DYNEX CAPITAL INC
Form 10-K
March 12, 2015

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549
FORM 10-K

x Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the fiscal year ended December 31, 2014
or
o Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
Commission File Number: 1-9819
DYNEX CAPITAL, INC.
(Exact name of registrant as specified in its charter)

Virginia (State or other jurisdiction of incorporation or organization)	52-1549373 (I.R.S. Employer Identification No.)
4991 Lake Brook Drive, Suite 100, Glen Allen, Virginia (Address of principal executive offices)	23060-9245 (Zip Code)

(804) 217-5800
(Registrant’s telephone number, including area code)

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

Title of each class	Name of each exchange on which registered
Common Stock, $.01 par value	New York Stock Exchange
8.50% Series A Cumulative Redeemable Preferred Stock, par value $0.01 per share	New York Stock Exchange
7.625% Series B Cumulative Redeemable Preferred Stock, par value $0.01 per share	New York Stock Exchange

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes o No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act.
Yes o No x

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 x 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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes x No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) 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. o

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 company” in Rule 12b-2 of the Act.

Large accelerated filer	o	Accelerated filer	x
Non-accelerated filer	o (Do not check if a smaller reporting company)	Smaller reporting company	o

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

As of June 30, 2014, the aggregate market value of the voting stock held by non-affiliates of the registrant was approximately $448,865,442 based on the closing sales price on the New York Stock Exchange of $8.85.

On February 27, 2015, the registrant had 54,938,908 shares outstanding of common stock, $0.01 par value, which is the registrant’s only class of common stock.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Definitive Proxy Statement for the registrant's 2015 annual meeting of shareholders, expected to be filed pursuant to Regulation 14A within 120 days from December 31, 2014, are incorporated by reference into Part III.

DYNEX CAPITAL, INC.
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CAUTIONARY STATEMENT – This Annual Report on Form 10-K may contain “forward-looking” statements within the meaning of Section 27A of the Securities Act of 1933, as amended (or “1933 Act”), and Section 21E of the Securities Exchange Act of 1934, as amended (or “Exchange Act”). We caution that any such forward-looking statements made by us are not guarantees of future performance, and actual results may differ materially from those expressed or implied in such forward-looking statements. Some of the factors that could cause actual results to differ materially from estimates expressed or implied in our forward-looking statements are set forth in this Annual Report on Form 10-K for the year ended December 31, 2014. See Item 1A. “Risk Factors” as well as “Forward-Looking Statements” set forth in Item 7. “Management’s Discussion and Analysis of Financial Condition and Results of Operations” of this Annual Report on Form 10-K.

In this Annual Report on Form 10-K, we refer to Dynex Capital, Inc. and its subsidiaries as “the Company,” “we,” “us,” or “our,” unless we specifically state otherwise or the context indicates otherwise.

PART I.

ITEM 1. BUSINESS

COMPANY OVERVIEW

We are an internally managed mortgage real estate investment trust, or mortgage REIT, which invests in residential and commercial mortgage securities on a leveraged basis. Our common stock is traded on the New York Stock Exchange ("NYSE") under the symbol "DX". We also have two series of preferred stock outstanding, our 8.50% Series A Cumulative Redeemable Preferred Stock (the "Series A Preferred Stock") which is traded on the NYSE under the symbol "DXPRA", and our 7.625% Series B Cumulative Redeemable Preferred Stock (the "Series B Preferred Stock") which is traded on the NYSE under the symbol "DXPRB". Our objective is to provide attractive risk-adjusted returns to our shareholders over the long term that are reflective of a leveraged, high quality fixed income portfolio with a focus on capital preservation. We seek to provide returns to our shareholders primarily through regular quarterly dividends and also through capital appreciation.

We were formed in 1987 and commenced operations in 1988. From our inception through 2000, our operations largely consisted of originating and securitizing various types of loans, principally single-family and commercial mortgage loans and manufactured housing loans. Since 2000, we have been investing in Agency and non-Agency mortgage-backed securities (“MBS”) and are no longer originating or securitizing mortgage loans. MBS consist of residential MBS (“RMBS”) and commercial MBS (“CMBS”), including CMBS interest-only ("IO") securities. Agency MBS have a guaranty of principal payment by an agency of the U.S. government or a U.S. government-sponsored entity ("GSE") such as Fannie Mae and Freddie Mac. Non-Agency MBS have no such guaranty of payment.

Our primary source of income is net interest income, which is the excess of the interest income earned on our investments over the cost of financing these investments. We invest our capital pursuant to our Operating Policies as approved by our Board of Directors which include an Investment Policy and Investment Risk Policy as discussed further below.

RMBS. Our Agency RMBS investments include MBS collateralized by adjustable-rate mortgage loans ("ARMS"), which have interest rates that generally will adjust at least annually to an increment over a specified interest rate index, and hybrid adjustable-rate mortgage loans ("hybrid ARMs"), which are loans that have a fixed rate of interest for a specified period (typically three to ten years) and then adjust their interest rate at least annually to an increment over a specified interest rate index as discussed further below. Agency ARMs also include hybrid Agency ARMs that are past their fixed-rate periods or within twelve months of their initial reset period. We may also invest in fixed-rate

Agency RMBS from time to time.

We also invest in non-Agency RMBS, which do not carry a principal guarantee from the U.S. government or a GSE. Non-Agency RMBS are collateralized by non-conforming residential mortgage loans and credit tranched into different classes of securities with payments to junior classes subordinate to senior classes. We generally invest in senior classes of non-Agency RMBS that are of higher credit quality and which may include unrated securities that have sufficiently high collateralization to protect our investment from most credit events.

Interest rates on loans collateralizing Agency and non-Agency ARMs are based on specific index rates, such as the London Interbank Offered Rate, or LIBOR, the one-year constant maturity treasury rate, or CMT, the Federal Reserve U.S. 12-month

cumulative average one-year CMT, or MTA, or the 11th District Cost of Funds Index, or COFI. These loans will typically have interim and lifetime caps on interest rate adjustments, or interest rate caps, limiting the amount that the rates on these loans may reset in any given period.

CMBS. Our Agency and non-Agency CMBS are collateralized by first mortgage loans and are primarily fixed-rate securities but also include securities with rates that reset monthly based on an index rate, such as LIBOR. The majority of the loans collateralizing our CMBS are secured by multifamily properties. Typically these loans have some form of prepayment protection provisions (such as prepayment lock-out) or prepayment compensation provisions (such as yield maintenance or prepayment penalty). Yield maintenance and prepayment penalty requirements are intended to create an economic disincentive for the loans to prepay.

CMBS IO. A portion of our Agency and non-Agency CMBS includes IO securities which represent the right to receive interest payments (but not principal cash flows) based on the unpaid principal balance of the underlying pool of mortgage loans. As these securities have no principal associated with them, the interest payments received are based on the unpaid principal balance of the underlying pool of mortgage loans, which is often referred to as the notional amount. CMBS IO securities generally have some level of prepayment protection in the form of lock-outs, prepayment penalties, or yield maintenance associated with the underlying loans similar to CMBS described above.

Operating Policies and Restrictions

Our Operating Policies set forth investment and risk limitations as they relate to the Company's investment activities and are reviewed annually by the Board but may be updated or amended at anytime by the Board. We also manage our operations and investments to comply with various REIT limitations (as discussed further below in “Federal Income Tax Considerations”) and to avoid qualifying as an investment company as such term is defined in the Investment Company Act of 1940 ("the 1940 Act") or as a commodity pool operator under the Commodity Exchange Act.

The Operating Policies in effect as of December 31, 2014 target an allocation of 40% of our assets to non-Agency MBS and limit our purchases of non-investment grade and non-rated MBS to no more than 10% of our total capital. Investment grade MBS are MBS which are rated 'BBB' or higher by at least one nationally recognized statistical ratings organization. We will conduct our own independent evaluation of the credit risk on any non-Agency MBS, such that we do not rely solely on the security’s credit rating. In general, our limited purchases of non-rated MBS in recent years have been shorter duration securities which we believe to have minimal credit risk as opposed to longer duration MBS that may have more significant credit risk.

The Operating Policies also limit the overall leverage of the Company to seven times our shareholders’ equity capital and place limits on certain risks to which we are exposed, such as interest rate and convexity risk, our earnings at risk, and our shareholders’ equity at risk as a result of changes in interest rates, prepayment rates, investment prices and spreads, and others items. The Operating Policies require us to perform a variety of stress tests to model the effect on the investment portfolio value and our liquidity of adverse market conditions.

Investment Philosophy and Strategy

Our investment philosophy encompasses a macroeconomic, top-down approach that focuses on the expected risk-adjusted outcome of any investment. Key points of our investment philosophy include the following:

- understanding macroeconomic conditions including the current state of the U.S. and global economies;
- understanding the regulatory environment, competition for assets, and the terms and availability of financing;
- sector analysis including understanding absolute returns, relative returns and risk-adjusted returns;
-

security and financing analysis including sensitivity analysis on credit, interest rate volatility, and market value risk; and

- managing performance and portfolio risks, including interest rate, credit, prepayment, and liquidity risks.

Our investment philosophy will dictate our investment strategy. In executing our strategy, we seek to balance the risks of owning various types of mortgage assets with the earnings opportunity on the investments. We believe our investment strategy provides superior diversification of these risks across our investment portfolio and therefore provides ample opportunities to generate attractive risk-adjusted returns while protecting our shareholders' capital.

The performance of our investment portfolio will depend on many factors including but not limited to interest rates, trends of interest rates, the steepness of interest rate curves, prepayment rates on our investments, demand for our investments, general market liquidity, and economic conditions and their impact on the credit performance of our investments. In addition, our business model may be impacted by other factors such as the state of the overall credit markets, which could impact the availability and costs of financing. See “Factors that Affect Our Results of Operations and Financial Condition” below and "Risk Factors-Risks Related to Our Business" in Item 1A of Part I of this Annual Report on Form 10-K for further discussion.

Financing and Hedging

We finance our investments primarily through the use of recourse repurchase agreements, and to a lesser extent, non-recourse collateralized financing.

Repurchase Agreements. The majority of our repurchase agreement financing is uncommitted short-term financing in which we pledge our MBS as collateral to secure loans made by the repurchase agreement counterparty. These repurchase agreements generally have original terms to maturity of 30 days to one year, though in some instances we may enter into longer- dated maturities depending on market conditions, and carry a rate of interest which is usually based on a spread to LIBOR and fixed for the term of the borrowing. Borrowings under these repurchase agreements are renewable at the discretion of our lenders and do not contain guaranteed roll-over terms. We also have available to us a committed repurchase agreement financing facility which was amended on February 5, 2015 to increase the aggregate borrowing capacity to $300.0 million and to extend its expiration date to August 6, 2016. The amount borrowed under a repurchase agreement is limited by the lender to a percentage of the estimated market value of the pledged collateral (or "haircut"), which is generally up to 95% of the estimated market value for Agency MBS, up to 90% for higher credit quality non-Agency MBS, and up to 85% for CMBS IO and for non-rated or lower credit quality non-Agency MBS. The difference between the market value of the pledged MBS collateral and the amount of the repurchase agreement is the amount of equity we have in the position and is intended to provide the lender some protection against fluctuations of value in the collateral and/or the failure by us to repay the borrowing at maturity.

The fair value of MBS fluctuates primarily as a result of principal payments and changes in market interest rates and spreads, prevailing market yields, actual or anticipated prepayment speeds, and other market conditions. If the fair value of the MBS pledged as collateral declines below the lender's required haircut, the lender has the right to initiate a margin call which requires us to pledge additional assets to collateralize the outstanding repurchase agreement borrowings. Lenders may also initiate margin calls during periods of market stress as a result of actual or expected volatility in asset prices.If we fail to meet any margin call, our lenders also have the right to terminate the repurchase agreement and sell any collateral pledged. Therefore, we attempt to maintain cash and other liquid securities in sufficient amounts to manage our exposure to margin calls by lenders.

Repurchase agreement financing is provided principally by major financial institutions and broker-dealers. A significant source of liquidity for the repurchase agreement market is money market funds which provide collateral-based lending to the financial institutions and broker-dealer community that, in turn, is provided to the repurchase agreement market. In order to reduce our exposure to counterparty-related risk, we generally seek to diversify our exposure by entering into repurchase agreements with multiple lenders.

For further discussion of repurchase agreement financing including significant risks, please refer to "Risk Factors-Risks Related to Our Business" in Item 1A of Part 1 and "Liquidity and Capital Resources" in Item 7 of Part II of this Annual Report on Form 10-K.

Derivative Instruments. We use a variety of derivative instruments to mitigate our exposure to market events outside of our control which could impact our earnings, cash flow or book value. Our hedging activities attempt primarily to

reduce our exposure to adverse effects of changes in interest rates. For example, given the nature of our investing and financing activities, in a period of rising interest rates our earnings and cash flow may be negatively impacted by borrowing costs increasing faster than income from our assets, and our book value may decline as a result of declining market values of our MBS. We enter into derivative instruments in an attempt to partially or fully mitigate our exposure to these changes in interest rates. We typically utilize interest rate swap agreements and Eurodollar futures to hedge interest rate risk, but may also utilize interest rate cap or floor agreements, put and call options on securities or securities underlying futures contracts, forward rate agreements, or swaptions.

As of December 31, 2014, our derivative instruments consisted of interest rate swap agreements and Eurodollar contracts. In conducting our hedging activities, we intend to comply with REIT and tax limitations on our hedging instruments which could limit our activities and the instruments that we may use. We also intend to enter into derivative contracts only with the counterparties that we believe have a strong credit rating to help mitigate the risk of counterparty default or insolvency.

Non-Recourse Collateralized Financing. In the past we have utilized securitization financing to finance securitized mortgage loans and certain MBS. Securitization financing is term financing collateralized by securitized mortgage loans and is non-recourse to us. Payments received on securitized mortgage loans and reinvestment income earned thereon is used to make payments on the securitization financing bonds. Management does not currently have plans to enter into any additional securitization financing arrangements.

Factors that Affect Our Results of Operations and Financial Condition

The performance of our investment portfolio, including the amount of net interest income we earn and fluctuations in investment values, will depend on multiple factors, many of which are beyond our control. These factors include, but are not limited to, the absolute level of interest rates, changes in expectations with regard to future interest rates, the relative steepness of interest rate curves, actual and estimated future prepayment rates on our investments, competition for investments, economic conditions and their impact on the credit performance of our investments (including multifamily, residential and commercial mortgage markets), and market required yields as reflected by market credit spreads. In addition, the performance of our investment portfolio, the cost and availability of financing, and the availability of investments at acceptable return levels could be influenced by actions and policy measures of the U.S. government including, but not limited to, the Federal Housing Finance Administration, the U. S. Department of the Treasury (the "Treasury"), and the Board of Governors of the Federal Reserve System (the "Federal Reserve") and could also be influenced by other central banks around the world. Please refer to Part I, Item 1A, "Risk Factors" as well as Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and Item 7A, "Quantitative and Qualitative Disclosures about Market Risk" of this Annual Report on Form 10-K for a detailed discussion of these factors and others that have the potential to impact our results of operations and financial condition.

INDUSTRY OVERVIEW

The public mortgage REIT industry includes approximately 37 companies with a total market capitalization of approximately $62.0 billion as of December 31, 2014. Mortgage REITs provide liquidity to the U.S. real estate markets through the purchase of RMBS and CMBS and through the origination or purchase of mortgage loans. The business models of mortgage REITs range from investing only in Agency MBS to investing substantially in non-investment grade MBS and originating and securitizing loans. Each mortgage REIT will assume risks in its investment strategy. Whereas we invest in shorter-duration and higher quality MBS in order to mitigate interest rate risk and credit risk, other mortgage REITs may be willing to accept more of these risks than we are and invest in mortgage assets that we do not.

Given the need for private capital to replace the capital currently supporting mortgage finance (from governmental and quasi-governmental public entities such as Fannie Mae, Freddie Mac, Ginnie Mae and the Federal Reserve), we believe that mortgage REITs will continue to increase in importance to the U.S. housing and mortgage finance industries. In addition, the uncertainty around regulation of financial institutions under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") , minimum capital standards implemented under the Basel III Accord, increased risk-weightings for certain types of mortgage loans held by depository institutions, increased regulatory requirements related to origination of certain types of residential mortgage loans, and other potential regulatory changes, may further impact capital formation in the U.S. mortgage market which could favor mortgage REITs. There are potential consequences to increased regulation however, including increasing borrowing

costs or reduced availability of repurchase agreement financing and the need to post more capital to leverage our investments and/or enter into derivative instruments.

COMPETITION

The financial services industry in which we compete is a highly competitive market. In purchasing investments and obtaining financing, we compete with other mortgage REITs, broker dealers and investment banking firms, mutual funds, banks, hedge funds, mortgage bankers, insurance companies, governmental bodies, and other entities, many of which have greater financial resources and a lower cost of capital than we do. Increased competition in the market may reduce the available supply of investments

and may drive prices of investments to unacceptable levels which would negatively impact our ability to earn an acceptable amount of income from these investments. Competition can also reduce the availability of borrowing capacity at our repurchase agreement counterparties as such capacity is not unlimited, and many of our repurchase agreement counterparties limit the amount of financing they offer to the mortgage REIT industry.

FEDERAL INCOME TAX CONSIDERATIONS

As a REIT, we are required to abide by certain requirements for qualification as a REIT under the Internal Revenue Code of 1986, as amended (the "Code"). To retain our REIT status, the REIT rules generally require that we invest primarily in real estate-related assets, that our activities be passive rather than active and that we distribute annually to our shareholders substantially all of our taxable income, after certain deductions, including deductions for our tax net operating loss ("NOL") carryforward. We could be subject to income tax if we failed to satisfy those requirements. We use the calendar year for both tax and financial reporting purposes.

We utilize our NOL carryforward to offset our taxable earnings after taking the REIT distribution requirements into account. As a result of our public offering of common stock in February 2012, we incurred an "ownership change" as such term is defined in Section 382 of the Code. Because of this ownership change, the amount of the NOL carryforward that we may use each year is limited to approximately $13.5 million, and portions of this amount not utilized are accumulated and rolled forward to the following year. Our NOL carryforward begins to expire substantially in 2020. The following table provides a rollforward of our NOL carryforward for the periods indicated:

	Cumulative NOL Available for Use	NOL Balance Remaining
As of December 31, 2012:		$145,759
Amount released for the year ended December 31, 2012 [(1)]	$11,249	
Amount released for the year ended December 31, 2013	13,451	
Amount released for the year ended December 31, 2014	13,451	
Amount available for use as of December 31, 2014	38,151	
Less amount used for the year ended December 31, 2012		—
Less amount used for the year ended December 31, 2013		—
Estimated amount to be used for the year ended December 31, 2014 [(2)]		(25,743)
Estimate of NOL remaining as of December 31, 2014 [(2)]		$120,016

(1) Prorated to account for timing of Section 382 ownership change during the year.
(2) Subject to completion of our 2014 federal income tax return.

There may be differences between taxable income and income computed in accordance with U.S. generally accepted accounting principles ("GAAP"). These differences primarily arise from timing differences in the recognition of revenue and expense for tax and GAAP purposes.

Failure to satisfy certain Code requirements could cause us to lose our status as a REIT. If we failed to qualify as a REIT for any taxable year, we may be subject to federal income tax (including any applicable alternative minimum tax) at regular corporate rates and would not receive deductions for dividends paid to shareholders. We could, however, utilize our NOL carryforward to offset all or part of our taxable income to the extent the NOL is available to us based on the limitations described above. If we lost or otherwise surrendered our status as a REIT, we could not elect REIT status again for five years. Several of our investments in securitized mortgage loans have ownership restrictions limiting their ownership to REITs. Therefore, if we fail to maintain our REIT status, we would have to sell these investments or otherwise provide for REIT ownership of these investments. In addition, many of our repurchase agreement lenders and interest rate swap counterparties require us to maintain our REIT status. If we were to lose our REIT status, these lenders would have the right to terminate any repurchase agreement borrowings and interest rate swaps outstanding at that time.

Qualification as a REIT

Qualification as a REIT requires that we satisfy a variety of tests relating to our income, assets, distributions and ownership. The significant tests are summarized below.

Sources of Income. To continue qualifying as a REIT, we must satisfy two distinct tests with respect to the sources of our income: the “75% income test” and the “95% income test.” The 75% income test requires that we derive at least 75% of our gross income (excluding gross income from prohibited transactions) from certain real estate-related sources. In order to satisfy the 95% income test, 95% of our gross income for the taxable year must consist of either income that qualifies under the 75% income test or certain other types of passive income.

If we fail to meet either the 75% income test or the 95% income test, or both, in a taxable year, we might nonetheless continue to qualify as a REIT, if our failure was due to reasonable cause and not willful neglect and the nature and amounts of our items of gross income were properly disclosed to the Internal Revenue Service. However, in such a case we would be required to pay a tax equal to 100% of any excess non-qualifying income.

Nature and Diversification of Assets. At the end of each calendar quarter, we must meet multiple asset tests. Under the “75% asset test”, at least 75% of the value of our total assets must represent cash or cash items (including receivables), government securities or real estate assets. Under the “10% asset test,” we may not own more than 10% of the outstanding voting power or value of securities of any single non-governmental issuer, provided such securities do not qualify under the 75% asset test or relate to taxable REIT subsidiaries. Under the “5% asset test,” ownership of any stocks or securities that do not qualify under the 75% asset test must be limited, in respect of any single non-governmental issuer, to an amount not greater than 5% of the value of our total assets (excluding ownership of any taxable REIT subsidiaries).

If we inadvertently fail to satisfy one or more of the asset tests at the end of a calendar quarter, such failure would not cause us to lose our REIT status, provided that (i) we satisfied all of the asset tests at the close of the preceding calendar quarter and (ii) the discrepancy between the values of our assets and the standards imposed by the asset tests either did not exist immediately after the acquisition of any particular asset or was not wholly or partially caused by such an acquisition. If the condition described in clause (ii) of the preceding sentence was not satisfied, we still could avoid disqualification by eliminating any discrepancy within 30 days after the close of the calendar quarter in which it arose.

Ownership. In order to maintain our REIT status, we must not be deemed to be closely held and must have more than 100 shareholders. The closely held prohibition requires that not more than 50% of the value of our outstanding shares be owned by five or fewer persons at any time during the last half of our taxable year. The "more than 100 shareholders" rule requires that we have at least 100 shareholders for 335 days of a twelve-month taxable year. In the event that we failed to satisfy the ownership requirements we would be subject to fines and be required to take curative action to meet the ownership requirements in order to maintain our REIT status.

EMPLOYEES

As of December 31, 2014, we have 17 employees and one corporate office in Glen Allen, Virginia. None of our employees are covered by any collective bargaining agreements, and we are not aware of any union organizing activity relating to our employees.

Executive Officers of the Registrant

Name (Age)	Current Title	Business Experience
Thomas B. Akin (62)	Executive Chairman and Director	Executive Chairman effective January 1, 2014; Chief Executive Officer between 2008 and 2013; Chairman of the Board since 2003; managing general partner of Talkot Capital, LLC.
Byron L. Boston (56)	Chief Executive Officer, President, Co-Chief Investment Officer, and Director	Chief Executive Officer and Co-Chief Investment Officer effective January 1, 2014; President and Director since 2012; Chief Investment Officer since 2008.
Stephen J. Benedetti (52)	Executive Vice President, Chief Operating Officer, and Chief Financial Officer	Executive Vice President and Chief Operating Officer since 2005; Executive Vice President and Chief Financial Officer from 2001 to 2005 and beginning again in 2008.
Smriti L. Popenoe (46)	Executive Vice President and Co-Chief Investment Officer	Executive Vice President and Co-Chief Investment Officer effective January 1, 2014; Chief Risk Officer of PHH Corporation between 2010 and 2013; Senior Vice President, Balance Sheet Management, of Wachovia Bank, from 2006 to 2009.

AVAILABLE INFORMATION

We are subject to the reporting requirements of the Exchange Act and its rules and regulations. The Exchange Act requires us to file reports, proxy statements, and other information with the SEC. Copies of these reports, proxy statements, and other information can be read and copied at:

SEC Public Reference Room
100 F Street, N.E.
Washington, D.C. 20549

Information on the operation of the Public Reference Room may be obtained by calling the SEC at 1-800-SEC-0330. The SEC maintains a website that contains reports, proxy statements, and other information regarding issuers that file electronically with the SEC. These materials may be obtained electronically by accessing the SEC's home page at www.sec.gov.

Our website can be found at www.dynexcapital.com. Our annual reports on Form 10-K, our quarterly reports on Form 10-Q, our current reports on Form 8-K, and amendments to those reports, filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act, are made available free of charge through our website as soon as reasonably practicable after such material is electronically filed with or furnished to the SEC.

We have adopted a Code of Business Conduct and Ethics ("Code of Conduct") that applies to all of our employees, officers and directors. Our Code of Conduct is also available free of charge on our website, along with our Audit Committee Charter, our Nominating and Corporate Governance Committee Charter, and our Compensation Committee Charter. We will post on our website amendments to the Code of Conduct or waivers from its provisions, if any, which are applicable to any of our directors or executive officers in accordance with SEC or NYSE requirements.

ITEM 1A. RISK FACTORS

The following is a summary of the risk factors that we believe are most relevant to our business. These are factors which, individually or in the aggregate, we think could cause our actual results to differ significantly from anticipated or historical results. In addition to understanding the key risks described below, investors should understand that it is not possible to predict or identify all risk factors, and consequently, the following is not a complete discussion of all potential risks or uncertainties.

RISKS RELATED TO OUR BUSINESS

Our strategy of using leverage to enhance returns to our shareholders increases the risk that we may incur losses, declines in book value, and material decreases in our liquidity.

The use of leverage in our business increases the risk of volatility in returns to our shareholders and increases the risk of a material decline in our book value and liquidity. Leverage increases returns on our invested capital if we can earn a greater return on investments purchased with leveraged funds than our cost of leverage, but can decrease returns on our invested capital if the cost of such leverage increases without having adequately hedged against such increase or if our ability to access or maintain leverage is limited or restricted in a material way. The use of leverage will also magnify increases or decreases in our book value depending on the change in value of assets that we purchase (which are generally longer-term in nature) relative to the change in value of the financing (which are generally shorter-term in nature) and the change in fair value of our hedges. The increase in liquidity risk stems from the potential for margin calls by our lenders for fluctuations in collateral values or if the lender fails to renew or roll over the financing.

Our ability to access cost-effective leverage sufficient to generate acceptable returns to our shareholders is impacted by the following:

- market conditions and overall market volatility and liquidity;
- regulation of our lenders;
- the liquidity of our investments;
- the market value of our investments;
- the ‘haircut’ our lenders accept for the types of investments we use as collateral, and;
- the willingness of our lenders to finance the types of investments we choose.

Because repurchase agreements are short-term commitments of capital, changes in conditions in the repurchase markets may make it more difficult for us to secure continued financing. In periods of high volatility such as was experienced during the financial crisis in 2008, some lenders may lose their ability or curtail their willingness to provide financing. Additionally, regulatory capital requirements adopted by financial and banking regulators and imposed on our lenders have changed significantly since 2008 and as a result the cost of the financing has increased, and may continue to increase from the higher regulatory costs and regulatory capital requirements. Our lenders also may revise their eligibility requirements for the types of assets they are willing to finance or the terms of such financings, based on, among other factors, the regulatory environment and their management of perceived risk related to such financings. Moreover, the amount of financing we receive under our repurchase agreements will be directly related to the lenders' valuation of the assets that secure the outstanding borrowings. All of these circumstances could increase the cost of our borrowings or reduce our ability to access leverage, which could adversely affect our financial condition and results of operations, and could also force us to sell assets at significant losses if the unfavorable market environment requires us to deleverage.

We may be required to post large amounts of additional assets as collateral or margin to secure our leveraged positions in the event of a sudden, precipitous drop in the value of our financed assets. Declines in the values of our financed assets could also require us to reduce our leverage by selling assets or not replacing MBS as they amortize and/or prepay, thereby decreasing the outstanding amount of our related borrowings. Even a small decrease in the value of a leveraged asset may require us to post additional collateral. The requirement to post additional collateral may decrease the amount of cash available to us for distributions to our shareholders, and deleveraging to manage declines in the values of our assets could reduce our interest income and interest expense, which could adversely affect our financial condition and results of operations.

For more information about our operating policies regarding leverage and historic leverage levels, please see “Liquidity and Capital Resources” within Part II, Item 7, “Management’s Discussion and Analysis of Financial Condition and

Results of Operation."

Repurchase agreements are generally uncommitted short-term financings and changes to terms of such financing may adversely affect our profitability.

Repurchase agreements are generally uncommitted financings from lenders with an average term of ninety days or less. Because we rely heavily on borrowings under repurchase agreements to finance certain of our investments, our ability to achieve our investment and profitability objectives can depend on our ability to access repurchase agreement financing in sufficient amounts and on favorable terms, and to renew or replace maturing financings on a continuing basis. If the terms on which we borrow change in a meaningful way, our profitability may be negatively impacted which could reduce distributions to our shareholders.

We invest in assets that are traded in over-the-counter (OTC) markets which are less liquid and have less price transparency than securities exchanges. Owning securities that are traded in OTC markets may increase our liquidity risk, particularly in a volatile market environment, because our assets may be more difficult to borrow against or sell in a prompt manner and on terms acceptable to us, and we may not realize the full value at which we previously recorded the investments and/or may incur additional losses upon sale.

Though Agency MBS are generally deemed to be very liquid securities, turbulent market conditions in the past have at times significantly and negatively impacted the liquidity of these assets, resulting in reductions in their market value. Non-Agency MBS are typically more difficult to value, less liquid, and experience greater price volatility than Agency MBS. In addition, market values for non-Agency MBS are typically more subjective than Agency MBS. As a result of these factors, the number of lenders willing to provide financing for non-Agency MBS or accept them as collateral has generally been limited.

A sudden reduction in the liquidity of our investments could limit our ability to finance or could make it difficult to sell investments if the need arises. If we are required to liquidate all or a portion of our portfolio quickly, we may realize significantly less than the value at which we have previously recorded our investments which would result in lower than anticipated gains or higher losses.

Furthermore, repurchase agreements grant the respective lender the right to reevaluate the market value of the assets that secure outstanding borrowings at any time. If a lender determines that the value of the assets has declined below the lender's required haircut, it has the right to initiate a margin call. A margin call would require us to transfer additional assets to such lender or to repay a portion of the outstanding borrowings. Any such margin call could have a material adverse effect on our results of operations, financial condition, business, liquidity and ability to make distributions to stockholders, and could cause the value of our common stock or preferred stock to decline. We may be forced to sell assets at significantly depressed prices to meet margin calls and to maintain adequate liquidity, which could cause us to incur losses. Moreover, to the extent that we are forced to sell assets because of changes in market conditions, other market participants may face similar pressures, which could exacerbate a difficult market environment and which could result in significantly greater losses on our sale of such assets. In an extreme case of market duress, a market may not exist for certain of our assets at any price.

Fluctuations in interest rates may have various negative effects on us and could lead to reduced net interest income and a lower book value.

Fluctuations in interest rates impact us in a number of ways. For example, in a period of rising rates, we may experience a decline in our profitability from borrowing rates increasing faster than rates on our assets reset or from our investments adjusting less frequently or relative to a different index (e.g., six month or one-year LIBOR) from our borrowings (repurchase agreements are typically based on one-month LIBOR). Most of our assets are also fixed rate for a period of their lives and are financed with floating rate repurchase agreements that mature faster. In a period of rising rates our borrowings will reset more quickly to market interest rates than most of our assets, which may negatively affect returns on our portfolio and our net interest income.

Fluctuations in interest rates may also negatively affect the market value of our securities. Since our securities are fixed rate or adjust generally over longer-term periods, rising interest rates will reduce the market value of our MBS

as a result of higher yield requirements by the market for these types of securities. In some instances, increases in short-term rates are rapid enough that short-term rates equal or exceed medium/long-term rates, resulting in a flat or inverted yield curve. Any fixed-rate or hybrid ARM investment will generally be more negatively affected by these increases than ARMs (which have interest-rates that adjust more frequently). Reductions in the market value of our securities could result in margin calls from our lenders, potentially forcing us to sell securities at a loss. Conversely, while declining interest rates are more favorable for us, we may experience increasing prepayments, resulting in reduced profitability due to reinvestment of our capital in lower yielding investments.

The mortgage loans collateralizing ARMs typically have periodic (or interim) and lifetime interest rate caps. Periodic interest rate caps limit the amount interest rates can adjust on a loan during any given period. Lifetime interest rate caps limit the amount interest rates can adjust from inception through maturity of a loan. Because of these caps, the amount of gross interest income earned by ARMs may become limited in a sustained period of rising interest rates or in any period in which interest rates rise rapidly. We may also experience price volatility as ARMs approach their interest rate caps. In addition, we could experience additional declines in net interest income as the repurchase agreements financing ARMs do not have periodic or lifetime interest rate caps.

A sudden shift in U.S. monetary policy may increase our borrowing costs and negatively impact the value of our investments and book value.

The Federal Open Market Committee (“FOMC”) of the Federal Reserve has maintained its targeted federal funds rate at the historically low range of between 0% and 0.25% since 2008. The FOMC has also sought to provide additional policy monetary stimulus with large-scale purchases of Treasury securities and Agency RMBS (which the market has referred to as quantitative easing, or "QE"). While the FRBNY, on behalf of the FOMC, is not actively purchasing additional securities under the QE program, it continues to reinvest principal repayments received on the securities which it owns in order to maintain an accommodative monetary policy.

The potential market volatility from the Federal Reserve's future withdrawal of its accommodative monetary policy through its reinvestment of principal payments received or increases in the targeted federal funds rate may be extreme. Once the Federal Reserve announces a higher targeted range or if markets determine that the Federal Reserve is likely to announce a higher targeted range, our borrowing costs are likely to increase which will negatively impact our results of operations and could impact our financial condition and book value. Further, significant price volatility could occur following large asset sales (or anticipation thereof) by the FRBNY. In such a case, it is likely that prices on our investments would decline which would cause a decline in our book value and also could result in margin calls by our lenders on Agency MBS pledged as collateral for repurchase agreements. If declines in prices are substantial, we could be forced to sell assets at a loss or at an otherwise inopportune time in order to meet margin calls or repay lenders.

Our repurchase agreements and derivative instruments may contain financial and non-financial covenants. Our inability to meet these covenants could adversely affect our financial condition, results of operations and cash flows.

In connection with certain of our repurchase agreements and derivative instruments, we are required to maintain certain financial and non-financial covenants. The most restrictive financial covenants as of February 28, 2015 require that, on any date, we have (i) a minimum of $30 million of liquidity; (ii) a minimum shareholders' equity of the sum of $110 million and 90% of all net capital contributions after June 30, 2008; (iii) declines in shareholders' equity less than 25% in any quarter and 35% in any year; and (iv) and a maximum debt-to-equity ratio of 7-to-1. In addition, virtually all of our repurchase agreements and derivative instruments require us to maintain our status as a REIT and to be exempted from the provisions of the 1940 Act. Compliance with these covenants depends on market factors and the strength of our business and operating results. Various risks, uncertainties and events beyond our control, including significant fluctuations in interest rates, could affect our ability to comply with these covenants. Failure to comply with these covenants could result in an event of default, termination of a repurchase agreement, acceleration of all amounts owing under a repurchase agreement, and generally would give the counterparty the right to exercise certain other remedies under the repurchase agreement, including the sale of the asset subject to repurchase at the time of default, unless we were able to negotiate a waiver in connection with any such default related to failure to comply with a covenant. Any such waiver could be conditioned on an amendment to the repurchase agreement and any related guaranty agreement on terms that may be unfavorable to us. If we are unable to negotiate a covenant waiver or replace or refinance our assets under a new repurchase facility on favorable terms or at all, our financial condition, results of operations and cash flows could be adversely affected. Further, certain of our repurchase agreements and derivative instruments have cross-default, cross-acceleration or similar provisions, such that if we were to violate a covenant

under one agreement, that violation could lead to defaults, accelerations, or other adverse events under other agreements, as well.

Prepayment rates on the mortgage loans underlying our investments may adversely affect our profitability and the market value of our investments. Changes in prepayment rates may also subject us to reinvestment risk.

We are subject to prepayment risk to the extent that we own investments at premiums to their par value. Our investment portfolio consists substantially of RMBS and CMBS owned at premiums, and CMBS IO securities which have no principal amounts outstanding and consist only of the right to receive interest payments on the underlying pools of CMBS loans included in the securitization trust. Prepayments on our investments can occur both on a voluntary and involuntary (i.e., a loan default and subsequent foreclosure and liquidation) basis. Voluntary prepayments tend to increase when interest rates are declining or, in the case of ARMs or hybrid ARMs, based on the shape of the yield curve. CMBS and CMBS IO are generally protected from voluntary prepayment either by an absolute prepayment lock-out on the loan or by yield maintenance or prepayment penalty provisions which compensate us for future lost interest income on the loan. RMBS provide no specific protection from voluntary prepayment. The actual level of prepayments on our investments will be impacted by economic and market conditions, the absolute and relative levels of interest rates, and the general availability of mortgage credit among other factors. We have no protection from involuntary prepayments which tend to increase in periods of economic stress and may occur for any of our investment types.

We amortize the premiums we pay on a security using the effective yield method, which is impacted by actual and projected borrower prepayments of principal on the loans. If we experience actual prepayments in excess of our projections or increase our expectations of future prepayment activity, we will amortize investment premiums at an accelerated rate which would reduce our interest income. The impact of accelerated amortization is particularly acute on CMBS IO securities since these securities consist entirely of premium.

Increases in actual prepayment rates or market expectations of prepayment rates could also negatively impact the market value of our investments. Faster prepayments generally negatively impact the market value of RMBS due to less predictability of payments on the underlying mortgage loans and will increase the required market yield on such security. Faster prepayments will also negatively impact the market value of CMBS IO, depending on the amount of prepayment protection for a given security. Increasing prepayments will typically reduce the value of our securities owned at premiums which will negatively impact our book value. We are also more likely to experience margin calls from our lenders as a result of the decline in value of our securities.

In certain circumstances, compensation for voluntary prepayment on CMBS IO securities may not be sufficient to compensate us for the loss of future excess interest as a result of the prepayment, thereby adversely affecting our results of operations. Also, the amount of prepayment penalties on loans underlying CMBS and CMBS IO decline over time, and as loans age, interest rates decline, or market values of the collateral supporting the loan increase, prepayment penalties may not serve as a sufficient economic disincentive to prevent the borrower from prepaying.

If we receive increased prepayments of our principal in a declining or low interest rate environment, we may earn a lower return on our new investments as compared to the MBS that prepay given the declining interest rate environment. If we reinvest our capital in lower yielding investments, we will likely have lower net interest income and reduced profitability unless the cost of financing these investments declines faster than the rate at which we may reinvest.

Provisions requiring yield maintenance charges, prepayment penalties, defeasance, or lock-outs in CMBS IO securities may not be enforceable.

Provisions in loan documents for mortgages in CMBS IO securities in which we invest requiring yield maintenance charges, prepayment penalties, defeasance, or lock-out periods may not be enforceable in some states and under federal bankruptcy law. Provisions in the loan documents requiring yield maintenance charges and prepayment penalties may also be interpreted as constituting the collection of interest for usury purposes. Accordingly, we cannot be assured that the obligation of a borrower to pay any yield maintenance charge or prepayment penalty under a loan document in a CMBS IO security will be enforceable. Also, we cannot be assured that foreclosure proceeds under a loan document in a CMBS IO security will be sufficient to pay an enforceable yield maintenance charge. If yield

maintenance charges and prepayment penalties are not collected, or if a lock-out period is not enforced, we may incur losses to write-down the value of the CMBS IO security for the present value of the amounts not collected. This would also likely cause margin calls from any lender on the CMBS IO impacted. Because a margin call would require us to transfer additional assets to such lender or to repay a portion of the outstanding borrowings, it could have a material adverse effect on our liquidity.

We invest in securities guaranteed by Fannie Mae and Freddie Mac which are currently under conservatorship by the Federal Housing Finance Agency ("FHFA"). As conservator, the FHFA has assumed all the powers of the shareholders, directors and officers of the GSEs with the goal of preserving and conserving their assets. Both Fannie Mae's and Freddie Mac's solvency

is being supported by the Treasury through their committed purchases of Fannie Mae and Freddie Mac preferred stock. The ultimate impact on the operations of Fannie Mae and Freddie Mac from the conservatorships and the support they receive from the U.S. government is not determinable and could affect Fannie Mae and Freddie Mac in such a way that our business, operations and financial condition may be adversely affected.

In 2008, the FHFA placed Fannie Mae and Freddie Mac under federal conservatorship. As its conservator, the FHFA has broad regulatory powers over Fannie Mae and Freddie Mac and has entered into Preferred Stock Purchase Agreements, as amended, ("PSPAs") pursuant to which the Treasury ensures that Fannie Mae and Freddie Mac will separately maintain a positive net worth by committing to purchase preferred stock of Fannie Mae and Freddie Mac. The FHFA as the regulator of the GSEs has proposed several reforms including, among other things, building a common, single, securitization platform between the two entities and gradually contracting their presence in the mortgage marketplace. In addition, the U.S. Congress at various times has considered structural changes to the GSEs, including winding down the GSEs and replacing them with a privately capitalized system that is intended to preserve market liquidity and protect taxpayers from future GSE losses due to economic downturns.

The outcome of the conservatorship and the scope and nature of actions that may ultimately be taken by the U.S. Congress to reform the GSEs and the housing finance system, are not predictable at this point. Actions limiting the guarantee on future Agency MBS could impact the amount of Agency MBS available to be purchased which could lead to increased competition and reduced returns from these assets. It could also negatively impact our ability to comply with the provisions of the 1940 Act (see further discussion below regarding the 1940 Act).

Both Fannie Mae and Freddie Mac have returned to profitability as a result of the housing market recovery but their long-term financial viability is highly dependent on governmental support. If the Treasury withdraws its support, the value of Agency MBS could significantly decline, which would make it difficult for us to obtain repurchase agreement financing and could force us to sell assets at substantial losses. In addition, future policies that change the relationship between Fannie Mae and Freddie Mac and the U.S. government, including those that result in their winding down, nationalization, privatization, or elimination, may create market uncertainty and have the effect of reducing the actual or perceived credit quality of securities issued or guaranteed by Fannie Mae and Freddie Mac. As a result, such policies could increase the risk of loss on investments in Agency MBS. It also is possible that such policies could adversely impact the market for such securities and spreads at which they trade, and thereby adversely impact the profitability of our investments.

All of the foregoing could materially adversely affect the availability, pricing, liquidity, market value and financing of our assets and materially adversely affect our business, operations and financial condition.

Global sovereign credit risk could have a material adverse effect on our business, financial condition and liquidity.

Sovereign credit in the United States and Europe is currently under pressure as a result of large budget deficits, fiscal imbalances and below trend growth or negative growth. While we do not borrow directly from any sovereign, global risk appetite is impacted by changes in actual or perceived credit risk of the United States, Europe and Asia. Adverse changes in sovereign credit ratings could have a material adverse impact on financial markets and economic conditions in the United States and worldwide, and on the availability of financing as well as the price of securities that we own. Any such adverse impact could have a material adverse effect on our liquidity, financial condition and results of operations.

In addition, since Fannie Mae and Freddie Mac are under conservatorship of the U.S. government which is supporting their solvency, it is unclear if any downgrade in the credit of the U.S. government would impact its ability to maintain the solvency of these entities. In such a case, the ability of Fannie Mae and Freddie Mac to perform pursuant to their guarantees on Agency MBS may be severely limited which could have a material adverse effect on our liquidity, financial condition and results of operations.

Our investment strategy includes investing in securities with credit risk. Many of these securities have some form of subordinate credit enhancement within the security structure. The performance of these securities is dependent in large part on the performance of the underlying mortgage loans relative to the amount of the subordinate credit enhancement within the security structure. These mortgage loans are subject to defaults, foreclosure timeline extension, fraud, price depreciation, and unfavorable modification of loan principal amount, interest rate, and premium, any of which could result in losses to us.

Mortgage-backed securities are secured by mortgage loans (generally single family residential properties for RMBS and pools of commercial mortgage loans for CMBS). We own securities that generally have some form of credit subordination to our investment with respect to credit losses on the underlying mortgage loans. We bear a risk of loss of principal on our security to the extent losses experienced on the loans in these securities are in excess of such subordination.

CMBS and CMBS IO securities that we own have a wide range of subordination levels and are collateralized by pools of commercial mortgage loans secured by multifamily or commercial properties. Commercial mortgage loans generally have a higher principal balance and the ability of a borrower to repay a loan secured by an income-producing property typically is dependent upon the successful operation of the property rather than upon the existence of independent income or assets of the borrower. If the net operating income of a commercial property is reduced, the borrower's ability to repay the loan may be impaired. Net operating income of an income-producing property can be affected by, among other things, economic conditions, tenancy, location and condition, property management decisions, competition, regulations, environmental conditions, occupancy rates, interest rates and real estate tax rates and other operating expenses. Losses on underlying commercial mortgage loans will potentially impact the yield on the CMBS and CMBS IO securities we own and could also negatively impact their market value. Negative impacts on yields will reduce our net income and reductions in market values could lead to margin calls by our lenders which, if significant, could force us to sell assets possibly at losses to meet margin calls.

Similar to CMBS and CMBS IO, we own RMBS that generally have some form of credit subordination to our investment with respect to credit losses on the underlying mortgage loans. We bear a risk of loss of principal on our security to the extent losses are sufficient to eliminate such subordination. RMBS securities are generally collateralized by pools of single family mortgage loans which have less idiosyncratic risk than CMBS and CMBS IO. The ability of a borrower to repay a mortgage loan secured by a residential property is dependent upon the income or assets of the borrower. A number of factors may impair borrowers' abilities to repay their loans, including among other things, their employment situation, economic conditions, and the availability of refinancing. In the event of defaults on the residential mortgage loans that underlie our investments in RMBS and the exhaustion of any underlying or any additional credit support, we may not realize our anticipated return on our investments and we may incur a loss on these investments.

For further discussion, see "Quantitative and Qualitative Disclosures About Market Risk" within Part II, Item 7A.

We may change our investment strategy, operating policies, dividend policy, and/or asset allocations without shareholder consent.

We may change our investment strategy, operating policies, dividend policy and/or asset allocation with respect to investments, acquisitions, leverage, growth, operations, indebtedness, capitalization and distributions at any time without the consent of our shareholders. A change in our investment strategy may increase our exposure to interest rate and/or credit risk, default risk and real estate market fluctuations. Furthermore, a change in our asset allocation could result in our making investments in asset categories different from our historical investments. These changes could adversely affect our financial condition, results of operations, the market price of our common stock or our ability to pay dividends to our shareholders.

Competition may prevent us from acquiring new investments at favorable yields, and we may not be able to achieve our investment objectives which may potentially have a negative impact on our profitability.

Our net income will largely depend on our ability to acquire mortgage-related assets with acceptable risk-return profiles at favorable spreads over our borrowing costs. The availability of mortgage-related assets meeting our investment criteria depends upon, among other things, the level of activity in the real estate market and the quality of and demand for securities in the mortgage securitization and secondary markets. The size and level of activity in real

estate lending markets depends on various factors, including interest rates, regional and national economic conditions, and real estate values. In acquiring investments, we may compete with other purchasers of these types of investments, including but not limited to other mortgage REITs, broker-dealers, hedge funds, banks, savings and loans, insurance companies, mutual funds, and other entities that purchase assets similar to ours, many of which have greater financial resources than we do. As a result of all of these factors, we may not be able to acquire sufficient assets at acceptable spreads to our borrowing costs, which would adversely affect our profitability.

In order to maintain our portfolio size and our earnings, we must reinvest the cash flows we receive from our existing investment portfolio, including monthly principal and interest payments and proceeds from sales. If the assets we acquire in the

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future earn lower yields than the assets we currently own, our reported earnings per share will likely decline over time as the older assets pay down or are sold. The risk that newly-acquired investments will not generate yields as attractive as yields on our current assets has been exacerbated in recent quarters due to the very low interest rate environment, Federal Reserve monetary policy, and increased competition for investment securities. In addition, based on market conditions, we may decide to not reinvest the cash flows we receive from our investment portfolio. If we retain, rather than reinvest, these cash flows, the size of our investment portfolio and the amount of net interest income generated by our investment portfolio will likely decline.

Our use of hedging strategies to mitigate our interest rate exposure may not be effective and may adversely affect our income and book value.

We use interest rate swap agreements, Eurodollar futures, interest rate caps, and other derivative transactions (collectively, “hedging instruments”) to help mitigate increased financing costs and volatility in book value from adverse changes in interest rates. Our hedging activity will vary in scope based on our portfolio construction and objectives, the actual and implied level and volatility of interest rates, our forecast of future interest rates, and financing sources used. No hedging strategy, however, can completely insulate us from the interest rate risks to which we are exposed, and there can be no assurance that the implementation of any hedging strategy will have the desired impact on our results of operations or financial condition. In addition, hedging instruments that we use may adversely affect our results of operations and book value (particularly if interest rates decline) as the fair value of hedging instruments fluctuate with changes in rates (and require us to post margin to counterparties) and also involve an expense that we will incur regardless of the effectiveness of the hedging activity.

Our hedging instruments can be traded on an exchange or administered through a clearing house, or are administered under bilateral agreements between us and a counterparty. Bilateral agreements expose us to increased counterparty risk, and we may be at risk of loss of any collateral held by a hedging counterparty if the counterparty becomes insolvent or files for bankruptcy.

Interest rate hedging may fail to protect or could adversely affect us because, among other things:

- The performance of instruments used to hedge may not completely correlate with the performance of the assets or liabilities being hedged;
- Interest rate hedging can be expensive, particularly during periods of volatile interest rates;
- Available hedging instruments may not correspond directly with the interest rate risk from which we seek protection;
- The duration of the hedge may not match the duration of the related asset or liability;
- The value of derivatives used for hedging will be adjusted from time to time in accordance with GAAP to reflect changes in fair value, and downward adjustments, or “mark-to-market losses,” would reduce our earnings, shareholders’ equity, and book value;
- The amount of income that a REIT may earn from hedging transactions (other than through taxable REIT subsidiaries) to offset interest rate losses may be limited by U.S. federal income tax provisions governing REITs;
- The credit quality of the party owing money on the hedge may be downgraded to such an extent that it impairs our ability to sell or assign our side of the hedging transaction; and
- The party owing money in the hedging transaction may default on its obligation to pay.

Our hedging transactions, which are intended to limit losses, may actually adversely affect our earnings, which could reduce our ability to pay dividends to our shareholders.

Clearing facilities or exchanges may increase the margin requirements we are required to post when entering into derivative instruments, which may negatively impact our ability to hedge and our liquidity.

We are required to post margin when entering into a hedging instrument which is traded on an exchange or administered through a clearing house. The amount of margin is set for each derivative by the exchange or clearinghouse and in prior periods, exchanges have required additional margin in response to events having or expected to have adverse economic consequences. For example, in response to the U.S. approaching its debt ceiling without resolution and the federal government shutdown in October 2013, the Chicago Mercantile Exchange announced that it would increase margin requirements by 12% for all over-the-counter interest rate swap portfolios that its clearinghouse guaranteed. This increase was subsequently rolled back shortly thereafter upon the news that Congress passed legislation to temporarily suspend the national debt ceiling. In the event that future adverse economic

developments or market uncertainty (including those due to governmental, regulatory, or legislative action or inaction) result in increased margin requirements for our hedging instruments, it could materially adversely affect our liquidity position, business, financial condition and results of operations.

We may be subject to the risks associated with inadequate or untimely services from third-party service providers, which may negatively impact our results of operations. We also rely on corporate trustees to act on behalf of us and other holders of securities in enforcing our rights.

Our loans and loans underlying non-Agency MBS we own are serviced by third-party service providers. These servicers provide for the primary and special servicing of our single-family and commercial mortgage loans and non-Agency MBS. In that capacity these service providers control all aspects of loan collection, loss mitigation, default management and ultimate resolution of a defaulted loan including as applicable the foreclosure and sale of the real estate owned. The servicer has a fiduciary obligation to act in the best interest of the securitization trust, but significant latitude exists with respect to certain of its servicing activities. We have no contractual rights with respect to these servicers, and our risk management operations may not be successful in limiting future delinquencies, defaults, and losses. If a third party servicer fails to perform its duties under the securitization documents, this may result in a material increase in delinquencies or losses on the MBS. As a result, the value of the MBS may be impacted, and we may incur losses on our investment.

In addition, should a servicer experience financial difficulties, it may not be able to perform its obligations. Due to application of provisions of bankruptcy law, servicers who have sought bankruptcy protection may not be required to make advance payments required under the terms of the MBS of amounts due from loan borrowers. Even if a servicer were able to advance amounts in respect of delinquent loans, its obligation to make the advances may be limited to the extent that is does not expect to recover the advances due to the deteriorating credit of the delinquent loans.

We also rely on corporate trustees to act on behalf of us and other holders of securities in enforcing our rights. Under the terms of most securities we hold we do not have the right to directly enforce remedies against the issuer of the security, but instead must rely on a trustee to act on behalf of us and other security holders. Should a trustee not be required to take action under the terms of the securities, or fail to take action, we could experience losses.

Credit ratings assigned to debt securities by the credit rating agencies may not accurately reflect the risks associated with those securities. Changes in credit ratings for securities we own or for similar securities might negatively impact the market value of these securities.

Rating agencies rate securities based upon their assessment of the safety of the receipt of principal and interest payments on the securities. Rating agencies do not consider the risks of fluctuations in fair value or other factors that may influence the value of securities and, therefore, the assigned credit rating may not fully reflect the true risks of an investment in securities. Also, rating agencies may fail to make timely adjustments to credit ratings based on available data or changes in economic outlook or may otherwise fail to make changes in credit ratings in response to subsequent events, so our investments may be better or worse than the ratings indicate. We attempt to reduce the impact of the risk that a credit rating may not accurately reflect the risks associated with a particular debt security by not relying solely on credit ratings as the indicator of the quality of an investment. We make our acquisition decisions after factoring in other information that we have obtained about the loans underlying the security and the credit subordination structure of the security. Despite these efforts, our assessment of the quality of an investment may also prove to be inaccurate and we may incur credit losses in excess of our initial expectations.

Credit rating agencies may change their methods of evaluating credit risk and determining ratings on securities backed by real estate loans and securities. These changes may occur quickly and often. The market's ability to understand and absorb these changes, and the impact to the securitization market in general, are difficult to predict. Such changes may have a negative impact on the value of securities that we own.

If a lender to us in a repurchase transaction defaults on its obligation to resell the underlying security back to us at the end of the transaction term, or if we default on our obligations under a repurchase agreement, we will incur losses.

Repurchase agreement transactions are legally structured as the sale of a security to a lender in return for cash from the lender. These transactions are accounted for as financing agreements because the lenders are obligated to resell the same securities

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back to us at the end of the transaction term. Because the cash we receive from the lender when we initially sell the securities to the lender is less than the value of those securities, if the lender defaults on its obligation to resell the same securities back to us, we would incur a loss on the transaction equal to the difference between the value of the securities sold and the amount borrowed from the lender. The lender may default on its obligation to resell if it experiences financial difficulty or if the lender has re-hypothecated the security to another party who fails to transfer the security back to the lender. Additionally, if we default on one of our obligations under a repurchase agreement, the lender can terminate the transaction, sell the underlying collateral and cease entering into any other repurchase transactions with us. Any losses we incur on our repurchase transactions could adversely affect our earnings and reduce our ability to pay dividends to our shareholders.

In the event of bankruptcy either by ourselves or one or more of our third party lenders, under the U.S. Bankruptcy Code, assets pledged as collateral under repurchase agreements may not be recoverable by us. We may incur losses equal to the excess of the collateral pledged over the amount of the associated repurchase agreement borrowing.

In the event that one of our lenders under a repurchase agreement files for bankruptcy, it may be difficult for us to recover our assets pledged as collateral to such lender. In addition, if we ever file for bankruptcy, lenders under our repurchase agreements may be able to avoid the automatic stay provisions of the U.S. Bankruptcy Code and take possession of and liquidate our collateral under our repurchase agreements without delay. In the event of a bankruptcy by one of our lenders, or us, we may incur losses in amounts equal to the excess of our collateral pledged over the amount of repurchase agreement borrowing due to the lender.

If we fail to properly conduct our operations we could become subject to regulation under the 1940 Act. Conducting our business in a manner so that we are exempt from registration under and compliance with the 1940 Act may reduce our flexibility and could limit our ability to pursue certain opportunities.

We seek to conduct our operations so as to avoid falling under the definition of an investment company pursuant to the 1940 Act. Specifically, we seek to conduct our operations under the exemption provided under Section 3(c)(5)(C) of the 1940 Act, a provision available to companies primarily engaged in the business of purchasing and otherwise acquiring mortgages and other liens on and interests in real estate. According to SEC no-action letters, companies relying on this exemption must ensure that at least 55% of their assets are mortgage loans and other qualifying assets, and at least 80% of their assets are real estate-related. The 1940 Act requires that we and each of our subsidiaries evaluate our qualification for exemption under the Act. Our subsidiaries will rely either on Section 3(c)(5)(C) or other sections that provide exemptions from registering under the 1940 Act, including Sections 3(a)(1)(C) and 3(c)(7). The SEC is currently reviewing the Section 3(c)(5)(C) exemption as further discussed below. We believe that we are operating our business in accordance with the exemption requirements of Section 3(c)(5)(C).

Under the 1940 Act, an investment company is required to register with the SEC and is subject to extensive restrictive and potentially adverse regulations relating to, among other things, operating methods, management, capital structure, dividends, and transactions with affiliates. If we were determined to be an investment company, our ability to use leverage and conduct business as we do today would be substantially impaired.

In August 2011, the SEC initiated a review of Section 3(c)(5)(C) of the 1940 Act and the regulations and regulatory interpretations promulgated thereunder. We rely on Section 3(c)(5)(C) as an exemption from registration and regulation under the 1940 Act and any regulatory changes as a result of this SEC review could require us to change our business and operations.

On August 31, 2011, the SEC issued a concept release relating to the exclusion from registration as an investment company provided to mortgage companies by Section 3(c)(5)(C) of the 1940 Act. This release raises concerns regarding the ability of mortgage REITs to continue to rely on the exclusion in the future. In particular, the release states the SEC is concerned that certain types of mortgage-related pools today appear to resemble in many respects

investment companies such as closed-end funds and may not be the kinds of companies that were intended to be excluded from regulation under the 1940 Act by Section 3(c)(5)(C).

Although we believe that we are properly relying on Section 3(c)(5)(C) to exempt us from regulation under the 1940 Act (which belief in large part is based on no-action letters issued by the SEC with respect to operations of other mortgage REITs), the SEC review could eventually affect our ability to rely on that exemption or could eventually require us to change our business and operations in order for us to continue to rely on that exemption. If the SEC changes or narrows this exemption, we could be required to sell a substantial amount of our MBS under potentially adverse market conditions, which could have a material adverse

effect on our financial condition and results of operations. We could also be forced to materially alter our business model and investment strategies which could materially and adversely affect our profitability.

The outcome of the review by the SEC at this time is not determinable, and the SEC may take no action as a result of its review of the Section 3(c)(5)(C) exemption from the 1940 Act. It is also possible that the SEC issues interpretative guidance for mortgage REITs as to how their operations must be structured in order to avoid being considered an investment company, and compliance with any such guidance could limit our operations and our profitability as indicated above. Finally, it is possible that the SEC requires mortgage REITs to be considered investment companies and to register under the 1940 Act which would severely limit our operations and profitability and likely have a material adverse effect on our financial condition and results of operations.

If we fail to abide by certain Commodity Futures Trading Commission (“CFTC”) rules and regulations, we may be subject enforcement action by the CFTC.

On December 7, 2012, the CFTC’s Division of Swap Dealer and Intermediary Oversight (the “Division”) issued no-action relief from commodity pool operator (“CPO”) registration to mortgage REITs that use CFTC-regulated products (“commodity interests”) and that satisfy certain enumerated criteria. Pursuant to the no-action letter, the Division will not recommend that the CFTC take enforcement action against a mortgage REIT if its operator fails to register as a CPO, provided that the mortgage REIT (i) submits a claim to take advantage of the relief and (ii) the mortgage REIT: (a) limits the initial margin and premiums required to establish its commodity interest positions to no greater than 5 percent of the fair market value of the mortgage REIT’s total assets; (b) limits the net income derived annually from its commodity interest positions, excluding the income from commodity interest positions that are “qualifying hedging transactions,” to less than 5 percent of its annual gross income; (c) does not market interests in the mortgage REIT to the public as interests in a commodity pool or otherwise in a vehicle for trading in the commodity futures, commodity options or swaps markets; and (d) either: (A) identified itself as a “mortgage REIT” in Item G of its last U.S. income tax return on Form 1120-REIT; or (B) if it has not yet filed its first U.S. income tax return on Form 1120-REIT, it discloses to its shareholders that it intends to identify itself as a “mortgage REIT” in its first U.S. income tax return on Form 1120-REIT.

We believe that we have complied with all of the requirements set forth above as of and for the year ended December 31, 2014. If we fail to satisfy the criteria set forth above, or if the criteria change, we may become subject to CFTC regulation or enforcement action, the consequences of which could have a material adverse effect on our financial condition or results of operations.

RISKS RELATED TO REGULATORY POLICY

The Federal Reserve and other U.S. regulators have adopted regulations to improve the financial strength of the U.S. and international banking systems. Such regulation has limited certain activities of banks and other financial institutions and also has increased liquidity and capitalization requirements, particularly those applied to the largest financial institutions. U.S. regulators have recently introduced capitalization standards for U.S. domiciled broker dealers of foreign banks. When fully implemented, these regulations and capitalization standards may impact the future availability of repurchase agreement financing which could impact our business model and adversely affect our financial conditions and results of operations.

During 2014 U.S. banking regulators and the Basel Committee on Banking Supervision (the “Basel Committee”) took steps to require financial institutions, and particularly the largest bank holding companies and their subsidiary banks and affiliates, to strengthen their funding and leverage positions in an effort to address factors that contributed to financial distress from 2007 through 2009. Several recently adopted regulations and rules that are expected to be proposed may significantly impact the future availability of repurchase agreement financing, which could impact our

business model.

U.S. banking regulators adopted final rules in 2014 to implement a supplemental leverage ratio (“SLR”) and a liquidity coverage ratio (“LCR”). The SLR applies to U.S. bank holding companies with $700 billion or more in consolidated assets, or over $10 trillion in assets under custody, and their bank subsidiaries. The SLR requires that a covered institution maintain a regulatory leverage buffer of 2% above the minimum leverage ratio that is otherwise required (3%), for a total of 5%, and covered bank subsidiaries must maintain a 6% leverage ratio to be considered well-capitalized. The LCR applies to all banking organizations with $250 billion or more in total consolidated assets, or $10 billion or more in foreign exposure on the organization’s balance

sheet, and a less stringent LCR applies to a banking organization with $50 billion or more in consolidated assets that does not meet the other tests. The LCR creates a minimum liquidity standard that requires a banking organization to hold high quality, liquid assets that would meet net cash outflows during a 30-day stress period. The SLR will be effective on January 1, 2018 and the LCR will be effective on January 1, 2017.

In addition, during 2014 the Basel Committee finalized a net stable funding ratio (NSFR) that requires banking organizations to maintain stable funding, as measured on a long-term funding horizon. The NSFR is designed to address funding and maturity mismatches. If adopted and implemented by banking regulators, including those in the U.S., the NSFR would most likely apply to internationally active banking organizations on a consolidated basis, and could also apply to other large domestic banking organizations. The NSFR requires a covered banking organization to obtain and rely more on funding sources that are stable and longer-term in nature as a regulatory tool to reduce a banking organization's reliance on more unstable, short-term funding (including short-term wholesale funding), which the Basel Committee believes may become endangered as a funding source during periods of significant economic stress. If applied in combination, the NSFR and the LCR could significantly impact a banking organization's short-term liquidity and longer-term liquidity requirements, funding sources and funding risks. The U.S. banking regulators are currently expected to propose rules to implement the NSFR during 2015.

The complete impact of the SLR and the LCR, when fully implemented, and the NSFR, if adopted by the U.S. banking regulators and when fully implemented, is not currently known. Application of these regulatory requirements and ratios would impact the leverage and funding profiles of large financial institutions and their affiliates, including many broker-dealers and other subsidiaries that are affiliated with large banking organizations and from which we obtain financing, and could lead to an increase in our cost of financing and reduce the amount of repurchase agreement financing made available to the financing markets.

In addition to the SLR, and LCR, and the NSFR if adopted, the Federal Reserve has adopted rules that will require foreign bank holding companies with combined U.S. assets of more than $50 billion to establish an intermediate holding company ("IHC") that is headquartered in the U.S. over the company's U.S. subsidiaries. Any such IHC will be subject to regulatory capital and leverage requirements, including the SLR and LCR, and the NSFR if adopted, subject to meeting relevant asset thresholds, as well as regulatory capital planning and stress testing requirements. This increased regulatory oversight could further limit the repurchase agreement financing made available by these foreign IHCs and their subsidiaries and affiliates, which could further increase our cost of financing. If the SLR, LCR or NSFR, including the application of these ratios to IHCs, causes the availability of repurchase agreement financing to decline, we may have fewer financing options in the future which could lead to lower profitability and could adversely affect our financial condition.

Recently adopted rules for money market funds could impact our access to funding for our non-Agency MBS which could negatively impact our business and results of operations.

During 2014 the SEC adopted amendments to the rules that govern money market mutual funds which made structural and operational reforms intended to address risks of investor runs in certain of these funds. The new rules require a floating net asset value (NAV) for institutional prime money market funds, which means that the daily share prices of these funds will fluctuate along with changes in the market-based value of fund assets. The new rules also provide non-government money market funds with new tools to address liquidity runs on the funds including the ability to charge fees and to temporarily suspend redemptions (also known as a redemption gate) during periods of extreme market stress.

With a floating NAV, institutional prime money market funds are required to value their portfolio securities using market-based factors and sell and redeem shares based on a floating NAV instead of allowing the funds to maintain a constant share price of $1.00. With liquidity fees and redemption gates, money market fund boards have the ability to impose fees and gates during periods of stress. The new rules will be effective in various stages over a two-year

transition period, with the rules implementing the floating NAV, liquidity fee and redemption gate provisions effective in October 2016.

Money market funds provide substantial liquidity to the repurchase agreement markets. The impact of the changes to the regulatory structure of institutional prime money market funds is not yet known, but it is possible that the new SEC rules may lead to reduced availability of liquidity to the repurchase agreement markets which in turn could lead to an increase in our funding costs.

The effect of legislative and regulatory changes, including the Dodd-Frank Act and regulations implementing it, on our business, the mortgage industry and the markets in which we invest is uncertain, and may be adverse to our business, results of operations and financial condition.

The Dodd-Frank Wall Street Reform and Consumer Protection Act, or the Dodd-Frank Act, was signed into law in July 2010, and significantly changes the regulation of financial institutions and the financial services industry, including the mortgage industry. The Dodd-Frank Act tasks many agencies with issuing a variety of new regulations, including rules related to mortgage origination and servicing, securitization and derivatives. Because a number of regulations under the Dodd-Frank Act have yet to be proposed,adopted or fully implemented, it is not yet known how these additional regulations will ultimately affect the borrowing environment, the investing environment for MBS, or interest rate swaps and other derivatives. Consequently, it is not possible for us to predict how additional regulations will affect our business, and there can be no assurance that these regulations will not have an adverse impact on our business, results of operations or financial condition.

In addition, there is an ongoing debate over the degree and kind of regulation that should be applied to entities that participate in what is popularly referred to as “shadow banking.” While there is no authoritative definition of what “shadow banking” is, it generally refers to financial intermediation involving entities and activities outside of the traditional depositary banking system, such as mortgage REITs, repurchase agreement financing, securitizations, private equity funds and hedge funds. A general policy concern is that an aspect or component of shadow banking that is not subject to banking regulation - such as safety and soundness regulation and capital requirements - or other government oversight could be a source of financial instability or pose systemic risk to the broader banking and financial markets.

In August 2013, the Financial Stability Board, an international body of which the United States is a member, issued policy recommendations to strengthen oversight and regulation of shadow banking. The policy recommendations outlined initial steps to define the scope of the shadow banking system and proposed general governing principles for a monitoring and regulatory framework, including a "toolkit" of potential regulatory responses that national regulators could employ to reduce systemic risk. While at this stage it is difficult to predict the type and scope of any new regulations that may be adopted by member countries, including the United States, if such regulations were to extend the regulatory and supervisory requirements currently applicable to banks, such as capital and liquidity standards, to our business or that of our financing counterparties or mortgage originators, or were to otherwise classify all or a portion of our business (including financing strategy) as shadow banking, our regulatory and operating costs, particularly borrowing costs, could increase, which may have a material adverse effect on our business.

The Federal Reserve and other banking regulators continue to explore regulatory initiatives that could impact complex transactions, or complex series of transactions, that relate to shadow banking and related financing markets. Many of these initiatives that are subject to preliminary discussions would, like the SLR and the LCR, aim to combat the build-up of leverage at, and the offer of leveraged financing by, large financial institutions. Series of transactions that transform short-term maturities into longer-term assets are subject to particular focus during these discussions. At this stage, it is impossible to predict what regulations may be imposed, by which regulator, on which segment of shadow banking, and with what effect. However, any regulations that successfully restrict the shadow banking system or repurchase agreement financing markets may have a material negative affect on our financial condition, results of operations and investment and financing.

The Treasury and Congress continue to seek ways to support the U.S. housing market and the overall U.S. economy, including seeking ways to make it easier to refinance loans owned or guaranteed by Fannie Mae or Freddie Mac where the borrower may have negative equity. In addition, mortgage loan modification programs and future legislative action may adversely affect the value of and the return on Agency RMBS securities in which we invest. Since we own our Agency RMBS at premiums to their par balance, we could incur substantial losses on our Agency RMBS if mortgage loan refinancings increased.

The Treasury and the Department of Housing and Urban Development ("HUD") have implemented the Home Affordable Refinance Program (or "HARP"), which allows borrowers who are current on their mortgage payments to refinance loans originated on or before May 31, 2009, with current loan-to-value ratios exceeding 80%, in order to reduce their monthly mortgage payments. HARP specifically targets borrowers that are current on their mortgage payment but who have negative equity in their home and, as a result, have been unable to refinance into a lower cost mortgage (given the decline in current mortgage rates compared to pre-May 31, 2009). HUD also recently announced a reduction in mortgage insurance premiums effective January 26, 2015, which could further encourage some homeowners to refinance existing mortgages. If refinance activity increases for Agency RMBS as a result of these or other government programs or efforts, or if we increase forecasted prepayments on our Agency RMBS, our net

interest income would be negatively impacted by the additional amortization of premium on our Agency RMBS. In addition, we may experience significant volatility in the market value of Agency RMBS as the market resets prepayment expectations on Agency RMBS. Such volatility could lead to margin calls from our repurchase agreement lenders and could force us to sell these securities under unfavorable conditions and possibly at a loss.

The Treasury and HUD have also created a number of different programs intended to assist borrowers that are struggling to make their mortgage payment that may involve, among other things, the modification of mortgage loans to reduce the principal amount of the loans (through forbearance and/or forgiveness) and/or the rate of interest payable on the loans, or to extend the payment terms of the loans. Loan modifications such as these could result in our ultimately receiving less than we are contractually due on certain of our investments. A significant number of loan modifications with respect to a given security could negatively impact the realized yields and cash flows on such security. These loan modification programs, future legislative or regulatory actions, including new mortgage loan modification programs and possible amendments to the bankruptcy laws, which result in the modification of outstanding residential mortgage loans, as well as changes in the requirements necessary to qualify for refinancing mortgage loans with Fannie Mae, Freddie Mac or Ginnie Mae, may adversely affect the value of, and the returns on, our securitized single-family mortgage loans and Agency RMBS.

RISKS RELATED TO OUR TAXATION AS A REIT AND OTHER TAX RELATED MATTERS

Qualifying as a REIT involves highly technical and complex provisions of the Code, and a technical or inadvertent violation could jeopardize our REIT qualification. Maintaining our REIT status may reduce our flexibility to manage our operations.

Qualification as a REIT involves the application of highly technical and complex Code provisions for which only limited judicial and administrative authorities exist. Even a technical or inadvertent violation could jeopardize our REIT qualification. Our qualification as a REIT will depend on our satisfaction of certain asset, income, organizational, distribution, stockholder ownership and other requirements on a continuing basis. Our operations and use of leverage also subjects us to interpretations of the Code, and technical or inadvertent violations of the relevant requirements under the Code could cause us to lose our REIT status or to pay significant penalties and interest. In addition, our ability to satisfy the requirements to qualify as a REIT depends in part on the actions of third parties over which we have no control or only limited influence, including in cases where we own an equity interest in an entity that is classified as a partnership for U.S. federal income tax purposes.

Maintaining our REIT status may limit flexibility in managing our operations. For instance:

- If we make frequent asset sales from our REIT entities to persons deemed customers, we could be viewed as a "dealer," and thus subject to 100% prohibited transaction taxes or other entity level taxes on income from such transactions.
- Compliance with the REIT income and asset requirements may limit the type or extent of hedging that we can undertake.
- Our ability to own non-real estate related assets and earn non-real estate related income is limited. Our ability to own equity interests in other entities is limited. If we fail to comply with these limits, we may be forced to liquidate attractive assets on short notice on unfavorable terms in order to maintain our REIT status.
- Our ability to invest in taxable subsidiaries is limited under the REIT rules. Maintaining compliance with this limitation could require us to constrain the growth of future taxable REIT affiliates.
- Notwithstanding our NOL carryforward, meeting minimum REIT dividend distribution requirements could reduce our liquidity. Earning non-cash REIT taxable income could necessitate our selling assets, incurring debt, or raising new equity in order to fund dividend distributions.
- Stock ownership tests may limit our ability to raise significant amounts of equity capital from one source.

If we fail to maintain our REIT status, our ability to utilize repurchase agreements as a source of financing and to enter into interest rate swap agreements may be impacted.

Most of our repurchase agreements and the agreements governing our interest rate swaps require that we maintain our REIT status as a condition to engaging in a transaction with us. Even though repurchase agreements generally are not committed facilities with our lenders, if we failed to maintain our REIT status our ability to enter into new repurchase agreement transactions

or renew existing, maturing repurchase agreements will likely be limited. Some of our repurchase agreements and swap agreements have cross-default provisions which provide for lenders to terminate these agreements if we default under any of our repurchase agreements or swap agreements. As such, we may be required to sell investments, potentially under adverse circumstances, that were previously financed with repurchase agreements and we may be forced to terminate our interest rate swap agreements.

If we do not qualify as a REIT or fail to remain qualified as a REIT, we may be subject to tax as a regular corporation and could face a tax liability, which would reduce the amount of cash available for distribution to our shareholders.

We intend to operate in a manner that will allow us to qualify as a REIT for federal income tax purposes. Our qualification as a REIT will depend on our satisfaction of certain asset, income, organizational, distribution, stockholder ownership and other requirements on a continuing basis. Our ability to satisfy the asset tests depends upon our analysis of the characterization and fair market values of our assets, some of which are not susceptible to a precise determination, and for which we will not obtain independent appraisals. Our compliance with the REIT income and quarterly asset requirements also depends upon our ability to successfully manage the composition of our income and assets on an ongoing basis.

If we were to fail to qualify as a REIT in any taxable year, we would be subject to federal income tax, after consideration of our NOL carryforward but not considering any dividends paid to our shareholders during the respective tax year. If we could not otherwise offset this taxable income with our NOL carryforward, the resulting corporate tax liability could be material to our results and would reduce the amount of cash available for distribution to our shareholders, which in turn could have an adverse impact on the value of our common stock. Unless we were entitled to relief under certain Code provisions, we also would be disqualified from taxation as a REIT until the fifth taxable year following the year for which we failed to qualify as a REIT.

Our future use of our tax NOL carryforward is limited under Section 382 of the Code, which could result in higher taxable income and greater distribution requirements in order to maintain our REIT status. Further, if we unknowingly undergo another ownership change pursuant to Section 382, or miscalculate the limitations imposed by a known ownership change, and utilize an impermissible amount of the NOL, we may fail to meet the distribution requirements of a REIT and therefore we could lose our REIT status.

We can use our tax NOL carryforward to offset our taxable earnings after taking the REIT distribution requirements into account. Section 382 of the Code limits the amount of NOL that could be used to offset taxable earnings after an “ownership change” occurs. A Section 382 ownership change generally occurs if one or more shareholders who own at least 5% of our stock, or certain groups of shareholders, increase their aggregate ownership by more than 50 percentage points over their lowest ownership percentage within a rolling three-year period.

Our public offering of common stock in February 2012 resulted in an ownership change under Section 382. Based on management's analysis and expert third-party advice, which necessarily includes certain assumptions regarding the characterization under Section 382 of our use of capital raised by us, we determined that the ownership change under Section 382 will limit our ability to use our NOL carryforward to offset our taxable income to an estimated maximum amount of $13.5 million per year. Because NOLs generally may be carried forward for up to 20 years, this annual limitation may effectively limit the cumulative amount of pre-ownership change losses, including certain recognized built-in losses, that we may utilize. This would result in higher taxable income and greater distribution requirements in order to maintain REIT qualification than if such limitation were not in effect.

We may incur additional ownership changes under Section 382 in the future, in which case the use of our NOL could be further limited. Future issuances or sales of our stock (including transactions involving our stock that are out of our control) could result in an ownership change under Section 382. If further ownership changes occur, Section 382 would impose stricter annual limits on the amount of pre-ownership change NOLs and other losses we could use to

reduce our taxable income.

If we unknowingly undergo another ownership change under Section 382, or miscalculate the limitations imposed by a known ownership change, the use of the NOL could be limited more than we have determined and we may utilize (or may have utilized) more of the NOL than we otherwise may have been allowed. In such an instance we may be required to pay taxes, penalties and interest on the excess amount of NOL used, or we may be required to declare a deficiency dividend to our shareholders for the excess amount. In addition, if any impermissible use of the NOL led to a failure to comply with the REIT distribution requirements, we could fail to qualify as a REIT.

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

Repurchase agreement financing arrangements are structured legally as a sale and repurchase whereby we sell certain of our investments to a counterparty and simultaneously enter into an agreement to repurchase these securities at a later date in exchange for a purchase price. Economically, these agreements are financings which are secured by the investments sold pursuant thereto. We believe that we would be treated for REIT asset and income test purposes as the owner of the securities that are the subject of any such sale and repurchase agreement, notwithstanding that such agreements may legally transfer record ownership of the securities to the counterparty during the term of the agreement. It is possible, however, that the IRS could assert that we did not own the securities during the term of the sale and repurchase agreement, in which case we could fail to qualify as a REIT.

Even if we remain qualified as a REIT, we may face other tax liabilities that reduce our cash flow and our profitability.

Even if we remain qualified for taxation as a REIT, we may be subject to certain federal, state and local taxes on our income and assets, including taxes on any undistributed income, tax on income from some activities conducted as a result of a foreclosure or considered prohibited transactions under the Code, and state or local income taxes. Any of these taxes would decrease cash available for distribution to our shareholders. In addition, in order to meet the REIT qualification requirements, or to avert the imposition of a 100% tax that applies to certain gains derived by a REIT from prohibited transactions, we may hold some of our assets through a taxable REIT subsidiary (“TRS”) or other subsidiary corporations that will be subject to corporate-level income tax at regular rates to the extent that such TRS does not have an NOL carryforward. Any of these taxes would decrease cash available for distribution to our shareholders.

Recognition of excess inclusion income by us could have adverse consequences to us or our shareholders.

Certain of our securities have historically generated excess inclusion income and may continue to do so in the future. Certain categories of shareholders, such as foreign shareholders eligible for treaty or other benefits, shareholders with NOLs, and certain tax-exempt shareholders that are subject to unrelated business income tax, could be subject to increased taxes on a portion of their dividend income from us that is attributable to excess inclusion income. In addition, to the extent that our stock is owned by tax-exempt “disqualified organizations,” such as certain government-related entities and charitable remainder trusts that are not subject to tax on unrelated business income, we may incur a corporate level tax on a portion of our income. In that case, we may reduce the amount of our distributions to any disqualified organization whose stock ownership gave rise to the tax.

Dividends payable by REITs do not qualify for the reduced tax rates available for some dividends.

The maximum tax rate applicable to income from “qualified dividends” payable to domestic shareholders that are individuals, trusts and estates may be either15% or 20%, depending on whether the taxpayer's income exceeds the threshold for the newly enacted 39.6% income tax bracket. Dividends payable by REITs, however, generally are not eligible for the reduced rates. Although this legislation does not adversely affect the taxation of REITs or dividends payable by REITs, the more favorable rates applicable to regular corporate qualified dividends could cause investors who are individuals, trusts and estates to perceive investments in REITs to be relatively less attractive than investments in the stocks of non-REIT corporations that pay dividends, which could adversely affect the value of the stock of REITs, including our common stock.

RISKS RELATED TO OUR CORPORATE STRUCTURE

The stock ownership limit imposed by the Code for REITs and our Articles of Incorporation may restrict our business combination opportunities. The stock ownership limitation may also result in reduced liquidity in our stock and may result in losses to an acquiring shareholder.

To qualify as a REIT under the Code, not more than 50% in value of our outstanding stock may be owned, directly or indirectly, by five or fewer individuals (as defined in the Code to include certain entities) at any time during the last half of each taxable year after our first year in which we qualify as a REIT. Our Articles of Incorporation, with certain exceptions, authorize our Board of Directors to take the actions that are necessary and desirable to qualify as a REIT. Pursuant to our Articles of

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Incorporation, no person may beneficially or constructively own more than 9.8% of our capital stock (including our common stock, Series A Preferred Stock, and Series B Preferred Stock). Our Board of Directors may grant an exemption from this 9.8% stock ownership limitation, in its sole discretion, subject to such conditions, representations and undertakings as it may determine are reasonably necessary.

The ownership limits imposed by the tax law are based upon direct or indirect ownership by "individuals," but only during the last half of a tax year. The ownership limits contained in our Articles of Incorporation apply to the ownership at any time by any "person," which includes entities, and are intended to assist us in complying with the tax law requirements and to minimize administrative burdens. However, these ownership limits might also delay or prevent a transaction or a change in our control that might involve a premium price for our stock or otherwise be in the best interest of our shareholders.

Whether we would waive the ownership limitation for any other shareholder will be determined by our Board of Directors on a case by case basis. Our Articles of Incorporation's constructive ownership rules are complex and may cause the outstanding stock owned by a group of related individuals or entities to be deemed to be constructively owned by one individual or entity. As a result, the acquisition of less than these percentages of the outstanding stock by an individual or entity could cause that individual or entity to own constructively in excess of these percentages of the outstanding stock and thus be subject to the ownership limit. The Board of Directors has the right to refuse to transfer any shares of our capital stock in a transaction that would result in ownership in excess of the ownership limit. In addition, we have the right to redeem shares of our capital stock held in excess of the ownership limit.

The stock ownership limit imposed by the Code for REITs and our Articles of Incorporation may impair the ability of holders to convert shares of our Series A Preferred Stock or Series B Preferred Stock into shares of our common stock upon a change of control.

The terms of our Series A Preferred Stock and Series B Preferred Stock provide that, upon occurrence of a change of control (as defined in the Articles of Incorporation), each holder of Series A Preferred Stock or Series B Preferred Stock will have the right (unless, prior to the Change of Control Conversion Date (as defined herein), we provide notice of our election to redeem the Series A Preferred Stock or Series B Preferred Stock, as applicable) to convert all or part of the Series A Preferred Stock and Series B Preferred Stock held by such holder on the Change of Control Conversion Date into a number of shares of our common stock per share of Series A Preferred Stock or Series B Preferred Stock, respectively, based on formulas set forth in our Articles of Incorporation. However, the stock ownership restrictions in our Articles of Incorporation also restrict ownership of shares of our Series A Preferred Stock and Series B Preferred Stock. As a result, no holder of Series A Preferred Stock or Series B Preferred Stock will be entitled to convert such stock into our common stock to the extent that receipt of our common stock would cause the holder to exceed the ownership limitations contained in our Articles of Incorporation, endanger the tax status of one or more real estate mortgage investment conduits ("REMICs") in which we have or plan to have an interest, or result in the imposition of a direct or indirect penalty tax on us. These provisions may limit the ability of a holder of Series A Preferred Stock or Series B Preferred Stock to convert shares of Series A Preferred Stock or Series B Preferred Stock into our common stock upon a change of control, which could adversely affect the market price of shares of our Series A Preferred Stock or of our Series B Preferred Stock.

ITEM 1B. UNRESOLVED STAFF COMMENTS

There are no unresolved comments from the SEC Staff.

ITEM 2. PROPERTIES

We lease one facility located at 4991 Lake Brook Drive, Suite 100, Glen Allen, Virginia 23060 which provides 9,350 square feet of office space for our executive officers and employees. The term of the lease expires in March 2020, but may be renewed at our option for four additional periods of one year each at a rental rate 2.5% greater than the rate in effect during the preceding 12-month period or for one additional five-year period at the fair market rental rate for the

time period such determination is being made for office space of comparable condition and location.

ITEM 3. LEGAL PROCEEDINGS

The Company and its subsidiaries are parties to various legal proceedings, including those described below. Although the ultimate outcome of these legal proceedings cannot be ascertained at this time, and the results of legal proceedings cannot be predicted with certainty, the Company believes, based on current knowledge, that the resolution of any of these proceedings will not have a material adverse effect on the Company's consolidated financial condition or liquidity. However, the resolution of any of the proceedings described below could have a material impact on consolidated results of operations or cash flows in a given future reporting period as the proceedings are resolved.

One of the Company's subsidiaries, GLS Capital, Inc. ("GLS"), the County of Allegheny, Pennsylvania ("Allegheny County"), and the Company are named defendants in a putative class action lawsuit filed in June 2012 in the Court of Common Pleas of Allegheny County, Pennsylvania (the "Court"). Between 1995 and 1997, GLS purchased from Allegheny County delinquent property tax lien receivables for properties located in the county. The purported class in this action consists of owners of real estate in Allegheny County whose property is or has been subject to a tax lien filed by Allegheny County that Allegheny County either retained or sold to GLS and who were billed by Allegheny County or GLS for attorneys' fees, interest, and certain other fees and who sustained economic damages on and after August 14, 2003. The putative class allegations are that Allegheny County, GLS, and the Company violated the class's constitutional due process rights in connection with delinquent tax collection efforts. There are also allegations that amounts recovered from the class by GLS and /or Allegheny County are an unconstitutional taking of private property. The claims against the Company are solely based upon its ownership of GLS. The complaint requests that the Court order GLS to account for amounts alleged to have been collected in violation of the putative class members' rights and create a constructive trust for the return of such amounts to members of the purported class. On June 30, 2014, the Court dismissed with prejudice the plaintiffs' complaint in its entirety. The plaintiffs have appealed.

ITEM 4. MINE SAFETY DISCLOSURES

None.

PART II.

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

Our common stock is traded on the New York Stock Exchange under the trading symbol “DX”. The common stock was held by approximately 22,424 holders of record as of February 27, 2015. On that date, the closing price of our common stock on the New York Stock Exchange was $8.34 per share. The high and low stock prices and cash dividends declared on our common stock, our Series A Preferred Stock, and our Series B Preferred Stock for each quarter during the last two years were as follows:

	High	Low	Common Stock	Series A Preferred Stock	Series B Preferred Stock
2014:					
First quarter	$9.14	$7.88	$0.25	$0.53125	$0.4765625
Second quarter	$8.98	$8.33	$0.25	$0.53125	$0.4765625
Third quarter	$8.76	$8.06	$0.25	$0.53125	$0.4765625
Fourth quarter	$8.67	7.75	$0.25	$0.53125	$0.4765625
2013:					
First quarter	$11.06	$9.53	$0.27	$0.53125	$—
Second quarter	$11.00	$9.79	$0.27	$0.53125	$0.4606800
Third quarter	$10.25	$7.71	$0.29	$0.53125	$0.4765620
Fourth quarter	$9.00	$7.91	$0.29	$0.53125	$0.4765625

Any dividends declared by the Board of Directors have generally been for the purpose of maintaining our REIT status and maintaining compliance with dividend requirements of the Series A Preferred Stock and Series B Preferred Stock.

The following table summarizes dividends declared per share of common stock for years ending December 31, 2014, 2013, and 2012 and their related tax characterization:

		Tax Characterization		
	Dividends Declared per Common Share	Ordinary	Capital Gain	Return of Capital
Year ended December 31, 2014	$1.0000	$0.6860464	$0.3139536	$—
Year ended December 31, 2013	1.1200	1.0649674	0.0550326	—
Year ended December 31, 2012	1.1500	1.0038500	0.1461500	—

The following graph is a five year comparison of cumulative total returns for the shares of our common stock, the Standard & Poor’s 500 Stock Index (“S&P 500”), the Bloomberg Mortgage REIT Index, and the SNL U.S. Finance REIT Index. The table below assumes $100 was invested at the close of trading on December 31, 2009 in each of our common stock, the S&P 500, the Bloomberg Mortgage REIT Index, and the SNL U.S. Finance REIT Index and assumes reinvestment of dividends.

Index	Cumulative Total Stockholder Returns as of December 31, 2009	2010	2011	2012	2013	2014
Dynex Capital, Inc. Common Stock	$100.00	$137.81	$129.47	$150.24	$143.48	$166.40
S&P 500	$100.00	$115.06	$117.49	$136.30	$180.44	$205.14
Bloomberg Mortgage REIT Index	$100.00	$124.79	$122.50	$145.04	$141.73	$169.27
SNL U.S. Finance REIT Index	$100.00	$124.46	$121.94	$146.43	$141.43	$161.96

The sources of this information are Bloomberg, SNL Financial, and Standard & Poor’s, which management believes to be reliable sources. The historical information set forth above is not necessarily indicative of future performance. Accordingly, we do not make or endorse any predictions as to future share performance.

In December 2014, the Board of Directors authorized the Company to repurchase up to $50 million of its outstanding shares of common stock through December 31, 2016. Subject to applicable securities laws and the terms of the Series A Preferred Stock designation and the Series B Preferred Stock designation, both of which are contained in our Articles of Incorporation, future repurchases of common stock will be made at times and in amounts as the Company deems appropriate, provided that the repurchase price per share is less than the Company's estimate of the current net book value of a share of common stock. Repurchases may be suspended or discontinued at any time. This new repurchase authorization replaces the Company's prior share repurchase program which was to expire on December 31, 2014. The Company did not repurchase any shares during the three months ended December 31, 2014.

ITEM 6. SELECTED FINANCIAL DATA

Our selected financial data presented below is derived from our audited financial statements and should be read in conjunction with our consolidated financial statements and the accompanying notes included under Item 8 of this Annual Report on Form 10-K.

Non-GAAP Financial Measures

In addition to our operating results presented in accordance with GAAP, the information presented below and within Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" of this Annual Report on Form 10-K contains the following non-GAAP financial measures: core net operating income to common shareholders (including per common share), effective borrowing costs and rates, adjusted net interest income, adjusted net interest spread, and adjusted return on average common equity. Management uses these non-GAAP financial measures in its internal analysis of results and operating performance and believes these measures may be important to investors and present useful information about the Company's performance. Schedules reconciling these non-GAAP financial measures to GAAP financial measures are provided below.

Management believes these non-GAAP financial measures are useful because they provide investors greater transparency to the information we use in our financial and operational decision-making processes. Management also believes the presentation of these measures, when analyzed in conjunction with the our GAAP operating results, allows investors to more effectively evaluate and compare our performance to that of our peers. Because these non-GAAP financial measures exclude certain items used to compute GAAP net income to common shareholders and GAAP interest expense, these non-GAAP measures should be considered as a supplement to, and not as a substitute for, our GAAP results as reported in our consolidated statements of comprehensive income (loss). In addition, because not all companies use identical calculations, our presentation of core net operating income, effective borrowing costs and rates, adjusted net interest income, adjusted net interest spread, and adjusted return on average common equity may not be comparable to other similarly-titled measures of other companies.

	As of/For the Year Ended December 31,				
	2014	2013	2012	2011	2010
Balance Sheet Data:	($ in thousands except share and per share data)				
MBS	$3,516,239	$4,018,161	$4,103,981	$2,386,255	$1,459,935
Total assets	3,688,311	4,217,137	4,280,229	2,582,193	1,649,584
Repurchase agreements	3,013,110	3,580,754	3,564,128	2,093,793	1,234,183
Total liabilities	3,081,009	3,631,261	3,663,519	2,210,844	1,357,227
Shareholders’ equity	607,302	585,876	616,710	371,349	292,357
Common shares outstanding	54,739,111	54,310,484	54,268,915	40,382,530	30,342,897
Book value per common share	$9.02	$8.69	$10.30	$9.20	$9.64
Income Statement Data:					
Interest income	$105,644	$127,132	$113,548	$83,377	$48,781
Interest expense	25,915	39,028	35,147	24,082	14,357
Net interest income	79,729	88,104	78,401	59,295	34,424
Loss on derivative instruments, net [1]	(53,393)	(10,076)	(908)	(2,825)	—
Gain on sale of investments, net	16,223	3,354	8,461	2,096	2,891
General and administrative expenses	(16,007)	(13,058)	(12,736)	(9,956)	(8,817)
Net income to common shareholders	18,630	60,167	72,006	39,812	26,411
Net income per common share:					
Basic	$0.34	$1.10	$1.35	$1.03	$1.50
Diluted	$0.34	$1.10	$1.35	$1.03	$1.41
Dividends declared per share:					
Common	$1.00	$1.12	$1.15	$1.09	$0.98
Series A Preferred	$2.13	$2.13	$0.97	$—	$—
Series B Preferred	$1.91	$0.94	$—	$—	$—
Series D Preferred	$—	$—	$—	$—	$0.71

(1) Loss on derivative instruments, net increased significantly during the year ended December 31, 2013 and subsequent periods due to our discontinuation of cash flow hedge accounting for our interest rate derivative instruments effective June 30, 2013.

	For the Year Ended December 31,				
	2014	2013	2012	2011	2010
Other Data Including Non-GAAP Financial Measures:	($ in thousands except per share data)				
Effective borrowing costs [1]	$27,345	$42,783	$35,801	$24,680	$14,357
Adjusted net interest income [1]	78,299	84,349	77,747	58,697	34,424
Core net operating income to common shareholders [1]	54,162	63,786	63,064	50,829	22,665
Core net operating income per common share [1]	$0.99	$1.17	$1.19	$1.32	$1.29
Average common equity during the period	$497,081	$522,432	$521,200	$361,212	$169,660
Return on average common equity	3.7 %	11.5 %	13.8 %	11.0 %	15.6 %
Adjusted return on average common equity[1]	10.9 %	12.2 %	12.1 %	14.1 %	13.4 %
Average interest earning assets	$3,822,870	$4,290,073	$3,492,158	$2,283,440	$1,012,520
Average balance of borrowings	3,347,701	3,797,845	3,069,348	2,002,981	865,920
Weighted average effective yield [2]	2.76 %	2.96 %	3.25 %	3.64 %	4.81 %
Annualized cost of funds [3]	0.76 %	1.01 %	1.12 %	1.19 %	1.64 %
Net interest spread	2.00 %	1.95 %	2.13 %	2.45 %	3.17 %
Effective borrowing rate [1]	0.81 %	1.10 %	1.14 %	1.22 %	1.64 %
Adjusted net interest spread [4]	1.95 %	1.86 %	2.11 %	2.42 %	3.17 %

(1) Represents a non-GAAP financial measure. See reconciliations provided below.
(2) Weighted average effective yields are based on annualized amounts. Recalculation of weighted average effective yields may not be possible using data provided because certain components of interest income use a 360-day year for the calculation while others use actual number of days in the year.
(3) Rates shown are based on annualized interest expense amounts divided by average balance of borrowings. Recalculation of annualized cost of funds using total interest expense shown in the table may not be possible because certain expense items use a 360-day year for the calculation while others use actual number of days in the year.
(4) Adjusted net interest spread is a non-GAAP financial measure and is equal to the weighted average effective yield less the effective borrowing rate, both of which are included in the table above.

	For the Year Ended December 31,				
	2014	2013	2012	2011	2010
Reconciliations of GAAP to Non-GAAP Financial Measures:	($ in thousands except share and per share data)				
GAAP net income to common shareholders	$18,630	$60,167	$72,006	$39,812	$26,411
Amortization of de-designated cash flow hedges (1)	6,788	5,193	—	—	—
Change in fair value on derivative instruments, net (2)	45,175	1,128	254	2,227	—
Litigation settlement and related costs	—	—	—	8,240	—
Loss on non-recourse collateralized financing	—	—	—	1,970	—
Gain on sale of investments, net	(16,223)	(3,354)	(8,461)	(2,096)	(3,452)
Fair value adjustments, net	(208)	652	(735)	676	(294)
Core net operating income to common shareholders	$54,162	$63,786	$63,064	$50,829	$22,665
Average common shares outstanding	54,701,485	54,647,643	53,146,416	38,579,780	17,595,022
Core net operating income per common share	$0.99	$1.17	$1.19	$1.32	$1.29
GAAP interest expense	$25,915	$39,028	$35,147	$24,082	$14,357
Amortization of de-designated cash flow hedges (1)	(6,788)	(5,193)	—	—	—
Net periodic interest costs of derivative instruments (3)	8,218	8,948	654	598	—
Effective borrowing cost	$27,345	$42,783	$35,801	$24,680	$14,357
GAAP annualized cost of funds (4)	0.76 %	1.01 %	1.12 %	1.19 %	1.64 %
Effect of amortization of de-designated cash flow hedges (1)	(0.20)%	(0.15)%	— %	— %	— %
Effect of net periodic interest costs of derivative instruments (3)	0.25 %	0.24 %	0.02 %	0.03 %	— %
Effective borrowing rate (4)	0.81 %	1.10 %	1.14 %	1.22 %	1.64 %
GAAP interest income	$105,644	$127,132	$113,548	$83,377	$48,781
Effective borrowing costs	27,345	42,783	35,801	24,680	14,357
Adjusted net interest income	$78,299	$84,349	$77,747	$58,697	$34,424

(1) Amount recorded as a portion of "interest expense" in accordance with GAAP related to the amortization of the balance remaining in accumulated other comprehensive loss as of June 30, 2013 as a result of the Company's

discontinuation of cash flow hedge accounting.

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(2) Represents net realized and unrealized gains and losses on derivatives and excludes net periodic interest costs related to these instruments.
(3) Amount equals the net interest cost related to interest rate derivatives during the period which is recorded in "loss on derivative instruments, net" and not already included in "interest expense" in accordance with GAAP.
(4) Rates shown are based on annualized interest expense amounts divided by average balance of borrowings. Recalculation of annualized cost of funds and effective borrowing rates using interest expense shown in the table may not be possible because certain items use a 360-day year for the calculation while others use actual number of days in the year.

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

The following discussion should be read in conjunction with our financial statements and the related notes included in Item 8. “Financial Statements and Supplementary Data” in this Annual Report on Form 10-K.
This discussion contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors including, but not limited to, those disclosed in Item 1A. “Risk Factors” elsewhere in this Annual Report on Form 10-K and in other documents filed with the SEC and otherwise publicly disclosed. Please refer to “Forward-Looking Statements” contained within this Item 7 for additional information.
This discussion also contains non-GAAP financial measures. Please refer to Item 6 of this Annual Report on Form 10-K for reconciliations of these non-GAAP measures and additional information about why management believes these non-GAAP measures are useful for shareholders.

EXECUTIVE OVERVIEW

For a complete description of our business including our operating policies, investment philosophy and strategy, financing and hedging strategies, and other important information, please refer to Item 1 of Part 1 of this Annual Report on Form 10-K.

Highlights of the 2014 Fiscal Year and Outlook for 2015

We believe we were successful in meeting the challenges presented during 2014 to the mortgage REIT industry from an increasingly complex global macroeconomic environment. While we reduced the assets on our balance sheet and lowered our leverage and spread risk, we generated a total economic return of 15.3% for 2014, which consisted of $1.00 in common dividends plus a $0.33 increase in book value per common share divided by book value per common share of $8.69 at December 31, 2013. The increase in book value was primarily driven by the increase in fair value of our investments as a result of asset credit spread tightening. We believe our balance sheet as of December 31, 2014 reflects a stronger liquidity and capital profile versus December 31, 2013. Entering 2015 with a stronger balance sheet is important to us as we anticipate the market in 2015 will likely hold surprises similar to 2014, given the potential for Federal Reserve action, the low level of absolute rates, the flatter yield curve, and the tighter spread environment.

Despite some fluctuations during 2014, yields available on RMBS and CMBS in the market place generally trended lower during 2014, as market valuations for such bonds generally trended upward in 2014. We believe valuations continue to be supported by market technicals, such as US central bank and global central bank policies which have contributed to excess global liquidity and complacency around risk. We delevered our balance sheet throughout the year by selling investments which we believed were at a higher risk for spread widening and by not fully reinvesting principal payments received on our investments. We have continued to maintain our duration exposure within our guidelines of 0.5-1.5 years, predominantly on the short-end of the curve. We made minimal changes to our hedging portfolio during the fourth quarter of 2014, but our hedging portfolio as of December 31, 2014 has changed

significantly since December 31, 2013. We had a lower weighted average net fixed-pay rate and therefore lower net periodic interest costs from derivative instruments. We have continued to extend the maturities of our repurchase agreements to protect us from increased financing costs due to either FOMC action or from higher regulatory costs on our lenders.

The following table provides quarterly information on weighted average effective yields by type of MBS investment as well as other information:

	Three Months Ended				
	December 31, 2014	September 30, 2014	June 30, 2014	March 31, 2014	December 31, 2013
Weighted average effective yield:					
RMBS	1.87%	1.82%	1.85%	1.87%	1.85%
CMBS	4.09%	4.45%	4.66%	4.61%	4.65%
CMBS IO	3.94%	4.14%	4.21%	4.21%	4.47%
All other investments	4.68%	5.16%	5.17%	5.17%	5.26%
Total weighted average effective yield:	2.64%	2.73%	2.79%	2.74%	2.72%
Annualized cost of funds	(0.72)%	(0.70)%	(0.75)%	(0.87)%	(0.90)%
GAAP net interest spread	1.92%	2.03%	2.04%	1.87%	1.82%
Effective borrowing rate (1)	(0.67)%	(0.80)%	(0.87)%	(0.86)%	(0.95)%
Adjusted net interest spread (1)	1.97%	1.93%	1.92%	1.88%	1.77%

(1) Represents a non-GAAP financial measure. Please refer to the discussion regarding the use of non-GAAP financial measures and to the corresponding reconciliations of GAAP to non-GAAP financial measures provided in Item 6 of this Annual Report on Form 10-K.

Trends and Recent Market Impacts

There are certain conditions and prospective trends in the marketplace that have impacted our financial condition and results of operations and which may continue to impact us in the future. Conditions and trends that had significant developments during 2014 and that may impact us in 2015 are discussed below.

Federal Reserve Monetary Policy

The FOMC has held the targeted federal funds rate in a range of 0.00% - 0.25% since the end of 2008. The FOMC has indicated that it will assess progress towards its objectives of maximum employment and 2% inflation in determining how long to maintain the current target range. The FOMC has also indicated that it believes that it can be patient in beginning to normalize the stance of monetary policy, although the pace of normalization will depend on the speed of progress toward its objectives. Recent FOMC releases seem to indicate that the FOMC may begin monetary policy normalization in mid-2015. Given the uneven economic performance in the U.S., the lack of consistent global economic growth, and current and developing geopolitical risks, it is possible that the FOMC delays policy normalization or perhaps only modestly increases the targeted rate by 0.25% or 0.50% while it evaluates the impact of tighter credit on the U.S. economy.

The FOMC also continues to reinvest principal payments received on fixed-rate Agency MBS purchased under its now-ended asset purchase programs, collectively known as "QE3". At its peak in 2014, the FOMC was purchasing $85 billion per month in securities. During the fourth quarter of this year, Agency MBS net supply turned positive for the first time in several quarters, a trend which is likely to continue. This trend of positive net supply could negatively impact prices of fixed-rate Agency MBS and may, by extension, impact prices of certain Agency hybrid ARMs as well.

Asset Credit Spreads

Asset credit spreads are defined as the difference between the yields on securities with credit, prepayment or other risks and yields on benchmark securities without these risks (typically Treasuries or swaps), and that reflects the relative riskiness of owning the securities versus the benchmark. Changes in asset credit spreads result from changes

in the perceived riskiness of an investment versus its benchmark. Asset credit spreads tightened dramatically in 2014 due in part to Federal Reserve policy, supply and demand imbalances leading to increased competition for assets, and global market liquidity from central bank activities. Asset credit spreads widened modestly in the fourth quarter of 2014 as interest rates rallied and markets generally reduced risk. During the fourth quarter of 2014,we continued to sell assets at most risk to spread widening. We continue to believe that global events

will lead to periods of spread volatility in 2015. In general, central bank policy and excess global liquidity have contributed to very low interest rates and a lower volatility environment, and investors in fixed income securities have bid asset prices up as a result as they pursue asset yields. The tight credit spread environment is one of the primary reasons that the Company sold certain CMBS and CMBS IO assets during the second half of 2014.

Regulatory Uncertainty and Reform

Since the financial crisis erupted in 2007, regulators of financial institutions such as the Federal Reserve, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency have adopted regulatory requirements designed to enhance and maintain financial stability. Financial institutions, particularly larger ones, are now generally subject to higher capital requirements and have reduced their reliance on lower cost, short-term funding sources. Broker-dealer subsidiaries of financial institutions are our primary counterparties for repurchase agreement borrowings. In addition, certain regulations for money market funds have been instituted to address the risk of potential investor runs. Money market funds are an important source of liquidity for the repurchase agreement market. These new financial regulations will be effective beginning in 2015 and through 2018, although many institutions have begun initiatives to comply at a more rapid pace. We have been considering the potential impact of these new regulations on our counterparties and have been managing our financings in an effort to minimize the potential for our borrowing costs to increase. Because we expect the new regulations may lead toward increasing our borrowing costs on repurchase agreements, we are evaluating alternative sources of funding including sources other than broker-dealer subsidiaries of large financial institutions.

GSE Reform

Policy makers in Washington DC continue to debate the future of Fannie Mae and Freddie Mac's participation in the U.S. mortgage market. Several bills have been introduced in the U.S. Senate and the U.S. House of Representatives regarding the reform and/or dissolution of the GSEs. GSE reform has been a very slow process given the continued softness in the housing market and the subdued pace of overall economic growth. The Federal Housing Finance Agency ("FHFA") has offered details on a single MBS security platform that would combine elements of Fannie Mae's and Freddie Mac's current MBS features, which has a goal of eliminating pricing discrepancies in the two entities' securities and to increase liquidity to benefit the housing market. We expect that all of these factors will continue to influence the pace of GSE reform, but we do not expect any meaningful developments in the near term. For further discussion of the uncertainties and risks related to GSE reform, please refer to "Risk Factors" contained within Part I, Item 1A.

CRITICAL ACCOUNTING POLICIES

The discussion and analysis of our financial condition and results of operations are based in large part upon our consolidated financial statements, which have been prepared in accordance with GAAP. The preparation of our consolidated financial statements requires management to make estimates, judgments and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and disclosure of contingent assets and liabilities. We base these estimates and judgments on historical experience and assumptions believed to be reasonable under current facts and circumstances. Actual results, however, may differ from the estimated amounts we have recorded. Critical accounting policies are defined as those that require management's most difficult, subjective or complex judgments, and which may result in materially different results under different assumptions and conditions. The following discussion provides information on our accounting policies that require the most significant management estimates, judgments, or assumptions, or that management believes includes the most significant uncertainties, and are considered most critical to our results of operations or financial position.

Fair Value Measurements. As defined in Accounting Standards Codification ("ASC") Topic 820, the fair value of a financial instrument is the exchange price in an orderly transaction between market participants to sell an asset or transfer a 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 liability. ASC Topic 820 provides a consistent definition of fair value which focuses on exit price and prioritizes, within a measurement of fair value, the use of

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market-based inputs over entity-specific inputs. In addition, ASC Topic 820 provides a framework for measuring fair value and establishes a three-level hierarchy for fair value measurements based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date.
Our Agency MBS, as well a majority of our non-Agency MBS, are substantially similar to securities that either are currently actively traded or have been recently traded in their respective market. Their fair values are derived from an average of multiple pricing services and dealer quotes. Pricing services and dealers will have access to observable market information through their trading desks. We typically receive a total of three to six prices from pricing services and brokers for each of our securities; prices obtained from brokers are not binding on either the broker or us. Management does not adjust the prices received, but, for securities on which we receive five or more prices, the high and low prices are excluded from the calculation of the average price. In addition, management reviews the prices received for each security by comparing those prices to actual purchase and sale transactions, our internally modeled prices that are calculated based on observable market rates and credit spreads, and the prices that our borrowing counterparties use in financing the our securities. For any security for which significant variations in price exist (from other external prices received or from our internal price), management may exclude such prices from the calculation of the average price. The decision to exclude any price from use in the calculation of the fair values used in our consolidated financial statements is reviewed and approved by management independent of the pricing process. The average of the remaining prices received is used for the fair values included in our consolidated financial statements. If the price of a security is obtained from quoted prices for similar instruments or model-derived valuations whose inputs are observable, the security is classified as a level 2 security. If the inputs are unobservable, the security would be classified as a level 3 security.

As of December 31, 2014, less than 8% of our non-Agency MBS (and less than 2% of our total MBS) are comprised of securities for which there are not substantially similar securities that trade frequently, and therefore, estimates of fair value for those level 3 securities are based primarily on management's judgment. Management determines the fair value of those securities by discounting the estimated future cash flows derived from cash flow models using assumptions that are confirmed to the extent possible by third party dealers or other pricing indicators. Significant inputs into those pricing models are level 3 in nature due to the lack of readily available market quotes. Information utilized in those pricing models include the security’s credit rating, coupon rate, estimated prepayment speeds, expected weighted average life, collateral composition, estimated future interest rates, expected credit losses, and credit enhancement as well as certain other relevant information. Generally, level 3 assets are most sensitive to the default rate and severity assumptions. Significant changes in any of these inputs in isolation would result in a significantly different fair value measurement, and accordingly, there is no assurance that our estimates of fair value are indicative of the amounts that would be realized on the ultimate sale or exchange of these assets.

Amortization of Investment Premiums. We amortize premiums and accrete discounts associated with the purchase of our MBS into interest income over the projected lives of our securities, including contractual payments and estimated prepayments, using the effective yield method. Estimates and judgments related to future levels of prepayments are critical to this determination, and they are difficult for management to predict. With respect to both RMBS and CMBS, mortgage prepayment expectations can change based on how changes in current and projected interest rates impact a borrower's likelihood of refinancing as well as other factors, including but not limited to real estate prices, borrowers' credit quality, changes in the stringency of loan underwriting practices, and lending industry capacity constraints. With respect to RMBS, modifications to existing programs such as HARP, or the implementation of new programs can have a significant impact on the rate of prepayments. Further, GSE buyouts of loans in imminent risk of default, loans that have been modified, or loans that have defaulted will generally be reflected as prepayments on our securities and increase the uncertainty around management's estimates. We utilize a third party service to assist in estimating prepayment rates on all MBS. We review these estimates monthly and compare the results to any available market consensus prepayment speeds. We also consider historical prepayment rates and current market conditions to assess the reasonableness of the prepayment rates estimated by the third party service. Actual and anticipated prepayment experience is reviewed monthly and effective yields are adjusted for differences between the previously estimated future prepayments and the amounts actually received as well as changes in estimated future prepayments.

Other-than-Temporary Impairments. When the fair value of an available-for-sale security is less than its amortized cost as of the reporting date, the security is considered impaired. We assess our securities for impairment on at least a quarterly basis and determine if the impairments are either temporary or "other-than-temporary" in accordance with ASC Topic 320-10. Accounting literature does not define what it considers an other-than-temporary impairment ("OTTI") to be; however, it does state that an OTTI does not mean permanent impairment. The literature does provide some examples of factors which may be indicative of an OTTI, such as: (a) the length of time and extent to which market value has been less than cost; (b) the financial condition and near-

term prospects of the issuer; and (c) the intent and ability of the holder to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in market value.
We assess our ability to hold any Agency MBS or non-Agency MBS with an unrealized loss until the recovery in its value. Our ability to hold any such MBS is based on the amount of the unrealized loss and significance of the related investment as well as our current leverage and anticipated liquidity. Although Fannie Mae and Freddie Mac are not explicitly backed by the full faith and credit of the United States, given their guarantee and commitments for support received from the Treasury as well as the credit quality inherent in Agency MBS, we do not typically consider any of the unrealized losses on our Agency MBS to be credit-related. For our non-Agency MBS, we review the credit ratings of these MBS and the seasoning of the mortgage loans collateralizing these securities as well as the estimated future cash flows, which include any projected losses, in order to evaluate whether we believe any portion of the unrealized loss at the reporting date is related to credit losses.
The determination as to whether an OTTI exists as well as its amount is subjective, as such determinations are based not only on factual information available at the time of assessment but also on management's estimates of future performance and cash flow projections. As a result, the timing and amount of any OTTI may constitute a material estimate that is susceptible to significant change. Our expectations with respect to our securities in an unrealized loss position may change over time, given, among other things, the dynamic nature of markets and other variables. For example, although we believe that the conservatorship of Fannie Mae and Freddie Mac has further strengthened their creditworthiness, there can be no assurance that these actions will be adequate for their needs. Accordingly, if these government actions are inadequate and the GSEs continue to suffer losses or cease to exist, our view of the credit worthiness of our Agency MBS could materially change, which may affect our assessment of OTTI for Agency MBS in future periods. Future sales or changes in our expectations with respect to Agency or non-Agency securities in an unrealized loss position could result in us recognizing other-than-temporary impairment charges or realizing losses on sales of MBS in the future.

FINANCIAL CONDITION

The majority of our MBS as of December 31, 2014 continue to be Agency investments, principally RMBS. During 2014, we shifted our investment mix into more Agency and non-Agency CMBS IO. We sold lower yielding Agency RMBS and used the sale proceeds and principal repayments on our MBS to purchase higher yielding CMBS IO securities. These securities generally have less prepayment risk and therefore more predictable cash flows and yield profiles than Agency RMBS. During the latter half of 2014, we also sold certain non-Agency CMBS investments in order to reduce our portfolio spread risk and to monetize gains from increased market values.

The following tables present our investment allocations based on amortized cost as of the periods indicated:

($ in thousands)	December 31, 2014		December 31, 2013	
By issuer type:				
Agency RMBS and CMBS	$2,520,427	72.2%	$3,065,599	75.9%
Agency CMBS IO	426,564	12.2%	453,766	11.2%
Non-Agency RMBS and CMBS	224,253	6.4%	370,933	9.2%
Non-Agency CMBS IO	319,280	9.2%	150,518	3.7%
	$3,490,524	100.0%	$4,040,816	100.0%
By collateral type:				
RMBS	$2,222,857	63.7%	$2,759,295	68.3%
CMBS	521,823	14.9%	677,237	16.8%
CMBS IO	745,844	21.4%	604,284	14.9%
	$3,490,524	100.00%	$4,040,816	100.0%

RMBS

Our RMBS are collateralized substantially by ARMs and hybrid ARMs. Activity related to our RMBS for the year ended December 31, 2014 is as follows:

($ in thousands)	Agency RMBS	Non-Agency RMBS	Total
Balance as of December 31, 2013	$2,692,150	13,765	$2,705,915
Purchases	75,591	22,982	98,573
Principal payments	(449,278)	(14,413)	(463,691)
Sales	(143,112)	—	(143,112)
Net (amortization) accretion	(28,547)	339	(28,208)
Change in net unrealized gain (loss)	39,896	(225)	39,671
Balance as of December 31, 2014	$2,186,700	$22,448	$2,209,148

Our investment in Agency RMBS as of December 31, 2014 has decreased over the past year as principal payments and sales have outpaced purchases. Our sales of Agency RMBS during 2014 have consisted of certain lower yielding Agency ARMs that were at or near their initial interest rate reset periods. During 2014, we also purchased a modest amount of non-Agency RMBS at or near par value.

As of December 31, 2014, approximately 97% of our variable-rate Agency RMBS portfolio resets based on one-year LIBOR. The following table presents the reset margin and weighted average coupon (“WAC”) by weighted average months to reset ("MTR") for the variable-rate portion of our Agency RMBS portfolio based on par value as of the periods indicated:

	December 31, 2014			December 31, 2013		
($ in thousands)	Par Value	Reset Margin	WAC	Par Value	Reset Margin	WAC
0-12 MTR	$486,638	1.77%	2.75%	$575,763	1.79%	2.97%
13-36 MTR	286,741	1.84%	3.87%	276,862	1.84%	3.89%
37-60 MTR	399,643	1.79%	3.22%	619,887	1.79%	3.57%
61-84 MTR	268,864	1.80%	3.54%	171,839	1.80%	3.01%
85-120 MTR	627,772	1.69%	2.75%	928,580	1.74%	2.99%
ARMs and Hybrid ARMs	2,069,658	1.77%	3.10%	2,572,931	1.78%	3.22%
Fixed	17,149		2.51%	18,637		2.51%
Total	$2,086,807		3.09%	$2,591,568		3.22%

The rate at which we amortize the premiums we pay for our investments is impacted by the current and forecasted constant prepayment rate ("CPR"). The following table provides the CPRs on our Agency RMBS for the periods indicated:

	Three Months Ended				
	December 31, 2014	September 30, 2014	June 30, 2014	March 31, 2014	December 31, 2013
Agency RMBS	12.5%	15.3%	14.1%	12.7%	14.3%

We experienced relatively stable prepayments during 2014 despite the generally lower interest rate environment.We believe this stability is due to constrained lending conditions in the single family mortgage market overall during the past year as well as due to the seasoning of our RMBS.

CMBS

Our Agency CMBS are collateralized primarily by fixed rate mortgage loans secured by multifamily properties. Our non-Agency CMBS are collateralized by fixed rate mortgage loans secured by income producing properties such as office, retail, hotel, and multifamily. Both Agency and non-Agency CMBS will generally have some form of prepayment protection provisions (such as prepayment lock-outs) or prepayment compensation provisions (such as yield maintenance or prepayment penalties) to prevent early voluntary prepayment of principal.

Activity related to our CMBS for the year ended December 31, 2014 is as follows:

($ in thousands)	Agency CMBS	Non-Agency CMBS	Total
Balance as of December 31, 2013	$331,501	$369,281	$700,782
Purchases	21,158	102,419	123,577
Principal payments	(16,160)	(32,874)	(49,034)
Sales	—	(226,066)	(226,066)
Net (amortization) accretion	(4,823)	933	(3,890)
Change in net unrealized gain	3,521	(5,655)	(2,134)
Balance as of December 31, 2014	$335,197	$208,038	$543,235

During 2014, we sold a substantial portion of our non-Agency CMBS in order to reduce our exposure to the risk of credit spread widening on those assets. We recognized gains on those sales because of significant price appreciation that resulted from the rally in interest rates and the tightening of credit spreads during the year. Although issued by Freddie Mac, these securities, which we sometimes refer to as "Agency credit securities", are classified by us as non-Agency CMBS because they do not have a guarantee of principal. We partially replaced these investments with purchases of higher credit quality CMBS and CMBS IO. The following table shows purchase price and related net discount on purchases of our non-Agency CMBS during the year ended December 31, 2014 by credit rating at the time of purchase:

	Year Ended December 31, 2014	
Credit Rating At Purchase	Purchase Price	Net Discount
($ in thousands)		
AAA	$73,618	$(113)
AA	15,906	(50)
A or BBB	12,895	(375)
Total purchases	$102,419	$(538)

The following table presents the par value, amortized cost, and weighted average months to estimated maturity of our CMBS investments as of December 31, 2014 by year of origination:

CMBS by year of origination:	December 31, 2014 Par Value	Amortized Cost	Months to Estimated Maturity [1]
($ in thousands)			
Prior to 2000	$58,171	$50,294	39
2001 to 2005	29,715	31,788	56
2006 to 2008	42,992	45,684	37
2009 to 2012	276,245	288,903	52
2013 to 2014	105,178	105,154	56
	$512,301	$521,823	51

(1) Months to estimated maturity is an average weighted by the amortized cost of the investment.

The following table presents the geographic diversification of the collateral underlying our non-Agency CMBS by the top 5 states as of December 31, 2014:

($ in thousands)	December 31, 2014 Market Value of Collateral	Percentage	
Florida	$61,338	29.1	%
California	23,319	11.1	%
Texas	20,523	9.8	%
Massachusetts	14,428	6.9	%
Arizona	12,704	6.0	%
Remaining states (not exceeding 5.9% individually)	78,112	37.1	%
	$210,424	100.0	%

CMBS IO

The majority of our CMBS IO investments are collateralized primarily by fixed rate mortgage loans. Agency CMBS IO are exclusively collateralized by multifamily properties and non-Agency CMBS IO are secured by income producing properties such as office, retail, and hotel. Both types of CMBS IO have some form of prepayment protection (such as prepayment lock-outs) or prepayment compensation provisions (such as yield maintenance or prepayment penalties). Most of our CMBS IO investments are rated 'AAA' by at least one of the nationally recognized statistical ratings organizations.

Activity related to our CMBS IO for the year ended December 31, 2014 is as follows:

($ in thousands)	Agency CMBS IO [1]	Non-Agency CMBS IO [1]	Total
Balance as of December 31, 2013	$460,327	$151,137	$611,464
Purchases	150,648	216,226	366,874
Sales	(106,005)	(12,513)	(118,518)
Net premium amortization	(71,845)	(34,951)	(106,796)
Change in net unrealized gain	5,612	5,220	10,832
Balance as of December 31, 2014	$438,737	$325,119	$763,856

(1) Amounts shown for CMBS IO represent premium only and exclude underlying notional balances.

The underlying notional balances of our Agency and non-Agency CMBS IO portfolios increased to $10.5 billion and $7.9 billion, respectively, as of December 31, 2014 from $10.2 billion and $4.3 billion, respectively, as of December 31, 2013. While we made significant purchases of both Agency and non-Agency CMBS IO during the year, we also sold certain Agency CMBS IO to monetize gains from their significant price appreciation and to reduce our exposure to prepayment risk.

The following table presents the notional value, amortized cost, and weighted average months to estimated maturity of our CMBS IO investments as of December 31, 2014 by year of origination:

	December 31, 2014		
CMBS IO by year of origination:	Notional Value	Amortized Cost	Months to Estimated Maturity [(1)]
($ in thousands)			
2010	$415,466	$23,335	64
2011	3,614,305	91,947	63
2012	3,780,240	188,093	80
2013	6,363,194	176,571	97
2014	4,155,804	265,898	113
	$18,329,009	$745,844	93

(1) Months to estimated maturity is an average weighted by the amortized cost of the investment.

The following table presents the geographic diversification of the collateral underlying our non-Agency CMBS IO by the top 5 states as of December 31, 2014:

	December 31, 2014		
($ in thousands)	Market Value of Collateral	Percentage	
California	$41,701	12.9	%
Texas	37,687	11.6	%
New York	30,753	9.5	%
Florida	26,438	8.1	%
Georgia	13,783	4.2	%
Remaining states (not exceeding 3.9% individually)	174,393	53.7	%
	$324,755	100.0	%

Derivative Assets and Liabilities

Our derivative assets and liabilities consist of interest rate swap agreements and Eurodollar futures, which we use to hedge our earnings and book value exposure to fluctuations in interest rates. Eurodollar futures represent forward starting 3-month LIBOR contracts and allow us to synthetically replicate swap curves and/or hedge specific points on the swap curve where we may have duration risk by shorting contracts at various points of the LIBOR curve. We use both pay-fixed and receive-fixed interest rate swaps to manage our overall hedge position. As of December 31, 2014, the weighted average notional amount of interest rate derivatives that will be effective for future periods are shown in the following table:

Effective Period	Pay-Fixed Interest Rate Swaps	Pay-Fixed Weighted Average Rate [1]		Receive-Fixed Interest Rate Swaps	Receive-Fixed Weighted Average Rate [1]		Eurodollar Futures	Eurodollar Futures Weighted-Average Rate [1]	
($ in thousands)									
Effective 2015	$650,000	1.52	%	$275,000	1.99	%	$381,096	0.87	%
Effective 2016	650,000	1.52	%	275,000	1.99	%	1,292,691	1.67	%
Effective 2017	538,178	1.64	%	275,000	1.99	%	1,113,767	2.99	%
Effective 2018	465,000	1.76	%	275,000	1.99	%	681,027	3.74	%
Effective 2019	257,041	2.00	%	199,863	2.01	%	487,055	4.00	%
Effective 2020	216,216	2.11	%	25,000	2.71	%	194,604	4.56	%
Effective 2021	184,178	2.13	%	25,000	2.71	%	—	—	%
Effective 2022	180,000	2.13	%	25,000	2.71	%	—	—	%
Effective 2023	159,370	2.15	%	25,000	2.71	%	—	—	%
Effective 2024	38,661	2.18	%	17,896	2.71	%	—	—	%

(1) Weighted average rate is based on the weighted average notional outstanding.

Please refer to Note 6 of the Notes to the Consolidated Financial Statements contained with this Annual Report on Form 10-K as well as "Loss on Derivative Instruments, Net" within "Results of Operations" contained within this Item 7 for additional information related to our derivative assets and liabilities.

Repurchase Agreements

Our repurchase agreement borrowings have decreased $567.6 million from December 31, 2013 to December 31, 2014 because we have slowed our reinvestment of principal payments and sale proceeds received on our MBS. In addition, the majority of our purchases during the past twelve months have been for non-Agency investments for which we typically borrow a lower percentage of the asset's value. The following tables present the leverage against the amortized cost and fair value of our non-Agency CMBS and CMBS IO investments by credit rating of the collateral pledged as of December 31, 2014 and December 31, 2013:

	December 31, 2014			December 31, 2013		
($ in thousands)	Fair Value	Amortized Cost	Related Borrowings	Fair Value	Amortized Cost	Related Borrowings
Non-Agency CMBS:						
AAA	$73,553	$73,541	$7,279	$40,379	$38,253	$35,637
AA	65,937	64,638	57,619	40,022	39,960	35,402
A	30,828	28,568	25,384	237,261	226,954	194,952
Below A/Not Rated	37,720	35,091	24,613	51,619	52,259	37,683
	$208,038	$201,838	$114,895	$369,281	$357,426	$303,674
Non-Agency CMBS IO:						
AAA	$321,154	$315,396	$263,510	$149,692	$149,138	$106,787
AA	1,057	995	1,005	1,445	1,380	16
A	—	—	—	—	—	—
Below A/Not Rated	2,908	2,889	2,467	—	—	—
	$325,119	$319,280	$264,517	$151,137	$150,518	$106,803

Please refer to Note 5 of the Notes to the Consolidated Financial Statements contained within this Annual Report on Form 10-K as well as "Interest Expense, Annualized Cost of Funds, and Effective Borrowings Costs" within "Results of Operations" and “Liquidity and Capital Resources” contained within this Item 7 for additional information relating to our repurchase agreements.

RESULTS OF OPERATIONS

In addition to our operating results presented in accordance with GAAP, our results of operations discussed below contain certain non-GAAP financial measures including core net operating income, adjusted net interest income, and effective borrowing cost and certain financial metrics derived from non-GAAP information, such as adjusted net interest spread and effective borrowing rate. Schedules reconciling these non-GAAP financial measures to GAAP financial measures are provided in Item 6 within Part II of this Annual Report on From 10-K. As discussed in more detail below, management believes these non-GAAP financial measures are useful because they provide investors greater transparency to the information we use in our financial and operational decision-making processes. Management also believes the presentation of these measures, when analyzed in conjunction with the our GAAP operating results, allows investors to more effectively evaluate and compare our performance to that of our peers. However, because such measures are incomplete measures of our financial performance and involve differences from results computed in accordance with GAAP, these non-GAAP measures should be considered as a supplement to, and not as a substitute for, our GAAP results as reported in our consolidated statements of comprehensive income (loss). In addition, because not all companies use identical calculations, our presentation of such non-GAAP measures may not be comparable to other similarly-titled measures of other companies.

Interest Income and Asset Yields

Interest income includes gross interest earned from the coupon rate on the securities, effects of premium amortization and discount accretion, and other interest income resulting from prepayment penalty income or other yield maintenance items. The following tables present information regarding interest income earned and effective yield on our MBS by collateral type for the periods indicated:

	Year Ended December 31, 2014				2013			
($ in thousands)	Interest Income	Average Balance [1]	Effective Yield [2]		Interest Income	Average Balance [1]	Effective Yield [2]	
RMBS:								
Agency	$44,432	$2,450,100	1.81	%	$56,376	$2,835,130	1.99	%
Non-Agency	941	13,586	6.93	%	659	12,641	5.22	%
	45,373	2,463,686	1.84	%	57,035	2,847,771	2.00	%
CMBS:								
Agency	11,883	324,338	3.62	%	11,726	323,174	3.59	%
Non-Agency	17,285	317,763	5.44	%	23,383	415,212	5.63	%
	29,168	642,101	4.52	%	35,109	738,386	4.74	%
CMBS IO:								
Agency	18,695	429,664	4.35	%	25,760	520,689	4.95	%
Non-Agency	9,645	236,624	4.08	%	5,725	118,759	4.82	%
	28,340	666,288	4.25	%	31,485	639,448	4.92	%
Total MBS portfolio:	$102,881	$3,772,075	2.72	%	$123,629	$4,225,605	2.92	%

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($ in thousands)	Year Ended December 31, 2013 Interest Income	Average Balance (1)	Effective Yield (2)	2012 Interest Income	Average Balance (1)	Effective Yield (2)
RMBS:						
Agency	$56,376	$2,835,130	1.99 %	$50,319	$2,250,477	2.24 %
Non-Agency	659	12,641	5.22 %	884	15,401	5.74 %
	57,035	2,847,771	2.00 %	51,203	2,265,878	2.26 %
CMBS:						
Agency	11,726	323,174	3.59 %	11,601	307,691	3.69 %
Non-Agency	23,383	415,212	5.63 %	24,568	406,918	6.06 %
	35,109	738,386	4.74 %	36,169	714,609	5.04 %
CMBS IO:						
Agency	25,760	520,689	4.95 %	15,841	328,541	5.02 %
Non-Agency	5,725	118,759	4.82 %	4,515	71,882	5.39 %
	31,485	639,448	4.92 %	20,356	400,423	5.08 %
Total MBS portfolio:	$123,629	$4,225,605	2.92 %	$107,728	$3,380,910	3.18 %

(1) Average balances are calculated as a simple average of the daily amortized cost and exclude unrealized gains and losses as well as securities pending settlement if applicable.
(2) Effective yields are weighted by average balance of the investments and based on annualized amounts. Recalculation of effective yields may not be possible using data provided because certain components of interest income use a 360-day year for the calculation while others use actual number of days in the year.

The following table presents the estimated impact of changes in average balances and average yields on the increase (decrease) in interest income for the periods indicated:

($ in thousands)	Year Ended December 31, 2014 vs. December 31, 2013			Year Ended December 31, 2013 vs. December 31, 2012		
		Due to Change in			Due to Change in	
	Increase (Decrease)	Average Balance (1)	Effective Yield	Increase (Decrease)	Average Balance (1)	Effective Yield
RMBS	$(11,662)	$(7,334)	$(4,328)	$5,832	$13,245	$(7,413)
CMBS	(5,942)	(5,463)	(479)	(1,060)	1,074	(2,134)
CMBS IO	(3,144)	1,098	(4,242)	11,129	10,407	722
Total	$(20,748)	$(11,699)	$(9,049)	$15,901	$24,726	$(8,825)

(1) Average balances are calculated as a simple average of the daily amortized cost and exclude unrealized gains and losses as well as securities pending settlement if applicable.
(2) Amount includes other interest income amounts of $3.9 million, $3,2 million, and $1.6 million for the years ended December 31, 2014, 2013, and 2012, respectively, related to prepayment penalty income and other yield maintenance items. The majority of the other interest income amounts for the years ended December 31, 2014 and December 31, 2013 related to CMBS IO and the majority of the other interest income amount for the year ended December 31, 2012 related to CMBS.

Our interest income from MBS for the year ended December 31, 2014 decreased compared to the year ended December 31, 2013 due to a decrease in the average balance of our MBS portfolio and a decrease in the weighted average effective yield earned on our MBS portfolio. The balance of our investment portfolio declined throughout the year as the proceeds we received from sales of and principal repayments on our MBS were used to pay down our

repurchase agreements borrowings rather than fully reinvesting into new assets. Our purchases of new assets declined during 2014 as there were fewer opportunities to add investments with acceptable risk and return profiles. Average yields on our MBS were lower as purchases across the portfolio

were made at lower yields, in particular CMBS IO, and we experienced downward resets in interest rates on our variable-rate securities during 2014.

Our interest income from MBS for the year ended December 31, 2013 increased compared to the year ended December 31, 2012 due to an increase in the average balance of our MBS portfolio, and in particular an increase in our Agency and non-Agency CMBS IO portfolios. The impact of a larger average balance was partially offset by lower weighted average effective yields earned on our investments due to lower weighted average coupons (primarily on MBS purchased during 2013) and higher premium amortization during the year ended December 31, 2013.

The following table presents information regarding net premium amortization by collateral type for the periods indicated:

	Year Ended December 31,					
	2014		2013		2012	
($ in thousands)	Net Premium Amortization	Average Balance of Unamortized Premium, Net	Net Premium Amortization	Average Balance of Unamortized Premium, Net	Net Premium Amortization	Average Balance of Unamortized Premium, Net
RMBS	$28,533	$131,899	$33,116	$156,882	$32,391	$118,997
CMBS	3,874	4,392	3,709	5,213	3,613	5,929
CMBS IO	$106,833	666,288	92,056	639,448	55,475	399,703
	$139,240	$802,579	$128,881	$801,543	$91,479	$524,629

Net premium amortization increased for the year ended December 31, 2014 compared to the same period in 2013 because of the shift in our portfolio toward CMBS IO which typically have higher premium balances than RMBS. Our average balance of net unamortized premium did not increase significantly for the year ended December 31, 2014 compared to the same period in 2013 as we reduced our investment portfolio as noted in "Financial Condition" discussed above. Similarly, our average balance of net unamortized premium during the year ended December 31, 2013 was more heavily weighted toward higher priced CMBS and CMBS IO than in 2012. Unlike 2014, however, we also experienced significant growth in our RMBS premiums for the year ended December 31, 2013 which further contributed to the increase in net premium amortization compared to the year ended December 31, 2012.

Interest Expense, Annualized Cost of Funds, and Effective Borrowing Costs

The following table summarizes the components of interest expense as well as average balances and annualized cost of funds for the periods indicated:

	Year Ended December 31,		
($ in thousands)	2014	2013	2012
Interest expense on repurchase agreement borrowings	$19,033	$24,113	$19,341
Interest rate swap expense from cash flow hedging	—	8,796	14,448
Amortization of de-designated cash flow hedges [1]	6,788	5,193	—
Non-recourse collateralized financing and other interest expense	94	926	1,358
Total interest expense	$25,915	$39,028	$35,147
Average balance of repurchase agreements	$3,335,786	$3,773,744	$3,033,634
Average balance of non-recourse collateralized financing	11,915	24,101	35,713
Average balance of borrowings	$3,347,701	$3,797,845	$3,069,347
Annualized cost of funds [2]	0.76 %	1.01 %	1.12 %

(1) Amount recorded in accordance with GAAP related to the amortization of the balance remaining in accumulated other comprehensive loss as of June 30, 2013 as a result of our discontinuation of cash flow hedge accounting.

(2) Rates shown are based on annualized interest expense amounts divided by average balance of borrowings. Recalculation of annualized cost of funds using total interest expense shown in the table may not be possible because certain expense items use a 360-day year for the calculation while others use actual number of days in the year.

The following table presents the estimated impact of changes in the average balance of repurchase agreement borrowings and average borrowing rates on the decrease in interest expense for the comparative periods presented:

($ in thousands)	Year Ended December 31, 2014 vs. December 31, 2013			Year Ended December 31, 2013 vs. December 31, 2012		
		Due to Change in			Due to Change in	
	Decrease in Interest Expense	Average Balance	Average Borrowing Rate	Decrease in Interest Expense	Average Balance	Average Borrowing Rate
Repurchase agreements	$(5,080)	$(2,798)	$(2,282)	$4,772	$4,719	$53

Interest expense from repurchase agreements borrowings for 2014 was lower than 2013 as a result of the lower average balance outstanding as well as a lower borrowing rate overall. Average balances of repurchase agreement borrowings were lower in 2014 compared to 2013 given our smaller investment portfolio and the overall shift in our portfolio mix to lower leveraged CMBS IO investments. Repurchase agreement borrowing rates declined throughout 2014 as funding markets adjusted their expectations of when the FOMC would begin to raise rates and as excess liquidity in the financing markets increased competition among our repurchase agreement counterparties. During the second half of 2014, we began to extend the maturities of our repurchase agreement financings to take advantage of lower rates. Our weighted average original term to maturity for our repurchase agreements as of December 31, 2014 was 144 days compared to 114 days as of December 31, 2013.

Because we use interest rate derivative instruments as economic hedges of our interest rate risk exposure, management considers net periodic interest costs from these derivatives to be an additional cost of financing investments. As such, management utilizes a non-GAAP financial measure "effective borrowing costs" which includes the net periodic interest costs of our derivative instruments excluded from GAAP interest expense. The table below presents a reconciliation of GAAP interest expense and annualized costs of funds to our effective borrowing costs and related rates as well as a schedule detailing the total net periodic interest costs from derivative instruments during the periods indicated:

($ in thousands)	Year Ended December 31, 2014		2013		2012	
	Amount	Rate [2]	Amount	Rate [2]	Amount	Rate [2]
GAAP interest expense/annualized cost of funds	$25,915	0.76 %	$39,028	1.01 %	$35,147	1.12 %
Amortization of de-designated cash flow hedges [1]	(6,788)	(0.20)%	(5,193)	(0.15)%	—	— %
Net periodic interest costs recorded in "loss on derivative instruments, net"	8,218	0.25 %	8,948	0.24 %	654	0.02 %
Effective borrowing costs/rate	$27,345	0.81 %	$42,783	1.10 %	$35,801	1.14 %
Net periodic interest costs from derivative instruments:						
Recorded in GAAP interest expense	$—	— %	$8,796	0.23 %	$14,448	0.48 %
Recorded in "loss on derivative instruments, net"	8,218	0.25 %	8,948	0.24 %	654	0.02 %
Total net periodic interest costs from derivative instruments	$8,218	0.25 %	$17,744	0.47 %	$15,102	0.50 %
Average balance of repurchase agreements	$3,335,786		$3,773,744		$3,033,634	

(1) Amount recorded as a portion of "interest expense" in accordance with GAAP and is related to the amortization of the balance in accumulated other comprehensive loss as of June 30, 2013 related to the derivatives on which the Company discontinued cash flow hedge accounting.

(2) Rates shown are based on annualized interest expense amounts divided by average balance of borrowings. Recalculation of annualized cost of funds and effective borrowing rates using interest expense shown in the table may not be possible because certain expense items use a 360-day year for the calculation while others use actual number of days in the year.

Effective borrowing costs were $15.4 million lower for the year ended December 31, 2014 versus the same period in 2013, of which $9.5 million resulted from a decrease in the weighted average notional balance outstanding for our interest rate

swaps of approximately $793.8 million as well as a decrease of approximately 9 basis point in the weighted average net pay rate. As part of our overall interest rate risk management process, we entered into receive-fixed interest rate swaps to offset pay-fixed interest rate swap positions we held at certain points in time. Using interest rate swaps in offsetting positions provides us the flexibility to better manage exposure to specific points on the yield curve. We expect to continue to use both pay-fixed and receive-fixed interest rate swaps to manage our overall hedge position. Please refer to "Derivative Assets and Liabilities" contained in "Financial Condition" as well as "Loss on Derivative Instruments, Net" contained with these "Results of Operations" for further information on our derivative instruments. The remainder of the decrease in our effective borrowing costs for the year ended December 31, 2014 versus the same period in 2013 resulted from the lower average balances outstanding for our repurchase agreement and non-recourse collateralized financings as well as our overall lower average borrowing rates for our repurchase agreements.

Effective borrowing costs increased $7.0 million for the year ended December 31, 2013 versus the same period in 2012, of which $4.8 million resulted primarily from an increased average balance of repurchase agreement borrowings used to fund our investment purchases and $2.6 million resulted from increased net periodic interest costs due to additional derivative instruments we used to hedge exposure to increases in interest rates during 2013. These increases were offset by a decrease of $0.4 million in our interest expense from non-recourse collateralized financing. In spite of the increase in our effective borrowing costs, our effective borrowing rate decreased for the year ended December 31, 2013 versus for the year ended December 31, 2012 because our non-recourse collateralized financing, which has a higher rate of financing, comprised a smaller portion of our average balance of total financings for the year ended December 31, 2013 compared to the year ended December 31, 2012. In addition, our effective borrowing rate decreased because, although our total net periodic interest costs increased $2.6 million for 2013 versus 2012, these costs decreased as a percentage of our average repurchase agreement borrowings for the year ended December 31, 2013 compared to the year ended December 31, 2012. Average borrowing rate from our repurchase agreements was stable at 0.63% for the year ended December 31, 2013 compared to the year ended December 31, 2012.

Net Interest Income and Net Interest Spread

The tables below present net interest income and related net interest spread pursuant to GAAP, and also present the non-GAAP measures "adjusted net interest income" and "adjusted net interest spread" for the periods indicated. "Adjusted net interest income" and "adjusted net interest spread" are calculated using the non-GAAP measure "effective borrowing cost" reconciled in the table above, and therefore include net periodic interest cost of derivative instruments whereas GAAP net interest income and GAAP net interest spread do not.

	Year Ended December 31,					
	2014		2013		2012	
($ in thousands)	Amount	Yield	Amount	Yield	Amount	Yield
GAAP interest income	$105,644	2.76 %	$127,132	2.96 %	$113,548	3.25 %
GAAP interest expense	25,915	0.76 %	39,028	1.01 %	35,147	1.12 %
Net interest income/spread	79,729	2.00 %	88,104	1.95 %	78,401	2.13 %
Amortization of de-designated cash flow hedges [1]	6,788	0.20 %	5,193	0.15 %	—	— %
Net periodic interest costs of derivative instruments [2]	(8,218)	(0.25)%	(8,948)	(0.24)%	(654)	(0.02)%
Adjusted net interest income/spread	$78,299	1.95 %	$84,349	1.86 %	$77,747	2.11 %
Average interest earning assets [3]	$3,822,870		$4,290,073		$3,492,158	
Average balance of borrowings [4]	$3,347,701		$3,797,845		$3,069,348	

(1) Amount recorded as a portion of "interest expense" in accordance with GAAP related to the amortization of the balance remaining in accumulated other comprehensive loss as of June 30, 2013 as a result of the Company's discontinuation of cash flow hedge accounting.

(2) Amount equals the net interest cost related to interest rate derivatives during the period which is recorded in "loss on derivative instruments, net" and not already included in "interest expense" in accordance with GAAP.

(3) Average balances are calculated as a simple average of the daily amortized cost and exclude unrealized gains and losses as well as securities pending settlement if applicable.

(4) Average balances are calculated as a simple average of the daily borrowings outstanding for both repurchase agreement and non-recourse collateralized financing.

Our net interest income and adjusted net interest income decreased for the year ended December 31, 2014 compared to the same period in 2013 due to smaller average interest earning asset balances, lower coupons earned on our investments, and higher premium amortization resulting from the shift in our portfolio toward CMBS IO as discussed above under "Interest Income and Asset Yields". The impact of smaller average interest earning asset balances and lower coupons was partially offset by lower overall annualized cost of funds and lower effective borrowing costs as further discussed above under "Interest Expense, Annualized Cost of Funds, and Effective Borrowing Costs" and below under "Loss on Derivative Instruments, Net". Conversely, our net interest spread increased 5 basis points for the year ended December 31, 2014 compared to the same period in 2013 as a result of declining repurchase agreement costs which more than offset the decline in weighted average effective yields on our investments. Adjusted net interest spread increased 9 basis points for the year ended December 31, 2014 compared to the same period in 2013 as a result of lower net periodic interest costs.

The increase in net interest income and adjusted net interest income for the year ended December 31, 2013 compared to the same period in 2012 was primarily the result of growth in our investment portfolio during 2013. Conversely, our net interest spread and adjusted net interest spread decreased for the year ended December 31, 2013 compared to the same period in 2012. This decrease was driven primarily by declining weighted average effective yields on our overall investment portfolio as we were adding lower yielding purchases at higher premiums and our existing variable-rate RMBS were reaching their reset periods in a lower interest rate environment.

Loss on Derivative Instruments, Net

The following table provides information on the components of our "loss on derivative instruments, net" for the periods indicated:

($ in thousands)	Year Ended [(1)] December 31, 2014			2013		
Type of Derivative Instrument	Net Periodic Interest Costs	Change in Fair Value	Total	Net Periodic Interest Costs [(2)]	Change in Fair Value	Total
Interest rate swap-payers	$(9,654)	$(21,100)	$(30,754)	$(8,948)	$18,263	$9,315
Interest rate swap-receivers	1,436	3,476	4,912	—	—	—
Eurodollar futures	—	(27,551)	(27,551)	—	(19,391)	(19,391)
Loss on derivative instruments, net	$(8,218)	$(45,175)	$(53,393)	$(8,948)	$(1,128)	$(10,076)

(1) This table does not include detail for loss on derivative instruments, net for the year ended December 31, 2012 because the results are not directly comparable to the other periods presented. Because the majority of our interest rate swaps outstanding during the year ended December 31, 2012 were accounted for cash flow hedges, the majority of the change in their fair value during that period were recorded in "other comprehensive income". Loss on derivative instruments, net for the year ended December 31, 2012 consisted of $0.6 million net periodic interest costs and $0.3 million change in fair value from interest rate swap-payers that were not designated as cash flow hedges for accounting purposes. We did not have Eurodollar futures or interest rate swap-receivers outstanding during the year ended December 31, 2012.

(2) During the years ended December 31, 2013 and December 31, 2012, we recorded an additional $8.8 million and $14.4 million, respectively, within "interest expense" for net periodic interest costs from interest rate swap-payers while they were designated as cash flow hedges for accounting purposes. We discontinued cash flow hedge accounting for all of our derivative instruments as of June 30, 2013.

Loss on derivative instruments, net for the year ended December 31, 2014 increased by $43.3 million compared to the year ended December 31, 2013, principally as a result of the shifts in the yield curve during 2014. For example, the

two-year swap rate increased by 0.41% during the year but the ten-year swap rate declined during the year by 0.83%. Our derivatives hedge different points on the yield curve, but, in general, declines in longer-term swap rates will result in a higher amount of losses on our derivative position. These losses were offset by increases in the fair value of our investments which are included in other comprehensive income. The notional amount of derivative instruments outstanding from period to period fluctuate based on the composition of our investment portfolio and the current interest rate environment as well as management's expectation of future interest rates.

Gain on Sale of Investments, Net

The following tables provide information related to our gain (loss) on sale of investments, net for the periods indicated:

	Year Ended December 31, 2014		2013		2012	
($ in thousands)	Amortized cost basis sold	(Loss) gain on sale of investments, net	Amortized cost basis sold	(Loss) gain on sale of investments, net	Amortized cost basis sold	Gain on sale of investments, net
Type of Investment						
Agency RMBS	$143,112	$(5,762)	$4,496	$(254)	$61,534	$2,112
Agency CMBS	—	—	36,311	689	—	—
Agency CMBS IO	106,005	1,630	161,550	2,010	23,939	194
Non-Agency RMBS	—	—	5,631	(340)	—	—
Non-Agency CMBS	226,066	19,773	136,287	793	34,315	3,013
Non-Agency CMBS IO	12,513	582	10,263	456	—	—
Securitized mortgage loan liquidation	—	—	—	—	3,612	2,072
Freddie Mac Senior Unsecured Reference Notes	—	—	—	—	99,966	1,070
	$487,696	$16,223	$354,538	$		