

MFA FINANCIAL, INC.  
Form 10-Q  
November 04, 2014  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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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, 2014

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)

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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)

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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

369,079,139 shares of the registrant’s common stock, \$0.01 par value, were outstanding as of October 30, 2014.

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## MFA FINANCIAL, INC.

## CONSOLIDATED BALANCE SHEETS

(In Thousands Except Per Share Amounts)	September 30, 2014 (Unaudited)	December 31, 2013
<b>Assets:</b>		
Mortgage-backed securities ("MBS"):		
Agency MBS, at fair value (\$5,765,633 and \$6,142,306 pledged as collateral, respectively)	\$ 6,174,176	\$ 6,519,221
Non-Agency MBS, at fair value (\$2,178,412 and \$1,778,067 pledged as collateral, respectively)	3,311,062	2,569,766
Non-Agency MBS transferred to consolidated variable interest entities ("VIEs") (1)	1,452,264	2,282,371
Securities obtained and pledged as collateral, at fair value	442,370	383,743
Cash and cash equivalents	423,891	565,370
Restricted cash	43,751	37,520
Interest receivable	32,499	35,828
Derivative instruments:		
MBS linked transactions, net ("Linked Transactions"), at fair value	190,681	28,181
Interest rate swap agreements ("Swaps"), at fair value	4,322	13,000
Goodwill	7,189	7,189
Prepaid and other assets (See Notes 2(d) and 15)	160,572	29,719
<b>Total Assets</b>	<b>\$ 12,242,777</b>	<b>\$ 12,471,908</b>
<b>Liabilities:</b>		
Repurchase agreements	\$ 8,125,723	\$ 8,339,297
Securitized debt (2)	156,276	366,205
Obligation to return securities obtained as collateral, at fair value	442,370	383,743
8% Senior Notes due 2042 ("Senior Notes")	100,000	100,000
Accrued interest payable	12,172	14,726
Swaps, at fair value	35,493	28,217
Dividends and dividend equivalents rights ("DERs") payable	74,126	73,643
Accrued expenses and other liabilities	42,873	23,826
<b>Total Liabilities</b>	<b>\$ 8,989,033</b>	<b>\$ 9,329,657</b>
Commitments and contingencies (See Note 10)		
<b>Stockholders' Equity:</b>		
Preferred stock, \$.01 par value; 7.50% Series B cumulative redeemable; 8,050 shares authorized; 8,000 shares issued and outstanding (\$200,000 aggregate liquidation preference)	\$ 80	\$ 80
Common stock, \$.01 par value; 886,950 shares authorized; 368,721 and 365,125 shares issued and outstanding, respectively	3,687	3,651
Additional paid-in capital, in excess of par	3,002,549	2,972,369
Accumulated deficit	(570,106 )	(571,544 )
Accumulated other comprehensive income	817,534	737,695
<b>Total Stockholders' Equity</b>	<b>\$ 3,253,744</b>	<b>\$ 3,142,251</b>
<b>Total Liabilities and Stockholders' Equity</b>	<b>\$ 12,242,777</b>	<b>\$ 12,471,908</b>

(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.

Securitized Debt represents third-party liabilities of consolidated VIEs and excludes liabilities of the VIEs acquired (2) by the Company that eliminate on 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,	
	2014	2013	2014	2013
<b>Interest Income:</b>				
Agency MBS	\$33,066	\$36,158	\$110,004	\$116,982
Non-Agency MBS	48,571	43,131	135,199	128,175
Non-Agency MBS transferred to consolidated VIEs	29,303	39,172	105,510	116,641
Cash and cash equivalent investments	20	21	63	93
<b>Interest Income</b>	<b>\$110,960</b>	<b>\$118,482</b>	<b>\$350,776</b>	<b>\$361,891</b>
<b>Interest Expense:</b>				
Repurchase agreements	\$35,935	\$37,113	\$109,354	\$105,185
Securitized debt	1,415	2,830	5,471	9,381
Senior Notes	2,008	2,007	6,023	6,020
<b>Interest Expense</b>	<b>\$39,358</b>	<b>\$41,950</b>	<b>\$120,848</b>	<b>\$120,586</b>
<b>Net Interest Income</b>	<b>\$71,602</b>	<b>\$76,532</b>	<b>\$229,928</b>	<b>\$241,305</b>
<b>Other Income, net:</b>				
Unrealized net gains and net interest income from Linked Transactions	\$2,559	\$544	\$9,586	\$1,785
Unrealized losses on TBA short positions	—	(8,724)	—	(8,724)
Gain on sales of MBS and U.S. Treasury securities, net	13,880	13,680	25,303	19,678
Other, net	1,251	55	1,543	165
<b>Other Income, net</b>	<b>\$17,690</b>	<b>\$5,555</b>	<b>\$36,432</b>	<b>\$12,904</b>
<b>Operating and Other Expense:</b>				
Compensation and benefits	\$5,970	\$5,294	\$18,378	\$15,851
Other general and administrative expense	3,831	3,434	11,461	10,175
Excise tax and interest	—	—	1,175	2,000
Impairment of resecuritization related costs	—	2,031	—	2,031
Other investment related operating expenses	609	—	1,550	—
<b>Operating and Other Expense</b>	<b>\$10,410</b>	<b>\$10,759</b>	<b>\$32,564</b>	<b>\$30,057</b>
<b>Net Income</b>	<b>\$78,882</b>	<b>\$71,328</b>	<b>\$233,796</b>	<b>\$224,152</b>
Less Preferred Stock Dividends	3,750	3,750	11,250	10,000
Less Issuance Costs of Redeemed Preferred Stock	—	—	—	3,947
<b>Net Income Available to Common Stock and Participating Securities</b>	<b>\$75,132</b>	<b>\$67,578</b>	<b>\$222,546</b>	<b>\$210,205</b>
<b>Earnings per Common Share - Basic and Diluted</b>	<b>\$0.20</b>	<b>\$0.19</b>	<b>\$0.60</b>	<b>\$0.58</b>

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Dividends Declared per Share of Common Stock	\$0.20	\$0.50	(1) \$0.60	\$1.44	(1)(2)
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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,	
	2014	2013	2014	2013
Net income	\$78,882	\$71,328	\$233,796	\$224,152
Other Comprehensive (Loss)/Income:				
Unrealized (loss)/gain on Agency MBS, net	(14,937	) 15,469	46,000	(152,302 )
Unrealized (loss)/gain on Non-Agency MBS, net	(28,473	) 16,381	70,973	62,455
Reclassification adjustment for MBS sales included in net income	(13,589	) (15,158 )	(21,180 )	(17,398 )
Unrealized gain/(loss) on derivative hedging instruments, net	23,500	(19,934 )	(16,401 )	10,930
Reclassification of unrealized loss on de-designated derivative hedging instruments	—	—	447	—
Other Comprehensive (Loss)/Income	(33,499	) (3,242 )	79,839	(96,315 )
Comprehensive income before preferred stock dividends and issuance costs of redeemed preferred stock	\$45,383	\$68,086	\$313,635	\$127,837
Dividends declared on preferred stock	(3,750	) (3,750 )	(11,250 )	(10,000 )
Issuance costs of redeemed preferred stock	—	—	—	(3,947 )
Comprehensive Income Available to Common Stock and Participating Securities	\$41,633	\$64,336	\$302,385	\$113,890

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, 2014	
	Dollars	Shares
Preferred Stock, 7.50% Series B Cumulative Redeemable - Liquidation Preference \$25.00 per Share:		
Balance at September 30, 2014 and December 31, 2013	\$80	8,000
Common Stock, Par Value \$.01:		
Balance at December 31, 2013	\$3,651	365,125
Issuance of common stock (1)	36	3,690
Repurchase of shares of common stock (1)	—	(94 )
Balance at September 30, 2014	\$3,687	368,721
Additional Paid-in Capital, in excess of Par:		
Balance at December 31, 2013	\$2,972,369	
Issuance of common stock, net of expenses (1)	26,335	
Equity-based compensation expense	4,357	
Accrued dividends attributable to stock-based awards	(164 )	
Repurchase of shares of common stock (1)	(348 )	
Balance at September 30, 2014	\$3,002,549	
Accumulated Deficit:		
Balance at December 31, 2013	\$(571,544 )	
Net income	233,796	
Dividends declared on common stock	(220,724 )	
Dividends declared on preferred stock	(11,250 )	
Dividends attributable to DERs	(384 )	
Balance at September 30, 2014	\$(570,106 )	
Accumulated Other Comprehensive Income:		
Balance at December 31, 2013	\$737,695	
Change in unrealized gains on MBS, net	95,793	
Change in unrealized losses on derivative hedging instruments, net	(15,954 )	
Balance at September 30, 2014	\$817,534	
Total Stockholders' Equity at September 30, 2014	\$3,253,744	

(1) For the nine months ended September 30, 2014, includes approximately \$721,000 (94,073 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, 2014	2013
Cash Flows From Operating Activities:		
Net income	\$233,796	\$224,152
Adjustments to reconcile net income to net cash provided by operating activities:		
Gain on sales of MBS and U.S. Treasury securities	(25,303	) (19,678
Accretion of purchase discounts on MBS and other investments	(68,871	) (48,322
Amortization of purchase premiums on MBS	25,986	47,198
Depreciation and amortization on fixed assets and other assets	936	3,133
Equity-based compensation expense	4,357	2,946
Unrealized (losses)/gains on derivative instruments	(2,542	) 8,318
Decrease in interest receivable	3,318	6,193
Increase in prepaid and other assets	(19,824	) (5,146
(Decrease)/increase in accrued expenses and other liabilities, and excise tax and interest	(6,434	) 10,837
Increase/(decrease) in accrued interest payable on financial instruments	32,080	(2,503
Net cash provided by operating activities	\$177,499	\$227,128
Cash Flows From Investing Activities:		
Principal payments on MBS and other investments	\$1,470,390	\$2,231,495
Proceeds from sale of MBS and U.S. Treasury securities	103,625	493,613
Purchases of MBS and other investments	(1,068,713	) (1,532,982
Additions to leasehold improvements, furniture and fixtures	(383	) (272
Net cash provided by investing activities	\$504,919	\$1,191,854
Cash Flows From Financing Activities:		
Principal payments on repurchase agreements	\$(62,567,398)	\$(60,312,234)
Proceeds from borrowings under repurchase agreements	62,353,824	60,127,933
Proceeds from issuance of securitized debt	—	76,485
Principal payments on securitized debt	(208,702	) (303,608
Payments made on obligation to return securities obtained as collateral	—	(200,050
Maturity of obligation to return securities obtained as collateral	—	(275,402
Cash disbursements on financial instruments underlying Linked Transactions	(2,738,961	) (254,155
Cash received from financial instruments underlying Linked Transactions	2,583,744	243,325
Payments made for margin calls on repurchase agreements and Swaps	(111,800	) (61,402
Proceeds from reverse margin calls on repurchase agreements and Swaps	70,900	2,000
Proceeds from issuances of common stock	26,371	67,409
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
Payments made to repurchase common stock	—	(27
Dividends paid on preferred stock	(11,250	) (10,000
Dividends paid on common stock and DERs	(220,625	) (514,013
Net cash used in financing activities	\$(823,897	) \$(1,316,423

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Net (decrease)/increase in cash and cash equivalents	\$(141,479 )	\$102,559
Cash and cash equivalents at beginning of period	\$565,370	\$401,293
Cash and cash equivalents at end of period	\$423,891	\$503,852
Non-cash Investing and Financing Activities:		
MBS recorded upon de-linking of Linked Transactions	\$36,258	\$—
Net increase in securities obtained as collateral/obligation to return securities obtained as collateral	\$63,691	\$221,578
Dividends and DERs declared and unpaid	\$74,126	\$81,171

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, 2014

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 Notes 2(n) and 11)

2. Summary of Significant Accounting Policies

(a) Basis of Presentation and Consolidation

The interim unaudited consolidated 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 consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2013. In the opinion of management, all normal and recurring adjustments necessary to present fairly the financial condition of the Company at September 30, 2014 and results of operations for all periods presented have been made. The results of operations for the nine months ended September 30, 2014 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 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(n)). 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. Certain prior period amounts have been reclassified to conform to the current period presentation.

(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, 2014

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 assessed as high credit quality 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 which is the security's internal rate of return ("IRR"). The IRR is determined using 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 IRR/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)

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MFA FINANCIAL, INC.

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2014

Non-Agency MBS that are assessed to be of less than high credit quality and 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 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 ("LTVs"), 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 IRR.

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(o) 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(j) for Repurchase Agreements and Reverse Repurchase Agreements)

(d) Residential Whole Loans

Residential whole loans included in the Company's consolidated balance sheets are comprised of pools of fixed and adjustable rate residential mortgage loans acquired through a consolidated trust. The Company has elected to account for these loans as credit impaired as they were acquired at discounted prices that reflect, in part, the credit history of the borrower. In addition, many of the borrowers have previously experienced payment delinquencies and the amount owed on the mortgage loan may exceed the value of the property pledged as collateral. Consequently, the Company has assessed that these loans have a higher likelihood of default than newly originated mortgage loans with LTVs of



80% or less to credit worthy borrowers. The Company believes that amounts paid to acquire residential whole loans represent fair market value at the date of acquisition. Residential whole loans are initially recorded at fair value with no allowance for loan losses. Subsequent to acquisition, the recorded amount reflects the original investment amount, plus accretion of interest income, less principal and interest cash flows received and principal amounts forgiven or otherwise charged off as they are considered not recoverable. Residential whole loans are presented in Prepaid and other assets in the Company's consolidated balance sheets at carrying value, which reflects the recorded amount net of any allowance for loan losses established subsequent to acquisition.

The Company may aggregate into pools loans acquired in the same fiscal quarter that are assessed as having similar risk characteristics. For each pool established, or on an individual loans basis for loans not aggregated into pools, the Company estimates at acquisition and periodically on at least a quarterly basis, the principal and interest cash flows expected to be collected. The difference between the cash flows expected to be collected and the carrying amount of the loans is referred to as the "accretable yield". This amount is accreted as interest income over the life of the loans using an effective interest rate (level yield) methodology. Interest income recorded each period reflects the amount of accretable yield recognized and not the coupon interest payments

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received on the underlying loans. The difference between contractually required principal and interest payments and the cash flows expected to be collected, referred to as the “nonaccretable difference,” includes estimates of both the impact of prepayments and expected credit losses over the life of the underlying loans.

A decrease in expected cash flows in subsequent periods may indicate impairment at the pool and/or individual loan level thus requiring the establishment of an allowance for loan losses by a charge to the provision for loan losses. The allowance for loan losses represents the present value of cash flows expected at acquisition that are no longer expected to be received at the relevant measurement date. An increase in expected cash flows in subsequent periods initially reduces any previously established allowance for loan losses by the increase in the present value of cash flows expected to be collected, and results in a recalculation of the amount of accretable yield. The adjustment of accretable yield due to an increase in expected cash flows is accounted for prospectively as a change in estimate and results in reclassification from nonaccretable difference to accretable yield. (See Note 15)

(e) Cash and Cash Equivalents

Cash and cash equivalents include cash on deposit with financial institutions and investments in money market funds and U. S. Treasury Bills, 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, 2014 or December 31, 2013. The Company’s investments in 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 were \$314.9 million and \$534.4 million at September 30, 2014 and December 31, 2013, respectively. (See Notes 7 and 14)

(f) 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 and repurchase agreements of \$43.8 million at September 30, 2014 and \$37.5 million held as collateral against its Swaps at December 31, 2013. (See Notes 5, 6, 7 and 14)

(g) Goodwill

At September 30, 2014 and December 31, 2013, 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, 2014, the Company had not recognized any impairment against its goodwill.

(h) 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.

(i) 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 resecuritization 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

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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.

(j) 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(o) 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(o), 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 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))

(k) 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. From 2011 through 2013, the Company granted certain RSUs that vest annually over a one or three-year period, provided that certain criteria are met,

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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. During 2014, the Company made grants of RSUs certain of which generally cliff vest after a three-year period and certain of which generally cliff vest after a three-year period subject to the achievement of a market-based condition that is based on a formula tied to the Company's achievement of average total stockholder return during the three-year period. 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(l) and 13)

(l) 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)

(m) 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 derivative hedging instruments, (to the extent that such changes are not recorded in earnings), adjusted by realized net gains/(losses) reclassified out of AOCI for MBS and de-designated derivative hedging instruments and is reduced by dividends declared on the Company's preferred stock and issuance costs of redeemed preferred stock.

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(n) 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 (excluding net long-term capital gains) to stockholders in the timeframe permitted by the Code. As long as the Company maintains its status as a REIT, the Company will not be subject to regular Federal income tax to the extent that it distributes 100% of its REIT taxable income (including net long-term capital gains) 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, 2014, December 31, 2013, or September 30, 2013. The Company filed its 2013 tax return prior to September 15, 2014. The Company’s tax returns for tax years 2009 through 2013 are open to examination.

(o) Derivative Financial 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, the majority of which are designated as cash flow hedges against the interest rate risk associated with its borrowings. During 2013, the Company 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 for all Swaps designated as hedging transactions. The Company assesses, both at inception of a hedge and on a quarterly basis thereafter, whether or not the hedge is “highly effective.”

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 designated in hedging transactions 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 designated as hedges through earnings as a result of hedge ineffectiveness.

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)

TBA Short Positions

During 2013, the Company 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 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 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 derivative assets or liabilities, 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.

The Company did not have any TBA short positions at September 30, 2014 and December 31, 2013.

(p) 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.

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(q) Variable Interest Entities and Other Consolidated Special Purpose 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 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)

The Company also includes in its consolidated balance sheets certain financial assets and liabilities that are acquired/issued by trusts and/or other special purpose entities that have been evaluated as being required to be consolidated by the Company under the applicable accounting guidance.

(r) 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)

(s) New Accounting Standards and Interpretations

Accounting Standards Adopted in 2014

Financial Services - Investment Companies

In June 2013, the Financial Accounting Standard Board ("FASB") issued Accounting Standards Update ("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. The Company’s adoption of ASU 2013-08 beginning on January 1, 2014 did not have a material impact on the Company’s consolidated financial statements 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.

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3. MBS

The Company's MBS are comprised of Agency MBS and Non-Agency MBS which include MBS issued prior to 2008 ("Legacy Non-Agency MBS") and MBS backed by re-performing/non-performing loans ("RPL/NPL 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. Credit risk associated with Non-Agency MBS is regularly assessed as new information regarding the underlying collateral becomes available and based on updated estimates of cash flows generated by the underlying collateral.

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The following tables present certain information about the Company's MBS at September 30, 2014 and December 31, 2013:

September 30, 2014

(In Thousands)	Principal/ Current Face	Purchase Premiums	Accretible 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	\$4,825,285	\$183,663	\$(73)	\$—	\$5,008,875	\$5,079,098	\$102,619	\$(32,396)	\$70,223
Freddie Mac	1,050,873	40,421	—	—	1,093,168	1,083,010	11,130	(21,288)	(10,158)
Ginnie Mae	11,559	199	—	—	11,758	12,068	310	—	310
Total Agency MBS	5,887,717	224,283	(73)	—	6,113,801	6,174,176	114,059	(53,684)	60,375
Non-Agency MBS:									
Expected to Recover Par (3)(4)	315,003	624	(31,304)	—	284,323	311,950	29,035	(1,408)	27,627
Expected to Recover Less Than Par (3)(5)	5,014,820	—	(395,047)	(929,100)	3,690,673	4,451,376	762,425	(1,722)	760,703
Total Non-Agency MBS	5,329,823	624	(426,351)	(929,100)	3,974,996	4,763,326	791,460	(3,130)	788,330
Total MBS	\$11,217,540	\$224,907	\$(426,424)	\$(929,100)	\$10,088,797	\$10,937,502	\$905,519	\$(56,814)	\$848,705

December 31, 2013

(In Thousands)	Principal/ Current Face	Purchase Premiums	Accretible 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	\$5,092,410	\$181,710	\$(87)	\$—	\$5,274,033	\$5,315,363	\$96,516	\$(55,186)	\$41,330
Freddie Mac	1,171,841	44,967	—	—	1,217,927	1,190,670	9,842	(37,099)	(27,257)
Ginnie Mae	12,668	218	—	—	12,886	13,188	302	—	302
Total Agency MBS	6,276,919	226,895	(87)	—	6,504,846	6,519,221	106,660	(92,285)	14,375
Non-Agency MBS:									
Expected to Recover Par	234,187	638	(24,450)	—	210,375	230,738	21,720	(1,357)	20,363

(3)(4) Expected to Recover Less Than Par (3)(5) Total	5,381,851	—	(435,589 )	(1,043,037 )	3,903,225	4,621,399	720,566	(2,392 )	718,174
Non-Agency MBS	5,616,038	638	(460,039 )	(1,043,037 )	4,113,600	4,852,137	742,286	(3,749 )	738,537
Total MBS	\$11,892,957	\$227,533	\$(460,126)	\$(1,043,037)	\$10,618,446	\$11,371,358	\$848,946	\$(96,034)	\$752,912

- (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, 2014 reflect Credit Reserve of \$897.7 million and OTTI of \$31.4 million. Amounts disclosed at December 31, 2013 reflect Credit Reserve of \$998.5 million and OTTI of \$44.5 million.
- (2) Includes principal payments receivable of \$1.9 million and \$1.1 million at September 30, 2014 and December 31, 2013, respectively, which are not included in the Principal/Current Face.
- (3) Based on management's current estimates of future principal cash flows expected to be received. Includes RPL/NPL MBS which had a \$26.5 million Principal/Current face, \$26.7 million amortized cost and \$26.6 million fair value at September 30, 2014. At December 31, 2013, RPL/NPL MBS had a \$3.9 million Principal/Current face, amortized cost and fair value.
- (5) At September 30, 2014 and December 31, 2013, the Company expected to recover approximately 83% and 81%, respectively, of the then-current face amount of Non-Agency MBS.

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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, 2014:

## Unrealized Loss Position For:

(Dollars 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	\$451,536	\$ 1,639	46	\$1,316,459	\$ 30,757	143	\$1,767,995	\$ 32,396
Freddie Mac	28,903	184	3	702,935	21,104	103	731,838	21,288
Total Agency MBS	480,439	1,823	49	2,019,394	51,861	246	2,499,833	53,684
Non-Agency MBS:								
Expected to Recover Par (1)	29,826	333	3	22,309	1,075	8	52,135	1,408
Expected to Recover Less Than Par (1)	66,674	654	9	20,041	1,068	7	86,715	1,722
Total Non-Agency MBS	96,500	987	12	42,350	2,143	15	138,850	3,130
Total MBS	\$576,939	\$ 2,810	61	\$2,061,744	\$ 54,004	261	\$2,638,683	\$ 56,814

(1) Based on management's current estimates of future principal cash flows expected to be received.

At September 30, 2014, 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 has occurred to date.

Gross unrealized losses on the Company's Agency MBS were \$53.7 million at September 30, 2014. 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 U.S. 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 U.S. 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 its 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, 2014 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 \$3.1 million at September 30, 2014. 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.

The Company did not recognize any credit-related OTTI losses through earnings related to its MBS during the three and nine months ended September 30, 2014 and 2013.

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 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

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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 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, 2014	Nine Months Ended September 30, 2014
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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## 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, 2014 and 2013:

(In Thousands)	Three Months Ended September 30, 2014		Three Months Ended September 30, 2013	
	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	\$(986,842 )	\$(436,111 )	\$(1,264,971 )	\$(396,581 )
Accretion of discount	—	25,504	—	19,556
Realized credit losses	20,733	—	48,642	—
Purchases	(4,200 )	272	(851 )	879
Sales	21,024	4,169	27,178	4,248
Transfers/release of credit reserve	20,185	(20,185 )	71,010	(71,010 )
Balance at end of period	\$(929,100 )	\$(426,351 )	\$(1,118,992 )	\$(442,908 )

(In Thousands)	Nine Months Ended September 30, 2014		Nine Months Ended September 30, 2013	
	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	\$(1,043,037 )	\$(460,039 )	\$(1,380,506 )	\$(371,626 )
Accretion of discount	—	78,701	—	48,305
Realized credit losses	69,129	—	137,324	—
Purchases	(70,535 )	25,314	(74,238 )	30,533
Sales	34,780	10,236	38,150	10,158
Transfers/release of credit reserve	80,563	(80,563 )	160,278	(160,278 )
Balance at end of period	\$(929,100 )	\$(426,351 )	\$(1,118,992 )	\$(442,908 )

The Company reallocated \$333,000 of purchase discount designated as accretable purchase discount to Credit Reserve on Non-Agency MBS underlying Linked Transactions during the three months ended September 30, 2014.

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

(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, 2014, the Company reallocated \$218,000 of purchase discount designated as accretable purchase discount to Credit Reserve on Non-Agency MBS underlying Linked Transactions. In addition, the Company reallocated \$129,000 of purchase discount designated as Credit Reserve to accretable purchase discount on Non-Agency MBS underlying Linked Transactions during the nine months ended

September 30, 2013.

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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, 2014 and 2013:

(In Thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
AOCI from MBS:				
Unrealized gain on MBS at beginning of period	\$905,704	\$700,871	\$752,912	\$824,808
Unrealized (loss)/gain on Agency MBS, net	(14,937 )	15,469	46,000	(152,302 )
Unrealized (loss)/gain on Non-Agency MBS, net	(28,473 )	16,381	70,973	62,455
Reclassification adjustment for MBS sales included in net income	(13,589 )	(15,158 )	(21,180 )	(17,398 )
Change in AOCI from MBS	(56,999 )	16,692	\$95,793	\$(107,245 )
Balance at end of period	\$848,705	\$717,563	\$848,705	\$717,563

## Sales of MBS

During the three and nine months ended September 30, 2014, the Company sold certain Non-Agency MBS for \$61.6 million and \$103.6 million, realizing gross gains of \$13.9 million and \$25.3 million, respectively. 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. 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, 2014 and 2013:

(In Thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Coupon interest	\$46,529	\$51,997	\$145,864	\$163,986
Effective yield adjustment (1)	(13,463 )	(15,839 )	(35,860 )	(47,004 )
Agency MBS interest income	\$33,066	\$36,158	\$110,004	\$116,982

(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, 2014 and 2013:

(In Thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013

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Coupon interest	\$52,396	\$62,802	\$162,148	\$196,688
Effective yield adjustment (1)	25,478	19,501	78,561	48,128
Non-Agency MBS interest income	\$77,874	\$82,303	\$240,709	\$244,816

(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, 2014 and December 31, 2013:

(In Thousands)	September 30, 2014	December 31, 2013
MBS interest receivable:		
Fannie Mae	\$12,599	\$13,760
Freddie Mac	2,728	3,110
Ginnie Mae	18	19
Non-Agency MBS	17,127	18,917
Total MBS interest receivable	32,472	35,806
Money market and other investments	27	22
Total interest receivable	\$32,499	\$35,828

## 5. Derivative Instruments

The Company's derivative instruments are primarily comprised of Swaps, the majority of which are designated as cash flow hedges against the interest rate risk associated with its borrowings. The Company has also entered into Linked Transactions, 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, 2014 and December 31, 2013:

Derivative Instrument	Designation	Balance Sheet Location	September 30, 2014 Notional Amount	September 30, 2014 Fair Value	December 31, 2013
(In Thousands)					
Linked Transactions	Non-Hedging	Assets	N/A	\$190,681	\$28,181
Non-cleared legacy Swaps (1)	Hedging	Assets	\$450,000	\$4,322	\$4,925
Cleared Swaps (2)	Hedging	Assets	\$—	\$—	\$8,075
Non-cleared legacy Swaps (1)	Hedging	Liabilities	\$880,892	\$(8,187)	\$(24,437)
Cleared Swaps (2)	Hedging	Liabilities	\$2,550,000	\$(27,306)	\$(3,780)

(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 Legacy Non-Agency MBS and RPL/NPL MBS and repurchase agreements underlying the Company's Linked Transactions at September 30, 2014 and December 31, 2013:

## Linked Transactions at September 30, 2014

Linked Repurchase Agreements	Linked MBS			Fair Value	Amortized Cost	Par/Current Face	Weighted	
	Balance	Average Interest Rate					Average Coupon Rate	
Maturity or Repricing								
(Dollars in Thousands)			(Dollars in Thousands)					
Within 30 days	\$786,207	1.48 %	Legacy Non-Agency MBS	\$65,656	\$60,588	\$71,982	4.38 %	
>30 days to 90 days	5,600	1.35 %	RPL/NPL MBS	916,652	915,839	917,332	3.36 %	
Total	\$791,807	1.48 %	Total	\$982,308	\$976,427	\$989,314	3.44 %	

## Linked Transactions at December 31, 2013

Linked Repurchase Agreements	Linked MBS			Fair Value	Amortized Cost	Par/Current Face	Weighted	
	Balance	Average Interest Rate					Average Coupon Rate	
Maturity or Repricing								
(Dollars in Thousands)			(Dollars in Thousands)					
Within 30 days	\$93,835	1.76 %	Legacy Non-Agency MBS	\$39,280	\$35,028	\$42,199	3.92 %	
>30 days to 90 days	8,902	1.44 %	RPL/NPL MBS	91,510	91,469	92,231	3.97 %	
Total	\$102,737	1.73 %	Total	\$130,790	\$126,497	\$134,430	3.96 %	

At September 30, 2014, Linked Transactions also included approximately \$709,000 of associated accrued interest receivable and \$529,000 of accrued interest payable. At December 31, 2013, Linked Transactions also included approximately \$210,000 of associated accrued interest receivable and \$82,000 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, 2014 and 2013:

(In Thousands)	Three Months Ended		Nine Months Ended	
	September 30, 2014	2013	September 30, 2014	2013
Interest income attributable to MBS underlying Linked Transactions	\$6,625	\$1,109	\$11,591	\$2,431
Interest expense attributable to linked repurchase agreement borrowings underlying Linked Transactions	(2,246)	(275)	(3,719)	(552)
Change in fair value of Linked Transactions included in earnings	(1,820)	(290)	1,714	(94)

Unrealized net gains and net interest income from Linked Transactions	\$2,559	\$544	\$9,586	\$1,785
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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, 2014. At September 30, 2014, 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 \$37.7 million, including accrued interest payable of approximately \$2.2 million.

The following table presents the assets pledged as collateral against the Company's Swap contracts at September 30, 2014 and December 31, 2013:

(In Thousands)	September 30, 2014	December 31, 2013
Agency MBS, at fair value	\$67,431	\$73,859
Restricted cash	35,351	37,520
Total assets pledged against Swaps	\$102,782	\$111,379

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.

The Company's derivative hedging instruments, or a portion thereof, could become ineffective in the future if the associated repurchase agreements that such derivatives hedge fail to exist or fail to have terms that match those of the derivatives that hedge such borrowings.

The Company's Swaps designated as hedging transactions have the effect of modifying the repricing characteristics of the Company's repurchase agreements 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 did not recognize any change in the value of its existing Swaps designated as hedges

through earnings as a result of hedge ineffectiveness during the three and nine months ended September 30, 2014 and 2013.

At September 30, 2014, the Company had Swaps designated in hedging relationships with an aggregate notional amount of \$3.881 billion, which had net unrealized losses of \$31.2 million, and extended 49 months on average with a maximum term of approximately 107 months.

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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, 2014:

(Dollars in Thousands)	Three Months Ended September 30, 2014	Nine Months Ended September 30, 2014
New Swaps:		
Aggregate notional amount	\$—	\$400,000
Weighted average fixed-pay rate	—	% 1.95
Initial maturity date	N/A	5 years to 7 years
Number of new Swaps	—	Four
Swaps amortized/expired:		
Aggregate notional amount	\$46,322	\$564,320
Weighted average fixed-pay rate	2.84	% 2.05

The following table presents information about the Company's Swaps at September 30, 2014 and December 31, 2013:

Maturity (1)	September 30, 2014			December 31, 2013		
	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	\$56,861	4.67	% 0.17	% \$17,635	3.90	% 0.21
Over 30 days to 3 months	63,860	2.19	0.17	24,216	3.93	0.21
Over 3 months to 6 months	410,171	1.90	0.16	476,147	1.80	0.17
Over 6 months to 12 months	300,000	2.06	0.16	167,043	3.22	0.18
Over 12 months to 24 months	50,000	2.13	0.15	710,171	1.97	0.17
Over 24 months to 36 months	450,000	0.56	0.16	150,000	1.03	0.17
Over 36 months to 48 months	550,000	1.49	0.15	350,000	0.58	0.17
Over 48 months to 60 months	200,000	1.71	0.15	550,000	1.49	0.17
Over 60 months to 72 months	1,500,000	2.22	0.15	—	—	—
Over 72 months to 84 months	200,000	2.20	0.15	1,500,000	2.22	0.17
Over 84 months (3)	100,000	2.75	0.15	100,000	2.75	0.17
Total Swaps	\$3,880,892	1.90	% 0.16	% \$4,045,212	1.91	% 0.17

(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.

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, 2014 and 2013:

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(Dollars in Thousands)	Three Months Ended		Nine Months Ended			
	September 30,		September 30,			
	2014	2013	2014	2013		
Interest expense attributable to Swaps	\$17,491	\$15,888	\$53,129	\$40,884		
Weighted average Swap rate paid	1.91	% 2.07	% 1.92	% 2.15	%	%
Weighted average Swap rate received	0.16	% 0.20	% 0.16	% 0.20	%	%

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## TBA Short Positions

During 2013, the Company 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 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 derivative assets or liabilities, 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. During the three and nine months ended September 30, 2013, the Company recognized an unrealized loss of \$8.7 million on TBA short positions. The Company did not have any TBA short positions at September 30, 2014 and December 31, 2013.

## 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, 2014 and 2013:

(In Thousands)	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2014	2013	2014	2013
AOCI from derivative hedging instruments:				
Balance at beginning of period	\$ (54,671 )	\$ (31,967 )	\$ (15,217 )	\$ (62,831 )
Unrealized gain/(loss) on Swaps, net	23,500	(19,934 )	(16,401 )	10,930
Reclassification of unrealized loss on de-designated Swaps	—	—	447	—
Balance at end of period	\$ (31,171 )	\$ (51,901 )	\$ (31,171 )	\$ (51,901 )

## Counterparty Credit Risk from Use of Swaps

By using Swaps, 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 Swaps is considered in determining fair value of such derivatives and its assessment of hedge effectiveness.

## 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, 2014, the Company's borrowings under repurchase agreements had a weighted average remaining term-to-interest rate reset of 26 days and an effective repricing period of 21 months, including the impact of related Swaps. At December 31, 2013, the Company's borrowings under repurchase agreements had a weighted average remaining term-to-interest rate reset of 25 days and an effective repricing period of 24 months, including the impact of related Swaps.



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The following table presents information with respect to the Company's borrowings under repurchase agreements and associated assets pledged as collateral at September 30, 2014 and December 31, 2013:

(Dollars in Thousands)	September 30, 2014	December 31, 2013		
Repurchase agreement borrowings secured by Agency MBS	\$5,417,797	\$5,750,053		
Fair Value of Agency MBS pledged as collateral under repurchase agreements	\$5,698,202	\$6,068,447		
Weighted average haircut on Agency MBS (1)	4.70	% 4.89		%
Repurchase agreement borrowings secured by Non-Agency MBS (2)	\$2,263,910	\$2,206,586		
Fair Value of Non-Agency MBS pledged as collateral under repurchase agreements (2)(3)	\$3,454,698	\$3,663,523		
Weighted average haircut on Non-Agency MBS (1)	28.48	% 32.48		%
Repurchase agreements secured by U.S. Treasuries	\$444,016	\$382,658		
Fair value of U.S. Treasuries pledged as collateral under repurchase agreements	\$442,370	\$383,743		
Weighted average haircut on U.S. Treasuries (1)	1.41	% 1.65		%

(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 \$1.276 billion and \$1.885 billion of Non-Agency MBS acquired from consolidated VIEs at September 30, 2014, and December 31, 2013, respectively, that are eliminated from the Company's consolidated balance sheets.

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, 2014 and December 31, 2013:

Time Until Interest Rate Reset	September 30, 2014		December 31, 2013		
	Balance (1)	Weighted Average Interest Rate	Balance (1)	Weighted Average Interest Rate	
(Dollars in Thousands)					
Within 30 days	\$6,619,916	0.65	% \$7,064,598	0.68	%
Over 30 days to 3 months	1,367,544	0.82	1,274,699	1.31	
Over 3 months to 12 months	138,263	1.65	—	—	
Total	\$8,125,723	0.70	% \$8,339,297	0.77	%

(1) At September 30, 2014 and December 31, 2013, the Company had repurchase agreements of \$791.8 million and \$102.7 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 presents contractual maturity information about the Company's borrowings under repurchase agreements at September 30, 2014 and does not reflect the impact of derivative contracts that hedge such repurchase agreements:

September 30, 2014

Contractual Maturity (Dollars in Thousands)	Balance (1)	Weighted Average Interest Rate	
Overnight	\$—	—	%
Within 30 days	6,069,537	0.55	
Over 30 days to 90 days	1,221,035	0.69	
Over 90 days to 12 months	835,151	1.84	
Total	\$8,125,723	0.70	%

At September 30, 2014, the Company had repurchase agreements of \$791.8 million that were linked to (1) 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 26 counterparties at both September 30, 2014 and December 31, 2013. 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, 2014:

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	\$509,523	0	15.7	%
Wells Fargo (4)	A+/A2/AA-	339,149	5	10.4	
RBS	BBB+/Baa2/A	295,142	2	9.1	
UBS (5)	A/A2/A	236,453	16	7.3	
RBC (6)	AA-/Aa3/AA	179,387	5	5.5	

(1) As rated at September 30, 2014 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 Transactions, including accrued interest receivable on such securities.

(3) Includes \$353.8 million at risk with Alpine Securitization Corporation and \$155.7 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 \$199.3 million at risk with Wells Fargo Bank, NA and \$139.9 million at risk with Wells Fargo Securities LLC.

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

(6) Includes \$167.4 million at risk with Royal Bank of Canada and \$12.0 million at risk with RBC Capital Markets LLC.

## 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, 2014 and December 31, 2013:

(In Thousands)	September 30, 2014		December 31, 2013	
	Assets Pledged	Collateral Held	Assets Pledged	Collateral Held
<b>Derivative Hedging Instruments:</b>				
Agency MBS	\$67,431	\$—	\$73,859	\$—
Cash (1)	35,351	—	37,520	—
	102,782	—	111,379	—
<b>Repurchase Agreement Borrowings:</b>				
Agency MBS	\$5,698,202	\$—	\$6,068,447	\$—
Non-Agency MBS (2)(3)	3,454,698	—	3,663,523	—
U.S. Treasury securities	442,370	—	383,743	—
Cash (1)	8,400	—	—	—
	9,603,670	—	10,115,713	—
<b>Reverse Repurchase Agreements:</b>				
U.S. Treasury securities	\$—	\$442,370	\$—	\$383,743
	—	442,370	—	383,743
<b>Total</b>	<b>\$9,706,452</b>	<b>\$442,370</b>	<b>\$10,227,092</b>	<b>\$383,743</b>

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

(2) Includes \$1.276 billion and \$1.885 billion of Non-Agency MBS acquired in connection with securitization transactions from consolidated VIEs at September 30, 2014 and December 31, 2013, respectively, that are eliminated from the Company's consolidated balance sheets.

(3) In addition, \$736.8 million and \$738.3 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, 2014 and December 31, 2013, respectively.

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, 2014:

(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	\$442,370	\$442,370	\$—	\$—	\$—	\$—	\$442,370
Fannie Mae	\$4,744,666	\$4,682,097	\$11,763	\$6,205	\$5,965	\$13	\$4,762,647
Freddie Mac	953,536	963,082	2,382	54,959	55,898	129	1,011,006
Ginnie Mae	—	—	—	6,267	6,144	9	6,276
Agency MBS	\$5,698,202	\$5,645,179	\$14,145	\$67,431	\$68,007	\$151	\$5,779,929
Non-Agency MBS (1)(2)	\$3,454,698	\$2,632,613	\$12,424	\$—	\$—	\$—	\$3,467,122
<b>Total</b>	<b>\$9,595,270</b>	<b>\$8,720,162</b>	<b>\$26,569</b>	<b>\$67,431</b>	<b>\$68,007</b>	<b>\$151</b>	<b>\$9,689,421</b>

- (1) Includes \$1.276 billion of Non-Agency MBS acquired in connection with resecuritization transactions from consolidated VIEs at September 30, 2014, that are eliminated from the Company's consolidated balance sheets.
- (2) In addition, \$736.8 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, 2014.

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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, 2014 and December 31, 2013:

## 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, 2014						
Swaps, at fair value	\$4,322	\$ —	\$ 4,322	\$ (4,322 )	\$ —	\$ —
Total	\$4,322	\$ —	\$ 4,322	\$ (4,322 )	\$ —	\$ —
December 31, 2013						
Swaps, at fair value	\$13,000	\$ —	\$ 13,000	\$ (13,000 )	\$ —	\$ —
Total	\$13,000	\$ —	\$ 13,000	\$ (13,000 )	\$ —	\$ —

## Offsetting of Financial Liabilities and Derivative Liabilities

(In Thousands)	Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Consolidated Balance Sheets	Net Amounts of Gross Amounts Not Offset in the Consolidated Balance Sheets			
			Liabilities Presented in the Consolidated Balance Sheets	Financial Instruments (1)	Cash Collateral Pledged (1)	Net Amount
September 30, 2014						
Swaps, at fair value (2)	\$35,493	\$ —	\$ 35,493	\$ (142 )	\$ (35,351 )	\$ —
Repurchase agreements (3)	8,125,723	—	8,125,723	(8,117,323 )	(8,400 )	—
Total	\$8,161,216	\$ —	\$ 8,161,216	\$ (8,117,465 )	\$ (43,751 )	\$ —
December 31, 2013						
Swaps, at fair value (2)	\$28,217	\$ —	\$ 28,217	\$ —	\$ (28,217 )	\$ —
Repurchase agreements (3)	8,339,297	—	8,339,297	(8,339,297 )	—	—
Total	\$8,367,514	\$ —	\$ 8,367,514	\$ (8,339,297 )	\$ (28,217 )	\$ —

(1) Amounts disclosed in the Financial Instruments column of the table above represents collateral pledged that is available to be offset against liability balances associated with repurchase agreement and derivative transactions. Amounts disclosed in the Cash Collateral Pledged column of the table above represents amounts pledged as collateral against derivative transactions and repurchase agreements, and excludes excess collateral of \$9.3 million at December 31, 2013.

(2) The fair value of securities pledged against the Company's Swaps was \$67.4 million and \$73.9 million at September 30, 2014 and December 31, 2013, respectively.

(3) The fair value of securities pledged against the Company's repurchase agreements was \$9.595 billion and \$10.116 billion at September 30, 2014 and December 31, 2013, respectively.

#### Nature of Setoff Rights

In the Company's consolidated balance sheets, all balances associated with the repurchase agreement and derivatives transactions are presented on a gross basis.

Certain of the Company's repurchase agreement and derivative transactions are governed by underlying agreements that generally provide for a right of setoff in the event of default or in the event of a bankruptcy of either party to the transaction. For one repurchase agreement counterparty, the underlying agreements provide for an unconditional right of setoff.



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9. Senior Notes

On April 11, 2012 the Company issued \$100.0 million in aggregate principal amount of its Senior Notes in an underwritten public offering. The total net proceeds to the Company from the offering of the Senior Notes were approximately \$96.6 million, after deducting offering expenses and the underwriting discount. The Senior Notes bear interest at a fixed rate of 8.00% per year, paid quarterly in arrears on January 15, April 15, July 15 and October 15 of each year and will mature on April 15, 2042. The Company may redeem the Senior Notes, in whole or in part, at any time on or after April 15, 2017 at a redemption price equal to 100% of the principal amount redeemed plus accrued and unpaid interest to, but not excluding, the redemption date.

The Senior Notes are the Company's senior unsecured obligations and are subordinate to all of the Company's secured indebtedness, which includes the Company's repurchase agreements, obligation to return securities obtained as collateral, and other financing arrangements, to the extent of the value of the collateral securing such indebtedness.

10. Commitments and Contingencies

(a) Lease Commitments

The Company pays monthly rent pursuant to two operating leases. The lease term for the Company's headquarters in New York, New York extends through May 31, 2020. The lease provides for aggregate cash payments ranging over time from approximately \$2.4 million to \$2.5 million per year, paid on a monthly basis, exclusive of escalation charges. In addition, as part of this lease agreement, the Company has provided the landlord a \$785,000 irrevocable standby letter of credit fully collateralized by cash. The letter of credit may be drawn upon by the landlord in the event that the Company defaults under certain terms of the lease. In addition, the Company has a lease through December 31, 2016 for its off-site back-up facility located in Rockville Centre, New York, which provides for, among other things, cash payments ranging over time from \$28,000 to \$30,000 per year, paid on a monthly basis.

(b) Representations and Warranties in Connection with Resecuritization Transactions

In connection with the securitization transactions engaged in by the Company (See Note 15 for further discussion), the Company has the obligation under certain circumstances to repurchase assets from its VIEs upon breach of certain representations and warranties.

11. Stockholders' Equity

(a) Preferred Stock

Redemption of 8.50% Series A Cumulative Redeemable Preferred Stock ("Series A Preferred Stock")

On May 16, 2013 (the "Redemption Date"), the Company redeemed all 3,840,000 outstanding shares of its Series A Preferred Stock at an aggregate redemption price of approximately \$97.0 million, or \$25.27153 per share, including all accrued and unpaid dividends to the Redemption Date. The redemption value of the Series A Preferred Stock exceeded its carrying value by \$3.9 million, which represents the original offering costs for the Series A Preferred Stock. This amount was included in the determination of net income available to common stock and participating securities from the Redemption Date through the year ended December 31, 2013. In addition, as part of the redemption price on its Series A Preferred Stock, the Company paid a dividend of \$0.27153 per share, which reflected accrued and unpaid dividends for the period from April 1, 2013, through and including the Redemption Date.



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## Issuance of 7.50% Series B Cumulative Redeemable Preferred Stock (“Series B Preferred Stock”)

On April 15, 2013, the Company amended its charter through the filing of articles supplementary to its charter to reclassify 8,050,000 shares of the Company’s authorized but unissued common stock as shares of the Company’s Series B Preferred Stock. On April 15, 2013, the Company completed the issuance of 8.0 million shares of its Series B Preferred Stock, with a par value of \$0.01 per share and a liquidation preference \$25.00 per share, plus accrued and unpaid dividends, in an underwritten public offering. The aggregate net proceeds to the Company from the offering of the Series B Preferred Stock were approximately \$193.3 million, after deducting the underwriting discount and related offering expenses. The Company used a portion of such net proceeds to redeem all of its outstanding Series A Preferred Stock (as discussed above), and used the remaining net proceeds of the offering for general corporate purposes, including, without limitation, to acquire additional MBS consistent with its investment policy, and for working capital, which included, among other things, the repayment of its repurchase agreements.

The Company’s Series B Preferred Stock, which is redeemable at \$25.00 per share plus accrued and unpaid dividends (whether or not authorized or declared) exclusively at the Company’s option commencing on April 15, 2018 (subject to the Company’s right under limited circumstances to redeem the Series B Preferred Stock prior to that date in order to preserve its qualification as a REIT and upon certain specified change in control transactions in which the Company’s common stock and the acquiring or surviving entity common securities would not be listed on the New York Stock Exchange (the “NYSE”), the NYSE MKT or NASDAQ, or any successor exchanges), is entitled to receive a dividend at a rate of 7.50% per year on the \$25.00 liquidation preference before the Company’s common stock is paid any dividends and is senior to the Company’s common stock with respect to distributions upon liquidation, dissolution or winding up.

Dividends on the Series B Preferred Stock are payable quarterly in arrears on or about March 31, June 30, September 30 and December 31 of each year. On May 20, 2013, the Company declared the first dividend payable on the Series B Preferred Stock, which was paid on July 1, 2013 to preferred stockholders of record as of June 3, 2013. The amount of such dividend payable was \$0.39583 per share, and was paid in respect of the partial period commencing on April 15, 2013, the date of original issue of the Series B Preferred Stock, and ending on, and including, June 30, 2013.

The Series B Preferred Stock generally does not have any voting rights, subject to an exception in the event the Company fails to pay dividends on such stock for six or more quarterly periods (whether or not consecutive). Under such circumstances, the Series B Preferred Stock will be entitled to vote to elect two additional directors to the Company’s Board of Directors (the “Board”), until all unpaid dividends have been paid or declared and set apart for payment. In addition, certain material and adverse changes to the terms of the Series B Preferred Stock cannot be made without the affirmative vote of holders of at least 66 2/3% of the outstanding shares of Series B Preferred Stock. The following table presents cash dividends declared by the Company on its Series B Preferred Stock from January 1, 2014 through September 30, 2014:

Declaration Date	Record Date	Payment Date	Dividend Per Share
August 25, 2014	September 8, 2014	September 30, 2014	\$ 0.46875
May 19, 2014	June 10, 2014	June 30, 2014	0.46875
February 14, 2014	February 28, 2014	March 31, 2014	0.46875

## (b) Dividends on Common Stock

The following table presents cash dividends declared by the Company on its common stock from January 1, 2014 through September 30, 2014:

Declaration Date (1)	Record Date	Payment Date	Dividend Per Share
September 17, 2014	September 29, 2014	October 31, 2014	\$ 0.20 (1)

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June 13, 2014	June 27, 2014	July 31, 2014	0.20
March 10, 2014	March 28, 2014	April 30, 2014	0.20

(1) At September 30, 2014, the Company had accrued dividends and DERs payable of \$74.1 million related to the common stock dividend declared on September 17, 2014.

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(c) Discount Waiver, Direct Stock Purchase and Dividend Reinvestment Plan (“DRSPP”)

On August 8, 2013, the Company filed a shelf registration statement on Form S-3 with the SEC under the Securities Act of 1933, as amended (the “1933 Act”), for the purpose of registering additional common stock for sale through its DRSPP. Pursuant to Rule 462(e) of the 1933 Act, this shelf registration statement became effective automatically upon filing with the SEC and, when combined with the unused portion of the Company’s previous DRSPP shelf registration statements, registered an aggregate of 15 million shares of common stock. The Company’s DRSPP is designed to provide existing stockholders and new investors with a convenient and economical way to purchase shares of common stock through the automatic reinvestment of dividends and/or optional cash investments. At September 30, 2014, 8.1 million shares of common stock remained available for issuance pursuant to the DRSPP shelf registration statement.

During the three and nine months ended September 30, 2014, the Company issued 1,185,728 and 3,421,859 shares of common stock through the DRSPP, raising net proceeds of approximately \$9.5 million and \$26.4 million, respectively. From the inception of the DRSPP in September 2003 through September 30, 2014, the Company issued 29,461,623 shares pursuant to the DRSPP, raising net proceeds of \$247.8 million.

(d) Stock Repurchase Program

As previously disclosed, in August 2005, the Company’s Board authorized a stock repurchase program (the “Repurchase Program”), to repurchase up to 4.0 million shares of its outstanding common stock under the Repurchase Program. The Board reaffirmed such authorization in May 2010. In December 2013, the Board increased the number of shares authorized for repurchase to an aggregate of 10.0 million. Such authorization does not have an expiration date and, at present, there is no intention to modify or otherwise rescind such authorization. Subject to applicable securities laws, repurchases of common stock under the Repurchase Program are made at times and in amounts as the Company deems appropriate, (including, in our discretion, through the use of one or more plans adopted under Rule 10b5-1 promulgated under the Securities Exchange Act of 1934, as amended (the “1934 Act”)) using available cash resources. Shares of common stock repurchased by the Company under the Repurchase Program are cancelled and, until reissued by the Company, are deemed to be authorized but unissued shares of the Company’s common stock. The Repurchase Program may be suspended or discontinued by the Company at any time and without prior notice. The Company did not repurchase any shares of its common stock during the nine months ended September 30, 2014. At September 30, 2014, 6,616,355 shares remained authorized for repurchase under the Repurchase Program.

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## (e) Accumulated Other Comprehensive Income/(Loss)

The following table presents changes in the balances of each component of the Company's AOCI for the three and nine months ended September 30, 2014:

(In Thousands)	Three Months Ended September 30, 2014			Nine Months Ended September 30, 2014		
	Net Unrealized Gain/(Loss) on Available-for-Sale MBS	Net Unrealized Gain/(Loss) on Swaps	Total AOCI	Net Unrealized Gain/(Loss) on Available-for-Sale MBS	Net Unrealized Gain/(Loss) on Swaps	Total AOCI
Balance at the beginning of the period	\$905,704	\$(54,671 )	\$851,033	\$752,912	\$(15,217 )	\$737,695
OCI before reclassifications	(43,410 )	23,500	(19,910 )	116,973	(16,401 )	100,572
Amounts reclassified from AOCI (1)	(13,589 )	—	(13,589 )	(21,180 )	447	(20,733 )
Net OCI during the period (2)	(56,999 )	23,500	(33,499 )	95,793	(15,954 )	79,839
Balance at end of period	\$848,705	\$(31,171 )	\$817,534	\$848,705	\$(31,171 )	\$817,534

The following table presents changes in the balances of each component of the Company's AOCI for the three and nine months ended September 30, 2013:

(In Thousands)	Three Months Ended September 30, 2013			Nine Months Ended September 30, 2013		
	Net Unrealized Gain/(Loss) on Available-for-Sale MBS	Net Unrealized Gain/(Loss) on Swaps	Total AOCI	Net Unrealized Gain/(Loss) on Available-for-Sale MBS	Net Unrealized Gain/(Loss) on Swaps	Total AOCI
Balance at the beginning of the period	\$700,871	\$(31,967 )	\$668,904	\$824,808	\$(62,831 )	\$761,977
OCI before reclassifications	31,850	(19,934 )	11,916	(89,847 )	10,930	(78,917 )
Amounts reclassified from AOCI (1)	(15,158 )	—	(15,158 )	(17,398 )	—	(17,398 )
Net OCI during the period (2)	16,692	(19,934 )	(3,242 )	(107,245 )	10,930	(96,315 )
Balance at end of period	\$717,563	\$(51,901 )	\$665,662	\$717,563	\$(51,901 )	\$665,662

(1) See separate table below for details about these reclassifications.

(2) For further information regarding changes in OCI, see the Company's consolidated statement of comprehensive income/(loss).

The following table presents information about the significant amounts reclassified out of the Company's AOCI for the three and nine months ended September 30, 2014:

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Details about AOCI Components (In Thousands)	Three Months Ended September 30, 2014	Nine Months Ended September 30, 2014	Affected Line Item in the Statement Where Net Income is Presented
Available-for-sale MBS:			
Realized gain on sale of securities	\$(13,589	) \$(21,180	) Gain on sales of MBS and U.S. Treasury securities, net
Swaps designated as cash flow hedges:			
De-designated Swaps	\$—	\$447	Other, net
Total reclassifications for period	\$(13,589	) \$(20,733	)

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The following table presents information about the significant amounts reclassified out of the Company's AOCI for the three and nine months ended September 30, 2013:

	Three Months Ended September 30, 2013 Amounts Reclassified from AOCI	Nine Months Ended September 30, 2013 Amounts Reclassified from AOCI	Affected Line Item in the Statement Where Net Income is Presented
(In Thousands)			
Available-for-sale MBS:			
Realized gain on sale of securities	\$(15,158	) \$(17,398	Gain on sales of MBS and U.S. Treasury securities, net
Total reclassifications for period	\$(15,158	) \$(17,398	)

At September 30, 2014 and December 31, 2013, the Company had OTTI recognized in AOCI of \$618,000 and \$609,000, respectively.

## 12. EPS Calculation

The following table presents a reconciliation of the earnings and shares used in calculating basic and diluted EPS for the three and nine months ended September 30, 2014 and 2013:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In Thousands, Except Per Share Amounts)	2014	2013	2014	2013
Numerator:				
Net income	\$78,882	\$71,328	\$233,796	\$224,152
Dividends declared on preferred stock	(3,750	) (3,750	) (11,250	) (10,000
Dividends, DERs and undistributed earnings allocated to participating securities	(281	) (230	) (842	) (880
Issuance costs of redeemed preferred stock (1)	—	—	—	(3,947
Net income to common stockholders - basic and diluted	\$74,851	\$67,348	\$221,704	\$209,325
Denominator:				
Weighted average common shares for basic and diluted earnings per share (2)	369,690	363,918	368,430	361,181
Basic and diluted earnings per share	\$0.20	\$0.19	\$0.60	\$0.58

(1) Issuance costs of redeemed preferred stock represent the original offering costs related to the Series A Preferred Stock, which was redeemed on May 16, 2013. (See Note 11)

(2) At September 30, 2014, the Company had an aggregate of 1.6 million equity instruments outstanding that were not included in the calculation of diluted EPS for the three and nine months ended September 30, 2014, as their inclusion would have been anti-dilutive. These equity instruments were comprised of approximately 358,000



shares of restricted common stock with a weighted average grant date fair value of \$7.47 and approximately 1.2 million RSUs with a weighted average grant date fair value of \$6.83. These equity instruments may have a dilutive impact on future EPS.

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NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2014

13. Equity Compensation, Employment Agreements and Other Benefit Plans

(a) 2010 Equity Compensation Plan

In accordance with the terms of the Company's Amended and Restated 2010 Equity Compensation Plan (the "2010 Plan"), directors, officers and employees of the Company and any of its subsidiaries and other persons expected to provide significant services for the Company and any of its subsidiaries are eligible to receive grants of stock options ("Options"), restricted stock, RSUs, DERs and other stock-based awards under the 2010 Plan.

Subject to certain exceptions, stock-based awards relating to a maximum of 13.5 million shares of common stock may be granted under the 2010 Plan; forfeitures and/or awards that expire unexercised do not count towards such limit. At September 30, 2014, approximately 9.2 million shares of common stock remained available for grant in connection with stock-based awards under the 2010 Plan. A participant may generally not receive stock-based awards in excess of 1,500,000 shares of common stock in any one year and no award may be granted to any person who, assuming exercise of all Options and payment of all awards held by such person, would own or be deemed to own more than 9.8% of the outstanding shares of the Company's common stock. Unless previously terminated by the Board, awards may be granted under the 2010 Plan until May 20, 2020.

DERs

A DER is a right to receive a distribution equal to the dividend distributions that would be paid on a share of the Company's common stock. DERs may be granted separately or together with other awards and are paid in cash or other consideration at such times and in accordance with such rules, as the Compensation Committee of the Board (the "Compensation Committee") shall determine at its discretion. Payments made on the Company's existing DERs are charged to stockholders' equity when the common stock dividends are declared to the extent that such DERs are expected to vest. The Company made DER payments of approximately \$195,000 and \$645,000 during the three months ended September 30, 2014 and 2013, and approximately \$557,000 and \$1.9 million during the nine months ended September 30, 2014 and 2013, respectively. DER payments for the three and nine months ended September 30, 2013 reflect special cash dividends paid of \$0.28 and \$0.78 per share, respectively. At September 30, 2014, the Company had 1,220,724 DERs outstanding, all of which were awarded in connection with, or attached to, RSUs. A 0% forfeiture rate was assumed with respect to DERs outstanding at September 30, 2014. The DERs were scheduled to elapse over a weighted average period of 1.9 years.

Options

Pursuant to Section 422(b) of the Code, in order for Options granted under the 2010 Plan and vesting in any one calendar year to qualify as an incentive stock option ("ISO") for tax purposes, the market value of the common stock to be received upon exercise of such Options as determined on the date of grant shall not exceed \$100,000 during such calendar year. The exercise price of an ISO may not be lower than 100% (110% in the case of an ISO granted to a 10% stockholder) of the fair market value of the Company's common stock on the date of grant. The exercise price for any other type of Option issued under the 2010 Plan may not be less than the fair market value on the date of grant. Each Option is exercisable after the period or periods specified in the award agreement, which will generally not exceed ten years from the date of grant.

The Company did not grant any stock options during the nine months ended September 30, 2014 and 2013. There were no stock options exercised during the nine months ended September 30, 2014 and 20,000 stock options exercised

during the nine months ended September 30, 2013. During the three and nine months ended September 30, 2014, 5,000 stock options expired which had an exercise price of \$8.40. No stock options were cancelled or expired during the nine months ended September 30, 2013. At September 30, 2014, the Company had no stock options outstanding.

#### Restricted Stock

The Company awarded 32,658 and 95,718 shares of restricted common stock during the three and nine months ended September 30, 2014 and awarded zero and 28,743 shares of restricted common stock during the three and nine months ended September 30, 2013. At September 30, 2014 and December 31, 2013, the Company had unrecognized compensation expense of \$2.2 million and \$3.3 million, respectively, related to the unvested shares of restricted common stock. The Company had accrued dividends payable of approximately \$354,000 and \$413,000 on unvested shares of restricted stock at September 30, 2014 and December 31, 2013, respectively. The unrecognized compensation expense at September 30, 2014 is expected to be recognized over a weighted average period of 2.2 years.

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## Restricted Stock Units and Associated DERs

Under the terms of the 2010 Plan, RSUs are instruments that provide the holder with the right to receive, subject to the satisfaction of conditions set by the Compensation Committee at the time of grant, a payment of a specified value, which may be a share of the Company's common stock, the fair market value of a share of the Company's common stock, or such fair market value to the extent in excess of an established base value, on the applicable settlement date. Although the 2010 Plan permits the Company to issue RSUs that can settle in cash, all of the Company's outstanding RSUs as of September 30, 2014 are designated to be settled in shares of the Company's common stock. The Company granted 3,334 and 630,815 RSUs during the three and nine months ended September 30, 2014, respectively and granted 72,500 and 112,824 RSUs during the three and nine months ended September 30, 2013, respectively. In addition, an aggregate of 97,164 previously awarded RSUs were forfeited by the holders' thereof during the nine months ended September 30, 2014 in connection with the negotiation of such holders' respective new employment agreements. All RSUs outstanding at September 30, 2014 had DERs attached or issued as separate associated instruments in connection with RSUs. At September 30, 2014 and December 31, 2013, the Company had unrecognized compensation expense of \$3.4 million and \$1.6 million, respectively, related to RSUs and DERs. The unrecognized compensation expense at September 30, 2014 is expected to be recognized over a weighted average period of 2.1 years. A 0% forfeiture rate was assumed with respect to unvested RSUs at September 30, 2014.

## Expense Recognized for Equity-Based Compensation Instruments

The following table presents the Company's expenses related to its equity-based compensation instruments for the three and nine months ended September 30, 2014 and 2013:

(In Thousands)	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2014	2013	2014	2013
Restricted shares of common stock	\$643	\$404	\$1,892	\$1,539
RSUs	591	314	2,354	(1) 1,263
DERs	37	42	111	144
Total	\$1,271	\$760	\$4,357	\$2,946

(1) RSU expense for the nine months ended September 30, 2014 includes approximately \$500,000 for a one-time grant to the Company's chief executive officer.

## (b) Employment Agreements

At September 30, 2014, the Company had employment agreements with five of its officers, with varying terms that provide for, among other things, base salary, bonus and change-in-control payments upon the occurrence of certain triggering events.

## (c) Deferred Compensation Plans

The Company administers deferred compensation plans for its senior officers and non-employee directors (collectively, the "Deferred Plans"), pursuant to which participants may elect to defer up to 100% of certain cash compensation. The Deferred Plans are designed to align participants' interests with those of the Company's

stockholders.

Amounts deferred under the Deferred Plans are considered to be converted into “stock units” of the Company. Stock units do not represent stock of the Company, but rather are a liability of the Company that changes in value as would equivalent shares of the Company’s common stock. Deferred compensation liabilities are settled in cash at the termination of the deferral period, based on the value of the stock units at that time. The Deferred Plans are non-qualified plans under the Employee Retirement Income Security Act of 1974 and, as such, are not funded. Prior to the time that the deferred accounts are settled, participants are unsecured creditors of the Company.

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The Company's liability for stock units in the Deferred Plans is based on the market price of the Company's common stock at the measurement date. The following table presents the Company's expenses related to its Deferred Plans for its non-employee directors and senior officers for the three and nine months ended September 30, 2014 and 2013:

(In Thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Non-employee directors	\$(11	) \$(30	) \$52	\$22
Total	\$(11	) \$(30	) \$52	\$22

The following table presents the aggregate amount of income deferred by participants of the Deferred Plans through September 30, 2014 and December 31, 2013 that had not been distributed and the Company's associated liability for such deferrals at September 30, 2014 and December 31, 2013:

(In Thousands)	September 30, 2014		December 31, 2013	
	Undistributed Income Deferred (1)	Liability Under Deferred Plans	Undistributed Income Deferred (1)	Liability Under Deferred Plans
Non-employee directors	\$263	\$367	\$270	\$382
Total	\$263	\$367	\$270	\$382

(1) Represents the cumulative amounts that were deferred by participants through September 30, 2014 and December 31, 2013, which had not been distributed through such date.

## (d) Savings Plan

The Company sponsors a tax-qualified employee savings plan (the "Savings Plan"), in accordance with Section 401(k) of the Code. Subject to certain restrictions, all of the Company's employees are eligible to make tax deferred contributions to the Savings Plan subject to limitations under applicable law. Participant's accounts are self-directed and the Company bears the costs of administering the Savings Plan. The Company matches 100% of the first 3% of eligible compensation deferred by employees and 50% of the next 2%, subject to a maximum as provided by the Code. The Company has elected to operate the Savings Plan under the applicable safe harbor provisions of the Code, whereby among other things, the Company must make contributions for all participating employees and all matches contributed by the Company immediately vest 100%. For the three months ended September 30, 2014 and 2013, the Company recognized expenses for matching contributions of \$65,000 and \$62,000, respectively, and \$195,000 and \$187,000 for the nine months ended September 30, 2014 and 2013, respectively.

## 14. Fair Value of Financial Instruments

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The three levels of valuation hierarchy are defined as follows:

Level 1 — inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 — inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level 3 — inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The following describes the valuation methodologies used for the Company's financial instruments measured at fair value on a recurring basis, as well as the general classification of such instruments pursuant to the valuation hierarchy.

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Securities Obtained and Pledged as Collateral/Obligation to Return Securities Obtained as Collateral

The fair value of U.S. Treasury securities obtained as collateral and the associated obligation to return securities obtained as collateral are based upon prices obtained from a third-party pricing service, which are indicative of market activity. Securities obtained as collateral are classified as Level 1 in the fair value hierarchy.

Agency MBS and Non-Agency MBS

The Company determines the fair value of its Agency MBS, based upon prices obtained from third-party pricing services, which are indicative of market activity and repurchase agreement counterparties.

For Agency MBS, the valuation methodology of the Company's third-party pricing services incorporate commonly used market pricing methods, trading activity observed in the marketplace and other data inputs. The methodology also considers the underlying characteristics of each security, which are also observable inputs, including: collateral vintage; coupon; maturity date; loan age; reset date; collateral type; periodic and life cap; geography; and prepayment speeds. Management analyzes pricing data received from third-party pricing services and compares it to other indications of fair value including data received from repurchase agreement counterparties and its own observations of trading activity observed in the marketplace.

In determining the fair value of its Non-Agency MBS and securitized debt, management considers a number of observable market data points, including prices obtained from pricing services and brokers as well as dialogue with market participants. In valuing Non-Agency MBS, the Company understands that pricing services use observable inputs that include, in addition to trading activity observed in the marketplace, loan delinquency data, credit enhancement levels and vintage, which are taken into account to assign pricing factors such as spread and prepayment assumptions. For tranches of Legacy Non-Agency MBS that are cross-collateralized, performance of all collateral groups involved in the tranche are considered. The Company collects and considers current market intelligence on all major markets, including benchmark security evaluations and bid-lists throughout the day from various sources, when available.

The Company's MBS are valued using various market data points as described above, which management considers directly or indirectly observable parameters. Accordingly, the Company's MBS are classified as Level 2 in the fair value hierarchy.

Derivative Instruments

Linked Transactions

The Non-Agency MBS underlying the Company's Linked Transactions are valued using similar techniques to those used for the Company's other Non-Agency MBS. The value of the underlying MBS is then netted against the carrying amount (which approximates fair value) of the repurchase agreement borrowing at the valuation date. The fair value of Linked Transactions also includes accrued interest receivable on the MBS and accrued interest payable on the underlying repurchase agreement borrowings. The Company's Linked Transactions are classified as Level 2 in the fair value hierarchy.

Swaps



The Company determines the fair value of non-centrally cleared Swaps considering valuations obtained from a third-party pricing service. For Swaps that are cleared by a central clearing house valuations provided by the clearing house are used. All valuations obtained are tested with internally developed models that apply readily observable market parameters. The Company considers the creditworthiness of both the Company and its counterparties, along with collateral provisions contained in each derivative agreement, from the perspective of both the Company and its counterparties. All of the Company's Swaps are subject either to bilateral collateral arrangements, or for cleared Swaps, to the clearing house's margin requirements. Consequently, no credit valuation adjustment was made in determining the fair value of such instruments. Swaps are classified as Level 2 in the fair value hierarchy.

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The following table presents the Company's financial instruments carried at fair value on a recurring basis as of September 30, 2014, on the consolidated balance sheet by the valuation hierarchy, as previously described:

## Fair Value at September 30, 2014

(In Thousands)	Level 1	Level 2	Level 3	Total
Assets:				
Agency MBS	\$—	\$6,174,176	\$—	\$6,174,176
Non-Agency MBS, including MBS transferred to consolidated VIEs	—	4,763,326	—	4,763,326
Securities obtained and pledged as collateral	442,370	—	—	442,370
Linked Transactions	—	190,681	—	190,681
Swaps	—	4,322	—	4,322
Total assets carried at fair value	\$442,370	\$11,132,505	\$—	\$11,574,875
Liabilities:				
Swaps	\$—	\$35,493	\$—	\$35,493
Obligation to return securities obtained as collateral	442,370	—	—	442,370
Total liabilities carried at fair value	\$442,370	\$35,493	\$—	\$477,863

Changes to the valuation methodologies used with respect to the Company's financial instruments are reviewed by management to ensure any such changes result in appropriate exit price valuations. The Company will refine its valuation methodologies as markets and products develop and pricing methodologies evolve. The methods described above may produce fair value estimates that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Company believes its valuation methods are appropriate and consistent with those used by market participants, the use of different methodologies, or assumptions, to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date. The Company uses inputs that are current as of the measurement date, which may include periods of market dislocation, during which price transparency may be reduced. The Company reviews the classification of its financial instruments within the fair value hierarchy on a quarterly basis, and management may conclude that its financial instruments should be reclassified to a different level in the future.

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The following table presents the carrying values and estimated fair values of the Company's financial instruments at fair value, at September 30, 2014 and December 31, 2013:

(In Thousands)	September 30, 2014		December 31, 2013	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
<b>Financial Assets:</b>				
Agency MBS	\$6,174,176	\$6,174,176	\$6,519,221	\$6,519,221
Non-Agency MBS, including MBS transferred to consolidated VIEs	4,763,326	4,763,326	4,852,137	4,852,137
Securities obtained and pledged as collateral	442,370	442,370	383,743	383,743
Cash and cash equivalents	423,891	423,891	565,370	565,370
Restricted cash	43,751	43,751	37,520	37,520
Linked Transactions	190,681	190,681	28,181	28,181
Swaps	4,322	4,322	13,000	13,000
Residential whole loans	112,924	114,357	—	—
<b>Financial Liabilities:</b>				
Repurchase agreements	8,125,723	8,124,355	8,339,297	8,339,071
Securitized debt	156,276	157,264	366,205	366,767
Obligation to return securities obtained as collateral	442,370	442,370	383,743	383,743
Senior Notes	100,000	105,000	100,000	98,000
Swaps	35,493	35,493	28,217	28,217

In addition to the methodologies used to determine the fair value of the Company's financial assets and liabilities reported at fair value on a recurring basis, as previously described, the following methods and assumptions were used by the Company in arriving at the fair value of the Company's other financial instruments presented in the above table:

**Cash and Cash Equivalents and Restricted Cash:** Cash and cash equivalents and restricted cash are comprised of cash held in overnight money market investments, demand deposit accounts and U.S. Treasury Bills. At September 30, 2014 and December 31, 2013, the Company's money market funds were invested in securities issued by the U.S. Government, or its agencies, instrumentalities, and sponsored entities, and repurchase agreements involving the securities described above. Given the overnight term and assessed credit risk, the Company's investments in money market funds are determined to have a fair value equal to their carrying value. The Company's investments in U.S. Treasury Bills have a carrying value which approximates fair value given the short-term to maturity of these instruments.

**Repurchase Agreements:** The fair value of repurchase agreements reflects the present value of the contractual cash flows discounted at market interest rates at the valuation date for repurchase agreements with a term equivalent to the remaining term to interest rate repricing, which may be at maturity. Such interest rates are estimated based on LIBOR rates observed in the market. The Company's repurchase agreements are classified as Level 2 in the fair value hierarchy.

**Securitized Debt:** In determining the fair value of securitized debt, management considers a number of observable market data points, including prices obtained from pricing services and brokers as well as dialogue with market participants. Accordingly, the Company's securitized debt is classified as Level 2 in the fair value hierarchy.

Senior Notes: The fair value of Senior Notes is determined using the end of day market price quoted on the NYSE at the reporting date. The Company's Senior Notes are classified as Level 1 in the fair value hierarchy.

Residential Whole Loans: The fair value of residential whole loans is estimated taking into consideration current interest rates, loan amount, payment status and property type, and forecasts of future interest rates, home prices and property values, prepayment speeds, default, loss severities, and actual purchases and sales of similar loans. The Company's residential whole loans are classified as Level 3 in the fair value hierarchy.

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## 15. Use of Special Purpose Entities and Variable Interest Entities

A Special Purpose Entity (“SPE”) is an entity designed to fulfill a specific limited need of the company that organized it. SPEs are often used to facilitate transactions that involve securitizing financial assets or resecuritizing previously securitized financial assets. The objective of such transactions may include obtaining non-recourse financing, obtaining liquidity or refinancing the underlying securitized financial assets on improved terms. Securitization involves transferring assets to a SPE to convert all or a portion of those assets into cash before they would have been realized in the normal course of business, through the SPE’s issuance of debt or equity instruments. Investors in an SPE usually have recourse only to the assets in the SPE and depending on the overall structure of the transaction, may benefit from various forms of credit enhancement, such as over-collateralization in the form of excess assets in the SPE, priority with respect to receipt of cash flows relative to holders of other debt or equity instruments issued by the SPE, or a line of credit or other form of liquidity agreement that is designed with the objective of ensuring that investors receive principal and/or interest cash flow on the investment in accordance with the terms of their investment agreement.

## Resecuritization transactions

Since October 2010, the Company has entered into several resecuritization transactions that resulted in the Company consolidating as VIEs the SPEs that were created to facilitate the transactions and to which the underlying assets in connection with the resecuritizations were transferred. See Note 2(q) for a discussion of the accounting policies applied to the consolidation of VIEs and transfers of financial assets in connection with resecuritization transactions.

The following table summarizes the key details of the resecuritization transactions the Company is involved in as of September 30, 2014:

(Dollars in Thousands)	February 2012 WFMLT Series	February 2011 CSMC Series	October 2010 DMSI
Name of Trust (Consolidated as a VIE)	2012-RR1	2011-1R	2010-RS2
Principal value of Non-Agency MBS sold	\$433,347	\$1,319,969	\$985,228
Face amount of Bonds issued by the VIE and purchased by 3rd party investors (1)	\$186,691	\$488,389	\$373,577
Outstanding amount of Senior Bonds at September 30, 2014	\$67,035	\$21,631	\$67,610
Pass-through rate for Senior Bonds issued	2.85	% One-month LIBOR plus 100 basis points	Weighted Average Coupon Rate
Face amount of Senior Support Certificates received by the Company (2)	\$220,216	\$779,679	\$484,630
Cash received	\$186,691	\$488,389	\$375,621
Notional amount acquired of non-rated, interest only senior certificates (1)	\$186,691	\$488,389	\$—
Unamortized deferred costs	\$577	\$202	\$97

(1) Amount disclosed reflects principal balance on the DMSI 2010-RS A1, A2 and A3 bonds. The DMSI 2010-RS2 A2 and A3 bond was sold to third party investors during 2013. The principal balance for the DMSI 2010-RS2 A1 Bond and associated interest only Senior certificate was paid off during the three months ended June 30, 2013.

(2) Provides credit support for the sequential Senior Non-Agency MBS sold to third-party investors in resecuritization transactions (“Senior Bonds”).

The Company engaged in these transactions primarily for the purpose of obtaining non-recourse financing on a portion of its Non-Agency MBS portfolio, as well as refinancing a portion of its Non-Agency MBS portfolio on improved terms. As a result of engaging in these transactions, the risks facing the Company are largely unchanged as the Company remains economically exposed to the first loss position on the underlying MBS transferred to the VIEs.

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The activities that can be performed by an entity created to facilitate a resecuritization transaction are predominantly specified in the entity's formation documents. Those documents do not permit the entity, any beneficial interest holder in the entity, or any other party associated with the entity to cause the entity to sell or replace the assets held by the entity, or limit such ability to specific events of default.

The Company concluded that the entities created to facilitate these resecuritization transactions are VIEs. The Company then completed an analysis of whether each VIE created to facilitate the resecuritization transaction should be consolidated by the Company, based on consideration of its involvement in each VIE, including the design and purpose of the SPE, and whether its involvement reflected a controlling financial interest that resulted in the Company being deemed the primary beneficiary of each VIE. In determining whether the Company would be considered the primary beneficiary, the following factors were assessed:

- Whether the Company has both the power to direct the activities that most significantly impact the economic performance of the VIE; and
- Whether the Company has a right to receive benefits or absorb losses of the entity that could be potentially significant to the VIE.

Based on its evaluation of the factors discussed above, including its involvement in the purpose and design of the entity, the Company determined that it was required to consolidate each VIE created to facilitate these transactions.

As of September 30, 2014 and December 31, 2013, the aggregate fair value of the Non-Agency MBS that were resecuritized as described above was \$1.452 billion and \$2.282 billion, respectively. These assets are included in the Company's consolidated balance sheets and disclosed as "Non-Agency MBS transferred to consolidated VIEs". As of September 30, 2014 and December 31, 2013, the aggregate outstanding balance of Senior Bonds issued by consolidated VIEs was \$156.3 million and \$366.2 million, respectively. These Senior Bonds are included in the Company's consolidated balance sheets and disclosed as "Securitized debt". The holders of the Senior Bonds have no recourse to the general credit of the Company, but the Company does have the obligation, under certain circumstances to repurchase assets from the VIE upon the breach of certain representations and warranties in relation to the Non-Agency MBS sold to the VIE. In the absence of such a breach, the Company has no obligation to provide any other explicit or implicit support to any VIE.

During the quarter ended September 30, 2014 and subsequent to the outstanding balance of Senior Bonds issued by the CSMC Series 2011-7R Trust (the "Trust") being repaid, this resecuritization financing structure was terminated. The termination was effected through an exchange of the remaining beneficial interests previously issued by the Trust and held by the Company for the underlying securities that were previously transferred to and held by the Trust at the date of termination. Following the exchange, the beneficial interests were cancelled by the trustee and the Trust was terminated. The exchange and termination of this financing structure did not result in any gain or loss to the Company. As a result of the termination, the underlying securities originally transferred as part of this resecuritization are reported as Non-Agency MBS in the Company's consolidated balance sheets at September 30, 2014 and interest income from the underlying securities from the date of termination through September 30, 2014 is reported as Interest income from Non-Agency MBS in the Company's consolidated statements of operations.

Prior to the completion of the Company's first resecuritization transaction in October 2010, the Company had not transferred assets to VIEs or QSPEs and other than acquiring MBS issued by such entities, had no other involvement with VIEs or QSPEs.

Residential Whole Loans

Included in Prepaid and other assets in the consolidated balance sheets as of September 30, 2014 is approximately \$112.9 million in residential whole loans arising from the Company's 100% equity interest in certificates issued by a trust established to acquire the loans. Based on its evaluation of its 100% interest in the trust and other factors, the Company has determined that the trust is required to be consolidated for financial reporting purposes. During the three and nine months ended September 30, 2014, approximately \$1.2 million and \$1.8 million, respectively, of income was recognized from residential whole loans and is included in Other income, net on the Company's consolidated statements of operations.



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

In this Quarterly Report on Form 10-Q, we refer to MFA Financial, Inc. and its subsidiaries as "the Company," "MFA," "we," "us," or "our," unless we specifically state otherwise or the context otherwise indicates.

The following discussion should be read in conjunction with our financial statements and accompanying notes included in Item 1 of this Quarterly Report on Form 10-Q as well as our Annual Report on Form 10-K for the year ended December 31, 2013.

Forward Looking Statements

When used in this Quarterly Report on Form 10-Q, in future filings with the SEC or in press releases or other written or oral communications, statements which are not historical in nature, including those containing words such as "will," "believe," "expect," "anticipate," "estimate," "plan," "continue," "intend," "should," "could," "would," "may" or similar expressions, are intended to identify "forward-looking statements" within the meaning of Section 27A of the 1933 Act and Section 21E of the 1934 Act, and, as such, may involve known and unknown risks, uncertainties and assumptions.

These forward-looking statements include information about possible or assumed future results with respect to our business, financial condition, liquidity, results of operations, plans and objectives. Statements regarding the following subjects, among others, may be forward-looking: changes in interest rates and the market value of our MBS; changes in the prepayment rates on the mortgage loans securing our MBS, an increase of which could result in a reduction of the yield on MBS in our portfolio and an increase of which could require us to reinvest the proceeds received by us as a result of such prepayments in MBS with lower coupons; changes in the default rates and management's assumptions regarding default rates on the mortgage loans securing our Non-Agency MBS; our ability to borrow to finance our assets and the terms, including the cost, maturity and other terms, of any such borrowings; implementation of or changes in government regulations or programs affecting our business; our estimates regarding taxable income the actual amount of which is dependent on a number of factors, including, but not limited to, changes in the amount of interest income and financing costs, the method elected by us to accrete the market discount on Non-Agency MBS and the extent of prepayments, realized losses and changes in the composition of our Agency MBS and Non-Agency MBS portfolios that may occur during the applicable tax period, including gain or loss on any MBS disposals; the timing and amount of distributions to stockholders, which are declared and paid at the discretion of our Board of Directors and will depend on, among other things, our taxable income, our financial results and overall financial condition and liquidity, maintenance of our REIT qualification and such other factors as the Board deems relevant; our ability to maintain our qualification as a REIT for federal income tax purposes; our ability to maintain our exemption from registration under the Investment Company Act of 1940, as amended (or the Investment Company Act), including statements regarding the concept release issued by the SEC relating to interpretive issues under the Investment Company Act with respect to the status under the Investment Company Act of certain companies that are engaged in the business of acquiring mortgages and mortgage-related interests; and risks associated with investing in real estate assets, including changes in business conditions and the general economy. These and other risks, uncertainties and factors, including those described in the annual, quarterly and current reports that we file with the SEC, could cause our actual results to differ materially from those projected in any forward-looking statements we make. All forward-looking statements are based on beliefs, assumptions and expectations of our future performance, taking into account all information currently available. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date they are made. New risks and uncertainties arise over time and it is not possible to predict those events or how they may affect us. Except as required by law, we are not obligated to, and do not intend to, update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Business/General

We are a REIT primarily engaged in the business of investing, on a leveraged basis, in residential Agency MBS and Non-Agency MBS. Our principal business objective is to generate net income for distribution to our stockholders resulting from the difference between the interest and other income we earn on our investments and the interest expense we pay on the borrowings that we use to finance our leveraged investments and our operating costs.

At September 30, 2014, we had total assets of approximately \$12.243 billion, of which \$10.938 billion, or 89.3%, represented our MBS portfolio. At such date, our MBS portfolio was comprised of \$6.174 billion of Agency MBS and \$4.763 billion of Non-Agency MBS which includes \$4.737 billion of Legacy Non-Agency MBS and \$26.6 million of RPL/NPL MBS. Our remaining investment-related assets were primarily comprised of cash and cash equivalents, restricted cash, collateral obtained in connection with reverse repurchase agreements, residential whole loans acquired through an interest in a consolidated trust, derivative instruments and MBS-related receivables.

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The results of our business operations are affected by a number of factors, many of which are beyond our control, and primarily depend on, among other things, the level of our net interest income, the market value of our assets, the supply and demand for MBS in the marketplace, the terms and availability of adequate financing, general economic and real estate conditions (both on national and local level), the impact of government actions in the real estate and mortgage sector, and the credit performance of our Non-Agency MBS and residential whole loans. Our net interest income varies primarily as a result of changes in interest rates, the slope of the yield curve (i.e., the differential between long-term and short-term interest rates), borrowing costs (i.e., our interest expense) and prepayment speeds on our MBS, the behavior of which involves various risks and uncertainties. Interest rates and conditional prepayment rates (or CPRs) (which measure the amount of unscheduled principal prepayment on a bond as a percentage of the bond balance), vary according to the type of investment, conditions in the financial markets, competition and other factors, none of which can be predicted with any certainty.

With respect to our business operations, increases in interest rates, in general, may over time cause: (i) the interest expense associated with our borrowings to increase; (ii) the value of our MBS portfolio and, correspondingly, our stockholders' equity to decline; (iii) coupons on our ARM-MBS to reset, on a delayed basis, to higher interest rates; (iv) prepayments on our MBS to decline, thereby slowing the amortization of our MBS purchase premiums and the accretion of our purchase discounts; and (v) the value of our derivative instruments and, correspondingly, our stockholders' equity to increase. Conversely, decreases in interest rates, in general, may over time cause: (i) the interest expense associated with our borrowings to decrease; (ii) the value of our MBS portfolio and, correspondingly, our stockholders' equity to increase; (iii) coupons on our ARM-MBS to reset, on a delayed basis, to lower interest rates; (iv) prepayments on our MBS to increase, thereby accelerating the amortization of our MBS purchase premiums and the accretion of our purchase discounts; and (v) the value of our derivative instruments and, correspondingly, our stockholders' equity to decrease. In addition, our borrowing costs and credit lines are further affected by the type of collateral we pledge and general conditions in the credit market.

We are exposed to credit risk in our Non-Agency MBS and residential whole loans, generally meaning that we are subject to credit losses in these portfolios that correspond to the risk of delinquency, default and foreclosure on the underlying real estate collateral. We believe the discounted purchase prices paid on certain of these investments effectively mitigates our risk of loss in the event, as we expect on most, that we receive less than 100% of the par value of these securities or loans. Our investment process for credit sensitive assets involves analysis focused primarily on quantifying and pricing credit risk. Interest income on these investments is recorded at an effective yield, based on management's estimate of expected cash flows from each security, which estimate is based on our 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.

As of September 30, 2014, approximately \$7.099 billion, or 64.9%, of our MBS portfolio was in its contractual fixed-rate period or were fixed-rate MBS and approximately \$3.836 billion, or 35.1%, was in its contractual adjustable-rate period, or were floating rate MBS. Our ARM-MBS in their contractual adjustable-rate period primarily include MBS collateralized by Hybrids for which the initial fixed-rate period has elapsed, such that the interest rate will typically adjust on an annual or semiannual basis. In addition, at September 30, 2014, we had \$200.0 million, or 1.8%, of MBS with interest rates that reset monthly.

Premiums arise when we acquire MBS at a price in excess of the principal balance of the mortgages securing such MBS (i.e., par value). Conversely, discounts arise when we acquire MBS at a price below the principal balance of the mortgages securing such MBS or acquire residential whole loans at a price below the principal balance of the mortgage. Premiums paid on our MBS are amortized against interest income and accretible purchase discounts on these investments are accreted to interest income. Purchase premiums on our MBS, which are primarily carried on our Agency MBS, are amortized against interest income over the life of each security using the effective yield method, adjusted for actual prepayment activity. An increase in the prepayment rate, as measured by the CPR, will

typically accelerate the amortization of purchase premiums, thereby reducing the IRR/interest income earned on such assets. Generally, if prepayments on these investments are less than anticipated, we expect that the income recognized on such assets would be reduced and MBS impairments and/or loan loss reserves could result.

CPR levels are impacted by, among other things, conditions in the housing market, new regulations, government and private sector initiatives, interest rates, availability of credit to home borrowers, underwriting standards and the economy in general. In particular, CPR reflects the conditional repayment rate (or CRR), which measures voluntary prepayments of mortgages collateralizing a particular MBS, and the conditional default rate (or CDR), which measures involuntary prepayments resulting from defaults. CPRs on Agency MBS and Non-Agency MBS may differ significantly. For the three months ended September 30, 2014, our Agency MBS portfolio experienced a weighted average CPR of 15.1%, and our Non-Agency MBS portfolio (including Non-Agency MBS underlying our Linked Transactions) experienced a weighted average CPR of 12.7%. Over the last consecutive eight quarters, ending with September 30, 2014, the monthly fair value weighted average CPR on our MBS portfolio ranged from a high of 19.7% experienced during the month ended August 31, 2013 to a low of 10.4%, experienced during the month ended March 31, 2014, with an average CPR over such quarters of 15.7%.

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When we purchase Non-Agency MBS at significant discounts to par value, we make certain assumptions with respect to each security. These assumptions include, but are not limited to, future interest rates, voluntary prepayment rates, default rates, mortgage modifications and loss severities. As part of our Non-Agency MBS surveillance process, we track and compare each security's actual performance over time to the performance expected at the time of purchase or, if we have modified our original purchase assumptions, to our revised performance expectations. To the extent that actual performance or our expectation of future performance of our Non-Agency MBS deviates materially from our expected performance parameters, we may revise our performance expectations, such that the amount of purchase discount designated as credit discount may be increased or decreased over time. Nevertheless, credit losses greater than those anticipated or in excess of the recorded purchase discount could occur, which could materially adversely impact our operating results.

It is our business strategy to hold our MBS as long-term investments. On at least a quarterly basis, we assess our ability and intent to continue to hold each security and, as part of this process, we monitor our securities for other-than-temporary impairment. A change in our ability and/or intent to continue to hold any of our securities that are in an unrealized loss position, or a deterioration in the underlying characteristics of these securities, could result in our recognizing future impairment charges or a loss upon the sale of any such security. At September 30, 2014, we had net unrealized gains of \$60.4 million on our Agency MBS, comprised of gross unrealized gains of \$114.1 million and gross unrealized losses of \$53.7 million, and had net unrealized gains on our Non-Agency MBS of \$788.3 million, comprised of gross unrealized gains of \$791.5 million and gross unrealized losses of \$3.1 million. At September 30, 2014, we did not intend to sell any of our MBS that were in an unrealized loss position, and we believe it is more likely than not that we will not be required to sell those MBS before recovery of their amortized cost basis, which may be at their maturity.

We rely primarily on borrowings under repurchase agreements to finance our Agency MBS and Non-Agency MBS. Our MBS have longer-term contractual maturities than our borrowings under repurchase agreements. We have also engaged in resecuritization transactions with respect to our Non-Agency MBS, which provide access to non-recourse financing. Even though the majority of our MBS have interest rates that adjust over time based on short-term changes in corresponding interest rate indices (typically following an initial fixed-rate period for our Hybrids), the interest rates we pay on our borrowings and securitized debt will typically change at a faster pace than the interest rates we earn on our MBS. In order to reduce this interest rate risk exposure, we may enter into derivative instruments, which at September 30, 2014 were comprised of Swaps.

Our Swap derivative instruments are typically designated as cash-flow hedges against a portion of our current and forecasted LIBOR-based repurchase agreements. Our Swaps do not extend the maturities of our repurchase agreements; they do, however, lock in a fixed rate of interest over their term for the notional amount of the Swap corresponding to the hedged item. During the nine months ended September 30, 2014, we entered into four new Swaps with an aggregate notional amount of \$400.0 million, a weighted average fixed-pay rate of 1.95% and initial maturities ranging from five to seven years, and had Swaps with an aggregate notional amount of \$564.3 million and a weighted average fixed-pay rate of 2.05% amortize and/or expire. At September 30, 2014, we had Swaps designated in hedging relationships with an aggregate notional amount of \$3.881 billion with a weighted average fixed-pay rate of 1.90% and a weighted average variable interest rate received of 0.16%.

## Recent Market Conditions and Our Strategy

During 2014, we have continued to invest in residential mortgage assets, including both Agency and Non-Agency MBS and through an interest in a consolidated trust, residential whole loans. During the three months ended September 30, 2014, we purchased \$525.4 million of securitizations of RPL/NPL MBS at a weighted average purchase price of 99.9% of par value, all of which are reported as a component of Linked Transactions. In addition, we purchased \$42.5 million of Legacy Non-Agency MBS purchased at a weighted average purchase price of 91.5% of

par value. During the nine months ended September 30, 2014, we acquired approximately (i) \$942.6 million of securitizations of RPL/NPL MBS at a weighted average purchase price of 99.9% of par value (of which \$902.6 million are reported as a component of Linked Transactions), (ii) \$599.3 million of Agency MBS at a weighted average purchase price of 105.9% of par value and (iii) \$369.0 million of Legacy Non-Agency MBS (of which \$30.2 million are reported as a component of Linked Transactions) at a weighted average purchase price of 87.9% of par value. At September 30, 2014, our combined MBS portfolio was approximately \$11.920 billion (including \$982.3 million MBS reported as components of Linked Transactions) compared to \$11.502 billion (including \$130.8 million MBS reported as components of Linked Transactions) at December 31, 2013.

At September 30, 2014, \$6.174 billion, or 56.4% of our MBS portfolio, was invested in Agency MBS. During the three months ended September 30, 2014, the fair value of our Agency MBS decreased by \$375.3 million. This was due to \$346.9 million of principal repayments, \$13.5 million of premium amortization and \$14.9 million of decrease in net unrealized gains.

At September 30, 2014, \$4.763 billion, or 43.6% of our MBS portfolio, was invested in Non-Agency MBS (excluding Legacy Non-Agency MBS and RPL/NPL MBS reported as a component of Linked Transactions). During the three months ended

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September 30, 2014, the fair value of our Non-Agency MBS holdings (excluding Legacy Non-Agency and RPL/NPL MBS reported as a component of Linked Transactions) decreased by \$238.0 million. The primary components of the change during the quarter in these Non-Agency balances include \$182.2 million of principal reductions, the sale of Non-Agency MBS with a fair value of \$61.6 million, \$66.0 million of RPL/NPL MBS that were reported as Non-Agency MBS on the trade date in June 2014, but were subsequently accounted for as Linked Transactions upon settlement in July 2014, and a reduction reflecting Non-Agency MBS price changes of \$6.8 million. Partially offsetting these decreases were \$42.5 million of purchases and an increase of \$36.3 million as a result of certain of our Linked Transactions becoming unlinked.

In addition to our holdings of Non-Agency MBS discussed in the preceding paragraph, at September 30, 2014 \$65.7 million was invested in Legacy Non-Agency MBS and \$916.7 million was invested in RPL/NPL MBS that are reported as a component of Linked Transactions. During the three months ended September 30, 2014, the fair value of our Legacy Non-Agency MBS and RPL/NPL MBS that are reported as a component of Linked Transactions increased by \$488.3 million. The primary components of the change during the quarter in these balances include \$525.4 million of RPL/NPL MBS purchases, \$66.0 million of RPL/NPL MBS that were reported as Non-Agency MBS on the trade date in June 2014, but were subsequently accounted for as Linked Transactions upon settlement in July 2014, partially offset by principal reductions of \$65.4 million, a decrease of \$36.3 million as a result of certain of our Linked Transactions becoming unlinked and a decrease in net unrealized gains of \$1.5 million.

Our book value per common share was \$8.28 as of September 30, 2014, representing a 1% decline from the end of the prior quarter. Book value per common share increased from \$8.06 as of December 31, 2013 due primarily to price appreciation within the Non-Agency and Agency MBS portfolios partially offset by higher unrealized losses on Swaps.

At the end of the third quarter of 2014, the average coupon on mortgages underlying our Agency MBS was lower compared to the end of the third quarter of 2013, due to acquisition of assets in the marketplace at generally lower coupons and as a result of prepayments on higher yielding assets and downward resets on Hybrid and ARM-MBS within the portfolio. As a result, the coupon yield on our Agency MBS portfolio declined 13 basis points to 2.94% for the three months ended September 30, 2014 from 3.07% for the three months ended September 30, 2013. The net Agency MBS yield decreased to 2.09% for the three months ended September 30, 2014, from 2.13% for the three months ended September 30, 2013. The overall yield for our Non-Agency MBS portfolio (excluding Legacy Non-Agency and RPL/NPL MBS reported as a component of Linked Transactions) was 7.68% for the three months ended September 30, 2014 compared to 7.33% for the three months ended September 30, 2013. The increase in the yield on our Non-Agency MBS portfolio is primarily due to increases in accretable discount due to the impact of improving credit quality on our cash flow estimates.

We continue to believe that loss-adjusted returns on Non-Agency MBS represent attractive investment opportunities. We believe that our \$929.1 million Credit Reserve and OTTI appropriately factors in remaining uncertainties regarding underlying mortgage performance and the potential impact on future cash flows. Home price appreciation and underlying mortgage loan amortization have decreased the loan-to-value ratio (or LTV) for many of the mortgages underlying our Non-Agency portfolio. Home price appreciation is generally due to a combination of limited housing supply, low mortgage rates, capital flows into own-to-rent foreclosure purchases and demographic-driven U.S. household formation. We estimate that the average LTV of mortgage loans underlying our Non-Agency MBS has declined from approximately 105% as of January 2012 to approximately 76% as of September 30, 2014. In addition, we estimate that the percentage of current loans underlying our Non-Agency MBS that are underwater (with LTVs greater than 100%), has declined from approximately 52% as of January 2012 to 12% at September 30, 2014. Lower LTVs lessen the likelihood of defaults and simultaneously decrease loss severities. Additionally, current to 60-days delinquent transition rates continue to decline from their 2009 peak. Further, during 2013 and the first nine months of 2014, we have also observed faster voluntary prepayment (i.e. prepayment of loans

in full with no loss) speeds than originally projected. The yields on our Non-Agency MBS that were purchased at a discount are generally positively impacted if prepayment rates on these securities exceed our prepayment assumptions. Based on these current conditions, we have reduced estimated future losses within our Non-Agency portfolio. As a result, during the three and nine months ended September 30, 2014, \$20.2 million and \$80.6 million, respectively was transferred from Credit Reserve to accretable discount. This increase in accretable discount is expected to increase the interest income realized over the remaining life of our Non-Agency MBS. The remaining average contractual life of such assets is approximately 22 years, but based on scheduled loan amortization and prepayments (both voluntary and involuntary), loan balances will decline substantially over time. Consequently, we believe that the majority of the impact on interest income from the reduction in Credit Reserve will occur over the next ten years.

During the three months ended September 30, 2014, we purchased, through an interest in a consolidated trust, approximately \$65.1 million principal value of residential whole loans for approximately \$54.4 million, bringing the carrying value of our investment in residential whole loans at September 30, 2014 to \$112.9 million. Approximately \$1.2 million of income was recognized on residential whole loans in our consolidated statement of operations for the three months ended September 30, 2014, representing an effective yield of 7.31% excluding servicing costs. During the nine months ended September 30, 2014, we purchased, through an interest in a consolidated trust, approximately \$138.9 million principal value of residential whole loans for



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approximately \$114.8 million and recorded approximately \$1.8 million of income in our consolidated statement of operations, representing an effective yield of 7.30% excluding servicing costs.

At September 30, 2014, we have access to various sources of liquidity which we estimate exceeds \$1.113 billion. This includes (i) \$423.9 million of cash and cash equivalents; (ii) \$411.5 million in estimated financing available from unpledged Agency MBS and other Agency MBS collateral that is currently pledged in excess of contractual requirements; and (iii) \$277.1 million in estimated financing available from unpledged Non-Agency MBS. Consequently, we believe that we are positioned to continue to take advantage of investment opportunities within the residential mortgage marketplace. During the remainder of 2014 we intend to continue to selectively acquire Agency MBS, Non-Agency MBS and residential whole loans. We believe that our Legacy Non-Agency assets will benefit going forward as the existing Legacy MBS universe continues to decline in size due to prepayments, defaults and limited issuance. In addition, while the majority of the Legacy Non-Agency MBS in our portfolio will not return their full face value due to loan defaults, we believe that they will deliver attractive loss adjusted yields due to our discounted average amortized cost of 75% of face value at September 30, 2014.

We believe the financial environment continues to be favorably impacted by accommodative U.S. monetary policy. Repurchase agreement funding for both Agency MBS and Non-Agency MBS continues to be available to us from multiple counterparties. Typically, repurchase agreement funding involving Non-Agency MBS is available from fewer counterparties, at terms requiring higher collateralization and higher interest rates, than for repurchase agreement funding involving Agency MBS. At September 30, 2014, our debt consisted of borrowings under repurchase agreements with 26 counterparties, securitized debt, Senior Notes outstanding, and obligation to return securities obtained as collateral, resulting in a debt-to-equity multiple of 2.7 times. (See table on page 65 under Results of Operations that presents our quarterly leverage multiples since September 30, 2013.)

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Information About Our Assets

The tables below present certain information about our asset allocation at September 30, 2014:

ASSET ALLOCATION

GAAP Basis	Agency MBS	Legacy Non-Agency MBS	RPL/NPL MBS (1)	MBS Portfolio	Residential Whole Loans (2)	Cash (3)	Other, net (4)	Total
(Dollars in Thousands)								
Amortized Cost	\$6,113,801	\$3,948,342	\$26,654	\$10,088,797	\$112,924	\$467,642	\$180,635	\$10,849,998
Market Value	\$6,174,176	\$4,736,719	\$26,607	\$10,937,502	\$112,924	\$467,642	\$180,635	\$11,698,703
Less Payable for Unsettled Purchases	—	—	—	—	(31,789 )	—	—	(31,789 )
Less Repurchase Agreements	(5,417,797 )	(2,700,880 )	(7,046 )	(8,125,723 )	—	—	—	(8,125,723 )
Less Securitized Debt	—	(156,276 )	—	(156,276 )	—	—	—	(156,276 )
Less Senior Notes	—	—	—	—	—	—	(100,000 )	(100,000 )
Equity Allocated	\$756,379	\$1,879,563	\$19,561	\$2,655,503	\$81,135	\$467,642	\$80,635	\$3,284,915
Less Swaps at Market Value	—	—	—	—	—	—	(31,171 )	(31,171 )
Net Equity Allocated	\$756,379	\$1,879,563	\$19,561	\$2,655,503	\$81,135	\$467,642	\$49,464	\$3,253,744
Debt/Net Equity Ratio (5)	7.16	x 1.52	x 0.36	x				2.72

Non-GAAP Adjustments	Agency MBS	Legacy Non-Agency MBS (6)	RPL/NPL MBS (6)	MBS Portfolio	Residential Whole Loans (2)	Cash (3)	Other, net (6)	Total
(Dollars in Thousands)								
Amortized Cost	\$—	\$60,588	\$915,839	\$976,427	\$—	\$—	\$(192,145)	\$784,282
Market Value	\$—	\$65,656	\$916,652	\$982,308	\$—	\$—	\$(192,145)	\$790,163
Repurchase Agreements	—	394,954	(742,747 )	(347,793 )	—	—	—	(347,793 )
Multi-year Collateralized Financing Arrangements	—	(442,370 )	—	(442,370 )	—	—	—	(442,370 )
Equity Allocated	\$—	\$18,240	\$173,905	\$192,145	\$—	\$—	\$(192,145)	\$—
Less Swaps at Market Value	—	—	—	—	—	—	—	—
Net Equity Allocated	\$—	\$18,240	\$173,905	\$192,145	\$—	\$—	\$(192,145)	\$—

Non-GAAP Basis	Agency MBS	Legacy Non-Agency MBS (6)	RPL/NPL MBS (6)	MBS Portfolio	Residential Whole Loans (2)	Cash (3)	Other, net (7)	Total
(Dollars in Thousands)								
Amortized Cost	\$6,113,801	\$4,008,930	\$942,493	\$11,065,224	\$112,924	\$467,642	\$(11,510 )	\$11,634,280
Market Value	\$6,174,176	\$4,802,375	\$943,259	\$11,919,810	\$112,924	\$467,642	\$(11,510 )	\$12,488,866
Less Payable for Unsettled Purchases	—	—	—	—	(31,789 )	—	—	(31,789 )
	(5,417,797 )	(2,305,926 )	(749,793 )	(8,473,516 )	—	—	—	(8,473,516 )

Less Repurchase Agreements								
Less Multi-year Collateralized Financing Arrangements	—	(442,370 )	—	(442,370 )	—	—	—	(442,370 )
Less Securitized Debt	—	(156,276 )	—	(156,276 )	—	—	—	(156,276 )
Less Senior Notes	—	—	—	—	—	—	(100,000 )	(100,000 )
Equity Allocated	\$756,379	\$1,897,803	\$193,466	\$2,847,648	\$81,135	\$467,642	\$(111,510)	\$3,284,915
Less Swaps at Market Value	—	—	—	—	—	—	(31,171 )	(31,171 )
Net Equity Allocated	\$756,379	\$1,897,803	\$193,466	\$2,847,648	\$81,135	\$467,642	\$(142,681)	\$3,253,744
Debt/Net Equity Ratio (8)	7.16	x 1.53	x 3.88	x				2.97

Represents private-label MBS issued in 2013 and 2014 in which the underlying collateral consists of (1) re-performing/non-performing loans that were originated in prior years. Included with the balance of Non-Agency MBS reported on our consolidated balance sheets.

Amount disclosed as market value reflects the carrying value and is included in Prepaid and other assets on our consolidated balance sheets as of September 30, 2014. These assets are acquired through a consolidated trust. No (2) debt-to-equity ratio is presented for residential whole loans, as unsettled purchases were settled in cash in October 2014.

(3) Includes cash and cash equivalents and restricted cash.

Includes securities obtained and pledged as collateral, Linked Transactions, interest receivable, goodwill, prepaid (4) and other assets, obligation to return securities obtained as collateral, interest payable, dividends payable and accrued expenses and other liabilities.

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(5) For the Agency, Non-Agency and RPL/NPL MBS portfolios, represents the sum of borrowings under repurchase agreements, payable for unsettled MBS purchases and securitized debt as a multiple of net equity allocated. The numerator of our Total Debt/Net Equity ratio also includes the obligation to return securities obtained as collateral of \$442.4 million and Senior Notes.

Includes Legacy Non-Agency and RPL/NPL MBS and repurchase agreements underlying Linked Transactions. The purchase of a Non-Agency MBS and contemporaneous repurchase borrowing of this MBS with the same counterparty are accounted for under GAAP as a “linked transaction.” The two components of a linked transaction (MBS and associated borrowings under a repurchase agreement) are evaluated on a combined basis and are presented net as “Linked Transactions” on our consolidated balance sheets. Amounts reported in the Non-Agency MBS column also includes the adjustment to reflect Non-Agency financing under multi-year collateralized financing arrangements of \$442.4 million, while borrowings under repurchase agreements of \$444.0 million for which U.S. Treasury securities are pledged as collateral is reclassified to other, net.

(6) Includes securities obtained and pledged as collateral, interest receivable, goodwill, prepaid and other assets, borrowings under repurchase agreements of \$444.0 million for which U.S. Treasury securities are pledged as collateral, interest payable, dividends payable, and accrued expenses and other liabilities.

(7) For the Agency, Non-Agency and RPL/NPL MBS portfolios, represents the sum of borrowings under repurchase agreements (including an aggregate of \$791.8 million repurchase agreements underlying linked transactions), payable for unsettled MBS purchases, multi-year collateralized financing arrangements of \$442.4 million and securitized debt as a multiple of net equity allocated. The numerator of our total debt-to-equity ratio also includes borrowings under repurchase agreements of \$444.0 million for which U.S. Treasury securities are pledged as collateral and Senior Notes.

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## Agency MBS

The following table presents certain information regarding the composition of our Agency MBS portfolio as of September 30, 2014 and December 31, 2013:

## September 30, 2014

(Dollars in Thousands)	Current Face	Weighted Average Purchase Price	Weighted Average Market Price	Fair Value (1)	Weighted Average Loan Age (Months) (2)	Weighted Average Coupon (2)	Weighted Average 3 Month CPR
15-Year Fixed Rate:							
Low Loan Balance (3)	\$1,771,960	104.3	% 103.1	% \$1,827,449	29	3.02	% 9.2
HARP (4)	183,877	104.7	103.0	189,328	28	3.00	6.5
Other (Post June 2009) (5)	204,278	103.9	106.7	217,918	48	4.15	14.4
Other (Pre June 2009) (6)	1,094	104.9	107.1	1,172	64	4.50	20.5
Total 15-Year Fixed Rate	\$2,161,209	104.3	% 103.5	% \$2,235,867	31	3.13	% 9.5
Hybrid:							
Other (Post June 2009) (5)	\$2,491,328	104.4	% 105.1	% \$2,619,592	41	3.18	% 21.7
Other (Pre June 2009) (6)	1,087,498	101.7	106.9	1,162,065	94	2.93	11.7
Total Hybrid	\$3,578,826	103.6	% 105.7	% \$3,781,657	57	3.11	% 18.7
CMO/Other	\$147,682	102.5	% 104.8	% \$154,778	161	2.42	% 8.6
Total Portfolio	\$5,887,717	103.8	% 104.8	% \$6,172,302	50	3.10	% 15.1

## December 31, 2013

(Dollars in Thousands)	Current Face	Weighted Average Purchase Price	Weighted Average Market Price	Fair Value (1)	Weighted Average Loan Age (Months) (2)	Weighted Average Coupon (2)	Weighted Average 3 Month CPR
15-Year Fixed Rate:							
Low Loan Balance (3)	\$1,977,798	104.3	% 101.8	% \$2,012,876	20	3.04	% 7.2
HARP (4)	205,895	104.7	101.8	209,597	19	3.01	6.3
Other (Post June 2009) (5)	222,691	103.7	106.1	236,253	40	4.16	17.0
Other (Pre June 2009) (6)	1,256	104.9	106.7	1,340	55	4.50	0.5
Total 15-Year Fixed Rate	\$2,407,640	104.3	% 102.2	% \$2,460,066	22	3.14	% 8.0
Hybrid:							
Other (Post June 2009) (5)	\$2,502,413	104.1	% 104.4	% \$2,612,108	32	3.22	% 17.7
Other (Pre June 2009) (6)	1,202,227	101.4	106.0	1,274,745	84	3.28	13.2
Total Hybrid	\$3,704,640	103.2	% 104.9	% \$3,886,853	49	3.24	% 16.2
CMO/Other	\$164,639	102.5	% 104.0	% \$171,182	154	2.44	% 8.7
Total Portfolio	\$6,276,919	103.6	% 103.8	% \$6,518,101	41	3.18	% 12.9

- (1) Does not include principal payments receivable of \$1.9 million and \$1.1 million at September 30, 2014 and December 31, 2013, respectively.
- (2) Weighted average is based on MBS current face at September 30, 2014 and December 31, 2013, respectively.
- (3) Low loan balance represents MBS collateralized by mortgages with original loan balance of less than or equal to \$175,000.
- (4) Home Affordable Refinance Program (or HARP) MBS are backed by refinanced loans with LTVs greater than or equal to 80% at origination.
- (5) MBS issued in June 2009 or later. Majority of underlying loans are ineligible to refinance through the HARP program.
- (6) MBS issued before June 2009.

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The following table presents certain information regarding our 15-year fixed-rate Agency MBS as of September 30, 2014 and December 31, 2013:

September 30, 2014

Coupon	Current Face	Weighted Average Purchase Price	Weighted Average Market Price	Fair Value (1)	Weighted Average Loan Age (Months) (2)	Weighted Average Loan Rate	Low Loan Balance and/or HARP (3)	Weighted Average 3 Month CPR
(Dollars in Thousands)								
15-Year Fixed Rate:								
2.5%	\$1,001,750	104.0 %	101.0 %	\$1,011,700	21	3.04 %	100 %	6.6 %
3.0%	432,683	105.9	103.3	447,166	27	3.49	100	8.8
3.5%	12,639	103.5	105.5	13,328	47	4.17	100	15.5
4.0%	607,644	103.5	106.9	649,514	46	4.40	79	13.7
4.5%	106,493	105.2	107.2	114,159	50	4.88	32	14.8
Total 15-Year Fixed Rate	\$2,161,209	104.3 %	103.5 %	\$2,235,867	31	3.61 %	91 %	9.5 %

December 31, 2013

Coupon	Current Face	Weighted Average Purchase Price	Weighted Average Market Price	Fair Value (1)	Weighted Average Loan Age (Months) (2)	Weighted Average Loan Rate	Low Loan Balance and/or HARP (3)	Weighted Average 3 Month CPR
(Dollars in Thousands)								
15-Year Fixed Rate:								
2.5%	\$1,096,097	104.0 %	99.2 %	\$1,086,853	12	3.04 %	100 %	4.0 %
3.0%	481,174	105.9	102.1	491,212	18	3.49	100	5.5
3.5%	15,429	103.5	104.8	16,162	38	4.16	100	24.1
4.0%	688,213	103.4	106.2	730,542	37	4.40	80	13.8
4.5%	126,727	105.2	106.8	135,297	41	4.87	32	15.8
Total 15-Year Fixed Rate	\$2,407,640	104.3 %	102.2 %	\$2,460,066	22	3.62 %	91 %	8.0 %

(1) Does not include principal payments receivable of \$1.9 million and \$1.1 million at September 30, 2014 and December 31, 2013, respectively.

(2) Weighted average is based on MBS current face at September 30, 2014 and December 31, 2013, respectively.

(3) Low Loan Balance represents MBS collateralized by mortgages with original loan balance less than or equal to \$175,000. HARP MBS are backed by refinanced loans with LTVs greater than or equal to 80% at origination.

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The following table presents certain information regarding our Hybrid Agency MBS as of September 30, 2014 and December 31, 2013:

## September 30, 2014

(Dollars in Thousands)	Current Face	Weighted Average Purchase Price	Weighted Average Market Price	Fair Value (1)	Weighted Average Coupon (2)	Weighted Average Loan Age (Months) (2)	Weighted Average Months to Reset (3)	Weighted Interest Only (4)	Weighted Average Month CPR
Hybrid Post June 2009:									
Agency 5/1	\$1,032,025	104.2 %	106.2 %	\$1,095,991	3.29 %	48	12	21 %	26.8 %
Agency 7/1	1,148,267	104.5	104.6	1,201,651	3.08	37	46	20	19.1
Agency 10/1	311,036	104.8	103.5	321,950	3.23	33	86	59	14.2
Total Hybrids Post June 2009	\$2,491,328	104.4 %	105.1 %	\$2,619,592	3.18 %	41	37	25 %	21.7 %
Hybrid Pre June 2009:									
Coupon < 4.5% (5)	\$865,121	101.8 %	106.8 %	\$923,887	2.33 %	97	6	56 %	8.8 %
Coupon >= 4.5% (6)	222,377	101.2	107.1	238,178	5.29	82	14	80	22.5
Total Hybrids Pre June 2009	\$1,087,498	101.7 %	106.9 %	\$1,162,065	2.93 %	94	7	61 %	11.7 %
Total Hybrids	\$3,578,826	103.6 %	105.7 %	\$3,781,657	3.11 %	57	28	36 %	18.7 %

## December 31, 2013

(Dollars in Thousands)	Current Face	Weighted Average Purchase Price	Weighted Average Market Price	Fair Value (1)	Weighted Average Coupon (2)	Weighted Average Loan Age (Months) (2)	Weighted Average Months to Reset (3)	Weighted Interest Only (4)	Weighted Average Month CPR
Hybrid Post June 2009:									
Agency 5/1	\$921,849	103.5 %	105.5 %	\$972,201	3.37 %	39	20	24 %	23.8 %
Agency 7/1	1,233,187	104.4	104.2	1,284,739	3.09	28	55	21	15.1
Agency 10/1	347,377	104.8	102.2	355,168	3.27	24	95	57	10.9
Total Hybrids Post June 2009	\$2,502,413	104.1 %	104.4 %	\$2,612,108	3.22 %	32	48	27 %	17.7 %
Hybrid Pre June 2009:									
Coupon < 4.5% (5)	\$860,491	101.5 %	105.9 %	\$910,849	2.44 %	88	6	56 %	8.8 %
Coupon >= 4.5% (6)	341,736	101.2	106.5	363,896	5.40	73	20	77	23.5
Total Hybrids Pre June 2009	\$1,202,227	101.4 %	106.0 %	\$1,274,745	3.28 %	84	10	62 %	13.2 %
Total Hybrids	\$3,704,640	103.2 %	104.9 %	\$3,886,853	3.24 %	49	35	38 %	16.2 %

(1) Does not include principal payments receivable of \$1.9 million and \$1.1 million at September 30, 2014 and December 31, 2013, respectively.

(2) Weighted average is based on MBS current face at September 30, 2014 and December 31, 2013, respectively.

(3) Weighted average months to reset is the number of months remaining before the coupon interest rate resets. At reset, the MBS coupon will adjust based upon the underlying benchmark interest rate index, margin and periodic or



lifetime caps. The months to reset do not reflect scheduled amortization or prepayments.

(4) Interest only represents MBS backed by mortgages currently in their interest only period. Percentage is based on MBS current face at September 30, 2014 and December 31, 2013, respectively.

(5) Agency 3/1, 5/1, 7/1 and 10/1 Hybrid ARM-MBS with coupon less than 4.5%.

(6) Agency 3/1, 5/1, 7/1 and 10/1 Hybrid ARM-MBS with coupon greater than or equal to 4.5%.

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## Non-Agency MBS

The following table presents information with respect to our Non-Agency MBS: (i) excluding Linked Transactions and reported in accordance with GAAP; (ii) underlying our Linked Transactions and reflected consistent with GAAP reporting requirements; and (iii) on a combined basis (Non-GAAP) as of September 30, 2014 and December 31, 2013:

(In Thousands)	September 30, 2014	December 31, 2013
(i) Non-Agency MBS (GAAP - excluding Linked Transactions)		
Face/Par	\$5,329,823	\$5,616,038
Fair Value	4,763,326	4,852,137
Amortized Cost	3,974,996	4,113,600
Purchase Discount Designated as Credit Reserve and OTTI	(929,100)	(1,043,037)
Purchase Discount Designated as Accretable	(426,351)	(460,039)
Purchase Premiums	624	638
(ii) Non-Agency MBS Underlying Linked Transactions		
Face/Par	\$989,314	\$134,430
Fair Value	982,308	130,790
Amortized Cost	976,427	126,497
Purchase Discount Designated as Credit Reserve	(11,010)	(4,721)
Purchase Discount Designated as Accretable	(1,877)	(3,212)
(iii) Combined Non-Agency MBS and MBS Underlying Linked Transactions (Non-GAAP)		
Face/Par	\$6,319,137	\$5,750,468
Fair Value	5,745,634	4,982,927
Amortized Cost	4,951,423	4,240,097
Purchase Discount Designated as Credit Reserve and OTTI	(940,110)	(1,047,758)
Purchase Discount Designated as Accretable	(428,228)	(463,251)
Purchase Premiums	624	638

(1) Includes discount designated as Credit Reserve of \$897.7 million and OTTI of \$31.4 million.

(2) Includes discount designated as Credit Reserve of \$998.5 million and OTTI of \$44.5 million.

(3) Includes discount designated as Credit Reserve of \$908.7 million and OTTI of \$31.4 million.

(4) Includes discount designated as Credit Reserve of \$1.003 billion and OTTI of \$44.5 million.

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## Purchase Discounts on Non-Agency MBS and Securities Underlying Linked Transactions

The following table presents the changes in the components of purchase discount on Non-Agency MBS with respect to purchase discount designated as Credit Reserve and OTTI, and accretable purchase discount, including securities underlying Linked Transactions, for the three months ended September 30, 2014 and September 30, 2013 on both a GAAP and Non-GAAP basis:

	Three Months Ended September 30, 2014		Three Months Ended September 30, 2013	
	Discount Designated as Credit Reserve and OTTI	Accretable Discount (1)	Discount Designated as Credit Reserve and OTTI	Accretable Discount (1)
GAAP Basis				
(In Thousands)				
Balance at beginning of period	\$ (986,842	) \$ (436,111	) \$ (1,264,971	) \$ (396,581
Accretion of discount		25,504	—	19,556
Realized credit losses	20,733	—	48,642	—
Purchases	(4,200	) 272	(851	) 879
Sales	21,024	4,169	27,178	4,248
Transfers/release of credit reserve	20,185	(20,185	) 71,010	(71,010
Balance at the end of period	\$ (929,100	) \$ (426,351	) \$ (1,118,992	) \$ (442,908
Non-GAAP Adjustments				
(In Thousands)				
Balance at beginning of period	\$ (11,094	) \$ (1,720	) \$ (5,523	) \$ (2,266
Accretion of discount	—	268	—	230
Realized credit losses	417	—	146	—
Purchases	—	(758	) —	(939
Transfers/release of credit reserve	(333	) 333	—	—
Balance at the end of period	\$ (11,010	) \$ (1,877	) \$ (5,377	) \$ (2,975
Non-GAAP Basis				
(In Thousands)				
Balance at beginning of period	\$ (997,936	) \$ (437,831	) \$ (1,270,494	) \$ (398,847
Accretion of discount	—	25,772	—	19,786
Realized credit losses	21,150	—	48,788	—
Purchases	(4,200	) (486	) (851	) (60
Sales	21,024	4,169	27,178	4,248
Transfers/release of credit reserve	19,852	(19,852	) 71,010	(71,010
Balance at the end of period	\$ (940,110	) \$ (428,228	) \$ (1,124,369	) \$ (445,883

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



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The following table presents the changes in the components of purchase discount on Non-Agency MBS with respect to purchase discount designated as Credit Reserve and OTTI, and accretable purchase discount, including securities underlying Linked Transactions, for the nine months ended September 30, 2014 and September 30, 2013 on both a GAAP and Non-GAAP basis:

	Nine Months Ended September 30, 2014		Nine Months Ended September 30, 2013	
	Discount Designated as Credit Reserve and OTTI	Accretable Discount (1)	Discount Designated as Credit Reserve and OTTI	Accretable Discount (1)
<b>GAAP Basis</b>				
(In Thousands)				
Balance at beginning of period	\$ (1,043,037 )	\$ (460,039 )	\$ (1,380,506 )	\$ (371,626 )
Accretion of discount	—	78,701	—	48,305
Realized credit losses	69,129	—	137,324	—
Purchases	(70,535 )	25,314	(74,238 )	30,533
Sales	34,780	10,236	38,150	10,158
Transfers/release of credit reserve	80,563	(80,563 )	160,278	(160,278 )
Balance at the end of period	\$ (929,100 )	\$ (426,351 )	\$ (1,118,992 )	\$ (442,908 )
<b>Non-GAAP Adjustments</b>				
(In Thousands)				
Balance at beginning of period	\$ (4,721 )	\$ (3,212 )	\$ (6,051 )	\$ (2,409 )
Accretion of discount	—	828	—	502
Realized credit losses	667	—	545	—
Purchases	(6,738 )	289	—	(939 )
Transfers/release of credit reserve	(218 )	218	129	(129 )
Balance at the end of period	\$ (11,010 )	\$ (1,877 )	\$ (5,377 )	\$ (2,975 )
<b>Non-GAAP Basis</b>				
(In Thousands)				
Balance at beginning of period	\$ (1,047,758 )	\$ (463,251 )	\$ (1,386,557 )	\$ (374,035 )
Accretion of discount	—	79,529	—	48,807
Realized credit losses	69,796	—	137,869	—
Purchases	(77,273 )	25,603	(74,238 )	29,594
Sales	34,780	10,236	38,150	10,158
Transfers/release of credit reserve	80,345	(80,345 )	160,407	(160,407 )
Balance at the end of period	\$ (940,110 )	\$ (428,228 )	\$ (1,124,369 )	\$ (445,883 )

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

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The following table presents information with respect to the yield components of our Non-Agency MBS for the three months ended September 30, 2014 and September 30, 2013:

Non-Agency MBS	Three Months Ended			
	September 30, 2014	September 30, 2013		
Coupon Yield (1)	5.17	% 5.59		%
Effective Yield Adjustment (2)	2.51	1.74		
Net Yield	7.68	% 7.33		%

- (1) Reflects the annualized coupon interest income divided by the average amortized cost. The discounted purchase price on Non-Agency MBS causes the coupon yield to be higher than the pass-through coupon interest rate.
- (2) The effective yield adjustment is the difference between the net yield, calculated utilizing management's estimates of future cash flows for Non-Agency MBS, less the current coupon yield.

The information in the above tables, on pages 53-55, includes certain underlying Non-Agency MBS and the associated repurchase agreement borrowings that are disclosed both separately and/or on a combined basis with our Non-Agency MBS portfolio. However, for GAAP financial reporting purposes, these items are required to be accounted for by us as Linked Transactions. Consequently, the presentation of this information in the above tables constitutes Non-GAAP financial measures within the meaning of Regulation G, as promulgated by the SEC.

In assessing the performance of the Non-Agency MBS portfolio, we do not view these transactions as linked, but rather view the performance of the linked Non-Agency MBS and the related repurchase agreement borrowings as we would any other Non-Agency MBS that is not part of a linked transaction. Accordingly, we consider that the Non-GAAP information disclosed in the above tables enhances the ability of investors to analyze the performance of our Non-Agency MBS in the same way that we assess such assets.

In addition, in connection with our financing strategy for Non-Agency MBS, we have entered into contemporaneous repurchase agreement and reverse repurchase agreement transactions with a single counterparty. The transactions effectively result in us pledging Non-Agency MBS as collateral to the counterparty in connection with the repurchase agreement financing and obtaining U.S. Treasury securities as collateral in connection with the reverse repurchase agreement. Both the repurchase agreement and the reverse repurchase agreement have a contractual maturity of January 2016 with no net exchange of cash at inception. The U.S. Treasury collateral obtained is pledged as collateral in a subsequent repurchase agreement transaction with a different counterparty for cash. This subsequent repurchase transaction has a term of 90 days at inception. For purposes of presentation of its repurchase agreement financing liabilities in the Non-GAAP Asset Allocation table on page 48, the obligation to return the \$442 million of U.S. Treasury collateral, is separately presented as "Multi-year collateralized financing arrangements" and is included in the numerator of the Debt/Net Equity Ratio for the Non-Agency MBS portfolio. In addition, the asset balance for U.S. Treasury securities obtained as collateral and the repurchase agreement liability to the second counterparty to which we pledged those U.S. Treasury securities as collateral are included in the "Other, net" column as we believe net presentation is consistent with the economic substance of the transactions. However, GAAP prohibits offsetting of this asset and liability for a number of reasons, including the fact that the counterparties to these transactions are different, and there is no legal right of offset. For GAAP presentation purposes, the repurchase agreement liability against which we have pledged U.S. Treasuries is disclosed as "Repurchase Agreements" and is included in the numerator of the Debt/Net Equity Ratio for the Non-Agency MBS portfolio. In addition, the asset balance for the U.S. Treasury securities obtained as collateral and the liability balance for the obligation to return this collateral are included in the "Other, net" column. However, management considers that the Non-GAAP Asset Allocation table presented on page 48 more appropriately reflects the economic substance of the transactions. Consequently, this presentation constitutes a Non-GAAP financial measure within the meaning of Regulation G, as promulgated by the SEC. The Non-GAAP

presentation of liabilities associated with the Company's collateralized financing arrangements does not impact the overall calculation of Debt/Net Equity for the Company as a whole.

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Actual maturities of MBS are generally shorter than stated contractual maturities because actual maturities of MBS are affected by the contractual lives of the underlying mortgages, periodic payments of principal, and prepayments of principal. The following table presents certain information regarding the amortized costs, weighted average yields and contractual maturities of our MBS at September 30, 2014 and does not reflect the effect of prepayments or scheduled principal amortization on our MBS:

(Dollars in Thousands)	One to Five Year		Five to Ten Years		Over Ten Years		Total MBS (1)		
	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Total Amortized Cost	Total Fair Value	Weighted Average Yield
Agency MBS:									
Fannie Mae	\$259	3.68 %	\$6,799	2.30 %	\$5,001,817	2.25 %	\$5,008,875	\$5,079,098	2.25 %
Freddie Mac	—	—	—	—	1,093,168	2.23	1,093,168	1,083,010	2.23
Ginnie Mae	—	—	—	—	11,758	1.62	11,758	12,068	1.62
Total Agency MBS	\$259	3.68 %	\$6,799	2.30 %	\$6,106,743	2.24 %	\$6,113,801	\$6,174,176	2.24 %
Non-Agency MBS	\$2,585	4.23 %	\$16,568	6.28 %	\$3,955,843	7.70 %	\$3,974,996	\$4,763,326	7.70 %
Total MBS	\$2,844	4.18 %	\$23,367	5.12 %	\$10,062,586	4.39 %	\$10,088,797	\$10,937,502	4.36 %

(1) We did not have any MBS with contractual maturities of less than one year at September 30, 2014.

## Exposure to Financial Counterparties

We finance the acquisition of a significant portion of our MBS with repurchase agreements. In connection with these financing arrangements, we pledge our securities as collateral to secure the borrowing. The amount of collateral pledged will typically exceed the amount of the financing with the extent of over-collateralization ranging from 0% - 6% of the amount borrowed (U.S. Treasury and Agency MBS collateral) to up to 60% (Non-Agency MBS collateral). Consequently, while repurchase agreement financing results in us recording a liability to the counterparty in our consolidated balance sheets, we are exposed to the counterparty, if during the term of the repurchase agreement financing, a lender should default on its obligation and we are not able to recover our pledged assets. The amount of this exposure is the difference between the amount loaned to us plus interest due to the counterparty and the fair value of the collateral pledged by us to the lender including accrued interest receivable on such collateral.

In addition, we use interest rate Swaps to manage interest rate risk exposure in connection with our repurchase agreement financings. We will make cash payments or pledge securities as collateral as part of a margin arrangement in connection with interest rate Swaps that are in an unrealized loss position. In the event that a counterparty for a Swap that is not subject to central clearing were to default on its obligation, we would be exposed to a loss to a Swap counterparty to the extent that the amount of cash or securities pledged exceeded the unrealized loss on the associated Swaps and we were not able to recover the excess collateral.



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The table below summarizes our exposure to our counterparties at September 30, 2014, by country of domicile:

Country	Number of Counterparties	Repurchase Agreement Financing	Swaps at Fair Value	Exposure (1)	Exposure as a Percentage of MFA Total Assets	
(Dollars in Thousands)						
European Countries: (2)						
Switzerland	3	\$1,656,822	\$—	\$745,965	6.09	%
United Kingdom	2	1,136,074	(4,226	) 325,543	2.66	
France	1	439,716	—	26,056	0.21	
Holland	1	391,176	1,677	14,340	0.12	
Germany	1	—	444	3,983	0.03	
Total	8	3,623,788	(2,105	) 1,115,887	9.11	%
Other Countries:						
United States (3)	13	\$4,343,513	\$(29,066	) \$725,732	5.93	%
Japan	4	611,212	—	34,977	0.29	
Canada	2	704,717	—	179,387	1.47	
China	1	134,300	—	7,490	0.06	
Total	20	5,793,742	(29,066	) 947,586	7.75	%
Total Counterparty Exposure	28	\$9,417,530	(4)(5) \$(31,171	) \$2,063,473	16.86	%

(1) Represents for each counterparty the amount of cash and/or securities pledged as collateral less the aggregate of repurchase agreement financing, Swaps at fair value, and net interest receivable/payable on all such instruments.

(2) Includes European-based counterparties as well as U.S.-domiciled subsidiaries of the European parent entity.

(3) Includes one counterparty that is a central clearing house for our Swaps.

(4) Includes \$500.0 million of repurchase agreements entered into in connection with contemporaneous repurchase and reverse repurchase agreements with a single counterparty.

(5) Includes \$791.8 million of repurchase agreements which are a component of our Linked Transactions.

At September 30, 2014, we did not use credit default Swaps or other forms of credit protection to hedge the exposures summarized in the table above.

Weak economic conditions in Europe could potentially impact our major European financial counterparties, with the possibility that this would also impact the operations of their U.S. domiciled subsidiaries. This could adversely affect our financing and operations as well as those of the entire mortgage sector in general. Management monitors our exposure to our repurchase agreement and Swap counterparties on a regular basis, using various methods, including review of recent rating agency actions or other developments and by monitoring the amount of cash and securities collateral pledged and the associated loan amount under repurchase agreements and/or the fair value of Swaps with our counterparties. We intend to make reverse margin calls on our counterparties to recover excess collateral as permitted by the agreements governing our financing arrangements, or take other necessary actions to reduce the amount of our exposure to a counterparty when such actions are considered necessary.

#### Tax Considerations

##### Key differences between GAAP net income and REIT Taxable Income for Non-Agency MBS

Our total Non-Agency MBS portfolio for tax differs from our portfolio reported for GAAP primarily due to the fact that for tax purposes; (i) certain of the MBS contributed to the VIEs used to facilitate resecuritization transactions

were deemed to be sold; (ii) the tax portfolio includes certain securities issued by these VIEs; and (iii) Non-Agency MBS underlying linked transactions are included in our tax portfolio. In addition, for our Non-Agency MBS and residential whole loans, potential timing differences arise with respect to the accretion of market discount into income and recognition of realized losses for tax purposes as compared to GAAP. Consequently, our REIT taxable income calculated in a given period may differ significantly from our GAAP net income.

The determination of taxable income attributable to Non-Agency MBS and residential whole loans is dependent on a number of factors, including principal payments, defaults and loss severities. In projecting taxable income for Non-Agency MBS and residential whole loans during the year, management considers estimates of the amount of discount expected to be accreted. Such

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estimates require significant judgment and actual results may differ from these estimates. Moreover, the deductibility of realized losses from Non-Agency MBS and residential whole loans and their effect on market discount accretion is analyzed on an asset-by-asset basis and while they will result in a reduction of taxable income, this reduction tends to occur gradually and primarily in periods after the realized losses are reported.

### Resecuritization transactions result in differences between GAAP net income and REIT Taxable Income

For tax purposes, depending on the transaction structure, a resecuritization transaction may be treated either as a sale or a financing of the underlying MBS. Income recognized from resecuritization transactions will differ for tax and GAAP. For tax purposes, we own and may in the future acquire interests in resecuritization trusts, in which several of the classes of securities are or will be issued with Original Issue Discount (or OID). As the holder of the retained interests in the trust, we generally will be required to include OID in our current gross interest income over the term of the applicable securities as the OID accrues. The rate at which the OID is recognized into taxable income is calculated using a constant rate of yield to maturity, with realized losses impacting the amount of OID recognized in REIT taxable income once they are actually incurred. For tax purposes, REIT taxable income may be recognized in excess of economic income (i.e., OID) or in advance of the corresponding cash flow from these assets, thereby effecting our dividend distribution requirement to stockholders.

We estimate that for the nine months ended September 30, 2014, our taxable income was approximately \$198.5 million. Based on dividends paid or declared during the nine months ended September 30, 2014, we have undistributed taxable income of approximately \$19.9 million, or \$0.05 per share. We have until the filing of our 2014 tax return (due not later than September 15, 2015) to declare the distribution of any 2014 REIT taxable income not previously distributed.

### Regulatory Developments

The U.S. Congress, Board of Governors of the Federal Reserve System, U.S. Treasury, Federal Deposit Insurance Corporation, SEC and other governmental and regulatory bodies have taken and continue to consider additional actions in response to the financial crisis. In particular, the Dodd-Frank Wall Street Reform and Consumer Protection Act (or the Dodd-Frank Act) created a new regulator housed within the Federal Reserve System, an independent bureau known as the Consumer Financial Protection Bureau (or the CFPB), which has broad authority over a wide range of consumer financial products and services, including mortgage lending. Another section of the Dodd-Frank Act, the Mortgage Reform and Anti-Predatory Lending Act (or the Mortgage Reform Act), contains new underwriting and servicing standards for the mortgage industry, as well as restrictions on compensation for mortgage originators. In addition, the Mortgage Reform Act grants broad discretionary regulatory authority to the CFPB to prohibit or condition terms, acts or practices relating to residential mortgage loans that the CFPB finds abusive, unfair, deceptive or predatory, as well as to take other actions that the CFPB finds are necessary or proper to ensure responsible affordable mortgage credit remains available to consumers. The Dodd-Frank Act also affects the securitization of mortgages (and other assets) with requirements for risk retention by securitizers and requirements for regulating credit rating agencies.

The Dodd-Frank Act requires numerous regulations, many of which (including those mentioned above regarding underwriting and mortgage originator compensation) have only recently been finalized and are only now becoming effective and implemented and operationalized. As a result, we are unable to fully predict at this time how the Dodd-Frank Act, as well as other laws that may be adopted in the future, will impact our business, results of operations and financial condition, or the environment for repurchase financing and other forms of borrowing, the investing environment for Agency MBS, Non-Agency MBS and/or residential mortgage loans, the securitization industry, Swaps and other derivatives. However, at a minimum, we believe that the Dodd-Frank Act and the regulations promulgated and made effective thereunder are likely to increase the economic and compliance costs for

participants in the mortgage and securitization industries, including us.

In addition to the regulatory actions being implemented under the Dodd-Frank Act, on August 31, 2011, the SEC issued a concept release under which it is reviewing interpretive issues related to Section 3(c)(5)(C) of the Investment Company Act. Section 3(c)(5)(C) excludes from the definition of “investment company” entities that are primarily engaged in, among other things, “purchasing or otherwise acquiring mortgages and other liens on and interests in real estate.” Many companies that engage in the business of acquiring mortgages and mortgage-related instruments seek to rely on existing interpretations of the SEC Staff with respect to Section 3(c)(5)(C) so as not to become an investment company for the purpose of regulation under the Investment Company Act. In connection with the concept release, the SEC requested comments on, among other things, whether it should reconsider its existing interpretation of Section 3(c)(5)(C). To date the SEC has not taken or otherwise announced any further action in connection with the concept release.

In the first quarter of 2014 Senators Tim Johnson (D-SD) and Mike Crapo (R-ID), the two most senior members of the Senate Banking Committee, released a proposed bill (or Johnson-Crapo Bill), which is generally based on earlier legislation proposed by Senators Bob Corker (R-TN) and Mark Warner (D-VA). The Johnson-Crapo Bill, among other things, would eliminate Freddie

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Mac and Fannie Mae and replace them with a new agency. The final outcome of the Johnson-Crapo Bill remains uncertain, as reports indicate that the House Republican leadership continues to favor a very different approach. However, it is possible that the adoption of the Johnson-Crapo Bill or other similar legislation could adversely effect the types of assets we can buy and our business operations. As the Federal Housing Finance Agency and both houses of Congress are each working on separate measures intended to dramatically restructure the U.S. housing finance system and the operations of Fannie Mae and Freddie Mac, we expect debate and discussion on the topic to continue throughout 2014.

Results of Operations

Quarter Ended September 30, 2014 Compared to the Quarter Ended September 30, 2013

General

For the third quarter of 2014, we had net income available to common stock and participating securities of \$75.1 million, or \$0.20 per basic and diluted common share, compared to net income available to common stock and participating securities of \$67.6 million, or \$0.19 per basic and diluted common share, for the third quarter of 2013. The increase in net income available to our common stock and participating securities, and the increase of this item on a per share basis primarily reflects the absence in the third quarter of 2014 of an \$8.7 million unrealized loss on TBA positions and a \$2.0 million charge related to the impairment of securitization related costs recognized during the third quarter of 2013 and a \$2.0 million increase in unrealized net gains and net interest income from Linked Transactions. Yields on Agency MBS were lower compared to the prior year period and were impacted by lower coupon yields. Non-Agency MBS yields were higher compared to the prior year period due primarily to the impact of credit reserve releases.

Net Interest Income

Net interest income represents the difference between income on interest-earning assets and expense on interest-bearing liabilities. Net interest income depends primarily upon the volume of interest-earning assets and interest-bearing liabilities and the corresponding interest rates earned or paid. Our net interest income varies primarily as a result of changes in interest rates, the slope of the yield curve (i.e., the differential between long-term and short-term interest rates), borrowing costs (i.e., our interest expense) and prepayment speeds on our MBS. Interest rates and CPRs (which measure the amount of unscheduled principal prepayment on a bond as a percentage of the bond balance), vary according to the type of investment, conditions in the financial markets, and other factors, none of which can be predicted with any certainty.

The changes in average interest-earning assets and average interest-bearing liabilities and their related yields and costs are discussed in greater detail below under “Interest Income” and “Interest Expense.”

For the third quarter of 2014, our net interest spread and margin were 2.30% and 2.67%, respectively, compared to a net interest spread and margin of 2.24% and 2.63%, respectively, for the third quarter of 2013. Although our net interest spread and margin increased, our net interest income decreased by \$4.9 million, or 6.4% to \$71.6 million from \$76.5 million for the third quarter of 2013. This decrease primarily reflects the impact of the lower average balance of our MBS portfolio as measured by amortized cost, increased Non-Agency MBS borrowing costs (including the impact of allocated Swap expense), partially offset by a decrease in the average balance of securitized debt, lower Agency MBS borrowing costs and higher yielding Non-Agency MBS due to improved credit performance. The net interest spread on our Agency MBS portfolio decreased to 0.95% for the third quarter of 2014 compared to 1.01% for the third quarter of 2013. The net interest spread on our Non-Agency MBS portfolio increased to 4.72% for the third quarter of 2014 compared to 4.42% for the third quarter of 2013.



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## Analysis of Net Interest Income

The following table sets forth certain information about the average balances of our assets and liabilities and their related yields and costs for the three months ended September 30, 2014 and 2013. Average yields are derived by dividing annualized interest income by the average amortized cost of the related assets and average costs are derived by dividing annualized interest expense by the daily average balance of the related liabilities, for the periods shown. The yields and costs include premium amortization and purchase discount accretion which are considered adjustments to interest rates.

(Dollars in Thousands)	Three Months Ended September 30, 2014			2013			
	Average Balance	Interest	Average Yield/Cost	Average Balance	Interest	Average Yield/Cost	
Assets:							
Interest-earning assets:							
Agency MBS (1)	\$6,319,985	\$33,066	2.09	% \$6,778,969	\$36,158	2.13	%
Non-Agency MBS (1)	4,053,778	77,874	7.68	4,492,861	82,303	7.33	
Total MBS	10,373,763	110,940	4.28	11,271,830	118,461	4.20	
Cash and cash equivalents (2)	387,984	20	0.02	436,816	21	0.02	
Total interest-earning assets	10,761,747	110,960	4.12	11,708,646	118,482	4.05	
Total non-interest-earning assets	1,721,751			1,157,365			
Total assets	\$12,483,498			\$12,866,011			
Liabilities and stockholders' equity:							
Interest-bearing liabilities:							
Agency repurchase agreements (3)	\$5,606,953	\$16,052	1.14	\$5,966,140	\$16,848	1.12	
Non-Agency repurchase agreements (3)	2,660,952	19,883	2.96	2,713,270	20,265	2.96	
Total repurchase agreements	8,267,905	35,935	1.72	8,679,410	37,113	1.70	
Securitized debt	190,753	1,415	2.94	440,665	2,830	2.55	
Senior Notes	100,000	2,008	8.03	100,000	2,007	8.03	
Total interest-bearing liabilities	8,558,658	39,358	1.82	9,220,075	41,950	1.81	
Total non-interest-bearing liabilities	645,002			542,139			
Total liabilities	9,203,660			9,762,214			
Stockholders' equity	3,279,838			3,103,797			
Total liabilities and stockholders' equity	\$12,483,498			\$12,866,011			
Net interest income/ net interest rate spread (4)		\$71,602	2.30	%	\$76,532	2.24	%
Net interest-earning assets/ net interest margin (5)	\$2,203,089		2.67	%	\$2,488,571	2.63	%
Ratio of interest-earning assets to interest-bearing liabilities	1.26	x			1.27	x	

(1) Yields presented throughout this Quarterly Report on Form 10-Q are calculated using average amortized cost data for MBS which excludes unrealized gains and losses and includes principal payments receivable on MBS. For GAAP reporting purposes, MBS purchases and sales are reported on the trade date. Average amortized cost data

used to determine yields is calculated based on the settlement date of the associated purchase or sale as interest income is not earned on purchased assets and continues to be earned on sold assets until settlement date. Includes Non-Agency MBS transferred to consolidated VIEs. Excludes Non-Agency MBS reported as a component of Linked Transactions.

(2) Includes average interest-earning cash, cash equivalents and restricted cash.

Average cost of repurchase agreements includes the cost of Swaps allocated based on the proportionate

(3) share of the overall estimated weighted average portfolio duration. Excludes interest expense associated with repurchase agreements reported as a component of Linked Transactions.

(4) Net interest rate spread reflects the difference between the yield on average interest-earning assets and average cost of funds.

(5) Net interest margin reflects annualized net interest income divided by average interest-earning assets.



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## Rate/Volume Analysis

The following table presents the extent to which changes in interest rates (yield/cost) and changes in the volume (average balance) of interest-earning assets and interest-bearing liabilities have affected our interest income and interest expense during the periods indicated. Information is provided in each category with respect to: (i) the changes attributable to changes in volume (changes in average balance multiplied by prior rate); (ii) the changes attributable to changes in rate (changes in rate multiplied by prior average balance); and (iii) the net change. The changes attributable to the combined impact of volume and rate have been allocated proportionately, based on absolute values, to the changes due to rate and volume.

(In Thousands)	Three Months Ended September 30, 2014 Compared to Three Months Ended September 30, 2013		
	Increase/(Decrease) due to Volume	Rate	Total Net Change in Interest Income/Expense
Interest-earning assets:			
Agency MBS	\$ (2,376)	) \$ (716)	) \$ (3,092)
Non-Agency MBS	(8,275)	) 3,846	(4,429)
Cash and cash equivalents	(2)	) 1	(1)
Total net change in income from interest-earning assets	\$ (10,653)	) \$ 3,131	\$ (7,522)
Interest-bearing liabilities:			
Agency repurchase agreements	\$ (1,043)	) \$ 227	\$ (816)
Non-Agency repurchase agreements	(369)	) 7	(362)
Securitized debt	(1,798)	) 383	(1,415)
Senior Notes	—	) 1	1
Total net change in expense of interest-bearing liabilities	\$ (3,210)	) \$ 618	\$ (2,592)
Net change in net interest income	\$ (7,443)	) \$ 2,513	\$ (4,930)

The following table presents certain quarterly information regarding our net interest spread and net interest margin for the quarterly periods presented:

Quarter Ended	Total Interest-Earning Assets and Interest-Bearing Liabilities	
	Net Interest Spread (1)	Net Interest Margin (2)
September 30, 2014	2.30	% 2.67 %
June 30, 2014	2.42	2.80
March 31, 2014	2.44	2.84
December 31, 2013	2.34	2.75
September 30, 2013	2.24	2.63

(1) Reflects the difference between the yield on average interest-earning assets and average cost of funds.

(2) Reflects annualized net interest income divided by average interest-earning assets.



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The following table presents the components of the net interest spread earned on our Agency and Non-Agency MBS for the quarterly periods presented:

Quarter Ended	Agency MBS			Non-Agency MBS			Total MBS		
	Net Yield (1)	Cost of Funding (2)	Net Interest Spread (3)	Net Yield (1)	Cost of Funding (2)	Net Interest Spread (3)	Net Yield (1)	Cost of Funding (2)	Net Interest Spread (3)
September 30, 2014	2.09 %	1.14 %	0.95 %	7.68 %	2.96 %	4.72 %	4.28 %	1.75 %	2.53 %
June 30, 2014	2.26	1.13	1.13	7.71	3.11	4.60	4.36	1.77	2.59
March 31, 2014	2.39	1.21	1.18	7.80	2.99	4.81	4.50	1.80	2.70
December 31, 2013	2.37	1.26	1.11	7.77	3.01	4.76	4.48	1.85	2.63
September 30, 2013	2.13	1.12	1.01	7.33	2.91	4.42	4.20	1.74	2.46

(1) Reflects annualized interest income on MBS divided by average amortized cost of MBS.

(2) Reflects annualized interest expense divided by average balance of repurchase agreements, including the cost of swaps allocated based on the proportionate share of the overall estimated weighted average portfolio duration and securitized debt. Agency cost of funding includes 82, 81, 85, 86 and 74 basis points and Non-Agency cost of funding includes 89, 88, 74, 72 and 57 basis points associated with Swaps to hedge interest rate sensitivity on these assets for the quarters ended September 30, 2014, June 30, 2014, March 31, 2014, December 31, 2013 and September 30, 2013, respectively.

(3) Reflects the difference between the net yield on average MBS and average cost of funds on MBS.

## Interest Income

Interest income on our Agency MBS for the third quarter of 2014 decreased by \$3.1 million, or 8.6% to \$33.1 million from \$36.2 million for the third quarter of 2013. This change primarily reflects a \$459.0 million decrease in the average amortized cost of our Agency MBS portfolio to \$6.320 billion for the third quarter of 2014 from \$6.779 billion for the third quarter of 2013 and a decrease in the net yield on our Agency MBS to 2.09% for the third quarter of 2014 from 2.13% for the third quarter of 2013. At the end of the third quarter of 2014, the average coupon on mortgages underlying our Agency MBS was lower compared to the end of the third quarter of 2013, due to acquisition of assets in the marketplace at generally lower coupons and as a result of prepayments on higher yielding assets and downward resets on Hybrid and ARM-MBS within the portfolio. As a result, the coupon yield on our Agency MBS portfolio declined 13 basis points to 2.94% for the third quarter of 2014 from 3.07% for the third quarter of 2013. During the third quarter of 2014, our Agency MBS portfolio experienced an 15.1% CPR and we recognized \$13.5 million of net premium amortization compared to a CPR of 19.3% and \$15.8 million of net premium amortization for the third quarter of 2013. At September 30, 2014, we had net purchase premiums on our Agency MBS of \$224.2 million, or 3.8% of current par value, compared to net purchase premiums of \$226.8 million and 3.6% of par value at December 31, 2013.

Interest income on our Non-Agency MBS (which includes Non-Agency MBS transferred to consolidated VIEs) decreased \$4.4 million, or 5.4%, for the third quarter of 2014 to \$77.9 million compared to \$82.3 million for the third quarter of 2013, primarily due to the decrease in the amortized cost of our Non-Agency MBS portfolio, partially offset by the increase in the net yield on our Non-Agency MBS portfolio. Our Non-Agency MBS portfolio yielded 7.68% for the third quarter of 2014 compared to 7.33% for the third quarter of 2013. For the third quarter of 2014, the average amortized cost of our Non-Agency MBS (excluding Non-Agency MBS reported as a component of Linked Transactions) decreased by \$439.1 million or 9.8%, to \$4.054 billion from \$4.493 billion for the third quarter of

2013. The increase in the yield on our Non-Agency MBS is primarily due to increases in accretable discount partially offset by changes in the forward yield curve. During the third quarter of 2014, we recognized net purchase discount accretion of \$25.5 million on our Non-Agency MBS, compared to \$19.5 million for the third quarter of 2013. At September 30, 2014, we had net purchase discounts of \$1.355 billion, including Credit Reserve and previously recognized OTTI of \$929.1 million, on our Non-Agency MBS, or 25.4% of par value. During the third quarter of 2014 we reallocated \$20.2 million of purchased discount designated as Credit Reserve to accretable purchase discount.

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The following table presents the components of the coupon yield and net yields earned on our Agency MBS and Non-Agency MBS and weighted average CPRs experienced for such MBS for the quarterly periods presented:

Quarter Ended	Agency MBS			Non-Agency MBS			Total MBS		
	Coupon Yield (1)	Net Yield (2)	Weighted Average CPR	Coupon Yield (1)	Net Yield (2)	Weighted Average CPR	Coupon Yield (1)	Net Yield (2)	Weighted Average CPR
September 30, 2014	2.94	% 2.09	% 15.11	5.17	% 7.68	% 12.71	% 3.81	% 4.28	% 13.94
June 30, 2014	2.99	2.26	13.05	5.27	7.71	12.05	3.87	4.36	12.58
March 31, 2014	3.01	2.39	11.54	5.19	7.80	11.90	3.86	4.50	11.71
December 31, 2013	3.04	2.37	12.87	5.40	7.77	14.16	3.96	4.48	13.42
September 30, 2013	3.07	2.13	19.25	5.59	7.33	18.15	4.07	4.20	18.77

Reflects the annualized coupon interest income divided by the average amortized cost. The discounted purchase price on Non-Agency MBS causes the coupon yield to be higher than the pass-through coupon interest rate. (Does not include MBS underlying our Linked Transactions. See Note 5 to the accompanying consolidated financial statements, included under Item 1 of this Quarterly Report on Form 10-Q.)

(2) Reflects annualized interest income on MBS divided by average amortized cost of MBS.

## Interest Expense

Our interest expense for the third quarter of 2014 decreased by \$2.6 million, or 6.2% to \$39.4 million, from \$42.0 million for the third quarter of 2013. This decrease primarily reflects a decrease in the average balance of securitized debt, a decrease in our average borrowings to finance Agency MBS and Non-Agency MBS and the lower effective interest rate paid on borrowings to finance Agency MBS, which was partially offset by higher effective funding costs associated with Non-Agency MBS, including allocated Swap financing costs, and securitized debt.

At September 30, 2014, we had repurchase agreement borrowings of \$8.126 billion of which \$3.881 billion was hedged with Swaps, and securitized debt of \$156.3 million. At September 30, 2014, our Swaps designated in hedging relationships had a weighted average fixed-pay rate of 1.90% and extended 49 months on average with a maximum remaining term of approximately 107 months.

The following table presents information about our securitized debt at September 30, 2014:

Benchmark Interest Rate (Dollars in Thousands)	At September 30, 2014 Securitized Debt Interest Rate		
30 Day LIBOR + 100 basis points	\$21,631	1.16	%
Fixed Rate	67,035	2.85	
Weighted Average Coupon Rate	67,610	3.81	
Total	\$156,276	3.03	%

The effective interest rate paid on our borrowings increased slightly to 1.82% for the quarter ended September 30, 2014 from 1.81% for the quarter ended September 30, 2013. This increase reflects additional higher cost financing (including the allocation of Swap expense) associated with our Non-Agency MBS portfolio partially offset by the lower average balance of Agency and Non-Agency repurchase agreements and securitized debt. Payments made and/or received on our Swaps are a component of our borrowing costs and accounted for interest expense of \$17.5 million or 81 basis points, for the third quarter of 2014, compared to interest expense of \$15.9 million, or 68 basis points, for the third quarter of 2013. The weighted average fixed-pay rate on our Swaps designated as hedges

decreased to 1.91% for the quarter ended September 30, 2014 from 2.07% for the quarter ended September 30, 2013. The weighted average variable interest rate received on our Swaps designated as hedges decreased to 0.16% for the quarter ended September 30, 2014 from 0.20% for the quarter ended September 30, 2013. During the quarter ended September 30, 2014, we did not enter into any new Swaps and had Swaps with an aggregate notional amount of \$46.3 million and a weighted average fixed-pay rate of 2.84% amortize and/or expire.

We expect that our interest expense and funding costs for the remainder of 2014 will be impacted by market interest rates, the amount of our borrowings and incremental hedging activity, our existing and future interest rates on our hedging instruments and the extent to which we execute additional longer-term structured financing transactions. As a result of these variables, our

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borrowing costs cannot be predicted with any certainty. (See Notes 5, 6 and 14 to the accompanying consolidated financial statements, included under Item 1 of this Quarterly Report on Form 10-Q.)

The following table presents our leverage multiples, as measured by debt-to-equity, at the dates presented:

At the Period Ended	GAAP Leverage Multiple (1)	Non-GAAP Leverage Multiple (2)
September 30, 2014	2.7	3.0
June 30, 2014	2.8	2.9
March 31, 2014	2.9	3.0
December 31, 2013	2.9	3.0
September 30, 2013	3.0	3.1

Represents the sum of borrowings under repurchase agreements, securitized debt, payable for unsettled MBS (1)purchases, and obligations to return securities obtained as collateral and Senior Notes divided by stockholders' equity.

The Non-GAAP Leverage Multiple reflects the sum of our borrowings under repurchase agreements, securitized debt, payable for unsettled MBS purchases, obligations to return securities obtained as collateral, Senior Notes and borrowings that are reported on our consolidated balance sheets as a component of Linked Transactions of \$791.8 million, \$387.5 million, \$206.0 million, \$102.7 million and \$82.4 million at September 30, 2014, June 30, 2014, (2)March 31, 2014, December 31, 2013 and September 30, 2013, respectively. We present a Non-GAAP leverage multiple since repurchase agreement borrowings that are a component of Linked Transactions may not be linked in the future and, if no longer linked, will be reported as repurchase agreement borrowings, which will increase our leverage multiple. (See Note 5 to the accompanying consolidated financial statements, included under Item 1 of this Quarterly Report on Form 10-Q.)

## OTTI

During the third quarters of 2014 and 2013, we did not recognize any OTTI charges through earnings against our Non-Agency MBS. At September 30, 2014, we had 295 Agency MBS with a gross unrealized loss of \$53.7 million and 27 Non-Agency MBS with a gross unrealized loss of \$3.1 million. Impairments on Agency MBS in an unrealized loss position at September 30, 2014 are considered temporary and not credit related. Unrealized losses on Non-Agency MBS for which no OTTI was recorded during the quarter are considered temporary based on an assessment of changes in the expected cash flows for such MBS, which considers recent bond performance and expected future performance of the underlying collateral. Significant judgment is used both in the Company's analysis of expected cash flows for its Non-Agency MBS and any determination of the credit component of OTTI.

## Other Income, net

For the third quarter of 2014, other income, net increased by \$12.1 million to \$17.7 million from \$5.6 million for the third quarter of 2013. Other income, net for the third quarter of 2014 primarily reflects \$13.9 million of net gains realized on the sale of certain Non-Agency MBS, unrealized net gains and net interest income of \$2.6 million on our Linked Transactions, and approximately \$1.2 million in income from an investment in residential whole loans through our interest in a consolidated trust. During the three months ended September 30, 2014, we sold Non-Agency MBS for \$61.6 million, realizing gross gains of \$13.9 million. During the three months ended September 30, 2013, we sold certain Non-Agency MBS for \$102.2 million, realizing gross gains of \$13.7 million. The unrealized net gains and net interest income from Linked Transactions of \$2.6 million for the three months ended September 30, 2014 included interest income of \$6.6 million on the underlying Non-Agency MBS, interest expense of \$2.2 million on the

borrowings under repurchase agreements and a decline of \$1.8 million in the fair value of the underlying securities. The unrealized net gains and net interest income on Linked Transactions of \$544,000 for the three months ended September 30, 2013 included interest income of \$1.1 million on the underlying Non-Agency MBS, interest expense of \$275,000 on the borrowings under repurchase agreements and a decline of \$290,000 in the fair value of the underlying securities. Changes in the market value of the securities underlying our Linked Transactions, the amount of bond purchases recorded as Linked Transactions in the future and the amount of Linked Transactions that become unlinked in the future, none of which can be predicted with any certainty, will impact future gains/(losses) on our Linked Transactions. During the three months ended September 30, 2014, certain of our Linked Transactions became unlinked, resulting in our recording Non-Agency MBS with a fair value of \$36.3 million on our consolidated balance sheets. The \$8.7 million of unrealized losses on TBA short positions for the third quarter of 2013 reflects unrealized losses on the sale of \$350.0 million notional of 15-year Agency MBS 2.5% TBA securities.



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## Operating and Other Expense

For the third quarter of 2014, we had compensation and benefits and other general and administrative expense of \$9.8 million, or 1.19% of average equity, compared to \$8.7 million, or 1.13% of average equity, for the third quarter of 2013. The \$676,000 increase in our compensation and benefits expense to \$6.0 million for the third quarter of 2014, compared to \$5.3 million for the third quarter of 2013, primarily reflects increases in equity-based compensation and bonus expenses. Our other general and administrative expenses increased by \$397,000 to \$3.8 million for the quarter ended September 30, 2014 compared to \$3.4 million for the quarter ended September 30, 2013. The increase was primarily due to higher business development expenses in support of our wider residential asset investment strategy. In addition, for the third quarter of 2014, we recorded \$609,000 of other investment related operating expenses related to our residential whole loan activities. During the third quarter of 2013, we realized a \$2.0 million charge related to the impairment of resecuritization related costs.

## Selected Financial Ratios

The following table presents information regarding certain of our financial ratios at or for the dates presented:

At or for the Quarter Ended	Return on Average Total Assets (1)	Return on Average Total Stockholders' Equity (2)	Total Average Stockholders' Equity to Total Average Assets (3)	Dividend Payout Ratio (4)	Book Value per Share of Common Stock (5)
September 30, 2014	2.41	% 9.16	% 26.27	1.00	% \$8.28
June 30, 2014	2.38	9.25	25.69	1.00	8.37
March 31, 2014	2.30	9.10	25.27	1.00	8.20
December 31, 2013	2.37	9.55	24.80	0.98	8.06
September 30, 2013	2.10	8.71	24.12	1.18	(6) 7.85

(1) Reflects annualized net income divided by average total assets.

(2) Reflects annualized net income divided by average total stockholders' equity.

(3) Reflects total average stockholders' equity divided by total average assets.

(4) Reflects dividends declared per share of common stock divided by earnings per share.

(5) Reflects total stockholders' equity less the preferred stock liquidation preference divided by total shares of common stock outstanding.

(6) Excludes the special common stock dividend declared on August 1, 2013.

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Nine Month Period Ended September 30, 2014 Compared to the Nine Month Period Ended September 30, 2013

General

For the nine months ended September 30, 2014, we had net income available to common stock and participating securities of \$222.5 million, or \$0.60 per basic and diluted common share, compared to net income available to common stock and participating securities of \$210.2 million, or \$0.58 per basic and diluted common share, for the nine months ended September 30, 2013. The increase in net income available to our common stock and participating securities, and the increase of this item on a per share basis reflects an increase in unrealized net gains and net interest income from Linked Transactions and higher gains on sales of MBS. In addition, during the first nine months of 2013, we had \$8.7 million of unrealized losses on TBA short positions, a \$3.9 million write-off of issuance costs on the redemption of the Series A Preferred Stock (see Note 11 to the accompanying consolidated financial statements, included under Item 1 of this Quarterly Report on Form 10-Q) and a \$2.0 million charge related to the impairment of resecuritization related costs. Yields on Agency MBS remained unchanged at 2.25% for the nine months ended September 30, 2014 and 2013 and were impacted by lower coupon yields. Non-Agency MBS yields were higher compared to the prior year period due primarily to the impact of credit reserve releases.

Net Interest Income

For the first nine months of 2014, our net interest spread and margin were 2.39% and 2.77%, respectively, compared to a net interest spread and margin of 2.32% and 2.68%, respectively, for the first nine months of 2013. Although our net interest spread and margin increased, our net interest income decreased by \$11.4 million, or 4.7% to \$229.9 million from \$241.3 million for the first nine months of 2013. This decrease primarily reflects the impact of the lower average balance of our MBS portfolio as measured by amortized cost, increased Non-Agency MBS borrowing costs (including the impact of allocated Swap expense), partially offset by higher yielding Non-Agency MBS due to improved credit performance, a decrease in the average balance of securitized debt and lower Agency MBS borrowing costs. The net interest spread on our Agency MBS portfolio increased to 1.09% for the first nine months of 2014 compared to 1.08% for the first nine months of 2013. The net interest spread on our Non-Agency MBS portfolio increased to 4.71% for the first nine months of 2014 compared to 4.50% for the first nine months of 2013.

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## Analysis of Net Interest Income

The following table sets forth certain information about the average balances of our assets and liabilities and their related yields and costs for the nine months ended September 30, 2014 and 2013. Average yields are derived by dividing annualized interest income by the average amortized cost of the related assets and average costs are derived by dividing annualized interest expense by the daily average balance of the related liabilities, for the periods shown. The yields and costs include premium amortization and purchase discount accretion which are considered adjustments to interest rates.

(Dollars in Thousands)	Nine Months Ended September 30,			2013		
	2014 Average Balance	Interest	Average Yield/Cost	Average Balance	Interest	Average Yield/Cost
Assets:						
Interest-earning assets:						
Agency MBS (1)	\$6,523,318	\$110,004	2.25 %	\$6,926,018	\$116,982	2.25 %
Non-Agency MBS (1)	4,150,710	240,709	7.73	4,605,323	244,816	7.09
Total MBS	10,674,028	350,713	4.38	11,531,341	361,798	4.18
Cash and cash equivalents (2)	367,848	63	0.02	448,280	93	0.03
Total interest-earning assets	11,041,876	350,776	4.24	11,979,621	361,891	4.03
Total non-interest-earning assets	1,530,427			1,443,042		
Total assets	\$12,572,303			\$13,422,663		
Liabilities and stockholders' equity:						
Interest-bearing liabilities:						
Agency repurchase agreements (3)	\$5,777,129	\$50,052	1.16	\$6,209,460	\$54,365	1.17
Non-Agency repurchase agreements (3)	2,603,705	59,302	3.05	2,588,254	50,820	2.63
Total repurchase agreements	8,380,834	109,354	1.74	8,797,714	105,185	1.60
Securitized debt	263,616	5,471	2.77	517,035	9,381	2.43
Senior Notes	100,000	6,023	8.05	100,000	6,020	8.05
Total interest-bearing liabilities	8,744,450	120,848	1.85	9,414,749	120,586	1.71
Total non-interest-bearing liabilities	591,895			702,271		
Total liabilities	9,336,345			10,117,020		
Stockholders' equity	3,235,958			3,305,643		
Total liabilities and stockholders' equity	\$12,572,303			\$13,422,663		
Net interest income/ net interest rate spread (4)		\$229,928	2.39 %		\$241,305	2.32 %
Net interest-earning assets/ net interest margin (5)	\$2,297,426		2.77 %	\$2,564,872		2.68 %
Ratio of interest-earning assets to interest-bearing liabilities	1.26	x		1.27	x	

(1) Yields presented throughout this Quarterly Report on Form 10-Q are calculated using average amortized cost data for MBS which excludes unrealized gains and losses and includes principal payments receivable on MBS. For GAAP reporting purposes, MBS purchases and sales are reported on the trade date. Average amortized cost data

used to determine yields is calculated based on the settlement date of the associated purchase or sale as interest income is not earned on purchased assets and continues to be earned on sold assets until settlement date. Includes Non-Agency MBS transferred to consolidated VIEs. Excludes Non-Agency MBS reported as a component of Linked Transactions.

(2) Includes average interest-earning cash, cash equivalents and restricted cash.

Average cost of repurchase agreements includes the cost of Swaps allocated based on the proportionate

(3) share of the overall estimated weighted average portfolio duration. Excludes interest expense associated with repurchase agreements reported as a component of Linked Transactions.

(4) Net interest rate spread reflects the difference between the yield on average interest-earning assets and average cost of funds.

(5) Net interest margin reflects annualized net interest income divided by average interest-earning assets.

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## Rate/Volume Analysis

The following table presents the extent to which changes in interest rates (yield/cost) and changes in the volume (average balance) of interest-earning assets and interest-bearing liabilities have affected our interest income and interest expense during the periods indicated. Information is provided in each category with respect to: (i) the changes attributable to changes in volume (changes in average balance multiplied by prior rate); (ii) the changes attributable to changes in rate (changes in rate multiplied by prior average balance); and (iii) the net change. The changes attributable to the combined impact of volume and rate have been allocated proportionately, based on absolute values, to the changes due to rate and volume.

(In Thousands)	Nine Months Ended September 30, 2014 Compared to Nine Months Ended September 30, 2013		
	Increase/(Decrease) due to Volume	Rate	Total Net Change in Interest Income/Expense
<b>Interest-earning assets:</b>			
Agency MBS	\$(6,896	) \$(82	) \$ (6,978 )
Non-Agency MBS	(25,239	) 21,132	(4,107 )
Cash and cash equivalents	(13	) (17	) (30 )
Total net change in income from interest-earning assets	\$(32,148	) \$21,033	\$ (11,115 )
<b>Interest-bearing liabilities:</b>			
Agency repurchase agreements	\$(3,791	) \$(543	) \$ (4,334 )
Non-Agency repurchase agreements	310	8,193	8,503
Securitized debt	(5,087	) 1,177	(3,910 )
Senior Notes	—	3	3
Total net change in expense of interest-bearing liabilities	\$(8,568	) \$8,830	\$ 262
Net change in net interest income	\$(23,580	) \$12,203	\$ (11,377 )

The following table presents the components of the net interest spread earned on our Agency and Non-Agency MBS for the periods presented:

Nine Months Ended	Agency MBS			Non-Agency MBS			Total MBS		
	Net Yield (1)	Cost of Funding (2)	Net Interest Spread (3)	Net Yield (1)	Cost of Funding (2)	Net Interest Spread (3)	Net Yield (1)	Cost of Funding (2)	Net Interest Spread (3)
September 30, 2014	2.25 %	1.16 %	1.09 %	7.73 %	3.02 %	4.71 %	4.38 %	1.78 %	2.60 %
September 30, 2013	2.25	1.17	1.08	7.09	2.59	4.50	4.18	1.64	2.54

(1) Reflects annualized interest income on MBS divided by average amortized cost of MBS.

(2) Reflects annualized interest expense divided by average balance of repurchase agreements, including the cost of swaps allocated based on the proportionate share of the overall estimated weighted average portfolio duration, and securitized debt. Agency cost of funding includes 82 basis points and Non-Agency cost of funding includes 82 basis points associated with Swaps to hedge interest rate sensitivity on these assets for the nine months ended September 30, 2014. Agency cost of funding includes 19 basis points associated with Swaps to hedge interest rate sensitivity on these

assets for the nine months ended September 30, 2013.

(3) Reflects the difference between the net yield on average MBS and average cost of funds on MBS.

#### Interest Income

Interest income on our Agency MBS for the first nine months of 2014 decreased by \$7.0 million, or 6.0% to \$110.0 million from \$117.0 million for the first nine months of 2013. This change primarily reflects a \$402.7 million decrease in the average amortized cost of our Agency MBS portfolio to \$6.523 billion for the first nine months of 2014 from \$6.926 billion for the first nine months of 2013. The net yield on our Agency MBS remained unchanged at 2.25% for both the first nine months of 2014 and 2013. At the end of the third quarter of 2014, the average coupon on mortgages underlying our Agency MBS was lower compared to the end of the third quarter of 2013, due to acquisition of assets in the marketplace at generally lower coupons and as a result of prepayments on higher yielding assets and downward resets on Hybrid and ARM-MBS within the portfolio. As a result, the coupon yield on our Agency MBS portfolio declined 18 basis points to 2.98% for the first nine months of 2014 from

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3.16% for the first nine months of 2013. During the first nine months of 2014, our Agency MBS portfolio experienced a 12.0% CPR and we recognized \$35.9 million of net premium amortization compared to a CPR of 19.5% and \$47.0 million of net premium amortization for the first nine months of 2013. At September 30, 2014, we had net purchase premiums on our Agency MBS of \$224.2 million, or 3.8% of current par value, compared to net purchase premiums of \$226.8 million and 3.6% of par value at December 31, 2013.

Interest income on our Non-Agency MBS (which includes Non-Agency MBS transferred to consolidated VIEs) decreased by \$4.1 million, or 1.7%, for the first nine months of 2014 to \$240.7 million compared to \$244.8 million for the first nine months of 2013, principally due to the decrease in the amortized cost of the portfolio partially offset by an increase in the yield of our Non-Agency MBS portfolio. For the first nine months of 2014, the average amortized cost of our Non-Agency MBS (excluding Non-Agency MBS reported as a component of Linked Transactions) decreased by \$454.6 million or 9.9%, to \$4.151 billion from \$4.605 billion for the first nine months of 2013. Our Non-Agency MBS portfolio yielded 7.73% for the first nine months of 2014 compared to 7.09% for the first nine months of 2013. The increase in the yield on our Non-Agency MBS is primarily due to increases in accretible discount partially offset by changes in the forward yield curve. During the first nine months of 2014, we recognized net purchase discount accretion of \$78.6 million on our Non-Agency MBS, compared to \$48.1 million for the first nine months of 2013. At September 30, 2014, we had net purchase discounts of \$1.355 billion, including Credit Reserve and previously recognized OTTI of \$929.1 million, on our Non-Agency MBS, or 25.4% of par value. During the first nine months of 2014 we reallocated \$80.6 million of purchased discount designated as Credit Reserve to accretible purchase discount.

The following table presents the coupon yields and net yields earned on our Agency MBS and Non-Agency MBS and weighted average CPRs experienced for such MBS for the periods presented:

Nine Months Ended	Agency MBS			Non-Agency MBS			Total MBS		
	Coupon Yield (1)	Net Yield (2)	Weighted Average CPR	Coupon Yield (1)	Net Yield (2)	Weighted Average CPR	Coupon Yield (1)	Net Yield (2)	Weighted Average CPR
September 30, 2014	2.98 %	2.25 %	11.97 %	5.21 %	7.73 %	11.03 %	3.85 %	4.38 %	11.53 %
September 30, 2013	3.16	2.25	19.50	5.69	7.09	16.50	4.17	4.18	18.20

Reflects the annualized coupon interest income divided by the average amortized cost. The discounted purchase price on Non-Agency MBS causes the coupon yield to be higher than the pass-through coupon interest rate. (Does not include MBS underlying our Linked Transactions. See Note 5 to the accompanying consolidated financial statements, included under Item 1 of this Quarterly Report on Form 10-Q.)

(2) Reflects annualized interest income on MBS divided by average amortized cost of MBS.

**Interest Expense**

Our interest expense for the first nine months of 2014 increased by \$262,000, or 0.2% to \$120.8 million, from \$120.6 million for the first nine months of 2013. This increase primarily reflects higher effective funding costs associated with Non-Agency MBS, including allocated Swap financing costs. In addition, the average balance of Non-Agency MBS financing increased, which was partially offset by a decrease in the average balance of securitized debt and a decrease in our average borrowings to finance Agency MBS.

At September 30, 2014, we had repurchase agreement borrowings of \$8.126 billion of which \$3.881 billion was hedged with Swaps, and securitized debt of \$156.3 million. At September 30, 2014, our Swaps designated in hedging

relationships had a weighted average fixed-pay rate of 1.90% and extended 49 months on average with a maximum remaining term of approximately 107 months.

The effective interest rate paid on our borrowings increased to 1.85% for the nine months ended September 30, 2014 from 1.71% for the nine months ended September 30, 2013. This increase reflects additional higher cost financing (including the allocation of Swap expense) associated with our Non-Agency MBS portfolio partially offset by the lower average balance of securitized debt and Agency repurchase agreements. Payments made and/or received on our Swaps are a component of our borrowing costs and accounted for interest expense of \$53.1 million, or 81 basis points, for the nine months ended September 30, 2014, compared to interest expense of \$40.9 million, or 58 basis points, for the first nine months of 2013. The weighted average fixed-pay rate on our Swaps designated as hedges decreased to 1.92% for the first nine months of 2014 from 2.15% for the first nine months of 2013. The weighted average variable interest rate received on our Swaps designated as hedges decreased to 0.16% for the first nine months of 2014 from 0.20% for the first nine months of 2013. During the first nine months ended September 30, 2014, we entered into four new Swaps with an aggregate notional amount of \$400.0 million, a weighted average fixed-pay rate of 1.95% with initial maturities ranging from five to seven years, and had Swaps with an aggregate notional amount of \$564.3 million and a weighted average fixed-pay rate of 2.05% amortize and/or expire.



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We expect that our interest expense and funding costs for the remainder of 2014 will be impacted by market interest rates, the amount of our borrowings and incremental hedging activity, our existing and future interest rates on our hedging instruments and the extent to which we execute additional longer-term structured financing transactions. As a result of these variables, our borrowing costs cannot be predicted with any certainty. (See Notes 5, 6 and 14 to the accompanying consolidated financial statements, included under Item 1 of this Quarterly Report on Form 10-Q.)

## Other Income, net

For the first nine months of 2014, other income, net increased by \$23.5 million or 182.3%, to \$36.4 million, from \$12.9 million for the first nine months of 2013. Other income, net for the first nine months of 2014 primarily reflects \$25.3 million of net gains realized on the sale of certain Non-Agency MBS, unrealized net gains and net interest income of \$9.6 million on our Linked Transactions, and approximately \$1.8 million in income from an investment in residential whole loans through our interest in a consolidated trust. During the nine months ended September 30, 2014, we sold Non-Agency MBS for \$103.6 million, realizing gross gains of \$25.3 million. During the nine months ended September 30, 2013, we sold Non-Agency MBS for \$118.2 million, realizing gross gains of \$19.7 million and sold U.S. Treasury securities for \$375.4 million, realizing gross losses of approximately \$31,000. The unrealized net gains and net interest income on Linked Transactions of \$9.6 million for the nine months ended September 30, 2014 included interest income of \$11.6 million on the underlying Non-Agency MBS, interest expense of \$3.7 million on the borrowings under repurchase agreements and an increase of \$1.7 million in the fair value of the underlying securities. The unrealized net gains and net interest income on Linked Transactions of \$1.8 million for the nine months ended September 30, 2013 included interest income of \$2.4 million on the underlying Non-Agency MBS, interest expense of \$552,000 on borrowings under repurchase agreements and a decline of \$94,000 in the fair value of the underlying securities. Changes in the market value of the securities underlying our Linked Transactions, the amount of bond purchases recorded as Linked Transactions in the future and the amount of Linked Transactions that become unlinked in the future, none of which can be predicted with any certainty, will impact future gains/(losses) on our Linked Transactions. During the nine months ended September 30, 2014, certain of our Linked Transactions became unlinked, resulting in our recording Non-Agency MBS with a fair value of \$36.3 million on our consolidated balance sheets. The \$8.7 million of unrealized losses on TBA short positions for the first nine months of 2013 reflects unrealized losses on the sale of \$350.0 million notional of 15-year Agency MBS 2.5% TBA securities.

## Operating and Other Expense

During the first nine months of 2014, we had compensation and benefits and other general and administrative expense of \$29.8 million, or 1.28% of average equity, compared to \$26.0 million, or 1.05% of average equity, for the first nine months of 2013. The \$2.5 million increase in our compensation and benefits expense to \$18.4 million for the first nine months ended September 30, 2014, compared to \$15.9 million for the first nine months ended September 30, 2013, primarily reflects increases in equity-based compensation expense, salary and bonus expense, and payroll taxes. Our other general and administrative expenses increased by \$1.3 million to \$11.5 million for the first nine months of 2014 compared to \$10.2 million for the first nine months of 2013. The increase was primarily due to higher business development expenses in support of our wider residential asset investment strategy.

During the first nine months of 2014, we recorded \$1.6 million of other investment related operating expenses related to our residential whole loan activities. In addition, during the first nine months of 2014, an interest accrual of \$1.2 million was recorded, reflecting an additional accrual of interest with respect to prior years undistributed taxable income. During the first nine months of 2013, we realized a \$2.0 million charge related to the impairment of securitization related costs. In addition, an excise tax and interest accrual of \$2.0 million was recorded during the nine months ended September 30, 2013, reflecting an updated estimate of excise tax payable in respect of undistributed REIT taxable income for the 2012 tax year and additional accrual of interest with respect to prior years

undistributed taxable income.

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## Selected Financial Ratios

The following table presents information regarding certain of our financial ratios at or for the dates presented:

At or for the Nine Months Ended	Return on Average Total Assets (1)	Return on Average Total Stockholders' Equity (2)	Total Average Stockholders' Equity to Total Average Assets (3)	Dividend Payout Ratio (4)	Book Value per Share of Common Stock (5)
September 30, 2014	2.36	% 9.17	% 25.74	% 1.00	% \$8.28
September 30, 2013	2.10	8.48	24.71	1.14	(6) 7.85

(1) Reflects annualized net income divided by average total assets.

(2) Reflects annualized net income divided by average total stockholders' equity.

(3) Reflects total average stockholders' equity divided by total average assets.

(4) Reflects dividends declared per share of common stock divided by earnings per share.

(5) Reflects total stockholders' equity less the preferred stock liquidation preference divided by total shares of common stock outstanding.

(6) Excludes the special common stock dividends declared on March 4, 2013 and August 1, 2013.

## Recent Accounting Standards to be Adopted in Future Periods

## Receivables - Recognition of Residential Real Estate upon Foreclosure

In January 2014, the FASB issued ASU 2014-04, Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure, (or ASU 2014-04). This ASU applies to all creditors who obtain physical possession (resulting from an in substance repossession or foreclosure) of residential real estate property collateralizing a consumer mortgage loan in satisfaction of a receivable. The ASU clarifies that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (i) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (ii) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendments require interim and annual disclosure of both (i) the amount of foreclosed residential real estate property held by the creditor and (ii) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction.

ASU 2014-04 is effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. An entity can elect to adopt the amendments in this ASU using either a modified retrospective transition method or a prospective transition method. We are currently evaluating the effect that ASU 2014-04 will have on our consolidated financial statements and related disclosures. We have not yet selected a transition method nor have we determined the effect of the standard on our ongoing financial reporting.

## Revenue from Contracts with Customers

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers, (or ASU 2014-09). The ASU requires an entity to recognize revenue in an amount that reflects the consideration to which it expects to be entitled for the transfer of promised goods or services to customers. ASU 2014-09 will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. ASU 2014-09 is effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2016. Early

application is not permitted. The standard permits the use of either the retrospective or cumulative effect transition method. We are currently evaluating the effect that ASU 2014-09 will have on our consolidated financial statements and related disclosures. We have not yet selected a transition method nor have we determined the effect of the standard on our ongoing financial reporting.

#### Transfers and Servicing

In June 2014, the FASB issued ASU 2014-11, Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures, (or ASU 2014-11). The amendments of ASU 2014-11 require two accounting changes. First, the amendments in this ASU change the accounting for repurchase-to-maturity transactions to secured borrowing accounting. Second, for repurchase financing arrangements, the amendments require separate accounting for a transfer of a financial asset executed contemporaneously with a repurchase agreement with the same counterparty, which will result in secured borrowing accounting for the repurchase agreement. In addition, the amendments in ASU 2014-11 require disclosures for certain transactions comprising (i) a transfer of

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a financial asset accounted for as a sale and (ii) an agreement with the same transferee entered into in contemplation of the initial transfer that results in the transferor retaining substantially all of the exposure to the economic return on the transferred asset throughout the term of the transaction. ASU 2014-11 also requires disclosures for repurchase agreements, securities lending transactions, and repurchase-to-maturity transactions that are accounted for as secured borrowings.

The accounting changes in ASU 2014-11 are effective for public business entities for the first interim or annual period beginning after December 15, 2014 and early application for a public business entity is prohibited. An entity is required to present changes in accounting for transactions outstanding on the effective date as a cumulative-effect adjustment to retained earnings as of the beginning of the period of adoption. For public business entities, the disclosure of certain transactions accounted for as a sale is required to be presented for interim and annual periods beginning after December 15, 2014 and the disclosure for repurchase agreements, securities lending transactions, and repurchase-to-maturity transactions accounted for as secured borrowings is required to be presented for annual periods beginning after December 15, 2014, and for interim periods beginning after March 15, 2015. We are currently evaluating the impact of our adoption of this new standard.

### Presentation of Financial Statements - Going Concern

In August 2014, the FASB issued ASU 2014-15, Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern, (or ASU 2014-15). The amendments in this ASU provide guidance in GAAP about management's responsibility to evaluate whether there is a substantial doubt about an entity's going concern and to provide related footnote disclosures. In connection with preparing financial statements for each annual and interim reporting period, an entity's management should evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued when applicable). The amendments in ASU 2014-15 are effective for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter. Early application is permitted. We do not expect adoption of ASU 2014-15 to have a significant impact on our financial position or financial statement disclosures.

### Proposed Accounting Standards

The FASB has recently issued or discussed a number of proposed standards on such topics as measurement of credit impairment, financial instrument measurement and classification, leases, hedging, and disclosures about liquidity risk and interest rate risk. Some of the proposed changes are potentially significant and could have a material impact on our reporting. We have not yet fully evaluated the potential impact of these proposals but will make such an evaluation as the standards are finalized.

### Liquidity and Capital Resources

#### General

Our principal sources of cash generally consist of borrowings under repurchase agreements, payments of principal and interest we receive on our MBS portfolio, cash generated from our operating results and, depending on market conditions, proceeds from capital market and resecuritization transactions. Our most significant uses of cash are generally to pay principal and interest on our borrowings under repurchase agreements and securitized debt, to purchase MBS, to make dividend payments on our capital stock, to fund our operations and to make other investments that we consider appropriate.

We seek to employ a diverse capital raising strategy under which we may issue capital stock and other types of securities. To the extent we raise additional funds through capital market transactions, we currently anticipate using the net proceeds from such transactions to acquire additional MBS and residential whole loans, consistent with our investment policy, and for working capital which may include, among other things, the repayment of our repurchase agreements. There can be no assurance, however, that we will be able to access the capital markets at any particular time or on any particular terms. We have available for issuance an unlimited amount (subject to the terms and limitations of our charter) of common stock, preferred stock, depositary shares representing preferred stock, warrants, debt securities, rights and/or units pursuant to our automatic shelf registration statement and, at September 30, 2014, we had 8.1 million shares of common stock available for issuance pursuant to our DRSPS shelf registration statement. During the nine months ended September 30, 2014, we issued 3,421,859 shares of common stock through our DRSPS, raising net proceeds of approximately \$26.4 million.

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On April 15, 2013, we completed the issuance of 8.0 million shares of our Series B Preferred Stock, with a par value of \$0.01 per share and a liquidation preference of \$25.00 per share, plus accrued and unpaid dividends, in an underwritten public offering. The aggregate net proceeds to us from the offering of the Series B Preferred Stock were approximately \$193.3 million, after deducting the underwriting discount and related offering expenses. We used a portion of the net proceeds to redeem all of our outstanding Series A Preferred Stock (as discussed below), and used the remaining net proceeds of the offering for general corporate purposes, including, without limitation, to acquire additional MBS consistent with our investment policy, and for working capital, which may include, among other things, the repayment of our repurchase agreements.

On May 16, 2013, we redeemed all 3,840,000 outstanding shares of our Series A Preferred Stock, at an aggregate redemption price of approximately \$97.0 million, or \$25.27153 per share, including all accrued and unpaid dividends to the Redemption Date. The redemption value of the Series A Preferred Stock exceeded its carrying value by \$3.9 million, which represents the original offering costs for the Series A Preferred Stock.

Our borrowings under repurchase agreements are uncommitted and renewable at the discretion of our lenders and, as such, our lenders could determine to reduce or terminate our access to future borrowings at virtually any time. The terms of the repurchase transaction borrowings under our master repurchase agreements as such terms relate to repayment, margin requirements and the segregation of all securities that are the subject of repurchase transactions generally conform to the terms in the standard master repurchase agreement as published by SIFMA or the global master repurchase agreement published by SIFMA and the International Capital Market Association. In addition, each lender typically requires that we include supplemental terms and conditions to the standard master repurchase agreement. Typical supplemental terms and conditions, which differ by lender, may include changes to the margin maintenance requirements, required haircuts (as defined below), purchase price maintenance requirements, requirements that all controversies related to the repurchase agreement be litigated in a particular jurisdiction and cross default and setoff provisions.

With respect to margin maintenance requirements for repurchase agreements with Non-Agency MBS as collateral, margin calls are typically determined by our counterparties based on their assessment of changes in the fair value of the underlying collateral and in accordance with the agreed upon haircuts specified in the transaction confirmation with the counterparty. We address margin call requests in accordance with the required terms specified in the applicable repurchase agreement and such requests are typically satisfied by posting additional cash or collateral on the same business day. We review margin calls made by counterparties and assess them for reasonableness by comparing the counterparty valuation against our valuation determination. When we believe that a margin call is unnecessary because our assessment of collateral value differs from the counterparty valuation, we typically hold discussions with the counterparty and are able to resolve the matter. In the unlikely event that resolution cannot be reached, we will look to resolve the dispute based on the remedies available to us under the terms of the repurchase agreement, which in some instances may include the engagement of a third party to review collateral valuations. For other agreements that do not include such provisions, we could resolve the matter by substituting collateral as permitted in accordance with the agreement or otherwise request the counterparty to return the collateral in exchange for cash to unwind the financing.

The following table presents information regarding the margin requirements, or the percentage amount by which the collateral value is contractually required to exceed the loan amount (this difference is referred to as the "haircut"), on our repurchase agreements at September 30, 2014 and December 31, 2013:

	Weighted Average Haircut	Low	High
At September 30, 2014			
Repurchase agreement borrowings secured by:			

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Agency MBS	4.70	% 3.00	% 6.00	%
Non-Agency MBS	28.48	10.00	60.00	
U.S. Treasury securities	1.41	0.00	2.00	
At December 31, 2013	Weighted Average Haircut	Low	High	
Repurchase agreement borrowings secured by:				
Agency MBS	4.89	% 3.00	% 6.00	%
Non-Agency MBS	32.48	10.00	63.00	
U.S. Treasury securities	1.65	1.00	2.00	



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The weighted average haircut requirements for Agency and U.S. Treasury collateral underlying our repurchase agreements have not significantly changed since December 31, 2013. Weighted average haircuts on Legacy Non-Agency MBS collateral declined during the third quarter of 2014, primarily as a result of the termination of a re-securitization financing structure.

During the first nine months of 2014, the financial market environment was impacted by continued accommodative monetary policy. Repurchase agreement funding for both Agency MBS and Non-Agency MBS has been available to us at generally attractive market terms from multiple counterparties. Typically, due to the credit risk inherent to Non-Agency MBS, repurchase agreement funding involving Non-Agency MBS is available from fewer counterparties, at terms requiring higher collateralization and higher interest rates, than repurchase agreement funding secured by Agency MBS and U.S. Treasury securities. Therefore, we generally expect to be able to finance our acquisitions of Agency MBS (which we expect will continue to comprise the majority of our assets) on more favorable terms than financing for Non-Agency MBS.

We maintain cash and cash equivalents, unpledged Agency and Non-Agency MBS and collateral in excess of margin requirements held by our counterparties (or collectively, “cash and other unpledged collateral”) to meet routine margin calls and protect against unforeseen reductions in our borrowing capabilities. Our ability to meet future margin calls will be impacted by our ability to use cash or obtain financing from unpledged collateral, which can vary based on the market value of such collateral, our cash position and margin requirements. Our cash position fluctuates based on the timing of our operating, investing and financing activities and is managed based on our anticipated cash needs. (See our consolidated statements of cash flows, included under Item 1 of this Quarterly Report on Form 10-Q and “Interest Rate Risk” included under Item 3 of this Quarterly Report on Form 10-Q.)

At September 30, 2014, we had a total of \$9.663 billion of MBS and U.S. Treasury securities and \$43.8 million of restricted cash pledged against our repurchase agreements and Swaps. At September 30, 2014, we have access to various sources of liquidity which we estimate exceeds \$1.113 billion. This includes (i) \$423.9 million of cash and cash equivalents; (ii) \$411.5 million in estimated financing available from unpledged Agency MBS and other Agency MBS collateral that is currently pledged in excess of contractual requirements; and (iii) \$277.1 million in estimated financing available from unpledged Non-Agency MBS.

The table below presents certain information about our borrowings under repurchase agreements and securitized debt:

Quarter Ended (1)	Repurchase Agreements			Securitized Debt		
	Quarterly Average Balance	End of Period Balance	Maximum Balance at Any Month-End	Quarterly Average Balance	End of Period Balance	Maximum Balance at Any Month-End
(In Thousands)						
September 30, 2014	\$8,267,905	\$ 8,125,723	\$ 8,272,039	\$ 190,753	\$ 156,276	\$ 190,423
June 30, 2014	8,464,135	8,384,101	8,501,978	264,806	214,048	267,740
March 31, 2014	8,412,045	8,606,129	8,606,129	336,893	292,526	338,965
December 31, 2013	8,462,138	8,339,297	8,504,593	399,762	366,205	398,384
September 30, 2013	8,679,410	8,568,171	8,721,573	440,665	419,693	462,207

(1) The information presented in the table above excludes Senior Notes issued in April 2012. The outstanding balance of Senior Notes has been unchanged at \$100.0 million since issuance.

Cash Flows and Liquidity For the Nine Months Ended September 30, 2014

Our cash and cash equivalents decreased by \$141.5 million during the nine months ended September 30, 2014, reflecting: \$823.9 million used in our financing activities; \$504.9 million provided by our investing activities; and \$177.5 million provided by our operating activities.

At September 30, 2014, our debt-to-equity multiple was 2.7 times compared to 2.9 times at December 31, 2013. At September 30, 2014, we had borrowings under repurchase agreements of \$8.126 billion with 26 counterparties, of which \$5.418 billion was secured by Agency MBS, \$2.264 billion was secured by Non-Agency MBS and \$444.0 million was secured by U.S. Treasuries. In addition, at such date, we had \$791.8 million of borrowings under repurchase agreements that were a component of our Linked Transactions. (See Note 5 to the consolidated financial statements, included under Item 1 of this Quarterly Report on Form 10-Q.) We continue to have available capacity under our repurchase agreement credit lines. At December 31, 2013, we had borrowings under repurchase agreements of \$8.339 billion with 26 counterparties and had borrowings under repurchase agreements of \$102.7 million that were a component of our Linked Transactions.

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At September 30, 2014, outstanding securitized debt was \$156.3 million, which had a weighted average expected remaining term of 0.60 years. During the nine months ended September 30, 2014, securitized debt was reduced by principal payments of \$208.7 million.

During the nine months ended September 30, 2014, \$504.9 million was provided through our investing activities. We received cash of \$1.468 billion from prepayments and scheduled amortization on our MBS portfolio, of which \$954.5 million was attributable to Agency MBS and \$513.9 million was from Non-Agency MBS. We purchased \$606.0 million of Agency MBS, \$369.0 million of Legacy Non-Agency MBS (of which \$30.2 million are reported as a component of Linked Transactions) and \$942.6 million of RPL/NPL MBS (of which \$902.6 million are reported as a component of Linked Transactions) funded with cash and repurchase agreement borrowings. While we generally intend to hold our MBS as long-term investments, we may sell certain MBS in order to manage our interest rate risk and liquidity needs, meet other operating objectives and adapt to market conditions. In addition, during the nine months ended September 30, 2014 we sold certain of our Non-Agency MBS for \$103.6 million, realizing gross gains of \$25.3 million.

In connection with our repurchase agreement borrowings and Swaps, we routinely receive margin calls/reverse margin calls from our counterparties and make margin calls to our counterparties. Margin calls and reverse margin calls, which requirements vary over time, may occur daily between us and any of our counterparties when the value of collateral pledged changes from the amount contractually required. The value of securities pledged as collateral fluctuates reflecting changes in: (i) the face (or par) value of our MBS; (ii) market interest rates and/or other market conditions; and (iii) the market value of our Swaps. Margin calls/reverse margin calls are satisfied when we pledge/receive additional collateral in the form of additional securities and/or cash.

The table below summarizes our margin activity with respect to our repurchase agreement financings (including underlying Linked Transactions) and derivative hedging instruments for the quarterly periods presented:

For the Quarter Ended	Collateral Pledged to Meet Margin Calls		Aggregate Assets Pledged For Margin Calls	Cash and Securities Received for Reverse Margin Calls	Net Assets Received/(Pledged) for Margin Activity
	Fair Value of Securities Pledged	Cash Pledged			
(In Thousands)					
September 30, 2014	\$340,341	\$24,100	\$364,441	\$315,594	\$ (48,847 )
June 30, 2014	248,163	58,700	306,863	281,233	(25,630 )
March 31, 2014	238,306	29,000	267,306	285,544	18,238
December 31, 2013	282,521	8,500	291,021	242,652	(48,369 )
September 30, 2013	395,970	61,400	457,370	506,703	49,333

We are subject to various financial covenants under our repurchase agreements and derivative contracts, which include minimum net worth and/or profitability requirements, maximum debt-to-equity ratios and minimum market capitalization requirements. We have maintained compliance with all of our financial covenants through September 30, 2014.

During the nine months ended September 30, 2014, we paid \$220.6 million for cash dividends on our common stock and DERs and paid cash dividends of \$11.3 million on our preferred stock. On September 17, 2014, we declared our third quarter 2014 dividend on our common stock of \$0.20 per share; on October 31, 2014, we paid this dividend which totaled approximately \$74.0 million, including DERs of approximately \$190,000.

We believe that we have adequate financial resources to meet our current obligations, including margin calls, as they come due, to fund dividends we declare and to actively pursue our investment strategies. However, should the value of our MBS suddenly decrease, significant margin calls on our repurchase agreement borrowings could result and our liquidity position could be materially and adversely affected. Further, should market liquidity tighten, our repurchase agreement counterparties may increase our margin requirements on new financings, reducing our ability to use leverage. Access to financing may also be negatively impacted by the ongoing volatility in the world financial markets, potentially adversely impacting our current or potential lenders' ability or willingness to provide us with financing. In addition, there is no assurance that favorable market conditions will continue to permit us to consummate additional securitization transactions if we determine to seek that form of financing.

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### Off-Balance Sheet Arrangements

We do not have any material off-balance-sheet arrangements. Our Linked Transactions are comprised of MBS, associated repurchase agreements and interest receivable/payable on such accounts. The extent to which these transactions become unlinked in the future, the underlying MBS and the borrowings under repurchase agreements and associated interest income and expense will be presented on a gross basis on our consolidated balance sheets and statements of operations, prospectively. (See page 65 for information about our leverage multiple and Note 5 to the accompanying consolidated financial statements, included under Item 1 of this Quarterly Report on Form 10-Q.)

### Inflation

Substantially all of our assets and liabilities are financial in nature. As a result, changes in interest rates and other factors impact our performance far more than does inflation. Our financial statements are prepared in accordance with GAAP and dividends declared are based upon net ordinary income as calculated for tax purposes. In each case, our results of operations and reported assets, liabilities and equity are measured with reference to historical cost or fair value without considering inflation.

### Other Matters

#### Investment Company Act of 1940

Commencing in the second quarter of 2014, we have organized ourselves as a holding company and conduct our real estate businesses primarily through wholly-owned subsidiaries. We conduct our real estate business so that we are not subject to regulation under the Investment Company Act by maintaining less than 40% of the value of our total assets, exclusive of U.S. Government securities and cash items (which we refer to as our adjusted total assets for Investment Company Act purposes), on an unconsolidated basis consist of “investment securities” as defined by the Investment Company Act. We refer to this test as the “40% Test”.

Certain of the subsidiaries through which we operate our business rely upon the exclusion from the definition of investment company provided by Section 3(c)(5)(C) of the Investment Company Act. Section 3(c)(5)(C), as interpreted by the staff of the SEC, requires an entity to invest at least 55% of its assets in “mortgages and other liens on and interests in real estate,” which we refer to as “qualifying real estate assets,” and at least 80% of its assets in qualifying real estate assets plus “real estate-related assets.” In satisfying the 55% requirement, the entity may treat securities issued with respect to an underlying pool of mortgage loans in which it holds all of the certificates issued by the pool as qualifying real estate assets. We treat the whole pool Agency certificates in which we invest as qualifying real estate assets for purposes of the 55% requirement.

We also have formed, and may in the future form, certain other wholly-owned or majority-owned subsidiaries that rely upon the exclusion from the definition of investment company under the Investment Company Act provided by Section 3(c)(1) or 3(c)(7) of the Investment Company Act. The securities issued by any wholly-owned or majority-owned subsidiary that relies on the exclusion from the definition of investment company provided by Section 3(c)(1) or 3(c)(7), together with any other investment securities we may own, may not have a value in excess of 40% of the value of our adjusted total assets on an unconsolidated basis. We monitor our compliance with the 40% Test and the operations of our subsidiaries so that we and each of our subsidiaries may maintain compliance with an exclusion from registration as an investment company under the Investment Company Act.

On August 31, 2011, the SEC issued a “concept release” under which it announced that it is reviewing interpretive issues related to the Section 3(c)(5)(C) exclusion, including requesting comments on whether it should reconsider whether whole pool certificates may be treated as qualifying real estate assets and whether companies, such as certain

of our subsidiaries, whose primary business consists of investing in whole pool certificates, are the type of entities that Congress intended to be covered by the exclusion provided by Section 3(c)(5)(C).

The potential timetable and outcome of the SEC's review are unclear. However, if the SEC determines that whole pool certificates are not qualifying real estate assets, adopts an otherwise adverse interpretation with respect to whole pool certificates, issues different guidance regarding any of the matters bearing upon the exclusion under Section 3(c)(5)(C) or otherwise believes we do not satisfy an Investment Company Act exclusion, we would be required to significantly restructure our operations in order to maintain our investment company exclusion. Under these circumstances, our ability to use leverage and our access to more favorable methods of financing would be substantially reduced, and we would be unable to conduct our business as we currently conduct it. We may also be required to sell certain of our assets and/or limit the types of assets we acquire. Under the circumstances described above, it is likely that our net interest income would be significantly reduced, which would materially and adversely affect our business.

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Implementation of 2013 COSO Internal Control Framework

In May of 2013 the Committee of Sponsoring Organizations of the Treadway Commission ( or COSO) released an updated version of the internal control framework (or 2013 COSO Framework) that we and many other organizations use to assess internal control over financial reporting. The 2013 COSO Framework is intended to address changes in the business, operating and regulatory environment that have occurred since COSO issued its original internal control framework in 1992 (or 1992 COSO Framework).

While the 2013 COSO Framework will officially supersede the 1992 COSO Framework on December 15, 2014 and be available for use in connection with our assessment of internal control as of December 31, 2014, our current plan is not to transition to the 2013 COSO Framework until sometime during 2015. To date, neither COSO, the Securities and Exchange Commission or any other regulatory body has mandated adoption of the 2013 COSO Framework by a specified date.

We are currently in the process of performing an analysis to evaluate what changes to our control environment, if any, would be needed to successfully implement the 2013 COSO Framework. We believe that adopting the 2013 COSO Framework during 2015 will provide management and our Audit Committee sufficient opportunity to analyze the required incremental effort and understand and address any Company specific or industry related practice issues associated with the implementation of the 2013 Framework.

Until such time as our transition to the 2013 Framework is complete, we will continue to use the 1992 COSO Framework in connection with our assessment of internal control.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk.

We seek to manage our risks related to interest rates, liquidity, prepayment speeds, market value and the credit quality of our assets while, at the same time, seeking to provide an opportunity to stockholders to realize attractive total returns through ownership of our capital stock. While we do not seek to avoid risk, we seek, consistent with our investment policies, to: assume risk that can be quantified based on management's judgment and experience and actively manage such risk; earn sufficient returns to justify the taking of such risks; and maintain capital levels consistent with the risks that we undertake.

Interest Rate Risk

We generally acquire interest-rate sensitive assets and fund them with interest-rate sensitive liabilities, a portion of which are hedged with Swaps. We are exposed to interest rate risk on our assets, both Agency and Non-Agency MBS, and our liabilities, repurchase agreements and securitized debt. Changes in interest rates can affect our net interest income and the fair value of our assets and liabilities.

We finance the majority of our investments in Agency and Non-Agency MBS with short-term repurchase agreements. In general, the borrowing cost of our repurchase agreements changes more quickly, including the impact of Swaps, than the yield on our assets when interest rates change. In a rising interest rate environment the borrowing cost of our repurchase agreements may increase faster than the interest income on our assets, lowering our net income. In order to mitigate compression in net income based on such interest rate movements, we use Swaps and other hedging instruments to lock in a portion of the net interest spread between assets and liabilities.

The fair value of our MBS assets could change at a different rate than the fair value of our liabilities when interest rates change. We measure the sensitivity of our portfolio to changes in interest rates by estimating the duration of our assets and liabilities. Duration is the approximate percentage change in fair value for a 100 basis point parallel shift in the yield curve. In general, our assets have higher duration than our liabilities and in order to reduce this exposure we use Swaps and other hedging instruments to reduce the gap in duration between our assets and liabilities.

In calculating the duration of our Agency MBS we take into account the characteristics of the underlying mortgage loans including whether the underlying loans are fixed rate, adjustable or hybrid; coupon, expected prepayment rates and lifetime and periodic caps. We use third-party financial models, combined with management's assumptions and observed empirical data when estimating the duration of our Agency MBS.

Over the past few years, as the expected yields on Non-Agency MBS were significantly greater than expected yields on non-credit sensitive assets, changes in Non-Agency MBS prices were generally not highly correlated to changes in market interest rates. We believe that this low sensitivity to increases in interest rates was due to the fact that periods of rising interest rates had been generally accompanied by an improvement in economic expectations and therefore, more positive scenarios for Non-Agency MBS. Also, wide risk premiums for Non-Agency MBS meant that spreads could tighten to allow Non-Agency MBS to retain value despite increases in interest rates.

Prices of our Legacy Non-Agency MBS have generally trended up over the last several years. As with other financial assets, this has been driven by very accommodative Federal Reserve monetary policy. It has also been driven by improved mortgage credit fundamentals with increasing home prices, declining defaults, stable severities and higher voluntary prepayment rates.

At these higher prices and therefore lower yields, we believe that our Legacy Non-Agency MBS have become more interest rate sensitive and now exhibit positive duration. In analyzing the interest rate sensitivity of our Legacy Non-Agency MBS we take into account the characteristics of the underlying mortgage loans including credit quality and whether the underlying loans are fixed-rate, adjustable or hybrid. We estimate the duration of our Legacy Non-Agency MBS using management's assumptions.

We use Swaps as part of our overall interest rate risk management strategy. Such derivative financial instruments are intended to act as a hedge against future interest rate increases on our repurchase agreement financings, which rates are typically highly correlated with LIBOR. While our derivatives do not extend the maturities of our borrowings



under repurchase agreements, they do, however, in effect, lock in a fixed rate of interest over their term for a corresponding amount of our repurchase agreements that are hedged.

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At September 30, 2014, MFA's \$10.975 billion of Agency MBS and Legacy Non-Agency MBS, which includes \$65.7 million of MBS underlying Linked Transactions, were backed by Hybrid, adjustable and fixed-rate mortgages. Additional information about these MBS, including average months to reset and three-month average CPR, is presented below:

Time to Reset	Agency MBS			Non-Agency MBS (1)			Total (1)		
	Fair Value (2)	Average Months to Reset (3)	Average CPR (4)	Fair Value	Average Months to Reset (3)	Average CPR (4)	Fair Value (2)	Average Months to Reset (3)	Average CPR (4)
(Dollars in Thousands)									
< 2 years (5)	\$2,246,508	7	18.9 %	\$2,986,428	6	11.5 %	\$5,232,936	6	15.0 %
2-5 years	1,339,036	45	16.7	326,039	30	16.4	1,665,075	42	16.7
> 5 years	350,891	84	9.1	—	—	—	350,891	84	9.1
ARM-MBS Total	\$3,936,435	27	18.3 %	\$3,312,467	8	11.6 %	\$7,248,902	18	15.0 %
15-year fixed (6)	\$2,235,867		9.5 %	\$12,119		16.7 %	\$2,247,986		9.5 %
30-year fixed (6)	—		—	1,472,076		14.9	1,472,076		14.9
40-year fixed (6)	—		—	5,713		6.7	5,713		6.7
Fixed-Rate Total	\$2,235,867		9.5 %	\$1,489,908		14.9 %	\$3,725,775		11.8 %
MBS Total	\$6,172,302		15.1 %	\$4,802,375		12.7 %	\$10,974,677		13.9 %

(1) Excludes \$943.3 million of RPL/NPL MBS. Refer to table below for further information on RPL/NPL MBS.

(2) Does not include principal payments receivable of \$1.9 million.

Months to reset is the number of months remaining before the coupon interest rate resets. At reset, the MBS

(3) coupon will adjust based upon the underlying benchmark interest rate index, margin and periodic or lifetime caps.

The months to reset do not reflect scheduled amortization or prepayments.

(4) Average CPR weighted by positions as of the beginning of each month in the quarter.

(5) Includes floating rate MBS that may be collateralized by fixed-rate mortgages.

(6) Information presented based on data available at time of loan origination.

The following table presents certain information about our RPL/NPL MBS portfolio at September 30, 2014:

	Fair Value	Net Coupon	Months to Step-Up (1)	Current Credit Support (2)	Original Credit Support	3 Month Bond CPR (3)
(Dollars in Thousands)						
Re-Performing MBS	\$331,453	3.60 %	31	40	% 38	% 19.0
Non-Performing MBS	611,807	3.24	33	54	53	20.0
Total RPL/NPL MBS	\$943,260	3.37 %	33	49	% 48	% 19.7

(1) Months to step-up is the weighted average number of months remaining before the coupon interest rate increases a cumulative 300 basis points. We anticipate that the securities will be redeemed prior to the step-up date.

(2) Credit Support for a particular security is expressed as a percentage of all outstanding mortgage loan collateral. A particular security will not be subject to principal loss as long as credit enhancement is greater than zero.

(3) All principal payments are considered to be prepayments for CPR purposes. Excludes RPL/NPL MBS that have not had a principal payment.



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The information presented in the following “Shock Table” projects the potential impact of sudden parallel changes in interest rates on our net interest income and portfolio value, including the impact of Swaps, over the next 12 months based on the assets in our investment portfolio at September 30, 2014. All changes in income and value are measured as the percentage change from the projected net interest income and portfolio value at the base interest rate scenario at September 30, 2014.

## Shock Table

Change in Interest Rates	Estimated Value of Assets (1)	Estimated Value of Swaps	Estimated Value of Financial Instruments	Change in Estimated Value	Percentage Change in Interest Income (2)	Percentage Change in Portfolio Value
(Dollars in Thousands)						
+100 Basis Point Increase	\$ 12,261,940	\$ 112,039	\$ 12,373,979	\$(95,226 )	0.04 %	(0.76 )%
+ 50 Basis Point Increase	\$ 12,385,479	\$ 40,434	\$ 12,425,913	\$(43,292 )	(0.42 )%	(0.35 )%
Actual at September 30, 2014	\$ 12,500,376	\$(31,171 )	\$ 12,469,205	\$—	—	—
- 50 Basis Point Decrease	\$ 12,606,633	\$(102,776 )	\$ 12,503,857	\$34,652	(3.71 )%	0.28 %
-100 Basis Point Decrease	\$ 12,704,249	\$(174,381 )	\$ 12,529,868	\$60,663	(9.88 )%	0.49 %

(1) Such assets include MBS, including linked MBS that are reported as a component of our Linked Transactions on our consolidated balance sheets, residential whole loans, cash and cash equivalents and restricted cash. Such linked MBS may not be linked in future periods.

(2) Includes underlying interest income and interest expense associated with MBS and repurchase agreement borrowings underlying our Linked Transactions. Such MBS and repurchase agreements may not be linked in future periods.

Certain assumptions have been made in connection with the calculation of the information set forth in the Shock Table and, as such, there can be no assurance that assumed events will occur or that other events will not occur that would affect the outcomes. The base interest rate scenario assumes interest rates at September 30, 2014. The analysis presented utilizes assumptions and estimates based on management’s judgment and experience. Furthermore, while we generally expect to retain the majority of such assets and the associated interest rate risk to maturity, future purchases and sales of assets could materially change our interest rate risk profile. It should be specifically noted that the information set forth in the above table and all related disclosure constitute forward-looking statements within the meaning of Section 27A of the 1933 Act and Section 21E of the 1934 Act. Actual results could differ significantly from those estimated in the Shock Table above.

The Shock Table quantifies the potential changes in net interest income and portfolio value, which includes the value of our Swaps (which are carried at fair value), should interest rates immediately change (i.e., shocked). The Shock Table presents the estimated impact of interest rates instantaneously rising 50 and 100 basis points, and falling 50 and 100 basis points. The cash flows associated with our portfolio of MBS for each rate shock are calculated based on assumptions, including, but not limited to, prepayment speeds, yield on replacement assets, the slope of the yield curve and composition of our portfolio. Assumptions made on the interest rate sensitive liabilities, which are assumed to be repurchase financings and securitized debt, include anticipated interest rates, collateral requirements as a percent of the repurchase agreement, amount and term of borrowing. At September 30, 2014, we applied a floor of 0% for all anticipated interest rates included in our assumptions. Due to this floor, it is anticipated that any hypothetical interest rate shock decrease would have a limited positive impact on our funding costs; however, because prepayments speeds are unaffected by this floor, it is expected that any increase in our prepayment speeds (occurring as a result of any interest rate shock decrease or otherwise) could result in an acceleration of our premium amortization on our Agency MBS and discount accretion on our Non-Agency MBS and the reinvestment of principal repayments in lower yielding assets. As a result, because the presence of this floor limits the positive impact of interest rate decrease on our funding

costs, hypothetical interest rate shock decreases could cause the fair value of our financial instruments and our net interest income to decline.

At September 30, 2014, the impact on portfolio value was approximated using estimated effective duration (i.e., the price sensitivity to changes in interest rates), including the effect of Swaps, of 0.62 which is the weighted average of 2.22 for our Agency MBS, 1.44 for our Non-Agency MBS, (3.72) for our Swaps and zero for our cash and cash equivalents. Estimated convexity (i.e., the approximate change in duration relative to the change in interest rates) of the portfolio was (0.28), which is the weighted average of (0.56) for our Agency MBS, zero for our Swaps, zero for our Non-Agency MBS and zero for our cash and cash equivalents. The impact on our net interest income is driven mainly by the difference between portfolio yield and cost of funding of our repurchase agreements (including those underlying our Linked Transactions), which includes the cost and/or benefit from Swaps. Our asset/liability structure is generally such that an increase in interest rates would be expected to result in a decrease in net interest income, as our borrowings are generally shorter in term than our interest-earning assets. When interest rates are shocked, prepayment assumptions are adjusted based on management's expectations along with the results from the prepayment model.

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Market Value Risk

Our MBS are designated as “available-for-sale” and, as such, are reported at their fair value. The difference between amortized cost and fair value of our MBS is reflected in AOCI, a component of stockholders’ equity, except that credit related impairments that are identified as other-than-temporary are recognized through earnings. Changes in the fair value of our Linked Transactions are reported in earnings. At September 30, 2014, our investment portfolio was comprised primarily of Agency MBS and Non-Agency MBS. While changes in the fair value of our Agency MBS are generally not credit-related, changes in the fair value of our Non-Agency MBS and Linked Transactions may reflect both market and interest rate conditions as well as credit risk. At September 30, 2014, our Non-Agency MBS had a fair value of \$4.763 billion and an amortized cost of \$3.975 billion, comprised of gross unrealized gains of \$791.5 million and gross unrealized losses of \$3.1 million. At September 30, 2014, our Linked Transactions included MBS with a fair value of \$982.3 million, including net unrealized gains of \$5.9 million, which have been reflected through earnings to date as a component of unrealized net gains and net interest income from Linked Transactions.

Generally, in a rising interest rate environment, the fair value of our MBS would be expected to decrease; conversely, in a decreasing interest rate environment, the fair value of such MBS would be expected to increase. If the fair value of MBS collateralizing our repurchase agreements decreases, we may receive margin calls from our repurchase agreement counterparties for additional MBS collateral or cash due to such decline. If such margin calls are not met, our lender could liquidate the securities collateralizing our repurchase agreements with such lender, potentially resulting in a loss to us. To avoid forced liquidations, we could apply a strategy of reducing borrowings and assets, by selling assets or not replacing securities as they amortize and/or prepay. Such an action would likely reduce our interest income, interest expense and net income, the extent of which would be dependent on the level of reduction in assets and liabilities as well as the price at which such assets are sold. Such a decrease in our net interest income could negatively impact cash available for dividend distributions, which in turn could reduce the market price of our issued and outstanding common stock and preferred stock.

In evaluating our asset/liability management and Non-Agency MBS credit performance, we consider the credit characteristics underlying our Non-Agency MBS, including those that are a component of our Linked Transactions. The following table presents certain information about our Non-Agency MBS portfolio and Non-Agency MBS underlying our Linked Transactions at September 30, 2014. Information presented with respect to the weighted average FICO scores and other information aggregated based on information reported at the time of mortgage origination are historical and, as such, does not reflect the impact of the general decline in home prices or changes in a borrower’s credit score or the current use of the mortgaged property.

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The information in the table below is presented as of September 30, 2014:

Year of Securitization (2) (Dollars in Thousands)	Securities with Average Loan FICO of 715 or Higher (1)			Securities with Average Loan FICO Below 715 (1)			Total	
	2007	2006	2005 and Prior	2007	2006	2005 and Prior		
Number of securities	105	95	106	20	49	63	438	
MBS current face (3)(4)	\$1,555,619	\$1,142,205	\$1,224,073	\$207,470	\$561,419	\$674,990	\$5,365,776	
Total purchase discounts, net (3)	\$(398,399 )	\$(322,118 )	\$(213,340 )	\$(70,278 )	\$(194,517)	\$(167,694)	\$(1,366,346)	
Purchase discount designated as Credit Reserve and OTTI (3)(5)	\$(274,420 )	\$(188,483 )	\$(110,738 )	\$(58,098 )	\$(192,453)	\$(115,918)	\$(940,110 )	
Purchase discount designated as Credit Reserve and OTTI as percentage of current face	17.6	% 16.5	% 9.0	% 28.0	% 34.3	% 17.2	% 17.5	%
MBS amortized cost (3)(4)	\$1,157,220	\$820,088	\$1,010,732	\$137,192	\$366,902	\$507,296	\$3,999,430	
MBS fair value (3)(4)	\$1,393,322	\$1,002,048	\$1,140,128	\$175,093	\$463,802	\$618,439	\$4,792,832	
Weighted average fair value to current face	89.6	% 87.7	% 93.1	% 84.4	% 82.6	% 91.6	% 89.3	%
Weighted average coupon (6)	4.04	% 3.64	% 3.20	% 4.35	% 4.79	% 4.32	% 3.89	%
Weighted average loan age (months) (6)(7)	90	99	113	94	101	114	102	
Weighted average current loan size (6)(7)	\$528	\$497	\$329	\$403	\$274	\$268	\$412	
Percentage amortizing (8)	44	% 55	% 67	% 49	% 57	% 64	% 56	%
Weighted average FICO score at origination (6)(9)	732	729	727	705	703	705	723	
Owner-occupied loans	90.1	% 89.2	% 85.6	% 80.3	% 85.5	% 83.8	% 87.2	%
Rate-term refinancings	28.0	% 18.9	% 15.1	% 19.8	% 15.9	% 14.0	% 19.8	%
Cash-out refinancings	32.9	% 34.2	% 26.2	% 45.9	% 42.7	% 37.1	% 33.7	%
3 Month CPR (7)	13.7	% 11.8	% 12.4	% 10.6	% 11.6	% 11.6	% 12.4	%
3 Month CRR (7)(10)	11.4	% 9.3	% 10.2	% 7.4	% 7.4	% 8.9	% 9.8	%
3 Month CDR (7)(10)	2.6	% 2.6	% 2.3	% 3.4	% 4.4	% 3.1	% 2.8	%

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3 Month loss severity	50.7	% 47.7	% 45.0	% 56.1	% 59.1	% 55.9	% 51.4	%
60+ days delinquent (9)	14.5	% 14.7	% 11.3	% 21.2	% 22.3	% 15.6	% 15.0	%
Percentage of always current borrowers (Lifetime) (11)	44.7	% 43.8	% 50.9	% 34.9	% 30.9	% 38.1	% 43.3	%
Percentage of always current borrowers (12M) (12)	74.1	% 73.2	% 76.4	% 61.5	% 62.3	% 67.2	% 71.8	%
Weighted average credit enhancement (9)(13)	0.6	% 1.3	% 4.5	% 0.3	% 0.9	% 6.3	% 2.4	%

- (1) FICO score is used by major credit bureaus to indicate a borrower's creditworthiness at time of loan origination. Information presented based on the initial year of securitization of the underlying collateral. Certain of our Non-Agency MBS have been resecuritized. The historical information presented in the table is based on the initial securitization date and data available at the time of original securitization (and not the date of resecuritized). No information has been updated with respect to any MBS that have been resecuritized.
- (2) Excludes Non-Agency MBS issued in 2013 and 2014 in which the underlying collateral consists of re-performing and non-performing loans that were originated in prior years. These Non-Agency MBS have a current face of \$943.9 million, amortized cost of \$942.5 million, fair value of \$943.3 million and purchase discounts of \$1.4 million at September 30, 2014.
- (3) Excludes Connecticut Avenue Securities ("CAS") which represent unsecured obligations of Fannie Mae and are structured to reflect the performance of a reference pool of residential mortgage loans. The CAS notes have a \$9.5 million current face, amortized cost and fair value at September 30, 2014.
- (4) Purchase discounts designated as Credit Reserve and OTTI are not expected to be accreted into interest income.
- (5) Weighted average is based on MBS current face at September 30, 2014.
- (6) Information provided is based on loans for individual groups owned by us.
- (7) Percentage of face amount for which the original mortgage note contractually calls for principal amortization in the current period.
- (8) Information provided is based on loans for all groups that provide credit enhancement for MBS with credit enhancement.
- (9) CRR represents voluntary prepayments and CDR represents involuntary prepayments.
- (10) Percentage of face amount of loans for which the borrower has not been delinquent since origination.
- (11) Percentage of face amount of loans for which the borrower has not been delinquent in the last twelve months. Credit enhancement for a particular security is expressed as a percentage of all outstanding mortgage loan collateral. A particular security will not be subject to principal loss as long as its credit enhancement is greater than zero. As of September 30, 2014, a total of 267 Non-Agency MBS in our portfolio representing approximately \$3.550 billion or 66% of the current face amount of the portfolio had no credit enhancement.
- (12) Information provided is based on loans for individual groups owned by us.
- (13) Percentage of face amount for which the original mortgage note contractually calls for principal amortization in the current period.



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The mortgages securing our Non-Agency MBS are located in many geographic regions across the United States. The following table presents the six largest geographic concentrations of the mortgages collateralizing our Non-Agency MBS, including Non-Agency MBS underlying our Linked Transactions, at September 30, 2014:

Property Location	Percent
Southern California	27.7 %
Northern California	16.6 %
Florida	7.8 %
New York	5.4 %
Virginia	3.9 %
Maryland	3.5 %

## Liquidity Risk

The primary liquidity risk for us arises from financing long-maturity assets, with shorter-term borrowings primarily in the form of repurchase agreements. We pledge MBS and cash to secure our repurchase agreements, including repurchase agreements that are reported as a component to our Linked Transactions, and Swaps. At September 30, 2014, we have access to various sources of liquidity which we estimate exceeds \$1.113 billion. This includes (i) \$423.9 million of cash and cash equivalents; (ii) \$411.5 million in estimated financing available from unpledged Agency MBS and other Agency MBS collateral that is currently pledged in excess of contractual requirements; and (iii) \$277.1 million in estimated financing available from unpledged Non-Agency MBS. Should the value of our MBS pledged as collateral suddenly decrease, margin calls relating to our repurchase agreements could increase, causing an adverse change in our liquidity position. As such, we cannot be assured that we will always be able to roll over our repurchase agreements. Further, should market liquidity tighten, our repurchase agreement counterparties may increase our margin requirements on new financings, including repurchase agreement borrowings that we roll with the same counterparty, reducing our ability to use leverage.

## Credit Risk

Although we do not believe that we are exposed to credit risk in our Agency MBS portfolio, we are exposed to credit risk in our Non-Agency MBS and residential whole loans. In the event of the return of less than 100% of par on our Non-Agency MBS, credit support contained in the MBS deal structures and the discount purchase prices we paid mitigate our risk of loss on these investments. Over time, we expect the level of credit support remaining in certain MBS deal structures to decrease, which will result in an increase in the amount of realized credit loss experienced by our Non-Agency MBS portfolio. Our Non-Agency investment process involves analysis focused primarily on quantifying and pricing credit risk. When we purchase Non-Agency MBS, we assign certain assumptions to each of the MBS, including but not limited to, future interest rates, voluntary prepayment rates, mortgage modifications, default rates and loss severities, and generally allocate a portion of the purchase discount as a Credit Reserve which provides credit protection for such securities. As part of our surveillance process, we review our Non-Agency MBS by tracking their actual performance compared to the security's expected performance at purchase or, if we have modified our original purchase assumptions, compared to our revised performance expectations. To the extent that actual performance of a Non-Agency MBS is less favorable than the expected performance of the security, we may revise our performance expectations. As a result, we could reduce the accretable discount on such security and/or recognize an other-than-temporary impairment through earnings, which could have a material adverse impact on our operating results. In addition, as discussed in Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations," of this Quarterly Report on Form 10-Q, we are potentially exposed to repurchase agreement counterparties should they default on their obligations, and we are unable to recover any excess collateral pledged to them.

### Prepayment and Reinvestment Risk

Premiums arise when we acquire MBS at a price in excess of the principal balance of the mortgages securing such MBS (i.e., par value). Conversely, discounts arise when we acquire MBS at a price below the principal balance of the mortgages securing such MBS or acquire residential whole loans at a price below the principal balance of the mortgage. Premiums paid on our MBS are amortized against interest income and accretable purchase discounts on these investments are accreted to interest income. Purchase premiums on our MBS, which are primarily carried on our Agency MBS, are amortized against interest income over the life of each security using the effective yield method, adjusted for actual prepayment activity. An increase in the prepayment rate, as measured by the CPR, will typically accelerate the amortization of purchase premiums, thereby reducing the IRR/interest income earned on such assets. Generally, if prepayments on these investments are less than anticipated, we expect that the income recognized on such assets would be reduced and MBS impairments and/or loan loss reserves could result.

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Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

Management, under the direction of its Chief Executive Officer and Chief Financial Officer, is responsible for maintaining disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the 1934 Act, that are designed to ensure that information required to be disclosed in reports filed or submitted under the 1934 Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and that such information is accumulated and communicated to management, including the Company's Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosures.

In connection with the preparation of this Quarterly Report on Form 10-Q, the Company's management reviewed and evaluated the Company's disclosure controls and procedures. The evaluation was performed under the direction of the Company's Chief Executive Officer and Chief Financial Officer to determine the effectiveness, as of September 30, 2014, of the design and operation of the Company's disclosure controls and procedures. Based on that review and evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures, as designed and implemented, were effective as of September 30, 2014. Notwithstanding the foregoing, a control system, no matter how well designed, implemented and operated, can provide only reasonable, not absolute, assurance that it will detect or uncover failures within the Company to disclose material information otherwise required to be set forth in our periodic reports.

(b) Changes in Internal Control Over Financial Reporting

There have been no changes in our internal control over financial reporting that occurred during the quarter ended September 30, 2014 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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## PART II. OTHER INFORMATION

## Item 1. Legal Proceedings

There are no material pending legal proceedings to which we are a party or any of our assets are subject.

## Item 1A. Risk Factors

For a discussion of the Company's risk factors, see Part 1, Item 1A. "Risk Factors" of the Company's Annual Report on Form 10-K for the year ended December 31, 2013. There are no material changes from the risk factors set forth in such Annual Report on Form 10-K. However, the risks and uncertainties that the Company faces are not limited to those set forth in the Company's Annual Report on Form 10-K for the year ended December 31, 2013. Additional risks and uncertainties not presently known to the Company or that it currently believes to be immaterial may also adversely affect the Company's business and the trading price of our securities.

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

## Purchases of Equity Securities

As previously disclosed, in August 2005, the Company's Board authorized a Repurchase Program, to repurchase up to 4.0 million shares of the Company's outstanding common stock. The Board reaffirmed such authorization in May 2010. In December 31, 2013, the Company's Board increased the number of shares authorized for repurchase to an aggregate of 10.0 million shares. Such authorization does not have an expiration date and, at present, there is no intention to modify or otherwise rescind such authorization. Subject to applicable securities laws, repurchases of common stock under the Repurchase Program may be made at times and in amounts as we deem appropriate (including, in our discretion, through the use of one or more plans adopted under Rule 10b-5-1 promulgated under the 1934 Act), using available cash resources. Shares of common stock repurchased by the Company under the Repurchase Program are cancelled and, until reissued by the Company, are deemed to be authorized but unissued shares of the Company's common stock. The Repurchase Program may be suspended or discontinued by the Company at any time and without prior notice.

The Company engaged in no share repurchase activity during the third quarter of 2014 pursuant to the Repurchase program. The Company did, however, withhold restricted shares (under the terms of grants under our 2010 Plan) to offset tax withholding obligations that occur upon the vesting and release of restricted stock awards and/or RSUs. The following table presents information with respect to (i) such withheld restricted shares, and (ii) eligible shares remaining for repurchase under the Repurchase Program:

Month	Total Number of Shares Purchased	Weighted Average Price Paid Per Share (1)	Total Number of Shares Repurchased as Part of Publicly Announced Repurchase Program or Employee Plan	Maximum Number of Shares that May Yet be Purchased Under the Repurchase Program or Employee Plan
July 1-31, 2014:				
Repurchase Program	(2) —	\$—	—	6,616,355
Employee Transactions	(3) 12,852	8.33	N/A	N/A
August 1-31, 2014:				
Repurchase Program	(2) —	—	—	—
Employee Transactions	(3) —	—	N/A	N/A
September 1-30, 2014:				

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Repurchase Program	(2)	—	—	—	—
Employee Transactions	(3)	17,209	\$7.78	N/A	N/A
Total Repurchase Program	(2)	—	\$—	—	—
Total Employee Transactions	(3)	30,061	\$8.02	N/A	N/A

(1) Includes brokerage commissions.

(2) As of September 30, 2014, the Company had repurchased an aggregate of 3,383,645 shares under the Repurchase Program.

(3) The Company's 2010 Plan provides that the value of the shares delivered or withheld be based on the price of our common stock on the date the relevant transaction occurs.

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Item 6. Exhibits

The list of exhibits required to be filed as exhibits to this report are listed on page E-1 hereof, under “Exhibit Index,” which is incorporated herein by reference.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: November 4, 2014

MFA FINANCIAL, INC.  
(Registrant)

By: /s/ William S. Gorin  
William S. Gorin  
Chief Executive Officer

By: /s/ Stephen D. Yarad  
Stephen D. Yarad  
Chief Financial Officer  
(Principal Financial Officer)

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EXHIBIT INDEX

The following exhibits are filed as part of this Quarterly Report:

Exhibit	Description
10.1	Summary Description of Compensation Payable to Non-Employee Directors of MFA Financial, Inc. (incorporated herein by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the three months ended June 30, 2014 (Commission File No. 1-13991)).
31.1	Certification of the Chief Executive Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of the Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of the Chief Executive Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of the Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS*	XBRL Instance Document
101.SCH*	XBRL Taxonomy Extension Schema Document
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document

\*These interactive data files are furnished and deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.