MFA FINANCIAL, INC.
Form 10-Q
May 01, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2014

OR

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

For the transition period from to

Commission File Number: 1-13991

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

Maryland (State or other jurisdiction of incorporation or organization)	13-3974868 (I.R.S. Employer Identification No.)
350 Park Avenue, 20th Floor, New York, New York (Address of principal executive offices)	10022 (Zip Code)

(212) 207-6400
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes 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 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 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 Exchange Act.

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o	Smaller reporting company o

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

366,631,614 shares of the registrant's common stock, $0.01 par value, were outstanding as of April 28, 2014.

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MFA FINANCIAL, INC.
CONSOLIDATED BALANCE SHEETS

(In Thousands Except Per Share Amounts)	March 31, 2014 (Unaudited)	December 31, 2013
Assets:		
Mortgage-backed securities ("MBS"):		
Agency MBS, at fair value ($6,404,803 and $6,142,306 pledged as collateral, respectively)	$6,841,033	$6,519,221
Non-Agency MBS, at fair value ($1,776,353 and $1,778,067 pledged as collateral, respectively)	2,801,336	2,569,766
Non-Agency MBS transferred to consolidated variable interest entities ("VIEs") (1)	2,243,819	2,282,371
Securities obtained and pledged as collateral, at fair value	435,888	383,743
Cash and cash equivalents	274,672	565,370
Restricted cash	26,139	37,520
Interest receivable	36,680	35,828
Derivative instruments:		
MBS linked transactions, net ("Linked Transactions"), at fair value	59,826	28,181
Interest rate swap agreements ("Swaps"), at fair value	5,485	13,000
Goodwill	7,189	7,189
Prepaid and other assets	60,922	29,719
Total Assets	$12,792,989	$12,471,908
Liabilities:		
Repurchase agreements	$8,606,129	$8,339,297
Securitized debt (2)	292,526	366,205
Obligation to return securities obtained as collateral, at fair value	435,888	383,743
8% Senior Notes due 2042 ("Senior Notes")	100,000	100,000
Accrued interest payable	11,743	14,726
Swaps, at fair value	32,755	28,217
Dividends and dividend equivalents rights ("DERs") payable	73,875	73,643
Excise tax and interest payable	6,198	6,398
Accrued expenses and other liabilities	29,288	17,428
Total Liabilities	$9,588,402	$9,329,657
Commitments and contingencies (Note 10)		
Stockholders' Equity:		
Preferred stock, $.01 par value; 7.50% Series B cumulative redeemable; 8,050 shares authorized; 8,000 shares issued and outstanding ($200,000 aggregate liquidation preference)	$80	$80
Common stock, $.01 par value; 886,950 shares authorized; 366,217 and 365,125 shares issued and outstanding, respectively	3,662	3,651
Additional paid-in capital, in excess of par	2,981,287	2,972,369
Accumulated deficit	(572,627)	(571,544)
Accumulated other comprehensive income	792,185	737,695
Total Stockholders' Equity	$3,204,587	$3,142,251

Total Liabilities and Stockholders' Equity	$ 12,792,989	$ 12,471,908

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

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

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

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MFA FINANCIAL, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	Three Months Ended March 31,		
(In Thousands, Except Per Share Amounts)	2014	2013	
Interest Income:			
Agency MBS	$39,329	$42,787	
Non-Agency MBS	43,155	41,047	
Non-Agency MBS transferred to consolidated VIEs	38,664	38,868	
Cash and cash equivalent investments	26	36	
Interest Income	$121,174	$122,738	
Interest Expense:			
Repurchase agreements	$36,729	$34,675	
Securitized debt	2,185	3,476	
Senior Notes	2,007	2,007	
Total Interest Expense	$40,921	$40,158	
Net Interest Income	$80,253	$82,580	
Other Income, net:			
Unrealized net gains and net interest income from Linked Transactions	$3,251	$1,536	
Gain on sales of MBS and U.S. Treasury securities, net	3,571	1,633	
Other, net	(416)	55	
Other Income, net	$6,406	$3,224	
Operating and Other Expense:			
Compensation and benefits	$6,507	$5,273	
Other general and administrative expense	3,964	3,180	
Operating and Other Expense	$10,471	$8,453	
Net Income	$76,188	$77,351	
Less Preferred Stock Dividends	3,750	2,040	
Net Income Available to Common Stock and Participating Securities	$72,438	$75,311	
Earnings per Common Share - Basic and Diluted	$0.20	$0.21	
Dividends Declared per Share of Common Stock	$0.20	$0.72	(1)

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

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

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MFA FINANCIAL, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(UNAUDITED)

(In Thousands)	Three Months Ended March 31, 2014	2013
Net income	$76,188	$77,351
Other Comprehensive Income:		
Unrealized gain/(loss) on Agency MBS, net	17,843	(27,291)
Unrealized gain on Non-Agency MBS, net	51,417	146,730
Reclassification adjustment for MBS sales included in net income	(2,950)	(1,360)
Unrealized (loss)/gain on derivative hedging instruments, net	(12,267)	12,316
Reclassification of unrealized loss on de-designated derivative hedging instruments	447	—
Other Comprehensive Income	54,490	130,395
Comprehensive income before preferred stock dividends	$130,678	$207,746
Dividends declared on preferred stock	(3,750)	(2,040)
Comprehensive Income Available to Common Stock and Participating Securities	$126,928	$205,706

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

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MFA FINANCIAL, INC.
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY
(UNAUDITED)

	Three Months Ended March 31, 2014	
(In Thousands, Except Per Share Amounts)	Dollars	Shares
Preferred Stock, 7.50% Series B Cumulative Redeemable - Liquidation Preference $25.00 per Share:		
Balance at March 31, 2014 and December 31, 2013	$80	8,000
Common Stock, Par Value $.01:		
Balance at December 31, 2013	$3,651	365,125
Issuance of common stock (1)	11	1,141
Repurchase of shares of common stock (1)	—	(49)
Balance at March 31, 2014	$3,662	366,217
Additional Paid-in Capital, in excess of Par:		
Balance at December 31, 2013	$2,972,369	
Issuance of common stock, net of expenses (1)	7,605	
Equity-based compensation expense	1,430	
Repurchase of shares of common stock (1)	(117)	
Balance at March 31, 2014	$2,981,287	
Accumulated Deficit:		
Balance at December 31, 2013	$(571,544)	
Net income	76,188	
Dividends declared on common stock	(73,332)	
Dividends declared on preferred stock	(3,750)	
Dividends attributable to DERs	(189)	
Balance at March 31, 2014	$(572,627)	
Accumulated Other Comprehensive Income:		
Balance at December 31, 2013	$737,695	
Change in unrealized gains on MBS, net	66,310	
Change in unrealized losses on derivative hedging instruments, net	(11,820)	
Balance at March 31, 2014	$792,185	
Total Stockholders' Equity at March 31, 2014	$3,204,587	

(1) For the three months ended March 31, 2014, includes approximately $356,000 (48,904 shares) surrendered for tax purposes related to equity-based compensation awards.

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

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

	Three Months Ended March 31,	
(In Thousands)	2014	2013
Cash Flows From Operating Activities:		
Net income	$76,188	$77,351
Adjustments to reconcile net income to net cash provided by operating activities:		
Gain on sales of MBS and U.S. Treasury securities	(3,571)	(1,633)
Accretion of purchase discounts on MBS	(27,434)	(12,058)
Amortization of purchase premiums on MBS	10,215	14,793
Depreciation and amortization on fixed assets and other assets	327	1,097
Equity-based compensation expense	1,484	885
Unrealized gains on derivative instruments	(2,076)	(1,136)
(Increase)/decrease in interest receivable	(863)	1,891
Increase in prepaid and other assets	(9,644)	(4,088)
Decrease in accrued expenses and other liabilities, and excise tax and interest	(3,745)	(2,699)
Increase/(decrease) in accrued interest payable on financial instruments	7,384	(3,237)
Net cash provided by operating activities	$48,265	$71,166
Cash Flows From Investing Activities:		
Principal payments on MBS	$438,149	$711,901
Proceeds from sale of MBS and U.S. Treasury securities	15,501	206,203
Purchases of MBS	(888,106)	(569,006)
Additions to leasehold improvements, furniture and fixtures	(85)	(54)
Net cash (used in)/provided by investing activities	$(434,541)	$349,044
Cash Flows From Financing Activities:		
Principal payments on repurchase agreements	$(20,203,589)	$(18,024,857)
Proceeds from borrowings under repurchase agreements	20,470,421	18,175,212
Principal payments on securitized debt	(73,262)	(104,802)
Payments made on obligation to return securities obtained as collateral	—	(200,050)
Cash disbursements on financial instruments underlying Linked Transactions	(374,073)	(57,977)
Cash received from financial instruments underlying Linked Transactions	344,504	59,245
Payments made for margin calls on repurchase agreements and Swaps	(29,000)	—
Proceeds from reverse margin calls on repurchase agreements and Swaps	30,000	—
Proceeds from issuances of common stock	7,616	7,278
Dividends paid on preferred stock	(3,750)	(2,040)
Dividends paid on common stock and DERs	(73,289)	(71,942)
Net cash provided by/(used in) financing activities	$95,578	$(219,933)
Net (decrease)/increase in cash and cash equivalents	$(290,698)	$200,277
Cash and cash equivalents at beginning of period	$565,370	$401,293
Cash and cash equivalents at end of period	$274,672	$601,570
Non-cash Investing and Financing Activities:		
Net increase in securities obtained as collateral/obligation to return securities obtained as collateral	$47,768	$200,099

Dividends and DERs declared and unpaid	$73,875	$259,607

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

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MFA FINANCIAL, INC.
NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2014

1. Organization

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

2. Summary of Significant Accounting Policies

(a) Basis of Presentation and Consolidation

The interim unaudited financial statements of the Company have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission (the "SEC"). Certain information and note disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles ("GAAP") have been condensed or omitted according to these SEC rules and regulations. Management believes that the disclosures included in these interim financial statements are adequate to make the information presented not misleading. The accompanying financial statements should be read in conjunction with the financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2013. In the opinion of management, all normal and recurring adjustments necessary to present fairly the financial condition of the Company at March 31, 2014 and results of operations for all periods presented have been made. The results of operations for the three months ended March 31, 2014 should not be construed as indicative of the results to be expected for the full year.

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

The consolidated financial statements of the Company include the accounts of all subsidiaries; significant intercompany accounts and transactions have been eliminated. Certain prior period amounts have been reclassified to conform to the current period presentation.

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

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

Designation

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

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

Revenue Recognition, Premium Amortization and Discount Accretion

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

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

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

Determination of MBS Fair Value

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

Impairments/OTTI

When the fair value of an investment security is less than its amortized cost at the balance sheet date, the security is considered impaired. The Company assesses its impaired securities on at least a quarterly basis and designates such impairments as either "temporary" or "other-than-temporary." If the Company intends to sell an impaired security, or it is more likely than not that it will be required to sell the impaired security before its anticipated recovery, then the Company must recognize an OTTI through charges to earnings equal to the entire difference between the investment's amortized cost and its fair value at the balance sheet date. If the Company does not expect to sell an other-than-temporarily impaired security, only the portion of the OTTI related to credit losses is recognized through charges to earnings with the remainder recognized through AOCI on the consolidated balance sheets. Impairments recognized through other comprehensive income/(loss) ("OCI") do not impact earnings. Following the recognition of an OTTI through earnings, a new cost basis is established for the security and may not be adjusted for subsequent recoveries in fair value through earnings. However, OTTIs recognized through charges to earnings may be accreted back to the amortized cost basis of the security on a prospective basis through interest income. The determination as to whether an OTTI exists and, if so, the amount of credit impairment recognized in earnings is subjective, as such determinations are based on factual information available at the time of assessment as well as the Company's estimates of the future performance and cash flow projections. As a result, the timing and amount of OTTIs constitute material estimates that are susceptible to significant change. (See Note 3)

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

Balance Sheet Presentation

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

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

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

(d) Cash and Cash Equivalents

Cash and cash equivalents include cash on deposit with financial institutions and investments in money market funds, all of which have original maturities of three months or less. Cash and cash equivalents may also include cash pledged as collateral to the Company by its repurchase agreement and/or Swap counterparties as a result of reverse margin calls (i.e., margin calls made by the Company). The Company did not hold any cash pledged by its counterparties at March 31, 2014 or December 31, 2013. At March 31, 2014 and December 31, 2013, all of the Company's cash investments were comprised of overnight money market funds, which are not bank deposits and are not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. (See Notes 7 and 14)

(e) Restricted Cash

Restricted cash represents the Company’s cash held by its counterparties as collateral against the Company’s Swaps and/or repurchase agreements. Restricted cash, which earns interest, is not available to the Company for general corporate purposes, but may be applied against amounts due to counterparties to the Company’s repurchase agreements and/or Swaps, or returned to the Company when the collateral requirements are exceeded or at the maturity of the Swap or repurchase agreement. The Company had aggregate restricted cash held as collateral against its Swaps of \$26.1 million and \$37.5 million at March 31, 2014 and December 31, 2013, respectively. (See Notes 5, 6, 7 and 14)

(f) Goodwill

At March 31, 2014 and December 31, 2013, the Company had goodwill of \$7.2 million, which represents the unamortized portion of the excess of the fair value of its common stock issued over the fair value of net assets acquired in connection with its formation in 1998. Goodwill is tested for impairment at least annually, or more frequently under certain circumstances, at the entity level. Through March 31, 2014, the Company had not recognized any impairment against its goodwill.

(g) Depreciation

Leasehold Improvements and Other Depreciable Assets

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

(h) Resecuritization and Senior Notes Related Costs

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

(i) Repurchase Agreements and Reverse Repurchase Agreements

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

The Company's repurchase financings typically have terms ranging from one month to six months at inception, but may also have longer or shorter terms. Should a counterparty decide not to renew a repurchase financing at maturity, the Company must either refinance elsewhere or be in a position to satisfy the obligation. If, during the term of a repurchase financing, a lender should default on its obligation, the Company might experience difficulty recovering its pledged assets which could result in an unsecured claim against the lender for the difference between the amount loaned to the Company plus interest due to the counterparty and the fair value of the collateral pledged by the Company to such lender, including accrued interest receivable or such collateral. (See Notes 2(n), 5, 6, 7 and 14)

In addition to the repurchase agreement financing arrangements discussed above, as part of its financing strategy for Non-Agency MBS, the Company has entered into contemporaneous repurchase and reverse repurchase agreements with a single counterparty. Under a typical reverse repurchase agreement, the Company buys securities from a borrower for cash and agrees to sell the same securities in the future for a price that is higher than the original purchase price. The difference between the purchase price the Company originally paid and the sale price represents interest received from the borrower. In contrast, the contemporaneous repurchase and reverse repurchase transactions effectively resulted in the Company pledging Non-Agency MBS as collateral to the counterparty in connection with the repurchase agreement financing and obtaining U.S. Treasury securities as collateral from the same counterparty in connection with the reverse repurchase agreement. No net cash was exchanged between the Company and counterparty at the inception of the transactions. Securities obtained and pledged as collateral are recorded as an asset on the Company's consolidated balance sheets. Interest income is recorded on the reverse repurchase agreement and interest expense is recorded on the repurchase agreement on an accrual basis. Both the Company and the counterparty have the right to make daily margin calls based on changes in the value of the collateral obtained and/or pledged. The Company's liability to the counterparty in connection with this financing arrangement is recorded on the Company's consolidated balance sheets and disclosed as "Obligation to return securities obtained as collateral." (See Note 2(c))

(j) Equity-Based Compensation

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

During 2010, the Company granted certain restricted stock units ("RSUs") that vest after either two or four years of service and provided that certain criteria are met, which are based on a formula that includes changes in the Company's closing stock price over a two- or four-year period and dividends declared on the Company's common stock during those periods. From 2011 through 2013, the Company granted certain RSUs that vest annually over a one or three-year period, provided that certain criteria are met, which are based on a formula that includes changes in the Company's closing stock price over the annual vesting period and dividends declared on the Company's common stock during those periods. During the first quarter of 2014, the Company made grants of RSUs certain of which generally cliff vest after a three-year period and certain of which generally cliff vest after a three-year period subject to the achievement of a market-based condition that is based on a formula tied to the Company's achievement of average total stockholder return during the three-year period. Such criteria constitute a "market condition" which impacts the amount of compensation expense recognized for these awards. Specifically, the uncertainty regarding whether the market condition will be achieved is reflected in the grant date fair valuation of the RSUs, which in addition to estimates regarding the amount of RSUs expected to be forfeited during the associated service period, determines the amount of compensation expense that is recognized. Compensation expense is not reversed should the market condition not be achieved, while differences in actual forfeiture experience relative to estimated forfeitures will result in adjustments to the timing and amount of compensation expense recognized.

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

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

Basic EPS is computed using the two-class method, which includes the weighted-average number of shares of common stock outstanding during the period and other securities that participate in dividends, such as the Company's unvested restricted stock and RSUs that have non-forfeitable rights to dividends and DERs attached to/associated with RSUs and vested stock options to arrive at total common equivalent shares. In applying the two-class method, earnings are allocated to both shares of common stock and securities that participate in dividends based on their respective weighted-average shares outstanding for the period. For the diluted EPS calculation, common equivalent shares are further adjusted for the effect of dilutive unexercised stock options and RSUs outstanding that are unvested and have dividends that are subject to forfeiture using the treasury stock method. Under the treasury stock method, common equivalent shares are calculated assuming that all dilutive common stock equivalents are exercised and the proceeds, along with future compensation expenses associated with such instruments, are used to repurchase shares of the Company's outstanding common stock at the average market price during the reported period. (See Note 12)

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MFA FINANCIAL, INC.
NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2014

(l) Comprehensive Income/(Loss)