

MFA FINANCIAL, INC.
Form 10-Q
November 04, 2013
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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 September 30, 2013

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: 1-13991

MFA FINANCIAL, INC.
(Exact name of registrant as specified in its charter)

Maryland (State or other jurisdiction of incorporation or organization)	13-3974868 (I.R.S. Employer Identification No.)
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350 Park Avenue, 20th Floor, New York, New York (Address of principal executive offices)	10022 (Zip Code)
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(212) 207-6400
(Registrant's telephone number, including area code)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting

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company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

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

366,212,669 shares of the registrant’s common stock, \$0.01 par value, were outstanding as of October 29, 2013.

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MFA FINANCIAL, INC.

CONSOLIDATED BALANCE SHEETS

(In Thousands Except Per Share Amounts)	September 30, 2013 (Unaudited)	December 31, 2012
Assets:		
Mortgage-backed securities ("MBS"):		
Agency MBS, at fair value (\$6,282,729 and \$6,747,299 pledged as collateral, respectively)	\$ 6,697,689	\$ 7,225,460
Non-Agency MBS, at fair value (\$1,837,996 and \$1,602,953 pledged as collateral, respectively)	2,632,659	2,762,006
Non-Agency MBS transferred to consolidated variable interest entities ("VIEs") (1)	2,340,719	2,620,159
Securities obtained and pledged as collateral, at fair value	252,796	408,833
Cash and cash equivalents	503,852	401,293
Restricted cash	59,275	5,016
Interest receivable	37,804	44,033
Derivative instruments:		
MBS linked transactions, net ("Linked Transactions"), at fair value	23,940	12,704
Other derivative instruments, at fair value	4,629	203
Goodwill	7,189	7,189
Prepaid and other assets	38,002	30,654
Total Assets	\$ 12,598,554	\$ 13,517,550
Liabilities:		
Repurchase agreements	\$ 8,568,171	\$ 8,752,472
Securitized debt (2)	419,693	646,816
Obligation to return securities obtained as collateral, at fair value	252,796	508,827
8% Senior Notes due 2042 ("Senior Notes")	100,000	100,000
Accrued interest payable	13,601	16,104
Other derivative instruments, at fair value	65,253	63,034
Dividends and dividend equivalents rights ("DERs") payable	81,171	72,222
Payable for unsettled purchases	—	33,479
Excise tax and interest payable	6,208	7,500
Accrued expenses and other liabilities	18,136	6,090
Total Liabilities	\$ 9,525,029	\$ 10,206,544
Commitments and contingencies (Note 10)		
Stockholders' Equity:		
Preferred stock, \$.01 par value; 8.50% Series A cumulative redeemable 5,000 shares authorized; 0 and 3,840 shares issued and outstanding, respectively (\$0 and \$96,000 aggregate liquidation preference, respectively)	\$ —	\$ 38
Preferred stock, \$.01 par value; 7.50% Series B cumulative redeemable 8,050 and 0 shares authorized; 8,000 and 0 shares issued and outstanding, respectively (\$200,000 and \$0 aggregate liquidation preference, respectively)	80	—
Common stock, \$.01 par value; 886,950 and 895,000 shares authorized; 365,833 and 357,546 shares issued and outstanding, respectively	3,658	3,575

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Additional paid-in capital, in excess of par	2,977,190	2,805,724
Accumulated deficit	(573,065)	(260,308)
Accumulated other comprehensive income	665,662	761,977
Total Stockholders' Equity	\$ 3,073,525	\$ 3,311,006
Total Liabilities and Stockholders' Equity	\$ 12,598,554	\$ 13,517,550

(1) Non-Agency MBS transferred to consolidated VIEs represent assets of the consolidated VIEs that can be used only to settle the obligations of each respective VIE.

(2) Securitized Debt represents third-party liabilities of consolidated VIEs and excludes liabilities of the VIEs acquired by the Company that eliminate in consolidation. The third-party beneficial interest holders in the VIEs have no recourse to the general credit of the Company. (See Notes 10 and 15 for further discussion.)

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

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CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

(In Thousands, Except Per Share Amounts)	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2013	2012	2013	2012
Interest Income:				
Agency MBS	\$36,158	\$47,198	\$116,982	\$150,048
Non-Agency MBS	43,131	37,087	128,175	95,555
Non-Agency MBS transferred to consolidated VIEs	39,172	40,812	116,641	128,502
Cash and cash equivalent investments	21	38	93	84
Interest Income	\$118,482	\$125,135	\$361,891	\$374,189
Interest Expense:				
Repurchase agreements	\$37,113	\$39,317	\$105,185	\$111,639
Securitized debt	2,830	4,477	9,381	13,186
Senior Notes	2,007	2,007	6,020	3,791
Total Interest Expense	\$41,950	\$45,801	\$120,586	\$128,616
Net Interest Income	\$76,532	\$79,334	\$241,305	\$245,573
Other-Than-Temporary Impairments:				
Total other-than-temporary impairment losses	\$—	\$—	\$—	\$(879)
Portion of loss reclassified from other comprehensive income	—	—	—	(321)
Net Impairment Losses Recognized in Earnings	\$—	\$—	\$—	\$(1,200)
Other Income, net:				
Unrealized net gains and net interest income from Linked Transactions	\$544	\$3,177	\$1,785	\$11,444
Unrealized losses on TBA short positions	(8,724)	—	(8,724)	—
Gain on sales of MBS and U.S. Treasury securities, net	13,680	4,279	19,678	7,232
Other, net	55	1	165	2
Other Income, net	\$5,555	\$7,457	\$12,904	\$18,678
Operating and Other Expense:				
Compensation and benefits	\$5,294	\$5,984	\$15,851	\$16,752
Other general and administrative expense	3,434	2,666	10,175	8,679
Excise tax and interest	—	—	2,000	—
Impairment of resecuritization related costs	2,031	—	2,031	—
Operating and Other Expense	\$10,759	\$8,650	\$30,057	\$25,431
Net Income	\$71,328	\$78,141	\$224,152	\$237,620
Less Preferred Stock Dividends	3,750	2,040	10,000	6,120
Less Issuance Costs of Redeemed Preferred Stock	—	—	3,947	—
Net Income Available to Common Stock and Participating Securities	\$67,578	\$76,101	\$210,205	\$231,500
Earnings per Common Share - Basic and Diluted	\$0.19	\$0.21	\$0.58	\$0.65

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Dividends Declared per Share of Common Stock	\$0.50	(1) \$0.21	\$1.44	(1)(2)\$0.68
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(1) Includes a special dividend of \$0.28 per share declared on August 1, 2013.

(2) Includes a special dividend of \$0.50 per share declared on March 4, 2013.

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

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CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(UNAUDITED)

(In Thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Net income	\$71,328	\$78,141	\$224,152	\$237,620
Other Comprehensive Income:				
Unrealized gain/(loss) on Agency MBS, net	15,469	61,999	(152,302)	47,169
Unrealized gain on Non-Agency MBS, net	16,381	409,742	62,455	666,287
Reclassification adjustment for MBS sales included in net income	(15,158)	(3,130)	(17,398)	(5,529)
Reclassification adjustment for other-than-temporary impairments included in net income	—	—	—	1,200
Unrealized (loss)/gain on derivative hedging instruments, net	(19,934)	11,654	10,930	36,025
Other Comprehensive (Loss)/Income	(3,242)	480,265	(96,315)	745,152
Comprehensive income before preferred stock dividends and issuance costs of redeemed preferred stock	\$68,086	\$558,406	\$127,837	\$982,772
Dividends declared on preferred stock	(3,750)	(2,040)	(10,000)	(6,120)
Issuance costs of redeemed preferred stock	—	—	(3,947)	—
Comprehensive Income Available to Common Stock and Participating Securities	\$64,336	\$556,366	\$113,890	\$976,652

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

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MFA FINANCIAL, INC.

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

(UNAUDITED)

(In Thousands, Except Per Share Amounts)	Nine Months Ended September 30, 2013	
	Dollars	Shares
Preferred Stock, 8.50% Series A Cumulative Redeemable - Liquidation Preference \$25.00 per Share:		
Balance at December 31, 2012	\$38	3,840
Redemption of Series A Preferred Stock	(38	) (3,840
Balance at September 30, 2013	—	—
Preferred Stock, 7.50% Series B Cumulative Redeemable - Liquidation Preference \$25.00 per Share:		
Balance at December 31, 2012	—	—
Issuance of Series B Preferred Stock	80	8,000
Balance at September 30, 2013	80	8,000
Common Stock, Par Value \$.01:		
Balance at December 31, 2012	3,575	357,546
Issuance of common stock (1)	83	8,373
Repurchase of shares of common stock (1)	—	(86
Balance at September 30, 2013	3,658	365,833
Additional Paid-in Capital, in excess of Par:		
Balance at December 31, 2012	2,805,724	
Issuance of common stock, net of expenses (1)	67,713	
Redemption of Series A Preferred Stock	(92,015)
Issuance of Series B Preferred Stock, net of expenses	193,236	
Equity-based compensation expense	2,946	
Repurchase of shares of common stock (1)	(414)
Balance at September 30, 2013	2,977,190	
Accumulated Deficit:		
Balance at December 31, 2012	(260,308)
Net income	224,152	
Dividends declared on common stock	(521,205)
Dividends declared on preferred stock	(10,000)
Dividends attributable to DERs	(1,757)
Issuance costs of redeemed Preferred Stock	(3,947)
Balance at September 30, 2013	(573,065)
Accumulated Other Comprehensive Income:		
Balance at December 31, 2012	761,977	
Change in unrealized gains on MBS, net	(107,245)
Change in unrealized losses on derivative hedging instruments, net	10,930	
Balance at September 30, 2013	665,662	

Total Stockholders' Equity at September 30, 2013

\$3,073,525

(1) For the nine months ended September 30, 2013, includes approximately \$27,000 (3,800 shares) repurchased through the Company's publicly announced stock repurchase program and approximately \$695,000 (82,380 shares) surrendered for tax purposes related to equity-based compensation awards.

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

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MFA FINANCIAL, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

(In Thousands)	Nine Months Ended	
	September 30, 2013	2012
Cash Flows From Operating Activities:		
Net income	\$224,152	\$237,620
Adjustments to reconcile net income to net cash provided by operating activities:		
Gain on sales of MBS and U.S. Treasury securities	(19,678)	(7,232)
Other-than-temporary impairment charges	—	1,200
Accretion of purchase discounts on MBS	(48,322)	(28,173)
Amortization of purchase premiums on MBS	47,198	38,175
Depreciation and amortization on fixed assets and other assets	3,133	2,471
Equity-based compensation expense	2,946	4,374
Unrealized losses/(gains) on derivative instruments	8,318	(8,851)
Decrease/(increase) in interest receivable	6,193	(1,998)
Increase in prepaid and other assets	(5,146)	(10,342)
Increase in accrued expenses and other liabilities, and excise tax and interest	10,837	344
(Decrease)/increase in accrued interest payable on financial instruments	(2,503)	5,005
Net cash provided by operating activities	\$227,128	\$232,593
Cash Flows From Investing Activities:		
Principal payments on MBS	\$2,231,495	\$1,977,366
Proceeds from sale of MBS and U.S. Treasury securities	493,613	137,079
Purchases of MBS	(1,532,982)	(2,896,359)
Additions to leasehold improvements, furniture and fixtures	(272)	(367)
Net cash provided by/(used in) investing activities	\$1,191,854	\$(782,281)
Cash Flows From Financing Activities:		
Principal payments on repurchase agreements	\$(60,312,234)	\$(48,911,503)
Proceeds from borrowings under repurchase agreements	60,127,933	49,930,670
Proceeds from issuance of securitized debt	76,485	186,691
Principal payments on securitized debt	(303,608)	(312,740)
Payments made on obligation to return securities obtained as collateral	(200,050)	—
Maturity of obligation to return securities obtained as collateral	(275,402)	—
Payments made for resecuritization related costs	—	(1,814)
Proceeds from issuance of Senior Notes	—	100,000
Payments made for Senior Notes related costs	—	(3,415)
Cash disbursements on financial instruments underlying Linked Transactions	(254,155)	(513,418)
Cash received from financial instruments underlying Linked Transactions	243,325	390,363
Payments made for margin calls on repurchase agreements and interest rate swaps (“Swaps”)	(61,402)	(2,390)
Proceeds from reverse margin calls on repurchase agreements and Swaps	2,000	10,890
Proceeds from issuances of common stock	67,409	4,398
Payments made for redemption of Series A Preferred Stock	(96,000)	—
Proceeds from issuance of Series B Preferred Stock	200,000	—
Payments made for preferred stock offering costs	(6,684)	—

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Payments made to repurchase common stock	(27) —
Dividends paid on preferred stock	(10,000) (6,120)
Dividends paid on common stock and DERs	(514,013	) (265,504)
Net cash (used in)/provided by financing activities	\$(1,316,423	) \$606,108
Net increase in cash and cash equivalents	\$102,559	\$56,420
Cash and cash equivalents at beginning of period	\$401,293	\$394,022
Cash and cash equivalents at end of period	\$503,852	\$450,442

Non-cash Investing and Financing Activities:

MBS recorded upon de-linking of Linked Transactions	\$—	\$174,940
Net increase in securities obtained as collateral/obligation to return securities obtained as collateral	\$221,578	\$203,303
Dividends and DERs declared and unpaid	\$81,171	\$76,051

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

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MFA FINANCIAL, INC.
NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2013

1. Organization

MFA Financial, Inc. (the “Company”) was incorporated in Maryland on July 24, 1997 and began operations on April 10, 1998. The Company has elected to be treated as a real estate investment trust (“REIT”) for federal income tax purposes. In order to maintain its qualification as a REIT, the Company must comply with a number of requirements under federal tax law, including that it must distribute at least 90% of its annual REIT taxable income to its stockholders. (See Note 11)

2. Summary of Significant Accounting Policies

(a) Basis of Presentation and Consolidation

The interim unaudited financial statements of the Company have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission (the “SEC”). Certain information and note disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) have been condensed or omitted according to these SEC rules and regulations. Management believes that the disclosures included in these interim financial statements are adequate to make the information presented not misleading. The accompanying financial statements should be read in conjunction with the financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2012. In the opinion of management, all normal and recurring adjustments necessary to present fairly the financial condition of the Company at September 30, 2013 and results of operations for all periods presented have been made. The results of operations for the nine months ended September 30, 2013 should not be construed as indicative of the results to be expected for the full year.

The accompanying consolidated financial statements of the Company have been prepared on the accrual basis of accounting in accordance with GAAP. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although the Company’s estimates contemplate current conditions and how it expects them to change in the future, it is reasonably possible that actual conditions could be worse than anticipated in those estimates, which could materially impact the Company’s results of operations and its financial condition. Management has made significant estimates in several areas, including other-than-temporary impairment (“OTTI”) on Agency and Non-Agency MBS (Note 3), valuation of Agency and Non-Agency MBS (Notes 3 and 14), derivative hedging instruments (Notes 5 and 14) and income recognition on certain Non-Agency MBS purchased at a discount (Note 3). In addition, estimates are used in the determination of taxable income used in the assessment of REIT compliance and contingent liabilities for related taxes, penalties and interest (Note 2(m)). Actual results could differ from those estimates.

The consolidated financial statements of the Company include the accounts of all subsidiaries; significant intercompany accounts and transactions have been eliminated.

(b) Agency and Non-Agency MBS (including Non-Agency MBS transferred to a consolidated VIE)

The Company has investments in residential MBS that are issued or guaranteed as to principal and/or interest by a federally chartered corporation, such as Fannie Mae or Freddie Mac, or any agency of the U.S. Government, such as Ginnie Mae (collectively, “Agency MBS”), and residential MBS that are not guaranteed by any U.S. Government agency or any federally chartered corporation (“Non-Agency MBS”), as described in Note 3.

Designation

The Company generally intends to hold its MBS until maturity; however, from time to time, it may sell any of its securities as part of the overall management of its business. As a result, all of the Company’s MBS are designated as “available-for-sale” and, accordingly, are carried at their fair value with unrealized gains and losses excluded from earnings (except when an OTTI is recognized, as discussed below) and reported in accumulated other comprehensive income/(loss) (“AOCI”), a component of stockholders’ equity.

Upon the sale of an investment security, any unrealized gain or loss is reclassified out of AOCI to earnings as a realized gain or loss using the specific identification method.

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MFA FINANCIAL, INC.

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2013

Revenue Recognition, Premium Amortization and Discount Accretion

Interest income on securities is accrued based on the outstanding principal balance and their contractual terms. Premiums and discounts associated with Agency MBS and Non-Agency MBS rated AA and higher at the time of purchase are amortized into interest income over the life of such securities using the effective yield method. Adjustments to premium amortization are made for actual prepayment activity.

Interest income on the Non-Agency MBS that were purchased at a discount to par value and/or are considered to be of less than high credit quality is recognized based on the security's effective interest rate. The effective interest rate is based on management's estimate of the projected cash flows for each security, which are based on the Company's observation of current information and events and include assumptions related to fluctuations in interest rates, prepayment speeds and the timing and amount of credit losses. On at least a quarterly basis, the Company reviews and, if appropriate, makes adjustments to its cash flow projections based on input and analysis received from external sources, internal models, and its judgment about interest rates, prepayment rates, the timing and amount of credit losses, and other factors. Changes in cash flows from those originally projected, or from those estimated at the last evaluation, may result in a prospective change in the yield/interest income recognized on these securities or in the recognition of OTTI. (See Note 3)

Based on the projected cash flows from the Company's Non-Agency MBS purchased at a discount to par value, a portion of the purchase discount may be designated as non-accretable purchase discount ("Credit Reserve"), which effectively mitigates the Company's risk of loss on the mortgages collateralizing such MBS and is not expected to be accreted into interest income. The amount designated as Credit Reserve may be adjusted over time, based on the actual performance of the security, its underlying collateral, actual and projected cash flow from such collateral, economic conditions and other factors. If the performance of a security with a Credit Reserve is more favorable than forecasted, a portion of the amount designated as Credit Reserve may be reallocated to accretable discount and recognized into interest income over time. Conversely, if the performance of a security with a Credit Reserve is less favorable than forecasted, the amount designated as Credit Reserve may be increased, or impairment charges and write-downs of such securities to a new cost basis could result.

Determination of MBS Fair Value

In determining the fair value of the Company's MBS, management considers a number of observable market data points, including prices obtained from pricing services, brokers and repurchase agreement counterparties, dialogue with market participants, as well as management's observations of market activity. (See Note 14)

Impairments/OTTI

When the fair value of an investment security is less than its amortized cost at the balance sheet date, the security is considered impaired. The Company assesses its impaired securities on at least a quarterly basis and designates such impairments as either "temporary" or "other-than-temporary." If the Company intends to sell an impaired security, or it is more likely than not that it will be required to sell the impaired security before its anticipated recovery, then the Company must recognize an OTTI through charges to earnings equal to the entire difference between the investment's amortized cost and its fair value at the balance sheet date. If the Company does not expect to sell an other-than-temporarily impaired security, only the portion of the OTTI related to credit losses is recognized through charges to earnings with the remainder recognized through AOCI on the consolidated balance sheets. Impairments

recognized through other comprehensive income/(loss) (“OCI”) do not impact earnings. Following the recognition of an OTTI through earnings, a new cost basis is established for the security and may not be adjusted for subsequent recoveries in fair value through earnings. However, OTTIs recognized through charges to earnings may be accreted back to the amortized cost basis of the security on a prospective basis through interest income. The determination as to whether an OTTI exists and, if so, the amount of credit impairment recognized in earnings is subjective, as such determinations are based on factual information available at the time of assessment as well as the Company’s estimates of the future performance and cash flow projections. As a result, the timing and amount of OTTIs constitute material estimates that are susceptible to significant change. (See Note 3)

Non-Agency MBS that are purchased at significant discounts to par/and are otherwise assessed to be of less than high credit quality on which impairments are recognized have experienced, or are expected to experience, credit-related adverse cash flow changes. The Company’s estimate of cash flows for its Non-Agency MBS is based on its review of the underlying mortgage loans securing the MBS. The Company considers information available about the past and expected future performance of underlying

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MFA FINANCIAL, INC.

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2013

mortgage loans, including timing of expected future cash flows, prepayment rates, default rates, loss severities, delinquency rates, percentage of non-performing loans, Fair Isaac Corporation (“FICO”) scores at loan origination, year of origination, loan-to-value ratios (or LTV), geographic concentrations, as well as reports by credit rating agencies, such as Moody’s Investors Services, Inc. (“Moody’s”), Standard & Poor’s Corporation (“S&P”), or Fitch, Inc. (collectively, “Rating Agencies”), general market assessments, and dialogue with market participants. As a result, significant judgment is used in the Company’s analysis to determine the expected cash flows for its Non-Agency MBS. In determining the OTTI related to credit losses for securities that were purchased at significant discounts to par and/or are considered to be of less than high credit quality, the Company compares the present value of the remaining cash flows expected to be collected at the purchase date (or last date previously revised) against the present value of the cash flows expected to be collected at the current financial reporting date. The discount rate used to calculate the present value of expected future cash flows is the current yield used for income recognition purposes. Impairment assessment for Non-Agency MBS that were purchased at prices close to par and are considered to be of high credit quality involves comparing the present value of the remaining cash flows expected to be collected against the amortized cost of the security at the assessment date. The discount rate used to calculate the present value of the expected future cash flows is based on the instrument’s effective interest rate.

Balance Sheet Presentation

The Company’s MBS pledged as collateral against repurchase agreements and Swaps are included in MBS on the consolidated balance sheets with the fair value of the MBS pledged disclosed parenthetically. Purchases and sales of securities are recorded on the trade date. However, if on the purchase settlement date, a repurchase agreement is used to finance the purchase of an MBS with the same counterparty and such transactions are determined to be linked, then the MBS and linked repurchase borrowing will be reported on the same settlement date as Linked Transactions. (See Notes 2(n) and 5)

(c) Securities Obtained and Pledged as Collateral/Obligation to Return Securities Obtained as Collateral

The Company has obtained securities as collateral under collateralized financing arrangements in connection with its financing strategy for Non-Agency MBS. Securities obtained as collateral in connection with these transactions are recorded on the Company’s consolidated balance sheets as an asset along with a liability representing the obligation to return the collateral obtained, at fair value. While beneficial ownership of securities obtained remains with the counterparty, the Company has the right to sell the collateral obtained or to pledge it as part of a subsequent collateralized financing transaction. (See Note 2(i) for Repurchase Agreements and Reverse Repurchase Agreements)

(d) Cash and Cash Equivalents

Cash and cash equivalents include cash on deposit with financial institutions and investments in money market funds, all of which have original maturities of three months or less. Cash and cash equivalents may also include cash pledged as collateral to the Company by its repurchase agreement and/or Swap counterparties as a result of reverse margin calls (i.e., margin calls made by the Company). The Company did not hold any cash pledged by its counterparties at September 30, 2013 or December 31, 2012. At September 30, 2013 and December 31, 2012, all of the Company’s cash investments were comprised of overnight money market funds, which are not bank deposits and are not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. (See Notes 7 and 14)

(e) Restricted Cash

Restricted cash represents the Company's cash held by its counterparties as collateral against the Company's Swaps and/or repurchase agreements. Restricted cash, which earns interest, is not available to the Company for general corporate purposes, but may be applied against amounts due to counterparties to the Company's repurchase agreements and/or Swaps, or returned to the Company when the collateral requirements are exceeded or at the maturity of the Swap or repurchase agreement. The Company had aggregate restricted cash held as collateral against its Swaps of \$59.3 million and \$5.0 million at September 30, 2013 and December 31, 2012, respectively. (See Notes 5, 6, 7 and 14)

(f) Goodwill

At September 30, 2013 and December 31, 2012, the Company had goodwill of \$7.2 million, which represents the unamortized portion of the excess of the fair value of its common stock issued over the fair value of net assets acquired in connection with its formation in 1998. Goodwill is tested for impairment at least annually, or more frequently under certain circumstances, at the entity level. Through September 30, 2013, the Company had not recognized any impairment against its goodwill.

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(g) Depreciation

Leasehold Improvements and Other Depreciable Assets

Depreciation is computed on the straight-line method over the estimated useful life of the related assets or, in the case of leasehold improvements, over the shorter of the useful life or the lease term. Furniture, fixtures, computers and related hardware have estimated useful lives ranging from five to eight years at the time of purchase.

(h) Resecuritization and Senior Notes Related Costs

Resecuritization related costs are costs associated with the issuance of beneficial interests by consolidated VIEs and incurred by the Company in connection with various securitization transactions completed by the Company. Senior Notes related costs are costs incurred by the Company in connection with the issuance of its Senior Notes in April, 2012. These costs may include underwriting, rating agency, legal, accounting and other fees. Such costs, which reflect deferred charges, are included on the Company's consolidated balance sheets in Prepaid and other assets. These deferred charges are amortized as an adjustment to interest expense using the effective interest method, based upon the actual repayments of the associated beneficial interests issued to third parties and over the stated legal maturity of the Senior Notes. The Company periodically reviews the recoverability of these deferred costs and in the event an impairment charge is required, such amount shall be included within Operating and other expense on the Company's consolidated statement of operations.

(i) Repurchase Agreements and Reverse Repurchase Agreements

The Company finances the acquisition of a significant portion of its MBS with repurchase agreements. Under repurchase agreements, the Company sells securities to a lender and agrees to repurchase the same securities in the future for a price that is higher than the original sale price. The difference between the sale price that the Company receives and the repurchase price that the Company pays represents interest paid to the lender. Although legally structured as sale and repurchase transactions, the Company accounts for repurchase agreements as secured borrowings, with the exception of certain repurchase agreements accounted for as components of Linked Transactions. (See Note 2(n) below.) Under its repurchase agreements, the Company pledges its securities as collateral to secure the borrowing, which is equal in value to a specified percentage of the fair value of the pledged collateral, while the Company retains beneficial ownership of the pledged collateral. At the maturity of a repurchase financing, unless the repurchase financing is renewed with the same counterparty, the Company is required to repay the loan including any accrued interest and concurrently receives back its pledged collateral from the lender. With the consent of the lender, the Company may renew a repurchase financing at the then prevailing financing terms. Margin calls, whereby a lender requires that the Company pledge additional securities or cash as collateral to secure borrowings under its repurchase financing with such lender, are routinely experienced by the Company when the value of the MBS pledged as collateral declines as a result of principal amortization and prepayments or due to changes in market interest rates, spreads or other market conditions. The Company also may make margin calls on counterparties when collateral values increase.

The Company's repurchase financings typically have terms ranging from one month to six months at inception, but may also have longer or shorter terms. Should a counterparty decide not to renew a repurchase financing at maturity, the Company must either refinance elsewhere or be in a position to satisfy the obligation. If, during the term of a repurchase financing, a lender should default on its obligation, the Company might experience difficulty recovering its

pledged assets which could result in an unsecured claim against the lender for the difference between the amount loaned to the Company plus interest due to the counterparty and the fair value of the collateral pledged by the Company to such lender, including accrued interest receivable or such collateral. (See Notes 2(n), 5, 6, 7 and 14)

In addition to the repurchase agreement financing arrangements discussed above, as part of its financing strategy for Non-Agency MBS, the Company has entered into contemporaneous repurchase and reverse repurchase agreements with a single counterparty. Under a typical reverse repurchase agreement, the Company buys securities from a borrower for cash and agrees to sell the same securities in the future for a price that is higher than the original purchase price. The difference between the purchase price the Company originally paid and the sale price represents interest received from the borrower. In contrast, the contemporaneous repurchase and reverse repurchase transactions effectively resulted in the Company pledging Non-Agency MBS as collateral to the counterparty in connection with the repurchase agreement financing and obtaining U.S. Treasury securities as collateral from the same counterparty in connection with the reverse repurchase agreement. No net cash was exchanged between the Company and counterparty at the inception of the transactions. Securities obtained and pledged as collateral are recorded as

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an asset on the Company's consolidated balance sheets. Interest income is recorded on the reverse repurchase agreement and interest expense is recorded on the repurchase agreement on an accrual basis. Both the Company and the counterparty have the right to make daily margin calls based on changes in the value of the collateral obtained and/or pledged. The Company's liability to the counterparty in connection with this financing arrangement is recorded on the Company's consolidated balance sheets and disclosed as "Obligation to return securities obtained as collateral." (See Note 2(c))

(j) Equity-Based Compensation

Compensation expense for equity based awards is recognized ratably over the vesting period of such awards, based upon the fair value of such awards at the grant date. With respect to awards granted in 2009 and prior years, the Company has applied a zero forfeiture rate for these awards, as they were granted to a limited number of employees, and historical forfeitures have been minimal. Forfeitures, or an indication that forfeitures are expected to occur, may result in a revised forfeiture rate and would be accounted for prospectively as a change in estimate.

During 2010, the Company granted certain restricted stock units ("RSUs") that vest after either two or four years of service and provided that certain criteria are met, which are based on a formula that includes changes in the Company's closing stock price over a two- or four-year period and dividends declared on the Company's common stock during those periods. During 2011, 2012 and 2013, the Company granted certain RSUs that vest annually over a one or three-year period, provided that certain criteria are met, which are based on a formula that includes changes in the Company's closing stock price over the annual vesting period and dividends declared on the Company's common stock during those periods. Such criteria constitute a "market condition" which impacts the amount of compensation expense recognized for these awards. Specifically, the uncertainty regarding whether the market condition will be achieved is reflected in the grant date fair valuation of the RSUs, which in addition to estimates regarding the amount of RSUs expected to be forfeited during the associated service period, determines the amount of compensation expense that is recognized. Compensation expense is not reversed should the market condition not be achieved, while differences in actual forfeiture experience relative to estimated forfeitures will result in adjustments to the timing and amount of compensation expense recognized.

The Company has awarded DERs that may be attached to or awarded separately from other equity based awards. Compensation expense for separately awarded DERs is based on the grant date fair value of such awards and is recognized over the vesting period. Payments pursuant to these DERs are charged to stockholders' equity. Payments pursuant to DERs that are attached to equity based awards are charged to stockholders' equity to the extent that the attached equity awards are expected to vest. Compensation expense is recognized for payments made for DERs to the extent that the attached equity awards do not or are not expected to vest and grantees are not required to return payments of dividends or DERs to the Company. (See Notes 2(k) and 13)

(k) Earnings per Common Share ("EPS")

Basic EPS is computed using the two-class method, which includes the weighted-average number of shares of common stock outstanding during the period and other securities that participate in dividends, such as the Company's unvested restricted stock and RSUs that have non-forfeitable rights to dividends and DERs attached to/associated with RSUs and vested stock options to arrive at total common equivalent shares. In applying the two-class method, earnings are allocated to both shares of common stock and securities that participate in dividends based on their respective weighted-average shares outstanding for the period. For the diluted EPS calculation, common equivalent shares are further adjusted for the effect of dilutive unexercised stock options and RSUs outstanding that are unvested

and have dividends that are subject to forfeiture using the treasury stock method. Under the treasury stock method, common equivalent shares are calculated assuming that all dilutive common stock equivalents are exercised and the proceeds, along with future compensation expenses associated with such instruments, are used to repurchase shares of the Company's outstanding common stock at the average market price during the reported period. (See Note 12)

(1) Comprehensive Income/(Loss)

The Company's comprehensive income/(loss) available to common stock and participating securities includes net income, the change in net unrealized gains/(losses) on its MBS and Swaps, (to the extent that such changes are not recorded in earnings), adjusted by realized net gains/(losses) reclassified out of AOCI for MBS and is reduced by dividends declared on the Company's preferred stock and issuance costs of redeemed preferred stock.

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(m) U.S. Federal Income Taxes

The Company has elected to be taxed as a REIT under the provisions of the Internal Revenue Code of 1986, as amended, (the "Code") and the corresponding provisions of state law. The Company expects to operate in a manner that will enable it to satisfy the various requirements to maintain its status as a REIT. In order to maintain its status as a REIT, the Company must, among other things, distribute at least 90% of its REIT taxable income to stockholders in the timeframe permitted by the Code. The Company is not subject to tax to the extent that it distributes 100% of its REIT taxable income to its stockholders within the permitted timeframe. Should this not occur, the Company would be subject to federal taxes at prevailing corporate tax rates on the difference between its REIT taxable income and the amounts deemed to be distributed for that tax year. As the Company's objective is to distribute 100% of its REIT taxable income to its stockholders within the permitted timeframe, no provision for current or deferred income taxes has been made in the accompanying consolidated financial statements. Should the Company incur a liability for corporate income tax, such amounts would be recorded as REIT income tax expense on the Company's consolidated statements of operations. Furthermore, if the Company fails to distribute during each calendar year, or by the end of January following the calendar year in the case of distributions with declaration and record dates falling in the last three months of the calendar year, at least the sum of (i) 85% its REIT ordinary income for such year; (ii) 95% of its REIT capital gain income for such year and; (iii) any undistributed taxable income from prior periods, the Company will be subject to a 4% nondeductible excise tax on the excess of such required distribution over the amounts actually distributed. To the extent that the Company incurs interest, penalties or related excise taxes in connection with its tax obligations, including as a result of its assessment of uncertain tax positions, such amounts shall be included within Operating and other expense on the Company's consolidated statements of operations.

Based on its analysis of any potential uncertain tax positions, the Company concluded that it does not have any material uncertain tax positions that meet the relevant recognition or measurement criteria as of September 30, 2013, December 31, 2012, or September 30, 2012. The Company filed its 2012 tax return prior to September 15, 2013. The Company's tax returns for tax years 2009 through 2012 are open to examination.

(n) Derivative Instruments

The Company uses a variety of derivative instruments to economically hedge a portion of its exposure to market risks, including interest rate risk, prepayment risk and extension risk. The objective of the Company's risk management strategy is to reduce fluctuations in net book value over a range of interest rate scenarios. In particular, the Company attempts to mitigate the risk of the cost of its variable rate liabilities increasing during a period of rising interest rates. The Company's derivative instruments are primarily comprised of Swaps, which are designated as cash flow hedges against the interest rate risk associated with its borrowings. The Company has also entered into forward contracts for the sale of agency MBS securities on a generic pool, or to-be-announced basis ("TBA short positions") and Linked Transactions. TBA short positions and Linked Transactions are not designated as hedging instruments.

Linked Transactions

It is presumed that the initial transfer of a financial asset (i.e., the purchase of an MBS by the Company) and contemporaneous repurchase financing of such MBS with the same counterparty are considered part of the same arrangement, or a "linked transaction," unless certain criteria are met. The two components of a linked transaction (MBS purchase and repurchase financing) are not reported separately but are evaluated on a combined basis and reported as a forward (derivative) contract and are presented as "Linked Transactions" on the Company's consolidated balance sheets. Changes in the fair value of the assets and liabilities underlying Linked Transactions and associated

interest income and expense are reported as “unrealized net gains/(losses) and net interest income from Linked Transactions” on the Company’s consolidated statements of operations and are not included in OCI. However, if certain criteria are met, the initial transfer (i.e., the purchase of a security by the Company) and repurchase financing will not be treated as a Linked Transaction and will be evaluated and reported separately, as an MBS purchase and repurchase financing. When or if a transaction is no longer considered to be linked, the MBS and repurchase financing will be reported on a gross basis. In this case, the fair value of the MBS at the time the transactions are no longer considered linked will become the cost basis of the MBS, and the income recognition yield for such MBS will be calculated prospectively using this new cost basis. (See Notes 5 and 14)

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Swaps

The Company documents its risk-management policies, including objectives and strategies, as they relate to its hedging activities and the relationship between the hedging instrument and the hedged liability. The Company assesses, both at inception of a hedge and on a quarterly basis thereafter, whether or not the hedge is “highly effective.”

The Company discontinues hedge accounting on a prospective basis and recognizes changes in the fair value through earnings when: (i) it is determined that the derivative is no longer effective in offsetting cash flows of a hedged item (including forecasted transactions); (ii) it is no longer probable that the forecasted transaction will occur; or (iii) it is determined that designating the derivative as a hedge is no longer appropriate.

Although permitted under certain circumstances, the Company does not offset cash collateral receivables or payables against its net derivative positions. (See Notes 5, 7 and 14)

Swaps are carried on the Company’s balance sheets at fair value, as assets, if their fair value is positive, or as liabilities, if their fair value is negative. Changes in the fair value of the Company’s Swaps are recorded in OCI provided that the hedge remains effective. Changes in fair value for any ineffective amount of a Swap are recognized in earnings. The Company has not recognized any change in the value of its existing Swaps through earnings as a result of hedge ineffectiveness.

TBA Short Positions

In addition to Swaps, the Company has entered into TBA short positions as a means of managing interest rate risk and MBS basis risk associated with its investment and financing activities. A TBA short position is a forward contract for sale of agency MBS at a predetermined price, face amount, issuer, coupon and stated maturity on an agreed-upon future date. The specific agency MBS that could be delivered into the contract upon the settlement date, published each month by the Securities Industry and Financial Markets Association (“SIFMA”), are not known at the time of the transaction.

The Company accounts for TBA short positions as derivative instruments since it cannot assert that it is probable at inception and throughout the term of the TBA contract that it will physically deliver the agency security upon settlement of the contract. The Company presents TBA short positions as either assets or liabilities in Other derivative instruments, at fair value on its consolidated balance sheets. Gains and losses associated with TBA short positions are reported in Other income on the Company's consolidated statements of operations. (See Notes 5 and 14)

(o) Fair Value Measurements and the Fair Value Option for Financial Assets and Financial Liabilities

The Company’s presentation of fair value for its financial assets and liabilities is determined within a framework that stipulates that the fair value of a financial asset or liability is an exchange price in an orderly transaction between market participants to sell the asset or transfer the liability in the market in which the reporting entity would transact for the asset or liability, that is, the principal or most advantageous market for the asset or liability. The transaction to sell the asset or transfer the liability is a hypothetical transaction at the measurement date, considered from the perspective of a market participant that holds the asset or owes the liability. This definition of fair value focuses on exit price and prioritizes the use of market-based inputs over entity-specific inputs when determining fair value. In addition, the framework for measuring fair value establishes a three-level hierarchy for fair value measurements based upon the observability of inputs to the valuation of an asset or liability as of the measurement date. (See Note 14)

Although permitted under GAAP to measure many financial instruments and certain other items at fair value, the Company has not elected the fair value option for any of its assets or liabilities. If the fair value option is elected, unrealized gains and losses on such items for which fair value is elected would be recognized in earnings at each subsequent reporting date. A decision to elect the fair value option for an eligible financial instrument, which may be made on an instrument by instrument basis, is irrevocable.

(p) Variable Interest Entities

An entity is referred to as a VIE if it meets at least one of the following criteria: (i) the entity has equity that is insufficient to permit the entity to finance its activities without additional subordinated financial support of other parties; or (ii) as a group, the holders of the equity investment at risk lack (a) the power to direct the activities of an entity that most significantly impact the

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entity's economic performance; (b) the obligation to absorb the expected losses; or (c) the right to receive the expected residual returns; or (iii) have disproportional voting rights and the entity's activities are conducted on behalf of the investor that has disproportionately few voting rights.

The Company consolidates a VIE when it has both the power to direct the activities that most significantly impact the economic performance of the VIE and a right to receive benefits or absorb losses of the entity that could be potentially significant to the VIE. The Company is required to reconsider its evaluation of whether to consolidate a VIE each reporting period, based upon changes in the facts and circumstances pertaining to the VIE.

The Company has entered into securitization transactions which result in the Company consolidating the VIEs that were created to facilitate the transactions and to which the underlying assets in connection with the securitizations were transferred. In determining the accounting treatment to be applied to these securitization transactions, the Company evaluated whether the entities used to facilitate these transactions were VIEs and, if so, whether they should be consolidated. Based on its evaluation, the Company concluded that the VIEs should be consolidated. If the Company had determined that consolidation was not required, it would have then assessed whether the transfer of the underlying assets would qualify as a sale or should be accounted for as secured financings under GAAP.

Prior to the completion of its initial securitization transaction in October 2010, the Company had not transferred assets to VIEs or Qualifying Special Purpose Entities ("QSPEs") and other than acquiring MBS issued by such entities, had no other involvement with VIEs or QSPEs. (See Note 15)

(q) Offering Costs Related to Issuance and Redemption of Preferred Stock

Offering costs related to issuance of preferred stock are recorded as a reduction in Additional paid-in capital, a component of stockholders' equity, at the time such preferred stock is issued. On redemption of preferred stock, any excess of the fair value of the consideration transferred to the holders of the preferred stock over the carrying amount of the preferred stock in the Company's consolidated balance sheets is included in the determination of Net Income Available to Common Stock and Participating Securities in the calculation of EPS. (See Notes 11 and 12)

(r) New and Proposed Accounting Standards and Interpretations

Accounting Standards Adopted in 2013

Balance Sheet

In December 2011, the FASB issued ASU 2011-11, Disclosures about Offsetting Assets and Liabilities, ("ASU 2011-11") regarding disclosures concerning the offsetting of assets and liabilities. Under ASU 2011-11, an entity is required to disclose both gross information and net information about both instruments and transactions eligible for offset in the statement of financial position and instruments and transactions subject to an agreement similar to a master netting arrangement. The scope includes derivatives, sale and repurchase agreements and reverse sale and repurchase agreements, and securities borrowing and securities lending arrangements. This disclosure is intended to support further the convergence of U.S. GAAP and International Financial Reporting Standards requirements. ASU 2011-11 was effective for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods.

In January 2013, the FASB issued ASU 2013-01, Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities (“ASU 2013-01”). The main objective of this ASU is to limit the scope of the new balance sheet and offsetting disclosure requirements of ASU 2011-11 to certain derivatives (including bifurcated embedded derivatives,) repurchase agreements and reverse repurchase agreements, and securities borrowing and securities lending transactions. The amendments of ASU 2013-01 should be applied for fiscal years beginning on or after January 1, 2013, and interim periods within those annual periods. An entity should provide the required disclosures retrospectively for all comparative periods presented.

The Company’s adoption of ASU 2011-11 and ASU 2013-01 beginning on January 1, 2013 did not have a material impact on the Company’s consolidated financial statements.

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Comprehensive Income

In February 2013, the FASB issued ASU 2013-02, Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income (“ASU 2013-02”). The amendments of this ASU do not change the current requirements for reporting net income or OCI in financial statements. However, the amendments require an entity to provide information about the amounts reclassified out of AOCI by component. In addition, an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of AOCI by the respective line items of net income but only if the amount reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures required under U.S. GAAP that provide additional detail about those amounts. ASU 2013-02 was effective prospectively for the Company for reporting periods beginning after December 15, 2012. The Company’s adoption of ASU 2013-02 beginning on January 1, 2013 did not have a material impact on the Company’s consolidated financial statements.

Derivatives and Hedging

In July 2013, the FASB issued ASU 2013-10, Inclusion of the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) as a Benchmark Interest Rate for Hedge Accounting Purposes (a consensus of the FASB Emerging Issues Task Force) (“ASU 2013-10”). The amendments of this ASU apply to all entities that elect to apply hedge accounting of the benchmark interest rate under Derivatives and Hedging (FASB Accounting Standards Codification Topic 815). ASU 2013-10 permits the Federal Funds Effective Rate (also referred to as the Overnight Index Swap Rate, or OIS) to be used as a U.S. benchmark interest rate for hedge accounting purposes in addition to the interest rates on direct Treasury obligations of the U.S. government and London Interbank Offered Rate. ASU 2013-10 was effective prospectively for qualifying new or redesignated hedging relationships entered into on or after July 17, 2013. The Company’s adoption of ASU 2103-10 is not expected to have a material impact on the Company’s consolidated financial statements.

Recent Accounting Standards to be Adopted in Future Periods

Financial Services - Investment Companies

In June 2013, the FASB issued ASU 2013-08, Financial Services - Investment Companies: Amendments to the Scope, Measurement, and Disclosure Requirements (“ASU 2013-08”). In general, the amendments of this ASU: (i) revise the definition of an investment company; (ii) require an investment company to measure non-controlling ownership interests in other investment companies at fair value rather than using the equity method of accounting; and (iii) require information to be disclosed concerning the status of the entity and any financial support provided, or contractually required to be provided, by the investment company to its investees. ASU 2013-08 is effective for interim and annual periods that begin after December 15, 2013 and early application is prohibited. As the FASB has decided to retain the current U.S. GAAP scope exception from investment company accounting and financial reporting for real estate investment trusts, the adoption of this ASU will not have a material impact on the Company’s consolidated financial statements.

Proposed Accounting Standards

The FASB has recently issued or discussed a number of proposed standards on such topics as repurchase agreements and similar transactions, measurement of credit impairment, financial instrument measurement and classification, revenue recognition, leases, hedging, disclosures about liquidity risk and interest rate risk, and disclosures of uncertainties about an Entity's going concern presumption. Some of the proposed changes are potentially 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.

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3. MBS

The Company's MBS are comprised of Agency MBS and Non-Agency MBS. These MBS are secured by: (i) hybrid mortgages ("Hybrids"), which have interest rates that are fixed for a specified period of time and, thereafter, generally adjust annually to an increment over a specified interest rate index; (ii) adjustable-rate mortgages ("ARMs"); (iii) mortgages that have interest rates that reset more frequently (collectively, "ARM-MBS"); and (iv) 15 year and longer-term fixed rate mortgages. MBS do not have a single maturity date, and further, the mortgage loans underlying ARM-MBS do not all reset at the same time.

The Company pledges a significant portion of its MBS as collateral against its borrowings under repurchase agreements and Swaps. Non-Agency MBS that are accounted for as components of Linked Transactions are not reflected in the tables set forth in this note, as they are accounted for as derivatives. (See Notes 5 and 7)

Agency MBS: Agency MBS are guaranteed as to principal and/or interest by a federally chartered corporation, such as Fannie Mae or Freddie Mac, or an agency of the U.S. Government, such as Ginnie Mae. The payment of principal and/or interest on Ginnie Mae MBS is explicitly backed by the full faith and credit of the U.S. Government. Since the third quarter of 2008, Fannie Mae and Freddie Mac have been under the conservatorship of the Federal Housing Finance Agency, which significantly strengthened the backing for these government-sponsored entities.

Non-Agency MBS (including Non-Agency MBS transferred to consolidated VIEs): The Company's Non-Agency MBS are secured by pools of residential mortgages, which are not guaranteed by an agency of the U.S. Government or any federally chartered corporation. Non-Agency MBS may be rated by one or more Rating Agencies or may be unrated (i.e., not assigned a rating by any Rating Agency). The rating indicates the opinion of the Rating Agency as to the creditworthiness of the investment, indicating the obligor's ability to meet its full financial commitment on the obligation. A rating of "D" is assigned when a security has defaulted on any of its contractual terms.

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The following tables present certain information about the Company's MBS at September 30, 2013 and December 31, 2012:

September 30, 2013

(In Thousands)	Principal/ Current Face	Purchase Premiums	Accretable Purchase Discounts	Discount Designated as Credit Reserve and OTTI (1)	Amortized Cost (2)	Fair Value	Gross Unrealized Gains	Gross Unrealized Losses	Net Unrealized Gain/(Loss)
Agency MBS:									
Fannie Mae	\$5,197,165	\$180,854	\$(95)	) \$—	\$5,377,924	\$5,440,656	\$104,702	\$(41,970)	\$62,732
Freddie Mac	1,208,358	46,134	—	—	1,257,912	1,243,489	11,258	(25,681)	(14,423)
Ginnie Mae	12,988	224	—	—	13,212	13,544	332	—	332
Total Agency MBS	6,418,511	227,212	(95)	) —	6,649,048	6,697,689	116,292	(67,651)	48,641
Non-Agency MBS (3)									
Rated AAA	16,889	85	(177)	) —	16,797	17,180	383	—	383
Rated A	698	15	—	—	713	681	—	(32)	(32)
Rated BBB	46,717	536	(1,182)	) —	46,071	46,645	1,434	(860)	574
Rated BB	104,253	45	(7,734)	) (861)	95,703	100,228	4,746	(221)	4,525
Rated B	273,241	—	(33,804)	) (7,003)	232,434	257,247	24,859	(46)	24,813
Rated CCC	1,244,536	12	(135,061)	) (190,357)	919,130	1,084,830	168,233	(2,533)	165,700
Rated CC	384,617	—	(36,426)	) (87,400)	260,791	309,776	49,017	(32)	48,985
Rated C	340,721	—	(40,131)	) (49,164)	251,426	297,497	46,252	(181)	46,071
Unrated and D-rated (4)	3,453,991	—	(188,393)	) (784,207)	2,481,391	2,859,294	382,767	(4,864)	377,903
Total Non-Agency MBS	5,865,663	693	(442,908)	) (1,118,992)	4,304,456	4,973,378	677,691	(8,769)	668,922
Total MBS	\$12,284,174	\$227,905	\$(443,003)	\$(1,118,992)	\$10,953,504	\$11,671,067	\$793,983	\$(76,420)	\$717,563

December 31, 2012

(In Thousands)	Principal/ Current Face	Purchase Premiums	Accretable Purchase Discounts	Discount Designated as Credit Reserve and OTTI (1)	Amortized Cost (2)	Fair Value	Gross Unrealized Gains	Gross Unrealized Losses	Net Unrealized Gain/(Loss)
Agency MBS:									
Fannie Mae	\$5,977,388	\$196,686	\$(58)	) \$—	\$6,174,016	\$6,351,621	\$178,970	\$(1,365)	\$177,605
Freddie Mac	800,854	30,447	—	—	835,724	858,560	22,925	(89)	22,836
Ginnie Mae	14,526	251	—	—	14,777	15,279	502	—	502
Total Agency MBS	6,792,768	227,384	(58)) —	7,024,517	7,225,460	202,397	(1,454)	200,943
Non-Agency MBS (3)									

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Rated AAA	25,209	158	(219)	—	25,148	25,905	757	—	757
Rated A	1,147	24	—	—	1,171	1,086	—	(85)	(85)
Rated BBB	49,301	637	(1,741)	(378)	47,819	48,563	1,806	(1,062)	744
Rated BB	118,031	39	(8,892)	(853)	108,325	112,905	4,937	(357)	4,580
Rated B	247,532	—	(31,133)	(12,462)	203,937	225,281	21,452	(108)	21,344
Rated CCC	1,235,638	14	(107,618)	(201,126)	926,908	1,055,757	131,826	(2,977)	128,849
Rated CC	579,632	—	(41,191)	(132,061)	406,380	468,017	61,739	(102)	61,637
Rated C	952,984	—	(55,294)	(166,529)	731,161	812,523	81,850	(488)	81,362
Unrated and D-rated (4)	3,300,086	—	(125,538)	(867,097)	2,307,451	2,632,128	325,796	(1,119)	324,677
Total									
Non-Agency MBS	6,509,560	872	(371,626)	(1,380,506)	4,758,300	5,382,165	630,163	(6,298)	623,865
Total MBS	\$13,302,328	\$228,256	\$(371,684)	\$(1,380,506)	\$11,782,817	\$12,607,625	\$832,560	\$(7,752)	\$824,808

(1) Discount designated as Credit Reserve and amounts related to OTTI are generally not expected to be accreted into interest income. Amounts disclosed at September 30, 2013 reflect Credit Reserve of \$1.074 billion and OTTI of \$45.0 million. Amounts disclosed at December 31, 2012 reflect Credit Reserve of \$1.332 billion and OTTI of \$48.7 million.

(2) Includes principal payments receivable of \$3.4 million and \$4.4 million at September 30, 2013 and December 31, 2012, respectively, which are not included in the Principal/Current Face.

(3) Non-Agency MBS, including Non-Agency MBS transferred to consolidated VIEs, are reported based on the lowest rating issued by a Rating Agency, if more than one rating is issued on the security, at the date presented.

(4) Includes Non-Agency MBS that were D-rated and had an aggregate amortized cost and fair value of \$2.436 billion and \$2.805 billion, respectively, at September 30, 2013 and Non-Agency MBS that were D-rated and had an aggregate amortized cost and fair value of \$2.252 billion and \$2.573 billion, respectively, at December 31, 2012.

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Unrealized Losses on MBS and Impairments

The following table presents information about the Company's MBS that were in an unrealized loss position at September 30, 2013:

Unrealized Loss Position For:

(In Thousands)	Less than 12 Months			12 Months or more			Total	
	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses
Agency MBS:								
Fannie Mae	\$1,796,814	\$38,545	154	\$119,958	\$3,425	29	\$1,916,772	\$41,970
Freddie Mac	775,718	23,955	100	42,551	1,726	6	818,269	25,681
Total Agency MBS	2,572,532	62,500	254	162,509	5,151	35	2,735,041	67,651
Non-Agency MBS:								
Rated A	—	—	—	681	32	1	681	32
Rated BBB	6,880	74	1	18,421	786	3	25,301	860
Rated BB	—	—	—	2,022	221	3	2,022	221
Rated B	6,690	46	1	—	—	—	6,690	46
Rated CCC	55,983	1,060	7	21,998	1,473	4	77,981	2,533
Rated CC	1,594	32	2	—	—	—	1,594	32
Rated C	8,951	181	1	—	—	—	8,951	181
Unrated and D-rated	252,240	4,832	25	1	32	1	252,241	4,864
Total Non-Agency MBS	332,338	6,225	37	43,123	2,544	12	375,461	8,769
Total MBS	\$2,904,870	\$68,725	291	\$205,632	\$7,695	47	\$3,110,502	\$76,420

At September 30, 2013, the Company did not intend to sell any of its MBS that were in an unrealized loss position, and it is "more likely than not" that the Company will not be required to sell these MBS before recovery of their amortized cost basis, which may be at their maturity. With respect to Non-Agency MBS held by consolidated VIEs, the ability of any entity to cause the sale by the VIE prior to the maturity of these Non-Agency MBS is either specifically precluded, or is limited to specified events of default, none of which have occurred to date.

Gross unrealized losses on the Company's Agency MBS were \$67.7 million at September 30, 2013. Agency MBS are issued by Government Sponsored Entities ("GSEs") that enjoy either the implicit or explicit backing of the full faith and credit of the United States Government. While the Company's Agency MBS are not rated by any rating agency, they are currently perceived by market participants to be of high credit quality, with risk of default limited to the unlikely event that the United States Government would not continue to support the GSEs. In addition the GSEs are currently profitable on a stand-alone basis with such profits being remitted to the U.S. Treasury. Given the credit quality inherent in Agency MBS, the Company does not consider any of the current impairments on its Agency MBS to be credit related. In assessing whether it is more likely than not that it will be required to sell any impaired security before its anticipated recovery, which may be at their maturity, the Company considers for each impaired security, the

significance of each investment, the amount of impairment, the projected future performance of such impaired securities, as well as the Company's current and anticipated leverage capacity and liquidity position. Based on these analyses, the Company determined that at September 30, 2013 any unrealized losses on its Agency MBS were temporary.

Unrealized losses on the Company's Non-Agency MBS (including Non-Agency MBS transferred to consolidated VIEs) were \$8.8 million at September 30, 2013. Based upon the most recent evaluation, the Company does not consider these unrealized losses to be indicative of OTTI and does not believe that these unrealized losses are credit related, but are rather due to non-credit related factors. The Company has reviewed its Non-Agency MBS that are in an unrealized loss position to identify those securities with losses that are other-than-temporary based on an assessment of changes in expected cash flows for such MBS, which considers recent bond performance and expected future performance of the underlying collateral.

Non-Agency MBS on which OTTI is recognized have experienced, or are expected to experience, credit-related adverse cash flow changes. The Company's estimate of cash flows for its Non-Agency MBS is based on its review of the underlying mortgage

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loans securing these MBS. The Company considers information available about the structure of the securitization, including structural credit enhancement, if any, and the past and expected future performance of underlying mortgage loans, including timing of expected future cash flows, prepayment rates, default rates, loss severities, delinquency rates, percentage of non-performing loans, FICO scores at loan origination, year of origination, loan-to-value ratios, geographic concentrations, as well as Rating Agency reports, general market assessments, and dialogue with market participants. Changes in the Company's evaluation of each of these factors impacts the cash flows expected to be collected at the OTTI assessment date. For Non-Agency MBS purchased at a discount to par that were assessed for OTTI during the quarter, such cash flow estimates indicated that the amount of expected losses decreased compared to the previous OTTI assessment date. These positive cash flow changes are primarily driven by recent improvements in loan-to-value ratios due to loan amortization and home price appreciation, which, in turn, positively impacts the Company's estimates of default rates and loss severities for the underlying collateral. In addition, voluntary prepayments (i.e. loans that prepay in full with no loss) have generally trended higher for these MBS which also positively impacts the Company's estimate of expected loss. Overall, the combination of higher voluntary prepayments and lower loan-to-value ratios supports the Company's assessment that such MBS are not other-than-temporarily impaired. Significant judgment is used in both the Company's analysis of the expected cash flows for its Non-Agency MBS and any determination of the credit component of OTTI.

The following table presents the composition of OTTI charges recorded by the Company for the three and nine months ended September 30, 2013 and 2012:

(In Thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Total OTTI losses	\$—	\$—	\$—	\$(879)
OTTI reclassified from OCI	—	—	—	(321)
OTTI recognized in earnings	\$—	\$—	\$—	\$(1,200)

The following table presents a roll-forward of the credit loss component of OTTI on the Company's Non-Agency MBS for which a non-credit component of OTTI was previously recognized in OCI. Changes in the credit loss component of OTTI are presented based upon whether the current period is the first time OTTI was recorded on a security or a subsequent OTTI charge was recorded.

(In Thousands)	Three Months Ended September 30,	Nine Months Ended September 30,
	2013	2013
Credit loss component of OTTI at beginning of period	\$36,115	\$36,115
Additions for credit related OTTI not previously recognized	—	—
Subsequent additional credit related OTTI recorded	—	—
Credit loss component of OTTI at end of period	\$36,115	\$36,115

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The significant inputs considered and assumptions made at time of impairment in determining the measurement of the component of OTTI recorded in earnings for the Company's Non-Agency MBS for the three and nine months ended September 30, 2013 and 2012 are summarized as follows:

	Three Months Ended September		Nine Months Ended September	
	30,	2012	30,	2012
	2013		2013	
Credit enhancement (1)(2)				
Weighted average (3)	—	—	—	3.26%
Range (4)	—	—	—	0.00-16.50%
Projected CPR (2)(5)				
Weighted average (3)	—	—	—	9.90%
Range (4)	—	—	—	9.10-13.30%
Projected Loss Severity (2)(6)				
Weighted average (3)	—	—	—	55.50%
Range (4)	—	—	—	45.90-60.00%
60+ days delinquent (2)(7)				
Weighted average (3)	—	—	—	24.40%
Range (4)	—	—	—	18.20-32.40%

(1) Represents a level of protection for these securities, expressed as a percentage of total current underlying loan balance.

(2) Information provided is based on loans for all groups that provide credit enhancement for MBS with credit enhancement. If an MBS no longer has credit enhancement, information provided is based on loans for the individual group owned by the Company.

(3) Calculated by weighting the relevant input/assumptions for each individual security by current outstanding face of the security.

(4) Represents the range of inputs/assumptions based on individual securities.

(5) CPR - conditional prepayment rate.

(6) Projected loss severity represents the projected amount of loss realized on liquidated properties as a percentage of the principal balance.

(7) Includes, for each security, underlying loans 60 or more days delinquent, foreclosed loans and other real estate owned.

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Purchase Discounts on Non-Agency MBS

The following tables present the changes in the components of the Company's purchase discount on its Non-Agency MBS between purchase discount designated as Credit Reserve and OTTI and accretable purchase discount for the three and nine months ended September 30, 2013 and 2012:

(In Thousands)	Three Months Ended September 30, 2013		Three Months Ended September 30, 2012	
	Discount Designated as Credit Reserve and OTTI (1)	Accretable Discount (1)(2)	Discount Designated as Credit Reserve and OTTI (1)	Accretable Discount (1)(2)
Balance at beginning of period	\$(1,264,971)	\$(396,581)	\$(1,440,752)	\$(265,137)
Accretion of discount	—	19,556	—	8,816
Realized credit losses	48,642	—	49,314	—
Purchases	(851)	879	(122,266)	4,554
Sales	27,178	4,248	—	—
Unlinking of Linked Transactions	—	—	—	(2,256)
Transfers/release of credit reserve	71,010	(71,010)	54,053	(54,053)
Balance at end of period	\$(1,118,992)	\$(442,908)	\$(1,459,651)	\$(308,076)

(In Thousands)	Nine Months Ended September 30, 2013		Nine Months Ended September 30, 2012	
	Discount Designated as Credit Reserve and OTTI (3)	Accretable Discount (2)(3)	Discount Designated as Credit Reserve and OTTI (3)	Accretable Discount (2)(3)
Balance at beginning of period	\$(1,380,506)	\$(371,626)	\$(1,228,766)	\$(250,479)
Accretion of discount	—	48,305	—	28,107
Realized credit losses	137,324	—	107,229	—
Purchases	(74,238)	30,533	(370,649)	(3,883)
Sales	38,150	10,158	—	—
Reclass discount for OTTI	—	—	866	(866)
Net impairment losses recognized in earnings	—	—	(1,200)	—
Unlinking of Linked Transactions	—	—	(38,662)	(9,424)
Transfers/release of credit reserve	160,278	(160,278)	71,531	(71,531)
Balance at end of period	\$(1,118,992)	\$(442,908)	\$(1,459,651)	\$(308,076)

(1) During the three months ended September 30, 2013, the Company did not reallocate any purchase discount designated as Credit Reserve to accretable purchase discount on Non-Agency MBS underlying Linked Transactions. The Company reallocated \$54,000 of purchase discount designated as Credit Reserve to accretable purchase discount on Non-Agency MBS underlying Linked Transactions during the three months ended September 30, 2012.

(2) Together with coupon interest, accretable purchase discount is recognized as interest income over the life of the security.

(3) During the nine months ended September 30, 2013, the Company reallocated \$129,000 of purchase discount designated as Credit Reserve to accretable purchase discount on Non-Agency MBS underlying Linked Transactions. In addition, the Company reallocated \$575,000 of purchase discount designated as accretable purchase discount to Credit Reserve on Non-Agency MBS underlying Linked Transactions during the nine months ended September 30, 2012.

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Impact of MBS on AOCI

The following table presents the impact of the Company's MBS on its AOCI for the three and nine months ended September 30, 2013 and 2012:

(In Thousands)	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2013	2012	2013	2012
AOCI from MBS:				
Unrealized gain on MBS at beginning of period	\$700,871	\$296,007	\$824,808	\$55,491
Unrealized gain/(loss) on Agency MBS, net	15,469	61,999	(152,302)	47,169
Unrealized gain on Non-Agency MBS, net	16,381	409,742	62,455	666,287
Reclassification adjustment for MBS sales included in net income	(15,158)	(3,130)	(17,398)	(5,529)
Reclassification adjustment for OTTI included in net income	—	—	—	1,200
Change in AOCI from MBS	\$16,692	\$468,611	\$(107,245)	\$709,127
Balance at end of period	\$717,563	\$764,618	\$717,563	\$764,618

Sales of MBS

During the three and nine months ended September 30, 2013, the Company sold certain Non-Agency MBS for \$102.2 million and \$118.2 million, realizing gross gains of \$13.7 million and \$19.7 million, respectively. During the three and nine months ended September 30, 2012, the Company sold certain Agency MBS for \$66.0 million and \$137.1 million, realizing gross gains of \$4.3 million and \$7.2 million, respectively. The Company has no continuing involvement with any of the sold MBS.

MBS Interest Income

The following table presents the components of interest income on the Company's Agency MBS for the three and nine months ended September 30, 2013 and 2012:

(In Thousands)	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2013	2012	2013	2012
Coupon interest	\$51,997	\$61,978	\$163,986	\$187,963
Effective yield adjustment (1)	(15,839)	(14,780)	(47,004)	(37,915)
Agency MBS interest income	\$36,158	\$47,198	\$116,982	\$150,048

(1) Includes amortization of premium paid net of accretion of purchase discount. For Agency MBS, interest income is recorded at an effective yield, which reflects net premium amortization based on actual prepayment activity.

The following table presents components of interest income for the Company's Non-Agency MBS (including MBS transferred to consolidated VIEs) for the three and nine months ended September 30, 2013 and 2012:

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(In Thousands)	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2013	2012	2013	2012
Coupon interest	\$62,802	\$69,139	\$196,688	\$196,144
Effective yield adjustment (1)	19,501	8,760	48,128	27,913
Non-Agency MBS interest income	\$82,303	\$77,899	\$244,816	\$224,057

(1) The effective yield adjustment is the difference between the net income calculated using the net yield, which is based on management's estimates of future cash flows for Non-Agency MBS, less the current coupon yield.

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4. Interest Receivable

The following table presents the Company's interest receivable by investment category at September 30, 2013 and December 31, 2012:

(In Thousands)	September 30, 2013	December 31, 2012
MBS interest receivable:		
Fannie Mae	\$ 14,252	\$ 17,597
Freddie Mac	3,257	2,696
Ginnie Mae	21	24
Non-Agency MBS	20,253	23,707
Total MBS interest receivable	37,783	44,024
Money market and other investments	21	9
Total interest receivable	\$ 37,804	\$ 44,033

5. Derivative Instruments

The Company's derivative instruments are primarily comprised of Swaps, which are designated as cash flow hedges against the interest rate risk associated with its borrowings. The Company has also entered into TBA short positions and Linked Transactions, both of which are not designated as hedging instruments. The following table presents the fair value of the Company's derivative instruments and their balance sheet location at September 30, 2013 and December 31, 2012:

Derivative Instrument	Designation	Balance Sheet Location	September 30, 2013 Notional Amount	September 30, 2013 Fair Value	December 31, 2012
(In Thousands)					
Linked Transactions	Non-Hedging	Assets	N/A	\$ 23,940	\$ 12,704
Non-cleared legacy Swaps (1)	Hedging	Assets	\$ 450,000	\$ 4,629	\$ 203
Non-cleared legacy Swaps (1)	Hedging	Liabilities	\$ 1,479,263	\$ (31,154)	\$ (63,034)
Cleared Swaps (2)	Hedging	Liabilities	\$ 2,150,000	\$ (25,375)	\$ —
TBA short positions	Non-Hedging	Liabilities	N/A	\$ (8,724)	\$ —

(1) Non-cleared legacy Swaps include Swaps executed and settled bilaterally with counterparties without the use of an organized exchange or central clearing house.

(2) Cleared Swaps include Swaps executed bilaterally with a counterparty in the over-the-counter market but then novated to a central clearing house, whereby the central clearing house becomes the counterparty to both of the original counterparties.

Linked Transactions

The Company's Linked Transactions are evaluated on a combined basis, reported as forward (derivative) instruments and presented as assets on the Company's consolidated balance sheets at fair value. The fair value of Linked Transactions reflect the value of the underlying Non-Agency MBS, linked repurchase agreement borrowings and

accrued interest receivable/payable on such instruments. The Company's Linked Transactions are not designated as hedging instruments and, as a result, the change in the fair value and net interest income from Linked Transactions is reported in other income on the Company's consolidated statements of operations.

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The following tables present certain information about the Non-Agency MBS and repurchase agreements underlying the Company's Linked Transactions at September 30, 2013 and December 31, 2012:

Linked Transactions at September 30, 2013

Linked Repurchase Agreements			Linked MBS					
Maturity or Repricing	Balance	Weighted Average Interest Rate	Non-Agency MBS	Fair Value	Amortized Cost	Par/Current Face	Weighted Average Coupon Rate	
(Dollars in Thousands)			(Dollars in Thousands)					
Within 30 days	\$61,642	1.72	% Rated AA	\$9,724	\$9,162	\$9,487	5.00	%
>30 days to 90 days	20,775	1.61	Rated A	2,654	2,138	2,793	1.28	
Total	\$82,417	1.69	% Rated BBB	7,672	6,730	8,149	2.31	
			Rated BB	6,637	6,177	6,773	2.56	
			Rated D	13,921	12,450	16,939	5.80	
			Rated NR	65,623	65,655	66,523	3.85	%
			Total	\$106,231	\$102,312	\$110,664	3.99	%

Linked Transactions at December 31, 2012

Linked Repurchase Agreements			Linked MBS					
Maturity or Repricing	Balance	Weighted Average Interest Rate	Non-Agency MBS	Fair Value	Amortized Cost	Par/Current Face	Weighted Average Coupon Rate	
(Dollars in Thousands)			(Dollars in Thousands)					
Within 30 days	\$13,672	1.57	% Rated AA	\$13,588	\$12,817	\$13,192	5.00	%
>30 days to 90 days	21,599	1.66	Rated A	3,075	2,548	3,342	0.76	
Total	\$35,271	1.63	% Rated BBB	8,299	7,226	8,847	2.55	
			Rated BB	7,365	6,854	7,593	2.75	
			Rated D	15,501	14,372	19,303	5.80	
			Total	\$47,828	\$43,817	\$52,277	4.28	%

At September 30, 2013, Linked Transactions also included approximately \$186,000 of associated accrued interest receivable and \$60,000 of accrued interest payable. At December 31, 2012, Linked Transactions also included approximately \$185,000 of associated accrued interest receivable and \$38,000 of accrued interest payable.

The following table presents certain information about the components of the unrealized net gains and net interest income from Linked Transactions included in the Company's consolidated statements of operations for the three and nine months ended September 30, 2013 and 2012:

Components of Unrealized Net Gains and Net Interest Income from Linked Transactions (In Thousands)	Three Months Ended		Nine Months Ended	
	September 30, 2013	September 30, 2012	September 30, 2013	September 30, 2012
	\$1,109	\$812	\$2,431	\$4,386

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Interest income attributable to MBS underlying Linked Transactions				
Interest expense attributable to linked repurchase agreement borrowings underlying Linked Transactions	(275) (168) (552) (965
Change in fair value of Linked Transactions included in earnings	(290	) 2,533	(94	) 8,023
Unrealized net gains and net interest income from Linked Transactions	\$544	\$3,177	\$1,785	\$11,444

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Swaps

Consistent with market practice, the Company has agreements with its Swap counterparties that provide for the posting of collateral based on the fair values of its derivative contracts. Through this margining process, either the Company or its derivative counterparty may be required to pledge cash or securities as collateral. In addition, Swaps novated to and cleared by a central clearing house are subject to initial margin requirements. Certain derivative contracts provide for cross collateralization with repurchase agreements with the same counterparty.

A number of the Company's Swap contracts include financial covenants, which, if breached, could cause an event of default or early termination event to occur under such agreements. Such financial covenants include minimum net worth requirements and maximum debt-to-equity ratios. If the Company were to cause an event of default or trigger an early termination event pursuant to one of its Swap contracts, the counterparty to such agreement may have the option to terminate all of its outstanding Swap contracts with the Company and, if applicable, any close-out amount due to the counterparty upon termination of the Swap contracts would be immediately payable by the Company. The Company was in compliance with all of its financial covenants through September 30, 2013. At September 30, 2013, the aggregate fair value of assets needed to immediately settle Swap contracts that were in a liability position to the Company, if so required, was approximately \$59.2 million, including accrued interest payable of approximately \$2.6 million.

The following table presents the assets pledged as collateral against the Company's Swap contracts at September 30, 2013 and December 31, 2012:

(In Thousands)	September 30, 2013	December 31, 2012
Agency MBS, at fair value	\$67,255	\$68,915
Restricted cash	59,275	5,016
Total assets pledged against Swaps	\$126,530	\$73,931

The use of derivative hedging instruments exposes the Company to counterparty credit risk. In the event of a default by a derivative counterparty, the Company may not receive payments to which it is entitled under its derivative agreements, and may have difficulty recovering its assets pledged as collateral against such agreements. If, during the term of a derivative contract, a counterparty should file for bankruptcy, the Company may experience difficulty recovering its assets pledged as collateral which could result in the Company having an unsecured claim against such counterparty's assets for the difference between the fair value of the derivative and the fair value of the collateral pledged to such counterparty. At September 30, 2013, all of the Company's derivative counterparties were rated A or better by a Rating Agency.

The Company's derivative hedging instruments, or a portion thereof, could become ineffective in the future if the associated repurchase agreements or securitized debt that such derivatives hedge fail to exist or fail to have terms that match those of the derivatives that hedge such borrowings. At September 30, 2013, all of the Company's derivatives were deemed effective for hedging purposes and no derivatives were terminated during the three and nine months ended September 30, 2013 and 2012.

The Company's Swaps have the effect of modifying the repricing characteristics of the Company's repurchase agreements and securitized debt and cash flows for such liabilities. To date, no cost has been incurred at the inception of a Swap (except for certain transaction fees related to entering in to Swaps cleared through a central clearing house),

pursuant to which the Company agrees to pay a fixed rate of interest and receive a variable interest rate, generally based on one-month or three-month London Interbank Offered Rate ("LIBOR"), on the notional amount of the Swap. The Company has not recognized any change in the value of its derivative hedging instruments in earnings as a result of the hedge or a portion thereof being ineffective during the three and nine months ended September 30, 2013 and 2012.

At September 30, 2013, the Company had Swaps with an aggregate notional amount of \$4.079 billion, which had net unrealized losses of \$51.9 million, and extended 51 months on average with a maximum term of approximately 9.94 years.

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The following table presents certain information with respect to the Company's Swap activity during the three and nine months ended September 30, 2013:

(Dollars in Thousands)	Three Months Ended September 30, 2013		Nine Months Ended September 30, 2013	
New Swaps:				
Aggregate notional amount	\$ 1,750,000		\$ 2,501,000	
Weighted average fixed-pay rate	2.13	%	1.85	%
Initial maturity date	Five years to ten years		Two months to ten years	
Number of new Swaps	14		23	
Swaps amortized/expired:				
Aggregate notional amount	\$ 358,012		\$ 941,300	
Weighted average fixed-pay rate	4.16	%	2.73	%

The following table presents information about the Company's Swaps at September 30, 2013 and December 31, 2012:

Maturity (1)	September 30, 2013			December 31, 2012			
	Notional Amount	Weighted Average Fixed-Pay Interest Rate	Weighted Average Variable Interest Rate (2)	Notional Amount	Weighted Average Fixed-Pay Interest Rate	Weighted Average Variable Interest Rate (2)	
(Dollars in Thousands)							
Within 30 days	\$ 14,509	4.02	% 0.23	% \$ 25,828	3.88	% 0.28	%
Over 30 days to 3 months	19,542	4.16	0.21	30,185	3.96	0.26	
Over 3 months to 6 months	41,851	3.92	0.23	527,275	1.63	0.21	
Over 6 months to 12 months	522,469	1.90	0.18	391,063	4.17	0.22	
Over 12 months to 24 months	830,892	2.17	0.19	685,042	2.28	0.22	
Over 24 months to 36 months	50,000	2.13	0.18	710,171	1.97	0.21	
Over 36 months to 48 months	450,000	0.56	0.18	150,000	1.03	0.21	
Over 48 months to 60 months	550,000	1.49	0.18	—	—	—	
Over 60 months to 72 months	—	—	—	—	—	—	
Over 72 months to 84 months	1,500,000	2.22	0.18	—	—	—	
Over 84 months (3)	100,000	2.75	0.18	—	—	—	
Total Swaps	\$ 4,079,263	1.93	% 0.18	% \$ 2,519,564	2.31	% 0.22	%

(1) Each maturity category reflects contractual amortization and/or maturity of notional amounts.

(2) Reflects the benchmark variable rate due from the counterparty at the date presented, which rate adjusts monthly or quarterly based on one-month or three-month LIBOR, respectively.

(3) Reflects one Swap with a maturity date of July 2023.

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The following table presents the net impact of the Company's derivative hedging instruments on its interest expense and the weighted average interest rate paid and received for such Swaps for the three and nine months ended September 30, 2013 and 2012:

(Dollars in Thousands)	Three Months Ended		Nine Months Ended		
	September 30,		September 30,		
	2013	2012	2013	2012	
Interest expense attributable to Swaps	\$15,888	\$18,138	\$40,884	\$58,275	
Weighted average Swap rate paid	2.07	% 2.72	% 2.15	% 2.74	%
Weighted average Swap rate received	0.20	% 0.27	% 0.20	% 0.29	%

Impact of Derivative Hedging Instruments on AOCI

The following table presents the impact of the Company's derivative hedging instruments on its AOCI for the three and nine months ended September 30, 2013 and 2012:

(In Thousands)	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2013	2012	2013	2012
AOCI from derivative hedging instruments:				
Balance at beginning of period	\$(31,967)	\$(89,823)	\$(62,831)	\$(114,194)
Unrealized (loss)/gain on Swaps, net	(19,934)	11,654	10,930	36,025
Balance at end of period	\$(51,901)	\$(78,169)	\$(51,901)	\$(78,169)

Counterparty Credit Risk

By using derivative hedging instruments, the Company is exposed to counterparty credit risk if counterparties to the derivative contracts do not perform as expected. If a counterparty fails to perform, the Company's counterparty credit risk is equal to the amount reported as a derivative asset on its consolidated balance sheets to the extent that amount exceeds collateral obtained from the counterparty or, if in a net liability position, the extent to which collateral posted exceeds the liability to the counterparty. The amounts reported as a derivative asset/(liability) are derivative contracts in a gain/(loss) position, and to the extent subject to master netting arrangements, net of derivatives in a loss/(gain) position with the same counterparty and collateral received/(pledged). The Company attempts to minimize counterparty credit risk through credit approvals, limits, monitoring procedures, executing master netting arrangements and obtaining collateral, where appropriate. Counterparty credit risk related to the Company's derivative hedging instruments is considered in determining fair value of such derivatives and its assessment of hedge effectiveness.

TBA Short Positions

The Company may also enter into TBA short positions as a means of managing interest rate risk and MBS basis risk associated with its investment and financing activities. A TBA short position is a forward contract for the sale of agency MBS at a predetermined price, face amount, issuer, coupon and stated maturity on an agreed-upon future date. The specific agency MBS that could be delivered into the contract upon the settlement date, published each month by SIFMA, are not known at the time of the transaction.

The Company accounts for TBA short positions as derivative instruments since it cannot assert that it is probable at inception and throughout the term of the TBA contract that it will physically deliver the agency security upon settlement of the contract. The Company presents TBA short positions as either assets or liabilities in Other derivative instruments, at fair value on its consolidated balance sheets. Gains and losses associated with TBA Securities are reported in Other income on the Company's consolidated statements of operations.

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The following table presents the Company's TBA short positions as of September 30, 2013 and December 31, 2012:

(In Thousands)	September 30, 2013				December 31, 2012			
	Principal	Cost Basis (1)	Fair Value (2)	Net Carrying Value (3)	Principal	Cost Basis (1)	Fair Value (2)	Net Carrying Value (3)
TBA short positions	\$350,000	\$343,436	\$352,160	\$(8,724)	\$—	\$—	\$—	\$—

(1) Cost basis represents the forward price to be received for the underlying agency security.

(2) Fair value represents the current fair value of the underlying agency security as of period-end.

(3) Net carrying value represents the difference between the fair value of the underlying agency security as of period-end and the cost basis and is reported in Other derivative instruments, at fair value in the Company's consolidated balance sheets. Gains and losses associated with TBA short positions are reported in Other income on the Company's consolidated statement of operations.

6. Repurchase Agreements

The Company's repurchase agreements are collateralized by the Company's MBS and U.S. Treasury securities (obtained as part of a reverse repurchase agreement) and cash and bear interest that is generally LIBOR-based. (See Note 7) At September 30, 2013, the Company's borrowings under repurchase agreements had a weighted average remaining term-to-interest rate reset of 28 days and an effective repricing period of twenty-four months, including the impact of related Swaps. At December 31, 2012, the Company's borrowings under repurchase agreements had a weighted average remaining term-to-interest rate reset of 28 days and an effective repricing period of five months, including the impact of related Swaps.

The following table presents information with respect to the Company's borrowings under repurchase agreements and associated assets pledged as collateral at September 30, 2013 and December 31, 2012:

(Dollars in Thousands)	September 30, 2013	December 31, 2012
Repurchase agreement borrowings secured by Agency MBS	\$5,895,943	\$6,353,489
Fair Value of Agency MBS pledged as collateral under repurchase agreements	\$6,215,474	\$6,678,384
Weighted average haircut on Agency MBS (1)	4.62	% 4.80 %
Repurchase agreement borrowings secured by Non-Agency MBS (2)	\$2,425,350	\$1,988,172
Fair Value of Non-Agency MBS pledged as collateral under repurchase agreements (2)(3)	\$3,721,195	\$3,463,128
Weighted average haircut on Non-Agency MBS (1)	31.91	% 30.49 %
Repurchase agreements secured by U.S. Treasuries	\$246,878	\$410,811
Fair value of U.S. Treasuries pledged as collateral under repurchase agreements	\$252,796	\$408,833
Weighted average haircut on U.S. Treasuries (1)	2.00	% 1.74 %

(1) Haircut represents the percentage amount by which the collateral value is contractually required to exceed the loan amount on the Company's repurchase agreements borrowings.

(2) Does not reflect Non-Agency MBS and repurchase agreement borrowings that are components of Linked Transactions.

(3) Includes \$1.883 billion and \$1.860 billion of Non-Agency MBS acquired from consolidated VIEs at September 30, 2013, and December 31, 2012, respectively, that are eliminated from the Company's consolidated balance sheets.

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The following table presents repricing information about the Company's borrowings under repurchase agreements, which does not reflect the impact of associated derivative hedging instruments, at September 30, 2013 and December 31, 2012:

Time Until Interest Rate Reset	September 30, 2013		December 31, 2012		
	Balance (1)	Weighted Average Interest Rate	Balance (1)	Weighted Average Interest Rate	
(Dollars in Thousands)					
Within 30 days	\$5,841,947	0.59	% \$6,293,802	0.71	%
Over 30 days to 3 months	1,245,570	1.21	2,458,670	1.21	
Over 6 months to 12 months	1,064,122	0.69	—	—	
Over 12 months	416,532	2.10	—	—	
Total	\$8,568,171	0.76	% \$8,752,472	0.85	%

(1) At September 30, 2013 and December 31, 2012, the Company had repurchase agreements of \$82.4 million and \$35.3 million, respectively, that were linked to Non-Agency MBS purchases and accounted for as Linked Transactions, and as such, the linked repurchase agreements are not included in the above table. (See Note 5)

The following table at September 30, 2013 presents contractual maturity information about the Company's borrowings under repurchase agreements and does not reflect the impact of derivative contracts that hedge such repurchase agreements:

Contractual Maturity	September 30, 2013		
	Balance (1)	Weighted Average Interest Rate	
(Dollars in Thousands)			
Overnight	\$—	—	%
Within 30 days	6,964,976	0.64	
Over 30 days to 90 days	1,368,088	1.19	
Over 90 days to 12 months	235,107	1.93	
Total	\$8,568,171	0.76	%

(1) At September 30, 2013, the Company had repurchase agreements of \$82.4 million that were linked to Non-Agency MBS purchases and were accounted for as Linked Transactions, and as such, the linked repurchase agreements are not included in the above table. (See Note 5)

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The Company had repurchase agreements with 27 counterparties at September 30, 2013 and 26 counterparties at December 31, 2012. The following table presents information with respect to any counterparty for repurchase agreements and/or Linked Transactions for which the Company had greater than 5% of stockholders' equity at risk in the aggregate at September 30, 2013:

Counterparty	Counterparty Rating (1)	Amount at Risk (2)	Weighted Average Months to Maturity for Repurchase Agreements	Percent of Stockholders' Equity	
(Dollars in Thousands)					
Alpine Securitization Corporation/Credit Suisse (3)	A-1/P-1/F1	\$727,812	2	23.7	%
Wells Fargo (4)	AA-/Aa3/AA-	365,222	8	11.9	
RBS	A-/Baa1/A	246,671	2	8.0	
UBS (5)(6)	A/A2/A	244,076	21	7.9	

(1) As rated at September 30, 2013 by S&P, Moody's and Fitch, Inc., respectively. The counterparty rating presented is the lowest published for these entities.

(2) The amount at risk reflects the difference between (a) the amount loaned to the Company through repurchase agreements and repurchase agreements underlying Linked Transactions, including interest payable, and (b) the cash and the fair value of the securities pledged by the Company as collateral and MBS underlying Linked Transaction, including accrued interest receivable on such securities.

(3) Includes \$710.2 million at risk with Alpine Securitization Corporation and \$17.6 million at risk with Credit Suisse Securities (USA) LLC. Alpine Securitization Corporation is a special purpose funding vehicle that is a consolidated affiliate of Credit Suisse Group. Counterparty rating shown is the asset backed short term rating for Alpine Securitization Corporation.

(4) Includes \$246.7 million at risk with Wells Fargo Bank, NA and \$118.5 million at risk with Wells Fargo Securities LLC.

(5) Includes \$242.7 million at risk with UBS AG and \$1.3 million at risk with UBS Securities LLC.

(6) Includes Non-Agency MBS pledged as collateral with contemporaneous repurchase and reverse repurchase agreements.

7. Collateral Positions

The Company pledges securities or cash as collateral to its counterparties pursuant to its borrowings under repurchase agreements and its derivative contracts that are in an unrealized loss position, and it receives securities or cash as collateral pursuant to financing provided under reverse repurchase agreements and certain of its derivative contracts in an unrealized gain position. The Company exchanges collateral with its counterparties based on changes in the fair value, notional amount and term of the associated repurchase and reverse repurchase agreements and derivative contracts, as applicable. Through this margining process, either the Company or its counterparty may be required to pledge cash or securities as collateral. In addition, Swaps novated to and cleared by a central clearing house are subject to initial margin requirements. When the Company's pledged collateral exceeds the required margin, the Company may initiate a reverse margin call, at which time the counterparty may either return the excess collateral, or provide collateral to the Company in the form of cash or high-quality securities.

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The following table summarizes the fair value of the Company's collateral positions, which includes collateral pledged and collateral held, with respect to its borrowings under repurchase agreements, reverse repurchase agreements and derivative hedging instruments at September 30, 2013 and December 31, 2012:

(In Thousands)	September 30, 2013		December 31, 2012	
	Assets Pledged	Collateral Held	Assets Pledged	Collateral Held
Derivative Hedging Instruments:				
Agency MBS	\$67,255	\$—	\$68,915	\$—
Cash (1)	59,275	—	5,016	—
	126,530	—	73,931	—
Repurchase Agreement Borrowings:				
Agency MBS	\$6,215,474	\$—	\$6,678,384	\$—
Non-Agency MBS (2)(3)	3,721,195	—	3,463,128	—
U.S. Treasury securities	252,796	—	408,833	—
	10,189,465	—	10,550,345	—
Reverse Repurchase Agreements:				
U.S. Treasury securities	\$—	\$252,796	\$—	\$408,833
	—	252,796	—	408,833
Total	\$10,315,995	\$252,796	\$10,624,276	\$408,833

(1) Cash pledged as collateral is reported as "restricted cash" on the Company's consolidated balance sheets.

(2) Includes \$1.883 billion and \$1.860 billion of Non-Agency MBS acquired in connection with securitization transactions from consolidated VIEs at September 30, 2013 and December 31, 2012, respectively, that are eliminated from the Company's consolidated balance sheets.

(3) In addition, \$742.9 million and \$759.2 million of Non-Agency MBS are pledged as collateral in connection with contemporaneous repurchase and reverse repurchase agreements entered into with a single counterparty at September 30, 2013 and December 31, 2012, respectively.

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The following table presents detailed information about the Company's assets pledged as collateral pursuant to its borrowings under repurchase agreements and derivative hedging instruments at September 30, 2013:

(In Thousands)	Assets Pledged Under Repurchase Agreements			Assets Pledged Against Derivative Hedging Instruments			Total Fair Value of Assets Pledged and Accrued Interest
	Fair Value/ Carrying Value	Amortized Cost	Accrued Interest on Pledged MBS	Fair Value/ Carrying Value	Amortized Cost	Accrued Interest on Pledged MBS	
U.S. Treasuries	\$252,796	\$252,796	\$—	\$—	\$—	\$—	\$252,796
Fannie Mae	\$5,045,758	\$4,986,669	\$13,209	\$47,530	\$47,091	\$121	\$5,106,618
Freddie Mac	1,167,765	1,182,485	3,013	12,284	12,061	45	1,183,107
Ginnie Mae	1,951	1,921	3	7,441	7,236	12	9,407
Agency MBS	\$6,215,474	\$6,171,075	\$16,225	\$67,255	\$66,388	\$178	\$6,299,132
Rated AAA	\$15,940	\$15,557	\$55	\$—	\$—	\$—	\$15,995
Rated AA	52,894	48,270	173	—	—	—	53,067
Rated A	55,805	49,465	182	—	—	—	55,987
Rated BBB	82,555	74,071	272	—	—	—	82,827
Rated BB	75,162	64,193	227	—	—	—	75,389
Rated B	150,637	133,201	406	—	—	—	151,043
Rated CCC	398,408	342,294	1,457	—	—	—	399,865
Rated CC	94,122	80,288	352	—	—	—	94,474
Rated C	85,490	75,362	266	—	—	—	85,756
Rated D	1,081,697	978,365	5,354	—	—	—	1,087,051
Not Rated	1,628,485	1,131,043	6,657	—	—	—	1,635,142
Non-Agency MBS (1)(2)(3)	\$3,721,195	\$2,992,109	\$15,401	\$—	\$—	\$—	\$3,736,596
Total	\$10,189,465	\$9,415,980	\$31,626	\$67,255	\$66,388	\$178	\$10,288,524

(1) Includes \$1.883 billion of Non-Agency MBS acquired in connection with resecuritization transactions from consolidated VIEs at September 30, 2013, that are eliminated from the Company's consolidated balance sheets.

(2) Reported based on the lowest rating issued by a Rating Agency, if more than one rating is issued on the security, at the date presented.

(3) In addition, \$742.9 million of Non-Agency MBS are pledged as collateral in connection with contemporaneous repurchase and reverse repurchase agreements entered into with a single counterparty at September 30, 2013.

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8. Offsetting Assets and Liabilities

The following tables present information about certain assets and liabilities that are subject to master netting arrangements (or similar agreements) and can potentially be offset on the Company's consolidated balance sheets at September 30, 2013 and December 31, 2012:

Offsetting of Financial Assets and Derivative Assets

(In Thousands)	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Consolidated Balance Sheets	Net Amounts of Gross Amounts Not Offset in the Consolidated Balance Sheets			
			Assets Presented in the Consolidated Balance Sheets	Financial Instruments	Cash Collateral Received	Net Amount
September 30, 2013						
Derivative hedging instruments, at fair value	\$4,629	\$ —	\$ 4,629	\$ (4,629)	\$ —	\$ —
Total	\$4,629	\$ —				