

MARCH 31, 2017

(dollars in tables in thousands, except share data)

**14. INCOME TAXES**

The provision for income taxes consists of the following:

	Three Months Ended March 31,	
	2017	2016
<b>Current:</b>		
Federal	\$ 539	\$ 43
State and Local	—	11
Total Current Provision	\$ 539	\$ 54
<b>Deferred:</b>		
Federal	\$ —	\$ (9)
State and Local	—	(1)
Total Deferred Benefit	\$ —	\$ (10)
<b>Total Provision for Income Taxes</b>	<b>\$ 539</b>	<b>\$ 44</b>

On February 23, 2017, the Company revoked its election to be treated as a REIT effective January 1, 2017. The Company operated in a manner intended to qualify as a REIT for federal income tax purposes through December 31, 2016. The change in tax status has had no effect on the Company's Consolidated Financial Statements as the corresponding net deferred tax asset created as a result of the tax status change has been fully offset with a valuation allowance.

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities as of March 31, 2017 are presented below:

	March 31, 2017	December 31, 2016
<b>Deferred tax assets:</b>		
Allowance for loan losses	\$ 391	\$ 358
Depreciation and amortization	39,039	38,598
Accrued expenses	1,764	2,885
Interest	13,234	16,503
Net operating losses	176,821	162,629
Other	2,094	2,036
Total deferred tax assets	233,343	223,009
Less valuation allowance	(153,541)	(133,192)
Net deferred tax assets	\$ 79,802	\$ 89,817
<b>Deferred tax liabilities:</b>		
Leaseholds	13,529	13,681
Cancellation of debt	66,178	75,632
Other	95	504
Total deferred tax liabilities	\$ 79,802	\$ 89,817
Net deferred tax assets (A)	\$ —	\$ —

(A) Recorded in receivables and other assets on the Consolidated Balance Sheets.

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which temporary differences become deductible.

**DRIVE SHACK INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

MARCH 31, 2017

(dollars in tables in thousands, except share data)

The Company recorded a valuation allowance against its deferred tax assets as of March 31, 2017 as management does not believe that it is more likely than not that the deferred tax assets will be realized.

**15. IMPAIRMENT**

The following table summarizes the amounts the Company recorded in the Consolidated Statement of Operations:

	Three Months Ended March 31,	
	2017	2016
Debt securities	—	110
Valuation allowance on loans	—	2,198
Total impairment	\$ —	\$ 2,308

**16. SUBSEQUENT EVENTS**

These Consolidated Financial Statements include a discussion of material events, if any, that have occurred subsequent to March 31, 2017 through the issuance of these Consolidated Financial Statements.

On May 4, 2017, the Company declared dividends of \$0.609375, \$0.503125 and \$0.523438 per share on the 9.750% Series B, 8.050% Series C and 8.375% Series D preferred stock, respectively, for the period beginning May 1, 2017 and ending July 31, 2017. Dividends totaling \$1.4 million will be paid on July 31, 2017 to shareholders of record on May 15, 2017.

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Management's discussion and analysis of financial condition and results of operations is intended to help the reader understand the results of operations and financial condition of Drive Shack Inc. (and its subsidiaries, "Drive Shack Inc." or the "Company"). The following should be read in conjunction with the unaudited Consolidated Financial Statements and notes thereto included herein, and with Part II, Item 1A. "Risk Factors."

### GENERAL

The Company is a leading owner and operator of golf-related leisure and entertainment businesses. On December 28, 2016, the Company changed its name from Newcastle Investment Corp. to Drive Shack Inc. in connection with its transformation to a leisure and entertainment company. The Company was formed in 2002 and its common stock is traded on the NYSE under the symbol "DS." We are externally managed and advised by an affiliate of Fortress Investment Group, LLC or Fortress (the "Manager"). For further information relating to our business, see "Liquidity and Capital Resources - Business Overview" below.

We conduct our business through the following segments: (i) Traditional Golf properties, (ii) Entertainment Golf venues, (iii) Debt Investments and (iv) corporate. Revenues attributable to each segment are disclosed below (in thousands):

	Traditional Golf	Entertainment Golf	Debt Investments	Corporate	Total
<b>Three Months Ended March 31, 2017</b>					
Revenues and interest and investment income	\$ 59,180	\$ —	\$ 7,802	\$ 47	\$ 67,029
<b>Three Months Ended March 31, 2016</b>					
Revenues and interest and investment income	\$ 62,200	\$ —	\$ 20,991	\$ 6	\$ 83,197

### MARKET CONSIDERATIONS

Our ability to execute our business strategy, particularly the development of our Entertainment Golf business, depends to a degree on our ability to monetize our Debt Investments and obtain additional capital. We have not accessed the capital markets since 2014, and rising interest rates or stock market volatility could impair our ability to raise equity capital on attractive terms.

Our ability to generate income is dependent on, among other factors, our ability to raise capital and finance investments on favorable terms, deploy capital on a timely basis at attractive returns, and exit investments at favorable yields. Market conditions outside of our control, such as interest rates, credit spreads and stock market volatility affect these objectives in a variety of ways.

#### Traditional Golf Business

With respect to our Traditional Golf business, trends in consumer discretionary spending, as well as climate and weather patterns, have a significant impact on the markets in which we operate. Traditional Golf is subject to seasonal fluctuations caused by significant reductions in golf activities due to shorter days and colder temperatures in the first and fourth quarters of each year. Consequently, a significantly larger portion of our revenue from our Traditional Golf operations is earned in the second and third quarters of our fiscal year. In addition, severe weather patterns can also negatively impact our results of operations.

While consumer spending in the Traditional Golf industry has not grown in recent years, we believe improving economic conditions and improvements in local housing markets have helped and will continue to help drive membership growth and increase the number of golf rounds played. In addition, we believe growth in related industries, including leisure entertainment, may positively impact our Traditional Golf business.

#### Debt Investments

During 2016 and the first three months of 2017, both short-term and long-term interest rates remained at or near historical lows. We project short- and long-term rates to increase in the future, although the timing of any further increases is uncertain. We have investments in both floating and fixed rate securities and loans, which are affected by interest rates in different ways. We expect that the value of our floating rate assets would not be significantly affected by a change in interest rates (whether an increase or decrease), since the coupon tracks the movement in rates, while the value of fixed rate assets can be negatively affected by rising interest rates. However, in general, rising interest rates are usually indicative of a strengthening economic environment, which



could reduce the credit risk of some of our investments. With respect to our fixed rate assets, we believe that the negative impact of rising interest rates could potentially be offset by the positive impact of reduced credit risk.

Credit spreads also affect the value of our investments in debt securities and loans. Credit spreads decreased or “tightened” marginally during 2016 and the first three months of 2017, which had a minimal impact on the value of our portfolio. Credit spreads measure the yield relative to a specified benchmark that the market demands on securities and loans based on the credit risk of such assets. The value of our portfolio tends to increase when spreads tighten and to decrease when spreads widen. Credit spreads also affect the cost of financing, with widening spreads tending to increase the cost, and tightening spreads tending to reduce it.

The net interest spread of our portfolio of Debt Investments can be impacted by (i) the timing and extent of changes in the composition of our portfolio as a result of purchases and sales of assets or the repayment of debt, repurchase agreements and other bonds, and the incurrence of new debt, (ii) the yields on new investments, which varies depending on the credit quality of the issuer, and (iii) changes in our estimates of the yields on securities acquired at a discount for credit quality. For instance, the net interest spread of our Debt Investments increases if we sell assets with lower yields relative to other assets in our portfolio or repay debt (such as in connection with an asset sale or refinancing) that has a higher interest rate relative to other financing on our portfolio (assuming no other changes to the composition of our portfolio). Conversely, the net interest spread of our portfolio decreases if we sell assets with higher yields relative to other assets in our portfolio or repay debt (such as in connection with an asset sale) that has a lower interest rate relative to other financing on our portfolio (again, assuming no other changes to the composition of our portfolio). Management continually monitors market conditions to opportunistically effect purchases and sales of debt investments.

### **APPLICATION OF CRITICAL ACCOUNTING POLICIES**

Management’s discussion and analysis of financial condition and results of operations is based upon our Consolidated Financial Statements, which have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”). The preparation of financial statements in conformity with GAAP requires the use of estimates and assumptions that could affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities and the reported amounts of revenue and expenses. Our estimates are based on information available to management at the time of preparation of the Consolidated Financial Statements, including the result of historical analysis, our understanding and experience of the Company’s operations, our knowledge of the industry and market-participant data available to us.

Actual results have historically been in line with management’s estimates and judgments used in applying each of the accounting policies described below and management periodically re-evaluates accounting estimates and assumptions. Actual results could differ from these estimates and materially impact our Consolidated Financial Statements. However, the Company does not expect our assessments and assumptions below to materially change in the future.

The following is a summary of our accounting policies that are most affected by judgments, estimates and assumptions.

#### *Variable Interest Entities*

Variable interest entities (“VIEs”) are defined as entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. A VIE is required to be consolidated by its primary beneficiary, and only by its primary beneficiary, which is defined as the party who has the power to direct the activities of a VIE that most significantly impact its economic performance and who has the obligation to absorb losses or the right to receive benefits from the VIE that could potentially be significant to the VIE.

In August 2016, the Company settled on a trade to sell \$14.8 million face amount of two CDO V securities for total proceeds of \$9.9 million. As a result of this trade, the Company no longer has an economic interest in CDO V.

On March 31, 2016, the Company sold \$11.0 million face amount of NCT 2013-VI Class I-MM-2. As a result of this sale, the Company was no longer deemed to be the primary beneficiary and deconsolidated CDO VI.

Our subprime securitizations are also considered VIEs, but we do not control the decisions that most significantly impact their economic performance and no longer receive a significant portion of their returns, and therefore do not consolidate them.

In addition, our investments in RMBS and real estate related and other loans may be deemed to be variable interests in VIEs, depending on their structure. We monitor these investments and analyze the potential need to consolidate the related securitization entities pursuant to the VIE consolidation requirements. These analyses require considerable judgment in determining whether an entity is a VIE and determining the primary beneficiary of a VIE since they involve subjective determinations of significance, with respect to both power and economics. The result could be the consolidation of an entity that otherwise would not have been consolidated or the deconsolidation of an entity that otherwise would have been consolidated.

#### *Valuation of Securities*

We have classified all of our real estate securities as available-for-sale. As such, they are carried at fair value with net unrealized gains or losses reported as a component of accumulated other comprehensive income, to the extent impairment losses are considered temporary as described below. Fair value may be based upon broker quotations, counterparty quotations or pricing services quotations, which provide valuation estimates based upon reasonable market order indications or a good faith estimate thereof and are subject to significant variability based on market conditions, such as interest rates, credit spreads and market liquidity. A significant portion of our securities are currently not traded in active markets and therefore have little or no price transparency. As a result, we have estimated the fair value of these illiquid securities based on internal pricing models rather than the sources described above. 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 and immediate increase or decrease in our book equity. For securities valued with pricing models, these inputs include the discount rate, assumptions relating to prepayments, default rates and loss severities, as well as other variables.

See Note 10 to our Consolidated Financial Statements in Part I, Item 1. "Financial Statements" for information regarding the fair value of our investments, and respective estimation methodologies as of March 31, 2017.

Our securities must be categorized by the "level" of inputs used in estimating their fair values. Level 1 would be assets or liabilities valued based on quoted prices for identical instruments in active markets. We have no Level 1 assets or liabilities. Level 2 would be assets or liabilities valued based on quoted prices in active markets for similar instruments, on quoted prices in less active or inactive markets, or on other "observable" market inputs. Level 3 would be assets or liabilities valued based significantly on "unobservable" market inputs. Fair value under GAAP represents an exit price in the normal course of business, not a forced liquidation price. If we were forced to sell assets in a short period to meet liquidity needs, the prices we receive could be substantially less than the recorded fair values.

We generally classify non-binding broker and pricing service quotations we receive as Level 3 inputs. Such quotations are quoted prices in generally inactive and illiquid markets for identical or similar securities. These quotations are generally received via email and contain disclaimers which state that they are "indicative" and "not actionable" - meaning that the party giving the quotation is not bound to actually purchase the security at the quoted price. These quotations are generally based on models prepared by the brokers, and we have little visibility into the inputs they use. Based on quarterly procedures we have performed with respect to quotations received from these brokers, including comparison to the outputs generated from our internal pricing models and transactions we have completed with respect to these securities, as well as on our knowledge and experience of these markets, we have generally determined that these quotes represent a reasonable estimate of fair value.

As of March 31, 2017, we had \$326.9 million carrying value of Level 2 assets.

Our estimation of the fair value of Level 3 assets valued using internal models involves significant judgment. The inputs to our models include discount rates, prepayment speeds, default rates and severity assumptions. We validate the inputs and outputs of our models by comparing them to available independent third-party market parameters and models for reasonableness, as well as historical performance. We believe the assumptions we use are within the range that a market participant would use and factor in the liquidity conditions currently in the markets.

For securities valued with internal models, which have an aggregate fair value of \$2.0 million as of March 31, 2017, a 10% unfavorable change in our assumptions would result in the following decreases in such aggregate fair value (in thousands):

	ABS - Non-Agency RMBS	
Outstanding face amount	\$	4,000
Fair value	\$	2,032
Effect on fair value with 10% unfavorable change in:		
Discount rate	\$	(158)

A 10% unfavorable change in prepayment rate, default rate and loss severity have no impact on the ABS - Non-Agency RMBS fair value.

#### *Impairment of Securities and Other Investments*

We must also assess whether unrealized losses on securities, if any, reflect a decline in value which is other-than-temporary and, if so, write the impaired security down to its fair value through earnings. A decline in value is deemed to be other-than-temporary if (i) it is probable that we will be unable to collect all amounts due according to the contractual terms of a security which was not impaired at acquisition (there is an expected credit loss), or (ii) if we have the intent to sell a security in an unrealized loss position or it is more likely than not we will be required to sell a security in an unrealized loss position prior to its anticipated recovery (if any). For the purposes of performing this analysis, we assume the anticipated recovery period is until the respective security's expected maturity. For certain securities which represent beneficial interests in securitized financial assets, an other-than-temporary impairment also will be deemed to have occurred whenever there is a probable adverse change in the timing or amounts of previously projected estimated cash flows.

Temporary declines in value generally result from changes in market factors, such as market interest rates and credit spreads, or from certain macroeconomic events, including market disruptions and supply changes, which do not directly impact our ability to collect amounts contractually due. We continually evaluate the credit status of each of our securities and the collateral supporting our securities. This evaluation includes a review of the credit of the issuer of the security (if applicable), the credit rating of the security, the key terms of the security (including credit support), debt service coverage and loan to value ratios, the performance of the pool of underlying loans and the estimated value of the collateral supporting such loans, including the effect of local, industry and broader economic trends and factors. These factors include loan default expectations and loss severities, which are analyzed in connection with a particular security's credit support, as well as prepayment rates. These factors are also analyzed in relation to the amount of the unrealized loss and the period elapsed since it was incurred. The result of this evaluation is considered when determining management's estimate of cash flows, particularly with respect to developing the necessary inputs and assumptions. Each security is impacted by different factors and in different ways; generally the more negative factors which are identified with respect to a given security, the more likely we are to determine that we do not expect to receive all contractual payments when due with respect to that security. Significant judgment is required in this analysis.

We generally do not depend on credit ratings in underwriting our securities, either at acquisition or on an ongoing basis. As of March 31, 2017, we had no securities that had been downgraded during the three months ended March 31, 2017. As mentioned above, a credit rating downgrade is one factor that we monitor and consider in our analysis regarding other-than-temporary impairment, but it is not determinative. Our securities generally benefit from the support of one or more subordinate classes of securities or equity or other forms of credit support. Therefore, credit rating downgrades, even to the extent they relate to an expectation that a securitization we have invested in, on an overall basis, has credit issues, may not ultimately impact cash flow estimates for the class of securities in which we are invested.

Furthermore, the analysis of whether it is more likely than not that we will be required to sell securities in an unrealized loss position prior to an expected recovery in value (if any), the amount of such expected required sales, and the projected identification of which securities would be sold is also subject to significant judgment.

We evaluate our other investments for impairment whenever events or changes in circumstances indicate that the carrying amount might not be recoverable. The evaluation of recoverability is based on management's assessment of the financial condition and near term prospects of the commercial real estate project, the length of time and the extent to which the market value of the investment has been less than cost, availability and cost of financing, demand for space, competition for tenants, changes in market

rental rates, and operating costs. As these factors are difficult to predict and are subject to future events that may alter management's assumptions, the values estimated by management in its recoverability analyses may not be realized, and actual losses or impairment may be realized in the future.

#### *Revenue Recognition on Securities*

Income on these securities is recognized using a level yield methodology based upon a number of cash flow assumptions that are subject to uncertainties and contingencies. These assumptions include the rate and timing of principal and interest receipts (which may be subject to prepayments and defaults). The assumptions that impact income recognition are updated on at least a quarterly basis to reflect changes related to a particular security, actual historical data, and market changes. These uncertainties and contingencies are difficult to predict and are subject to future events, and economic and market conditions, which may alter the assumptions.

#### *Valuation of Derivatives*

Our derivative instruments are carried at fair value which is based on counterparty quotations and pricing services. The Company reports the fair value of derivative instruments gross of cash paid or received pursuant to credit support agreements. To the extent they qualify as cash flow hedges, net unrealized gains or losses are reported as a component of accumulated other comprehensive income; otherwise, the net unrealized gains and losses are reported currently in other income. To the extent they qualify as fair value hedges, net unrealized gains or losses on both the derivative and the related portion of the hedged item are reported currently in income. Fair values of such derivatives are subject to significant variability based on many of the same factors as the securities discussed above, including counterparty credit risk. The results of such variability, the effectiveness of our hedging strategies and the extent to which a forecasted hedged transaction remains probable of occurring, could result in a significant increase or decrease in our earnings.

#### *Loans*

We invest in loans, including, but not limited to, real estate related and other loans, residential mortgage loans and subprime mortgage loans. Loans for which we do not have the intent or the ability to hold for the foreseeable future, or until maturity or payoff, are classified as held-for-sale. Loans are presented in the Consolidated Balance Sheet net of any unamortized discount (or gross of any unamortized premium) and an allowance for loan losses. We determine at acquisition whether loans will be aggregated into pools based on common risk characteristics (credit quality, loan type, and date of origination or acquisition); loans aggregated into pools are accounted for as if each pool were a single loan. We also evaluate our loans at acquisition for evidence of credit quality deterioration. Loans for which we determine that it is probable that we will not collect all contractually required principal and interest payments at acquisition are categorized as loans acquired at a discount for credit quality.

#### *Revenue Recognition on Loans Held for Sale*

Real estate related, commercial mortgage and residential mortgage loans that are considered held for sale are carried at the lower of amortized cost or market value determined on either an individual method basis, or in the aggregate for pools of similar loans. Interest income is recognized based on the loan's coupon rate to the extent management believes it is collectible. Purchase discounts are not amortized as interest income during the period the loan is held for sale, except when a pay down or sale has happened in the period. Similarly, for loans acquired at a discount for credit quality, accretable yield is not recorded as interest income during the period the loan is held for sale. A change in the market value of the loan, to the extent that the value is not above the average cost basis, is recorded in Valuation Allowance. A rollforward of the allowance is included in Note 5 to our Consolidated Financial Statements in Part I, Item 1. "Financial Statements."

#### *Acquisition Accounting*

In connection with an acquisition of a business, assets acquired and liabilities assumed are recorded at fair value as of the acquisition date. The accounting for acquisitions requires the identification and measurement of all acquired tangible and intangible assets and assumed liabilities at their respective fair values as of the acquisition date. In measuring the fair value of net tangible and identified intangible assets acquired, management uses information obtained as a result of pre-acquisition due diligence, marketing, leasing activities and independent appraisals. The determination of fair value involves the use of significant judgment and estimation.

### *Impairment of Investments in Real Estate*

Real estate and long-lived assets are tested for potential impairment when changes in circumstances indicate the carrying amount of the assets, or other appropriate grouping of assets, may not be fully recoverable. Indicators of impairment include material adverse changes in the projected revenues and expenses, significant underperformance relative to historical or projected future operating results, and significant negative industry or economic trends. An impairment is determined to have occurred if the future net undiscounted cash flows expected to be generated is less than the carrying value of an asset. The impairment is measured as the difference between the carrying value and the fair value. Significant judgment is required both in determining impairment and in estimating the fair value. We may use assumptions and estimates derived from a review of our operating results, business projections, expected growth rates, discount rates, and tax rates. We also make certain assumptions about future economic conditions, interest rates, and other market data. Many of the factors used in these assumptions and estimates are outside the control of management, and can change in future periods.

### *Impairment of Intangible Assets*

We assess the potential impairment of our intangible assets with indefinite lives on an annual basis, or if an event occurs or circumstances change between annual tests that indicate that it is more likely than not that the asset is impaired. We perform our impairment test by comparing the fair value of the intangible asset with its carrying amount. If the carrying amount exceeds its fair value, an impairment loss will be recognized in an amount equal to that excess.

We assess the potential impairment of our definite-lived intangible assets when changes in circumstances indicate the carrying amount of the assets, or other appropriate grouping of assets, may not be fully recoverable. The assessment of recoverability is based on comparing management's estimates of the sum of the estimated undiscounted cash flows generated by the underlying asset, or other appropriate grouping of assets, to its carrying value to determine whether an impairment existed at its lowest level of identifiable cash flows. Factors leading to impairment include significant under-performance relative to historical or projected results, significant changes in the manner of use of the acquired assets or the strategy for our overall business and significant negative industry or economic trends.

### *Membership Deposit Liabilities*

In our Traditional Golf business, private country club members generally pay an advance initiation fee deposit upon their acceptance as a member to the respective country club. Initiation fee deposits are refundable 30 years after the date of acceptance as a member. The difference between the initiation fee deposit paid by the member and the present value of the refund obligation is deferred and recognized into revenue in the Consolidated Statements of Operations on a straight-line basis over the expected life of an active membership, which is estimated to be seven years. The present value of the refund obligation is recorded as a membership deposit liability in the Consolidated Balance Sheets and accretes over a 30-year nonrefundable term using the effective interest method. This accretion is recorded as interest expense in the Consolidated Statements of Operations. The determination of the estimated average expected life of an active membership is based on company-specific historical data and involves significant judgment and estimation.

### *Recent Accounting Pronouncements*

See Note 2 to Part I, Item 1. "Financial Statements" for information about recent accounting pronouncements.

## RESULTS OF OPERATIONS

### Consolidated Results

The following tables summarize the changes in our results of operations for the three months ended March 31, 2017 and 2016 (dollars in thousands):

	Three Months Ended March 31,		Increase (Decrease)	
	2017	2016	Amount	%
<b>Revenues</b>				
Golf course operations	\$ 46,296	\$ 48,597	\$ (2,301)	(4.7)%
Sales of food and beverages	12,845	13,561	(716)	(5.3)%
Total revenues	59,141	62,158	(3,017)	(4.9)%
<b>Operating costs</b>				
Operating expenses	54,431	58,219	(3,788)	(6.5)%
Cost of sales - food and beverages	4,032	4,597	(565)	(12.3)%
General and administrative expense	3,565	2,937	628	21.4 %
Management fee to affiliate	2,677	2,675	2	0.1 %
Depreciation and amortization	5,793	6,031	(238)	(3.9)%
Impairment	—	2,308	(2,308)	(100.0)%
Realized/unrealized loss on investments	3,389	2,007	1,382	68.9 %
Total operating costs	73,887	78,774	(4,887)	(6.2)%
<b>Operating loss</b>	(14,746)	(16,616)	1,870	11.3 %
<b>Other income (expenses)</b>				
Interest and investment income	7,888	21,039	(13,151)	(62.5)%
Interest expense	(5,434)	(13,534)	(8,100)	(59.8)%
Gain on deconsolidation	—	82,130	(82,130)	(100.0)%
Other (loss) income, net	(123)	320	(443)	(138.4)%
Total other income (expenses)	2,331	89,955	(87,624)	(97.4)%
(Loss) income before income tax	\$ (12,415)	\$ 73,339	\$ (85,754)	(116.9)%

### Revenues from Golf Course Operations

Revenues from golf course operations decreased by \$2.3 million during the three months ended March 31, 2017 compared to the three months ended March 31, 2016 primarily due to: (i) a \$2.1 million decrease in green fee and cart rental revenue as a result of unfavorable weather conditions, especially in California and (ii) a \$1.7 million decrease from lease terminations in 2016, partially offset by (iii) a \$0.8 million increase due to additional initiation fees from new member sales and higher membership rates and (iv) a \$0.7 million increase in net driving range revenues at public golf properties as a result of the continued growth of The Players Club program.

### Sales of Food and Beverages

Sales of food and beverages decreased by \$0.7 million during the three months ended March 31, 2017 compared to the three months ended March 31, 2016 primarily due to: (i) a \$1.1 million decrease in property dining as a result of unfavorable weather conditions, especially in California and (ii) a \$0.4 million decrease from lease terminations in 2016, partially offset by (iii) a \$0.8 million increase in private events.

## **Operating Expenses**

Operating expenses decreased by \$3.8 million during the three months ended March 31, 2017 compared to the three months ended March 31, 2016 primarily due to: (i) a \$2.5 million decrease from lease terminations in 2016, (ii) a \$0.7 million decrease in utilities from lower water usage as a result of unfavorable weather conditions, especially in California, (iii) a \$0.4 million cost savings in rent, and (iv) a \$0.2 million decrease in equipment lease costs due to fewer operating leases.

## **Cost of Sales - Food and Beverages**

Cost of sales - food and beverages decreased by \$0.6 million during the three months ended March 31, 2017 compared to the three months ended March 31, 2016 primarily due to: (i) a \$0.5 million decrease due to lower food sales as a result of unfavorable weather conditions, especially in California and (ii) a \$0.1 million decrease from lease terminations in 2016.

## **General and Administrative Expense (including Acquisition and Transaction Expense)**

General and administrative expense increased by \$0.6 million during the three months ended March 31, 2017 compared to the three months ended March 31, 2016 primarily due to a \$1.0 million increase as a result of the build out of the Entertainment Golf business, offset by a \$0.4 million decrease in legal and accounting fees.

## **Management Fee to Affiliate**

There was no significant change in management fee to affiliate during the three months ended March 31, 2017 compared to the three months ended March 31, 2016.

## **Depreciation and Amortization**

There was no significant change in depreciation and amortization during the three months ended March 31, 2017 compared to the three months ended March 31, 2016.

## **Impairment**

There was no impairment recognized in the three months ended March 31, 2017. The impairment of \$2.3 million during the three months ended March 31, 2016 is primarily due to impairment recognized on a real estate loan.

## **Realized/Unrealized Loss on Investments**

Realized/unrealized loss on investments increased by \$1.4 million during the three months ended March 31, 2017 compared to the three months ended March 31, 2016. During the three months ended March 31, 2017, we recorded a realized loss of \$2.8 million on the sale of Agency RMBS, an unrealized loss of \$2.5 million on the mark-to-market on the value of derivatives, an unrealized loss of \$0.6 million on the mark-to-market of Agency RMBS, offset by a realized gain of \$2.5 million on the settlement of derivatives. During the three months ended March 31, 2016, we recorded a \$7.6 million loss on the settlement of derivatives and an unrealized loss of \$0.3 million on the mark-to-market of Agency RMBS, offset by a \$5.9 million gain on the sale of Agency RMBS.

## **Interest and Investment Income**

Interest income decreased by \$13.2 million during the three months ended March 31, 2017 as compared to the three months ended March 31, 2016 primarily due to: (i) a \$1.1 million decrease as a result of the deconsolidation of CDO VI in the first quarter of 2016, (ii) a \$4.6 million decrease of paid in kind ("PIK") interest earned on a corporate loan as a result of a pay down in the third quarter of 2016, (iii) an \$8.6 million decrease related to our subprime mortgage loan call option, which was sold in the fourth quarter of 2016, and (iv) a \$0.5 million decrease related to a real estate related loan, which was sold in the second quarter of 2016. These were offset by a \$1.6 million increase as a result of higher face amount of Agency RMBS held in the three months ended March 31, 2017 as compared to the three months ended March 31, 2016.

## **Interest Expense**

Interest expense decreased by \$8.1 million during the three months ended March 31, 2017 as compared to the three months ended March 31, 2016 primarily due to: (i) a \$8.6 million decrease related to our subprime mortgage loan call option which was sold in the fourth quarter of 2016, (ii) a \$0.5 million decrease as a result of the deconsolidation of CDO VI in the first quarter of 2016,

and (iii) a \$0.6 million decrease as a result of a lower weighted average coupon on the junior subordinated notes payable. These were offset by: (i) a \$1.0 million increase due to the financings related to our Traditional Golf business and (ii) a \$0.6 million increase due to higher financing costs and borrowing amounts incurred on repurchase agreements on the Agency RMBS.

#### Gain on Deconsolidation

There were no deconsolidations during the three months ended March 31, 2017. The gain on deconsolidation of \$82.1 million during the three months ended March 31, 2016 is related to the deconsolidation of CDO VI.

#### Other (Loss) Income, Net

Other (loss) income, net decreased by \$0.4 million during the three months ended March 31, 2017 as compared to the three months ended March 31, 2016 primarily due to \$0.3 million decrease related to lease disposition costs incurred in 2017 for leases exited in 2016 and \$0.1 million decrease in collateral management fees received.

#### Traditional Golf Segment Results

##### Comparison of Golf Results of Operations for the three months ended March 31, 2017 and 2016

	Three Months Ended March 31,		Increase (Decrease)	
	2017	2016	Amount	%
<b>Revenues</b>				
Golf course operations	\$ 46,296	\$ 48,597	\$ (2,301)	(4.7)%
Sales of food and beverages	12,845	13,561	(716)	(5.3)%
Total revenues	59,141	62,158	(3,017)	(4.9)%
<b>Operating costs</b>				
Operating expenses	54,431	58,219	(3,788)	(6.5)%
Cost of sales - food and beverages	4,032	4,597	(565)	(12.3)%
General and administrative expense	976	965	11	1.1 %
Depreciation and amortization	5,793	6,031	(238)	(3.9)%
Realized/unrealized loss on investments	120	1	119	N.M.
Total operating costs	65,352	69,813	(4,461)	(6.4)%
<b>Operating loss</b>	(6,211)	(7,655)	1,444	(18.9)%
<b>Other income (expenses)</b>			—	
Interest and investment income	39	42	(3)	(7.1)%
Interest expense	(3,817)	(2,665)	1,152	43.2 %
Other loss, net	(624)	(283)	341	120.5 %
Total other income (expenses)	(4,402)	(2,906)	(1,496)	(51.5)%
<b>Loss before income tax</b>	\$ (10,613)	\$ (10,561)	\$ (52)	(0.5)%

N.M. - Not meaningful

#### Revenues from Golf Course Operations

Revenues from golf course operations decreased by \$2.3 million during the three months ended March 31, 2017 compared to the three months ended March 31, 2016 primarily due to: (i) a \$2.1 million decrease in green fee and cart rental revenue as a result of unfavorable weather conditions, especially in California and (ii) a \$1.7 million decrease from lease terminations in 2016, partially offset by (iii) a \$0.8 million increase due to additional initiation fees from new member sales and higher membership rates and (iv) a \$0.7 million increase in net driving range revenues at public golf properties as a result of the continued growth of The Players Club program.



### **Sales of Food and Beverages**

Sales of food and beverages decreased by \$0.7 million during the three months ended March 31, 2017 compared to the three months ended March 31, 2016 primarily due to: (i) a \$1.1 million decrease in property dining as a result of unfavorable weather conditions, especially in California and (ii) a \$0.4 million decrease from lease terminations in 2016, partially offset by (iii) a \$0.8 million increase in private events.

### **Operating Expenses**

Operating expenses decreased by \$3.8 million during the three months ended March 31, 2017 compared to the three months ended March 31, 2016 primarily due to: (i) a \$2.5 million decrease from lease terminations in 2016, (ii) a \$0.7 million decrease in utilities from lower water usage as a result of unfavorable weather conditions, especially in California, (iii) a \$0.4 million cost savings in rent, and (iv) a \$0.2 million decrease in equipment lease costs due to fewer operating leases.

### **Cost of Sales - Food and Beverages**

Cost of sales - food and beverages decreased by \$0.6 million during the three months ended March 31, 2017 compared to the three months ended March 31, 2016 primarily due to (i) a \$0.5 million decrease due to lower food sales as a result of unfavorable weather conditions, especially in California and (ii) a \$0.1 million decrease from lease terminations in 2016.

### **General and Administrative Expense (including Acquisition and Transaction Expense)**

There was no significant change in general and administrative expense during the three months ended March 31, 2017 compared to the three months ended March 31, 2016.

### **Depreciation and Amortization**

There was no significant change in depreciation and amortization during the three months ended March 31, 2017 compared to the three months ended March 31, 2016.

### **Realized/Unrealized Loss on Investments**

There was no significant change in realized/unrealized loss on investments during the three months ended March 31, 2017 compared to the three months ended March 31, 2016.

### **Interest and Investment Income**

There was no significant change in interest income during the three months ended March 31, 2017 compared to the three months ended March 31, 2016.

### **Interest Expense**

Interest expense increased by \$1.2 million during the three months ended March 31, 2017 compared to the three months ended March 31, 2016 primarily due to: (i) a \$2.0 million increase related to the golf refinancing obtained in June 2016, (ii) a \$0.2 million increase in membership deposit liability interest accretion due to more members and (iii) a \$0.1 million increase due to additional capital leases, partially offset by (iv) a \$1.1 million decrease related to the golf repurchase agreement exited in June 2016.

### **Other Loss, Net**

Other loss, net increased by \$0.3 million during the three months ended March 31, 2017 compared to the three months ended March 31, 2016 primarily due to lease disposition costs incurred in 2017 for leases exited in 2016.

## LIQUIDITY AND CAPITAL RESOURCES

### *Overview*

Liquidity is a measurement of our ability to meet potential cash requirements, including ongoing commitments to repay borrowings, fund and maintain investments, fund capital for our Traditional and Entertainment Golf businesses and other general business needs.

Our primary sources of funds for liquidity consist of net cash provided by operating activities, sales or repayments of investments, potential refinancing of existing debt, potential issuance of new debt or equity securities, when feasible. We have the ability to publicly or privately issue common stock, preferred stock, depository shares, debt securities and warrants. Our debt obligations are generally secured directly by our investment assets, except for the junior subordinated notes payable.

### *Sources of Liquidity and Uses of Capital*

As of the date of this filing, we believe we have sufficient liquid assets, which include unrestricted cash, to satisfy all of our short-term recourse liabilities. Our junior subordinated notes payable are long-term obligations. With respect to the next 12 months, we expect that our cash on hand combined with our other primary sources of funds for liquidity will be sufficient to satisfy our anticipated liquidity needs with respect to our current portfolio, including related financings, capital expenditures for our Traditional and Entertainment Golf businesses, working capital needs, potential margin calls and operating expenses. In addition, we may have additional cash requirements with respect to incremental investments related to our Traditional Golf business and executing our strategic objectives for our Entertainment Golf business. In addition to our available cash, we may elect to meet the cash requirements of these incremental investments through proceeds from the monetization of our assets or from additional borrowings or equity offerings. While it is inherently more difficult to forecast beyond the next 12 months, we currently expect to meet our long-term liquidity requirements, specifically the repayment of our recourse debt obligations, through our cash on hand and, if needed, additional borrowings, proceeds from equity offerings and the liquidation or refinancing of our assets. We continually monitor market conditions for financing opportunities, and at any given time, we may enter into or pursue one or more of the transactions described above.

These short-term and long-term expectations are forward-looking and subject to a number of uncertainties and assumptions, which are described below under “—Factors That Could Impact Our Liquidity, Capital Resources and Capital Obligations” as well as Part II, Item 1A. “Risk Factors.” If our assumptions about our liquidity prove to be incorrect, we could be subject to a shortfall in liquidity in the future, and this shortfall may occur rapidly and with little or no notice, which would limit our ability to address the shortfall on a timely basis.

Cash flows provided by operations constitute a critical component of our liquidity. Essentially, our cash flows provided by operations is equal to (i) net cash flows received from our Traditional Golf business, plus (ii) the net cash flows from our Debt Investments that are not subject to mandatory debt repayment, including principal and sales proceeds, less (iii) Traditional Golf operating expenses, management fees, professional fees and insurance, less (iv) interest on the junior subordinated notes payable and less (v) preferred dividends.

Our cash flows provided by operations differs from our net income (loss) due to these primary factors: (i) accretion of discount or premium on our real estate securities and loans (including the accrual of interest payable at maturity) and deferred financing costs, (ii) amortization of favorable and unfavorable leasehold intangibles from the acquisition of the Traditional Golf business in December 2013, (iii) accretion of the golf membership deposit liabilities in interest expense, (iv) amortization of prepaid golf membership dues, (v) gains and losses from sales of assets, (vi) the valuation allowance recorded in connection with our loan assets, as well as other-than-temporary impairment on our securities, Traditional Golf business and other investments, (vii) unrealized gains or losses on our investments, (viii) non-cash gains or losses associated with our early extinguishment of debt, (ix) non-cash gains on deconsolidation, and (x) depreciation and amortization on our investments. Proceeds from the sale of assets which serve as collateral for our CDO financings, including gains thereon, are required to be retained in the CDO structure until the related bonds are retired and are, therefore, not available to fund current cash needs outside of these structures.

The sources of our distributions are net cash provided by operating activities, net cash provided by investing activities and cash equivalents as they represent the return on our portfolio of investments in real estate debt and golf related real estate and operations. The Company has paid preferred dividends of \$1.4 million thus far in fiscal year 2017, and our board of directors elected not to pay a common stock dividend in the first quarter of 2017 to retain capital for growth. For the three months ended March 31, 2017, the Company reported net cash used in operating activities of \$9.4 million, net cash provided by investing activities of \$295.8 million, net cash used in financing activities of \$299.5 million and cash and cash equivalents of \$127.0 million as of

March 31, 2017. As a result of our revocation of REIT election, effective January 1, 2017, we are no longer subject to the distribution requirements applicable to REITs. The timing and amount of distributions are in the sole discretion of our board of directors, which considers our earnings, financial performance and condition, debt service obligations and applicable debt covenants, tax considerations, as well as capital expenditure requirements, business prospects and other factors that our board of directors may deem relevant from time to time.

#### *Update on Liquidity, Capital Resources and Capital Obligations*

*Cash* – As of March 31, 2017, we had \$127.0 million of available cash, including \$7.8 million of working capital for the Traditional Golf business. On February 27, 2017, we declared quarterly preferred dividends of \$1.4 million which were paid on April 28, 2017.

Certain details regarding our liquidity, current financings and capital obligations as of April 26, 2017 are set forth below:

- *Margin Exposure and Recourse Financings* – We have margin exposure on \$311.3 million repurchase agreements related to the financing of FNMA/FHLMC securities. See Note 8 to Part I, Item 1. “Financial Statements” for additional information.

The following table compares our recourse financings excluding the junior subordinated notes (in thousands):

Recourse Financings	April 26, 2017	March 31, 2017	December 31, 2016
FNMA/FHLMC securities	\$ 311,274	\$ 310,630	\$ 600,964

Our liquidity, available capital resources and capital obligations could change rapidly due to a variety of factors, many of which are beyond our control. Set forth below is a discussion of some of the factors that could impact our liquidity, available capital resources and capital obligations.

#### *Factors That Could Impact Our Liquidity, Capital Resources and Capital Obligations*

We refer readers to our discussions in other sections of this report for the following information:

- For a further discussion of recent trends and events affecting our liquidity, see “– Market Considerations” above;
- As described above, under “– Update on Liquidity, Capital Resources and Capital Obligations,” we are subject to margin calls in connection with our repurchase agreements;
- As described above, under “– Sources of Liquidity and Uses of Capital,” we may be subject to capital obligations associated with our Traditional and Entertainment Golf businesses;
- Our remaining investments, generally financed with short-term debt or short-term repurchase agreements, are also subject to refinancing risk upon the maturity of the related debt. See “– Debt Obligations” below; and
- For a further discussion of a number of risks that could affect our liquidity, access to capital resources and our capital obligations, see Part II, Item 1A., “Risk Factors” below.

In addition to the information referenced above, the following factors could affect our liquidity, access to capital resources and our capital obligations related to our Traditional and Entertainment Golf businesses. As such, if their outcomes do not fall within our expectations, changes in these factors could negatively affect our liquidity.

- *Access to Financing from Counterparties* – Decisions by investors, counterparties and lenders to enter into transactions with us will depend upon a number of factors, such as our historical and projected financial performance, compliance with the terms of our current credit and derivative arrangements, industry and market trends, the availability of capital and our investors’, counterparties’ and lenders’ policies and rates applicable thereto, and the relative attractiveness of alternative investment or lending opportunities. Our business strategy is dependent upon our investments at rates that provide a positive net spread.
- *Impact of Expected Repayment or Forecasted Sale on Cash Flows* – The timing of and proceeds from the repayment or sale of certain investments may be different than expected or may not occur as expected. Proceeds from sales of assets in the current illiquid market environment are unpredictable and may vary materially from their estimated fair value and their carrying value.

**Traditional Golf | American Golf**

American Golf is one of the largest owners and operators of golf properties in the United States. As of March 31, 2017, we owned, leased or managed 78 properties across 13 states. American Golf and its dedicated employees are focused on delivering lasting experiences for our customers, including our more than 50,000 members, who played over 750,000 rounds at our properties in the first quarter of 2017.

American Golf was acquired by the Company in December 2013, when the Company restructured an existing mezzanine debt investment related to NGP Realty Sub, L.P. and American Golf Corporation (together, “American Golf”). As part of the restructuring, Drive Shack Inc. acquired the equity of American Golf’s indirect parent, AGC Mezzanine Pledge LLC.

Our operations are organized into three principal categories: (1) Public Properties, (2) Private Properties and (3) Managed Properties.

*Public Properties.* Our 49 public properties generate revenues principally through daily green fees, golf cart rentals and food, beverage and merchandise sales. Amenities at these properties generally include practice facilities and pro shops with food and beverage facilities. In some cases, our public properties have small clubhouses with banquet facilities. In addition, The Players Club is a monthly membership program offered at most of our public properties, with membership benefits ranging from daily range access to ability to participate in golf clinics, in return for a monthly membership fee.

*Private Properties.* Our 19 private properties are open to members only and generate revenues principally through initiation fees, membership dues, guest fees, and food, beverage and merchandise sales. Amenities at these properties typically include practice facilities, full service clubhouses with a pro shop, locker room facilities and multiple food and beverage outlets, including grills, restaurants and banquet facilities.

*Managed Properties.* Our 10 managed properties are properties that American Golf manages pursuant to a management agreement with the owner of each property. We recognize revenue from these properties in an amount equal to the respective management fee.

The following summarizes the American Golf properties and golf holes as of March 31, 2017:



**Entertainment Golf | Drive Shack**

Drive Shack is an entertainment company that combines golf, competition, dining and fun. Drive Shack plans to open a chain of next-generation entertainment golf venues across the United States and internationally, with each venue featuring multiple stories of hitting suites where friends, family, co-workers or complete strangers may compete in a technologically-enhanced golf games. Consumers who are seeking a good time, but not looking to participate in the game, would be able

to spectate from one of Drive Shack’s restaurant or lounge areas. Drive Shack is developing its inaugural venue in Orlando, Florida.

• **Debt Investments | Loans & Securities**

The Company historically invested in loans and securities. As the Company continues to transform to a leisure and entertainment company, under the name Drive Shack, management is working to optimize and monetize the loans and securities owned through pay downs and sales.

As of March 31, 2017, our debt investment portfolio consists primarily of agency Fannie Mae/Freddie Mac (“FNMA/FHLMC”) securities and our investment in a resorts-related loan as described below.

As of March 31, 2017, we hold one Agency FNMA/FHLMC fixed rate security with a carrying value of \$326.9 million. See Note 4 for additional information about our agency FNMA/FHLMC securities.

In April 2010, we made a cash investment of \$75.0 million through two of our CDOs in a new loan to Intrawest Cayman L.P. and its subsidiaries (“Intrawest”), which is a portfolio company of private equity funds managed by an affiliate of our Manager. In addition, Mr. Wesley R. Edens is Chairman of our board of directors and a director of Intrawest, and has an indirect ownership interest in Intrawest. Interest on the loan is accrued and deferred until maturity in 2019. In accordance with the loan agreement, as of April 24, 2015, the accrued and deferred interest rate stepped-up from 15.55% to 22.50%. On September 23, 2016, Drive Shack Inc. received a \$109.9 million pay down on this loan. The face amount of the loan was \$64.4 million as of March 31, 2017. Interest accrued on the loan accounts for a significant portion of our interest income and Core Earnings. We could be adversely affected if we are unable to recover our investment in the loan.

*Debt Obligations*

Our debt obligations including capital lease obligations, as summarized in Note 8 to our Consolidated Financial Statements included herein, existing at March 31, 2017 (gross of \$2.8 million of discounts) had contractual maturities as follows (in thousands):

	Nonrecourse	Recourse	Total
Period from April 1, 2017 through December 31, 2017	\$ 2,811	\$ 310,630	\$ 313,441
2018	3,959	—	3,959
2019	106,078	—	106,078
2020	3,034	—	3,034
2021	1,619	—	1,619
2022	171	—	171
Thereafter	200	51,004	51,204
Total	\$ 117,872	\$ 361,634	\$ 479,506

Certain of the debt obligations are obligations of our consolidated subsidiaries which own the related collateral. In some cases, such collateral is not available to other creditors of ours.

The financing of our Traditional Golf business contain various customary loan covenants, including certain coverage ratios. We were in compliance with all of the covenants as of March 31, 2017. In addition, as of March 31, 2017, we had complied with the general investment guidelines adopted by our board of directors that limit total leverage.

Repurchase Agreements

The following table provides additional information regarding short-term borrowings (dollars in thousands). The outstanding short-term borrowings were used to finance certain of our investments in FNMA/FHLMC securities. All of the repurchase agreements have full recourse to the Company.

	Outstanding Face Amount at March 31, 2017	Three Months Ended March 31, 2017		
		Average Daily Amount Outstanding	Maximum Amount Outstanding	Weighted Average Interest Rate
FNMA/FHLMC	\$ 310,630	\$ 537,888	\$ 600,964	0.90%

The weighted average differences between the fair value of the assets and the face amount of financing for the FNMA/FHLMC repurchase agreements was 4% as of March 31, 2017.

## Equity

### Common Stock

At March 31, 2017, we had 66,842,378 shares of common stock outstanding.

See Note 11 to Part I, Item 1. "Financial Statements" for information on our outstanding options as of March 31, 2017.

### Preferred Stock Dividends Paid

Declared for the Quarter Ended	Paid	Amount Per Share		
		Series B	Series C	Series D
January 31, 2017	January 2017	\$ 0.609	\$ 0.503	\$ 0.523
April 30, 2017	April 2017	\$ 0.609	\$ 0.503	\$ 0.523

### Accumulated Other Comprehensive Income

During the three months ended March 31, 2017, our accumulated other comprehensive income changed due to the following factors (in thousands):

	Total Accumulated Other Comprehensive Income
Accumulated other comprehensive income, December 31, 2016	\$ 1,168
Net unrealized gain on available-for-sale securities	47
Accumulated other comprehensive income, March 31, 2017	\$ 1,215

Our GAAP equity changes as our real estate securities portfolio and derivatives are marked to market each quarter, among other factors. The primary causes of mark-to-market changes are changes in interest rates. Net unrealized gains on our real estate securities decreased during the three months ended March 31, 2017 in accumulated other comprehensive income primarily as a result of unrealized losses on our fixed rate Agency RMBS caused by rising interest rates. These were partially offset by net losses realized in earnings that were primarily driven by the reclassification of unrealized losses into earnings on Agency RMBS due to the Company's intent to sell these securities.

See "- Market Considerations" above for a further discussion of recent trends and events affecting our unrealized gains and losses as well as our liquidity.

## Cash Flow

### Operating Activities

Net cash used in operating activities was \$9.4 million for the three months ended March 31, 2016 and \$9.4 million for the three months ended March 31, 2017. Changes in operating cash flow activities are described below:

- Operating cash flows increased by:
  - \$1.8 million in our Traditional Golf business primarily due to savings in as a result of the termination of certain leased golf properties in 2016;
  - \$1.1 million from our Debt Investment business primarily due to an increase of \$1.4 million of net interest received on our agency RMBS portfolio, offset by a decrease of \$0.3 million on lower collateral management fees received for the three months ended March 31, 2017 compared to the three months ended March 31, 2016; and
  - \$0.6 million due to savings in interest paid as a result of lower interest rates associated with our junior subordinated notes payable for the three months ended March 31, 2017 compared to the three months ended March 31, 2016.
- Operating cash flows decreased by:
  - \$3.6 million from our general and administrative costs paid primarily due to \$2.1 million of additional costs for Entertainment Golf and \$1.5 million for other corporate activities during the three months ended March 31, 2017 compared to the three months ended March 31, 2016.

## Investing Activities

Investing activities provided \$295.8 million and used \$6.8 million during the three months ended March 31, 2017 and 2016, respectively. Uses of cash flow from investing activities consisted primarily of investments made in Traditional Golf properties, Entertainment Golf venues and real estate securities and payments for settlement of derivatives. Proceeds from cash flows from investing activities consisted primarily of sale of investments, repayments from loans and securities and settlement of derivatives.

## Financing Activities

Financing activities used \$299.5 million and provided \$2.6 million during the three months ended March 31, 2017 and 2016, respectively. Proceeds of cash flow from financing activities consisted primarily of borrowings under debt obligations, return of margin deposits to our repurchase agreements and derivatives, and deposits received on golf memberships. Uses of cash flow from financing activities included the repayment of debt obligations, deposits made on margin calls related to our repurchase agreements and derivatives, the payment of financing costs, and the payment of common and preferred dividends.

## **Interest Rate, Credit and Spread Risk**

We are subject to interest rate, credit and spread risk with respect to our investments. These risks are further described in “Quantitative and Qualitative Disclosures About Market Risk.”

## **Off-Balance Sheet Arrangements**

As of March 31, 2017, we had the following material off-balance sheet arrangements. We believe that these off-balance sheet structures presented the most efficient and least expensive form of financing for these assets at the time they were entered, and represented the most common market-accepted method for financing such assets.

- In April 2006, we securitized Subprime Portfolio I. The loans were sold to a securitization trust, of which 80% were treated as a sale, which is an off-balance sheet financing.
- In July 2007, we securitized Subprime Portfolio II. The loans were sold to a securitization trust, of which 90% were treated as a sale, which is an off-balance sheet financing.

We have no obligation to repurchase any loans from either of our subprime securitizations. Therefore, it is expected that our exposure to loss is limited to the carrying amount of our retained interests in the securitization entities, as described above. A subsidiary of ours gave limited representations and warranties with respect to the second securitization; however, it has no assets and does not have recourse to the general credit of the Company.

In each case, our exposure to loss is limited to the carrying value of our investment. See Note 12 to our Consolidated Financial Statements in Part I, Item 1. “Financial Statements” for additional information.

## **CONTRACTUAL OBLIGATIONS**

During the three months ended March 31, 2017, we had all of the material contractual obligations referred to in our annual report on Form 10-K for the year ended December 31, 2016, excluding the debt which was repaid, spun-off or repurchased, as described in “– Liquidity and Capital Resources.”

In addition, we had the following material contractual obligations that we executed during the three months ended March 31, 2017.

- In October 2016, American Golf entered into an agreement to lease office space in El Segundo, California to serve as its new corporate headquarters. The lease commenced in February 2017 and expires in May 2022 with an option to extend to May 2027.

## **Inflation**

For our assets and liabilities that are financial in nature, 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 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. See “Quantitative and Qualitative Disclosure About Market Risk - Interest Rate Exposure” below.

## **Core Earnings**

The following primary variables impact our operating performance: (i) the current yield earned on our investments that are not included in non-recourse financing structures (i.e., unlevered investments, including investments in equity method investees and investments subject to recourse debt), (ii) the net yield we earn from our non-recourse financing structures, (iii) the interest expense and dividends incurred under our recourse debt and preferred stock, (iv) the net operating income on our real estate and golf investments, (v) our operating expenses and (vi) our realized and unrealized gains or losses, net of related provision for income taxes, including any impairment, on our investments, derivatives and debt obligations. Core earnings is a non-GAAP measure of our operating performance excluding the sixth variable listed above. Core earnings also excludes depreciation and amortization charges, including the accretion of membership deposit liabilities and the impact of the application of acquisition accounting, acquisition and spin-off related expenses and restructuring expenses. Core earnings is used by management to evaluate our performance without taking into account gains and losses, net of related provision for income taxes, which, although they represent a part of our recurring operations, are subject to significant variability and are only a potential indicator of future performance. These adjustments to our (loss) income applicable to common stockholders are not indicative of the performance of the assets that form the core of our activity.

Management utilizes core earnings as a measure in its decision-making process relating to the underlying fundamental operations of our investments, as well as the allocation of resources between those investments, and management also relies on core earnings as an indicator of the results of such decisions. As such, core earnings is not intended to reflect all of our activity and should be considered as only one of the factors in assessing our performance, along with GAAP net (loss) income, which is inclusive of all of our activities. Management also believes that the exclusion from core earnings of the items specified above allows investors and analysts to readily identify and track the operating performance of the assets that form the core of our activity, assists in comparing the core operating results between periods, and enables investors to evaluate our current core performance using the same measure that management uses to operate the business.

Core earnings does not represent an alternative to net (loss) income as an indicator of our operating performance or as an alternative to cash flows from operating activities as a measure of our liquidity, and is not indicative of cash available to fund cash needs. For a further description of the differences between cash flows provided by operations and net (loss) income, see “ – Liquidity and Capital Resources” above. Our calculation of core earnings may be different from the calculation used by other companies and, therefore, comparability may be limited.



Set forth below is a reconciliation of core earnings to the most directly comparable GAAP financial measure (in thousands).

	Three Months Ended March 31,	
	2017	2016
(Loss) income applicable to common stockholders	\$ (14,349)	\$ 72,024
Add (Deduct):		
Impairment	—	2,308
Realized/unrealized (gain) loss on investments	3,389	2,007
Other loss (income)(A)	502	(82,079)
Depreciation and amortization(B)	8,407	8,665
Acquisition, transaction, restructuring and spin-off related expenses(C)	1,662	491
Core earnings	\$ (389)	\$ 3,416

(A) Other income reconciliation:

	Three Months Ended March 31,	
	2017	2016
Total other (loss) income	\$ 2,331	\$ 89,955
Add (deduct):		
Equity in earnings from equity method investees	(379)	(371)
Interest and investment income	(7,888)	(21,039)
Interest expense	5,434	13,534
Other (loss) income	\$ (502)	\$ 82,079

(B) Including accretion of membership deposit liabilities of \$1.6 million and \$1.4 million and amortization of favorable and unfavorable leasehold intangibles of \$1.0 million and \$1.2 million in the three months ended March 31, 2017 and 2016, respectively. The accretion of membership deposit liabilities was recorded to interest expense and the amortization of favorable and unfavorable leasehold intangibles was recorded to operating expenses.

(C) Including acquisition and transaction expenses of \$1.7 million and \$0.2 million and restructuring expenses of less than \$0.1 million and \$0.3 million during the three months ended March 31, 2017 and 2016, respectively. The acquisition and transaction costs were recorded to general and administrative expense and restructuring expenses were recorded to operating expenses.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk is the exposure to loss resulting from changes in interest rates, credit spreads, foreign currency exchange rates, commodity prices and equity prices. The primary market risks that we are exposed to are interest rate risk and credit spread risk. These risks are highly sensitive to many factors, including governmental monetary and tax policies, domestic and international economic and political considerations and other factors beyond our control. All of our market risk sensitive assets, liabilities and derivative positions are for non-trading purposes only. For a further understanding of how market risk may affect our financial position or operating results, please refer to Part I, Item 2. "Management's Discussion and Analysis of Financial Condition and Results of Operations - Application of Critical Accounting Policies."

#### Interest Rate Exposure

Changes in interest rates, including changes in expected interest rates or "yield curves," affect our investments in two distinct ways, each of which is discussed below.

Changes in interest rates affect our net interest income, which is the difference between the interest income earned on assets and the interest expense incurred in connection with our debt obligations and hedges.

As of March 31, 2017, a 100 basis point increase in short-term interest rates would decrease our earnings by approximately \$0.5 million per annum, based on the current net floating rate exposure from our investments, financings and interest rate derivatives.

Second, changes in the level of interest rates also affect the yields required by the marketplace on debt. Increasing interest rates would decrease the value of the fixed rate assets we hold at the time because higher required yields result in lower prices on existing fixed rate assets in order to adjust their yield upward to meet the market.

Changes in unrealized gains or losses resulting from changes in market interest rates do not directly affect our cash flows, or our ability to pay a dividend, as the related assets are expected to be held, as their fair value is not relevant to their underlying cash flows. Changes in unrealized gains or losses would impact our ability to realize gains on existing investments if they were sold. Furthermore, with respect to changes in unrealized gains or losses on investments which are carried at fair value, changes in unrealized gains or losses would impact our net book value and, in the cases of impaired assets and non-hedge derivatives, our net income.

Changes in the value of our assets could affect our ability to borrow and access capital. Also, if the value of our assets subject to short-term financing were to decline, it could cause us to fund margin and affect our ability to refinance such assets upon the maturity of the related financings, adversely impacting our rate of return on such securities.

As of March 31, 2017, a 100 basis point change in short-term interest rates would impact our net book value by approximately \$0.3 million, based on the current net fixed rate exposure from our investments and interest rate derivatives.

An interest rate cap or floor agreement is a contract in which we purchase a cap or floor contract on a notional face amount. We will make an upfront payment to the counterparty for which the counterparty agrees to make future payments to us should the reference rate (typically LIBOR) rise above (cap agreements) or fall below (floor agreements) the "strike" rate specified in the contract. Payments on an annualized basis will equal the contractual notional face amount multiplied by the difference between the actual reference rate and the contracted strike rate.

Our hedging transactions using derivative instruments also involve certain additional risks such as counterparty credit risk, the enforceability of hedging contracts and the risk that unanticipated and significant changes in interest rates will cause a significant loss of basis in the contract. There can be no assurance that we will be able to adequately protect against the foregoing risks and will ultimately realize an economic benefit that exceeds the related amounts incurred in connection with engaging in such hedging strategies.

#### Credit Spread Exposure

Credit spreads measure the yield demanded on loans and securities by the market based on their credit relative to U.S. Treasuries, for fixed rate credit, or LIBOR, for floating rate credit. Our fixed rate loans and securities are valued based on a market credit spread over the rate payable on fixed rate U.S. Treasuries of like maturity. Our floating rate loans and securities are valued based on a market credit spread over LIBOR. Excessive supply of such loans and securities combined with reduced demand will generally cause the market to require a higher yield on such loans and securities, resulting in the use of a higher (or "wider") spread over the benchmark rate to value them.

Widening credit spreads would result in higher yields being required by the marketplace on loans and securities. This widening would reduce the value of the loans and securities we hold at the time because higher required yields result in lower prices on existing securities in order to adjust their yield upward to meet the market. The effects of such a decrease in values on our financial position, results of operations and liquidity are discussed above under “- Interest Rate Exposure.”

As of March 31, 2017, a 25 basis point movement in credit spreads would impact our net book value by approximately \$0.1 million, assuming a static portfolio of current investments and financings, but would not directly affect our earnings or cash flow.

In an environment where spreads are tightening, if spreads tighten on the assets we purchase to a greater degree than they tighten on the liabilities we issue, our net spread will be reduced.

### **Credit Risk**

In addition to the above described market risks, the Company is subject to credit risk.

Credit risk refers to the ability of each individual borrower under our loans and securities to make required interest and principal payments on the scheduled due dates. The commercial mortgage and asset backed securities we invest in are generally junior in right of payment of interest and principal to one or more senior classes, but benefit from the support of one or more subordinate classes of securities or other form of credit support (which absorbs losses before the securities in which we invest) within a securitization transaction. We also invest in loans and securities which represent “first loss” pieces; in other words, they do not benefit from credit support although we believe at acquisition they predominantly benefit from underlying collateral value in excess of their carrying amounts. Corporate loans are also subject to the risk of a bankruptcy filing of the related entity.

We seek to reduce credit risk by actively monitoring our asset portfolio and the underlying credit quality of our holdings and, where appropriate and achievable, repositioning our investments to upgrade their credit quality. In the event of a significant rising interest rate environment and/or economic downturn, loan and collateral defaults may increase and result in credit losses that would adversely affect our liquidity and operating results. As described in “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Market Considerations” and elsewhere in this quarterly report, adverse market and credit conditions have resulted in our recording of other-than-temporary impairment and valuation allowance in certain securities and loans.

### **Margin**

We are subject to margin calls on our repurchase agreements and derivative agreements. Furthermore, we may, from time to time, be a party to other financing arrangements that are subject to margin calls based on the value of such instruments. 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.

### **Interest Rate and Credit Spread Risk Sensitive Instruments and Fair Value**

Our holdings of such financial instruments, and their fair values and the estimation methodology thereof, are detailed in Note 10 to Part I, Item 1. “Financial Statements.” For information regarding the impact of prepayment, reinvestment, and expected loss factors on the timing of realization of our investments, please refer to the Consolidated Financial Statements included herein and in our Annual Report on Form 10-K for the year ended December 31, 2016. For information regarding the impact of changes in these factors on the value of securities valued with internal models, see Part I, Item 2. “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Application of Critical Accounting Policies.”

We note that the values of our investments in real estate securities, loans and derivative instruments are sensitive to changes in market interest rates, credit spreads and other market factors. The value of these investments can vary, and has varied, materially from period to period.

### **Trends**

See Part I, Item 2. “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Market Considerations” for a further discussion of recent trends and events affecting our liquidity, unrealized gains and losses.

#### **ITEM 4. CONTROLS AND PROCEDURES**

- (a) **Disclosure Controls and Procedures.** The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has 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 (the "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 completely. Based on such evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, the Company's disclosure controls and procedures are effective.
  
- (b) **Changes in Internal Control Over Financial Reporting.** There have not been any 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 fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## PART II. OTHER INFORMATION

### Item 1. Legal Proceedings

We are and may become involved in legal proceedings, including but not limited to regulatory investigations and inquiries, in the ordinary course of our business. Although we are unable to predict with certainty the eventual outcome of any litigation, regulatory investigation or inquiry, in the opinion of management, we do not expect our current and any threatened legal proceedings, to have a material adverse effect on our business, financial position or results of operations. Given the inherent unpredictability of these types of proceedings, however, it is possible that future adverse outcomes could have a material effect on our financial results.

### Item 1A. Risk Factors

*Before you invest in our common stock, you should carefully consider the risks involved, including the risks set forth below.*

#### Risks Related to Our Business

**We may not be able to retain members at our public and private properties, and attract golf rounds played, which could harm our business, financial condition and results of operations.**

Our success depends on our ability to retain members at our public and private properties, attract golf rounds played and maintain or increase revenues generated from our properties. Changes in consumer financial condition, leisure tastes and preferences, particularly those affecting the popularity of golf, and other social and demographic trends could adversely affect our business. Significant periods where attrition rates exceed enrollment rates or where facilities usage is below historical levels would have a material adverse effect on our business, results of operations and financial condition. If we cannot attract new members, retain our existing members, or maintain golf rounds played, our financial condition and results of operations could be harmed.

**Changes in consumer financial condition, leisure tastes and preferences, spending patterns, particularly discretionary expenditures for leisure and recreation, are subject to factors beyond our control that may impact our business, financial condition and results of operations.**

Consumer spending patterns, particularly discretionary expenditures for leisure and recreation, are subject to factors beyond our control that may impact our business, including demand for memberships, golf rounds played, and food and beverage sales. These factors include:

- economic recessions or downturns;
- increased unemployment
- low consumer confidence and outlook;
- depressed housing markets;
- decreased corporate spending, including on events or tournaments;
- natural disasters, such as earthquakes, tornadoes, hurricanes, wildfires, blizzards, droughts and floods;
- outbreaks of epidemic, pandemic or contagious diseases;
- war, terrorist activities or threats and heightened travel security measures instituted in response to these events; and
- the financial condition of the airline, automotive and other transportation-related industries and its impact on travel.

These factors and other global, national and regional conditions can adversely affect, and from time to time have adversely affected, individual properties, particular regions or our business as a whole. Any one or more of these factors could limit or reduce demand or the rates are able to charge for our memberships, services, or rounds, which could harm our business and results of operations.

Our businesses will remain subject to future economic recessions or downturns, and any significant adverse shift in increased unemployment and general economic conditions, whether local, regional, national or global, or in geographic areas in which we

have concentrations of golf properties, such as California, may have a material adverse effect on our business, financial condition and results of operations. During such periods of adverse economic conditions, we may be unable to increase membership dues or the price of our rounds, products and services and may experience increased rates of resignations of existing members, a decrease in the rate of new member enrollment, a decrease in golf rounds played or reduced spending on our properties, any of which may result in, among other things, financial losses and decreased revenues.

**Unusual weather patterns and extreme weather events, as well as periodic and quasi-periodic weather patterns, could adversely affect the value of our golf courses or negatively impact our business and results of operations.**

Our golf business is subject to various risks that may not apply to our other investments. For example, unusual weather patterns and extreme weather events, such as heavy rains, prolonged snow accumulations, high winds, extended heat waves and drought, could negatively affect the income generated by our facilities. The maintenance of satisfactory turf grass conditions on our golf properties requires significant amounts of water. Our ability to irrigate a golf course could be adversely affected by a drought or other cause of water shortage, such as government imposed restrictions on water usage. Additionally, we may be subject to significant increases in the cost of water. We have a concentration of golf facilities in states (such as California, Georgia, New York and Texas) that experience periods of unusually hot, cold, dry or rainy weather. Unfavorable weather patterns in such states, or any other circumstance or event that causes a prolonged disruption in the operations of our facilities in such states (including, without limitation, economic and demographic changes in these areas), could have a particularly adverse impact on our Traditional Golf business. See “-We may not be able to retain members and attract golf rounds played, which could harm our business, financial condition and results of operations” and “-Economic recessions or downturns could negatively affect our business, financial condition and results of operations.”

**We have significant operations concentrated in certain geographic areas, and any disruption in the operations of our properties in any of these areas could harm our results of operations.**

As of March 31, 2017, we operated multiple golf properties in several metropolitan areas, including 31 in the greater Los Angeles, California region. As a result, any prolonged disruption in the operations of our properties in any of these markets, whether due to technical difficulties, power failures or destruction or damage to the properties as a result of a natural disaster, fire or any other reason, could harm our results of operations or may result in property closures. In addition, some of the metropolitan areas where we operate properties could be disproportionately affected by regional economic conditions, such as declining home prices and rising unemployment. Concentration in these markets increases our exposure to adverse developments related to competition, as well as economic and demographic changes in these areas.

**Seasonality may adversely affect our business and results of operations.**

Seasonality will affect our golf business’s results of operations. Usage of golf facilities tends to decline significantly during the first and fourth quarters, when colder temperatures and shorter days reduce the demand for outdoor activities. As a result, we expect the golf business to generate a disproportionate share of its annual revenue in the second and third quarters of each year. Accordingly, our golf business is especially vulnerable to events that may negatively impact its operations during the second and third quarters, when guest and member usage is highest.

**Competition in the industry in which we operate could have a material adverse effect on our business and results of operations.**

We operate in a highly competitive industry, and compete primarily on the basis of reputation, featured facilities, location, quality and breadth of member product offerings and price. As a result, competition for market share in the industry in which we compete is significant. In order to succeed, we must take market share from local and regional competitors and sustain our membership base in the face of increasing recreational alternatives available to our existing and prospective members. Our properties compete on a local and regional level with restaurants and other business, dining and social clubs. The number and variety of competitors in this business varies based on the location and setting of each facility, with some situated in intensely competitive upscale urban areas characterized by frequent innovations in the products and services offered by competing restaurants and other business, dining and social clubs. In addition, in most regions, these businesses are in constant flux as new restaurants and other social and meeting venues open or expand their amenities. As a result of these characteristics, the supply in a given region often exceeds the demand for such facilities, and any increase in the number or quality of restaurants and other social and meeting venues, or the products and services they provide, in such region could significantly impact the ability of our properties to attract and retain members, which could harm our business and results of operations.

Our golf properties compete on a local and regional level with other country clubs and golf properties. The level of competition in the golf business varies from region to region and is subject to change as existing facilities are renovated or new facilities are developed. An increase in the number or quality of similar clubs and other facilities in a particular region could significantly increase competition, which could have a negative impact on our business and results of operations.

Our results of operations also could be affected by a number of additional competitive factors, including the availability of, and demand for, alternative venues for recreational pursuits, such as multi-use sports and athletic centers. In addition, member-owned and individual privately-owned clubs may be able to create a perception of exclusivity that we have difficulty replicating given the diversity of our portfolio and the scope of our holdings. To the extent these alternatives succeed in diverting actual or prospective members away from our facilities or affect our membership rates, our business and results of operations could be harmed.

**Our large workforce subjects us to risks associated with increases in the cost of labor as a result of increased competition for employees, higher employee turnover rates and required wage increases and health benefit coverage, lawsuits or labor union activity.**

Labor is one of our primary property-level operating expenses. We may face labor shortages or increased labor costs because of increased competition for employees, higher employee turnover rates, or increases in the federal or state minimum wage or other employee benefit costs. For example, if the federal minimum wage were increased significantly, we would have to assess the financial impact on our operations as we have a large population of hourly employees. If labor-related expenses increase, our operating expense could increase and our business, financial condition and results of operations could be harmed.

We are subject to the Fair Labor Standards Act and various federal and state laws governing such matters as minimum wage requirements, overtime compensation and other working conditions, citizenship requirements, discrimination and family and medical leave. In recent years, a number of companies have been subject to lawsuits, including class action lawsuits, alleging violations of federal and state law regarding workplace and employment matters, overtime wage policies, discrimination and similar matters. A number of these lawsuits have resulted in the payment of substantial damages by the defendants. Similar lawsuits may be threatened or instituted against us from time to time, and we may incur substantial damages and expenses resulting from lawsuits of this type, which could have a material adverse effect on our business, financial condition or results of operations.

**Increases in our cost of goods, rent, water, utilities and taxes could reduce our operating margins and harm our business, financial condition and results of operations.**

Increases in operating costs due to inflation and other factors may not be directly offset by increased revenue. Our most significant operating costs, other than labor, are our cost of goods, water, utilities, rent and property taxes. Many, and in some cases all, of the factors affecting these costs are beyond our control. Our cost of goods such as food and beverage costs account for a significant portion of our total property-level operating expense. While we have not experienced material increases in the cost of goods, if our cost of goods increased significantly and we are not able to pass along those increased costs to our members in the form of higher prices or otherwise, our operating margins would suffer, which would have an adverse effect on our business, financial condition and results of operations.

In addition, rent accounts for a significant portion of our property-level operating expense. Significant increases in our rent costs would increase our operating expense and our business, financial condition and results of operations may suffer. The prices of utilities are volatile, and shortages sometimes occur. In particular, municipalities are increasingly placing restrictions on the use of water for golf course irrigation and increasing the cost of water. Significant increases in the cost of our utilities, or any shortages, could interrupt or curtail our operations and lower our operating margins, which could have a negative impact on our business, financial condition and results of operations.

Each of our properties is subject to real and personal property taxes. The real and personal property taxes on our properties may increase or decrease as tax rates change and as our properties are assessed or reassessed by taxing authorities. If real and personal property taxes increase, our financial condition and results of operations may suffer.

**We could be required to make material cash outlays in future periods if the number of initiation deposit refund requests we receive materially increases or if we are required to surrender unclaimed initiation deposits to state authorities under applicable escheatment laws.**

We may be required to make significant cash outlays in connection with initiation fee deposits. Members of our private properties are generally required to pay an initiation fee deposit upon their acceptance as a member and, in most cases, such deposits are fully refundable after a fixed number of years (typically 30 years) and upon the occurrence of other contract-specific conditions. While we will make a refund to any member whose initiation fee deposit is eligible to be refunded, we may be subject to various

states' escheatment laws with respect to initiation fee deposits that have not been refunded to members. All states have escheatment laws and generally require companies to remit to the state cash in an amount equal to unclaimed and abandoned property after a specified period of dormancy, which is typically 3 to 5 years. Moreover, most of the states in which we conduct business hire independent agents to conduct unclaimed and abandoned property audits. We currently do not remit to states any amounts relating to initiation fee deposits that are eligible to be refunded to members based upon our interpretation of the applicability of such laws to initiation fee deposits. The analysis of the potential application of escheatment laws to our initiation fee deposits is complex, involving an analysis of constitutional and statutory provisions and contractual and factual issues. While we do not believe that initiation fee deposits must be escheated, we may be forced to remit such amounts if we are challenged and fail to prevail in our position.

**We have concentrated our investments in golf-related and business real estate and facilities, which are subject to numerous risks, including the risk that the values of our investments may decline if there is a prolonged downturn in real estate values.**

Our operations consist almost entirely of golf properties that encompass a large amount of real estate holdings. Accordingly, we are subject to the risks associated with holding real estate investments. A prolonged decline in the popularity of traditional golf could adversely affect the value of our real estate holdings and could make it difficult to sell facilities or businesses.

Our real estate holdings (including our long-term leaseholds) are subject to risks typically associated with investments in real estate. The investment returns available from equity investments in real estate depend in large part on the amount of income earned, expenses incurred and capital appreciation generated by the related properties. In addition, a variety of other factors affect income from properties and real estate values, including governmental regulations, real estate, insurance, zoning, tax and eminent domain laws, interest rate levels and the availability of financing. For example, new or existing real estate zoning or tax laws can make it more expensive and time-consuming to expand, modify or renovate older properties. Under eminent domain laws, governments can take real property. Sometimes this taking is for less compensation than the owner believes the property is worth. Any of these factors could have an adverse impact on our business, financial condition or results of operations.

**The illiquidity of real estate may make it difficult for us to dispose of one or more of our properties or negatively affect our ability to profitably sell such properties.**

We may from time to time decide to dispose of one or more of our real estate assets. Because real estate holdings generally, and properties like ours in particular, are relatively illiquid, we may not be able to dispose of one or more real estate assets on a timely basis. In some circumstances, sales may result in investment losses which could adversely affect our financial condition. The illiquidity of our real estate assets could mean that we continue to operate a facility that management has identified for disposition. Failure to dispose of a real estate asset in a timely fashion, or at all, could adversely affect our business, financial condition and results of operations.

**Timing, budgeting and other risks could delay our efforts to develop, redevelop or renovate the properties that we own, or make these activities more expensive, which could reduce our profits or impair our ability to compete effectively.**

We must regularly expend capital to construct, maintain and renovate the properties that we own in order to remain competitive, pursue our business strategies, maintain and build the value and brand standards of our properties and comply with applicable laws and regulations. We must also periodically upgrade or replace the furniture, fixtures and equipment necessary to operate our business. These efforts are subject to a number of risks, including:

- construction delays or cost overruns (including labor and materials) that may increase project costs;
- obtaining zoning, occupancy and other required permits or authorizations;
- governmental restrictions on the size or kind of development;
- force majeure events, including earthquakes, tornadoes, hurricanes or floods;
- design defects that could increase costs; and
- environmental concerns which may create delays or increase costs.



**Our insurance policies may not provide adequate levels of coverage against all claims and we may incur losses that are not covered by our insurance.**

There are certain types of losses, generally of a catastrophic nature, such as earthquakes, floods, hurricanes, terrorism or acts of war, that may be uninsurable or not economically insurable. Inflation, changes in building codes and ordinances, environmental considerations, and other factors, including terrorism or acts of war, also might make the insurance proceeds insufficient to repair or replace a property, including a golf property, if it is damaged or destroyed. Under such circumstances, the insurance proceeds received might not be adequate to restore our economic position with respect to the affected real property. For example, we may suffer losses from acts of terrorism that are not covered by insurance.

In addition, the mortgage loans that are secured by certain of the properties in which we have interests contain customary covenants, including covenants that require property insurance to be maintained in an amount equal to the replacement cost of the properties. There can be no assurance that the lenders under these mortgage loans will not take the position that exclusions from coverage for losses due to terrorist acts is a breach of a covenant which, if uncured, could allow the lenders to declare an event of default and accelerate repayment of the mortgage loans.

**Accidents or injuries in our properties or in connection with our operations may subject us to liability, and accidents or injuries could negatively impact our reputation and attendance, which would harm our business, financial condition and results of operations.**

There are inherent risks of accidents or injuries at our properties or in connection with our operations, including injuries from premises liabilities such as slips, trips and falls. If accidents or injuries occur at any of our properties, we may be held liable for costs related to the injuries. We maintain insurance of the type and in the amounts that we believe are commercially reasonable and that are available to businesses in our industry, but there can be no assurance that our liability insurance will be adequate or available at all times and in all circumstances. There can also be no assurance that the liability insurance we have carried in the past was adequate or available to cover any liability related to previous incidents. Our business, financial condition and results of operations could be harmed to the extent claims and associated expenses resulting from accidents or injuries exceed our insurance recoveries.

**The failure to comply with regulations relating to public facilities or the failure to retain licenses or permits relating to our properties may harm our business and results of operations.**

Our business is subject to extensive federal, state and local government regulation in the various jurisdictions in which our properties are located, including regulations relating to alcoholic beverage control, public health and safety, environmental hazards and food safety. Alcoholic beverage control regulations require each of our properties to obtain licenses and permits to sell alcoholic beverages on the premises. Typically, licenses must be renewed annually and may be revoked or suspended for cause at any time. In some states, the loss of a license for cause with respect to one location may lead to the loss of licenses at all locations in that state and could make it more difficult to obtain additional licenses in that state. Alcoholic beverage control regulations relate to numerous aspects of the daily operations of each venue, including minimum age of patrons and employees, hours of operation, advertising, wholesale purchasing, inventory control and handling and storage and dispensing of alcoholic beverages.

The failure of a property to obtain or retain its licenses and permits would adversely affect that property's operations and profitability, as well as our ability to obtain such a license or permit in other locations. We may also be subject to dram shop statutes in certain states, which generally provide a person injured by an intoxicated person the right to recover damages from an establishment that wrongfully served alcoholic beverages to the intoxicated person. Even though we are covered by general liability insurance, a settlement or judgment against us under a dram shop lawsuit in excess of liability coverage could have a material adverse effect on our operations.

We are also subject to the American with Disabilities Act (the "ADA") which, among other things, may require certain renovations to our facilities to comply with access and use requirements. A determination that we are not in compliance with the ADA or any other similar law or regulation could result in the imposition of fines or an award of damages to private litigants. While we believe we are operating in substantial compliance, and will continue to remove architectural barriers in our facilities when readily achievable, in accordance with current applicable laws and regulations, there can be no assurance that our expenses for compliance with these laws and regulations will not increase significantly and harm our business, financial condition and results of operations.

Businesses operating in the private country club industry are also subject to numerous other federal, state and local governmental regulations related to building and zoning requirements and the use and operation of clubs, including changes to building codes and fire and life safety codes, which can affect our ability to obtain and maintain licenses relating to our business and properties.

If we were required to make substantial modifications at our properties to comply with these regulations, our business, financial condition and results of operations could be negatively impacted.

**Environmental compliance costs and liabilities related to real estate that we own, or in which we have interests, may adversely affect our results of operations.**

Our operating costs may be affected by the cost of complying with existing or future environmental laws, ordinances and regulations with respect to the properties (or loans secured by such properties) or by environmental problems that materially impair the value of such properties. Under various federal, state and local environmental laws, ordinances and regulations, a current or previous owner or operator of real property may be liable for the costs of removal or remediation of hazardous or toxic substances on, under, or in such property. Such laws often impose liability whether or not the owner or operator knew of, or was responsible for, the presence of such hazardous or toxic substances. In addition, the presence of hazardous or toxic substances, or the failure to remediate properly, may adversely affect the owner's ability to borrow using such real property as collateral. Certain environmental laws and common law principles could be used to impose liability for releases of hazardous materials, including asbestos-containing materials, into the environment, and third parties may seek recovery from owners or operators of real properties for personal injury associated with exposure to released asbestos-containing materials or other hazardous materials. Environmental laws may also impose restrictions on the manner in which a property may be used or transferred or in which businesses it may be operated, and these restrictions may require expenditures. In connection with the direct or indirect ownership and operation of properties, we may be potentially liable for any such costs. The cost of defending against claims of liability or remediating contaminated property and the cost of complying with environmental laws could adversely affect our results of operations and financial condition.

**Our growth strategy depends on our ability to develop and open new entertainment venues and operate them profitably.**

A key element of our growth strategy is to develop and open entertainment golf venues. We have identified a number of locations for potential future entertainment golf venues. Our ability to develop and open these venues on a timely and cost-effective basis, or at all, is dependent on a number of factors, many of which are beyond our control, including but not limited to our ability to:

- find quality locations;
- reach acceptable agreements regarding the lease or purchase of locations;
- comply with applicable zoning, licensing, land use and environmental regulations;
- raise or have available an adequate amount of cash or currently available financing for construction and opening costs;
- adequately complete construction for operations;
- timely hire, train and retain the skilled management and other employees necessary to meet staffing needs;
- obtain, for acceptable cost, required permits and approvals, including liquor licenses; and
- efficiently manage the amount of time and money used to build and open each new venue.

If we succeed in opening entertainment golf venues on a timely and cost-effective basis, we may nonetheless be unable to attract enough customers to these new venues because potential customers may be unfamiliar with our venue or concept, or our entertainment and menu options might not appeal to them. New venues may operate at a loss, which could have a significant adverse effect on our overall operating results. Opening new entertainment golf venues in an existing market of our competitors could reduce the revenue at our existing venues in that market.

**Our procurement of certain materials for developing, redeveloping or renovating our venues is dependent upon a few suppliers.**

Our ability to continue to procure certain materials is important to our business strategy for developing, redeveloping or renovating our venues. The number of suppliers from which we can purchase our materials is limited. To the extent that the number of suppliers declines, we could be subject to the risk of distribution delays, pricing pressure, lack of innovation and other associated risks which could adversely affect our business, financial condition or results of operations.

**Changes in laws, regulations and other requirements could adversely affect our business, results of operations or financial condition.**

We are also subject to federal, state and local environmental laws, regulations and other requirements. More stringent and varied requirements of local and state governmental bodies with respect to zoning, land use and environmental factors could delay or prevent development of new stores in particular locations. Environmental laws and regulations also govern, among other things, discharges of pollutants into the air and water as well as the presence, handling, release and disposal of and exposure to hazardous substances. These laws provide for significant fines and penalties for noncompliance. Third parties may also make personal injury, property damage or other claims against us associated with actual or alleged release of, or exposure to, hazardous substances at our properties. We could also be strictly liable, without regard to fault, for certain environmental conditions at properties we formerly owned or operated as well as our current properties.

**Our investments in loans, and the loans underlying our investments in securities, are subject to delinquency, foreclosure and loss which could result in losses to us and expose us to additional risks.**

Mortgage and asset-backed securities are bonds or notes backed by loans and/or other financial assets and include commercial mortgage-backed securities, FNMA/FHLMC securities, and real estate related asset-backed securities. The ability of a borrower to repay these loans or other financial assets is dependent upon the income or assets of these borrowers. If a borrower has insufficient income or assets to repay these loans, it will default on its loan. While we intend to focus on real estate related asset-backed securities, there can be no assurance that we will not invest in other types of asset-backed securities.

Our investments in mortgage and asset-backed securities will be adversely affected by defaults under the loans underlying such securities. To the extent losses are realized on the loans underlying the securities in which we invest, we may not recover the amount invested in, or, in extreme cases, any of our investment in such securities.

**Declines in real estate values could harm our results of operations.**

We believe the risks associated with our business are more severe during periods in which an economic slowdown or recession is accompanied by declining real estate values. Borrowers may be less able to pay principal and interest on our loans, and the loans underlying our securities, if the economy weakens. Further, declining real estate values significantly increase the likelihood that we will incur losses on our loans and securities in the event of default because the value of our collateral may be insufficient to cover our basis. Any sustained period of increased payment delinquencies, foreclosures or losses could adversely affect our net interest income from loans and securities in our portfolio, as well as our ability to sell and securitize loans, which would significantly harm our revenues, results of operations, financial condition, liquidity, business prospects and our ability to make distributions to our stockholders. For more information on the impact of market conditions on our business and results of operations generally, see Part II, Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations-Market Considerations."

**Lawsuits, investigations and indemnification claims could result in significant liabilities and reputational harm, which could materially adversely affect our results of operations, financial condition and liquidity.**

From time to time, we are and may become involved in lawsuits, inquiries or investigations or receive claims for indemnification. Our efforts to resolve any such lawsuits, inquiries, investigations or claims could be very expensive and highly damaging to our reputation, even if the underlying claims are without merit. We could potentially be found liable for significant damages or indemnification obligations. Such developments could have a material adverse effect on our business, results of operations and financial condition.

Our risk of litigation includes, but is not limited to, lawsuits that could be brought by users of our Traditional Golf properties and property-level employees in our Traditional Golf business. For instance, we are subject to federal and state laws governing minimum wage requirements, overtime compensation, discrimination and family and medical leave. Any lawsuit alleging a violation of any such laws could result in a settlement or other resolution that requires us to make a substantial payment, which could have a material adverse effect on our financial condition and results of operations. In addition, accidents or injuries in connection with our Traditional Golf properties could subject us to liability and reputational harm.

**A failure in our systems or infrastructure which maintain our internal and customer data, or those of our third-party service providers, including as a result of cyber-attacks, could result in faulty business decisions or harm to our reputation or subject us to costs, fines or lawsuits.**

Certain information relating to our members and guests, including personally identifiable information and credit card numbers, is collected and maintained by us, or by third-parties that do business with us or facilitate our business activities. This information is maintained for a period of time for various business purposes, including maintaining records of member preferences to enhance our customer service and for billing, marketing and promotional purposes. We also maintain personally identifiable information about our employees. The integrity and protection of our customer, employee and company data is critical to our business. Our members and our employees expect that we will adequately protect their personal information, and the regulations applicable to security and privacy are increasingly demanding. Privacy regulation is an evolving area and compliance with applicable privacy regulations may increase our operating costs or adversely impact our ability to service our members and guests and market our properties and services.

To date we have not experienced any material losses relating to cyber-attacks, computer viruses or other systems or infrastructure failures. While we have cyber security procedures in place, given the evolving nature of these threats, there can be no assurance

that we will not suffer material losses in the future due to cyber-attacks or other systems or infrastructure failures. The theft, loss, misappropriation, fraudulent or unlawful use of customer, employee or company data, including in connection with one or more cyber-attacks on us or one of our third-party providers, could harm our reputation, result in loss of members or business disruption or result in remedial and other costs, fines or lawsuits. In addition, non-compliance with applicable privacy regulations by us (or in some circumstances non-compliance by third-parties engaged by us) could result in fines or restrictions on our use or transfer of data. Any of these matters could adversely affect our business, financial condition or results of operations.

**We rely on information technology in our operations, and any material failure, inadequacy, interruption or security failure of that technology could harm our business.**

We rely on information technology networks and systems, including the Internet, to process, transmit and store electronic information and to manage or support a variety of our business processes, including financial transactions and maintenance of records, which in the case of our Traditional Golf business, may include personal identifying information. We rely on commercially available systems, software, tools and monitoring to provide security for processing, transmitting and storing this confidential information, such as individually identifiable information relating to financial accounts. Although we have taken steps to protect the security of the data maintained in our information systems, it is possible that our security measures will not be able to prevent the systems' improper functioning, or the improper disclosure of personally identifiable information such as in the event of cyber attacks. Security breaches, including physical or electronic break-ins, computer viruses, attacks by hackers and similar breaches, can create system disruptions, shutdowns or unauthorized disclosure of confidential information. Any failure to maintain proper function, security and availability of our information systems could interrupt our operations, damage our reputation, subject us to liability claims or regulatory penalties and could materially and adversely affect our business, financial condition and results of operations.

**Our investments may be subject to significant impairment charges, which would adversely affect our results of operations.**

We are required to periodically evaluate our investments for impairment indicators. The value of an investment is impaired when our analysis indicates that, with respect to a loan, it is probable that we will not be able to collect the full amount we intended to collect from the loan or, with respect to a security or golf property, it is probable that the value of the security or golf property is other than temporarily impaired. The judgment regarding the existence of impairment indicators is based on a variety of factors depending upon the nature of the investment and the manner in which the income related to such investment was calculated for purposes of our financial statements. If we determine that an impairment has occurred, we are required to make an adjustment to the net carrying value of the investment and the amount of accrued interest recognized as income from such investment, which could have a material adverse effect on our results of operations.

**Market conditions could negatively impact our business, results of operations and financial condition.**

The markets in which we operate are affected by a number of factors that are largely beyond our control but can nonetheless have a potentially significant, negative impact on us. These factors include, among other things:

- Interest rates and credit spreads;
- The availability of credit, including the price, terms and conditions under which it can be obtained;
- The quality, pricing and availability of suitable investments and credit losses with respect to our investments;
- The ability to obtain accurate market-based valuations;
- Loan values relative to the value of the underlying real estate assets;
- Default rates on both residential and commercial mortgages and the amount of the related losses;
- Prepayment speeds;
- The actual and perceived state of the real estate markets, the U.S. economy and public capital markets generally;
- Unemployment rates; and
- The attractiveness of other types of investments relative to investments in real estate or generally.

Changes in these factors are difficult to predict, and a change in one factor can affect other factors. For example, during 2007, increased default rates in the subprime mortgage market played a role in causing credit spreads to widen, reducing availability of credit on favorable terms, reducing liquidity and price transparency of real estate related assets, resulting in difficulty in obtaining accurate mark-to-market valuations, and causing a negative perception of the state of the real estate. These conditions worsened during 2008, and intensified meaningfully during the fourth quarter of 2008 as a result of the global credit and liquidity crisis, resulting in extraordinarily challenging market conditions. Since then, despite recent market volatility, market conditions have generally improved, but they could deteriorate in the future for a variety of reasons.

**We have assumed the role of manager of numerous CDOs previously managed by a third party. Each such engagement exposes us to a number of potential risks.**

Changes within our industry may result in CDO collateral managers being replaced. In such instances, we have sought to be engaged as the collateral manager of CDOs currently managed by third parties. For example, in February 2011, one of our subsidiaries became the collateral manager of certain CDOs previously managed by C-BASS Investment Management LLC (“C-BASS”).

While being engaged as the collateral manager of such CDOs potentially enables us to grow our business, it also entails a number of risks that could harm our reputation, results of operations and financial condition. For example, we purchased the management rights with respect to the C-BASS CDOs pursuant to a bankruptcy proceeding. As a result, we were not able to conduct extensive due diligence on the CDO assets even though many classes of securities issued by the CDOs were rated as “distressed” by the rating agencies as of the most recent rating date prior to our becoming the collateral manager of the CDOs. We may willingly or unknowingly assume actual or contingent liabilities for significant expenses, we may become subject to new laws and regulations with which we are not familiar, and we may become subject to increased risk of litigation, regulatory investigation or negative publicity. For example, we determined that it would be prudent to register the subsidiary that became the collateral manager of the C-BASS CDOs as a registered investment adviser, which has increased our regulatory compliance costs. In addition to defending against litigation and complying with regulatory requirements, being engaged as collateral manager may require us to invest other resources for various other reasons, which could detract from our ability to capitalize on future opportunities. Moreover, being engaged as collateral manager may require us to integrate complex technological, accounting and management systems, which may be difficult, expensive and time-consuming and which we may not be successful in integrating into our current systems. In addition to the risk that we face if we are successful in becoming the manager of additional CDOs, we may attempt but fail to become the collateral manager of CDOs in the future, which could harm our reputation and subject us to costly litigation. Finally, if we include the financial performance of the C-BASS CDOs or other CDOs for which we become the collateral manager in our public filings, we are subject to the risk that, particularly during the period immediately after we become the collateral manager, this information may prove to be inaccurate or incomplete. The occurrence of any of these negative integration events could negatively impact our reputation with both regulators and investors, which could, in turn, subject us to additional regulatory scrutiny and impair our relationships with the investment community. The occurrence of any of these problems could negatively affect our reputation, financial condition and results of operations.

**The lenders under our repurchase agreements may elect not to extend financing to us, which could quickly and seriously impair our liquidity.**

We have historically financed a meaningful portion of our investments in securities and loans with repurchase agreements, which are short-term financing arrangements, and we may enter into additional repurchase agreements in the future. Under the terms of these agreements, we sell a security or loan to a counterparty for a specified price and concurrently agree to repurchase the same security or loan from our counterparty at a later date for a higher specified price. During the term of the repurchase agreement—generally 30 days—the counterparty makes funds available to us and holds the security or loan as collateral. Our counterparties can also require us to post additional margin as collateral at any time during the term of the agreement. When the term of a repurchase agreement ends, we are required to repurchase the security or loan for the specified repurchase price, with the difference between the sale and repurchase prices serving as the equivalent of paying interest to the counterparty in return for extending financing to us. If we want to continue to finance the security or loan with a repurchase agreement, we ask the counterparty to extend-or “roll”—the repurchase agreement for another term.

Our counterparties are not required to roll our repurchase agreements upon the expiration of their stated terms, which subjects us to a number of risks. As we have experienced in the past and may experience in the future, counterparties electing to roll our repurchase agreements may charge higher spreads and impose more onerous terms upon us, including the requirement that we post additional margin as collateral. More significantly, if a repurchase agreement counterparty elects not to extend our financing, we would be required to pay the counterparty the full repurchase price on the maturity date and find an alternate source of financing.

Alternate sources of financing may be more expensive, contain more onerous terms or may not be available in a timely manner or at all. If we were unable to pay the repurchase price for any security or loan financed with a repurchase agreement, the counterparty has the right to sell the underlying security or loan being held as collateral and require us to compensate for any shortfall between the value of our obligation to the counterparty and the amount for which the collateral was sold (which may be a significantly discounted price). As of March 31, 2017, we had \$310.6 million outstanding face amount under repurchase agreement financings. These repurchase agreement obligations are with one counterparty.

**Our determination of how much leverage to apply to our investments may adversely affect our return on our investments and may reduce cash available for distribution.**

We leverage a meaningful portion of our portfolio through borrowings, generally through the use of credit facilities, warehouse facilities, repurchase agreements, mortgage loans on real estate, private or public offerings of debt by subsidiaries, loans to entities in which we hold, directly or indirectly, interests in pools of properties or loans, and other borrowings. Our investment policies do not limit the amount of leverage we may incur with respect to any specific asset or pool of assets, subject to an overall limit on our use of leverage to 90% (as defined in our governing documents) of the value of our assets on an aggregate basis. We cannot assure you that we will be able to sustain our liquidity position.

**We are party to agreements that require cash payments upon the occurrence of certain events, and the failure to make such payments may adversely affect our business, financial condition and results of operations.**

We are currently party to repurchase agreements that may require us to post additional margin as collateral at any time during the term of the agreement, based on the value of the collateral. We are currently and may become party to other types of financing agreements that require us to make cash payments at periodic intervals or upon the occurrence of certain events, including upon the conveyance of substantially all of our assets. Events could occur or circumstances could arise, which we may not be able to foresee, that may cause us to be unable to make any such cash payments when they become due. While we try to comply with all of our financing agreements, failure to make the payments required under our financing documents would give the lenders the right to require us to repay all amounts owed to them under the applicable financing immediately. In addition, differing interpretations of the terms of our financing agreements could give rise to disputes over compliance and would result in unanticipated prepayments of such debt or otherwise negatively affect our liquidity, financial position or results of operations.

**We are subject to counterparty default and concentration risks.**

In the ordinary course of our business, we enter into various types of financing arrangements with counterparties. Currently, the majority of our financing arrangements take the form of repurchase agreements, loans and other derivative and non-derivative contracts. The terms of these contracts are often customized and complex, and many of these arrangements occur in markets or relate to products that are not subject to regulatory oversight.

We are subject to the risk that the counterparty to one or more of these contracts defaults, either voluntarily or involuntarily, on its performance under the contract. Any such counterparty default may occur rapidly and without notice to us. Moreover, if a counterparty defaults, we may be unable to take action to cover our exposure, either because we lack the contractual ability or because market conditions make it difficult to take effective action. This inability could occur in times of market stress, which are precisely the times when defaults may be most likely to occur.

In addition, our risk-management processes may not accurately anticipate the impact of market stress or counterparty financial condition, and as a result, we may not take sufficient action to reduce our risks effectively. Although we monitor our credit exposures, default risk may arise from events or circumstances that are difficult to detect, foresee or evaluate. In addition, concerns about, or a default by, one large participant could lead to significant liquidity problems for other participants, which may in turn expose us to significant losses.

In the event of a counterparty default, particularly a default by a major investment bank, we could incur material losses rapidly, and the resulting market impact of a major counterparty default could seriously harm our business, results of operations and financial condition. In the event that one of our counterparties becomes insolvent or files for bankruptcy, our ability to eventually recover any losses suffered as a result of that counterparty's default may be limited by the liquidity of the counterparty or the applicable legal regime governing the bankruptcy proceeding.

The consolidation and elimination of counterparties has increased our counterparty concentration risk. We are not restricted from dealing with any particular counterparty or from concentrating any or all of our transactions with a few counterparties. If any of our counterparties elected not to roll these repurchase agreements, we may not be able to find a replacement counterparty. In

addition, counterparties have generally tightened their underwriting standards and increased their margin requirements for financing, which has negatively impacted us in several ways, including, decreasing the number of counterparties willing to provide financing to us, decreasing the overall amount of leverage available to us, and increasing the costs of borrowing.

Any loss suffered by us as a result of a counterparty defaulting, refusing to conduct business with us or imposing more onerous terms on us would also negatively affect our business, results of operations and financial condition.

**Our investments in debt securities are subject to specific risks relating to the particular issuer of the securities and to the general risks of investing in subordinated real estate securities.**

Our investments in debt securities involve special risks. Our investments in debt are subject to the risks described above with respect to mortgage loans and mortgage-backed securities and similar risks, including:

- risks of delinquency and foreclosure, and risks of loss in the event thereof;
- the dependence upon the successful operation of and net income from real property;
- risks generally incident to interests in real property; and
- risks that may be presented by the type and use of a particular property.

Debt securities may be unsecured and may also be subordinated to other obligations of the issuer. We may also invest in debt securities that are rated below investment grade. As a result, investments in debt securities are also subject to risks of:

- limited liquidity in the secondary trading market;
- substantial market price volatility resulting from changes in prevailing interest rates or credit spreads;
- subordination to the prior claims of senior lenders to the issuer;
- the possibility that earnings of the debt security issuer may be insufficient to meet its debt service; and
- the declining creditworthiness and potential for insolvency of the issuer of such debt securities.

These risks may adversely affect the value of outstanding debt securities and the ability of the issuers thereof to repay principal and interest.

**Our investments in real estate related and other loans and other direct and indirect interests in pools of real estate properties or other loans may be subject to additional risks relating to the structure and terms of these transactions, which may result in losses to us.**

We have investments in real estate related and other loans and other direct and indirect interests in pools of real estate properties or loans, such as mezzanine loans. We have invested in mezzanine loans that take the form of subordinated loans secured by second mortgages on the underlying real property or other business assets or revenue streams or loans secured by a pledge of the ownership interests of the entity owning real property or other business assets or revenue streams (or the ownership interest of the parent of such entity). These types of investments involve a higher degree of risk than long-term senior lending secured by business assets or income producing real property because the investment may become unsecured as a result of foreclosure by a senior lender. In the event of a bankruptcy of the entity providing the pledge of its ownership interests as security, we may not have full recourse to the assets of such entity, or the assets of the entity may not be sufficient to repay our mezzanine loan. If a borrower defaults on our mezzanine loan or debt senior to our loan, or in the event of a borrower bankruptcy, our mezzanine loan will be satisfied only after the senior debt is repaid in full. As a result, we may not recover some or all of our investment. In addition, mezzanine loans may have higher loan to value ratios than conventional mortgage loans, resulting in less equity in the property and increasing the risk of loss of principal.

**Investment in non-investment grade loans may involve increased risk of loss.**

We have acquired certain loans that do not conform to conventional loan criteria applied by traditional lenders and are not rated or are rated as non-investment grade (for example, for investments rated by Moody's Investors Service, ratings lower than Baa3, and for Standard & Poor's, BBB- or below). The non-investment grade ratings for these loans typically result from the overall leverage of the loans, the lack of a strong operating history for the properties or businesses underlying the loans, the borrowers' credit history, the properties' underlying cash flows or other factors. As a result, these loans have a higher risk of default and loss than conventional loans. Any loss we incur may reduce distributions to our stockholders. There are no limits on the percentage of unrated or non-investment grade assets we may hold in our portfolio.

**Many of our investments are illiquid, and this lack of liquidity could significantly impede our ability to vary our portfolio in response to changes in economic and other conditions or to realize the value at which such investments are carried if we are required to dispose of them.**

The real estate properties that we own and operate and our other direct and indirect investments in real estate, loans and securities are generally illiquid. In addition, the real estate securities that we purchase in connection with privately negotiated transactions are not registered under the relevant securities laws, resulting in a prohibition against their transfer, sale, pledge or other disposition except in a transaction that is exempt from the registration requirements of, or is otherwise in accordance with, those laws. In addition, there are no established trading markets for a majority of our investments. As a result, our ability to vary our portfolio in response to changes in economic and other conditions may be limited.

Our securities have historically been valued based primarily on third-party quotations, which are subject to significant variability based on the liquidity and price transparency created by market trading activity. In the past, dislocation in the trading markets has reduced the trading for many real estate securities, resulting in less transparent prices for those securities. During such times, it is more difficult for us to sell many of our assets because, if we were to sell such assets, we would likely not have access to readily ascertainable market prices when establishing valuations of them. If we are required to liquidate all or a portion of our illiquid investments quickly, we may realize significantly less than the amount at which we have previously valued these investments.

**Interest rate fluctuations and shifts in the yield curve may cause losses.**

Interest rates are highly sensitive to many factors, including governmental monetary and tax policies, domestic and international economic and political considerations and other factors beyond our control. Our primary interest rate exposures relate to our real estate securities, loans, floating rate debt obligations and interest rate swaps. Changes in interest rates, including changes in expected interest rates or “yield curves,” affect our business in a number of ways. Changes in the general level of interest rates can affect our net interest income, which is the difference between the interest income earned on our interest-earning assets and the interest expense incurred in connection with our interest-bearing liabilities and hedges. Changes in the level of interest rates also can affect, among other things, our ability to acquire real estate securities and loans at attractive prices, the value of our real estate securities, loans and derivatives and our ability to realize gains from the sale of such assets. In the past, we have utilized hedging transactions to protect our positions from interest rate fluctuations, but as a result of market conditions we face significant obstacles to entering into new hedging transactions. As a result, we may not be able to protect new investments from interest rate fluctuations to the same degree as in the past, which could adversely affect our financial condition and results of operations. In the event of a significant rising interest rate environment and/or economic downturn, loan and collateral defaults may increase and result in credit losses that would adversely affect our liquidity and operating results.

Our ability to execute our business strategy, particularly the growth of our investment portfolio, depends to a significant degree on our ability to obtain additional capital. Our financing strategy for certain of our investments is dependent on our ability to place the match funded debt we use to finance our investments at rates that provide a positive net spread. If spreads for such liabilities widen or if demand for such liabilities ceases to exist, then our ability to execute future financings will be severely restricted.

Interest rate changes may also impact our net book value as our real estate securities, real estate related and other loans and hedge derivatives are marked to market each quarter. Debt obligations are not marked to market. Generally, as interest rates increase, the value of our fixed rate securities decreases, which will decrease the book value of our equity.

Furthermore, shifts in the U.S. Treasury yield curve reflecting an increase in interest rates would also affect the yield required on our real estate securities and therefore their value. For example, increasing interest rates would reduce the value of the fixed rate assets we hold at the time because the higher yields required by increased interest rates result in lower market prices on existing fixed rate assets in order to adjust the yield upward to meet the market, and vice versa. This would have similar effects on our real estate securities portfolio and our financial position and operations to a change in interest rates generally. In December 2016, the U.S. Federal Reserve announced that it would raise short-term interest rates by a quarter percentage point to between 50 basis points and 75 basis points in the next year.

**Our investments in debt securities and loans are subject to changes in credit spreads, which could adversely affect our ability to realize gains on the sale of such investments.**

Debt securities and loans are subject to changes in credit spreads. Credit spreads measure the yield demanded on securities and loans by the market based on their credit relative to a specific benchmark.



Fixed rate securities and loans are valued based on a market credit spread over the rate payable on fixed rate U.S. Treasuries of like maturity. Floating rate securities and loans are valued based on a market credit spread over LIBOR and are affected similarly by changes in LIBOR spreads. Excessive supply of these securities combined with reduced demand will generally cause the market to require a higher yield on these securities and loans, resulting in the use of a higher, or “wider,” spread over the benchmark rate to value such securities. Under such conditions, the value of our debt securities and loan portfolios would tend to decline. Conversely, if the spread used to value such securities were to decrease, or “tighten,” the value of our debt securities portfolio would tend to increase. Such changes in the market value of our debt securities and loan portfolios may affect our net equity, net income or cash flows directly through their impact on unrealized gains or losses on available-for-sale securities, and therefore our ability to realize gains on such securities, or indirectly through their impact on our ability to borrow and access capital. During 2008 through the first quarter of 2009, credit spreads widened substantially. This widening of credit spreads caused the net unrealized gains on our securities, loans and derivatives, recorded in accumulated other comprehensive income or retained earnings, and therefore our book value per share, to decrease and resulted in net losses.

In addition, if the value of our loans subject to financing agreements were to decline, it could affect our ability to refinance such loans upon the maturity of the related repurchase agreements. Any credit or spread related losses incurred with respect to our loans would affect us in the same way as similar losses on our real estate securities portfolio as described above.

**Under certain conditions, increases in prepayment rates can adversely affect yields on many of our investments.**

The value of many of the assets in which we invest may be affected by prepayment rates on these assets. Prepayment rates are influenced by changes in current interest rates and a variety of economic, geographic and other factors beyond our control, and consequently, prepayment rates cannot be predicted with certainty. In periods of declining mortgage interest rates, prepayments on loans generally increase. If general interest rates decline as well, the proceeds of such prepayments received during such periods are likely to be reinvested by us in assets yielding less than the yields on the assets that were prepaid. In addition, the market value of floating rate assets may, because of the risk of prepayment, benefit less than fixed rate assets from declining interest rates. Conversely, in periods of rising interest rates, prepayments on loans generally decrease, in which case we would not have the prepayment proceeds available to invest in assets with higher yields. Under certain interest rate and prepayment scenarios we may fail to recoup fully our cost of acquisition of certain investments.

**We are actively exploring new business opportunities and asset categories, which could entail a meaningful change in our investment focus and operations and pose significant risks to our financial condition, results of operations and liquidity.**

Consistent with our broad investment guidelines and our investment objectives, we have acquired and/or are pursuing a variety of assets that differ from the assets in our legacy portfolio, such as a Traditional Golf business (which we acquired in December 2013), excess mortgage servicing rights (“Excess MSRs”) (which we spun-off in May 2013), media assets (which we spun-off in February 2014) and senior housing properties (which we spun-off in November 2014). Although we currently believe that we will have significant investment opportunities in the future, these opportunities may not materialize. In addition, our ability to act on new investment opportunities may be constrained by the requirements of the Investment Company Act of 1940, as amended (the “1940 Act”), or federal tax law. See “-Risks Related to Our Tax Status and the 1940 Act.”

New investments may not be profitable (or as profitable as we expect), may increase our exposure to certain industries (such as the lodging, gaming and leisure industry), may increase our exposure to interest rate, foreign currency, real estate market or credit market fluctuations, may divert managerial attention from more profitable opportunities, and may require significant financial and other resources. A change in our investment strategy may also increase our use of non-match-funded financing, increase the guarantee obligations we agree to incur or increase the number of transactions we enter into with affiliates. Moreover, new investments may present risks that are difficult for us to adequately assess, given our lack of familiarity with a particular industry, asset class or other reasons. The risks related to new asset categories or the financing risks associated with such assets could adversely affect our results of operations, financial condition and liquidity, and could impair our ability to pay dividends on both our common stock and preferred stock. In addition, our ability to invest in or finance new investments, including our Traditional Golf business, may be dependent upon our ability to monetize our real estate debt portfolio. See “-Risks Related to Our Manager-Our directors have approved very broad investment guidelines for our Manager, and we are not required to obtain stockholder consent to change our investment strategy or asset portfolio.”

**Changes in accounting rules could occur at any time and could impact us in significantly negative ways that we are unable to predict or protect against.**

As has been widely publicized, the SEC, the Financial Accounting Standards Board and other regulatory bodies that establish the accounting rules applicable to us have recently proposed or enacted a wide array of changes to accounting rules. Moreover, in

the future these regulators may propose additional changes that we do not currently anticipate. Changes to accounting rules that apply to us could significantly impact our business or our reported financial performance in negative ways that we cannot predict or protect against. We cannot predict whether any changes to current accounting rules will occur or what impact any codified changes will have on our business, results of operations, liquidity or financial condition.

**Failure to maintain effective internal control over financial reporting in accordance with Section 404 of the Sarbanes-Oxley Act could have a material adverse effect on our business and stock price.**

As a public company, we are required to maintain effective internal control over financial reporting in accordance with Section 404 of the Sarbanes-Oxley Act of 2002. Internal control over financial reporting is complex and may be revised over time to adapt to changes in our business, or changes in applicable accounting rules. In connection with new investments, we may be required to consolidate additional entities, and, therefore, to document and test effective internal controls over the financial reporting of these entities in accordance with Section 404, which we may not be able to do. Even if we are able to do so, there could be significant costs and delays, particularly if these entities were not subject to Section 404 prior to being acquired by us. Under certain circumstances, the SEC permits newly acquired businesses to be excluded for a limited period of time from management's annual assessment of the effectiveness of internal control. Our management identified a material weakness in our internal controls with respect to our financial statements for the year ended December 31, 2011. Although this was remediated, we cannot assure you that our internal control over financial reporting will be effective in the future or that a material weakness will not be discovered with respect to a prior period for which we believe that internal controls were effective. If we are not able to maintain or document effective internal control over financial reporting, our independent registered public accounting firm may not be able to certify as to the effectiveness of our internal control over financial reporting as of the required dates. Matters impacting our internal controls may cause us to be unable to report our financial information on a timely basis, or may cause us to restate previously issued financial information, and thereby subject us to adverse regulatory consequences, including sanctions or investigations by the SEC, or violations of applicable stock exchange listing rules. There could also be a negative reaction in the financial markets due to a loss of investor confidence in us and the reliability of our financial statements. Confidence in the reliability of our financial statements is also likely to suffer if we or our independent registered public accounting firm reports a material weakness in our internal control over financial reporting. This could materially adversely affect us by, for example, leading to a decline in our share price and impairing our ability to raise capital.

**Our agreements with New Residential and New Senior may not reflect terms that would have resulted from negotiations among unaffiliated third parties, and we have agreed to indemnify New Residential and New Senior for certain liabilities in connection with their respective spin-offs.**

We completed the spin-off of New Residential in May 2013. The terms of the agreements related to the spin-off of New Residential, including a separation and distribution agreement dated April 26, 2013 (the "NRZ Separation and Distribution Agreement") between us and New Residential and a management agreement between our Manager and New Residential, were not negotiated among unaffiliated third parties. Such terms were proposed by our officers and other employees of our Manager and approved by our board of directors. As a result, these terms may be less favorable to us than the terms that would have resulted from negotiations among unaffiliated third parties.

In the NRZ Separation and Distribution Agreement, we have agreed to indemnify New Residential and its affiliates and representatives against losses arising from: (a) any liability related to our junior subordinated notes due 2035; (b) any other liability that has not been defined as a liability of New Residential; (c) any failure by us and our subsidiaries (other than New Residential and its subsidiaries) (collectively, the "Newcastle Group") to pay, perform or otherwise promptly discharge any liability listed under (a) and (b) above in accordance with their respective terms, whether prior to, at or after the time of effectiveness of the NRZ Separation and Distribution Agreement; (d) any breach by any member of the Newcastle Group of any provision of the NRZ Separation and Distribution Agreement and any agreements ancillary thereto (if any), subject to any limitations of liability provisions and other provisions applicable to any such breach set forth therein; and (e) any untrue statement or alleged untrue statement of a material fact or omission or alleged omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading, with respect to all information contained in the information statement or the registration statement of which the information statement is a part that relates solely to any assets owned, directly or indirectly by us, other than New Residential's initial portfolio of assets. Any indemnification payments that we may be required to make could have a significantly negative effect on our liquidity and results of operations.

We completed the spin-off of New Senior in November 2014. The terms of the separation and distribution agreement dated October 16, 2014 between us and New Senior are substantially similar to the terms of the NRZ Separation and Distribution Agreement and therefore subjects us to similar risks.

## Risks Related to Our Manager

### **We are dependent on our Manager and may not find a suitable replacement if our Manager terminates the management agreement.**

None of our officers or other senior employees who perform services for us is an employee of the Company. Instead, these individuals are employees of our Manager. Accordingly, we are completely reliant on our Manager, which has significant discretion as to the implementation of our operating policies and strategies, to conduct our business. Furthermore, we are dependent on the services of certain key employees of our Manager whose compensation is partially dependent upon the amount of incentive or management compensation earned by our Manager and whose continued service is not guaranteed, and the loss of such services could adversely affect our operations. We are subject to the risk that our Manager will terminate the management agreement and that we will not be able to find a suitable replacement for our Manager in a timely manner, at a reasonable cost or at all. We may also be adversely affected by operational risks, including cyber security attacks, that could disrupt our Manager's financial, accounting and other data processing systems.

On February 14, 2017, Fortress announced that it had entered into the Merger Agreement with SB Foundation Holdings LP, a Cayman Islands exempted limited partnership ("Parent") and an affiliate of SoftBank, and Foundation Acquisition LLC, a Delaware limited liability company and wholly owned subsidiary of Parent ("Merger Sub"), pursuant to which Merger Sub will merge with and into Fortress, with Fortress surviving as a wholly owned subsidiary of Parent. While Fortress's senior investment professionals are expected to remain in place, including those individuals who perform services for us, there can be no assurance that the Merger will not have an impact on us or our relationship with the Manager.

### **There are conflicts of interest in our relationship with our Manager.**

There are conflicts of interest inherent in our relationship with our Manager. Actual, potential or perceived conflicts have given, and may in the future give, rise to investor dissatisfaction, litigation or regulatory inquiries or enforcement actions. Appropriately dealing with conflicts of interest is complex and difficult, and our reputation could be damaged if we fail, or appear to fail, to deal appropriately with one or more potential, actual or perceived conflicts of interest. Regulatory scrutiny of, or litigation in connection with, conflicts of interest could have a material adverse effect on our reputation, which could materially adversely affect our business in a number of ways, including causing an inability to raise additional funds, a reluctance of counterparties to do business with us, a decrease in the prices of our common and preferred securities and a resulting increased risk of litigation and regulatory enforcement actions.

Our management agreement with our Manager was not negotiated between unaffiliated parties, and its terms, including fees payable, although approved by our independent directors as fair, may not be as favorable to us as if they had been negotiated with an unaffiliated third party. Our management agreement, as amended, does not limit or restrict our Manager or its affiliates from engaging in any business or managing other pooled investment vehicles that make investments that meet our investment objectives. Entities managed by our Manager or its affiliates—including investment funds, private investment funds, or businesses managed by our Manager—have investment objectives that overlap with our investment objectives. Certain investments appropriate for us may also be appropriate for one or more of these other investment vehicles. These entities may invest in assets that meet our investment objectives, including real estate securities, real estate related and other loans, and other operating real estate, and other assets. Our Manager or its affiliates may have investments in and/or earn fees from such other investment vehicles that are higher than their economic interests in us and which may therefore create an incentive to allocate investments to such other investment vehicles. Our Manager or its affiliates may determine, in their discretion, to make a particular investment through an investment vehicle other than us and have no obligation to offer to us the opportunity to participate in any particular investment opportunity.

Our chairman is an officer of our Manager. Certain employees of our Manager who perform services for us also perform services for companies and funds that compete with us. These employees may serve as officers and/or directors of these other entities. The ability of our Manager and its officers and employees to engage in other business activities may reduce the amount of time our Manager, its officers or other employees spend managing us.

In addition, we have engaged or may engage (subject to our investment guidelines) in material transactions with our Manager or an entity managed by our Manager or one of its affiliates, including, but not limited to, certain financing arrangements, purchases of debt and co-investments, that present an actual, potential or perceived conflict of interest. We may invest in portfolio companies of private equity funds managed by our Manager (or an affiliate thereof). We currently have debt investments in a portfolio company of private equity funds managed by our Manager (or an affiliate thereof). All investments, including investments in or involving affiliates or portfolio companies of affiliates are subject to an array of risks, including the risk that the investment is ultimately less profitable than the prior estimates or not profitable at all.

Our management agreement, as amended, does not limit or restrict our Manager or its affiliates from engaging in any business or managing other pooled investment vehicles that make investments that meet our investment objectives. Our Manager or its affiliates have and may in the future raise, acquire or manage investment vehicles that are entitled to a priority or exclusive right to invest in certain types of assets. If such an investment vehicle exists, that vehicle's exclusivity would prevent us from investing in the assets over which the investment vehicle has exclusivity because we do not have the exclusive right to invest in any particular type of asset. This dynamic may reduce the type of assets in which we are able to invest.

The management compensation structure that we have agreed to with our Manager, as well as compensation arrangements that we may enter into with our Manager in the future (in connection with new lines of business or other activities), may incentivize our Manager to invest in high risk investments or to pursue separation transactions, such as the spin-offs of New Residential Investment Corp. ("New Residential"), New Media Investment Group Inc. ("New Media") and New Senior Investment Group Inc. ("New Senior"). See "-Risks Related to Our Business-Our agreements with New Residential and New Senior may not reflect terms that would have resulted from arm's-length negotiations among unaffiliated third parties, and we have agreed to indemnify New Residential and New Senior for certain liabilities." In addition to its management fee, our Manager is entitled to receive incentive compensation based in part upon our achievement of targeted levels of funds from operations (as defined in the management agreement). In evaluating investments and other management strategies, the opportunity to earn incentive compensation based on funds from operations or, in the case of any future incentive compensation arrangement, other financial measures on which incentive compensation may be based, may lead our Manager to place undue emphasis on the maximization of such measures at the expense of other criteria, such as preservation of capital, in order to achieve higher incentive compensation, particularly in light of the fact that our Manager has not received any incentive compensation from us since 2008. Investments with higher yield potential are generally riskier or more speculative than lower-yielding investments.

Our Manager is eligible to receive compensation in the form of options in connection with the completion of our common equity offerings. Therefore, our Manager may be incentivized to cause us to issue additional common stock, which could be dilutive to existing stockholders. On April 7, 2016, our board of directors adopted the 2016 Newcastle Investment Corp. Nonqualified Option and Incentive Award Plan (the "2016 Plan"), which our stockholders approved at our 2016 Annual Meeting of Stockholders and provides for 300,000 shares of our common stock to be available for grants of equity awards thereunder, as increased on the date of any equity issuance by us during the one-year term of the 2016 Plan by ten percent of the equity securities issued by us in such equity issuance. In addition to the shares available for issuance under the 2012 Newcastle Nonqualified Stock Option and Incentive Plan, the 2014 Newcastle Nonqualified Stock Option and Incentive Plan, the 2015 Newcastle Nonqualified Option and Incentive Award Plan, and the 2016 Plan or any successor plan thereto (collectively, the "Option Plans"), our board of directors may also determine to grant options to our Manager that are not issued pursuant to the Option Plans, provided that the number of shares underlying any options granted to our Manager in connection with any capital raising efforts will not exceed 10% of the shares sold in such offering and would be subject to NYSE rules.

**It would be difficult and costly to terminate our management agreement with our Manager.**

It would be difficult and costly for us to terminate our management agreement with our Manager. The management agreement may only be terminated annually upon (i) the affirmative vote of at least two-thirds of our independent directors, or by a vote of the holders of a simple majority of the outstanding shares of our common stock, that there has been unsatisfactory performance by our Manager that is materially detrimental to us or (ii) a determination by a simple majority of our independent directors that the management fee payable to our Manager is not fair, subject to our Manager's right to prevent such a termination by accepting a mutually acceptable reduction of fees. Our Manager will be provided 60 days' prior notice of any such termination and will be paid a termination fee equal to the amount of the management fee earned by the Manager during the 12-month period preceding such termination. In addition, following any termination of the management agreement, the Manager may require us to purchase its right to receive incentive compensation at a price determined as if our assets were sold for their fair market value (as determined by an appraisal, taking into account, among other things, the expected future value of the underlying investments) or otherwise we may continue to pay the incentive compensation to our Manager. These provisions may increase the effective cost to us of terminating the management agreement, thereby adversely affecting our ability to terminate our Manager without cause.

**Our directors have approved very broad investment guidelines for our Manager, and we are not required to obtain stockholder consent to change our investment strategy or asset portfolio.**

Our Manager is authorized to follow very broad investment guidelines, and our directors do not approve each investment decision made by our Manager. Our investment guidelines are purposefully broad to enable our Manager to make investments in a wide array of assets. Our Manager's investment decisions are based on a variety of factors, such as changing market conditions, perceived investment opportunities and available capital. Investment opportunities that present unattractive risk-return profiles relative to other available investment opportunities under particular market conditions may become relatively attractive under changed market conditions, and changes in market conditions may therefore result in changes in the investments we target. We do not have

policies requiring the allocation of equity to different investment categories, although our investment guidelines do restrict investments of more than 20% of our total equity (as determined on the date of such investment) in any single asset. Consequently, our Manager has great latitude in determining which investments are appropriate for us, including the latitude to build concentrations in certain positions and to invest in asset classes that may differ significantly from those in our existing portfolio. Our directors periodically review our investment guidelines and our investment portfolio. However, our directors rely primarily on information provided to them by our Manager, and they do not review or pre-approve each proposed investment or the related financing arrangements. A transaction entered into by our Manager that contravenes the terms of our management agreement may be difficult or impossible to unwind by the time it is reviewed by our directors. In addition, we are not required to obtain stockholder consent in order to change our investment strategy and asset portfolio, which may result in making investments that are different, riskier or less profitable than our current investments.

Our investment strategy and asset portfolio have undergone meaningful changes in recent years through spin-offs and other strategic transactions and will continue to evolve in light of existing market conditions and investment opportunities. See “-Risks Related to Our Business-We are actively exploring new business opportunities and asset categories, which could entail a meaningful change in our investment focus and operations and pose significant risks to our financial condition, results of operations and liquidity.”

**Our Manager will not be liable to us for any acts or omissions performed in accordance with the management agreement, including with respect to the performance of our investments.**

Pursuant to our management agreement, our Manager will not assume any responsibility other than to render the services called for thereunder and will not be responsible for any action of our board of directors in following or declining to follow its advice or recommendations. Under the terms of our management agreement, our Manager, its officers, partners, members, managers, directors, personnel, other agents, any person controlling or controlled by our Manager and any person providing sub-advisory services to our Manager will not be liable to us, any subsidiary of ours, our directors, our stockholders or any subsidiary's stockholders or partners for acts or omissions performed in accordance with and pursuant to our management agreement, except because of acts constituting bad faith, willful misconduct or gross negligence, as determined by a final non-appealable order of a court of competent jurisdiction. In addition, we have agreed to indemnify our Manager, its officers, partners, members, managers, directors, personnel, other agents, any person controlling or controlled by our Manager and any person providing sub-advisory services to our Manager with respect to all expenses, losses, damages, liabilities, demands, charges and claims arising from acts of our Manager not constituting bad faith, willful misconduct or gross negligence, pursuant to our management agreement.

**Our Manager's due diligence of investment opportunities or other transactions may not identify all pertinent risks, which could materially affect our business, financial condition, liquidity and results of operations.**

Our Manager intends to conduct due diligence with respect to each investment opportunity or other transaction it pursues. It is possible, however, that our Manager's due diligence processes will not uncover all relevant facts, particularly with respect to any assets we acquire from third parties. In these cases, our Manager may be given limited access to information about the investment and will rely on information provided by the target of the investment. In addition, if investment opportunities are scarce, the process for selecting bidders is competitive, or the time-frame in which we are required to complete diligence is short, our ability to conduct a due diligence investigation may be limited, and we would be required to make investment decisions based upon a less thorough diligence process than would otherwise be the case. Accordingly, investments and other transactions that initially appear to be viable may prove not to be over time due to the limitations of the due diligence process or other factors.

Risks Related to Our Common Stock

**Our stock price has fluctuated meaningfully, particularly on a percentage basis, and may fluctuate meaningfully in the future. Accordingly, you may not be able to resell your shares at or above the price at which you purchased them.**

The trading price of our common stock has fluctuated significantly in the past. The trading price of our common stock could fluctuate significantly in the future and could be negatively affected in response to various factors, including:

- market conditions in the broader stock market in general, or in the real estate or golf industries in particular;
- our ability to make investments with attractive risk-adjusted returns;
- market perception of our current and projected financial condition, potential growth, future earnings and future cash dividends;
- announcements we make regarding dividends;
- actual or anticipated fluctuations in our quarterly financial and operating results;

- market perception or media coverage of our Manager or its affiliates;
- additional offerings of our common stock;
- actions by rating agencies;
- short sales of our common stock;
- any decision to pursue a distribution or disposition of a meaningful portion of our assets;
- issuance of new or changed securities analysts' reports or recommendations;
- media coverage of us, or the outlook of the real estate and golf industries;
- major reductions in trading volumes on the exchanges on which we operate;
- credit deterioration within our portfolio;
- legislative or regulatory developments, including changes in the status of our regulatory approvals or licenses;
- litigation and governmental investigations; and
- any decision to pursue a spin-off of a portion of our assets.

These and other factors may cause the market price and demand for our common stock to fluctuate substantially, which may negatively affect the price or liquidity of our common stock. When the market price of a stock has been volatile or has decreased significantly in the past, holders of that stock have, at times, instituted securities class action litigation against the company that issued the stock. If any of our stockholders brought a lawsuit against us, we could incur substantial costs defending, settling or paying any resulting judgments related to the lawsuit. Such a lawsuit could also divert the time and attention of our management from our business and hurt our share price.

**We may be unable or elect not to pay dividends on our common or preferred stock in the future, which would negatively impact our business in a number of ways and decrease the price of our common and preferred stock.**

Prior to termination of our REIT election, we made distributions of a minimum of 90% of our taxable income each year in order to maintain our REIT status. As a result of the revocation of our REIT election, effective January 1, 2017, we are no longer required by the REIT rules to make distributions of substantially all of our net taxable income. Our board of directors elected not to pay a common stock dividend in the first quarter of 2017 to retain capital for growth. All future dividend distributions will be made at the discretion of our board of directors and will depend upon, among other things, our earnings, investment strategy, financial condition and liquidity, and such other factors as the board of directors deems relevant. No assurance can be given that we will pay any dividends on our common stock in the future.

We do not currently have unpaid accrued dividends on our preferred stock. However, to the extent we do, we cannot pay any dividends on our common stock, pay any consideration to repurchase or otherwise acquire shares of our common stock or redeem any shares of any series of our preferred stock without redeeming all of our outstanding preferred shares in accordance with the governing documentation. Consequently, the failure to pay dividends on our preferred stock restricts the actions that we may take with respect to our common stock and preferred stock. Moreover, if we do not pay dividends on any series of preferred stock for six or more periods, then holders of each affected series obtain the right to call a special meeting and elect two members to our board of directors. We cannot predict whether the holders of our preferred stock would take such action or, if taken, how long the process would take or what impact the two new directors on our board of directors would have on our company (other than increasing our director compensation costs). However, the election of additional directors would affect the composition of our board of directors and, thus, could affect the management of our business.

**Shares eligible for future sale may adversely affect our common stock price.**

Sales of our common stock or other securities in the public or private market, or the perception that these sales may occur, could cause the market price of our common stock to decline. This could also impair our ability to raise additional capital through the sale of our equity securities. Under our certificate of incorporation, we are authorized to issue up to 1,000,000,000 shares of common stock and we are authorized to reclassify a portion of our authorized preferred stock into common stock, and there were 66,842,378 shares of our common stock outstanding as of April 26, 2017. We cannot predict the size of future issuances of our common stock or other securities or the effect, if any, that future sales and issuances would have on the market price of our common stock.

**An increase in market interest rates may have an adverse effect on the market price of our common stock.**

One of the factors that investors may consider in deciding whether to buy or sell shares of our common stock is our distribution rate as a percentage of our share price relative to market interest rates. If the market price of our common stock is based primarily on the earnings and return that we derive from our investments and income with respect to our investments and our related distributions to stockholders, and not from the market value of the investments themselves, then interest rate fluctuations and

capital market conditions will likely affect the market price of our common stock. For instance, if market interest rates rise without an increase in our distribution rate, the market price of our common stock could decrease as potential investors may require a higher distribution yield on our common stock or seek other securities paying higher distributions or interest. In addition, rising interest rates would result in increased interest expense on our variable rate debt, thereby adversely affecting cash flows and our ability to service our indebtedness and pay distributions.

**ERISA may restrict investments by plans in our common stock.**

A plan fiduciary considering an investment in our common stock should consider, among other things, whether such an investment is consistent with the fiduciary obligations under the Employee Retirement Income Security Act of 1974, as amended (“ERISA”), including whether such investment might constitute or give rise to a prohibited transaction under ERISA, the Code or any substantially similar federal, state or local law and, if so, whether an exemption from such prohibited transaction rules is available.

**Maryland takeover statutes may prevent a change of our control, which could depress our stock price.**

Under Maryland law, “business combinations” between a Maryland corporation and an interested stockholder or an affiliate of an interested stockholder are prohibited for five years after the most recent date on which the interested stockholder becomes an interested stockholder. These business combinations include certain mergers, consolidations, share exchanges, or, in circumstances specified in the statute, an asset transfer or issuance or reclassification of equity securities or a liquidation or dissolution. An interested stockholder is defined as:

- any person who beneficially owns 10% or more of the voting power of the corporation’s outstanding shares; or
- an affiliate or associate of a corporation who, at any time within the two-year period prior to the date in question, was the beneficial owner of 10% or more of the voting power of the then outstanding stock of the corporation.
- A person is not an interested stockholder under the statute if the board of directors approved in advance the transaction by which he or she otherwise would have become an interested stockholder.
- After the five-year prohibition, any business combination between the Maryland corporation and an interested stockholder generally must be recommended by the board of directors of the corporation and approved by the affirmative vote of at least:
- 80% of the votes entitled to be cast by holders of outstanding shares of voting stock of the corporation voting together as a single group; and
- two-thirds of the votes entitled to be cast by holders of voting stock of the corporation other than shares held by the interested stockholder with whom or with whose affiliate the business combination is to be effected or held by an affiliate or associate of the interested stockholder voting together as a single voting group.

The business combination statute may discourage others from trying to acquire control of us and increase the difficulty of consummating any offer, including potential acquisitions that might involve a premium price for our common stock or otherwise be in the best interest of our stockholders.

**Our staggered board and other provisions of our charter and bylaws may prevent a change in our control.**

Our board of directors is divided into three classes of directors. Directors of each class are chosen for three-year terms upon the expiration of their current terms, and each year one class of directors is elected by the stockholders. The staggered terms of our directors may reduce the possibility of a tender offer or an attempt at a change in control, even though a tender offer or change in control might be in the best interest of our stockholders. In addition, our charter and bylaws also contain other provisions that may delay or prevent a transaction or a change in control that might involve a premium price for our common stock or otherwise be in the best interest of our stockholders.

Our charter authorizes us to issue additional authorized but unissued shares of our common stock or preferred stock. In addition, our board of directors may classify or reclassify any unissued shares of our common stock or preferred stock and may set the preferences, rights and other terms of the classified or reclassified shares. As a result, our board of directors may establish a series of preferred stock that could delay or prevent a transaction or a change in control that might involve a premium price for our common stock or otherwise be in the best interest of our stockholders.

## Risks Related to Our Tax Status and the 1940 Act

**We no longer qualify for taxation as a REIT for U.S. federal income tax purposes effective as of January 1, 2017, and there can be no assurance that the IRS will not challenge our previous REIT status.**

Although we elected for U.S. federal income tax purposes to be treated as a REIT for the 2016 taxable year and in prior taxable years, we revoked our REIT election for the tax year beginning January 1, 2017 and intend to be treated as a regular “C corporation” for that year and any year in the foreseeable future, and, as a result, we will be unable to claim the United States federal income tax benefits associated with REIT status. Moreover, there can be no assurance that the IRS will not challenge our qualification as a REIT for years in which we intended to qualify as a REIT. Although we believe we did qualify as a REIT in each such year, if the IRS were to successfully challenge our previous REIT status, we would suffer adverse tax consequences, such as those described below.

For the 2017 taxable year and future years (and for any prior year if we were to fail to qualify as a REIT in such year), we will generally be subject to federal income tax, including any applicable alternative minimum tax, on our taxable income at regular corporate rates, and distributions to stockholders would not be deductible by us in computing our taxable income. Any such corporate tax liability could be substantial and would reduce the amount of cash available for distribution to our stockholders, which in turn could have an adverse impact on the value of, and trading prices for, our stock. Our decision to revoke our REIT election could also have other effects on any given stockholder, depending on its particular circumstances. For example, certain foreign investors that own large positions in our stock may be subject to less favorable rules under the Foreign Investment in Real Property Tax Act of 1980 following the revocation of our REIT election. Stockholders are urged consult their tax advisors regarding the effects to them of the revocation of our REIT elections in light of their particular circumstances.

**Our board of directors’ decision to revoke our REIT election means we will no longer be required to distribute substantially all of our net taxable income to our stockholders.**

Prior to termination of our REIT election, we made distributions of a minimum of 90% of our taxable income each year in order to maintain our REIT status. On February 23, 2017, we revoked our election to be treated as a REIT, effective January 1, 2017. Consequently, we are no longer subject to the distribution requirements applicable to REITs. Our board of directors elected not to pay a common stock dividend in the first quarter of 2017 to retain capital for growth. All future dividend distributions will be made at the discretion of our board of directors and will depend upon, among other things, our earnings, investment strategy, financial condition and liquidity, and such other factors as the board of directors deems relevant, as well as any contractual restrictions.

**In January 2013, we experienced an “ownership change” for purposes of Section 382 of the Code, which limits our ability to utilize our net operating loss and net capital loss carryforwards and certain built-in losses to reduce our future taxable income, potentially increases the net taxable income on which we must pay corporate-level taxes, and potentially adversely affects our liquidity, and we could experience another ownership change in the future or forgo otherwise attractive opportunities in order to avoid experiencing another ownership change.**

As a result of our January 2013 “ownership change,” our future ability to utilize our net operating loss and net capital loss carryforwards to reduce our taxable income may be limited by certain provisions of the Code.

Specifically, the Code limits the ability of a company that undergoes an “ownership change” to utilize its net operating loss and net capital loss carryforwards and certain built-in losses to offset taxable income earned in years after the ownership change. An ownership change occurs if, during a three-year testing period, more than 50% of the stock of a company is acquired by one or more persons (or certain groups of persons) who own, directly or constructively, 5% or more of the stock of such company. An ownership change can occur as a result of a public offering of stock, as well as through secondary market purchases of our stock and certain types of reorganization transactions. Generally, when an ownership change occurs, the annual limitation on the use of net operating loss and net capital loss carryforwards and certain built-in losses is equal to the product of the applicable long-term tax exempt rate and the value of the company’s stock immediately before the ownership change. We have substantial net operating and net capital loss carry forwards which we have used, and will continue to use, to offset our taxable income. In January 2013, an “ownership change” for purposes of Section 382 of the Code occurred. Therefore, the provisions of Section 382 of the Code impose an annual limit on the amount of net operating loss and net capital loss carryforwards and built in losses that we can use to offset future taxable income.



The ownership change we experienced in January 2013 (and any subsequent ownership changes) could materially increase our income tax liability. As described above, the ownership change we experienced in January resulted in a limitation on our use of net operating losses and net capital loss carryforwards. These limitations could result in us incurring materially greater tax liability than if we had not undergone such an ownership change.

In addition, if we were to undergo an ownership change again in the future, our net operating losses and net capital loss carryforwards could become subject to additional limitations, which could result in us incurring materially greater tax liability than if we had not undergone such an ownership change. The determination of whether an ownership change has occurred or will occur is complicated and depends on changes in percentage stock ownership among stockholders. We adopted the Tax Benefits Preservation Plan described below in order to discourage an ownership change. However, there can be no assurance that the Tax Benefits Preservation Plan will prevent an ownership change. In addition, to the extent not prohibited by our charter, we may decide in the future that it is necessary or in our interest to take certain actions that could result in an ownership change. Therefore, no assurance can be provided as to whether an ownership change has occurred or will occur in the future.

Moreover, the potential negative consequences of the limitations that would result from an ownership change may discourage us from, among other things, redeeming our stock or issuing additional common stock to raise capital or to acquire businesses or assets. Accordingly, our desire to preserve our net operating losses and net capital loss carryforwards may cause us to forgo otherwise attractive opportunities.

**Our Tax Benefits Preservation Plan could inhibit a change in our control that may otherwise be favorable to our stockholders.**

In December 2016, our board of directors adopted a Tax Benefits Preservation Plan in an effort to protect against a possible limitation on our ability to use our net operating losses and net capital loss carryforwards by discouraging investors from acquiring ownership of our common stock in a manner that could trigger an “ownership change” for purposes of Sections 382 and 383 of the Code. Under the terms of the Tax Benefits Preservation Plan, in general, if a person or group acquires beneficial ownership of 4.9% or more of the outstanding shares of our Common Stock without prior approval of our board of directors or without meeting certain exceptions (an “Acquiring Person”), the rights would become exercisable and our stockholders (other than the Acquiring Person) will have the right to purchase securities from us at a discount to such securities’ fair market value, thus causing substantial dilution to the Acquiring Person. As a result, the Tax Benefits Preservation Plan may have the effect of inhibiting or impeding a change in control not approved by our board of directors and, notwithstanding its purpose, could adversely affect our shareholders’ ability to realize a premium over the then-prevailing market price for our common stock in connection with such a transaction. In addition, because our board of directors may consent to certain transactions, the Tax Benefits Preservation Plan gives our board of directors significant discretion over whether a potential acquirer’s efforts to acquire a large interest in us will be successful. There can be no assurance that the Tax Benefits Preservation Plan will prevent an “ownership change” within the meaning of Sections 382 and 383 of the Code, in which case we may lose all or most of the anticipated tax benefits associated with our prior losses.

**Qualifying as a REIT involves highly technical and complex provisions of the Code, and our failure to qualify as a REIT for any taxable year through 2016 would result in higher taxes and reduced cash available for distribution to our stockholders.**

As described above, we operated through December 31, 2016 in a manner intended to qualify us as a REIT for federal income tax purposes. Qualification as a REIT involves the application of highly technical and complex Code provisions for which only limited judicial and administrative authorities exist. Even a technical or inadvertent violation could jeopardize our REIT qualification for such taxable years. Our qualification as a REIT depended on our satisfaction of certain asset, income, organizational, distribution, stockholder ownership and other requirements. Although we believe we satisfied those requirements, no assurance can be given in that regard.

**Our failure to qualify as a REIT for a taxable year ending on or before December 31, 2015, would potentially give rise to a claim for damages from New Residential or New Senior.**

In connection with the spin-off of New Residential, which was completed in May 2013, and the spin-off of New Senior which was completed in November 2014, we represented in the Separation Agreements that we had no knowledge of any fact or circumstance that would cause us to fail to qualify as a REIT. We also covenanted in the Separation Agreements to generally use our reasonable best efforts to maintain our REIT status for each of our taxable years ending on or before December 31, 2014 (in the case of New Residential) and December 31, 2015 (in the case of New Senior). If, notwithstanding our belief that we qualified as a REIT for such taxable years, we breached this representation or covenant, New Residential or New Senior, or both, could be able to seek damages from us, which could have a significantly negative effect on our liquidity and results of operations.

**If New Residential failed to qualify as a REIT for 2013, or if New Senior failed to qualify as a REIT for 2014, it would significantly affect our ability to maintain our REIT status through December 31, 2016.**

For federal income tax purposes we recorded approximately \$600 million of gain as a result of the spin-off of New Residential in May 2013 and \$450 million of gain as a result of the spin-off of New Senior in November 2014. If New Residential qualified for taxation as a REIT for 2013, and if New Senior so qualified for 2014, that gain is qualifying income for purposes of our REIT income tests in such years. If, however, New Residential failed to qualify as a REIT for 2013, or if New Senior failed to so qualify in 2014, that gain would be non-qualifying income for purposes of the 75% gross income test. Although New Residential and New Senior covenanted in their respective separation and distribution agreements to use reasonable best efforts to qualify as a REIT in 2013 and 2014, respectively, no assurance can be given that they so qualified. If New Residential or New Senior failed to qualify in such years, it could cause us to fail our REIT income tests for such years, which could cause us to lose our REIT status prior to the revocation of our REIT election for 2017, and thereby materially negatively impact our business, financial condition and potentially impair our ability to continue operating in the future.

**Uncertainty exists with respect to the treatment of TBAs for purposes of the REIT asset and income tests.**

We have invested in and may continue to invest in TBAs and recognize income or gains from the disposition of those TBAs, through dollar roll transactions or otherwise. In a dollar roll transaction, we exchange an existing TBA for another TBA with a different settlement date. There is no direct authority with respect to the qualification of TBAs as real estate assets or U.S. Government securities for purposes of the 75% asset test or the qualification of income or gains from dispositions of TBAs as gains from the sale of real property (including interests in real property and interests in mortgages on real property) or other qualifying income for purposes of the 75% gross income test.

For a particular taxable year, we treated such TBAs as qualifying assets for purposes of the REIT asset tests, and income and gains from such TBAs as qualifying income for purposes of the 75% gross income test, to the extent set forth in an opinion from Skadden, Arps, Slate, Meagher & Flom LLP substantially to the effect that (i) for purposes of the REIT asset tests, our ownership of a TBA should be treated as ownership of the underlying mortgage-backed securities, and (ii) for purposes of the 75% REIT gross income test, any gain recognized by us in connection with the settlement of such TBAs should be treated as gain from the sale or disposition of the underlying mortgage-backed securities. Opinions of counsel are not binding on the IRS, and no assurance can be given that the IRS would not successfully challenge the conclusions set forth in such opinions. In addition, it must be emphasized that any opinion of Skadden, Arps, Slate, Meagher & Flom LLP is based on various assumptions relating to any TBAs that we enter into and would be conditioned upon fact-based representations and covenants made by our management regarding such TBAs. No assurance can be given that the IRS would not assert that such assets or income were not qualifying assets or income. If the IRS were to successfully challenge any conclusions of Skadden, Arps, Slate, Meagher & Flom LLP, we could be subject to a penalty tax or we could fail to qualify as a REIT prior to the revocation of our REIT election for 2017 if a sufficient portion of our assets consisted of TBAs or a sufficient portion of our income consisted of income or gains from the disposition of TBAs.

**The failure of assets subject to repurchase agreements to qualify as real estate assets could adversely affect our ability to qualify as a REIT.**

We have historically financed a meaningful portion of our investments in securities and loans with repurchase agreements, which are short-term financing arrangements and we may enter into additional repurchase agreements in the future. Under these agreements, we nominally sell certain of our assets to a counterparty and simultaneously enter into an agreement to repurchase these assets at a later date in exchange for a purchase price. Economically, these agreements are financings that are secured by the assets sold pursuant thereto. We believe that, for purposes of the REIT asset and income tests, we should have been treated as the owner of the assets that are the subject of any such sale and repurchase agreement, notwithstanding that those agreements may transfer record ownership of the assets to the counterparty during the term of the agreement. It is possible, however, that the IRS could assert that we did not own the assets during the term of the sale and repurchase agreement, in which case we might fail to qualify as a REIT prior to the revocation of our REIT election in 2017.

**We may be subject to adverse legislative or regulatory tax changes that could increase our tax liability, reduce our operating flexibility and reduce the price of our common stock.**

The rules dealing with U.S. federal income taxation are continually under review Congress, the IRS, and the U.S. Department of the Treasury. According to publicly released statements, a top legislative priority of the new Congress and administration may be to enact significant reform of the Internal Revenue Code, including significant changes to taxation of business entities and the deductibility of interest expense and capital investment. There is a substantial lack of clarity around the likelihood, timing and details of any such tax reform and the impact of any potential tax reform on us or an investment in our securities, and we cannot,

at this time, determine whether any such changes will adversely affect our taxation or the taxation of our stockholders. Any such changes could have an adverse effect on an investment in our shares or on the market value or the resale potential of our assets. You are urged to consult with your tax advisor with respect to the status of legislative, regulatory or administrative developments and proposals and their potential effect on an investment in our shares.

**Maintenance of our 1940 Act exclusion imposes limits on our operations.**

We conduct our operations in reliance on an exclusion from the 1940 Act, which we refer to as the Section 3(c)(5)(C) exclusion, which is available for entities “primarily engaged in the business of purchasing or otherwise acquiring mortgages and other liens on and interests in real estate.”

Reliance on this exclusion limits our ability to make certain investments. The Section 3(c)(5)(C) exclusion generally requires that at least 55% of our assets be comprised of qualifying real estate assets and at least 80% of our assets be comprised of a combination of qualifying real estate assets and real estate related assets. In satisfying the 55% requirement under the Section 3(c)(5)(C) exclusion, based on guidance from the SEC and its staff, we treat whole pool Agency ARM RMBS issued with respect to an underlying pool of mortgage loans in which we hold all of the certificates issued by the pool as qualifying real estate assets. The SEC and its staff have not issued guidance with respect to whole pool non-Agency RMBS for purposes of the Section 3(c)(5)(C) exclusion. Accordingly, based on our own judgment and analysis of the guidance from the SEC and its staff identifying Agency whole pool certificates as qualifying real estate assets under the Section 3(c)(5)(C) exclusion, we treat whole pool non-Agency ARM RMBS issued with respect to an underlying pool of mortgage loans in which we hold all of the certificates issued by the pool as qualifying real estate assets. We also treat whole mortgage loans that we acquire directly as qualifying real estate assets provided that 100% of the loan is secured by real estate when we acquire the loan and we have the unilateral right to foreclose on the mortgage. In addition, we treat investments in Agency partial pool RMBS and non-Agency partial pool RMBS as real estate related assets for purposes of satisfying the 80% test under the Section 3(c)(5)(C) exclusion. The Section 3(c)(5)(C) exclusion generally limits the amount of our investments in non-real estate assets to no more than 20% of our total assets. To the extent that we acquire significant non-real estate assets in the future, in order to maintain our exclusion under the 1940 Act, we may need to offset those acquisitions with additional qualifying real estate and real estate related assets, which may not generate risk-adjusted returns as attractive as those generated by non-real estate related assets.

In August 2011, the SEC issued a concept release soliciting public comments on a wide range of issues relating to companies, which are typically REITs, engaged in the business of acquiring mortgages and mortgage-related instruments and that rely on Section 3(c)(5)(C) of the 1940 Act, including the nature of the assets that qualify for purposes of the Section 3(c)(5)(C) exclusion and whether mortgage REITs like us should be regulated in a manner similar to investment companies. Therefore, there can be no assurance that the laws and regulations governing the 1940 Act status of REITs, or guidance from the SEC or its staff regarding the Section 3(c)(5)(C) exclusion, will not change in a manner that adversely affects our operations. If we fail to maintain an exclusion or exception from the 1940 Act, we could, among other things, be required either to (a) change the manner in which we conduct our operations to avoid being required to register as an investment company, (b) effect sales of our assets in a manner that, or at a time when, we would not otherwise choose to do so, or (c) register as an investment company (which, among other things, would require us to comply with the leverage constraints applicable to investment companies), any of which could negatively affect the value of our common stock, the sustainability of our business model, and our ability to make distributions to our stockholders, which could, in turn, materially adversely affect us and the market price of our stock.

**Rapid changes in the values of assets that we hold may make it more difficult for us to maintain our exclusion from the 1940 Act.**

If the market value or income potential of qualifying assets for purposes of our exclusion from registration as an investment company under the 1940 Act declines as a result of increased interest rates, changes in prepayment rates or other factors, or the market value or income potential from non-qualifying assets increases, we may need to increase our investments in qualifying assets and/or liquidate our non-qualifying assets to maintain our exclusion from registration under the 1940 Act. If the change in market values or income occurs quickly, this may be especially difficult to accomplish. This difficulty may be exacerbated by the illiquid nature of any non-qualifying assets we may own. We may have to make investment decisions that we otherwise would not make absent the intent to maintain our exclusion from registration under the 1940 Act.

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

None.

**Item 3. Defaults upon Senior Securities**

None.

**Item 4. Mine Safety Disclosures**

None.

**Item 5. Other Information**

None.

**Item 6. Exhibits**

<b><u>Exhibit Number</u></b>	<b><u>Exhibit Description</u></b>
2.1 †	Separation and Distribution Agreement dated April 26, 2013, between New Residential Investment Corp. and the Registrant (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q, Exhibit 2.1, filed on May 3, 2013).
2.2 †	Separation and Distribution Agreement dated October 16, 2014, between New Senior Investment Group Inc. and the Registrant (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q, Exhibit 3.2, filed on November 5, 2014).
3.1	Articles of Restatement (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 3.1, filed on December 8, 2016).
3.2	Articles Supplementary relating to the Series B Preferred Stock (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q, Exhibit 3.3, filed on May 13, 2003).
3.3	Articles Supplementary relating to the Series C Preferred Stock (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 3.3, filed on October 25, 2005).
3.4	Articles Supplementary relating to the Series D Preferred Stock (incorporated by reference to the Registrant's Report on Form 8-A, Exhibit 3.1, filed on March 14, 2007).
3.5	Articles Supplementary of Series E Junior Participating Preferred Stock (incorporated by reference to the Registrant's Annual Report on Form 10-K, Exhibit 3.5, filed on March 2, 2017).
3.6	Amended and Restated By-laws (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 3.4, filed on December 8, 2016).
4.1	Junior Subordinated Indenture between Newcastle Investment Corp. and The Bank of New York Mellon Trust Company, National Association, dated April 30, 2009 (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 4.1, filed on May 4, 2009).
4.2	Pledge and Security Agreement between Newcastle Investment Corp. and The Bank of New York Mellon Trust Company, National Association, as trustee, dated April 30, 2009 (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 4.2, filed on May 4, 2009).
4.3	Pledge, Security Agreement and Account Control Agreement among Newcastle Investment Corp., NIC TP LLC, as pledgor, and The Bank of New York Mellon Trust Company, National Association, as bank and trustee, dated April 30, 2009 (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 4.3, filed on May 4, 2009).
4.4	Tax Benefits Preservation Plan, dated as of December 7, 2016, between Newcastle Investment Corp. and American Stock Transfer & Trust Company, LLC (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 4.1, filed on December 8, 2016.)
10.1	Amended and Restated Management and Advisory Agreement by and among the Registrant and FIG LLC, dated January 1, 2017 (incorporated by reference to the Registrant's Annual Report on Form 10-K, Exhibit 10.1, filed on March 2, 2017).
10.2	2012 Newcastle Investment Corp. Nonqualified Stock Option and Incentive Award Plan, adopted as of May 7, 2012 (incorporated by reference to the Registrant's Annual Report on Form 10-K, Exhibit 10.3, filed on February 28, 2013).
10.3	Amended and Restated 2014 Newcastle Investment Corp. Nonqualified Stock Option and Incentive Award Plan, adopted as of November 3, 2014 (incorporated by reference to the Registrant's Annual Report on Form 10-K, Exhibit 10.5, filed on March 2, 2015).
10.4	2015 Newcastle Investment Corp. Nonqualified Option and Incentive Award Plan, adopted as of April 16, 2015 (incorporated by reference to Annex A of the Registrant's definitive proxy statement for the 2015 annual meeting of stockholders filed on April 17, 2015).
10.5	2016 Newcastle Investment Corp. Nonqualified Option and Incentive Award Plan (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 10.1, filed on May 19, 2016).

<u>Exhibit Number</u>	<u>Exhibit Description</u>
10.6	Exchange Agreement between Newcastle Investment Corp. and Taberna Preferred Funding IV, Ltd., Taberna Preferred Funding V, Ltd., Taberna Preferred Funding VI, Ltd. And Taberna Preferred Funding VII, Ltd., dated April 30, 2009 (incorporated by reference to the Registrant's Report on Form 8-K, Exhibit 10.1, filed on May 4, 2009).
10.7	Exchange Agreement, dated as of January 29, 2010, by and among Newcastle Investment Corp., Taberna Capital Management, LLC, Taberna Preferred Funding IV, Ltd., Taberna Preferred Funding V, Ltd., Taberna Preferred Funding VI, Ltd. And Taberna Preferred Funding VII, Ltd. (incorporated by reference to the Registrant's Report on Form 8-K, Exhibit 10.1, filed on February 2, 2010).
10.8	Sale and Cooperation Agreement, dated September 7, 2012, among Newcastle Investment Corp., Barclays Bank PLC and ED LIMITED (incorporated by reference to the Registrant's Report on Form 10-Q, Exhibit 10.33, filed on October 26, 2012).
10.9	Form of Indemnification Agreement (incorporated by reference to the Registrant's Report on Form 10-Q, Exhibit 10.19, filed on August 8, 2014).
31.1	Certification of Chief Executive Officer as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief 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 Document.
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document.
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document.

† Schedules and exhibits may have been omitted pursuant to Item 601(b)(2) of Regulation S-K.

\*XBRL (Extensible Business Reporting Language) information is furnished and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934.



- b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

May 5, 2017

/s/ Sarah L. Watterson

Sarah L. Watterson

Chief Executive Officer and President

[\(Back To Top\)](#)

## Section 3: EX-31.2 (EXHIBIT 31.2)

### EXHIBIT 31.2

#### CERTIFICATION OF CHIEF FINANCIAL OFFICER

I, Lawrence A. Goodfield, Jr., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Drive Shack Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

May 5, 2017

/s/ Lawrence A. Goodfield, Jr.

Lawrence A. Goodfield, Jr.

Chief Financial Officer, Chief Accounting Officer and Treasurer

[\(Back To Top\)](#)

## Section 4: EX-32.1 (EXHIBIT 32.1)



**EXHIBIT 32.1**

**CERTIFICATION OF CEO PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report on Form 10-Q of Drive Shack Inc. (the "Company") for the quarterly period ended March 31, 2017 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), Sarah L. Watterson, as Chief Executive Officer of the Company, hereby certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of her knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Sarah L. Watterson

---

Sarah L. Watterson

Chief Executive Officer and President

May 5, 2017

This certification accompanies the Report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not, except to the extent required by the Sarbanes-Oxley Act of 2002, be deemed filed by the Company for purposes of Section 18 of the Securities Exchange Act of 1934, as amended.

A signed original of this written statement required by Section 906 of the Sarbanes-Oxley Act of 2002 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

[\(Back To Top\)](#)

## **Section 5: EX-32.2 (EXHIBIT 32.2)**

**EXHIBIT 32.2**

**CERTIFICATION OF CFO PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report on Form 10-Q of Drive Shack Inc. (the "Company") for the quarterly period ended March 31, 2017 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), Lawrence A. Goodfield, Jr., as Chief Financial Officer of the Company, hereby certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of his knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Lawrence A. Goodfield, Jr.

---

Lawrence A. Goodfield, Jr.

Chief Financial Officer, Chief Accounting Officer and Treasurer

May 5, 2017

This certification accompanies the Report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not, except to the extent required by the Sarbanes-Oxley Act of 2002, be deemed filed by the Company for purposes of Section 18 of the Securities Exchange Act of 1934, as amended.

A signed original of this written statement required by Section 906 of the Sarbanes-Oxley Act of 2002 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

[\(Back To Top\)](#)