CAPSTEAD MORTGAGE CORP
Form 10-K
February 28, 2014

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

FORM 10-K

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

For the fiscal year ended: December 31, 2013

OR

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

For the transition period from ____________ to ______________

Commission File Number: 001-08896

CAPSTEAD MORTGAGE CORPORATION
(Exact name of Registrant as specified in its Charter)

Maryland	75 2027937
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
8401 North Central Expressway, Suite 800, Dallas, TX	75225-4404
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (214) 874-2323

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Exchange on Which Registered
Common Stock ($0.01 par value)	New York Stock Exchange
$7.50% Series E Cumulative Redeemable Preferred Stock ($0.10 par value)	New York Stock Exchange

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES þ NO o
Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES o NO þ
Indicate by check mark whether the Registrant (1) has filed all documents and reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to such filing requirements for the past 90 days. YES þ NO o
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 Registrant was required to submit and post such files). YES þ NO o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K:
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company.
Large accelerated filer þ Accelerated filer o Non-accelerated filer o Smaller reporting company o
Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Act). YES o NO þ

At June 28, 2013 the aggregate market value of the common stock held by nonaffiliates was $1,139,155,262.

Number of shares of Common Stock outstanding at February 28, 2014: 95,767,180

DOCUMENTS INCORPORATED BY REFERENCE:

Portions of the Registrant's definitive Proxy Statement, to be issued in connection with the 2014 Annual Meeting of Stockholders of the Registrant, are incorporated by reference into Part III.

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PART I

PART I

ITEM 1. BUSINESS

Capstead Mortgage Corporation operates as a self-managed real estate investment trust for federal income tax purposes (a "REIT") and is based in Dallas, Texas. Unless the context otherwise indicates, Capstead Mortgage Corporation, together with its subsidiaries, is referred to as "Capstead" or the "Company." Capstead was incorporated in the state of Maryland in 1985 and its common and 7.50% Series E preferred shares are listed on the New York Stock Exchange under the symbols "CMO" and "CMOPRE," respectively.

Capstead's investment strategy involves managing a leveraged portfolio of residential mortgage pass-through securities consisting almost exclusively of relatively short duration adjustable-rate mortgage ("ARM") securities issued and guaranteed by government-sponsored enterprises, either Fannie Mae or Freddie Mac (together, the "GSEs"), or by an agency of the federal government, Ginnie Mae. Residential mortgage pass-through securities guaranteed by the GSEs or Ginnie Mae, referred to as "Agency Securities," are considered to have limited, if any, credit risk because of federal government support for the GSEs. Duration is a measure of market price sensitivity to changes in interest rates. Declines in fair value caused by increases in interest rates are typically modest for investments in short duration ARM Agency Securities compared to investments in longer duration ARM or fixed-rate assets. These declines are generally recoverable in a relatively short period of time as coupon interest rates on the underlying mortgage loans reset to rates more reflective of the then current interest rate environment.

For further discussion of the Company's business and financial condition, see Item 7 of this report, "Management's Discussion and Analysis of Financial Condition and Results of Operations," which is incorporated herein by reference.

Competition

As a residential mortgage REIT that focuses on investing in ARM Agency Securities, Capstead competes for the acquisition of suitable investments with other mortgage REITs, commercial banks, savings banks, insurance companies, and institutional investors such as private equity funds, mutual funds, pension funds and sovereign wealth funds. Many of these entities have lower yield requirements as well as greater financial resources and access to capital than the Company. In addition, the federal government, through the Federal Reserve, the GSEs and the Federal Home Loan Banks, has substantial holdings of primarily fixed-rate Agency Securities and the Federal Reserve is currently acquiring additional fixed-rate Agency Securities as well as U.S. Treasury securities. This expansion of the Federal Reserve's balance sheet is often referred to as quantitative easing, or QE. Increased competition for the acquisition of Agency Securities can result in higher pricing levels for such assets and lead to lower mortgage interest rates. Although higher pricing levels generally correspond to a higher book value per common share for the Company, higher pricing levels also generally result in lower portfolio yields, which could adversely affect future profitability. Lower mortgage interest rates can result in higher levels of mortgage prepayments, generally resulting in lower portfolio yields because of increases in investment premium amortization which can adversely affect current profitability.

The policy goals of the federal government may differ from the economic goals of other investors in Agency Securities. In December 2013 the Federal Reserve began reducing, or "tapering", the monthly amount of fixed-rate Agency Securities it has been acquiring. Market expectations for the timing and extent of tapering led to higher mortgage interest rates and lower portfolio pricing levels the latter half of 2013. By the fourth quarter of 2013, mortgage prepayment levels declined improving the Company's profitability even as book value per common share was negatively affected. Lower pricing levels also created opportunities to acquire assets at relatively attractive yields. In the future, the Federal Reserve or the GSEs may determine it is appropriate to reduce holdings of Agency Securities which could also result in lower pricing levels.

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Regulation and Related Matters

Operating as a REIT that primarily invests in Agency Securities subjects Capstead to various federal tax and regulatory requirements. For further discussion, see Item 7 of this report, "Management's Discussion and Analysis of Financial Condition and Results of Operations," on pages 28 through 32 under the captions "Risks Related to Capstead's Status as a REIT and Other Tax Matters" and "Risk Factors Related to Capstead's Corporate Structure," which is incorporated herein by reference.

Employees

As of December 31, 2013, Capstead had 13 full-time employees and one part-time employee.

Website Access to Company Reports and Other Company Information

Capstead makes available on its website at www.capstead.com, free of charge, its annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, investor presentations and press releases, including any amendments to such documents as soon as reasonably practicable after such materials are electronically filed or furnished to the SEC or otherwise publicly released.

Investors may also read and copy any materials filed with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Washington, D.C. 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC also maintains an Internet site (www.sec.gov) through which investors may view reports, proxy and information statements, and other information filed with the SEC.

The Company also makes available on its website charters for the committees of its board of directors, its Board of Directors' Guidelines, its Amended and Restated Bylaws, its Code of Business Conduct and Ethics, its Financial Code of Professional Conduct and other information, including amendments to such documents and waivers, if any, to the codes. Such information will also be furnished, free of charge, upon written request to Capstead Mortgage Corporation, Attention: Stockholder Relations, 8401 North Central Expressway, Suite 800, Dallas, Texas 75225-4404.

Cautionary Statement Concerning Forward-Looking Statements

This document contains "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements include, without limitation, any statement that may predict, forecast, indicate or imply future results, performance or achievements, and may contain the words "believe," "anticipate," "expect," "estimate," "intend," "will be," "will likely continue," "will likely result," or words or phrases of similar meaning. Forward-looking statements are based largely on the expectations of management and are subject to a number of risks and uncertainties including, but not limited to, the following:

- changes in general economic conditions;
- fluctuations in interest rates and levels of mortgage prepayments;
- the effectiveness of risk management strategies;
- the impact of differing levels of leverage employed;
- liquidity of secondary markets and credit markets;
- the availability of financing at reasonable levels and terms to support investing at current leverage levels;
- the availability of new investment capital;
- the availability of suitable qualifying investments from both an investment return and regulatory perspective;
- changes in legislation or regulation affecting the GSEs, Ginnie Mae and similar federal government agencies and related guarantees;
- other changes in legislation or regulation affecting the mortgage and banking industries;

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- changes in market conditions as a result of Federal Reserve monetary policy or federal government fiscal challenges;
- deterioration in credit quality and ratings of existing or future issuances of GSE or Ginnie Mae securities;
- changes in legislation or regulation affecting exemptions for mortgage REITs from regulation under the Investment Company Act of 1940; and
- increases in costs and other general competitive factors.

In addition to the above considerations, actual results and liquidity are affected by other risks and uncertainties which could cause actual results to be significantly different from those expressed or implied by any forward-looking statements included herein. It is not possible to identify all of the risks, uncertainties and other factors that may affect future results. In light of these risks and uncertainties, the forward-looking events and circumstances discussed herein may not occur and actual results could differ materially from those anticipated or implied in the forward-looking statements. Forward-looking statements speak only as of the date the statement is made and the Company undertakes no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. Accordingly, readers of this document are cautioned not to place undue reliance on any forward-looking statements included herein.

ITEM 1A. RISK FACTORS

Under the captions "Risk Factors" and "Critical Accounting Policies" on pages 23 through 31 and 31 through 34, respectively, of Item 7 are discussions of risk factors and critical accounting policies affecting Capstead's financial condition and results of operations that are an integral part of this report. Readers are strongly urged to consider the potential impact of these factors and accounting policies on the Company while reading this document.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Capstead's headquarters are located in Dallas, Texas in office space leased by the Company.

ITEM 3. LEGAL PROCEEDINGS

None.

ITEM 4. MINING SAFETY DISCLOSURES

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

The New York Stock Exchange trading symbol for Capstead's common shares is CMO. As of December 31, 2013, the Company had 1,259 common stockholders of record and depository companies held common shares for 48,420 beneficial owners. Under the caption "Common Share Repurchases" on page 8 of Item 7 are disclosures relative to a $100 million common share repurchase authorization announced in October 2012, which are incorporated herein by reference.

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The high and low sales prices and dividends declared on the common shares were as follows:

	Year ended December 31, 2013			Year ended December 31, 2012		
	Sales Prices		Dividends	Sales Prices		Dividends
	High	Low	Declared	High	Low	Declared
First quarter	$13.22	$11.62	$ 0.31	$13.62	$12.29	$ 0.43
Second quarter	13.28	11.67	0.31	14.29	12.84	0.40
Third quarter	12.52	11.08	0.31	14.59	13.49	0.36
Fourth quarter	12.54	11.25	0.31	13.60	10.81	0.30

Set forth below is a graph comparing the yearly percentage change in the cumulative total return on Capstead common shares, with the cumulative total return of the Russell 2000 Index and the NAREIT Mortgage REIT Index for the five years ended December 31, 2013 assuming the investment of $100 on December 31, 2008 and the reinvestment of dividends. The stock price and dividend performance reflected in the graph is not necessarily indicative of future performance.

	Year ended December 31					
	2008	2009	2010	2011	2012	2013
Capstead Mortgage Corporation	$100.00	$150.24	$157.17	$178.25	$184.06	$214.34
Russell 2000 Index	100.00	127.17	161.32	154.59	179.86	249.69
NAREIT Mortgage REIT Index	100.00	124.63	152.79	149.10	178.75	175.25

See Item 11 of this report for information regarding equity compensation plans which is incorporated herein by reference. Capstead did not issue any unregistered securities during the past three fiscal years.

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ITEM 6. SELECTED FINANCIAL DATA

This table summarizes selected financial information, including key operating data (in thousands, except percentages, ratios and per share data). For additional information, refer to the audited consolidated financial statements and notes thereto included under Item 8 and "Management's Discussion and Analysis of Financial Condition and Results of Operations," included under Item 7 of this report.

	As of or for the year ended December 31				
	2013	2012	2011	2010	2009
Selected statement of income data:					
Interest income on residential mortgage investments (before investment premium amortization)	$341,009	$352,608	$311,154	$256,069	$343,096
Investment premium amortization	(125,872)	(96,677)	(68,077)	(57,581)	(29,420)
Related interest expense	(66,368)	(69,101)	(57,328)	(47,502)	(120,083)
	148,769	186,830	185,749	150,986	193,593
Other interest income (expense) [(a)]	(8,165)	(7,790)	(8,192)	(7,200)	(7,569)
	140,604	179,040	177,557	143,786	186,024
Other revenue (expense) [(b)]	(14,117)	(15,414)	(17,353)	(16,890)	(56,761)
Net income	$126,487	$163,626	$160,204	$126,896	$129,263
Net income per diluted common share [(c)]	$0.93	$1.50	$1.75	$1.52	$1.66
Cash dividends per common share	1.24	1.49	1.76	1.51	2.24
Average diluted common shares outstanding	95,393	95,012	79,696	69,901	65,449
Selected balance sheet data:					
Residential mortgage investments	$13,475,874	$13,860,158	$12,264,906	$8,515,691	$8,081,050
Total assets	14,015,968	14,469,263	12,844,622	8,999,362	8,628,903
Repurchase arrangements and similar borrowings	12,482,900	12,784,238	11,352,444	7,792,743	7,435,256
Long-term investment capital ("LTIC"):					
Unsecured borrowings (net of related investments in statutory trusts prior to dissolution in December 2013)	100,000	99,978	99,978	99,978	99,978
Preferred stockholders' equity	165,756	188,992	184,514	179,323	179,333
Common stockholders' equity	1,200,027	1,308,133	1,108,193	848,102	834,608
Book value per common share (unaudited)	12.47	13.58	12.52	12.02	11.99
Key operating data: (unaudited)					
Portfolio acquisitions (principal amount)	$3,187,534	$4,206,459	$5,673,803	$3,299,600	$1,969,113
Portfolio runoff (principal amount)	3,483,756	2,784,687	2,127,812	2,932,978	1,513,967
Common equity capital raised	–	142,036	231,673	10,423	81,441
Common share repurchases	7,292	35,062	–	–	–
Year-end portfolio leverage ratio [(d)]	8.52:1	8.00:1	8.15:1	6.91:1	6.67:1
Average financing spreads on residential mortgage investments [(e)]	1.07 %	1.38 %	1.68 %	1.93 %	2.42 %
Average total financing spreads [(e)]	0.96	1.26	1.56	1.74	2.23

Average mortgage prepayment rates, (expressed as constant prepayment rates, or CPRs)	21.45	17.60	16.58	29.47	16.84
Return on average LTIC	8.72	10.98	13.14	12.08	13.34
Return on average common equity capital	7.08	11.15	13.94	12.68	14.90

(a) Consists principally of interest on unsecured borrowings and is presented net of earnings of related statutory trusts prior to dissolution in December 2013.

(b) In 2009 Capstead recorded impairment charges totaling $40 million substantially reducing its exposure to investments in commercial real estate loans.

(c) Net income per diluted common share in 2013 includes charges totaling $0.23 related to Series A and B preferred share redemption preference premiums paid and dividends accruing on the Company's Series A and B preferred shares from the May 2013 issue date of the Company's Series E preferred shares through the June 2013 redemption of the Series A and B preferred shares. See Item 7 pages 8 and 14 for further discussion.

(d) Year-end portfolio leverage ratios were calculated by dividing repurchase arrangements and similar borrowings by long-term investment capital.

(e) Financing spreads on residential mortgage investments is a non-GAAP financial measure based solely on yields on Capstead's residential mortgage investments, net of borrowing rates on repurchase arrangements and similar borrowings, adjusted for currently-paying interest rate swap agreements held for hedging purposes. This measure differs from total financing spreads, an all-inclusive GAAP measure that includes yields on all interest-earning assets, as well as rates paid on all interest-bearing liabilities, principally unsecured borrowings. See Item 7 page 14 for reconciliations of these measures.

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

Capstead operates as a self-managed REIT and earns income from investing in a leveraged portfolio of residential mortgage pass-through securities consisting almost exclusively of relatively short duration ARM Agency Securities, which are considered to have limited, if any, credit risk. This strategy of investing in ARM Agency Securities that reset to more current interest rates within a relatively short period of time positions the Company to benefit from potential recoveries in financing spreads diminished during periods of rising interest rates and can result in smaller fluctuations in portfolio values compared to portfolios containing a significant amount of longer duration ARM or fixed-rate mortgage securities (duration is a common measure of market price sensitivity to interest rate movements).

Capstead finances its investments with borrowings under repurchase arrangements with commercial banks and other financial institutions supported by its long-term investment capital, which as of December 31, 2013 totaled $1.47 billion and consisted of $1.20 billion of common and $166 million of perpetual preferred stockholders' equity (recorded amounts) and $100 million of long-term unsecured borrowings. Long-term investment capital decreased by $131 million during 2013 primarily as a result of portfolio runoff and lower portfolio pricing levels, net of higher pricing levels for interest rate swap agreements held for hedging purposes ($75 million), and the June 2013 redemption of the Company's higher cost Series A and B preferred shares using proceeds from the May 2013 issuance of its 7.50% Series E perpetual preferred shares and cash on hand ($43 million). Other contributing factors included early first quarter common share repurchases ($7 million) and dividend payments in excess of earnings ($10 million) partially offset by other operational factors and Series E preferred capital raised late in the year using an at-the-market continuous offering program.

Taking advantage of relatively sharp increases in longer-term interest rates that began in May 2013, Capstead replaced most of its portfolio runoff at relatively attractive levels and did not sell any mortgage assets during 2013. The recorded value of Capstead's holdings of ARM Agency Securities decreased by $384 million to $13.48 billion at December 31, 2013, $101 million of which is attributable to the elimination of unrealized gains on investments that paid off and a 56 basis point decline in portfolio pricing levels as the market adjusted to higher prevailing longer-term interest rates. Borrowings under repurchase arrangements decreased by $301 million during 2013 to $12.48 billion. Portfolio leverage (borrowings under repurchase arrangements divided by long-term investment capital) increased to 8.52 to one at December 31, 2013 from 8.00 to one at December 31, 2012 primarily reflecting the decline in long-term investment capital noted above. Management believes borrowing at current levels represents an appropriate and prudent use of leverage under current market conditions for a portfolio consisting almost entirely of relatively short duration and well-seasoned ARM Agency Securities.

Capstead reported net income of $126 million or $0.93 per diluted common share for the year ended December 31, 2013 compared to $164 million or $1.50 per diluted common share in 2012. Net income per diluted common share for the year ended December 31, 2013 includes $0.23 in redemption preference premiums paid and other one-time effects of the second quarter's preferred capital transactions; excluding these items, core earnings were $1.16 per diluted common share. See pages 8 and 14 for further information and a reconciliation of these GAAP and non-GAAP financial measures.

Financing spreads on residential mortgage investments averaged 107 basis points for 2013, compared to 138 basis points for 2012. Financing spreads on residential mortgage investments is a non-GAAP financial measure based solely on yields on residential mortgage investments, net of borrowing rates on repurchase arrangements and similar borrowings, adjusted for currently-paying interest rate swap agreements held for hedging purposes. This measure differs from total financing spreads, an all-inclusive GAAP measure that includes yields on all interest-earning assets, as well as rates paid on all interest-bearing liabilities, principally unsecured borrowings. See page 14 for a reconciliation of these GAAP and non-GAAP financial measures. Lower financing spreads reflect (a) lower cash yields on the portfolio because of the effects of ARM loan coupon interest rates resetting lower to more current rates as well as lower coupon interest rates on acquisitions, and (b) higher investment premium amortization primarily because of higher levels of mortgage prepayments during the first three quarters of 2013, as well as higher prices paid for portfolio acquisitions in recent years. Borrowing rates were modestly lower as older, higher rate interest rate swap positions used for hedging purposes were replaced at lower rates.

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Incentive compensation, salaries and benefits and other general and administrative expense (referred to as “operating costs”) as a percentage of long-term investment capital averaged 89 basis points for 2013, compared to 97 basis points during 2012. Operating costs were lower during 2013 primarily reflecting lower incentive compensation.

The size and composition of Capstead’s investment portfolio depends on investment strategies being implemented by management, as well as overall market conditions, including the availability of attractively priced investments and suitable financing to leverage the Company’s investment capital. Market conditions are influenced by, among other things, current levels of, and expectations for future levels of, short-term interest rates, mortgage prepayments and market liquidity.

Risk Factors and Critical Accounting Policies

Under the captions “Risk Factors” and “Critical Accounting Policies” are discussions of risk factors and critical accounting policies affecting Capstead’s financial condition and earnings that are an integral part of this discussion and analysis. Readers are strongly urged to consider the potential impact of these factors and accounting policies on the Company and its financial results.

Issuance of 7.50% Series E and Redemption of Series A and B Perpetual Preferred Shares

In May 2013 Capstead completed a public offering of 6.8 million shares ($170 million face amount) of its 7.50% Series E Cumulative Redeemable Preferred Stock, liquidation preference $25.00 per share. Net proceeds of the offering, after underwriting fees and other costs, totaled $164 million and together with $43 million of cash on hand were used to fund the June 2013 redemption of 77,000 and 16.5 million of the Company’s Series A and B perpetual preferred shares, respectively. Stockholders holding the remaining Series A and B shares outstanding prior to announcing the redemption exercised their conversion rights resulting in the issuance of 201,000 common shares. The preferred shares that were redeemed had redemption preferences aggregating $207 million, a total of $20 million in excess of these shares’ recorded amounts on the Company’s balance sheet. This redemption preference premium is reflected as a $0.21 per common share reduction in net income available to common stockholders for the year ended December 31, 2013. As a result of these transactions, net income available to common stockholders and net income per diluted common share have begun benefiting from an annualized $8 million in lower preferred dividend requirements (nearly $0.09 per diluted common share).

In late 2013 the Company issued an additional 61,000 Series E preferred shares through an at-the-market continuous offering program at an average price of $23.78, net of expenses, for net proceeds of over $1 million. The Company may raise modest additional amounts of Series E preferred capital in the future under this program subject to compliance with federal securities laws, market conditions and blackout periods associated with the dissemination of earnings and dividend announcements and other important Company-specific news.

Common Share Repurchases

In late 2012 Capstead implemented a $100 million common share repurchase program and suspended its common share continuous offering program until further notice. Purchases pursuant to the common share repurchase program can be made in the open market or through privately negotiated transactions from time to time as permitted by securities laws and other legal requirements. The timing, manner, price and amount of any repurchases are determined by the Company in its discretion and are subject to economic and market conditions, applicable legal requirements and other factors.

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Pursuant to this authorization, in late 2012 repurchases totaled 3 million common shares at an average cost of $11.80 per share for $35 million. An additional 638,000 shares were repurchased in early January 2013 at an average cost of $11.43 per share for $7 million, leaving $58 million of the authorization available for future repurchases. The authorization does not obligate the Company to acquire any particular amount of common shares and the program may be suspended or discontinued at the Company's discretion without prior notice. Upon suspension of the repurchase program, issuances of common shares under the continuous offering program or by other means may resume subject to the same restraints noted above.

Book Value per Common Share

Nearly all of Capstead's residential mortgage investments and all of its interest rate swap agreements are reflected at fair value on the Company's balance sheet and are therefore included in the calculation of book value per common share (total stockholders' equity, less aggregate liquidation preferences for preferred shares, divided by common shares outstanding). The fair value of these investments is impacted by market conditions, including changes in interest rates, and the availability of financing at reasonable rates and leverage levels, among other factors. The Company's investment strategy attempts to mitigate these risks by focusing on investments in Agency Securities, which are considered to have little, if any, credit risk and are collateralized by ARM loans with interest rates that reset periodically to more current levels. Because of these characteristics, the fair value of Capstead's portfolio is considerably less vulnerable to significant pricing declines caused by credit concerns or rising interest rates compared to portfolios containing a significant amount of non-agency and/or fixed-rate mortgage securities. The following table illustrates the progression of the Company's book value per common share for the indicated periods:

	As of and for the year ended December 31					
	2013		2012		2011	
Book value per common share, beginning of year	$13.58		$12.52		$12.02	
One-time effects of second quarter 2013 redemption of Series A and B preferred shares and issuance of Series E preferred shares	(0.28)		–		–	
Other capital transactions:						
Dividend distributions in excess of core earnings	(0.08)		(0.01)		(0.06)	
Accretion from capital raises	–		0.12		0.22	
Accretion from common share repurchases	0.01		0.02		–	
Increase related to stock awards	0.02		–		–	
	(0.33)	(2.4)%	0.13	1.1%	0.16	1.4%
Change in unrealized gains and losses on mortgage securities classified as available-for-sale	(1.05)		0.95		0.61	
Change in unrealized gains and losses on interest rate swap agreements designated as cash flow hedges of:						
Borrowings under repurchase arrangements	0.08		(0.04)		0.01	
Unsecured borrowings	0.19		0.02		(0.28)	
	(0.78)	(5.8)%	0.93	7.4%	0.34	2.8%
Book value per common share, end of year	$12.47		$13.58		$12.52	
Change in book value per common share during the indicated year	$(1.11)	(8.2)%	$1.06	8.5%	$0.50	4.2%

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Residential Mortgage Investments

Capstead's investment strategy focuses on managing a large portfolio of residential mortgage investments consisting almost exclusively of ARM Agency Securities. Agency Securities are considered to have limited, if any, credit risk because the timely payment of principal and interest is guaranteed by the GSEs, which are federally chartered corporations, or Ginnie Mae, which is an agency of the federal government. Federal government support for the GSEs has largely alleviated market concerns regarding the ability of the GSEs to fulfill their guarantee obligations. By focusing on investing in relatively short duration and well-seasoned ARM Agency Securities, declines in fair value caused by increases in interest rates are typically relatively modest compared to investments in longer duration ARM or fixed-rate assets. These declines are generally recoverable in a relatively short period of time as coupon interest rates on the underlying mortgage loans reset to rates more reflective of the then current interest rate environment. This investment strategy positions the Company to benefit from potential recoveries in financing spreads diminished during periods of rising short-term interest rates. The following table illustrates the progression of the Company's portfolio of residential mortgage investments for the indicated periods (dollars in thousands):

	As of and for the year ended December 31		
	2013	2012	2011
Residential mortgage investments, beginning of year	$13,860,158	$12,264,906	$8,515,691
(Decrease) increase in net unrealized gains on mortgage securities classified as available-for-sale	(101,001)	91,750	54,325
Portfolio acquisitions (principal amount) at average lifetime purchased yields of 2.28%, 2.17% and 2.75%, respectively	3,187,534	4,206,459	5,673,803
Securities effectively sold in connection with the bankruptcy of a lending counterparty	–	–	(8,262)
Investment premiums on acquisitions*	138,811	178,407	225,238
Portfolio runoff (principal amount)	(3,483,756)	(2,784,687)	(2,127,812)
Investment premium amortization	(125,872)	(96,677)	(68,077)
Residential mortgage investments, end of year	$13,475,874	$13,860,158	$12,264,906

* Residential mortgage investments typically are acquired at a premium to the securities' unpaid principal balances. Investment premiums are recognized in earnings as portfolio yield adjustments using the interest method over the estimated lives of the related investments. As such, the level of mortgage prepayments impacts how quickly investment premiums are amortized.

ARM securities are backed by residential mortgage loans that have coupon interest rates that adjust at least annually to more current interest rates or begin doing so after an initial fixed-rate period. After the initial fixed-rate period, if applicable, mortgage loans underlying the Company's ARM securities either (i) adjust annually based on specified margins over the one-year Constant Maturity U.S. Treasury Note Rate ("CMT") or the one-year London interbank offered rate ("LIBOR"), (ii) adjust semiannually based on specified margins over six-month LIBOR, or (iii) adjust monthly based on specified margins over indices such as one-month LIBOR, the Eleventh District Federal Reserve Bank Cost of Funds Index, or over a rolling twelve month average of the one-year CMT index, usually subject to periodic and lifetime limits, or caps, on the amount of such adjustments during any single interest rate adjustment period and over the contractual term of the underlying loans.

Capstead classifies its ARM securities based on the average length of time until the loans underlying each security reset to more current rates ("months-to-roll") (less than 18 months for "current-reset" ARM securities, and 18 months or greater for "longer-to-reset" ARM securities). After consideration of any applicable initial fixed-rate periods, at December 31, 2013 approximately 83%, 10% and 7% of the Company's ARM securities were backed by mortgage loans that reset annually, semi-annually and monthly, respectively. Approximately 87% of the Company's current-reset ARM securities have reached an initial coupon reset date, while none of its longer-to-reset ARM securities have reached an initial coupon reset date. Additionally, at December 31, 2013 approximately 16% of the Company's ARM securities were backed by interest-only loans that have not reached an initial coupon reset date. All percentages are approximate and based on averages of the characteristics of mortgage loans underlying each security and calculated using unpaid principal balances as of the indicated date. The Company's ARM holdings featured the following characteristics at December 31, 2013 (dollars in thousands):

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ARM Type [a]	Amortized Cost Basis [b]	Net WAC [c]	Fully Indexed WAC [c]	Average Net Margins [c]	Average Periodic Caps [c]	Average Lifetime Caps [c]	Months To Roll [a]
Current-reset ARMs:							
Fannie Mae Agency Securities	$4,658,862	2.33 %	2.16 %	1.71 %	3.29 %	10.09 %	5.4
Freddie Mac Agency Securities	1,637,500	2.44	2.25	1.83	2.13	10.58	6.4
Ginnie Mae Agency Securities	1,181,571	2.52	1.66	1.51	1.04	8.80	8.7
Residential mortgage loans	4,262	3.45	2.26	2.02	1.50	10.94	4.5
	7,482,195	2.39	2.10	1.70	2.69	9.99	6.1
Longer-to-reset ARMs:							
Fannie Mae Agency Securities	2,972,662	2.86	2.33	1.75	4.89	7.87	40.3
Freddie Mac Agency Securities	1,750,047	2.93	2.40	1.82	4.83	7.96	40.7
Ginnie Mae Agency Securities	1,038,465	2.78	1.66	1.51	1.11	7.87	30.9
	5,761,174	2.86	2.23	1.73	4.19	7.90	38.7
	$13,243,369	2.59	2.16	1.71	3.34	9.08	20.2
Gross WAC (rate paid by borrowers) [d]		3.20					

(a) Capstead classifies its ARM securities based on the average length of time until the loans underlying each security reset to more current rates ("months-to-roll") (less than 18 months for "current-reset" ARM securities, and 18 months or greater for "longer-to-reset" ARM securities). Once an ARM loan reaches its initial reset date, it will reset at least once a year to a margin over a corresponding interest rate index, subject to periodic and lifetime limits or caps.

(b) Amortized cost basis represents the Company's investment (unpaid principal balance plus unamortized investment premiums) before unrealized gains and losses. As of December 31, 2013, the ratio of amortized cost basis to related unpaid principal balance for the Company's ARM securities was 103.26. This table excludes $2 million in fixed-rate Agency Securities, $3 million in fixed-rate residential mortgage loans and $2 million in private residential mortgage pass-through securities held as collateral for structured financings.

(c) Net WAC, or weighted average coupon, is the weighted average interest rate of the mortgage loans underlying the indicated investments, net of servicing and other fees as of the indicated date. Net WAC is expressed as a percentage calculated on an annualized basis on the unpaid principal balances of the mortgage loans underlying these investments. Fully indexed WAC represents the weighted average coupon upon one or more resets using interest rate indexes and net margins as of the indicated date. Average net margins represent the weighted average levels over the underlying indexes that the underlying loans can adjust to upon reset, usually subject to initial, periodic and/or lifetime limits, or caps, on the amount of such adjustments during any single interest rate adjustment period and over the contractual term of the underlying loans. ARM securities issued by the GSEs with initial fixed-rate periods of five years or longer typically have 500 basis point initial caps with 200 basis point periodic caps. Additionally, certain ARM securities held by the Company are subject only to lifetime caps or were not subject to a cap. For presentation purposes, average periodic caps in the table above reflect initial caps until after an ARM security has reached its initial reset date and lifetime caps, less related current net WAC, for ARM securities subject only to lifetime caps. At year-end, 73% of current-reset ARMs were subject to periodic caps averaging 1.82%; 13% were subject to initial caps averaging 2.67%; 13% were subject to lifetime caps, less related current net WAC, averaging 7.63%; and 1% were not subject to a cap. All longer-to-reset ARM securities at December 31, 2013 were subject to initial caps.

(d) Gross WAC is the weighted average interest rate of the mortgage loans underlying the indicated investments, which includes servicing and other fees paid by borrowers, as of the indicated balance sheet date.

Capstead generally pledges its residential mortgage investments as collateral under repurchase arrangements with commercial banks and other financial institutions, referred to as counterparties, the terms and conditions of which are negotiated on a transaction-by-transaction basis when each borrowing is initiated or renewed. None of the Company's counterparties are obligated to renew or otherwise enter into new repurchase transactions at the conclusion of existing repurchase transactions. Repurchase arrangements entered into by the Company involve the sale and a simultaneous agreement to repurchase the transferred assets at a future date, typically with terms of 30 to 90 days, and are accounted for as financings by the Company. The Company maintains the beneficial interest in the specific securities pledged during the term of the repurchase arrangement and receives the related principal and interest payments. The amount borrowed is generally equal to the fair value of the assets pledged, as determined by the lending counterparty, less an agreed-upon discount, referred to as a “haircut.” Haircuts on outstanding borrowings averaged 4.5 percent and ranged from 3.0 to 5.0 percent of the fair value of pledged residential mortgage pass-through securities at December 31, 2013, little changed from the prior year. After considering haircuts and related interest receivable on the collateral, as well as interest payable on these borrowings, the Company had $666 million of capital at risk with its lending counterparties as of December 31, 2013.

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Interest rates charged on repurchase arrangements are fixed based on prevailing rates corresponding to the terms of the borrowings, and interest is paid at the termination of the repurchase arrangement at which time the Company may enter into a new repurchase arrangement at prevailing market rates with the same counterparty or repay that counterparty and negotiate financing with a different counterparty. When the fair value of pledged securities declines due to changes in market conditions or the publishing of monthly security pay down factors, lenders typically require the Company to post additional securities as collateral, pay down borrowings or fund cash margin accounts with the counterparties in order to re-establish the agreed-upon collateral requirements, referred to as margin calls. Conversely, if collateral fair values increase, lenders are required to release collateral back to the Company pursuant to Company-issued margin calls.

The Company's borrowings under repurchase arrangements and similar borrowings at December 31, 2013 consisted of $12.48 billion of primarily 30-day borrowings with 22 counterparties at average rates of 0.38%, before the effects of interest rate swap agreements held as cash flow hedges and 0.49% including the effects of these derivatives.

To help mitigate exposure to higher short-term interest rates, Capstead typically uses currently-paying and forward-starting, one-month LIBOR-indexed, pay-fixed, receive-variable, interest rate swap agreements that require interest payments for two-year terms. Variable payments received by the Company under these swap agreements offset a significant portion of the interest accruing on a like amount of the Company's 30- to 90-day borrowings. As a result, the Company's effective borrowing rate for these borrowings consists of fixed-rate payments made on the swap agreements adjusted for differences between variable rate payments received on the swap agreements and related actual borrowing rates, as well as the effects of measured hedge ineffectiveness.

At December 31, 2013, the Company held portfolio financing-related swap agreements totaling $6.70 billion notional amount with average contract expirations of 18 months. These swap positions consisted of (a) $4.20 billion notional amount in currently-paying swap agreements requiring the payment of fixed rates of interest averaging 0.50% for average remaining interest-payment terms of 14 months and (b) $2.50 billion notional amount in forward-starting swap agreements that will begin requiring fixed rate interest payments averaging 0.50% for two-year periods that commence on various dates between January 2014 and April 2014, with average contract expirations of 25 months. After consideration of all portfolio financing-related swap positions entered into as of year-end, the Company's residential mortgage investments and related borrowings had estimated durations at December 31, 2013 of 11¾ months and 9¾ months, respectively, for a net duration gap of approximately 2 months – see pages 21 and 22 under the caption "Interest Rate Risk" for further information about the Company's sensitivity to changes in market interest rates. The Company intends to continue to manage interest rate risk associated with holding and financing its residential mortgage investments by utilizing suitable derivative financial instruments such as interest rate swap agreements as well as longer-dated repurchase arrangements if available at attractive terms.

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Components of quarterly financing spreads on residential mortgage investments, a non-GAAP financial measure, and mortgage prepayment rates, expressed as an annualized constant prepayment rate, or "CPR," were as follows for the indicated periods:

	2013				2012			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Yields on residential mortgage investments:[(a)]								
Cash yields	2.48 %	2.50 %	2.52 %	2.57 %	2.60 %	2.65 %	2.71 %	2.74 %
Investment premium amortization	(0.74)	(1.14)	(0.99)	(0.84)	(0.84)	(0.79)	(0.67)	(0.60)
Adjusted yields	1.74	1.36	1.53	1.73	1.76	1.86	2.04	2.14
Related borrowing rates:[(b)]								
Unhedged borrowing rates	0.38	0.37	0.39	0.41	0.45	0.41	0.37	0.32
Fixed swap rates	0.52	0.59	0.65	0.71	0.75	0.78	0.80	0.85
Adjusted borrowing rates	0.49	0.49	0.53	0.58	0.63	0.56	0.54	0.49
Financing spreads on residential mortgage investments	1.25	0.87	1.00	1.15	1.13	1.30	1.50	1.65
CPR	17.14	25.49	23.12	20.05	19.99	19.14	16.31	14.97

(a) Cash yields are based on the cash component of interest income. Investment premium amortization is determined using the interest method which incorporates actual and anticipated future mortgage prepayments. Both are expressed as a percentage calculated on an annualized basis on average amortized cost basis for the indicated periods.

(b) Unhedged borrowing rates represent average rates on repurchase agreements and similar borrowings, before consideration of related currently-paying interest rate swap agreements.

Fixed swap rates represent the average fixed-rate payments made on currently-paying interest rate swap agreements used to hedge short-term borrowing rates and exclude differences between LIBOR-based variable-rate payments received on these swaps and unhedged borrowing rates, as well as the effects of any hedge ineffectiveness. These differences averaged 19 and 14 basis points on average currently-paying swap notional amounts outstanding during 2013 and 2012, respectively.

Adjusted borrowing rates reflect unhedged borrowing rates, fixed swap rates and the above-mentioned differences, calculated on average related borrowings outstanding for the indicated periods.

Cash yields declined during 2013 reflecting lower coupon interest rates on mortgage loans underlying the Company's holdings of ARM securities resulting from changes in portfolio composition due to acquisitions and portfolio runoff as well as ARM loan coupon resets. Declines in coupon interest rates because of ARM coupon resets have moderated as an increasing number of these loans approach fully-indexed levels. Investment premium amortization is primarily driven by changes in mortgage prepayment rates and investment premium levels. Mortgage prepayment levels decreased significantly in September and October 2013 after peaking earlier in the third quarter, resulting in a corresponding decline in the yield adjustment necessary for investment premium amortization. The availability of low mortgage rates and rising housing prices spurred mortgage refinancing activity contributing to higher levels of mortgage prepayments during the latter half of 2012 and through much of 2013. With mortgage rates beginning to increase in May 2013, refinancing opportunities began receding leading to falling prepayment levels as committed loan closings were fulfilled by mortgage originators. Because of higher prices paid in recent years for acquisitions as well as runoff of older, lower-basis securities, the Company's cost basis in its portfolio (expressed as a ratio of amortized cost basis to unpaid principal balance) increased 17 basis points during 2013 to 103.26 at December 31, 2013. A higher cost basis in the portfolio contributes over time to larger yield adjustments for investment premium amortization.

Unhedged borrowing rates receded modestly during 2013 from the higher levels experienced the latter half of 2012 in part reflecting lower market demands for borrowings under repurchase arrangements. Fixed swap rates continued trending lower with the maturity of higher rate interest rate swap agreements. During the year ended December 31, 2013, $2.90 billion notional amount of swap agreements with average fixed rates of 0.85% matured and were replaced with a like amount of two-year swap agreements with average fixed rates of 0.47%. See NOTE 7 to the consolidated financial statements for further information regarding the Company’s currently-paying and forward-starting swap agreements.

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Reconciliation of Financing Spreads on Residential Mortgage Investments to Total Financing Spreads

Financing spreads on residential mortgage investments differs from total financing spreads, an all-inclusive GAAP measure, that is based on all interest-earning assets and all interest-paying liabilities. The Company believes that presenting financing spreads on residential mortgage investments provides useful information for evaluating the performance of this portfolio. The following tables reconciles these two measures for the indicated periods:

	2013				2012			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Financing spreads on residential mortgage investments	1.25 %	0.87 %	1.00 %	1.15 %	1.13 %	1.30 %	1.50 %	1.65 %
Impact of yields on other interest-earning assets*	(0.03)	(0.02)	(0.05)	(0.05)	(0.07)	(0.05)	(0.06)	(0.06)
Impact of borrowing rates on unsecured borrowings and interest-paying liabilities*	(0.07)	(0.06)	(0.06)	(0.06)	(0.06)	(0.06)	(0.07)	(0.07)
Total financing spreads	1.15	0.79	0.89	1.04	1.00	1.19	1.37	1.52

	2013	2012	2011	2010	2009
Financing spreads on residential mortgage investments	1.07 %	1.38 %	1.68 %	1.93 %	2.42 %
Impact of yields on other interest-earning assets*	(0.04)	(0.06)	(0.04)	(0.07)	(0.09)
Impact of borrowing rates on unsecured borrowings and other interest-paying liabilities*	(0.07)	(0.06)	(0.08)	(0.12)	(0.10)
Total financing spreads	0.96	1.26	1.56	1.74	2.23

* Other interest-earning assets consist of overnight investments and cash collateral receivable from interest rate swap counterparties. Other interest-paying liabilities consist of long-term unsecured borrowings (at an average borrowing rate of 8.49%) that the Company considers a component of its long-term investment capital and cash collateral payable to interest rate swap counterparties.

Reconciliation of Core Earnings to Net Income per Diluted Common Share

Core earnings per diluted common share is a non-GAAP financial measure that differs from the related GAAP measure of net income per diluted common share by excluding certain one-time effects of the second quarter 2013 preferred capital redemption and issuance transactions as detailed below. Management believes presenting this metric on a core earnings basis provides useful, comparative information for evaluating the Company’s performance. The following table reconciles this measure for the year ended December 31, 2013:

Net income available to common stockholders/net income per diluted common share	$89,027	$0.93
Series A and B redemption preference premiums paid	19,924	0.21
Series A and B preferred dividends accruing from the issue date of the Series E preferred shares to the Series A and B redemption date	1,741	0.02
Core earnings available to common stockholders/core earnings per diluted common share	$110,692	$1.16

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Utilization of Long-term Investment Capital and Potential Liquidity

Capstead's investment strategy is to manage a conservatively leveraged portfolio of ARM Agency Securities that can produce attractive risk-adjusted returns over the long term, while reducing, but not eliminating, sensitivity to changes in interest rates. Borrowings under repurchase arrangements generally can be increased or decreased on a daily basis to meet cash flow requirements and otherwise manage capital resources efficiently. Consequently, potential liquidity inherent in the Company's unencumbered residential mortgage investments is as important as the actual level of cash and cash equivalents carried on the balance sheet. Potential liquidity is affected by, among other things, current portfolio leverage levels; changes in market value of assets pledged and interest rate swap agreements held for hedging purposes as determined by lending and swap counterparties; principal prepayments; collateral requirements of lenders and swap counterparties; and general conditions in the commercial banking and mortgage finance industries. Future levels of portfolio leverage will be dependent upon many factors, including the size and composition of the Company's investment portfolio (see "Liquidity and Capital Resources"). The Company's utilization of its long-term investment capital and its estimated potential liquidity were as follows as of December 31, 2013 in comparison with December 31, 2012 (in thousands):

	Investments [(a)]	Related Borrowings	Capital Employed	Potential Liquidity [(b)]	Portfolio Leverage [(c)]
Balances as of December 31, 2013:					
Residential mortgage investment portfolio	$13,475,874	$12,482,900	$992,974	$357,283	
Cash collateral receivable from swap counterparties, net [(d)]			19,203	–	
Other assets, net of other liabilities			453,606	413,356	
			$1,465,783	$770,639	8.52:1
Balances as of December 31, 2012	$13,860,158	$12,784,238	$1,597,103	$890,625	8.00:1

(a) Investments are stated at balance sheet carrying amounts, which generally reflect estimated fair value as of the indicated dates.

(b) Potential liquidity is based on maximum amounts of borrowings available under existing uncommitted repurchase arrangements considering management's estimate of the fair value of related collateral as of the indicated dates adjusted for other sources of liquidity such as cash and cash equivalents.

(c) Portfolio leverage is expressed as the ratio of repurchase agreements and similar borrowings (Related Borrowings in the table above) to long-term investment capital (total Capital Employed in the table above).

(d) Cash collateral receivable from swap counterparties is presented net of cash collateral payable to swap counterparties, if applicable, and the fair value of interest rate swap positions as of the indicated date.

In order to prudently and efficiently manage its liquidity and capital resources, Capstead attempts to maintain sufficient liquidity reserves to fund borrowing and interest rate swap margin calls under stressed market conditions, including margin calls resulting from monthly principal payments (remitted to the Company 20 to 45 days after any given month-end), as well as reasonably possible declines in the market value of pledged assets and swap positions. Should market conditions deteriorate, management may reduce portfolio leverage and therefore increase liquidity by raising new equity capital, selling mortgage securities and/or curtailing the replacement of portfolio runoff. Additionally, the Company routinely does business with a large number of lending counterparties, which bolsters financial flexibility to address challenging market conditions and limits exposure to any individual counterparty.

Despite relatively sharp increases in longer-term interest rates that began during the second quarter of 2013, Capstead replaced most of its portfolio runoff and did not sell any mortgage assets during 2013. Portfolio leverage increased to 8.52 to one at December 31, 2013 from 8.00 to one at December 31, 2012 and potential liquidity declined by $120 million during the year. This reflects declines in long-term investment capital primarily resulting from portfolio runoff and lower portfolio pricing levels, net of higher pricing levels for interest rate swap agreements held for hedging purposes, and the June 2013 redemption of the Company's Series A and B preferred shares using proceeds from the May issuance of its 7.50% Series E preferred shares and $43 million in cash on hand. Management believes current portfolio leverage levels represent an appropriate and prudent use of leverage under current market conditions for a portfolio consisting almost entirely of short duration and well-seasoned ARM Agency Securities.

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Tax Considerations of Dividends Paid on Capstead Common and Preferred Shares

Capstead's common and preferred dividend distributions are characterized as ordinary income or non-taxable return of capital based on the relative amounts of the Company's earnings and profits (taxable income, with certain prescribed adjustments) compared to total distributions applicable to a given tax year. Distributions in excess of earnings and profits, if any, are characterized as non-taxable return of capital, reducing the tax basis of the related shares. If the Company were to realize gains on sales of assets, a portion of its dividends may be characterized as long term capital gains. Except in limited circumstances, none of the Company's dividends will be considered qualifying dividends eligible to be taxed at a reduced dividend tax rate. All dividends taxable in 2013, 2012 and 2011 are characterized as ordinary income. In accordance with the spillover distribution provisions of IRC 857(b)(9), $0.214753 of the fourth quarter 2013 common dividend of $0.31 paid in January 2014 was taxable in 2013 and the remaining $0.095247 is expected to be taxable in 2014. Similarly, $0.286266 of the fourth quarter 2012 dividend of $0.30 paid in January 2013 was taxable in 2012 and $0.013734 is taxable in 2013. Dividend characterization for all tax years is available in the investor relations section of the Company's website at www.capstead.com. Due to the complex nature of applicable tax rules, it is recommended that stockholders consult their tax advisors to ensure proper tax treatment of dividends received.

Off-Balance Sheet Arrangements and Contractual Obligations

At December 31, 2013, Capstead did not have any off-balance sheet arrangements. The Company's contractual obligations at December 31, 2013 were as follows (in thousands):

	Payments Due by Period*				
	Total	12 Months or Less	13 – 36 Months	37 – 60 Months	>Than 60 Months
Repurchase arrangements and similar borrowings	$12,489,711	$12,488,244	$990	$327	$150
Unsecured borrowings	273,516	8,382	13,858	13,054	238,222
Interest rate swap agreements designated as cash flow hedges of:					
Repurchase arrangements	15,712	12,454	3,258	–	–
Unsecured borrowings	3,671	–	1,793	1,878	–
Corporate office lease	1,872	273	559	588	452
	$12,784,482	$12,509,353	$20,458	$15,847	$238,824

* Repurchase arrangements and similar borrowings include an interest component based on contractual rates in effect at year-end. Obligations under interest rate swap agreements are net of variable-rate payments owed to the Company under the agreements' terms that are based on market interest rate expectations as of year-end. Excluded from consideration are an estimated $11 million in variable-rate payments expected to be received beginning in 2019 in excess of related fixed-rate payment obligations. This presentation excludes acquisitions of investments and any other contractual obligations committed to subsequent to year-end.

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RESULTS OF OPERATIONS

	Year ended December 31		
	2013	2012	2011
Income statement data: (in thousands, except per share data)			
Interest income on residential mortgage investments (before investment premium amortization)	$341,009	$352,608	$311,154
Investment premium amortization	(125,872)	(96,677)	(68,077)
Related interest expense	(66,368)	(69,101)	(57,328)
	148,769	186,830	185,749
Other interest income (expense) [(a)]	(8,165)	(7,790)	(8,192)
	140,604	179,040	177,557
Other revenue (expense):			
Salaries and benefits	(5,776)	(5,929)	(5,741)
Short-term incentive compensation	(3,565)	(5,043)	(6,657)
Other general and administrative expense	(4,476)	(4,271)	(3,932)
Miscellaneous other revenue (expense)	(300)	(171)	(1,023)
	(14,117)	(15,414)	(17,353)
Net income	$126,487	$163,626	$160,204
Net income per diluted common share	$0.93	$1.50	$1.75
Core earnings per diluted common share	$1.16	$1.50	$1.75
Average diluted shares outstanding	95,393	95,012	79,696
Key operating statistics: (dollars in millions)			
Average yields:			
Residentia			