Western Asset Mortgage Capital Corp
Form 10-Q
August 11, 2014
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the quarterly period ended June 30, 2014

o **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the transition period from to

Commission File Number: 001-35543

Western Asset Mortgage Capital Corporation

(Exact name of Registrant as specified in its charter)

Delaware	**27-0298092**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification Number)

Western Asset Mortgage Capital Corporation

385 East Colorado Boulevard

Pasadena, California 91101

(Address of Registrant s principal executive offices)

(626) 844-9400

(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 (§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 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 (check one).

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 under the Securities Exchange Act of 1934). Yes o No x

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practical date.

As of August 4, 2014, there were 41,718,467 shares, par value $0.01, of the registrant s common stock issued and outstanding.

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Western Asset Mortgage Capital Corporation

Balance Sheets (Unaudited)

(in thousands except share and per share data)

		June 30, 2014		December 31, 2013
Assets:				
Cash and cash equivalents	$	1,047	$	48,525
Mortgage-backed securities and other securities, at fair value ($4,621,548 and $2,818,947 pledged as collateral, at fair value, respectively)		4,674,131		2,853,587
Linked transactions, net, at fair value		13,075		18,559
Investment related receivable ($1,716 and $0 pledged as collateral, at fair value, respectively)		67,822		341
Accrued interest receivable		26,705		12,266
Due from counterparties		135,259		55,434
Derivative assets, at fair value		68,430		105,826
Other assets		813		339
Total Assets	$	4,987,282	$	3,094,877
Liabilities and Stockholders Equity:				
Liabilities:				
Borrowings under repurchase agreements	$	4,111,248	$	2,579,067
Accrued interest payable		22,639		12,534
Investment related payables		56,977		
Due to counterparties		19,436		65,861
Derivative liability, at fair value		105,570		4,673
Accounts payable and accrued expenses		1,637		1,353
Underwriting and offering costs payable		150		8
Payable to related party		2,758		1,842
Dividend payable		27,951		19,445
Total Liabilities		4,348,366		2,684,783
Commitments and contingencies				
Stockholders Equity:				
Common stock, $0.01 par value, 500,000,000 shares authorized, 41,718,467 and 26,853,287 shares issued and outstanding, respectively		417		268
Preferred stock, $0.01 par value, 100,000,000 shares authorized and no shares outstanding				
Additional paid-in capital		759,783		544,143
Retained earnings (accumulated deficit)		(121,284)		(134,317)
Total Stockholders Equity		638,916		410,094
Total Liabilities and Stockholders Equity	$	4,987,282	$	3,094,877

See notes to unaudited financial statements.

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Western Asset Mortgage Capital Corporation

Statement of Operations (Unaudited)

(in thousands except share and per share data)

	For the three months ended June 30, 2014	**For the three months ended June 30, 2013, as Revised**	**For the six months ended June 30, 2014**	**For the six months ended June 30, 2013, as Revised**
Net Interest Income:				
Interest income	$ 44,604	$ 32,742	$ 68,034	$ 66,492
Interest expense	5,971	4,522	9,361	9,703
Net Interest Income	38,633	28,220	58,673	56,789
Other Income (Loss):				
Interest income on cash balances and other income (loss), net	24	12	12	45
Realized gain (loss) on sale of Mortgage-backed securities and other securities, net	(11,278)	(6,083)	(7,562)	(17,743)
Other loss on Mortgage-backed securities and other securities	(2,999)	(3,533)	(4,708)	(5,801)
Unrealized gain (loss) on Mortgage-backed securities and other securities, net	114,117	(156,286)	145,208	(211,045)
Gain on linked transactions, net	688	3,909	2,907	4,505
Gain (loss) on derivative instruments, net	(66,677)	109,474	(126,583)	124,314
Other Income (Loss), net	33,875	(52,507)	9,274	(105,725)
Operating Expenses:				
General and administrative (includes $479, $251, $1,067 and $537 non-cash stock based compensation, respectively)	2,375	1,541	4,450	3,278
Management fee related party	2,559	1,826	4,364	3,939
Total Operating Expenses	4,934	3,367	8,814	7,217
Net income (loss) available to Common Stock and participating securities	$ 67,574	$ (27,654)	$ 59,133	$ (56,153)
Net income (loss) per Common Share Basic	$ 1.68	$ (1.16)	$ 1.76	$ (2.34)
Net income (loss) per Common Share Diluted	$ 1.68	$ (1.16)	$ 1.76	$ (2.34)
Dividends Declared per Share of Common Stock	$ 0.67	$ 1.85	$ 1.34	$ 1.85

See notes to unaudited financial statements.

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Western Asset Mortgage Capital Corporation

Statement of Changes in Stockholders Equity (Unaudited)

(in thousands except shares and share data)

	Common Stock Shares	Common Stock Par	Additional Paid-In Capital	Retained Earnings (Accumulated) Deficit	Total
Balance at December 31, 2013	26,853,287	$ 268	$ 544,143	$ (134,317)	$ 410,094
Proceeds from public offering of common stock, net	14,000,000	140	205,240		205,380
Offering costs, public offerings of common stock			(386)		(386)
Proceeds from private placement of common stock	650,000	7	9,646		9,653
Grants of restricted stock	215,180	2	(2)		
Vesting of restricted stock			1,129		1,129
Net income				59,133	59,133
Dividends on common stock			13	(46,100)	(46,087)
Balance at June 30, 2014	41,718,467	$ 417	$ 759,783	$ (121,284)	$ 638,916

See notes to unaudited financial statements.

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Western Asset Mortgage Capital Corporation

Statement of Cash Flows (Unaudited)

(in thousands)

	For the six months ended June 30, 2014	For the six months ended June 30, 2013
Cash flows from operating activities:		
Net income (loss)	$ 59,133	$ (56,153)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Premium amortization and (discount accretion), net	4,214	14,199
Restricted stock amortization expense	1,067	505
Unrealized (gain) loss on Mortgage-backed securities and other securities, net	(145,208)	211,045
Mark-to-market adjustments on linked transactions	(590)	(711)
Mark-to-market adjustments on derivative instruments	132,126	(90,303)
Other loss on Mortgage-backed securities and other securities	4,708	5,801
Realized loss on sale of Mortgage-backed securities and other securities, net	7,562	17,743
Realized loss on sale of Interest-Only Strips accounted for as derivatives, net	1,144	99
Realized (gain) loss on sale of TBAs, net	(22,561)	2,563
Realized (gain) loss on sale of swaptions, net	5,908	(1,038)
Realized loss on futures	16,495	
Realized loss on expiration of option derivatives, net		925
Realized gain on linked transaction, net	(1,290)	(3,748)
Realized gain on termination of swaps		(8,895)
Changes in operating assets and liabilities:		
(Increase) decrease in accrued interest receivable	(14,439)	2,253
Increase in other assets	(474)	(406)
Increase (decrease) in accrued interest payable	10,105	(674)
Increase in accounts payable and accrued expenses	346	323
Increase in payable to related party	916	92
Net cash provided by operating activities	59,162	93,620
Cash flows from investing activities:		
Purchase of Mortgage-backed securities and other securities	(3,490,944)	(1,725,304)
Purchase of securities underlying linked transactions	(25,141)	(76,408)
Proceeds from sale of Mortgage-backed securities and other securities	1,692,817	2,209,607
Proceeds from sale of securities underlying linked transactions		21,733
Principal payments and basis recovered on Mortgage-backed securities and other securities	137,908	156,970
Principal payments and basis recovered on securities underlying linked transactions	3,777	1,043
Payment of premium for option derivatives		(4,675)
Premium received from option derivatives		3,750
Proceeds from gross settlement of TBAs		208,312
Net settlements of TBAs	22,561	(2,058)
Proceeds from currency swaps	25,160	
Payment on termination of futures	(16,495)	
Proceeds from sale of interest rate swaptions		16,325
Premium for interest rate swaptions, net	(323)	(23,544)
Net cash provided by (used in) investing activities	(1,650,680)	785,751
Cash flows from financing activities:		

Proceeds from issuance of common stock		205,380		
Proceeds from private placement of common stock (concurrent with initial public offering)		9,653		
Payment of offering costs		(244)		(67)
Proceeds from repurchase agreement borrowings		11,783,312		20,074,104
Proceeds from repurchase agreement borrowings underlying linked transactions		75,809		86,245
Repayments of repurchase agreement borrowings		(10,241,325)		(20,907,205)
Repayments of repurchase agreement borrowings underlying linked transactions		(124,714)		(82,960)
Repayment of cash overdraft				(5,666)
Due from counterparties		(79,825)		(80,267)
Due to counterparties		(46,425)		39,000
Dividends on common stock		(37,581)		(50,131)
Net cash provided by (used in) financing activities		1,544,040		(926,947)
Net decrease in cash and cash equivalents		(47,478)		(47,576)
Cash and cash equivalents beginning of period		48,525		56,292
Cash and cash equivalents end of period	$	1,047	$	8,716
Supplemental disclosure of operating cash flow information:				
Interest paid	$	7,755	$	11,681
Interest rate swaps terminated, not settled	$		$	8,895
Supplemental disclosure of non-cash financing/investing activities:				
Principal payments of mortgage-backed securities, not settled	$	(237)	$	
Mortgage-backed securities and other securities sold, not settled	$	35,615	$	3,465
Mortgage-backed securities and other securities purchased, not settled	$	(5,106)	$	(22,167)
Mortgage-backed securities recorded upon unlinking of linked transactions	$	(62,435)	$	53,159
Mortgage-backed securities used to settle TBAs	$		$	208,817
Deferred offering costs payable	$	142	$	
Repurchase agreements, not settled	$	(9,806)	$	
Repurchase agreements underlying linked transactions, not settled	$	15,198	$	
Currency swaps, not settled	$	(25,160)	$	
Dividends and distributions declared, not paid	$	27,951	$	21,878

See notes to unaudited financial statements.

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Western Asset Mortgage Capital Corporation

Notes to Financial Statements (Unaudited)

(in thousands-except share and per share data)

The following defines certain of the commonly used terms in these Notes to Financial Statements: Agency or Agencies refer to a federally chartered corporation, such as the Federal National Mortgage Association (Fannie Mae or FNMA) or the Federal Home Loan Mortgage Corporation (Freddie Mac or FHLMC), or an agency of the U.S. Government, such as the Government National Mortgage Association (Ginnie Mae or GNMA); references to MBS refer to mortgage backed securities, including residential mortgage-backed securities or RMBS , commercial mortgage-backed securities or CMBS , and Interest-Only Strips (as defined herein); Agency MBS refer to RMBS, CMBS and Interest-Only Strips issued or guaranteed by the Agencies while Non-Agency MBS refer to RMBS, CMBS and Interest-Only Strips that are not issued or guaranteed by the Agencies; references to ARMs refers to adjustable rate mortgages; references to Interest-Only Strips refer to interest-only (IO) and inverse interest-only (IIO) securities issued as part of or collateralized with MBS.

Note 1 Organization

Western Asset Mortgage Capital Corporation (is referred to throughout this report as the Company) is a real estate finance company. At the Company s launch in May 2012, its initial investment strategy focused primarily on Agency RMBS (including TBAs as defined herein). Over time, the Company has expanded its investment strategy to include both Non-Agency RMBS and subsequently, Agency and Non-Agency CMBS. In addition, and to a significantly lesser extent, the Company has invested in other securities including certain Agency obligations that are not technically MBS and is currently evaluating investments in asset backed securities (ABS). The Company s Manager, as defined below, is also actively pursuing investing in whole loans or whole loan securities as set forth in more detail herein. These changes in the Company s investment strategy, including future changes, are based on the Manager s perspective of which mix of portfolio assets it believes provide the Company with the best risk-reward opportunities at any given time.

The Company is externally managed by Western Asset Management Company (WAM , or the Manager), an investment advisor registered with the Securities and Exchange Commission (SEC). WAM is a wholly-owned subsidiary of Legg Mason, Inc. The Company operates and has elected to be taxed as a real estate investment trust or REIT commencing with its taxable year ended December 31, 2012.

In light of the aforementioned developments and given the Manager s current market outlook and investment view, while it can be expected that Agency RMBS will continue to be a significant part of the Company s portfolio, Agency RMBS will not necessarily be our primary investment in the future. Going forward, the Manager may vary the allocation among various asset classes subject to maintaining the Company s qualification as a REIT under federal tax law and maintaining its exemption from the Investment Company Act of 1940 (the 1940 Act). These restrictions limit the Company s ability to invest in non-real estate assets and/or assets which are not secured by real estate. Accordingly, the Company s portfolio will continue to be principally invested in MBS and other real estate related assets.

Note 2 Summary of Significant Accounting Policies

Basis of Presentation

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (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 periods. Actual results could differ from those estimates.

In the opinion of management, all adjustments (which include only normal recurring adjustments) necessary have been made to present fairly the Company s financial position, results of operations and cash flows. Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted in accordance with Article 10 of Regulation S-X and the instructions to Form 10-Q. These financial statements should be read in conjunction with the Company s annual report on Form 10-K for the year ended December 31, 2013, filed with the Securities and Exchange Commission (SEC) on March 17, 2014. The results of operations for the period ended June 30, 2014 are not necessarily indicative of the results to be expected for the full year or any future period.

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The Company currently operates as one business segment.

Cash and Cash Equivalents

The Company considers all highly-liquid short term investments with original maturities of 90 days or less when purchased to be cash equivalents. Cash and cash equivalents are exposed to concentrations of credit risk. The Company places its cash and cash equivalents with what it believes to be high credit quality institutions. At times such investments may be in excess of the Federal Deposit Insurance Corporation insurance limit.

Classification of mortgage-backed securities and other securities and valuations of financial instruments

Mortgage-backed and other securities - Fair value election

The Company has elected the fair value option for all of its MBS and other securities at the date of purchase, which permits the Company to measure these securities at fair value with the change in fair value included as a component of earnings. In the Manager s view, this election more appropriately reflects the results of the Company s operations for a particular reporting period, as financial asset fair value changes are presented in a manner consistent with the presentation and timing of the fair value changes of economic hedging instruments.

Balance Sheet Presentation

The Company s mortgage-backed securities and other securities purchases and sales are recorded on the trade date, which results in an investment related payable (receivable) for MBS and other securities purchased (sold) for which settlement has not taken place as of the balance sheet date. The Company s MBS and other securities are pledged as collateral against borrowings under repurchase agreements. Other than MBS and other securities which are accounted for as linked transactions, described below, the Company s MBS and other securities are included in Mortgage-backed securities and other securities at fair value and Investment related receivables on the Balance Sheet, with the fair value of such MBS and other securities pledged disclosed parenthetically.

Valuation of financial instruments

The Company discloses the fair value of its financial instruments according to a fair value hierarchy (Levels I, II, and III, as defined below). In accordance with GAAP, the Company is required to provide enhanced disclosures regarding instruments in the Level III category (which require significant management judgment), including a separate reconciliation of the beginning and ending balances for each major category of assets and liabilities. GAAP establishes a framework for measuring fair value and expands financial statement disclosure requirements for fair value measurements. GAAP further specifies a hierarchy of valuation techniques, which is based on whether the inputs into the valuation technique are

observable or unobservable. The hierarchy is as follows:

Level I Quoted prices in active markets for identical assets or liabilities.

Level II Quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose inputs are observable or whose significant value drivers are observable.

Level III Prices are determined using significant unobservable inputs. In situations where quoted prices or observable inputs are unavailable, for example, when there is little or no market activity for an investment at the end of the period, unobservable inputs may be used.

The level in the fair value hierarchy within which a fair value measurement in its entirety falls is based on the lowest level input that is significant to the fair value measurement in its entirety. Transfers between levels are determined by the Company at the end of the reporting period.

When available, the Company uses quoted market prices to determine the fair value of an asset or liability. If quoted market prices are not available, the Company consults with independent pricing services or obtains third party broker quotes. If independent pricing service, or third party broker quotes are not available, the Company determines the fair value of the securities using valuation techniques that use, when possible, current market-based or independently-sourced market parameters, such as interest rates and when applicable, estimates of prepayment and credit losses.

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Valuation techniques for MBS and other securities may be based upon models that consider the estimated cash flows of the security. When applicable, the primary inputs to the model include yields for Agency To-Be-Announced securities (also known as TBAs), Agency MBS, the U.S. Treasury market and floating rate indices such as the London interbank offered rate or LIBOR, the Constant Maturity Treasury rate and the prime rate as a benchmark yield. In addition, the model may incorporate the current weighted average maturity and additional pool level information such as prepayment speeds, default frequencies and default severities, if applicable. To the extent such inputs are observable and timely, these securities are categorized as Level II of the fair value hierarchy; otherwise, unless alternative pricing information as described above is available, they are categorized as Level III.

While linked transactions, described below, are treated as derivatives for GAAP, the securities underlying the Company s linked transactions are valued using similar techniques to those used for the Company s securities portfolio. The value of the underlying security is then netted against the carrying amount (which approximates fair value) of the repurchase agreement at the valuation date. Additionally, TBA instruments are similar in substance to the Company s Agency RMBS portfolio, and the Company therefore estimates fair value based on similar methods.

The Company determines the fair value of derivative financial instruments by obtaining quotes from a third party pricing service, whose pricing is subject to review by the Manager s pricing committee. In valuing its interest rate derivatives, such as swaps and swaptions, and its currency derivatives, such as swaps and forwards, the Company considers the creditworthiness of both the Company and its counterparties, along with collateral provisions contained in each derivative agreement, from the perspective of both the Company and its counterparties. All of the Company s interest rate swaps are either cleared through a central clearing house and subject to the clearing house margin requirements or subject to bilateral collateral arrangements. The Company s agreements with its derivative counterparties also contain netting provisions; however the Company has elected to report the interest rate swaps and currency swaps on a gross basis. No credit valuation adjustment was made in determining the fair value of interest rate and/or currency derivatives.

Fair value under GAAP represents an exit price in the normal course of business, not a forced liquidation price. If the Company is forced to sell assets in a short period to meet liquidity needs, the prices it receives can be substantially less than their recorded fair values. Furthermore, the analysis of whether it is more likely than not that the Company will not be required to sell securities in an unrealized loss position before recovery of its amortized cost basis, the amount of such expected required sales, and the projected identification of which securities will be sold is also subject to significant judgment, particularly in times of market illiquidity.

Any changes to the valuation methodology will be reviewed by the Company and its Manager to ensure the changes are appropriate. As markets and products develop and the pricing for certain products becomes more transparent, the Company will continue to refine its valuation methodologies. The Company utilizes and follows the pricing methodology and fair value hierarchy employed by its Manager, including its review and challenge process. The methods used by the Company may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Company anticipates that its valuation methods will be appropriate and consistent with other market participants, the use of different methodologies, or assumptions, to determine the fair value of certain financial instruments can result in a different estimate of fair value at the reporting date. The Company uses inputs that are current as of the measurement date, which may include periods of market dislocation, during which price transparency may be reduced.

All valuations received from independent pricing services are non-binding. The Company primarily utilizes an independent third party pricing service as the primary source for valuing the Company s assets.

The Company generally receives one independent pricing service price for each investment in the Company s portfolio. The Manager has established a process to review and validate the pricing received from the independent pricing service and has a process for challenging prices

received from the independent pricing service when necessary. The Company utilizes our Manager s policies in this regard. The Company s and the Manager s review of the independent third party pricing data may consist of a review of the daily change in the prices provided by the independent pricing vendor which exceed established tolerances or comparisons to executed transaction prices. The Manager s pricing group, which functions independently from its portfolio management personnel, corroborates the price differences or changes in price by comparing the vendor price to alternate sources including other independent pricing services or broker quotations. If the price change or difference cannot be corroborated, the Manager s pricing group consults with the portfolio management team for market color in reviewing such pricing data as warranted. To the extent that the Manager has information, typically in the form of broker quotations that would indicate that a price received from the independent pricing service is outside of a tolerance range, our Manager generally challenges the independent pricing service price.

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To ensure proper fair value hierarchy, The Company and the Manager review the methodology and data used by the third party pricing service to understand whether observable market data is being utilized in the vendor s pricing methodology. Generally, this review is conducted annually, however ad-hoc reviews of the pricing methodology and the data does occur. The review of the assumptive data received from the vendor includes comparing key inputs. In addition, as part of the Company s regular review of pricing, the Manager s pricing group may have informal discussions with the independent pricing vendor regarding their evaluation methodology or the market data utilized in their determination. The conclusion that a price should be overridden in accordance with the Manager s pricing methodology may impact the fair value hierarchy of the security for which such price has been adjusted.

Interest income recognition and Impairment

Agency MBS Non-Agency MBS and other securities, excluding Interest-Only Strips, rated AA and higher at the time of purchase

Interest income on mortgage-backed and other securities is accrued based on the respective outstanding principal balances and corresponding contractual terms. Premiums and discounts associated with Agency MBS, Non-Agency MBS and other securities, excluding Interest-Only Strips, rated AA and higher at the time of purchase, are amortized into interest income over the estimated life of such securities using the effective yield method. Adjustments to premium and discount amortization are made for actual prepayment activity. The Company estimates prepayments at least quarterly for its securities and as a result, if prepayments increase (or are expected to increase), the Company will accelerate the rate of amortization on premiums or discounts and make a retrospective adjustment to historical amortization. Alternatively, if prepayments decrease (or are expected to decrease) the Company will reduce the rate of amortization on the premiums or discounts and make a retrospective adjustment to historical amortization.

A change in the calculation used to determine the amortization of bond premium as of April 1, 2014, resulted in a change in estimate of approximately $1.2 million. The impact of the change in estimate was limited to an increase of approximately $1.2 million to Interest Income and an offsetting reduction to Unrealized gain (loss) on Mortgage-backed securities and other securities, net on the Statement of Operations. The Company does not believe the aforementioned change in estimate will have a material impact to subsequent periods.

The Company assesses its Agency MBS, Non-Agency MBS and other securities, excluding Interest-Only Strips, rated AA and higher at the time of purchase for other-than-temporary impairment on at least a quarterly basis. When the fair value of an investment is less than its amortized cost at the balance sheet date of the reporting period for which impairment is assessed, the impairment is designated as either temporary or other-than-temporary. In deciding on whether or not a security is other-than-temporarily impaired, the Company considers several factors, including the nature of the investment, communications (if any) from the trustees of securitizations regarding the credit quality of the security, the severity and duration of the impairment, the cause of the impairment, and the Company s intent not to sell the security and whether it is more likely than not that Company will not be required to sell the security until recovery of its amortized cost basis. An other-than-temporary impairment is deemed to have occurred when there is an adverse change in the expected cash flows (principal or interest) to be received and the fair value of the security is less than its carrying amount. In determining whether an adverse change in cash flows occurred, the present value of the remaining cash flows, as estimated at the initial transaction date (or the last date previously revised), is compared to the present value of the expected cash flows at the current reporting date. The estimated cash flows reflect those a market participant would use and are discounted at a rate equal to the current yield used to accrete interest income. These adjustments are reflected in the Company s Statement of Operations as Other loss on Mortgage-backed securities and other securities.

The determination as to whether an other-than-temporary impairment exists is subject to management estimates based on consideration of both factual information available at the time of assessment as well as the Company s estimates ofhe future performance and projected amount and

timing of cash flows expected to be collected on the security. As a result, the timing and amount of an other-than-temporary impairment constitutes an accounting estimate that may change materially over time.

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Non-Agency MBS and other securities that are rated below AA at the time of purchase and Interest-Only Strips that are not classified as derivatives

Interest income on Non-Agency MBS and other securities that are rated below AA at the time of purchase and Interest-Only Strips that are not classified as derivatives are recognized based on the effective yield method. The effective yield on these securities is based on the projected cash flows from each security, which is estimated based on the Company s observation of the then current information and events, where applicable, and will include assumptions related to interest rates, prepayment rates 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 (if applicable), 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 such securities. Actual maturities of the securities are affected by the contractual lives of the underlying collateral, periodic payments of scheduled principal, and prepayments of principal. Therefore, actual maturities of the securities will generally be shorter than stated contractual maturities.

Based on the projected cash flow of such securities purchased at a discount to par value, the Company may designate a portion of such purchase discount as credit protection against future credit losses and, therefore, not accrete such amount into interest income. The amount designated as credit discount 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 discount is more favorable than forecasted, a portion of the amount designated as credit discount may be accreted into interest income prospectively.

In addition, an other-than-temporary impairment is deemed to have occurred when there is an adverse change in the expected cash flows (principal or interest) to be received and the fair value of the security is less than its carrying amount. In determining whether an adverse change in cash flows occurred, the present value of the remaining cash flows, as estimated at the initial transaction date (or the last date previously revised), is compared to the present value of the expected cash flows at the current reporting date. The estimated cash flows reflect those a market participant would use and are discounted at a rate equal to the current yield used to accrete interest income. These adjustments are reflected in the Company s Statement of Operations as Other loss on Mortgage-backed securities and other securities.

The determination as to whether an other-than-temporary impairment exists is subject to management estimates based on consideration of both factual information available at the time of assessment as well as the Company s estimates of the future performance and projected amount and timing of cash flows expected to be collected on the security. As a result, the timing and amount of an other-than-temporary impairment constitutes an accounting estimate that may change materially over time.

Finally, certain of the Company s MBS and other securities that are in an unrealized loss position at June 30, 2014 are also not considered other-than-temporarily impaired because the Company has no intent to sell these investments, it is more likely than not that the Company will not be required to sell the investment before recovery of its amortized cost basis and the Company is not required to sell the security for regulatory or other reasons.

Sales of securities

Sales of securities are driven by the Company s portfolio management process. The Company seeks to mitigate risks including those associated with prepayments and will opportunistically rotate the portfolio into securities the Company s Manager believes have more favorable attributes. Strategies may also be employed to manage net capital gains, which need to be distributed for tax purposes. Realized gains or losses on sales of securities, including Agency Interest-Only Strips not characterized as derivatives, are included in the net Realized gain (loss) on sale of Mortgage-backed securities and other securities, net line item on the Statement of Operations, and are recorded at the time of disposition. Realized gains or losses on sales of securities which are part of a linked transaction are included in Gain (loss) on linked transactions, net while realized gains losses on Interest-Only Strips which are characterized as derivatives are included in Gain (loss) on derivative instruments, net line item in the Statement of Operations. The cost of positions sold is calculated using the specific identification method.

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Securities in an unrealized loss position at the end of each reporting period are evaluated by the Company s Manager to determine whether the Company has the intent to sell such securities. To the extent the Company has no intent as of the end of such reporting period to sell such investments and it is more likely than not that the Company will not be required to sell the investment before recovery of its amortized cost basis, such unrealized loss is included in Unrealized gain (loss) on Mortgage-backed securities and other securities, net in the Statement of Operations. Otherwise, when the Company has determined its intent to sell such securities, the unrealized loss is characterized as a realized loss and included in Other loss on Mortgage-backed securities and other securities on the Statement of Operations. The Company has no intent to sell any of its investments in an unrealized loss position at June 30, 2014.

Foreign currency transactions

The Company expects to enter into transactions denominated in foreign currency from time to time. At the date the transaction is recognized, the asset and/or liability will be measured and recorded using the exchange rate in effect at the date of the transaction. At each balance sheet date, such foreign currency assets and liabilities are re-measured using the exchange rate in effect at the date of the balance sheet, resulting in unrealized foreign currency gains or losses. Unrealized foreign currency gains or losses on MBS and other securities are recorded in Unrealized gain (loss) on Mortgage-backed securities and other securities, net on the Statement of Operations. Unrealized and realized foreign currency gains or losses on borrowings under repurchase agreements are recorded in Interest income on cash balances and other income (loss), net on the Statement of Operations. Interest income from investments denominated in a foreign currency and interest expense on borrowings denominated in a foreign currency are recorded at the average rate of exchange during the period.

Due from counterparties/Due to counterparties

Due from counterparties represents cash posted by the Company with its counterparties as collateral for the Company s interest rate and/or currency derivative financial instruments and repurchase agreements. Due to counterparties represents cash posted with the Company by its counterparties as collateral under the Company s interest rate and/or currency derivative financial instruments and repurchase agreements. To the extent the Company receives collateral other than cash from its counterparties such assets are not included in the Company s Balance Sheet. Notwithstanding the foregoing, if the Company either rehypothecates such assets or pledges the assets as collateral pursuant to a repurchase agreement, the cash received and the corresponding liability is reflected on the Balance Sheet.

Derivatives and hedging activities

Subject to maintaining its qualification as a REIT for U.S. federal income tax purposes, the Company utilizes derivative financial instruments, including interest rate swaps, interest rate swaptions, currency swaps and forwards, futures contracts, TBAs and Agency and Non-Agency Interest-Only Strips to hedge the interest rate and currency risk associated with its portfolio and related borrowings. Derivatives are used for hedging purposes rather than speculation. The Company determines the fair value of its derivative positions and obtains quotations from a third party to facilitate the process of determining such fair values. If the Company s hedging activities do not achieve the desired results, reported earnings may be adversely affected.

GAAP requires an entity to recognize all derivatives as either assets or liabilities and to measure those instruments at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative, whether the Company has elected to designate a

derivative in a hedging relationship and apply hedge accounting and whether the hedging relationship has satisfied the criteria necessary to apply hedge accounting. Derivatives are classified as either hedges of the fair value of a recognized asset or liability or of an unrecognized firm commitment (fair value hedge) or hedges of a forecasted transaction or the variability of cash flows to be received or paid related to a recognized asset or liability (cash flow hedge). Fair value adjustments are recorded in earnings immediately, if the Company does not elect hedge accounting for a derivative instrument.

The Company elected not to apply hedge accounting for its derivative instruments and records the change in fair value, net interest rate swap payments (including accrued amounts) and net currency payments (including accrued amounts) related to interest rate swaps and currency swaps, respectively in Gain (loss) on derivative instruments, net in its Statement of Operations.

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The Company also invests in Agency and Non-Agency Interest-Only Strips, interest rate swaptions, currency forwards, futures contracts and TBAs. The Company evaluates the terms and conditions of its holdings of Agency and Non-Agency Interest-Only Strips, interest rate swaptions, currency forwards, futures contracts and TBAs to determine if these instruments have the characteristics of an investment or should be considered a derivative under GAAP. In determining the classification of its holdings of Interest-Only Strips, the Company evaluates the securities to determine if the nature of the cash flows has been altered from that of the underlying mortgage collateral. Generally, Interest-Only Strips for which the security represents a strip off of a mortgage pass through security will be considered a hybrid instrument classified as a MBS investment on the Balance Sheet utilizing the fair value option. Alternatively, those Interest-Only Strips, for which the underlying mortgage collateral has been included into a structured security that alters the cash flows from the underlying mortgage collateral, are accounted for as derivatives at fair value. Accordingly, Agency and Non-Agency Interest-Only Strips, interest rate swaptions, currency forwards, futures contracts and TBAs having the characteristics of derivatives are accounted for at fair value with such changes recognized in Gain (loss) on derivative instruments, net in its Statement of Operations, along with any interest earned (including accrued amounts). The carrying value of the Agency and Non-Agency Interest-Only Strips, accounted for as derivatives, is included in Mortgage-backed securities on the Balance Sheet. The carrying value of interest rate swaptions, currency forwards, futures contracts and TBAs is included in Derivative assets or Derivative liabilities on the Balance Sheet.

The Company evaluates all of its financial instruments to determine if such instruments are derivatives or contain features that qualify as embedded derivatives. An embedded derivative is separated from the host contact and accounted for separately when all of the guidance criteria are met. Hybrid instruments that are remeasured at fair value through earnings, including the fair value option are not bifurcated. Derivative instruments, including derivative instruments accounted for as liabilities, are recorded at fair value and are re-valued at each reporting date, with changes in the fair value together with interest earned (including accrued amounts) reported in the Gain (loss) on derivatives, net in the Statements of Operations. See Warrants below.

Repurchase agreements

Mortgage-backed securities and other securities sold under repurchase agreements are treated as collateralized financing transactions, unless they meet sales treatment. Securities financed through a repurchase agreement remain on the Company s Balance Sheet as assets and cash received from the lender is recorded in the Company s Balance Sheet as a liability, unless such transactions is accounted for as linked transaction, described below. Interest paid in accordance with repurchase agreements is recorded as interest expense, unless the repurchase agreement is accounted for as a linked transaction, described below. The Company reflects all proceeds from repurchase agreement borrowings and repayment of repurchase agreement borrowings which are not linked transactions, including transactions pertaining to collateral received with respect to certain swap transactions, on a gross basis on the Statement of Cash Flows.

Linked transactions

In instances where the Company acquires a security through a repurchase agreement with the same counterparty from which the security was purchased, the Company evaluates such transaction in accordance with GAAP. This guidance requires that if the initial transfer of a financial asset and repurchase financing are entered into contemporaneously with, or in contemplation of, one another such transaction shall be considered linked unless all of the criteria found in the guidance are met at the inception of the transaction. If the transaction meets all of the conditions, the initial transfer shall be accounted for separately from the repurchase financing, and the Company will record the security and the related financing on a gross basis on its Balance Sheet with the corresponding interest income and interest expense in the Statements of Operations. If the transaction is determined to be linked, the Company will record the initial transfer and repurchase financing on a net basis and record a forward commitment to purchase the security as a derivative instrument with changes in market value being recorded on the Statement of Operations. Such forward commitment is recorded at fair value with subsequent changes in fair value recognized in Gain (loss) on linked transactions, net on its Statement of Operations. The Company refers to these transactions as Linked Transactions. When or if a transaction is no

longer considered to be linked, the security and related repurchase financing will be reported on a gross basis. The unlinking of a transaction causes a realized event in which the fair value of the security as of the date of unlinking will become the cost basis of the security. The difference between the fair value on the unlinking date and the existing cost basis of the security will be the realized gain or loss. Recognition of effective yield for such security will be calculated prospectively using the new cost basis. For linked transactions, the Company reflects purchases and sales of securities within the investing section of the Statement of Cash Flows. Proceeds from repurchase agreements borrowings and repayments of repurchase agreement borrowings are reflected in the financing section of the Statement of Cash Flows.

Share-based compensation

The Company accounts for share-based compensation to its independent directors, to any employee, to its Manager and to employees of its Manager and its affiliates using the fair value based methodology prescribed by GAAP. Compensation cost related to restricted common stock issued to the Company s independent directors including any such restricted stock which is subject to a deferred compensation program, and any employee of the Company is measured at its fair value at the grant date, and amortized into expense over the service period on a straight-line basis. Compensation cost related to restricted common stock issued to the Manager and to employees of the Manager, including officers of the Company who are employees of the Manager and its affiliates, is initially measured at fair value at the grant date, and amortized into expense over the vesting period on a straight-line basis and re-measured on subsequent dates to the extent the awards are unvested.

Warrants

For the Company s warrants, the Company uses a variation of the adjusted Black-Scholes option valuation model to record the financial instruments at their relative fair values at issuance. The warrants issued with the Company s common stock in the private placement to certain accredited institutional investors on May 15, 2012, were evaluated by the Company and were recorded at their relative fair value as a component of equity at the date of issuance. See Derivatives and hedging activities above.

Income taxes

The Company operates and has elected to be taxed as a REIT commencing with its taxable year ended December 31, 2012. Accordingly, the Company will generally not be subject to corporate U.S. federal or state income tax to the extent that the Company makes qualifying distributions to stockholders, and provided that the Company satisfies, on a continuing basis, through actual investment and operating results, the REIT requirements including certain asset, income, distribution and stock ownership tests. If the Company fails to qualify as a REIT, and does not qualify for certain statutory relief provisions, the Company will be subject to U.S. federal, state and local income taxes and may be precluded from qualifying as a REIT for the subsequent four taxable years following the year in which the Company lost its REIT qualification. Accordingly, the failure to qualify as a REIT could have a material adverse impact on the Company s results of operations and amounts available for distribution to stockholders.

The dividends paid deduction for qualifying dividends paid to stockholders is computed using the Company s taxable income as opposed to net income reported on the financial statements. Taxable income, generally, will differ from net income reported on the financial statements because the determination of taxable income is based on tax provisions and not GAAP.

The Company may create and elect to treat certain subsidiaries as Taxable REIT Subsidiaries (TRS). In general, a TRS may hold assets and engage in activities that the Company cannot hold or engage in directly and generally may engage in any real estate or non-real estate-related business. A TRS is subject to U.S. federal, state and local corporate income taxes, and its value may not exceed 25% of the value of the Company. While a TRS may generate net income, a TRS can declare dividends to the Company, which will be included in the Company s taxable income and necessitate a distribution to its stockholders. Conversely, if the Company retains earnings at the TRS level, no distribution is required and it can increase book equity of the consolidated entity. As of June 30, 2014, the Company did not have a TRS, or any other subsidiary.

The Company evaluates uncertain tax positions, if any, and classifies interest and penalties, if any, related to unrecognized tax benefits, if any, as a component of the provision for income taxes.

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Offering costs

Offering costs borne by the Company in connection with its IPO and concurrent private placements completed on May 15, 2012 as well as its follow-on public stock offerings completed on October 3, 2012 and its follow-on public stock offering and concurrent private placement completed on April 9, 2014 (exclusive of the partial exercise of the greenshoe which was completed on May 7, 2014) are reflected as a reduction of additional paid-in-capital.

Earnings per share

GAAP requires use of the two-class method of computing earnings per share for all periods presented for each class of common stock and participating securities as if all earnings for the period had been distributed. Under the two-class method, during periods of net income, the net income is first reduced for dividends declared on all classes of securities to arrive at undistributed earnings. During periods of net losses, the net loss is reduced for dividends declared on participating securities only if the security has the right to participate in the earnings of the entity and an objectively determinable contractual obligation to share in net losses of the entity. The Company s participating securities are not allocated a share of the net loss as the participating securities do not have a contractual obligation to share in the net losses of the Company.

The remaining earnings are allocated to common stockholders and participating securities, to the extent that each security shares in earnings, as if all of the earnings for the period had been distributed. Each total is then divided by the applicable number of shares to arrive at basic earnings per share. For the diluted earnings, the denominator includes all outstanding common shares and all potential common shares assumed issued if they are dilutive. The numerator is adjusted for any changes in income or loss that would result from the assumed conversion of these potential common shares.

Comprehensive Income (Loss)

The Company has none of the components of comprehensive income (loss) and therefore comprehensive income (loss) is not presented.

Accounting standards applicable to emerging growth companies

The JOBS Act contains provisions that relax certain requirements for emerging growth companies , which includes the Company. For as long as the Company is an emerging growth company, which may be up to five full fiscal years, unlike other public companies, the Company will not be required to: (i) comply with any new or revised financial accounting standards applicable to public companies until such standards are also applicable to private companies under Section 102(b)(1) of the JOBS Act; (ii) provide an auditor s attestation report on management s assessment of the effectiveness of the Company s system of internal control over financial reporting pursuant to Section 404 of the Sarbanes-Oxley Act; (iii) comply with any new requirements adopted by the PCAOB requiring mandatory audit firm rotation or a supplement to the auditor s report in which the auditor would be required to provide additional information about the audit and the financial statements of the issuer; or (iv) comply with any new audit rules adopted by the PCAOB after April 5, 2012, unless the SEC determines otherwise.

As noted above, under the JOBS Act, emerging growth companies can delay adopting new or revised accounting standards that have different effective dates for public and private companies until such time as those standards apply to private companies. The Company intends to take advantage of such extended transition period. Since the Company will not be required to comply with new or revised accounting standards on the relevant dates on which adoption of such standards is required for other public companies, its financial statements may not be comparable to the financial statements of companies that comply with public company effective dates. If the Company were to elect to comply with these public company effective dates, such election would be irrevocable pursuant to Section 107 of the JOBS Act.

Recent accounting pronouncements

Accounting Standards to be Adopted in Future Periods

In April 2014, the Financial Accounting Standards Board issued updated guidance that changes the requirements for reporting discontinued operations. Under the new guidance, a discontinued operation is defined as a disposal of a component of an entity or group of components of an entity that is disposed of or is classified as held for sale and represents a strategic shift that has (or will have) a major effect on an entity s operations and financial results. The guidance is effective prospectively as of the first quarter of 2015, with early adoption permitted for new disposals or new classifications as held-for-sale. The guidance is effective for annual periods beginning on or after December 15, 2014 and interim periods within annual periods beginning on or after December 15, 2015. Early adoption is permitted but only for disposals (or classifications as held for sale) that have not been reported in financial statements previously issued or available for issue. The new guidance is not expected to have a material impact on the Company s financial statements.

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In June 2014, the Financial Accounting Standards Board issued guidance that changes the accounting for repurchase-to-maturity transactions and repurchase financing arrangements. The new guidance aligns the accounting for repurchase-to-maturity transactions and repurchase agreements executed as a repurchase financing with the accounting for other typical repurchase agreements. These transactions would all be accounted for as secured borrowings. The guidance eliminates sale accounting for repurchase-to-maturity transactions and supersedes the guidance under which a transfer of a financial asset and a contemporaneous repurchase financing could be accounted for on a combined basis as a forward agreement, which has resulted in outcomes referred to as off-balance-sheet accounting. In addition, the guidance requires additional disclosures. The guidance is effective for the first interim or annual period beginning after December 15, 2014. Earlier application for a public company is prohibited. The Company currently accounts for certain transfers as forward agreements under the existing guidance, which are currently classified as linked transactions. The new guidance will require the Company to record these transfers as secured borrowings. The Company is currently assessing the impact that this accounting guidance will have on the Company s financial statements when adopted.

Note 3 Fair Value of Financial Instruments

Fair Value Accounting Elections

The Company s MBS and other securities are designated as available-for-sale and the Company has elected the fair value option for all of its MBS and other securities, and as a result, all changes in the fair value of such securities are reflected in the results of operations.

Financial Instruments carried at Fair Value

The following tables present the Company s financial instruments carried at fair value as of June 30, 2014 and December 31, 2013, based upon the valuation hierarchy (dollars in thousands):

	June 30, 2014 Fair Value			
	Level I	**Level II**	**Level III**	**Total**
Assets				
Agency RMBS	$	$ 3,375,807	$ 4,796	$ 3,380,603
Agency and Non-Agency Interest-Only Strips accounted for as derivatives, included in MBS		91,213	4,349	95,562
Non-Agency RMBS		683,089	69,737	752,826
Agency and Non-Agency CMBS		359,592	51,702	411,294
Other securities		33,846		33,846
Subtotal		4,543,547	130,584	4,674,131
Derivative assets	437	67,993		68,430
Non-Agency RMBS linked transactions		2,943		2,943
Non-Agency CMBS linked transactions, including Non U.S.		10,132		10,132
Total	$ 437	$ 4,624,615	$ 130,584	$ 4,755,636

Liabilities				
Derivative liabilities	$ 548	$ 104,159	$ 863	$ 105,570
Total	$ 548	$ 104,159	$ 863	$ 105,570

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	December 31, 2013 Fair Value			
	Level I	Level II	Level III	Total
Assets				
Agency RMBS	$	$ 2,360,073	$	$ 2,360,073
Agency and Non-Agency Interest-Only Strips accounted for as derivatives, included in MBS		109,235		109,235
Non-Agency RMBS		325,371	6,152	331,523
Agency and Non-Agency CMBS		16,542	9,529	26,071
Other securities		26,685		26,685
Subtotal		2,837,906	15,681	2,853,587
Derivative assets		105,826		105,826
Non-Agency linked transactions		18,559		18,559
Total	$	$ 2,962,291	$ 15,681	$ 2,977,972
Liabilities				
Derivative liabilities	$	$ 4,673	$	$ 4,673
Total	$	$ 4,673	$	$ 4,673

The following tables present additional information about the Company s financial instruments, which are measured at fair value on a recurring basis for which the Company has utilized Level III inputs to determine fair value:

	Mortgage-backed securities and other securities			
$ in thousands	Three months ended June 30, 2014	Three months ended June 30, 2013	Six months ended June 30, 2014	Six months ended June 30, 2013
Beginning balance	$ 56,441	$	$ 15,681	$
Transfers into Level III from Level II	17,823		37,291	
Transfers out Level III into Level II	(16,703)		(16,703)	
Purchases	93,564		113,418	
Sales and settlements	(23,442)		(23,442)	
Principal repayments	(19)		(19)	
Total net gains/(losses) included in net income				
Realized gains/(losses), net	2,861		2,861	
Other loss on Mortgage-backed securities				
Unrealized gains/(losses), net(1)	857		2,371	
Premium and discount amortization, net	(798)		(874)	
Ending balance	$ 130,584	$	$ 130,584	$

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(1) For Mortgage-backed securities and other securities classified as Level III at June 30, 2014, the Company recorded gross unrealized gains of approximately $1.1 million and $1.3 million and gross unrealized losses of $377 thousand and $377 thousand for the three and six months ended June 30, 2014, respectively. These gains and losses are included in Unrealized gain (loss) on Mortgage-backed securities and other securities, net on the Statement of Operations.

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$ in thousands	Derivative assets Three months ended June 30, 2014	Three months ended June 30, 2013	Six months ended June 30, 2014	Six months ended June 30, 2013
Beginning balance	$ 126	$	$	$
Transfers into Level III from Level II			126	
Transfers out Level III into Level II				
Purchases				
Sales and settlements				
Principal repayments				
Total net gains/(losses) included in net income				
Realized gains/(losses), net	(1,163)		(1,163)	
Other loss on Mortgage-backed securities				
Unrealized gains/(losses), net	1,037		1,037	
Premium and discount amortization, net				
Ending balance	$	$	$	$

$ in thousands	Derivative liabilities Three months ended June 30, 2014	Three months ended June 30, 2013	Six months ended June 30, 2014	Six months ended June 30, 2013
Beginning balance	$	$	$	$
Transfers into Level III from Level II				
Transfers out Level III into Level II				
Purchases				
Sales and settlements				
Principal repayments				
Total net gains/(losses) included in net income				
Realized gains/(losses), net				
Other loss on Mortgage-backed securities				
Unrealized gains/(losses), net	863		863	
Premium and discount amortization, net				
Ending balance	$ 863	$	$ 863	$

Transfers between hierarchy levels during operations for the three and six months ended June 30, 2014, were based on the availability of sufficient observable inputs to meet Level II versus Level III criteria. The valuation and leveling of these assets were based on information received from a third party pricing service which utilized significant unobservable inputs, along with the back-testing of historical sales transactions performed by the Manager.

The Company primarily utilizes an independent third party pricing services as the primary source for valuing the Company s assets. All valuations received from independent pricing services are non-binding. The Company generally receives one independent pricing service price for each investment in its portfolio. The Manager has established a process to review and validate the pricing received from the independent pricing service and has a process for challenging prices received from the independent pricing service when necessary. The Company utilizes its Manager s policies in this regard. The Company s and the Manager s review of the independent third party pricing data may consist of a review of the daily change in the prices provided by the independent pricing vendor which exceed established tolerances or comparisons to executed transaction prices. The Manager s pricing group, which functions independently from its portfolio management personnel, corroborates the price

differences or changes in price by comparing the vendor price to alternate sources including other independent pricing services or broker quotations. If the price change or difference cannot be corroborated, the Manager s pricing group consults with the portfolio management team for market color in reviewing such pricing data as warranted. To the extent that the Manager has information, typically in the form of broker quotations that would indicate that a price received from the independent pricing service is outside of a tolerance range, the Manager generally challenges the independent pricing service price. To ensure proper fair value hierarchy, the Company and the Manager review the methodology used by the third party pricing service to understand whether observable market data is being utilized in the vendor s pricing methodology. Generally, this review is conducted annually, however ad-hoc reviews of the pricing methodology and the data does occur. In addition, as part of the Company s regular review of pricing, the Manager s pricing group may have informal discussions with the independent pricing vendor regarding their evaluation methodology or the market data utilized in their determination.

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Other Fair Value Disclosures

Due from counterparties and Due to counterparties on the Company s Balance Sheets are reflected at cost which approximates fair value.

The fair value of the repurchase agreements is based on an expected present value technique. This method discounts future estimated cash flows using rates the Company determined best estimate current market interest rates that would be offered for loans with similar characteristics and credit quality. The use of different market assumptions or estimation methodologies could have a material effect on the fair value amounts. At June 30, 2014, the Company s borrowings under repurchase agreements had a fair value of approximately $4.1 billion and a carrying value of approximately $4.1 billion and would be considered a Level II fair value measurement.

Note 4 Mortgage-Backed Securities and other securities

The following tables present certain information about the Company s investment portfolio at June 30, 2014 and December 31, 2013 (dollars in thousands). Real estate securities and other securities that are accounted for as a component of linked transactions are not reflected in the tables set forth in this note. See Note 7 for further details.

	June 30, 2014						
	Principal Balance	Unamortized Premium (Discount), net	Discount Designated as Credit Reserve and OTTI	Amortized Cost	Unrealized Gain (Loss), net	Estimated Fair Value	Net Weighted Average Coupon (1)
Agency RMBS:							
20-Year Mortgage	$ 1,069,883	$ 60,249	$	$ 1,130,132	$ (2,677)	$ 1,127,455	3.6%
30-Year Mortgage	1,910,531	151,488		2,062,019	(23,092)	2,038,927	4.1%
Agency RMBS Interest-Only Strips	N/A	N/A	N/A	208,738	5,483	214,221	4.2%(2)
Agency and Non-Agency Interest-Only Strips, accounted for as derivatives (3)	N/A	N/A	N/A	N/A	N/A	95,562	2.9%(2)
Non-Agency RMBS	878,940	(10,420)	(179,891)	688,629	9,349	697,978	3.3%
Non-Agency RMBS Interest- Only Strips	N/A	N/A	N/A	52,584	2,264	54,848	6.1%
Agency and Non-Agency CMBS	430,439	1,733	(26,483)	405,689	5,605	411,294	5.4%
Other securities	25,560	4,580		30,140	3,706	33,846	7.3%
Total	$ 4,315,353	$ 207,630	$ (206,374)	$ 4,577,931	$ 638	$ 4,674,131	4.0%

	December 31, 2013						
	Principal Balance	Unamortized Premium (Discount), net	Discount Designated as Credit Reserve and OTTI	Amortized Cost	Unrealized Gain (Loss), net	Estimated Fair Value	Net Weighted Average Coupon (1)
Agency RMBS:							

20-Year Mortgage	$ 504,023	$ 28,498	$	$ 532,521	$ (29,595)	$ 502,926	3.2%
30-Year Mortgage	1,677,863	144,356		1,822,219	(127,981)	1,694,238	3.8%
Agency RMBS Interest-Only Strips	N/A	N/A	N/A	158,825	4,084	162,909	4.4%(2)
Agency and Non-Agency Interest-Only Strips, accounted for as derivatives (3)	N/A	N/A	N/A	N/A	N/A	109,235	4.6%(2)
Non-Agency RMBS	446,473	(49,334)	(79,898)	317,241	6,792	324,033	2.3%
Non-Agency RMBS Interest- Only Strips	N/A	N/A	N/A	7,420	70	7,490	5.2%
Agency and Non-Agency CMBS	11,979	(3,446)		8,533	996	9,529	1.6%
CMBS Interest-Only Strips	N/A	N/A	N/A	16,682	(140)	16,542	4.7%(2)
Other securities	23,510	2,110	N/A	25,620	1,065	26,685	6.7%
Total	$ 2,663,848	$ 122,184	$ (79,898)	$ 2,889,061	$ (144,709)	$ 2,853,587	3.6%

(1) Net weighted average coupon as of June 30, 2014 and December 31, 2013 is presented, net of servicing and other fees.

(2) Agency and Non-Agency Interest-Only Strips, accounted for as derivatives and CMBS Interest-Only Strips have no principal balances and earn contractual interest based on a notional balance. The notional balance is used solely to determine interest distributions on interest-only class of securities.

(3) Interest on these securities is reported as a component of Gain (loss) on derivative instruments, net on the Statement of Operations.

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As of June 30, 2014 and December 31, 2013, the weighted average expected remaining term to the expected maturity of the investment portfolio, excluding linked transactions was 7.9 years and 8.5 years, respectively.

The components of the carrying value of the Company s investment portfolio are as follows:

	June 30, 2014	December 31, 2013
Principal balance	$ 4,315,353	$ 2,663,848
Amortized cost of Interest-Only Strips	261,322	182,927
Carrying value of Agency and Non-Agency Interest-Only Strips accounted for as derivatives	95,562	109,235
Unamortized premium	243,330	183,324
Unamortized discount	(35,700)	(61,140)
Discount designated as Credit Reserve and OTTI	(206,374)	(79,898)
Gross unrealized gains	56,980	19,798
Gross unrealized losses	(56,342)	(164,507)
Fair value	$ 4,674,131	$ 2,853,587

The following tables present the changes in the components of the Company s purchase discount and amortizable premium on its Non-Agency RMBS, Non-Agency CMBS and other securities for the three and six months ended June 30, 2014 and 2013 (dollars in thousands):

	Three months ended June 30, 2014		
	Discount Designated as Credit Reserve and OTTI	Accretable Discount (1)	Amortizable Premium
Balance at beginning of period	$ (96,949)	$ (53,916)	$ 58,213
Accretion of discount		2,288	
Amortization of premium			(199)
Realized credit losses	1,075		
Purchases	(111,998)	(89,407)	53,258
Sales	4,692	24,461	
Net impairment losses recognized in earnings	(1,999)		
Unlinking of Linked Transactions			
Transfers/release of credit reserve	(1,195)	9,206	(8,011)
Balance of end of period	$ (206,374)	$ (107,368)	$ 103,261

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

	Six months ended June 30, 2014		
	Discount Designated as Credit Reserve and OTTI	Accretable Discount (1)	Amortizable Premium
Balance at beginning of period	$ (79,898)	$ (71,295)	$ 20,625
Accretion of discount		7,544	

Amortization of premium						(3,668)
Realized credit losses		1,770				
Purchases		(131,725)		(95,088)		59,941
Sales		19,411		46,432		
Net impairment losses recognized in earnings		(2,476)				
Unlinking of Linked Transactions		(13,889)		(297)		32,132
Transfers/release of credit reserve		433		5,336		(5,769)
Balance of end of period	$	(206,374)	$	(107,368)	$	103,261

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

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	Three months ended June 30, 2013		
	Discount Designated as Credit Reserve and OTTI	Accretable Discount (1)	Amortizable Premium
Balance at beginning of period	$ (120,480)	$ (29,755)	$ 22,804
Accretion of discount		1,378	
Amortization of premium			333
Realized credit losses	123		
Purchases	(5,508)	(8,880)	
Sales	74,113	9,434	(20,649)
Net impairment losses recognized in earnings			
Unlinking of Linked Transactions	(20,489)	(4,695)	3,438
Transfers/release of credit reserve	4,170	(3,787)	(383)
Balance of end of period	$ (68,071)	$ (36,305)	$ 5,543

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

	Six months ended June 30, 2013		
	Discount Designated as Credit Reserve and OTTI	Accretable Discount (1)	Amortizable Premium
Balance at beginning of period	$ (12,659)	$ (5,523)	$ 12
Accretion of discount		2,149	
Amortization of premium			660
Realized credit losses	242		
Purchases	(112,923)	(34,303)	22,360
Sales	74,113	9,434	(20,649)
Net impairment losses recognized in earnings			
Unlinking of Linked Transactions	(20,489)	(4,695)	3,438
Transfers/release of credit reserve	3,645	(3,367)	(278)
Balance of end of period	$ (68,071)	$ (36,305)	$ 5,543

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

The following tables present the gross unrealized losses and estimated fair value of the Company s MBS and other securities by length of time that such securities have been in a continuous unrealized loss position at June 30, 2014 and December 31, 2013:

	June 30, 2014								
	Less than 12 Months			12 Months or More			Total		
	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses	Number of Securities
Agency RMBS:									
20-Year Mortgage	$ 19,301	$ (89)	4	$ 451,448	$ (12,043)	55	$ 470,749	$ (12,132)	59
30-Year Mortgage	7,815	(7)	1	1,003,871	(39,290)	137	1,011,686	(39,297)	138
	46,293	(2,551)	14				46,293	(2,551)	14

Agency Interest-Only Strips									
Non-Agency RMBS	293,489	(2,048)	30				293,489	(2,048)	30
Agency and Non-Agency CMBS	96,993	(314)	12				96,993	(314)	12
Total	$ 463,891	$ (5,009)	61	$ 1,455,319	$ (51,333)	192	$ 1,919,210	$ (56,342)	253

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	December 31, 2013												
	Less than 12 Months					12 Months or More					Total		
	Fair Value		Unrealized Losses		Number of Securities	Fair Value		Unrealized Losses		Number of Securities	Fair Value		Unrealized Losses		Number of Securities

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The Company recorded other-than-temporary-impairments for the three and six months ended June 30, 2014 of approximately $1.0 million and $2.2 million, respectively and approximately $3.5 million and $5.8 million for the three and six months ended June 30, 2013, respectively, for Agency IOs, Agency IIOs and 20-year Agency RMBS. The Company recorded approximately $1.9 million and $2.4 million of other-than-temporary impairments for the three and six months ended June 30, 2014, respectively, and $0 for the three and six months ended June 30, 2013, for Non-Agency RMBS. The Company recorded approximately $111 thousand of other-than-temporary-impairments for the three and six months ended June 30, 2014, and $0 for the three and six months ended June 30, 2013, for Non-Agency CMBS. Other-than-temporary-impairments are reported as Other loss on Mortgage-backed securities and other securities in the Company s Statement of Operations.

The following tables present components of interest income on the Company s MBS and other securities (dollars in thousands).

	For the three months ended June 30, 2014		
	Coupon Interest	Net (Premium Amortization/ Amortization Basis) Discount Amortization	Interest Income
Agency RMBS	$ 44,683	$ (13,937)	$ 30,746
Non-Agency RMBS	9,327	(516)	8,811
Agency and Non-Agency CMBS	3,694	291	3,985
Other securities	948	114	1,062
Total	$ 58,652	$ (14,048)	$ 44,604

	For the six months ended June 30, 2014		
	Coupon Interest	Net (Premium Amortization/ Amortization Basis) Discount Amortization	Interest Income
Agency RMBS	$ 74,457	$ (26,000)	$ 48,457
Non-Agency RMBS	13,692	121	13,813
Agency and Non-Agency CMBS	3,741	468	4,209
Other securities	1,340	215	1,555
Total	$ 93,230	$ (25,196)	$ 68,034

	For the three months ended June 30, 2013		
	Coupon Interest	Net (Premium Amortization/ Amortization Basis) Discount Amortization	Interest Income
Agency RMBS	$ 45,788	$ (15,380)	$ 30,408
Non-Agency RMBS	623	1,711	2,334
Total	$ 46,411	$ (13,669)	$ 32,742

	For the six months ended June 30, 2013		
	Coupon Interest	**Net (Premium Amortization/ Amortization Basis) Discount Amortization**	**Interest Income**
Agency RMBS	$ 96,307	$ (33,729)	$ 62,578
Non-Agency RMBS	1,105	2,809	3,914
Total	$ 97,412	$ (30,920)	$ 66,492

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The following tables present the sales of the Company s MBS and other securities (dollars in thousands):

	For the three months ended June 30, 2014			
	Proceeds	Gross Gains	Gross Losses	Net Gain (Loss)
Agency RMBS (1)	$ 1,323,065	$ 8,997	$ (35,201)	$ (26,204)
Non-Agency RMBS	136,913	9,267	(45)	9,222
Agency and Non-Agency CMBS	73,059	367	(2)	365
Other securities	78,932	5,064		5,064
Total	$ 1,611,969	$ 23,695	$ (35,248)	$ (11,553)

(1) Includes proceeds for Agency Interest-Only Strips, accounted for as derivatives, of approximately $20.2 million, gross realized gains of $437 thousand and gross realized losses of $712 thousand.

	For the six months ended June 30, 2014			
	Proceeds	Gross Gains	Gross Losses	Net Gain (Loss)
Agency RMBS (1)	$ 1,336,352	$ 9,013	$ (36,070)	$ (27,057)
Non-Agency RMBS	240,089	13,502	(580)	12,922
Agency and Non-Agency CMBS	73,059	367	(2)	365
Other securities	78,932	5,064		5,064
Total	$ 1,728,432	$ 27,946	$ (36,652)	$ (8,706)

(1) Includes proceeds for Agency Interest-Only Strips, accounted for as derivatives, of approximately $31.4 million, gross realized gains of $437 thousand and gross realized losses of approximately $1.6 million.

	For the three months ended June 30, 2013			
	Proceeds	Gross Gains	Gross Losses	Net Gain (Loss)
Agency RMBS	$ 317,170	$	$ (10,462)	$ (10,462)
Non-Agency RMBS	67,184	4,379		4,379
Total	$ 384,354	$ 4,379	$ (10,462)	$ (6,083)

	For the six months ended June 30, 2013			
	Proceeds	Gross Gains	Gross Losses	Net Gain (Loss)
Agency RMBS (1)	$ 2,145,888	$ 8,646	$ (30,867)	$ (22,221)
Non-Agency RMBS	67,184	4,379		4,379
Total	$ 2,213,072	$ 13,025	$ (30,867)	$ (17,842)

(1) Includes proceeds for Agency Interest-Only Strips, accounted for as derivatives, of approximately $8.4 million and gross realized losses of $99 thousand.

Note 5 Borrowings under Repurchase Agreements

As of June 30, 2014, the Company had master repurchase agreements with 22 counterparties. As of June 30, 2014, the Company had borrowings under repurchase agreements with 18 counterparties, excluding borrowings for linked transactions. The following tables summarize certain characteristics of the Company s repurchase agreements at June 30, 2014 and December 31, 2013 (dollars in thousands):

	June 30, 2014		
Securities Pledged	**Repurchase Agreement Borrowings**	**Weighted Average Interest Rate on Borrowings Outstanding at end of period**	**Weighted Average Remaining Maturity (days)**
Agency RMBS	$ 3,264,316	0.37%	28
Non-Agency RMBS	504,733	1.63%	32
Agency and Non-Agency CMBS	315,214	1.53%	35
Other securities	26,985	1.55%	23
Total	$ 4,111,248	0.62%	29

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Securities Pledged		Repurchase Agreement Borrowings	December 31, 2013 Weighted Average Interest Rate on Borrowings Outstanding at end of period	Weighted Average Remaining Maturity (days)
Agency RMBS	$	2,331,276	0.43%	24
Non-Agency RMBS		208,923	1.71%	14
Agency and Non-Agency CMBS		17,544	1.33%	58
Other securities		21,324	1.68%	52
Total	$	2,579,067	0.55%	24

For the three and six months ended June 30, 2014, the Company had average borrowings under its repurchase agreements of approximately $4.1 billion and $3.7 billion, respectively, and had a maximum month-end balance during the three and six months ended of approximately $4.2 billion and $4.2 billion, respectively. The Company had accrued interest payable at June 30, 2014 of approximately $3.3 million. For the three and six months ended June 30, 2013, the Company had average borrowings under its repurchase agreements of approximately $4.0 billion and $4.3 billion, respectively, had a maximum month-end balance during the three and six months ended of approximately $4.2 billion and $4.8 billion, respectively, and had accrued interest payable of approximately $1.5 million at June 30, 2013. In addition, at June 30, 2014, the Company had entered into repurchase agreement borrowings of approximately $50.2 million, which settled on July 1, 2014, with a weighted average interest rate of 1.64%, a weighted average contractual maturity of 64 days and secured by collateral of approximately $72.4 million.

The repurchase agreements bear interest at a contractually agreed-upon rate and typically have terms ranging from one month to three months. The Company s repurchase agreement borrowings are accounted for as secured borrowings when the Company maintains effective control of the financed assets. Under the repurchase agreements, the respective lender retains the right to determine the fair value of the underlying collateral. A reduction in the value of pledged assets requires the Company to post additional securities as collateral, pay down borrowings or establish cash margin accounts with the counterparties in order to re-establish the agreed-upon collateral requirements, and is referred to as a margin call. The inability of the Company to post adequate collateral for a margin call by the counterparty, in a timeframe as short as the close of the same business day, could result in a condition of default under the Company s repurchase agreements, thereby enabling the counterparty to liquidate the collateral pledged by the Company, which may have a material adverse effect on the Company s financial position, results of operations and cash flows. During 2013, the volatility in both the Agency and Non-Agency MBS markets necessitated the Company being required to post additional collateral with respect to its repurchase agreements. The Company was able to satisfy the requirement for incremental collateral by utilizing unpledged assets, cash on hand, and reducing its overall leverage. In addition, during the second and third quarters of 2013, the Company also rehypothecated pledged U.S. Treasury securities it received from its interest rate swap counterparties as incremental collateral in order to generate additional cash proceeds in order to satisfy such margin requirements. The maximum amount of repurchase borrowings for the rehypothecated securities was $130.7 million during the year ended December 31, 2013. At June 30, 2014 and December 31, 2013, the Company did not have any rehypothecated U.S. Treasury securities.

A return of such volatility in these markets may create additional stress on the overall liquidity of the Company due to the long-term nature of its assets and the short-term nature of its liabilities. In an instance of severe volatility, or where the additional stress on liquidity resulting from volatility is sustained over an extended period of time, the Company could be required to sell securities, possibly even at a loss, to generate sufficient liquidity to satisfy collateral and margin requirements which could have a material adverse effect on the Company s financial position, results of operations and cash flows. All of the Company s repurchase agreement counterparties are either U.S. financial institutions or the U.S. broker-dealer subsidiaries of foreign financial institutions.

Further, if the Company is unable to renew, replace or expand repurchase financing with other sources of financing on substantially similar terms it may have a material adverse effect on the Company s financial position, results of operations and cash flow, due to the long term nature of the Company s investments and relatively short-term maturities of the Company s repurchase agreements. Certain of the repurchase agreements provide the counterparty with the right to terminate the agreement if the Company does not maintain certain equity and leverage

metrics, the most restrictive of which include a limit on leverage based on the composition of the Company s portfolio.

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At June 30, 2014, repurchase agreements collateralized by MBS and other securities had the following remaining maturities.

(dollars in thousands)	Balance
Overnight	$ 66,446
1 to 29 days	2,300,606
30 to 59 days	1,390,403
60 to 89 days	320,491
90 to 119 days	33,302
Greater than or equal to 120 days	
Total	$ 4,111,248

As discussed in Note 2, for any transactions determined to be linked, the initial transfer and repurchase financing will be recorded as a forward commitment to purchase assets. At June 30, 2014, the Company had repurchase agreements of approximately $27.5 million that were accounted for as linked transactions. At December 31, 2013, the Company had repurchase agreements of approximately $61.2 million that were accounted for as linked transactions. Linked repurchase agreements are not included in the tables above. See Note 7 for details.

At June 30, 2014, the following table reflects amounts of collateral at risk under its repurchase agreements greater than 10% of the Company s equity with any counterparty, including linked transactions.

	June 30, 2014 (dollars in thousands)		
Counterparty	Amount Collateral at Risk, at fair value	Weighted Average Remaining Maturity (days)	Percentage of Stockholders Equity
Credit Suisse Securities (USA) LLC	$ 87,718	21	13.7%
Barclays Capital Inc.	85,436	29	13.4
JP Morgan Securities LLC	83,441	31	13.1
Royal Bank of Canada	64,400	38	10.1

Note 6 Collateral Positions

The following tables summarize the Company s collateral positions, with respect to its borrowings under repurchase agreements, derivatives and clearing margin accounts at June 30, 2014 and December 31, 2013 (dollars in thousands):

	June 30, 2014		
	Assets Pledged- Fair Value	Accrued Interest	Fair Value of Assets Pledged and Accrued Interest
Assets pledged for borrowings under repurchase agreements:			
Agency RMBS	$ 3,447,802	$ 13,896	$ 3,461,698
Non-Agency RMBS	721,260	1,495	722,755

Agency and Non-Agency CMBS	420,356	1,838	422,194
Other securities	33,846	31	33,877
Cash (1)	18,060		18,060
Cash collateral for derivatives (1):	117,199		117,199
Total	$ 4,758,523	$ 17,260	$ 4,775,783

	December 31, 2013		
	Assets Pledged- Fair Value	**Accrued Interest**	**Fair Value of Assets Pledged and Accrued Interest**
Assets pledged for borrowings under repurchase agreements:			
Agency RMBS	$ 2,463,347	$ 10,453	$ 2,473,800
Non-Agency RMBS	305,318	417	305,735
Agency and Non-Agency CMBS	23,597	159	23,756
Other securities	26,685	26	26,711
Cash (1)	32,597		32,597
Cash collateral for derivatives (1):	22,837		22,837
Total	$ 2,874,381	$ 11,055	$ 2,885,436

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(1) Cash posted as collateral is included in Due from counterparties on the Company s Balance Sheets.

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A reduction in the value of pledged assets typically results in the repurchase agreement counterparties, derivative counterparties and clearing margin counterparties initiating a daily margin call. At June 30, 2014 and December 31, 2013, MBS and other securities held by counterparties as security for repurchase agreements totaled approximately $4.6 billion and approximately $2.8 billion, respectively. Cash collateral held by counterparties at June 30, 2014 and December 31, 2013 was approximately $135.3 million and $55.4 million, respectively. Cash posted by counterparties at June 30, 2014 and December 31, 2013, was approximately $19.4 million and $65.9 million, respectively. At June 30, 2014, the Company does not hold any securities received as collateral from its repurchase agreement and derivative counterparties.

Note 7 Derivative Instruments

At June 30, 2014, the Company s derivatives include interest rate swaps (interest rate swaps), interest rate swaptions, currency swaps and forwards, futures contracts, TBAs, linked transactions, Agency and Non-Agency Interest-Only Strips that are classified as derivatives, and options.

Interest rate swaps and interest rate swaptions

The Company is exposed to certain risks arising from both its business operations and economic conditions. Specifically, the Company s primary source of debt funding is repurchase agreements and the Company enters into derivative financial instruments to manage exposure to variable cash flows on portions of its borrowings under those repurchase agreements. Since the interest rates on repurchase agreements typically change with market interest rates such as LIBOR, the Company is exposed to constantly changing interest rates, which accordingly affects cash flows associated with these rates on its borrowings. To mitigate the effect of changes in these interest rates, the Company enters into interest rate swap agreements which help to mitigate the volatility in the interest rate exposures and their related cash flows. Interest rate swaps generally involve the receipt of variable-rate amounts from a counterparty in exchange for the Company making fixed-rate payments over the life of the interest rate swap without exchange of the underlying notional amount. Notwithstanding the foregoing, in order to manage its hedge position with regard to its liabilities, the Company on occasion will enter into interest rate swaps which involve the receipt of fixed-rate amounts from a counterparty in exchange for the Company making variable-rate payments over the life of the interest rate swap without exchange of the underlying notional amount. The Company also enters into interest rate swaptions to help mitigate the effects of increases in interest rates on a portion of its borrowings under repurchase agreements. Interest rate swaptions provide the Company the option to enter into an interest rate swap agreement for a predetermined notional amount, stated term and pay and receive interest rates in the future.

While the Company has not elected to account for its interest rate swap derivative instruments as hedges under GAAP, it does not use interest rate swaps and swaptions for speculative purposes, but rather uses such instruments to manage interest rate risk and views them as economic hedges. Changes in the fair value of derivatives not designated in hedging relationships are recorded directly in earnings together with periodic net interest settlement amounts.

The Company s interest rate swaps, interest rate swaptions, currency swaps and forwards, futures contracts, TBA derivative instruments and linked transactions consisted of the following at June 30, 2014 and December 31, 2013 (dollars in thousands):

			June 30, 2014
Derivative Instrument	**Designation**	**Balance Sheet Location**	

			Notional Amount	Fair Value, excluding accrued interest	Accrued Interest Payable
Interest rate swaps, assets	Non-Hedge	Derivative assets, at fair value	$ 4,024,550	$ 59,605	$ (3,164)
Interest rate swaptions, assets	Non-Hedge	Derivative assets, at fair value	305,000	337	
Futures contracts, assets	Non-Hedge	Derivative assets, at fair value	592,000	437	
Foreign currency swaps, asset	Non-Hedge	Derivative assets, at fair value	25,160	15	(1)
TBA securities, assets	Non-Hedge	Derivative assets, at fair value	2,173,400	8,036	
Total derivative instruments, assets			7,120,110	68,430	(3,165)
Interest rate swaps, liability	Non-Hedge	Derivative liability, at fair value	5,476,400	(98,308)	13,354
Futures contract, liability	Non-Hedge	Derivative liability, at fair value	592,000	(548)	
Foreign currency forward contracts, liability	Non-Hedge	Derivative liability, at fair value	15,205	(138)	
TBA securities, liabilities	Non-Hedge	Derivative liability, at fair value	1,893,000	(6,576)	
Total derivative instruments, liabilities			7,976,605	(105,570)	13,354
Linked transactions (1)	Non-Hedge	Linked transactions, net, at fair value	34,674	13,075	(47)
Total derivative instruments			$ 15,131,389	$ (24,065)	$ 10,142

(1) Notional amount represents the current face of the securities comprising the linked transactions.

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			December 31, 2013		
Derivative Instrument	Designation	Balance Sheet Location	Notional Amount	Fair Value, excluding accrued interest	Accrued Interest Payable
Interest rate swaps, assets	Non-Hedge	Derivative assets, at fair value	$ 2,135,950	$ 94,614	$ 9,994
Interest rate swaptions, assets	Non-Hedge	Derivative assets, at fair value	2,200,000	11,177	
TBA securities, assets	Non-Hedge	Derivative assets, at fair value	13,600	35	
Total derivative instruments, assets			4,349,550	105,826	9,994
Interest rate swaps, liability	Non-Hedge	Derivative liability, at fair value	678,900	(3,202)	(26)
Interest rate swaptions, liability	Non-Hedge	Derivative liability, at fair value	100,000	(264)	
TBA securities, liabilities	Non-Hedge	Derivative liability, at fair value	176,400	(1,207)	
Total derivative instruments, liabilities			955,300	(4,673)	(26)
Linked transactions (1)	Non-Hedge	Linked transactions, net, at fair value	56,028	18,559	(207)
Total derivative instruments			$ 5,360,878	$ 119,712	$ 9,761

(1) Notional amount represents the current face of the securities comprising the linked transactions.

The following tables summarize the average fixed pay rate and average maturity for the Company s interest rate swaps as of June 30, 2014 and December 31, 2013 (excludes interest rate swaptions) (dollars in thousands):

	June 30, 2014			
Remaining Interest Rate interest rate swap Term	Notional Amount	Average Fixed Pay Rate	Average Maturity (Years)	Forward Starting
1 year or less	$ 215,900	0.4%	0.3	%
Greater than 1 year and less than 3 years	1,129,100	0.8	2.1	35.4
Greater than 3 years and less than 5 years	2,297,800	1.7	4.6	
Greater than 5 years	3,206,050	2.7	10.3	31.6
Total	$ 6,848,850	2.0%	6.7	20.6%

	December 31, 2013			
Remaining Interest Rate interest rate swap Term	Notional Amount	Average Fixed Pay Rate	Average Maturity (Years)	Forward Starting
1 year or less	$ 215,900	0.4%	0.8	%
Greater than 1 year and less than 3 years	179,100	0.5	1.9	
Greater than 3 years and less than 5 years	574,200	1.3	4.4	
Greater than 5 years	1,718,650	2.4	10.8	28.6
Total	$ 2,687,850	1.9%	8.0	18.3%

The following tables summarize the average variable pay rate and average maturity for the Company s interest rate swaps as of June 30, 2014 and December 31, 2013 (excludes interest rate swaptions) (dollars in thousands):

	June 30, 2014			
Remaining Interest Rate interest rate swap Term	**Notional Amount**	**Average Variable Pay Rate**	**Average Maturity (Years)**	**Forward Starting**
Greater than 3 years and less than 5 years	$ 1,520,000	0.2%	4.9	%
Greater than 5 years	1,132,100	0.2	10.4	9.7
Total	$ 2,652,100	0.2%	7.2	4.1%

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	December 31, 2013			
Remaining Interest Rate interest rate swap Term	Notional Amount	Average Variable Pay Rate	Average Maturity (Years)	Forward Starting
Greater than 3 years and less than 5 years	$ 81,000	0.2%	4.8	%
Greater than 5 years	46,000	0.2	24.1	
Total	$ 127,000	0.2%	11.8	%

The Company s agreements with certain of its bilateral interest rate swap counterparties may be terminated at the option of the counterparty if the Company does not maintain certain equity and leverage metrics, the most restrictive of which contain provisions which become more restrictive based upon portfolio composition. Through June 30, 2014, the Company was in compliance with the terms of such financial tests.

The following tables present information about the Company s interest rate swaptions as of June 30, 2014 and December 31, 2013 (dollars in thousands):

	June 30, 2014			
	Option		Underlying Swap	
Fixed-Pay Rate for Underlying Swap	Fair Value	Weighted Average Months Until Option Expiration	Notional Amount	Weighted Average Swap Term (Years)
2.26 2.50%	$ 276	23.8	$ 105,000	1.0
3.51 3.75%	61	3.6	200,000	10.0
	$ 337	10.6	$ 305,000	6.9

	December 31, 2013			
	Option		Underlying Swap	
Fixed-Pay Rate for Underlying Swap	Fair Value	Weighted Average Months Until Option Expiration	Notional Amount	Weighted Average Swap Term (Years)
2.51 2.75%	$ 1,889	4.4	$ 150,000	7.0
2.76 3.00%	2,762	4.3	250,000	7.0
3.01 3.25%	1,192	4.6	1,500,000	10.0
3.26 3.50%	971	4.0	100,000	10.0
3.51 3.75%	4,363	9.6	200,000	10.0
	$ 11,177	5.0	$ 2,200,000	9.5

	December 31, 2013			
	Option		Underlying Swap	
Fixed-Receive Rate for Underlying Swap	Fair Value	Weighted Average Months Until Option Expiration	Notional Amount	Weighted Average Swap Term (Years)
3.76 4.00%	$ (264)	4.0	$ 100,000	10.0
	$ (264)	4.0	$ 100,000	10.0

The Company has minimum collateral posting thresholds with certain of its derivative counterparties, including with its clearing broker for cleared swaps, for which it typically pledges cash. As of June 30, 2014 and December 31, 2013, the Company had cash pledged as collateral of approximately $117.2 million and $22.8 million, respectively, which is reported on the Balance Sheet as Due from counterparties. The Company received cash of approximately $10.9 million and $62.7 as collateral against derivatives at June 30, 2014 and December 31, 2013, respectively, which is reported on the Balance Sheet as Due to counterparties. As of June 30, 2014, the Company has swaps with two counterparties that are based in England and Switzerland, with fair values in an asset position of approximately $6.4 million and $15.7 million and notional balances of $321.8 million and $825.1 million, respectively. At December 31, 2013, the Company had swaps with fair values in an asset position of $19.4 million and $34.2 million and notional balances of $321.8 million and $825.1 million with these two counterparties. Included in the $10.9 million and $62.7 million received by the Company is cash posted as collateral by these two counterparties of approximately $9.8 million and $42.7 million at June 30, 2014 and December 31, 2013, respectively.

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Currency Swaps and Forwards

The Company has invested in and, in the future, may invest in additional MBS which are denominated in a currency or currencies other than U.S. dollars. Similarly, it has and may in the future, finance such assets in a currency or currencies other than U.S. dollars. In order to mitigate the impact to the Company may enter into derivative financial instruments, including foreign currency swaps and foreign currency forwards, to manage of fluctuations in the valuation between U.S. dollars and such foreign currencies. Foreign currency swaps involve the payment of a foreign currency at fixed interest on a fixed notional amount and the receipt of U.S. dollars at a fixed interest rate on a fixed notional amount. Foreign currency forwards provide for the payment of a fixed amount of a foreign currency in exchange for a fixed amount of U.S. dollars at a date certain in the future. The carrying value of foreign currency swaps and forwards is included in Derivative assets (liabilities), at fair value on the Balance Sheet with changes in valuation included in Gain (loss) on derivative instruments, net on the Statement of Operations. The following is a summary of the Company s foreign currency forwards with a fair value in a liability position of $138 thousand at June 30, 2014:

Derivative Type	Notional Amount		Notional (USD Equivalent)	Maturity
Sell EUR/Buy USD Currency forward	11,100	$	15,199	July 2014
Buy EUR/Sell USD Currency forward	11,100	$	15,205	September 2014

The following is a summary of the Company s foreign currency swaps with a fair value of $15 thousand at June 30, 2014:

Date entered	Maturity	Fixed Rate	Denomination	Notional Amount
June 2014	July 2024	7.25%	EUR	18,500
June 2014	July 2024	9.005%	USD	25,160

Interest-Only Strips

The Company also invests in Interest-Only Strips. In determining the classification of its holdings of Interest-Only Strips, the Company evaluates the securities to determine if the nature of the cash flows has been altered from that of the underlying mortgage collateral. Generally, Interest-Only Strips for which the security represents a strip off of a mortgage pass through security will be considered a hybrid instrument classified as a MBS investment on the Balance Sheet utilizing the fair value option. Alternatively, those Interest-Only Strips, for which the underlying mortgage collateral has been included into a structured security that alters the cash flows from the underlying mortgage collateral, are accounted for as derivatives at fair value with changes recognized in Gain (loss) on derivative instruments, net in the Statement of Operations, along with any interest received. The carrying value of these Interest-Only Strips is included in Mortgage-backed securities on the Balance Sheet.

To-be-announced securities

The Company also purchased or sold TBAs. As of June 30, 2014 and December 31, 2013, the Company had contracts to purchase (long position) and sell (short position) TBAs on a forward basis. Following is a summary of the Company s long and short TBA positions reported in Derivative assets, at fair value on the Balance Sheet as of June 30, 2014 and December 31, 2013 (dollars in thousands):

	June 30, 2014		December 31, 2013	
	Notional Amount	Fair Value	Notional Amount	Fair Value
Purchase contracts, asset	$ 2,173,400	$ 8,036	$ 13,600	$ 35
Sale contracts, asset				
TBA securities, asset	2,173,400	8,036	13,600	35
Purchase contracts, liability	200,000	(863)	176,400	(1,207)
Sale contracts, liability	(1,693,000)	(5,713)		
TBA securities, liability	(1,493,000)	(6,576)	176,400	(1,207)
TBA securities, net	$ 680,400	$ 1,460	$ 190,000	$ (1,172)

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The following table presents additional information about the Company s contracts to purchase and sell TBAs for the six months ended June 30, 2014 (dollars in thousands):

	Notional Amount as of December 31, 2013	Additions	Settlement, Termination, Expiration or Exercise	Notional Amount as of June 30, 2014
Purchase of TBAs	$ 190,000	11,811,896	$ (9,628,496)	$ 2,373,400
Sale of TBAs	$	11,321,496	$ (9,628,496)	$ 1,693,000

Futures Contracts

The Company also entered into Eurodollar futures during the six months ended June 30, 2014. As of June 30, 2014, the Company had purchase contracts (long position), representing a notional amount of $592.0 million with a fair value of $437 thousand and an expiration date of June 2016. In addition, as of June 30, 2014, the Company had contracts to sell (short position), representing a notional amount of $592.0 million with a fair value in a liability position of $548 thousand and an expiration date of June 2018.

Gain (loss) on derivative instruments

The below tables summarize the effect of interest rate swaps, interest rate swaptions, foreign currency swaps, foreign currency forwards, options, futures contracts, Agency and Non-Agency Interest-Only Strips as derivatives and TBAs reported in Gain (loss) on derivative instruments, net on our Statement of Operations for the three and six months ended June 30, 2014 and 2013 (dollars in thousands):

	Three months ended June 30, 2014				
Description	Realized Gain (Loss), net	Contractual interest income (expense), net(1)	Basis Recovery	Mark-to-market adjustments	Total
Interest rate swaps	$ 15,996	$ (6,083)	$	$ (84,619)	$ (74,706)
Interest rate swaptions	(5,908)			4,333	(1,575)
Agency and Non-Agency Interest-Only Strips accounted for as derivatives	(275)	6,139	(4,507)	1,803	3,160
Futures contracts	(16,495)			(229)	(16,724)
Foreign currency forwards				(138)	(138)
Foreign currency swaps		1		15	16
TBAs	20,191			3,099	23,290
Total	$ 13,509	$ 57	$ (4,507)	$ (75,736)	$ (66,677)

	Six months ended June 30, 2014				
Description	Realized Gain (Loss), net	Contractual interest income (expense), net(1)	Basis Recovery	Mark-to-market adjustments	Total

Interest rate swaps	$ 15,998	$ (13,936)	$	$ (130,115)	$ (128,053)
Interest rate swaptions	(5,908)			(4,991)	(10,899)
Agency and Non-Agency Interest-Only Strips accounted for as derivatives	(1,144)	14,565	(10,099)	583	3,905
Futures contracts	(16,495)			(111)	(16,606)
Foreign currency forwards				(138)	(138)
Foreign currency swaps		1		15	16
TBAs	22,561			2,631	25,192
Total	$ 15,012	$ 630	$ (10,099)	$ (132,126)	$ (126,583)

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Description	Three months ended June 30, 2013 Realized Gain (Loss), net	Contractual interest income (expense), net(1)	Basis Recovery	Mark-to-market adjustments	Total
Interest rate swaps	$ 23,881	$ (5,156)	$	$ 71,202	$ 89,927
Interest rate swaptions	1,038			20,751	21,789
Agency Interest-Only Strips and Agency Inverse Interest-Only Strips accounted for as derivatives		7,032	(4,631)	3,633	6,034
Options	(925)			324	(601)
TBAs	(3,164)			(4,511)	(7,675)
Total	$ 20,830	$ 1,876	$ (4,631)	$ 91,399	$ 109,474

Description	Six months ended June 30, 2013 Realized Gain (Loss), net	Contractual interest income (expense), net(1)	Basis Recovery	Mark-to-market adjustments	Total
Interest rate swaps	$ 42,139	$ (9,738)	$	$ 73,060	$ 105,461
Interest rate swaptions	1,038			19,245	20,283
Agency Interest-Only Strips and Agency Inverse Interest-Only Strips accounted for as derivatives	(99)	12,975	(8,816)	1,285	5,345
Options	(925)				(925)
TBAs	(2,563)			(3,287)	(5,850)
Total	$ 39,590	$ 3,237	$ (8,816)	$ 90,303	$ 124,314

(1) Contractual interest income (expense), net on derivative instruments includes interest settlement paid or received.

Linked Transactions

As discussed in Note 2, when the initial transfer of a financial asset and repurchase financing are entered into contemporaneously with, or in contemplation of, one another, the transaction will be considered linked unless all of the criteria found in the applicable accounting guidance are met at the inception of the transaction. If the transaction is determined to be linked, the Company records the initial transfer and repurchase financing on a net basis and records a forward commitment to purchase assets as a derivative instrument with changes in market value being recorded in the Gain (loss) on linked transactions, net on the Statement of Operations. While linked transactions are treated as derivatives for GAAP, the fair value of linked transactions reflects the value of the underlying security s fair market value netted with the respective linked repurchase agreement borrowings.

The following tables present certain information related to the securities and repurchase agreements accounted for as part of linked transaction which is reported in Linked transactions, net, at fair value on the Balance Sheet at June 30, 2014, and Gain (loss) on linked transactions, net on the Statement of Operations for the three and six months ended June 30, 2014 and 2013 (dollars in thousands):

	For the three months ended June 30, 2014						
Instrument	Fair Value(2)	Net Interest Income(1) (Expense)	Mark-to-market adjustments on linked transactions	Net Realized Gain (loss)	Gain (loss) on linked transactions, net	Weighted Average Coupon / Cost of Funds(2)	Weighted Average Life (years)/ Weighted Average days to Maturity(2)
Non-Agency RMBS	$ 15,226	$ 246	$ 298	$	$ 544	31.10%	10.3 years
Non-Agency CMBS, including Non U.S.	25,329	5	189		194	7.25%	8.7 years
Non-Agency Repurchase Agreement	(12,282)	(49)			(49)	1.55%	17 days
CMBS Repurchase Agreement, including Non U.S.	(15,198)	(1)			(1)	2.11%	92 days
Linked transactions, net, at fair value	$ 13,075	$ 201	$ 487	$	$ 688	n/a	n/a

(1) Net interest income includes amortization of premium of approximately $509 thousand for Non-Agency RMBS and $0 for Non-Agency CMBS.

(2) Includes information only for linked transactions at June 30, 2014.

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Instrument	Fair Value(2)	Net Interest Income(1) (Expense)	Mark-to-market adjustments on linked transactions	Net Realized Gain (loss)	Gain (loss) on linked transactions, net	Weighted Average Coupon / Cost of Funds(2)	Weighted Average Life (years)/ Weighted Average days to Maturity(2)
	For the six months ended June 30, 2014						
Non-Agency RMBS	$ 15,226	$ 1,174	$ 524	$ 1,290	$ 2,988	31.10%	10.3 years
Non-Agency CMBS, including Non U.S.	25,329	5	189		194	7.25%	8.7 years
Non-Agency Repurchase Agreement	(12,282)	(274)			(274)	1.55%	17 days
CMBS Repurchase Agreement, including Non U.S.	(15,198)	(1)			(1)	2.11%	92 days
Linked transactions, net, at fair value	$ 13,075	$ 904	$ 713	$ 1,290	$ 2,907	n/a	n/a

(1) Net interest income includes amortization of premium of approximately $2.7 million for Non-Agency RMBS and $ 0 for Non-Agency CMBS.

(2) Includes information only for linked transactions at June 30, 2014.

Instrument	Fair Value(2)	Net Interest Income(1) (Expense)	Mark-to-market adjustments on linked transactions	Net Realized Gain (loss)	Gain (loss) on linked transactions, net	Weighted Average Coupon / Cost of Funds(2)	Weighted Average Life (years)/ Weighted Average days to Maturity(2)
	For the three months ended June 30, 2013						
Agency RMBS	$	$ 44	$	$ (254)	$ (210)	n/a	n/a
Non-Agency RMBS	4,933	518	(296)	4,002	4,224	0.35%	8.4 years
Agency Repurchase Agreement		(6)			(6)	n/a	n/a
Non-Agency Repurchase Agreement	(3,286)	(99)			(99)	1.70%	26 days
Linked transactions, net, at fair value	$ 1,647	$ 457	$ (296)	$ 3,748	$ 3,909	n/a	n/a

(1) Net interest income includes amortization of premium of $9 thousand for Agency RMBS and accretion of discount of $437 thousand for Non-Agency RMBS.

(2) Includes information only for linked transactions at June 30, 2013.

Instrument	Fair Value(2)	Net Interest Income(1) (Expense)	Mark-to-market adjustments on linked transactions	Net Realized Gain (loss)	Gain (loss) on linked transactions, net	Weighted Average Coupon / Cost of Funds(2)	Weighted Average Life (years)/ Weighted Average days to Maturity(2)
	For the six months ended June 30, 2013						
Agency RMBS	$	$ 44	$	$ (254)	$ (210)	n/a	n/a
Non-Agency RMBS	4,933	953	(46)	4,002	4,909	0.35%	8.4 years
Agency Repurchase Agreement		(6)			(6)	n/a	n/a
Non-Agency Repurchase Agreement	(3,286)	(188)			(188)	1.70%	26 days
Linked transactions, net, at fair value	$ 1,647	$ 803	$ (46)	$ 3,748	$ 4,505	n/a	n/a

(1) Net interest income includes amortization of premium of $9 thousand for Agency RMBS and accretion of discount of $766 thousand for Non-Agency RMBS.

(2) Includes information only for linked transactions at June 30, 2013.

At June 30, 2014, the Company pledged MBS accounted for as linked transactions with a fair value of approximately $40.6 million as collateral for the related linked repurchase agreements. The Company reduces credit risk on the majority of its derivative instruments by entering into agreements that permit the closeout and netting of transactions with the same counterparty upon occurrence of certain events.

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Note 8 Offsetting Assets and Liabilities

The following tables present information about certain assets and liabilities that are subject to master netting agreements (or similar agreements) and can potentially be offset on the Company s Balance Sheets at June 30, 2014 and December 31, 2013:

Offsetting of Derivative Assets

As of June 30, 2014

$s in thousands Description	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Balance Sheet	Net Amounts of Assets presented in the Balance Sheet	Gross Amounts Not Offset in the Balance Sheet		Net Amount
				Financial Instruments (1)	Cash Collateral Received	
Agency and Non-Agency Interest-Only Strips, accounted for as derivatives included in MBS	$ 95,562	$	$ 95,562	$ (95,562)	$	$
Derivative asset, at fair value	68,430		68,430	(30,474)	(10,761)	27,195
Linked transactions, net, at fair value	40,555	(27,480)	13,075			13,075
Total	$ 204,547	$ (27,480)	$ 177,067	$ (126,036)	$ (10,761)	$ 40,270

Offsetting of Derivative Liabilities and Repurchase agreements

As of June 30, 2014

$s in thousands Description	Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Balance Sheet	Net Amounts of Liabilities presented in the Balance Sheet	Gross Amounts Not Offset in the Balance Sheet		Net Amount
				Financial Instruments (1)	Cash Collateral Pledged(1)	
Derivative liability, at fair value(2)	$ 105,570	$	$ 105,570	$ (30,474)	$ (72,434)	$ 2,662
Repurchase Agreements(3)	4,111,248		4,111,248	(4,111,248)		

	$	4,216,818	$		$	4,216,818	$	(4,141,722)	$	(72,434)	$	2,662

(1) Amounts disclosed in the Financial Instruments column of the table above represent securities collateral pledged and derivative assets that are available to be offset against liability balances associated with repurchase agreement and derivative liabilities. Amounts disclosed in the Cash Collateral Pledged column of the table above represents amounts pledged as collateral against derivative transactions.

(2) Cash collateral pledged against the Company s derivative counterparties was approximately $117.2 million as of June 30, 2014.

(3) The fair value of securities pledged against the Company s repurchase agreements was approximately $4.6 billion as of June 30, 2014.

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Offsetting of Derivative Assets

As of December 31, 2013

$s in thousands Description	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Balance Sheet	Net Amounts of Assets presented in the Balance Sheet	Gross Amounts Not Offset in the Balance Sheet: Financial Instruments (1)	Gross Amounts Not Offset in the Balance Sheet: Cash Collateral Received	Net Amount
Agency and Non-Agency Interest-Only Strips, accounted for as derivatives included in MBS	$ 109,235	$	$ 109,235	$ (109,235)	$	$
Derivative asset, at fair value	105,826		105,826	(3,501)	(62,651)	39,674
Linked transactions, net, at fair value	79,746	(61,187)	18,559			18,559
Total	$ 294,807	$ (61,187)	$ 233,620	$ (112,736)	$ (62,651)	$ 58,233

Offsetting of Derivative Liabilities and Repurchase agreements

As of December 31, 2013

$s in thousands Description	Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Balance Sheet	Net Amounts of Liabilities presented in the Balance Sheet	Gross Amounts Not Offset in the Balance Sheet: Financial Instruments (1)	Gross Amounts Not Offset in the Balance Sheet: Cash Collateral Pledged(1)	Net Amount
Derivative liability, at fair value(2)	$ 4,673	$	$ 4,673	$ (3,501)	$	$ 1,172
Repurchase Agreements(3)	2,579,067		2,579,067	(2,579,067)		
	$ 2,583,740	$	$ 2,583,740	$ (2,582,568)	$	$ 1,172

(1) Amounts disclosed in the Financial Instruments column of the table above represent securities collateral pledged and derivative assets that are available to be offset against liability balances associated with repurchase agreement and derivative liabilities. Amounts disclosed in the Cash Collateral Pledged column of the table above represents amounts pledged as collateral against derivative transactions.

(2) Cash collateral pledged against the Company s Swaps was approximately $22.8 million as of December 31, 2013.

(3) The fair value of securities pledged against the Company s repurchase agreements was approximately $2.8 billion as of December 31, 2013.

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

Note 9 Related Party Transactions

Management Agreement

In connection with the Company s IPO in May 2012, the Company entered into a management agreement (the Management Agreement) with the Manager, which describes the services to be provided by the Manager and compensation for such services. The Manager is responsible for managing the Company s operations, including: (i) performing all of its day-to-day functions; (ii) determining investment criteria in conjunction with the board of directors; (iii) sourcing, analyzing and executing investments, asset sales and financings; (iv) performing asset management duties; and (v) performing financial and accounting management, subject to the direction and oversight of the Company s board of directors. Pursuant to the terms of the Management Agreement, the Manager is paid a management fee equal to 1.50% per annum of the Company s stockholders equity (as defined in the Management Agreement), calculated and payable (in cash) quarterly in arrears. For purposes of calculating the management fee, stockholders equity means the sum of the net proceeds from any issuances of the Company s equity securities since inception (allocated on a pro rata daily basis for such issuances during the fiscal quarter of any such issuance), plus retained earnings, calculated in accordance with GAAP, at the end of the most recently completed fiscal quarter (without taking into account any non-cash equity compensation expense incurred in current or prior periods), less any amount paid for repurchases of the Company s shares of common stock, excluding any unrealized gains, losses or other non-cash items, including OTTI charges included in other loss on MBS and other securities, unrealized gain (loss) on MBS and other securities and non-cash portion of gain (loss) on derivative instruments, that have impacted stockholder s equity as reported in the Company s financial statements prepared in accordance with GAAP, regardless of whether such items are included in other comprehensive income or loss, or in net income, and excluding one-time events pursuant to changes in GAAP and certain other non-cash charges after discussions between the Manager and the Company s independent directors and after approval by a majority of the Company s independent directors. However, if the Company s stockholders equity for any given quarter is negative based on the calculation described above, the Manager will not be entitled to receive any management fee for that quarter.

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In addition, the Company may be required to reimburse the Manager for certain expenses as described below, and shall reimburse for the compensation paid to the Company s CFO and controller. Expense reimbursements to the Manager are made in cash on a monthly basis following the end of each month. The Company s reimbursement obligation is not subject to any dollar limitation. Because the Manager s personnel perform certain legal, accounting, due diligence tasks and other services that outside professionals or outside consultants otherwise would perform, the Manager may be paid or reimbursed for the documented cost of performing such tasks, provided that such costs and reimbursements are in amounts which are no greater than those which would be payable to outside professionals or consultants engaged to perform such services pursuant to agreements negotiated on an arm s-length basis.

The Management Agreement may be amended, supplemented or modified by agreement between the Company and the Manager. The initial term of the Management Agreement expires on May 15, 2015 and it is automatically renewed for one-year terms on each anniversary thereafter unless previously terminated as described below. The Company s independent directors will review the Manager s performance and any fees payable to the Manager annually and, following the initial term, the Management Agreement may be terminated annually upon the affirmative vote of at least two-thirds of the Company s independent directors, based upon: (i) the Manager s unsatisfactory performance that is materially detrimental to the Company; or (ii) the Company s determination that any fees payable to the Manager are not fair, subject to the Manager s right to prevent such termination due to unfair fees by accepting a reduction of management fees agreed to by at least two-thirds (2/3) of the Company s independent directors. The Company will provide the Manager 180 days prior notice of any such termination. Unless terminated for cause, the Company will pay the Manager a termination fee equal to three times the average annual management fee earned by the Manager during the prior 24-month period immediately preceding the date of termination, calculated as of the end of the most recently completed fiscal quarter prior to the date of termination.

The Company may also terminate the Management Agreement at any time, including during the initial term, without the payment of any termination fee, with 30 days prior written notice from the Company s board of directors for cause, which will be determined by a majority of the Company s independent directors, which is defined as: (i) the Manager s continued material breach of any provision of the Management Agreement (including the Manager s failure to comply with the Company s investment guidelines); (ii) the Manager s fraud, misappropriation of funds, or embezzlement against the Company; (iii) the Manager s gross negligence in the performance of its duties under the Management Agreement; (iv) the occurrence of certain events with respect to the bankruptcy or insolvency of the Manager, including an order for relief in an involuntary bankruptcy case or the Manager authorizing or filing a voluntary bankruptcy petition; (v) the Manager is convicted (including a plea of nolo contendere) of a felony; or (vi) the dissolution of the Manager.

For the three and six months ended June 30, 2014, the Company incurred approximately $2.6 million and $4.4 million in management fees, respectively. For the three and six months ended June 30, 2013, the Company incurred approximately $1.8 million and $3.9 million in management fees, respectively.

In addition to the management fee, the Company is also responsible for reimbursing the Manager for certain expenses paid by the Manager on behalf of the Company and for certain services provided by the Manager to the Company. For the three and six months ended June 30, 2014, the Company recorded expenses included in general and administrative expense totaling approximately $199 thousand and $409 thousand, respectively related to employee costs and benefits associated with the Company s CFO and controller paid by the Manager on behalf of the Company. For the three and six months ended June 30, 2013, the Company recorded expenses included in general and administrative expense totaling approximately $45 thousand and $54 thousand, respectively related to employee costs and benefits associated with the Company s sole employee paid by the Manager on behalf of the Company. As of January 1, 2014, the aforementioned employee became an employee of the Manager. Accordingly, as of January 1, 2014 the Company has and will reimburse the Manager for such employee s compensation including employee benefits as well as the compensation and employee benefits of the Company s controller. Any such expenses incurred by the Manager and reimbursed by the Company, including the employee compensation expense discussed above, are typically included in the Company s general and administrative expense on its Statement of Operations, or may be reflected on the Balance Sheet and associated statement of changes in stockholders equity, based on the nature of the item. At June 30, 2014 and December 31, 2013, approximately $2.6 million and approximately $1.8 million, respectively for management fees incurred but not yet paid was included in payable to related party on the Balance Sheet. In addition, at June 30, 2014 and December 31, 2013, approximately $198 thousand and $0, respectively of costs incurred but not yet

paid was included in Payable to related party on the Balance Sheet.

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Note 10 Share-Based Payments

In conjunction with the Company s IPO and concurrent private placement, the Company s board of directors approved the Western Asset Mortgage Capital Corporation Equity Plan (the Equity Plan) and the Western Asset Manager Equity Plan (the Manager Equity Plan and collectively the Equity Incentive Plans).

On May 15, 2012, the Company granted 51,159 shares of restricted common stock to the Manager under the Manager Equity Plan that is equal to 0.5% of the aggregate number of shares of common stock sold in the IPO and units sold in the concurrent private placement to certain institutional accredited investors. One-third of these restricted shares vested on May 15, 2013, the first anniversary of the grant date, one-third vested on May 15, 2014, the second anniversary of the grant date, and the remaining one-third will vest on the third anniversary of the grant date.

On May 15, 2012, the Company granted a total of 4,500 shares (1,500 each) of restricted common stock under the Equity Plan to the Company s three independent directors. These restricted shares vested in full on May 15, 2013, the first anniversary of the grant date.

On June 25, 2012, the Company granted 10,455 shares of restricted common stock to its chief financial officer under the Equity Plan. One-third of these restricted shares vested on January 1, 2013, one-third vested on January 1, 2014 and the remaining one-third will vest on January 1, 2015. As of January 1, 2014, the Company s chief financial officer became an employee of the Manager. As such, the method for recognizing stock based compensation expense for the remaining unvested shares changed to be accounted for as a non-employee grant subject to subsequent fair value re-measurement.

On March 1, 2013, the Company granted a total of 150,000 shares of restricted common stock to the Manager under the Manager Equity Plan. One-third of these shares vested on March 1, 2014 and one third will vest on each of the second and third anniversaries of the grant date.

On March 1, 2013, the Company granted 10,559 shares of restricted common stock to its chief financial officer under the Equity Plan. One-third of these restricted shares vested on January 1, 2014, one-third will vest on January 1, 2015 and the remaining one-third will vest on January 1, 2016. As of January 1, 2014, the Company s chief financial officer became an employee of the Manager. As such, the method for recognizing stock based compensation expense for the remaining unvested shares changed to be accounted for as a non-employee grant subject to subsequent fair value re-measurement.

On June 10, 2013, the Company granted a total of 4,887 (1,629 each) of restricted common stock under the Equity Plan to the Company s three independent directors. These restricted shares vested in full on June 10, 2014, the first anniversary of the grant date. Each of the independent directors has elected to defer the shares granted to him under the Company s Director Deferred Fee Plan (the Director Deferred Fee Plan). The Director Deferred Fee Plan permits eligible members of the Company s board of directors to defer certain stock awards made under its director compensation programs. The Director Deferred Fee Plan allows directors to defer issuance of their stock awards and therefore defer payment of any tax liability until the deferral is terminated, pursuant to the election form executed each year by each eligible director.

On March 12, 2014, the Company granted 200,000 shares of restricted common stock to the Manager under the Manager Equity Plan. One-third of these shares will vest on March 1, 2015, one-third will vest on March 1, 2016 and the remaining one-third will vest on March 1, 2017.

On March 12, 2014, the Company granted 15,180 shares of restricted common stock to its chief financial officer under the Equity Plan. One-third of these shares will vest on January 1, 2015, one-third will vest on January 1, 2016 and the remaining one-third will vest on January 1, 2017. As of January 1, 2014, the Company s chief financial officer became an employee of the Manager. As such, the stock based compensation expense for the unvested shares is accounted for as a non-employee grant subject to subsequent fair value re-measurement.

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On June 11, 2014, the Company granted a total of 6,264 (2,088 each) of restricted common stock under the Equity Plan to the Company s three independent directors. These restricted shares will vest in full on June 11, 2015, the first anniversary of the grant date. Each of the independent directors has elected to defer the shares granted to him under the Company s Director Deferred Fee Plan (the Director Deferred Fee Plan). The Director Deferred Fee Plan permits eligible members of the Company s board of directors to defer certain stock awards made under its director compensation programs. The Director Deferred Fee Plan allows directors to defer issuance of their stock awards and therefore defer payment of any tax liability until the deferral is terminated, pursuant to the election form executed each year by each eligible director.

The Equity Incentive Plans include provisions for grants of restricted common stock and other equity-based awards to the Manager, its employees and employees of its affiliates and to the Company s directors, officers and employees. The Company can issue up to 3.0% of the total number of issued and outstanding shares of its common stock (on a fully diluted basis) at the time of each award (other than any shares previously issued or subject to awards made pursuant to one of the Company s Equity Incentive Plans) under these Equity Incentive Plans. At May 15, 2012, there were 308,335 shares of common stock initially reserved for issuance under the Equity Incentive Plans. Upon the completion of the October 3, 2012 follow-on common stock offering, the stock portion of the Company s dividend declared December 19, 2013, and the April 9, 2014 follow-on offering (which includes the partial exercise of the greenshoe on May 7, 2014) and private placement of common stock, the number of shares of common stock available for issuance under the Equity Incentive Plans increased to 1,237,711, inclusive of the 453,004 shares of restricted stock issued as provided above and 20,965 shares of restricted stock issued as a result of the stock portion of the dividend declared on December 19, 2013 and restricted stock attributed to dividends on restricted stock under the Director Deferred Fee Plan. The Company recognized stock-based compensation expense of approximately $479 thousand and approximately $1.1 million for the three and six months ended June 30, 2014, respectively, and approximately $251 thousand and $537 thousand for the three and six months ended June 30, 2013, respectively, and had unamortized compensation expense of $85 thousand for equity awards and approximately $5.9 million for liability awards and $565 thousand for equity awards and approximately $3.6 million for liability awards at June 30, 2014 and 2013, respectively.

All restricted common shares granted, other than those whose issuance has been deferred pursuant the Director Deferred Fee Plan, possess all incidents of ownership, including the right to receive dividends and distributions currently, and the right to vote. Dividend equivalent payments otherwise allocable to restricted common shares under the Deferred Compensation Plan are deemed to purchase additional phantom shares of the Company s common stock that are credited to each participant s deferral account. The award agreements include restrictions whereby the restricted shares cannot be sold, assigned, transferred, pledged, hypothecated or otherwise disposed of prior to the lapse of restrictions under the respective award agreement. The restrictions lapse on the unvested restricted shares awarded when vested, subject to the grantee s continuing to provide services to the Company as of the vesting date. Unvested restricted shares and rights to dividends thereon are forfeited upon termination of the grantee.

The following is a summary of restricted common stock vesting dates as of June 30, 2014 and December 31, 2013, including shares whose issuance has been deferred under the Director Deferred Fee Plan:

Vesting Date	**June 30, 2014 Shares Vesting**	**December 31, 2013 Shares Vesting**
January 2014		7,685
March 2014		54,852
May 2014		18,707
June 2014		6,279
January 2015	12,745	7,685
March 2015	121,518	54,852
May 2015	18,708	18,707
June 2015	6,264	
January 2016	8,920	3,860
March 2016	121,518	54,852
January 2017	5,060	

March 2017	66,667	
	361,400	227,479

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The following table presents information with respect to the Company s restricted stock for the six months ended June 30, 2014 including shares whose issuance has been deferred under the Director Deferred Fee Plan:

	Shares of Restricted Stock		Weighted Average Grant Date Fair Value (1)
Outstanding at beginning of period	252,517	$	20.34
Granted	221,740		16.41
Cancelled/forfeited			
Outstanding at end of year	474,257	$	18.50
Unvested at end of year	361,400	$	18.06

(1) The grant date fair value of restricted stock awards is based on the closing market price of the Company s common stock at the grant date.

Note 11 Stockholders Equity

On April 3, 2014, the Company entered into a binding agreement with a group of underwriters to sell an incremental 13.0 million shares of the Company s common stock, which closed on April 9, 2014. The agreement provided the underwriters with the right to purchase an additional 1.95 million shares (15% of 13.0 million) during the succeeding thirty (30) days. The shares were offered to the market at a price of $14.85 per share and the underwriters exercised a portion of their option and purchased an incremental 1.0 million shares on May 2, 2014, which closed on May 7, 2014. Net proceeds to the Company were approximately $205.4 million after subtracting underwriting commissions and offering expenses of approximately $2.9 million. On April 3, 2014, the Company also entered into an agreement to sell 650,000 shares of the Company s common stock, for $14.85 per share, to its Manager in a private placement for an aggregate offering price of approximately $9.7 million, which closed on April 9, 2014.

As a result of the April 3, 2014 follow-on public offering and private placement, the exercise price of each of the outstanding warrants was reduced from $17.59 to $16.70.

Note 12 Net Income (Loss) per Common Share

The table below presents basic and diluted net income (loss) per share of common stock using the two-class method for the three and six months ended June 30, 2014 and 2013 (dollars, other than shares and per share amounts, in thousands):

	For the three months ended June 30, 2014	For the three months ended June 30, 2013, Revised (1)	For the six months ended June 30, 2014	For the six months ended June 30, 2013, Revised (1)

Numerator:								
Net income (loss) attributable to common stockholders and participating securities for basic and diluted earnings per share	$	67,574	$	(27,654)	$	59,133	$	(56,153)
Less:								
Dividends and undistributed earnings allocated to participating securities		627		394		548		314
Net income (loss) allocable to common stockholders basic and diluted	$	66,947	$	(28,048)	$	58,585	$	(56,467)
Denominator:								
Weighted average common shares outstanding for basic earnings per share		39,758,681		24,092,447		33,244,860		24,086,912
Weighted average diluted shares outstanding (stock awards)								
Weighted average diluted shares outstanding (warrants)								
Weighted average common shares outstanding for diluted earnings per share		39,758,681		24,092,447		33,244,860		24,086,912
Basic earnings per common share	$	1.68	$	(1.16)	$	1.76	$	(2.34)
Diluted earnings per common share	$	1.68	$	(1.16)	$	1.76	$	(2.34)

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(1) The Company identified an error relating to Basic and Diluted Net Loss per share amounts of $1.14 and $2.32 for the three and six months ended June 30, 2013, respectively, as previously reported in the June 30, 2013 Form 10-Q. The error understated Basic and Diluted Net Loss per share by $0.02 per share. Management evaluated the impact of the error on the previously reported financial statements and concluded the impact was not material to the financial statements for the three and six month periods ended June 30, 2013 taken as a whole. However, Management has elected to revise the per share amounts to correct for the impact of this error and the revised amounts of $1.16 and $2.34 per share are reflected above for the three and six months ended June 30, 2013, respectively. In addition, the Company reported the revised per share amounts in the 2013 Form 10-K previously filed.

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The following potential common shares discussed herein, which are securities or other contracts that may entitle its holder to obtain common shares, were excluded from diluted earnings per share for the three and six months ended June 30, 2013, since the Company had a net loss for the period and their inclusion would have been anti-dilutive: 56,770 and 89,351 related to warrants, and 12,207 and 11,832 related to stock awards, respectively.

Note 13 Income Taxes

Based on the Company s analysis of any potential uncertain income tax positions, the Company concluded that it does not have any uncertain tax positions that meet the recognition or measurement criteria as of June 30, 2014. The Company files U.S. federal and state income tax returns. As of June 30, 2014, tax returns filed by the Company for 2012 are open for examination pursuant to relevant statutes of limitation. In the event that the Company incurs income tax related interest and penalties, the Company s policy is to classify them as a component of its provision for income taxes.

Note 14 Contingencies

From time to time, the Company may become involved in various claims and legal actions arising in the ordinary course of business. Management is not aware of any material contingencies at June 30, 2014.

Note 15 Subsequent Events

On July 29, 2014, the Company formed a wholly owned subsidiary Western Asset Mortgage TRS, LLC, a taxable REIT subsidiary which was formed under Delaware law. The Company intends to utilize this entity to make certain investments which it otherwise would be prohibited from doing so.

On July 31, 2014, Board of Directors has authorized the repurchase of up to 2,050,000 shares of its common stock through December 31, 2015. Purchases made pursuant to the program will be made in the open market, in privately negotiated transactions, or pursuant to any trading plan that may be adopted in accordance with Rules 10b5-1 and 10b-18 of the Securities and Exchange Commission. The authorization does not obligate the Company to acquire any particular amount of common shares and the program may be suspended or discontinued at the Company s discretion without prior notice. The timing, manner, price and amount of any repurchases will be determined by the Company in its discretion and will be subject to economic and market conditions, stock price, applicable legal requirements and other factors. The Company has not yet entered into definitive agreements to utilize the authorization and, accordingly, has not repurchased any shares of common stock pursuant to the authorization as of the date hereof.

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

FORWARD-LOOKING INFORMATION

The Company makes forward-looking statements herein and will make forward-looking statements in future filings with the Securities and Exchange Commission (the SEC), press releases or other written or oral communications within the meaning of Section 27A of the Securities Act of 1933, as amended (the Securities Act), and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). For these statements, the Company claims the protections of the safe harbor for forward-looking statements contained in such sections. Forward-looking statements are subject to substantial risks and uncertainties, many of which are difficult to predict and are generally beyond the Company s control. These forward-looking statements include information about possible or assumed future results of the Company s business, financial condition, liquidity, results of operations, plans and objectives. When the Company uses the words believe, expect, anticipate, estimate, plan, continue, intend, should, may or similar expressions, the Company intends to identify forward-looking statements. Statem regarding the following subjects, among others, may be forward-looking: market trends in the Company s industry, interest rates, real estate values, the debt securities markets, the U.S. housing and the U.S. and foreign commercial real estate markets or the general economy or the demand for residential and/or commercial mortgage loans; the Company s business and investment strategy; the Company s projected operating results; actions and initiatives of the U.S. Government and changes to U.S. Government policies and the execution and impact of these actions, initiatives and policies; the state of the U.S. and, to a lesser extent, international economy generally or in specific geographic regions; economic trends and economic recoveries; the Company s ability to obtain and maintain financing arrangements, including securitizations; the current potential return dynamics available in residential mortgage-backed securities (RMBS) and commercial mortgage-backed securities (CMBS and collectively with RMBS, MBS); the level of government involvement in the U.S. mortgage market; the anticipated default rates on Agency and Non-Agency MBS (as defined herein); the loss severity on Non-Agency MBS; the return of the Non-Agency RMBS CMBS and asset-backed securities (ABS) securitization markets; the general volatility of the securities markets in which the Company participates; changes in the value of the Company s assets; the Company s expected portfolio of assets; the Company s expected investment and underwriting process; interest rate mismatches between the Company s target assets and any borrowings used to fund such assets; changes in interest rates and the market value of the Company s target assets; changes in prepayment rates on the Company s target assets; effects of hedging instruments on the Company s target assets; rates of default or decreased recovery rates on the Company s target assets; the degree to which the Company s hedging strategies may or may not protect the Company from interest rate volatility; the impact of and changes in governmental regulations, tax law and rates, accounting guidance and similar matters; the Company s ability to maintain the Company s qualification as a real estate investment trust for U.S. federal income tax purposes; the Company s ability to maintain its exemption from registration under the Investment Company Act of 1940, as amended (the 1940 Act); the availability of opportunities to acquire Agency RMBS, Non-Agency RMBS, CMBS, residential and/or commercial mortgage loans and other mortgage assets; the availability of opportunities to acquire ABS (as defined herein); the availability of qualified personnel; estimates relating to the Company s ability to make distributions to its stockholders in the future; and the Company s understanding of its competition.

The forward-looking statements are based on the Company s beliefs, assumptions and expectations of its future performance, taking into account all information currently available to it. Forward-looking statements are not predictions of future events. These beliefs, assumptions and expectations can change as a result of many possible events or factors, not all of which are known to the Company. Some of these factors are described in Item 1A - Risk Factors in the Company s annual report on Form 10-K for the year ended December 31, 2013, as filed on March 17, 2014 with the SEC. These and other risks, uncertainties and factors, including those described in the annual, quarterly and current reports that the Company files with the SEC, could cause its actual results to differ materially from those included in any forward-looking statements the Company makes. All forward-looking statements speak only as of the date they are made. New risks and uncertainties arise over time and it is not possible to predict those events or how they may affect the Company. Except as required by law, the Company is not obligated to, and does not intend to, update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

The following discussion should be read in conjunction with the Company s financial statements and the accompanying notes to the Company s financial statements, which are included in Item 1 of this Quarterly Report on Form 10-Q, as well as the information contained in the Company s

annual report on Form 10-K for the year ended December 31, 2013, as filed on March 17, 2014 with the SEC.

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Overview

Western Asset Mortgage Capital Corporation (the Company unless otherwise indicated or except where the context otherwise requires we , us or our) upon commencing operations in May 2012, had an initial investment strategy which was primarily focused on investing in, financing and managing Agency RMBS (including TBA contracts as defined herein). Over time, we have expanded our investment strategy to include both Non-Agency RMBS and subsequently Agency and Non-Agency CMBS, In addition, and to a significantly lesser extent, we have invested in other securities including certain Agency obligations that are not technically MBS and are currently evaluating investments in ABS. Our Manager (as defined herein) is also actively pursuing investing in whole loans or whole securities as set forth in more detail below. These changes in our investment strategy, including future changes, are based on our Manager s perspective of which mix of portfolio assets it believes provide us with the best risk-reward opportunities at any given time. We have and expect to continue to finance our investment portfolio primarily through the use of repurchase agreements.

We operate and elected to be taxed as a real estate investment trust (REIT), commencing with our taxable year ended December 31, 2012. We generally will not be subject to U.S. federal income taxes on our taxable income to the extent that we annually distribute, in accordance with the REIT regulations, all of our net taxable income to stockholders and maintain our intended qualification as a REIT. We also intend to operate our business in a manner that will permit us to maintain our exemption from registration under the 1940 Act.

We are externally managed and advised by Western Asset Management Company (WAM , or the Manager), an SEC-registered investment advisor and a wholly-owned subsidiary of Legg Mason, Inc. Our Manager is responsible for administering our business activities and our day-to-day operations, subject to the supervision of our board of directors.

In light of the aforementioned developments and given our Manager s current market outlook and investment view, while we expect that Agency RMBS will continue to be a significant part of our portfolio, Agency RMBS will not necessarily be our primary investment in the future. Going forward, our Manager may vary the allocation among various asset classes subject to maintaining our qualification as a REIT under the federal tax law and maintaining our exemption from the 1940 Act. These restrictions limit our ability to invest in non-real estate assets and/or assets which are not secured by real estate. Accordingly, our portfolio will continue to be principally invested in MBS.

On April 3, 2014, we entered into a binding agreement with a group of underwriters to sell an incremental 13.0 million shares of our common stock, which closed on April 9, 2014. The agreement provided the underwriters with the right to purchase an additional 1.95 million shares (15% of 13.0 million) during the succeeding thirty (30) days. The shares were offered to the market at a price of $14.85 per share and the underwriters exercised a portion of their option and purchased an incremental 1.0 million shares on May 2, 2014, which closed on May 7, 2014. We received net proceeds of approximately $205.4 million after subtracting underwriting commissions and offering expenses of approximately $2.9 million. On April 3, 2014, we also entered into an agreement to sell 650,000 shares of our common stock, for $14.85 per share, to our Manager in a private placement for an aggregate offering price of approximately $9.7 million, which closed on April 9, 2014.

We have invested the proceeds of our IPO, concurrent private placements and follow-on public offerings primarily in Agency RMBS, including Mortgage pass-through certificates, Agency derivatives, Agency Interest-Only Strips, and Agency CMOs, Non-Agency RMBS as well as Agency and Non-Agency CMBS and Non U.S. CMBS. We have also used to-be-announced forward contracts, or TBAs, in order to invest in Agency RMBS. Pursuant to these TBAs, we agree to purchase, for future delivery, Agency RMBS with certain principal and interest terms. At June 30, 2014, our portfolio was comprised of approximately $3.5 billion of Agency RMBS, approximately $757.2 million of Non-Agency RMBS, approximately $39.2 million of Agency CMBS, approximately $392.1 million of Non-Agency CMBS and approximately $33.8 million

of other securities, exclusive of linked transactions. In addition, at June 30, 2014, our linked transactions included approximately $15.2 million of Non-Agency MBS and approximately $25.3 million of Non U.S. CMBS.

We use leverage, currently comprised of borrowings under repurchase agreements, as part of our business strategy in order to increase potential returns to stockholders. We accomplish this by borrowing against existing MBS and other securities through repurchase agreements. There are no limits on the maximum amount of leverage that we may use, and we are not required to maintain any particular debt-to-equity leverage ratio under our charter. We may also change our financing strategy and leverage without the consent of stockholders.

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As of June 30, 2014, we had entered into master repurchase agreements with 22 counterparties. As of June 30, 2014, we had approximately $4.1 billion of borrowings, including borrowing on linked transactions, outstanding under our repurchase agreements collateralized by approximately $4.7 billion of MBS and other securities. The balance outstanding at June 30, 2014 includes approximately $27.5 million related to linked transactions collateralized by approximately $40.6 million of MBS. We have entered into swaps to effectively fix the interest rate of our borrowings (for the life of the swap); net of variable-rate payment swaps, of approximately $2.9 billion of borrowings under our repurchase agreements, excluding forward starting swaps of $1.3 billion. In addition, as of June 30, 2014, we also owned swaptions on approximately an incremental $305.0 million of borrowings. As of June 30, 2014, our aggregate debt-to-equity ratio was approximately 6.5 to 1, including repurchase agreements on linked transactions and 6.4 to 1, excluding repurchase agreements on linked transactions.

Recent Market Conditions and Strategy

Our business is affected by general U.S. residential real estate fundamentals, domestic and foreign commercial real estate fundamentals and the overall U.S. and, to a lesser extent, international economic environment. In particular, our strategy is influenced by the specific characteristics of these markets, including but not limited to, prepayment rates and interest rate levels. We expect the results of our operations to be affected by various factors, many of which are beyond our control. Our results of operations will primarily depend on, among other things, the level of our net interest income, the market value of our investment portfolio and the supply of and demand for mortgage-related securities. Our net interest income, which includes the amortization of purchase premiums and accretion of discounts, will vary primarily as a result of changes in interest rates, borrowing costs, and prepayment speeds on our MBS investments. Similarly, the overall value of our MBS investment portfolio will be impacted by these factors as well as changes in the value of residential and commercial real estate and continuing regulatory changes.

The current economic and market outlook are shaped in a significant manner by the unprecedented level of fiscal and monetary stimulus that the U.S. Government and U.S. Federal Reserve Board provided in the aftermath of the 2007-2010 financial crisis. The current rate environment is characterized by a steep yield curve with the spread between two-year U.S. Treasury Notes and ten-year U.S. Treasury Notes well above the average spread over the last three decades. The U.S. Federal Reserve Board has maintained a near-zero target for the federal funds rate, and has reiterated its commitment to fulfilling its mandate to promote higher growth and lower unemployment and to maintain price stability in the U.S. economy. On July 30, 2014, the U.S. Federal Reserve Board reaffirmed its view that a highly accommodative stance of monetary policy remains appropriate.

Notwithstanding economic data which suggests continued improvement in the U.S. economy and the Federal Reserve s indication in the minutes to its June 17-18 Open Market Committee Meeting that it anticipates completing its reduction in open market security purchases following its October 2014 meeting, it is our Manager s view that the significant mortgage debt burden, run-off of fiscal stimulus and budget discipline at both the U.S. federal and state level will serve as an impediment to real GDP and employment growth throughout the remainder of 2014 and well into 2015. Real gross domestic product (GDP) is estimated to have declined sharply in the first quarter of 2014, but rebounded in the second quarter of 2014. Nevertheless, the housing sector continues to struggle and recent headline inflation data remains relatively benign. In this slow growth environment it is the Manager s prospective that credit related securities provide us with attractive risk adjusted opportunities. Accordingly, we believe core rates will be range bound with slow inflation. For these reasons, and considering its dual mandate to manage both inflation and unemployment, we believe that the U.S. Federal Reserve Board will continue its accommodative monetary policy now in effect. U.S. Federal Reserve Chair Yellen affirmed this position during her Semi-annual Monetary Policy Report to Congress in July 2014, stating that she expected that highly accommodative monetary policy would remain appropriate for a considerable time after the asset purchases end, especially if projected inflation continues below the Federal Reserve s stated long run goal of 2%. Despite the recent decline in the unemployment rate to 6.1%, Ms. Yellen expressed continuing concern regarding the overall health of the labor market. She pointed out that the unemployment rate remains above the Federal Reserve s expected longer-run normal level and stated, Labor force participation appears weaker than one would expect based on the aging of the population and the level of unemployment. These and other indications that significant slack remains in labor markets are corroborated by the continued slow pace of growth in most measures of hourly compensation . While the yield curve did flatten during the second quarter of 2014, we expect that, on a historical basis, the yield curve will remain relatively steep and interest rates will remain range bound due to the continuing muted recovery. Barring any system shocks to the capital markets, this should provide for

continued strong demand for mortgage securities.

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As the capital markets have recovered, commercial banks have re-entered the secured lending market, which has quickened the pace of asset recovery, and the return to more normalized credit spreads. Financing of Agency and Non-Agency RMBS as well as Agency and Non-Agency CMBS is currently widely available through, among other vehicles, repurchase agreements. Haircuts, or the discount attributed to the value of securities sold under repurchase agreements, range from a low of 3.0% to a high of 5.0% for Agency RMBS, depending on the specific security used as collateral for such repurchase agreements, while haircuts for IOs and IIOs can be as high as 25.0% and haircuts for Non-Agency RMBS and Agency and Non-Agency CMBS range from a low of 10.0% to a high of 45.0%. Even during last year s market volatility, such financing remained readily available. Notwithstanding the foregoing, such financing may not be as readily available in the future as a result of the increased regulatory capital requirements under the Dodd-Frank Act and Basel III.

In response to the financial crisis, the U.S. government, through the FHA, the Federal Deposit Insurance Corporation, or FDIC, and the U.S. Treasury, has commenced or proposed implementation of programs designed to provide homeowners with assistance in avoiding residential mortgage loan foreclosures. These loan modification and refinance programs, future U.S. federal, state and/or local legislative or regulatory actions that result in the modification of outstanding mortgage loans, as well as changes in the requirements necessary to qualify for refinancing mortgage loans with FNMA, FHLMC or GNMA, may adversely affect the value of, and the returns on, residential mortgage loans, RMBS, real estate-related securities and various other asset classes in which we may invest. In addition to the foregoing, the U.S. Congress and/or various states and local legislators may enact additional legislation or regulatory action, such as the recently enacted qualifying mortgage requirements under the Dodd-Frank Act, to address the current economic crisis or for other purposes that could have a material adverse effect on our ability to execute our business strategies. In particular, we believe that while the recently enacted qualifying mortgage requirements under the Dodd-Frank Act may present an opportunity to acquire and securitized certain non-qualifying or Non-QM mortgages, it is likely to reduce the overall production of new mortgages, thereby negatively impacting the general supply of MBS.

On January 4, 2012, the U.S. Federal Reserve Board released a report titled *The U.S. Housing Market: Current Conditions and Policy Considerations* to Congress providing a framework for thinking about certain issues and tradeoffs that policy makers might consider. In March 2014, Senate Banking Committee Chairman Tim Johnson and Ranking Member Mike Crapo announced an agreement on their own version of GSE reform which would eventually replace FNMA and FHLMC with a new system. It is unclear how future legislation may impact the housing finance market and the investing environment for agency securities as the method of reform is undecided and has not yet been defined by the regulators.

Our Investment Strategy

Our Manager s investment philosophy, which developed from a singular focus in fixed-income asset management over a variety of credit cycles and conditions, is to provide clients with diversified, tightly controlled, long-term value-oriented portfolios. Through rigorous analysis of all sectors of the fixed-income market, our Manager seeks to identify assets with the greatest risk-adjusted total value potential. In making investment decisions on our behalf, our Manager incorporates its views on the economic environment and the outlook for the mortgage markets, including relative valuation, supply and demand trends, the level of interest rates, the shape of the yield curve, prepayment rates, financing and liquidity, commercial and residential real estate prices, delinquencies, default rates, recovery of various segments of the economy and vintage of collateral, subject to maintaining our REIT qualification and our exemption from registration under the 1940 Act. We benefit from the breadth and depth of our Manager s overall investment philosophy, which focuses on a macroeconomic analysis as well as an in-depth analysis of individual assets and their relative value.

We rely on our Manager s expertise in asset allocation and identifying attractive assets within our investment strategy. At the time of our IPO, our core investment strategy was focused primarily on Agency RMBS. Our Manager s expertise in related investment disciplines such as Non-Agency RMBS, CMBS, and ABS has provided us with the ability to expand our investment portfolio to include Non-Agency RMBS, Agency and Non-Agency CMBS, Non U.S. CMBS and other structured securities, as well as, providing valuable investment insights to our

Agency RMBS investment selection and strategy.

We currently purchase and sell Agency (including TBAs) and Non-Agency RMBS, Agency and Non-Agency CMBS, Non U.S. CMBS as well as other structured securities. Currently, our Manager expects to expand our purchase of Non-Agency RMBS, Agency and Non-Agency CMBS and Non U.S. CMBS as well as commence investing in whole loans or whole loan securities and ABS. We do not have specific investment guidelines providing for precise minimum or maximum allocations to any sector other than those necessary for our qualification as a REIT and exemption from the 1940 Act. Our Manager has not and does not expect to purchase securities on our behalf with a view to selling them shortly after purchase. However, in order to maximize returns and manage portfolio risk while remaining opportunistic, we may dispose of securities earlier than anticipated or hold securities longer than anticipated depending upon prevailing market conditions, credit performance, availability of leverage or other factors regarding a particular security or our capital position.

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Our Target Assets

We have invested the proceeds of our IPO, concurrent private placements and follow-on public offerings and expect to continue to focus on investing in the following types of securities:

Agency RMBS - Agency RMBS, which are RMBS for which the principal and interest payments are guaranteed by a U.S. Government agency, such as Government National Mortgage Association (GNMA), or a U.S. Government-sponsored entity, such as Federal National Mortgage Association (FNMA) or Federal Home Loan Mortgage Corporation (FHLMC). The Agency RMBS we acquire can be secured by fixed-rate mortgages, adjustable-rate mortgages or hybrid adjustable-rate mortgages. Fixed-rate mortgages have interest rates that are fixed for the term of the loan and do not adjust. The interest rates on adjustable-rate mortgages generally adjust annually (although some may adjust more frequently) to an increment over a specified interest rate index. Hybrid adjustable-rate mortgages have interest rates that are fixed for a specified period of time (typically three, five, seven or ten years) and, thereafter, adjust to an increment over a specified interest rate index. Adjustable-rate mortgages and hybrid adjustable-rate mortgages generally have periodic and lifetime constraints on the amount by which the loan interest rate can change on any predetermined interest rate reset date. As of June 30, 2014, all of our Agency RMBS are secured by fixed-rate mortgages.

Mortgage pass-through certificates. - Mortgage pass-through certificates are securities representing interests in pools of mortgage loans secured by residential real property where payments of both interest and scheduled principal, plus pre-paid principal, on the securities are made monthly to holders of the securities, in effect passing through monthly payments made by the individual borrowers on the mortgage loans that underlie the securities, net of fees paid to the issuer/guarantor of the securities and servicers of the underlying mortgages.

Interest-Only Strips or IOs. - This type of security only entitles the holder to interest payments. The yield to maturity of Interest-Only Strips is extremely sensitive to the rate of principal payments (particularly prepayments) on the underlying pool of mortgages. We invest in these types of securities primarily to take advantage of particularly attractive prepayment-related or structural opportunities in the MBS markets, as well as to help manage the duration of our overall portfolio.

Inverse Interest-Only Strips or IIOs. - This type of security has a coupon with an inverse relationship to its index and is subject to caps and floors. Inverse Interest-Only MBS entitles the holder to interest only payments based on a notional principal balance, which is typically equal to a fixed rate of interest on the notional principal balance less a floating rate of interest on the notional principal balance that adjusts according to an index subject to set minimum and maximum rates. The current yield of Inverse Interest-Only MBS will generally decrease when its related index rate increases and increase when its related index rate decreases.

Principal-Only Strips. This type of security generally only entitles the holder to receive cash flows that are derived from principal repayments of an underlying loan pool, but in the case of Non-Agency Principal-Only Strips will also include cash flows from default recoveries and excess interest. The yield to maturity of Principal-Only Strips is extremely sensitive to the rate of principal payments (particularly prepayments) on the underlying pool of mortgages. We invest in these types of securities primarily to take advantage of structural opportunities in the MBS markets.

TBAs. - We may utilize TBAs, in order to invest in Agency RMBS. Pursuant to these TBAs, we would agree to purchase (or deliver), for future settlement, Agency RMBS with certain principal and interest terms and certain types of underlying collateral, but the particular Agency RMBS to be delivered would not be identified until shortly before the TBA settlement date. Our ability to purchase Agency RMBS through TBAs may

be limited by the 75% income and asset tests applicable to REITs.

Collateralized Mortgage Obligations or CMOs. - CMOs are securities that are structured from residential and/or commercial pass-through certificates, which receive monthly payments of principal and interest. CMOs divide the cash flows which come from the underlying mortgage pass-through certificates into different classes of securities that may have different maturities and different weighted average lives than the underlying pass-through certificates.

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Non-Agency RMBS. - RMBS that are not guaranteed by a U.S. Government agency or U.S. Government-sponsored entity, with an emphasis on securities that when originally issued were rated in the highest rating category by one or more of the nationally recognized statistical rating organizations.

The mortgage loan collateral for Non-Agency RMBS consists of residential mortgage loans that do not generally conform to underwriting guidelines issued by a U.S. Government agency or U.S. Government-sponsored entity due to certain factors, including mortgage balances in excess of agency underwriting guidelines, borrower characteristics, loan characteristics and level of documentation, and therefore are not issued or guaranteed by a U.S. Government agency or U.S. Government-sponsored entity. The mortgage loan collateral may be classified as subprime, Alternative-A or prime depending on the borrower s credit rating and the underlying level of documentation. Non-Agency RMBS may be secured by fixed-rate mortgages, adjustable-rate mortgages or hybrid adjustable-rate mortgages.

Agency CMBS. - We may also invest in fixed and floating rate commercial mortgage-backed securities, or CMBS, for which the principal and interest payments are guaranteed by a U.S. Government agency or U.S. Government-sponsored entity, but for which the underlying mortgage loans are secured by real property other than single family residences. These may include, but are not limited to Fannie Mae DUS (Delegated Underwriting and Servicing) MBS, Freddie Mac Multifamily Mortgage Participation Certificates and Ginnie Mae project loan pools, and/or CMOs structured from such collateral.

Non-Agency CMBS. - Fixed and floating rate CMBS for which the principal and interest payments are not guaranteed by a U.S. Government agency or U.S. Government-sponsored entity. To date, our primary emphasis has been on legacy securities that when originally issued were rated in the highest rating category by one or more of the nationally recognized statistical rating organizations but we have also invested in subordinated classes for which the property securing the underlying mortgage collateral is located within the U.S. We do not have an established a minimum current rating requirement for such investments.

Non U.S. CMBS. - As of June 30, 2014, we have made an investment in a security secured by commercial real estate outside of the U.S. and may make additional such investments in the future. Although our Manager believes that these investments can provide attractive risk-reward opportunities and offer additional asset diversification, investing in international real estate has a number of additional risks, including but not limited to currency risk, political risk and the legal risk of investing in jurisdiction(s) with varying laws and regulations and potential tax implications. See Item 3: Quantitative and Qualitative Disclosures about Market Risk Foreign Investment Risk and Currency Risk herein.

Agency and Non-Agency CMBS IO and IIO Securities. Interest-Only and Inverse Interest-Only securities for which the underlying collateral is commercial mortgages the principal and interest on which may or may not be guaranteed by a U.S Government agency or U.S. Government-sponsored entity. Unlike single family residential mortgages in which the borrower, generally, can prepay at any time, commercial mortgages frequently limit the ability of the borrower to prepay, thereby providing a certain level of prepayment protection. Common restrictions include yield maintenance and prepayment penalties, the proceeds of which are generally at least partially allocable to these securities, as well as defeasance.

Risk Sharing Securities Issued by Fannie Mae and Freddie Mac. - From time to time we have and may in the future continue to invest in risk sharing securities issued by Fannie Mae and Freddie Mac. Principal and interest payments on these securities are based on the performance of a specified pool of Agency residential mortgages but the securities are not secured by the referenced mortgages, but by the full faith and credit of Fannie Mae or Freddie Mac, respectively. Accordingly, our ability to invest these securities will be limited by the 75% income and asset tests applicable to REITs as such securities are not considered real assets and therefore the income generated by these securities is not real estate

income.

Historically, our primary investment strategy focused on Agency RMBS. As discussed above, we continue to increase the portion of our portfolio allocated to Non-Agency RMBS and Agency and Non-Agency CMBS and in the future are likely to expand our investments in these securities as well as residential and commercial whole-loans which are described below. In addition, we may also invest in asset-backed securities or ABS which are also described below. The allocation to Non-Agency RMBS, Agency and Non-Agency CMBS, residential and commercial whole-loans and ABS may vary from time to time based on market conditions.

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Residential and commercial whole-loans. - We may in the future invest in or seek to gain exposure to whole loan mortgages, secured by both single family residential and/or commercial properties. In this regard, our Manager is actively working on a number of potential whole loan programs involving RMBS. As currently contemplated, this program would involve investing in structured Non-Agency RMBS programs crafted specifically for us, although it is possible that we could hold mortgage loans directly at some point. In addition to holding these instruments for investment, our Manager is also working to provide us with the ability to invest in or acquire whole-loans directly or gain exposure to whole-loans through investments in structured programs with the intention of securitizing the whole-loans in the future, selling the investment grade portion of the securitized structure and retaining the residual portion Although our expectation is that we will begin to make at least a limited amount of these investments in the near future, adding these instruments to our target assets involves complex investment, structural, regulatory and accounting issues and there can be no assurance that we will in fact expand our target assets to include whole loans or, if we do, in what form and to what extent we will do so.

ABS. - Debt and/or equity tranches of securitizations backed by various asset classes including, but not limited to, aircrafts, automobiles, credit cards, equipment, franchises, recreational vehicles and student loans. Investments in ABS generally are not qualifying assets for purposes of the 75% asset test applicable to REITs and generally do not generate qualifying income for purposes of the 75% income test applicable to REITs. As a result, we may be limited in our ability to invest in such assets.

Other investments. - In addition to MBS, our principal investment, and ABS from time to time, we may also make other investments in securities which our Manager believes will assist us in meeting our investment objective and are consistent with our overall investment policies. Consistent with our ABS investments, these investments will normally be limited by the REIT requirements that 75% our assets be real estate assets and that 75% of our income be generated from real estate, thereby limiting our ability to invest in such assets.

As of June 30, 2014, the fair value of our investment portfolio was comprised of 73.9% of Agency RMBS, 16.2% of Non-Agency RMBS, 0.8% of Agency CMBS, 8.4% of Non-Agency CMBS and 0.7% of other securities, excluding linked transactions. As of June 30, 2014, the fair value of our investment portfolio was comprised of 73.2% of Agency RMBS, 16.4% of Non-Agency RMBS, 0.8% of Agency CMBS, 8.9% of Non-Agency CMBS and 0.7% of other securities, including linked transactions which includes $25.3 million (or less than 1% of the fair value of our investment portfolio) of Non-Agency CMBS the underlying mortgage collateral of which is secured by real property located outside of the United States.

Our Financing Strategy

The leverage that we employ is specific to each asset class and is determined based on several factors, including potential asset price volatility, margin requirements, the current cycle for interest rates, the shape of the yield curve, the outlook for interest rates and our ability to use and the effectiveness of interest rate hedges. We analyze both historical volatility and market-driven implied volatility for each asset class in order to determine potential asset price volatility. Our leverage targets attempt to risk-adjust asset classes based on each asset class s potential price volatility. The goal of our leverage strategy is to ensure that, at all times, our investment portfolio s overall leverage ratio is appropriate for the level of risk inherent in the investment portfolio.

We may fund the acquisition of our assets through the use of leverage from a number of financing sources, subject to maintaining our qualification as a REIT. We finance purchases of MBS and our other securities primarily through the use of repurchase agreements.

Our operating results depend in large part on differences between the income earned on our assets and our cost of borrowing and hedging activities. We use leverage to increase potential returns to our stockholders. We currently accomplish this by borrowing against existing assets through repurchase agreements. Our investment policies place no limits on the maximum amount of leverage that we may use, and we are not required to maintain any particular debt-to-equity leverage ratio under our charter. We may also change our financing strategy and leverage without the consent of our stockholders.

The costs associated with our borrowings are generally based on prevailing market interest rates. During a period of rising interest rates, our borrowing costs generally will increase while the yields earned on our existing portfolio of leveraged fixed-rate MBS will remain static. This could result in a decline in our net interest spread and net interest margin. The severity of any such decline would depend on our asset/liability composition at the time, as well as the magnitude and duration of the interest rate increase. Further, an increase in short-term interest rates could also have a negative impact on the market value of our assets. If either of these events happens, we could experience a decrease in net income or incur a net loss during these periods, which could adversely affect our liquidity and results of operations.

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We expect to maintain a debt to equity ratio of six to ten times the amount of our stockholders equity, although there is no minimum or maximum leverage that our investment policies explicitly require. To the extent the Agency percentage of our portfolio decreases, our overall leverage is likely to decrease. Depending on the different cost of borrowing funds at different maturities, we will vary the maturities of our borrowed funds to attempt to produce lower borrowing costs and reduce interest rate risk. We enter into collateralized borrowings only with institutions that are rated investment grade by at least one nationally-recognized statistical rating organization. We rely on financing to acquire, on a leveraged basis, assets in which we invest. If market conditions deteriorate, our lenders may exit the repurchase market, and tighten lending standards, or increase the amount of equity capital required to obtain financing making it more difficult and costly for us to obtain financing.

For the three and six months ended June 30, 2014, we financed our MBS with repurchase agreements, on a debt-to-equity basis, ranging from approximately six to eight times leverage calculated at each month-end. In the future, we may, however, be limited or restricted in the amount of leverage we may employ by the terms and provisions of any financing or other agreements, and may be subject to margin calls as a result of our financing activity. We had an aggregate debt-to-equity ratio, related to our repurchase agreements of approximately 6.5 to 1, including repurchase agreements on linked transactions, and 6.4 to 1, excluding repurchase agreements on linked transactions at June 30, 2014. Our debt-to-equity ratio is computed by dividing repurchase borrowings by total stockholders equity.

We finance MBS with repurchase agreement financing with maturities ranging from one to three months, but in some cases longer. At June 30, 2014, we had entered into master repurchase agreements with 22 counterparties. We had approximately $4.1 billion outstanding under our repurchase agreements, including repurchase agreements accounted for as part of linked transactions at June 30, 2014. The balance outstanding at June 30, 2014 includes approximately $27.5 million related to linked transactions.

Our Hedging Strategy

Subject to maintaining our qualification as a REIT for U.S. federal income purposes, we pursue various economic hedging strategies to seek to reduce our exposure to adverse changes in interest rates and, to a much more limited extent, foreign currency. The U.S. federal income tax rules applicable to REITs may require us to implement certain of these techniques through a domestic taxable REIT subsidiary (TRS) that is fully subject to federal corporate income taxation. As of June 30, 2014 we do not utilize a domestic TRS, although we may consider doing so in future. Our hedging activity varies in scope based on the level and volatility of interest rates, the type of assets held, including currency denomination, and other changing market conditions. As of June 30, 2014, the vast majority of swaps we entered into are designed to mitigate the effects of increases in interest rates under a portion of our repurchase agreements. These swaps generally provide for fixed interest rates indexed off of the London interbank offered rate or LIBOR and effectively fix the floating interest rates. Notwithstanding the foregoing, in order to manage our hedge position with regard to our liabilities, we on occasion will enter into interest rate swaps which involve the receipt of fixed-rate amounts from a counterparty in exchange for us making variable-rate payments over the life of the interest rate swap without exchange of the underlying notional amount. As of June 30, 2014, we effectively fixed the floating interest rates on approximately $2.9 billion of borrowings under our repurchase agreements, net of variable-rate payment swaps. We also entered into forward starting swaps of $1.3 billion. We utilize forward starting swaps and swaptions for several reasons including replacing expiring swaps, in anticipation of increasing our overall financing and reducing our exposure to future interest rate increases. Interest rate swaptions provide us the option to enter into an interest rate swap agreement for a predetermined notional amount, stated term and pay and receive interest rates in the future. As of June 30, 2014, we owned swaptions on approximately an incremental $305.0 million of borrowings. As of June 30, 2014, we also entered into a foreign currency swap, agreeing to pay a fixed amount of euros in exchange a fixed amount of U.S. dollars as well as 90 day currency forward. We entered into the currency swap and currency forward in order to hedge our exposure to foreign currency with respect to a $25.3 million (18.5 million) CMBS investment and the corresponding repurchase financing utilized to make such investment. To date, we have not elected to apply hedge accounting for our derivatives and, as a result, we record the change in fair value of our derivatives and the associated interest and currency exchange in earnings.

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Our interest rate hedging techniques are partly based on assumed levels of prepayments of our target assets. If prepayments are slower or faster than assumed, the life of the investment will be longer or shorter, which would reduce the effectiveness of any of the interest rate hedging strategies we may use and may cause losses on such transactions. Hedging strategies both interest rate and foreign currency, involve the use of derivative securities which are highly complex and may produce volatile returns.

Critical Accounting Policies

Our financial statements are prepared in accordance with GAAP, which requires the use of estimates and assumptions that involve the exercise of judgment and use of assumptions as to future uncertainties. In accordance with SEC guidance, the following discussion addresses the accounting policies that we currently apply. Our most critical accounting policies will involve decisions and assessments that could affect our reported assets and liabilities, as well as our reported revenues and expenses. We believe that all of the decisions and assessments upon which our financial statements have been based were reasonable at the time made and based upon information available to us at that time. We have identified what we believe will be our most critical accounting policies to be the following:

Investments

We elected the fair value option for all of our MBS and other securities at the date of purchase, which permits us to measure these securities at fair value with the change in fair value included as a component of earnings. Although we have elected the fair value option for our MBS and other securities, we separately compute interest income on our MBS and other securities under the prescribed method based on the nature of the security. As such, premiums and discounts are amortized or accreted into interest income and are included in Interest income in the Statement of Operations.

Valuation of financial instruments

We disclose the fair value of our financial instruments according to a fair value hierarchy (Levels I, II, and III, as defined below). In accordance with GAAP, we are required to provide enhanced disclosures regarding instruments in the Level III category (which require significant management judgment), including a separate reconciliation of the beginning and ending balances for each major category of assets and liabilities. GAAP establishes a framework for measuring fair value in accordance with GAAP and expands financial statement disclosure requirements for fair value measurements. GAAP further specifies a hierarchy of valuation techniques, which is based on whether the inputs into the valuation technique are observable or unobservable. The hierarchy is as follows:

Level I   Quoted prices in active markets for identical assets or liabilities.

Level II   Quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose inputs are observable or whose significant value drivers are observable.

Level III Prices are determined using significant unobservable inputs. In situations where quoted prices or observable inputs are unavailable (for example, when there is little or no market activity for an investment at the end of the period), unobservable inputs may be used.

The level in the fair value hierarchy within which a fair measurement in its entirety falls is based on the lowest level input that is significant to the fair value measurement in its entirety.

When available, we use quoted market prices to determine the fair value of an asset or liability. If quoted market prices are not available, we consult with independent pricing services or obtain third party broker quotes. If independent pricing service, or third party broker quotes are not available, we determine the fair value of the securities using valuation techniques that use, when possible, current market-based or independently-sourced market parameters, such as interest rates.

While linked transactions are treated as derivatives for GAAP, the securities underlying the Company s linked transactions are valued using similar techniques to those used for our securities portfolio. The value of the underlying security is then netted against the carrying amount (which approximates fair value) of the repurchase agreement at the valuation date. Additionally, TBA instruments are similar in substance to our Agency RMBS portfolio, and the Company therefore estimates fair value based on similar methods.

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We determine the fair value of derivative financial instruments by obtaining quotes from a third party pricing service, whose pricing is subject to review by our Manager s pricing committee. In valuing our interest rate derivatives, such as swaps and swaptions, we consider the creditworthiness of our counterparties, along with collateral provisions contained in each derivative agreement, from the perspective of both us and our counterparties. All of our interest rate swaps are either cleared through a central clearing house and subject to the clearing house margin requirements or subject to bilateral collateral arrangements with the vast majority of interest rate swaps entered into beginning in September 2013 being cleared through a central clearing house. We also have netting arrangements in place with all derivative counterparties pursuant to standard documentation developed by the International Swap and Derivatives Association. Consequently, no credit valuation adjustment was made in determining the fair value of interest rate derivatives.

Valuation techniques for MBS and other structured securities may be based upon models that consider the estimated cash flows of the security. The primary inputs to the model include yields for to-be-announced (also known as TBAs) Agency RMBS, the U.S. Treasury market and floating rate indices such as LIBOR, the Constant Maturity Treasury rate and the prime rate as a benchmark yield. In addition, the model may incorporate the current weighted average maturity and additional pool level information such as prepayment speeds, default frequencies and default severities, if applicable. To the extent, the inputs are observable and timely, the securities are categorized in Level II of the fair value hierarchy; otherwise, unless alternative pricing information as described is available, they are categorized as Level III.

Fair value under GAAP represents an exit price in the normal course of business, not a forced liquidation price. If we are forced to sell assets in a short period to meet liquidity needs, the prices we receive could be substantially less than the recorded fair values of our assets. Furthermore, the analysis of whether it is more likely than not that we will be required to sell securities in an unrealized loss position prior to an expected recovery in value (if any), the amount of such expected required sales, and the projected identification of which securities will be sold is also subject to significant judgment, particularly in times of market illiquidity.

We determine the fair value of derivative financial instruments and obtain quotations from a third party to facilitate the process of determining these fair values.

We will review any changes to the valuation methodology to ensure the changes are appropriate. The methods used may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while we anticipate that our valuation methods will be appropriate and consistent with other market participants, the use of different methodologies, or assumptions, to determine the fair value of certain financial instruments can result in a different estimate of fair value at the reporting date. We use inputs that are current as of the measurement date, which may include periods of market dislocation, during which price transparency may be reduced.

All valuations received from independent pricing services are non-binding. We primarily utilize an independent third party pricing service as the primary source for valuing the Company s assets.

We generally receive one independent pricing service price for each investment in our portfolio. Our Manager has established a process to review and validate the pricing received from the independent pricing service and has a process for challenging prices received from the independent pricing service when necessary. The Company utilizes our Manager s policies in this regard. Our and our Manager s review of the independent third party pricing data may consist of a review of the daily change in the prices provided by the independent pricing vendor which exceed established tolerances or comparisons to executed transaction prices. Our Manager s pricing group, which functions independently from its portfolio management personnel, corroborates the price differences or changes in price by comparing the vendor price to alternate sources including other independent pricing services or broker quotations. If the price change or difference cannot be corroborated, the Manager s pricing group consults with the portfolio management team for market color in reviewing such pricing data as warranted. To the extent that our

Manager has information, typically in the form of broker quotations that would indicate that a price received from the independent pricing service is outside of a tolerance range, our Manager generally challenges the independent pricing service price.

To ensure proper fair value hierarchy, we and our Manager review the methodology used by the third party pricing service to understand whether observable market data is being utilized in the vendor s pricing methodology. Generally, this review is conducted annually, however ad-hoc reviews of the pricing methodology and the data do occur. The review of the assumptive data received from the vendor includes comparing key inputs. In addition, as part of our regular review of pricing, our Manager s pricing group may have informal discussions with the independent pricing vendor regarding their evaluation methodology or the market data utilized in their determination. The conclusion that a price should be overridden in accordance with our Manager s pricing methodology may impact the fair value hierarchy of the security for which such price has been adjusted.

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Linked transactions

In instances where we finance the acquisition of securities through repurchase agreements with the same counterparty from which the securities were purchased, we evaluate such transactions in accordance with GAAP. This guidance requires the initial transfer of a financial asset and repurchase financing that are entered into contemporaneously with, or in contemplation of, one another to be considered linked unless all of the criteria found in the guidance are met at the inception of the transaction. If the transaction meets all of the conditions, the initial transfer shall be accounted for separately from the repurchase financing, and we will record the securities and the related financing on a gross basis on our Balance Sheet with the corresponding interest income and interest expense in our Statements of Operations. If the transaction is determined to be linked, we will record the initial transfer and repurchase financing on a net basis and record a forward commitment to purchase securities as a derivative instrument with changes in market value being recorded on our Statement of Operations. Such forward commitments are recorded at fair value with subsequent changes in fair value recognized in Gain (loss) on linked transactions, net on our Statement of Operations. We refer to these transactions as Linked Transactions. When or if a transaction is no longer considered to be linked, the security and related repurchase financing will be reported on a gross basis. The unlinking of a transaction causes a realized event in which the fair value of the security as of the date of unlinking will become the cost basis of the security. The difference between the fair value on the unlinking date and the existing cost basis of the security will be the realized gain or loss. Recognition of effective yield for such security will be calculated prospectively using the new cost basis. For linked transactions, we reflect purchases and sales of securities within the investing section of our Statement of Cash Flows. Proceeds from repurchase agreements borrowings and repayments of repurchase agreement borrowings are reflected in the financing section of our Statement of Cash Flows.

The securities underlying our linked transactions are valued using similar techniques to those used for our securities portfolio.

Interest income recognition and Impairment

Agency MBS and Non-Agency MBS excluding Interest-Only Strips, and other securities rated AA and higher at the time of purchase

Interest income on mortgage-backed securities and other securities is accrued based on the respective outstanding principal balances and their corresponding contractual terms. Premiums and discounts associated with Agency MBS and Non-Agency MBS, excluding Interest-Only Strips, and other securities rated AA and higher at the time of purchase are amortized into interest income over the estimated life of such securities using the effective yield method. Adjustments to premium and discount amortization are made for actual prepayment activity. On at least a quarterly basis, we estimate prepayments for our securities and, as a result, if prepayments increase (or are expected to increase), we will accelerate the rate of amortization on premiums or discounts and make a retrospective adjustment to historical amortization. Alternatively, if prepayments decrease (or are expected to decrease) we will reduce the rate of amortization on the premiums or discounts and make a retrospective adjustment to historical amortization.

A change in the calculation used to determine the amortization of bond premium as of April 1, 2014, resulted in a change in estimate of approximately $1.2 million, or an accretive $0.03 core earnings per share (a non-GAAP measure). The impact of the change in estimate was limited to an increase of approximately $1.2 million to Interest Income and an offsetting reduction to Unrealized gain (loss) on Mortgage-backed securities and other securities, net on the Statement of Operations. We do not believe the aforementioned change in estimate will have a material impact to subsequent periods.

A decline in the fair market value of our assets may require us to recognize an other-than-temporary impairment against such assets under GAAP unless we were to determine that, with respect to any assets in unrealized loss positions, we do not have the intent to sell these investments, it is more likely than not that we will not be required to sell the investment before recovery of a security s amortized cost basis and we will not be required to sell the security for regulatory or other reasons. In addition, an other-than-temporary impairment is deemed to have occurred when there is an adverse change in the expected cash flows (principal or interest) to be received and the fair value of the security is less than its carrying amount. In determining whether an adverse change in cash flows occurred, the present value of the remaining cash flows, as estimated at the initial transaction date (or the last date previously revised), is compared to the present value of the expected cash flows at the current reporting date. The estimated cash flows reflect those a market participant would use and are discounted at a rate equal to the current yield used to accrete interest income. If such a determination is made, we would recognize unrealized losses through earnings and write down the amortized cost of such assets to a new cost basis, based on the fair value of such assets on the date they are considered to be other-than-temporarily impaired. Other than for plain-vanilla variable rate Non-Agency MBS we do not bifurcate the loss between credit loss and loss attributed to change in interest rates, therefore, the entire loss is recorded as other-than-temporary. Such impairment charges reflect non-cash losses at the time of recognition; subsequent disposition or sale of such assets can further affect our future losses or gains, as they are based on the difference between the sales price received and adjusted amortized cost of such assets at the time of sale.

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The determination of whether an other-than-temporary impairment exists is subject to management s estimates based on consideration of both factual information available at the time of assessment as well as our estimates of the future performance and projected amount and timing of cash flows expected to be collected on the security. As a result, the timing and amount of an other-than-temporary impairment constitutes an accounting estimate that may change materially over time.

Non-Agency MBS and other securities that are rated below AA at the time of purchase and Interest-Only Strips that are not classified as derivatives

Interest income on Non-Agency MBS and other securities that are rated below AA at the time of purchase and Interest-Only Strips that are not classified as derivatives are recognized based on the effective yield method. The effective yield on these securities is based on the projected cash flows from each security, which is estimated based on our observation of the then current market information and events and will include assumptions related to interest rates, prepayment rates and the timing and amount of credit losses. On at least a quarterly basis, we review and, if appropriate, make adjustments to our cash flow projections based on input and analysis received from external sources, internal models, and our judgment about interest rates, prepayment rates, the timing and amount of credit losses (if applicable), 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 such securities. Actual maturities of the securities are affected by the contractual lives of the associated mortgage collateral, or mortgages, periodic payments of scheduled principal, and prepayments of principal. Therefore, actual maturities of the securities will generally be shorter than stated contractual maturities.

Based on the projected cash flows from any Non-Agency MBS or other structured security, which we may purchase at a discount to par value, a portion of the purchase discount may be designated as credit protection against future credit losses and, therefore, not accreted into interest income. The amount designated as credit discount 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 discount is more favorable than forecasted, a portion of the amount designated as credit discount may be accreted into interest income prospectively.

In addition, an other-than-temporary impairment is deemed to have occurred when there is an adverse change in the expected cash flows (principal or interest) to be received and the fair value of the beneficial interest is less than its carrying amount. In determining whether an adverse change in cash flows occurred, the present value of the remaining cash flows, as estimated at the initial transaction date (or the last date previously revised), is compared to the present value of the expected cash flows at the current reporting date. The estimated cash flows reflect those a market participant would use and are discounted at a rate equal to the current yield used to accrete interest income. The Company does not bifurcate the loss between credit loss and loss attributed to change in interest rates, therefore, the entire loss is recorded as other-than-temporary. These adjustments are reflected in our Statement of Operations as Other loss on Mortgage-backed securities and other securities.

Following the recognition of an other-than-temporary impairment, a new amortized cost basis is established for the security. However, to the extent that there are subsequent increases in cash flows expected to be collected, the other-than-temporary impairment previously recorded may be accreted back through interest income via increased yield.

The determination of whether an other-than-temporary impairment exists is subject to management s estimates based on consideration of both factual information available at the time of assessment as well as our estimates of the future performance and projected amount and timing of

cash flows expected to be collected on the security. As a result, the timing and amount of an other-than-temporary impairment constitutes an accounting estimate that may change materially over time.

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Foreign currency transactions

We expect to enter into transactions denominated in foreign currency from time to time. At the date the transaction is recognized, the asset and/or liability will be measured and recorded using the exchange rate in effect at the date of the transaction. At each balance sheet date, such foreign currency assets and liabilities are re-measured using the exchange rate in effect at the date of the balance sheet, resulting in unrealized foreign currency gains or losses. Unrealized foreign currency gains or losses on MBS and other securities are recorded in Unrealized gain (loss) on Mortgage-backed securities and other securities, net on the Statement of Operations. Unrealized and realized foreign currency gains or losses on borrowings under repurchase agreements are recorded in Interest income on cash balances and other income (loss), net on the Statement of Operations. Interest income from investments denominated in a foreign currency and interest expense on borrowings denominated in a foreign currency are recorded at the average rate of exchange during the period.

Derivatives and hedging activities

Subject to maintaining our qualification as a REIT for U.S. federal income tax purposes, we utilize derivative financial instruments to hedge the interest rate risk associated with our borrowings and the currency risk associated with our non U.S. dollar denominated investments. Derivatives are used for hedging purposes rather than speculation. We determine their fair value and obtain quotations from a third party to facilitate the process of determining these fair values. If our hedging activities do not achieve the desired results, reported earnings may be adversely affected.

GAAP requires an entity to recognize all derivatives as either assets or liabilities on the Balance Sheet and to measure those instruments at fair value. Fair value adjustments are recorded in earnings immediately, if the reporting entity does not elect hedge accounting for a derivative instrument.

We elected not to apply hedge accounting for these derivative instruments and record the change in fair value and net interest rate swap payments (including accrued amounts) related to interest rate swaps in Gain (loss) on derivative instruments, net in our Statement of Operations. Similarly, the change in fair value and net currency payment (including accrued amounts) related to our currency hedges will also be included in Gain (loss) on derivative instruments net in our Statement of Operations.

We also invest in Agency and Non-Agency Interest-Only Strips, swaptions, futures contracts and TBAs. We evaluate the terms and conditions of our holdings of Agency and Non-Agency Interest-Only Strips, swaptions, futures contracts and TBAs to determine if these instruments have the characteristics of an investment or should be considered a derivative under GAAP. In determining the classification of our holdings of Interest-Only Strips, we evaluate the securities to determine if the nature of the cash flows has been altered from that of the underlying mortgage collateral. Generally, Interest-Only Strips for which the security represents a strip off of a mortgage pass through security will be considered a hybrid instrument classified as a MBS investment on our Balance Sheet utilizing the fair value option. Alternatively, those Interest-Only Strips, for which the underlying mortgage collateral has been included into a structured security that alters the cash flows from the underlying mortgage collateral, are accounted for as derivatives at fair value. Accordingly, Agency and Non-Agency Interest-Only Strips, swaptions, futures contracts and TBAs having the characteristics of derivatives are accounted for at fair value with such changes recognized in Gain (loss) on derivative instruments, net in our Statement of Operations, along with any interest earned (including accrued amounts). The carrying value of the Agency and Non-Agency Interest-Only Strips, accounted for as derivatives, is included in Mortgage-backed securities on the Balance Sheet. The carrying value of interest rate swaptions, currency forwards, futures contracts and TBAs is included in Derivative assets or Derivative liabilities on the Balance Sheet.

We evaluate all of our financial instruments to determine if such instruments are derivatives or contain features that qualify as embedded derivatives. An embedded derivative is separated from the host contact and accounted for separately when all of the guidance criteria are met. Hybrid instruments that are remeasured at fair value through earnings, including the fair value option are not bifurcated. Our derivative instruments also include linked transactions, which reflect a forward commitment to purchase assets. Derivative instruments are recorded at fair value and are re-valued at each reporting date, with changes in the fair value together with interest earned (including accrued amounts) reported in Gain (loss) on derivative instruments, net in our Statement of Operations.

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Repurchase agreements

Mortgage-backed securities and other securities sold under repurchase agreements are treated as collateralized financing transactions, unless they meet sales treatment. Securities financed through a repurchase agreement remain on our Balance Sheet as an asset and the amount of cash received from the lender is recorded in our Balance Sheet as a liability. Interest paid in accordance with repurchase agreements is recorded as interest expense.

In instances where we acquire securities through repurchase agreements with the same counterparty from which the securities were purchased, we will account for the purchase commitment and repurchase agreement on a net basis and record a forward commitment to purchase securities as a derivative instrument if the transaction does not comply with the criteria for gross presentation. Such forward commitments will be recorded at fair value with subsequent changes in fair value recognized in income. Additionally, we will record the cash portion of our investment in securities as a mortgage-related receivable from the counterparty on our balance sheet. If the transaction complies with the criteria for gross presentation, we will record the assets and the related financing on a gross basis in our Balance Sheet and the corresponding interest income and interest expense in our Statements of Operations.

Share-based compensation

We account for share-based compensation to our independent directors, to our officers and employees, to our Manager and to employees of our Manager and its affiliates using the fair value based methodology prescribed by GAAP. Compensation cost related to restricted common stock issued to our independent directors and employees is measured at its fair value at the grant date, and amortized into expense over the service period on a straight-line basis. Compensation cost related to restricted common stock issued to our Manager and to employees of our Manager and its affiliates is initially measured at fair value at the grant date, and re-measured at fair value on subsequent dates to the extent the awards are unvested and the change in fair value is reported in the Statement of Operations as non-cash stock based compensation.

Warrants

We account for the warrants comprising a part of the units issued in the private placement to certain institutional accredited investors concurrent with our IPO in accordance with Accounting Standards Codification 815, Accounting for Derivative Instruments and Hedging Activities, which provides guidance on the specific accounting treatment of a multitude of derivative instruments. We have evaluated the warrants issued by us and have recorded the warrants at their relative fair value as a component of equity, using a variation of the adjusted Black-Scholes option valuation model at their time of issuance.

Income taxes

We operate and have elected to be taxed as a REIT commencing with our taxable year ended December 31, 2012. Accordingly, we will generally not be subject to corporate U.S. federal or state income tax to the extent that we make qualifying distributions to our stockholders, and provided that we satisfy on a continuing basis, through actual investment and operating results, the REIT requirements including certain asset,

income, distribution and stock ownership tests. If we fail to qualify as a REIT, and do not qualify for certain statutory relief provisions, we will be subject to U.S. federal, state and local income taxes and may be precluded from qualifying as a REIT for the subsequent four taxable years following the year in which we lost our REIT qualification. Accordingly, our failure to qualify as a REIT could have a material adverse impact on our results of operations and amounts available for distribution to our stockholders.

Our dividends paid deduction for qualifying dividends paid to our stockholders is computed using our taxable income as opposed to net income reported on the financial statements. Taxable income, generally, will differ from net income reported on the financial statements because the determination of taxable income is based on tax provisions and not financial accounting principles.

We may elect to treat certain of our subsidiaries as TRSs. In general, a TRS of ours may hold assets and engage in activities that we cannot hold or engage in directly and generally may engage in any real estate or non-real estate-related business. A TRS is subject to U.S. federal, state and local corporate income taxes. While a TRS will generate net income, a TRS can declare dividends to us, which will be included in our taxable income and necessitate a distribution to our stockholders. Conversely, if we retain earnings at the TRS level, no distribution is required and we can increase book equity of the consolidated entity. As of June 30, 2014, we did not have a TRS, or any other subsidiary.

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We evaluate uncertain tax positions, if any, and classify interest and penalties, if any, related to unrecognized tax benefits as a component of the provision for income taxes.

Accounting standards applicable to emerging growth companies

The JOBS Act contains provisions that relax certain requirements for emerging growth companies for which we qualify. For as long as we are an emerging growth company, which may be up to five full fiscal years, unlike other public companies, we will not be required to: (i) comply with any new or revised financial accounting standards applicable to public companies until such standards are also applicable to private companies under Section 102(b)(1) of the JOBS Act; (ii) provide an auditor s attestation report on management s assessment of the effectiveness of our system of internal control over financial reporting pursuant to Section 404 of the Sarbanes-Oxley Act; (iii) comply with any new requirements adopted by the PCAOB requiring mandatory audit firm rotation or a supplement to the auditor s report in which the auditor would be required to provide additional information about the audit and the financial statements of the issuer; or (iv) comply with any new audit rules adopted by the PCAOB after April 5, 2012 unless the SEC determines otherwise. We may take advantage of any or all of such exemptions, but have not yet made a decision on whether to do so.

As noted above, under the JOBS Act, emerging growth companies can delay adopting new or revised accounting standards that have different effective dates for public and private companies until such time as those standards apply to private companies. We currently intend to take advantage of such extended transition period. Since we are not required to comply with new or revised accounting standards on the relevant dates on which adoption of such standards is required for other public companies, our financial statements may not be comparable to the financial statements of companies that comply with public company effective dates. If we were to elect to comply with these public company effective dates, such election would be irrevocable pursuant to Section 107 of the JOBS Act.

Recent accounting pronouncements

Accounting Standards to be Adopted in Future Periods

In April 2014, the Financial Accounting Standards Board issued updated guidance that changes the requirements for reporting discontinued operations. Under the new guidance, a discontinued operation is defined as a disposal of a component of an entity or group of components of an entity that is disposed of or is classified as held for sale and represents a strategic shift that has (or will have) a major effect on an entity s operations and financial results. The guidance is effective prospectively as of the first quarter of 2015, with early adoption permitted for new disposals or new classifications as held-for-sale. The guidance is effective for annual periods beginning on or after December 15, 2014 and interim periods within annual periods beginning on or after December 15, 2015. Early adoption is permitted but only for disposals (or classifications as held for sale) that have not been reported in financial statements previously issued or available for issue. The new guidance is not expected to have a material impact on our financial statements.

In June 2014, the Financial Accounting Standards Board issued guidance that changes the accounting for repurchase-to-maturity transactions and repurchase financing arrangements. The new guidance aligns the accounting for repurchase-to-maturity transactions and repurchase agreements executed as a repurchase financing with the accounting for other typical repurchase agreements. These transactions would all be accounted for as secured borrowings. The guidance eliminates sale accounting for repurchase-to-maturity transactions and supersedes the

guidance under which a transfer of a financial asset and a contemporaneous repurchase financing could be accounted for on a combined basis as a forward agreement, which has resulted in outcomes referred to as off-balance-sheet accounting. In addition, the guidance requires additional disclosures. The guidance is effective for the first interim or annual period beginning after December 15, 2014. Earlier application for a public company is prohibited. We currently account for certain transfers as forward agreements under the existing guidance, which are currently classified as linked transactions. The new guidance will require us to record these transfers as secured borrowings however, it is not expected to have a material impact on our financial statements.

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Results of Operations

The following discussion of our results of operations highlights our performance for the three and six months ended June 30, 2014 and 2013. For the three and six months ended June 30, 2014, we had a net income of $67.6 million and $59.1 million or $1.68 and $1.76 per basic and diluted weighted average common share, respectively. For the three and six months ended June 30, 2013, we had net loss of $27.7 million and $56.2 million or $1.16 and $2.34 per basic and diluted weighted average common share, respectively. During the later portion of 2013, and continuing through the six months ended June 30, 2014, we expanded our investment in Non-Agency MBS and commenced investing in CMBS and other structured securities and adjusted our overall leverage and hedging strategy pursuant to our current business plan.

Investments

The following table presents certain information about our investment portfolio at June 30, 2014 which is a Non-GAAP measure due to the inclusion of our Linked Transactions, in order to present a complete economic presentation of our portfolio, which is reconciled to GAAP below, as follows (dollars in thousands)**:**

	Principal Balance	Unamortized Premium (Discount)	Discount Designated as Credit Reserve and OTTI	Amortized Cost	Unrealized Gain (Loss)	Estimated Fair Value	Net Weighted Average Coupon (1)
20-Year Mortgage							
Coupon Rate:							
3.00%	$ 333,885	$ 16,119	$	$ 350,004	$ (9,263)	$ 340,741	3.0%
3.50%	95,026	6,015		101,041	(1,539)	99,502	3.5%
4.00%	640,972	38,115		679,087	8,125	687,212	4.0%
	1,069,883	60,249		1,130,132	(2,677)	1,127,455	3.6%
30-Year Mortgage							
Coupon Rate:							
3.50%	600,453	42,268		642,721	(25,198)	617,523	3.5%
4.00%	536,822	45,794		582,616	(12,016)	570,600	4.0%
4.50%	688,473	52,660		741,133	12,965	754,098	4.5%
5.50%	76,233	9,780		86,013	1,008	87,021	5.5%
6.00%	8,550	986		9,536	149	9,685	6.0%
	1,910,531	151,488		2,062,019	(23,092)	2,038,927	4.1%
Agency RMBS IOs and IIOs(2)	N/A	N/A		208,738	5,483	214,221	4.2%
Agency and Non-Agency IOs and IIOs accounted for as derivatives (2)(3)	N/A	N/A	N/A	N/A	N/A	95,562	2.9%
	N/A	N/A		208,738	5,483	309,783	3.7%
Non-Agency RMBS	888,473	(1,835)	(183,441)	703,197	10,006	713,203	3.6%
	N/A	N/A	N/A	52,584	2,264	54,848	6.1%

Non-Agency RMBS IOs and IIOs	888,473	(1,835)	(183,441)	755,781	12,270	768,051	4.2%
Agency and Non-Agency CMBS, including Non U.S.	455,580	1,733	(26,483)	430,830	5,794	436,624	5.5%
Other securities	25,560	4,580		30,140	3,706	33,846	7.3%
Total: Non GAAP Basis-Including Linked Transaction	4,350,027	216,215	(209,924)	4,617,640	1,484	4,714,686	4.0%
Linked Transactions, including Non U.S.	34,674	8,585	(3,550)	39,709	846	40,555	13.8%
Total: GAAP Basis	$ 4,315,353	$ 207,630	$ (206,374)	$ 4,577,931	$ 638	$ 4,674,131	4.0%

(1) Net weighted average coupon as of June 30, 2014 is presented net of servicing and other fees.

(2) Agency RMBS IOs and IIOs, Non-Agency RMBS IOs and IIOs, Agency and Non-Agency IOs and IIOs, accounted for as derivatives, and Agency and Non-Agency CMBS IOs and IIOs have no principal balances and bear interest based on a notional balance. The notional balance is used solely to determine interest distributions on interest-only class of securities. At June 30, 2014, the notional balance for Agency RMBS IOs and IIOs, Non-Agency IOs and IIOs, and for Agency and Non-Agency IOs and IIOs, accounted for as derivatives, was $1,249,977, $290,719 and $809,721, respectively.

(3) Interest on these securities is reported as a component of Gain (loss) on derivative instruments, net.

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As of June 30, 2014 and 2013, the fixed-rate Agency RMBS we held consisted primarily of securities which our Manager believes exhibit prepayment mitigation attributes, including Agency RMBS collateralized by low loan balances, loans where the underlying borrower is unable to access the Making Home Affordable Program, including the Home Affordable Refinance Program or HARP or loans which were not originated by third party originators or brokers.

The following table details the constant prepayment rates for our Agency portfolio as of June 30, 2014, based on our Manager s estimates which are based on third party models, as adjusted by our Manager, and are updated quarterly on a prospective basis:

Constant Prepayment Rates	**Low**	**High**
Agency RMBS		
20-Year Mortgage	3.91%	26.72%
30-Year Mortgage	4.57%	33.98%
Agency RMBS IOs and IIOs	5.21%	32.00%
Agency RMBS IOs and IIOs accounted for as derivatives	4.33%	25.67%
Agency CMBS IOs accounted for as derivatives(1)	N/A	N/A

(1) CMBS generally include prepayment restrictions; therefore, there are no Constant Prepayment Rates available.

The following table details information for our Non-Agency portfolio as of June 30, 2014, based on our Manager s estimates which are based on third party models, as adjusted by our Manager, and is updated quarterly on a prospective basis:

	Cumulative Default		**Cumulative Severity**		**Cumulative 5-Year CRR**	
	Low	**High**	**Low**	**High**	**Low**	**High**
Non-Agency RMBS	5.52%	61.06%	4.26%	88.60%	1.68%	12.58%
Non-Agency IOs and IIOs	25.28%	44.05%	11.39%	74.22%	4.68%	8.16%
Non-Agency IOs and IIOs accounted for as derivatives	14.57%	21.89%	4.26%	59.40%	1.81%	1.81%
Non-Agency CMBS	14.04%	14.04%	31.96%	31.96%	3.17%	3.17%
Other securities	0.97%	0.97%	0.00%	0.00%	0.13%	0.13%
Linked transactions, net, at fair value	0.00%	33.59%	0.00%	54.11%	0.00%	5.75%

Investment Activity

Agency and Non-Agency RMBS, Agency and Non-Agency CMBS, IO and IIO Securities and Other Securities.

The following tables present our MBS and other securities activity, including linked transactions (Non-GAAP) for the three and six months ended June 30, 2014 and 2013 (dollars in thousands):

	For the three months ended June 30, 2014		
	Purchases	Principal Payments and Basis Recovery	Proceeds from Sales
Agency RMBS and Agency RMBS IOs and IIOs	$ 1,987,402	$ 66,892	$ 1,323,065
Non-Agency RMBS	499,958	15,109	136,913
Agency CMBS and Agency CMBS IOs and IIOs	19,196	414	
Non-Agency CMBS	435,616		73,059
Other securities	78,174		78,932
Total MBS and other securities: Excluding Linked Transactions (GAAP)	$ 3,020,346	$ 82,415	$ 1,611,969
Non-Agency RMBS Linked Transactions		759	
Non-Agency CMBS Linked Transactions, including Non U.S.	25,141		
Total MBS: Including Linked Transactions (Non-GAAP)	$ 3,045,487	$ 83,174	$ 1,611,969

	For the six months ended June 30, 2014		
	Purchases	Principal Payments and Basis Recovery	Proceeds from Sales
Agency RMBS and Agency RMBS IOs and IIOs	$ 2,344,350	$ 114,075	$ 1,336,352
Non-Agency RMBS	604,015	22,762	240,089
Agency CMBS and Agency CMBS IOs and IIOs	19,196	834	
Non-Agency CMBS, including Non U.S.	450,315		73,059
Other securities	78,174		78,932
Total MBS: Excluding Linked Transactions (GAAP)	$ 3,496,050	$ 137,671	$ 1,728,432
Non-Agency RMBS Linked Transactions		3,777	
Non-Agency CMBS Linked Transactions, including Non U.S.	25,141		
Total MBS: Including Linked Transactions (Non-GAAP)	$ 3,521,191	$ 141,448	$ 1,728,432

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	For the three months ended June 30, 2013		
	Purchases	Principal Payments and Basis Recovery	Proceeds from Sales
Agency RMBS and Agency RMBS IOs and IIOs	$ 548,253	$ 74,043	$ 317,165
Non-Agency RMBS	48,506	3,435	67,184
Total MBS: Excluding Linked Transactions (GAAP)	$ 596,759	$ 77,478	$ 384,349
Agency RMBS Linked Transactions	9,705	58	
Non-Agency RMBS Linked Transactions		415	21,734
Total MBS: Including Linked Transactions (Non-GAAP)	$ 606,464	$ 77,951	$ 406,083

	For the six months ended June 30, 2013		
	Purchases	Principal Payments and Basis Recovery	Proceeds from Sales
Agency RMBS and Agency RMBS IOs and IIOs	$ 1,571,400	$ 151,763	$ 2,145,887
Non-Agency RMBS	176,071	5,207	67,184
Total MBS: Excluding Linked Transactions (GAAP)	$ 1,747,471	$ 156,970	$ 2,213,071
Agency RMBS Linked Transactions	9,705	58	
Non-Agency RMBS Linked Transactions	66,703	985	21,734
Total MBS: Including Linked Transactions (Non-GAAP)	$ 1,823,879	$ 158,013	$ 2,234,805

For the three and six months ended June 30, 2014, we realized a net gain of approximately $0 million and $1.3 million, respectively, from the unlinking of securities previously accounted for as derivatives through linked transactions. We reclassify, from mark-to-market, adjustments on linked transactions to realized gain (loss) on linked transactions during the period the security becomes unlinked. For the three and six months ended June 30, 2013, we realized a net gain of approximately $2.4 million and $2.4 million, respectively, from the unlinking of securities previously accounted for as derivatives through linked transactions.

The following table presents the vintage of our MBS investment portfolio, including linked transactions at June 30, 2014**:**

	1998	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Total
Agency RMBS																
20-Year Mortgage													6.1%	12.9%	4.8%	23.8%
30-Year Mortgage							0.2%			0.3%	1.5%	0.1%	14.6%	12.6%	14.0%	43.3%
Agency Interest Only- Strips				0.1%	0.1%	0.2%	0.1%	0.1%		0.2%	0.7%	0.5%	2.4%	0.2%		4.6%
Agency and Non-Agency Interest-Only Strips, accounted for as derivatives						0.1%			0.1%		0.2%	0.1%	1.0%	0.5%		2.0%
Non-Agency RMBS	0.3%	0.2%	0.3%	0.3%	0.5%	4.0%	6.8%	3.3%	0.3%							16.0%
Non-Agency Linked Transactions,							0.1%	0.2%							0.5%	0.8%

including Non U.S.																
Agency and Non-Agency CMBS					0.2%	0.6%	2.4%	4.0%			0.6%			0.6%	0.4%	8.8%
Other securities													0.7%			0.7%
Total MBS (Non-GAAP)	0.3%	0.2%	0.3%	0.4%	0.8%	4.9%	9.6%	7.6%	0.4%	0.5%	3.0%	0.7%	24.8%	26.8%	19.7%	100%

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As of June 30, 2014 the weighted average expected remaining term to the expected maturity of our investment portfolio, including linked transactions is 7.9 years.

Financing and Other Liabilities. We have entered into repurchase agreements to finance a substantial majority of our MBS and other securities. These agreements are secured by substantially all of our MBS and other securities and bear interest at rates that have historically moved in close relationship to LIBOR. The following table summarizes the fair value of MBS and other collateral pledged as of June 30, 2014 and December 31, 2013.

	June 30, 2014		December 31, 2013	
(dollars in thousands) Collateral	**Repurchase Agreement Borrowings Outstanding**	**Fair Value of MBS Collateral Pledged**	**Repurchase Agreement Borrowings Outstanding**	**Fair Value of MBS Collateral Pledged**
Agency RMBS	$ 3,264,316	$ 3,447,802	$ 2,331,276	$ 2,463,347
Non-Agency RMBS	504,733	721,260	208,923	305,318
Agency and Non-Agency CMBS	315,214	420,356	17,544	23,597
Other securities	26,985	33,846	21,324	26,685
Total: Excluding Linked Transactions	$ 4,111,248	$ 4,623,264	$ 2,579,067	$ 2,818,947
Non-Agency RMBS Linked Transactions	12,282	15,226	61,187	79,746
Non-Agency CMBS Linked Transactions, including Non U.S.	15,198	25,329		
Total: Including Linked Transactions (Non-GAAP)	$ 4,138,728	$ 4,663,819	$ 2,640,254	$ 2,898,693

The following tables present our borrowing activity, by type of collateral pledged, for the three and six months ended June 30, 2014 and 2013:

(dollars in thousands)	For the three months ended June 30, 2014		For the six months ended June 30, 2014	
Collateral	**Proceeds**	**Repayments**	**Proceeds**	**Repayments**
Agency RMBS	$ 5,928,825	$ 5,194,034	$ 9,819,517	$ 8,886,476
Non-Agency RMBS	896,241	649,327	1,321,850	1,026,040
Agency and Non-Agency CMBS	420,374	119,453	434,666	136,997
Other securities	224,185	218,524	224,185	218,524
Total: Excluding Linked Transactions	$ 7,469,625	$ 6,181,338	$ 11,800,218	$ 10,268,037
Agency RMBS Linked Transactions				
Non-Agency RMBS Linked Transactions	37,238	37,670	75,809	124,714
Non-Agency CMBS Linked Transactions, including Non U.S.	15,198		15,198	

Total	$	7,522,061	$	6,219,008	$	11,891,225	$	10,392,751

(dollars in thousands)	For the three months ended June 30, 2013				For the six months ended June 30, 2013			
Collateral		Proceeds		Repayments		Proceeds		Repayments
Agency RMBS	$	8,757,240	$	8,866,512	$	19,816,748	$	20,746,488
Non-Agency RMBS		113,115		97,144		257,356		160,717
Total: Excluding Linked Transactions	$	8,870,355	$	8,963,656	$	20,074,104	$	20,907,205
Agency RMBS Linked Transactions		18,618		18,618		18,618		18,618
Non-Agency RMBS Linked Transactions		19,732		60,317		67,627		64,342
Total	$	8,908,705	$	9,042,591	$	20,160,349	$	20,990,165

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At June 30, 2014, we had outstanding repurchase agreement borrowings with the following 19 counterparties totaling approximately $4.1 billion, which is a Non-GAAP measure due to our Linked Transactions, which is reconciled to GAAP below as follows:

(dollars in thousands) Repurchase Agreement Counterparties		Amount Outstanding	Percent of Total Amount Outstanding		Fair Value of Company Securities Held as Collateral	Counterparty Rating(2)
Barclays Capital Inc. (1)	$	616,326	14.9%	$	700,154	A
Merrill Lynch Pierce Fenner & Smith Inc. (1)		586,625	14.2%		608,781	A
JP Morgan Securities LLC (1)		467,758	11.3%		548,775	A+
Deutsche Bank Securities LLC (1)		467,688	11.3%		490,768	A
BNP Paribas Securities Corporation (1)		356,353	8.6%		383,822	A+
Credit Suisse Securities (USA) LLC (1)		301,543	7.3%		388,229	A
Goldman Sachs Bank USA (1)		245,519	5.9%		258,580	A
Mizuho Securities USA Inc. (1)		218,261	5.3%		246,567	(P)A2
UBS Securities LLC (1)		211,761	5.1%		250,424	A
Morgan Stanley & Co. LLC (1)		167,238	4.0%		174,388	A
Royal Bank of Canada (1)		162,043	3.9%		225,704	AA-
RBC Capital Markets LLC (1)		97,851	2.4%		106,289	AA-
Jefferies & Company Inc. (1)		79,546	1.9%		83,655	BBB
Wells Fargo Bank NA (1)		65,553	1.6%		69,529	AA-
Citigroup Global Markets Inc. (1)		36,290	0.9%		46,895	A
The Royal Bank of Scotland plc (1)		27,109	0.7%		36,448	BBB+
Deutsche Bank AG		15,198	0.4%		25,329	A
Nomura Securities International, Inc.		10,096	0.2%		11,459	Unrated(3)
Wells Fargo Securities LLC		5,970	0.1%		8,022	AA-
Total: Non-GAAP Basis Including Linked Transactions, including Non U.S.	$	4,138,728	100.0%	$	4,663,818	
Linked Transactions		27,480			40,554	
Total: GAAP Basis Excluding Linked Transactions	$	4,111,248		$	4,623,264	

(1) Counterparty holds collateral valued in excess of 5% of our stockholders equity as security for our obligations under the applicable repurchase agreements as of June 30, 2014.

(2) The counterparty rating presented above is the long-term issuer credit rating as rated at June 30, 2014 by S&P, except for Mizuho Securities USA Inc. which is the long-term issuer credit rating by Moody s at June 30, 2014.

(3) Nomura Holdings, Inc., the parent company of Nomura Securities International, Inc., is rated BBB+ by S&P at June 30, 2014.

At December 31, 2013, we had outstanding repurchase agreement borrowings with the following 16 counterparties totaling approximately $2.6 billion, which is a Non-GAAP measure, due to our Linked Transactions, which is reconciled to GAAP below as follows:

(dollars in thousands) Repurchase Agreement Counterparties		Amount Outstanding	Percent of Total Amount Outstanding		Fair Value of Company Securities Held as Collateral	Counterparty Rating(2)
Barclays Capital Inc. (1)	$	362,476	13.7%	$	414,344	A
Deutsche Bank Securities LLC (1)		356,372	13.5%		381,319	A
Goldman Sachs Bank USA (1)		306,708	11.6%		328,504	A
JP Morgan Securities LLC (1)		271,887	10.3%		313,967	A+
Citigroup Global Markets Inc. (1)		205,856	7.8%		213,358	A
Credit Suisse Securities (USA) LLC (1)		178,896	6.8%		235,680	A
Mizuho Securities USA Inc. (1)		173,030	6.6%		178,101	(P)A2
BNP Paribas Securities Corporation. (1)		152,084	5.8%		164,025	A+
Merrill Lynch Pierce Fenner & Smith Inc. (1)		142,665	5.4%		148,351	A
UBS Securities LLC (1)		130,833	5.0%		133,938	A
South Street Securities LLC (1)		100,818	3.8%		105,020	AA+
Jefferies & Company Inc. (1)		100,762	3.8%		104,302	BBB
RBC Capital Markets LLC (1)		56,222	2.1%		61,898	AA-
RBS Securities Inc. (1)		51,138	1.9%		52,625	A-
The Royal Bank of Scotland plc(1)		37,993	1.4%		50,834	BBB+
Morgan Stanley & Co. LLC		12,514	0.5%		12,427	A
Total: Non-GAAP Basis Including Linked Transactions	$	2,640,254	100.0%	$	2,898,693	
Linked Transactions		61,187			79,746	
Total: GAAP Basis Excluding Linked Transactions	$	2,579,067		$	2,818,947	

(1) Counterparty holds collateral valued in excess of 5% of our stockholders equity as security for our obligations under the applicable repurchase agreements as of December 31, 2013.

(2) The counterparty rating presented above is the long-term issuer credit rating as rated at March 12, 2014 by S&P, except for Mizuho Securities USA Inc. which is the long-term issuer credit rating by Moody s at March 12, 2014.

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We record the liability for MBS and other securities purchased, for which settlement has not taken place as an investment related payable. As of June 30, 2014, we had investment related payables of $57.0 million.

The following tables present our borrowings by type of collateral pledged as of June 30, 2014 and 2013, and the respective Effective Cost of Funds for the three and six months then ended (dollars in thousands):

Collateral		**Balance (GAAP) June 30, 2014**	**Weighted Average Cost of Funds for the three months ended June 30, 2014**	**Weighted Average Cost of Funds for the six months ended June 30, 2014**
Agency RMBS	$	3,264,316	0.38%	0.39%
Non-Agency RMBS		504,733	1.64	1.66
Agency and Non-Agency CMBS		315,214	1.55	1.53
Other securities		26,985	1.60	1.62
Total	$	4,111,248	0.58%	0.56%

Collateral		**Balance (GAAP) June 30, 2013**	**Weighted Average Cost of Funds for the three months ended June 30, 2013**	**Weighted Average Cost of Funds for the six months ended June 30, 2013**
Agency RMBS	$	3,864,990	0.42%	0.43%
Non-Agency RMBS		96,639	1.85	1.85
Total	$	3,961,629	0.45%	0.45%

The following tables present our borrowings by type of collateral pledged as of June, 2014 and 2013, and the respective Effective Cost of Funds (Non-GAAP financial measure) for the three and six months then ended (dollars in thousands) See Non-GAAP financial measures :

Collateral		**Balance (Non-GAAP) June 30, 2014**	**Weighted Average Effective Cost of Funds for the three months ended June 30, 2014 (1)**	**Weighted Average Effective Cost of Funds for the six months ended June 30, 2014 (1)**
Agency RMBS	$	3,264,316	1.05%	1.33%
Non-Agency RMBS		504,733	1.75	1.78
Agency and Non-Agency CMBS		315,214	1.98	1.99
Other securities		26,985	1.60	1.62
Total: Excluding Linked Transactions	$	4,111,248	1.17%	1.40%
Non-Agency RMBS Linked Transactions		12,282	1.57	1.71
		15,198	1.71	1.71

Non-Agency CMBS Linked Transactions, including Non U.S.				
Total	$	4,138,728	1.17%	1.40%

(1) The effective cost of funds for the three and six months ended June 30, 2014 are calculated on an annualized basis and include interest expense for the periods and net payments on interest rate swaps of approximately $6.1 million and $13.9 million, respectively and interest payments on Non-Agency and other securities linked transactions of approximately $50 thousand and $275 thousand, respectively. While swaps are not accounted for using hedge accounting, such instruments are viewed by us as an economic hedge against increases in interest rates on our liabilities and are classified as hedges for purposes of satisfying the REIT tax requirements. In addition, although certain securities and their respective repurchase borrowings are classified as derivatives, we view the interest expense attributed to these borrowings as additional cost of funds. See Non-GAAP Financial Measures.

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Collateral		Balance (Non-GAAP) June 30, 2013	Weighted Average Effective Cost of Funds for the three months ended June 30, 2013 (1)	Weighted Average Effective Cost of Funds for the six months ended June 30, 2013 (1)
Agency RMBS	$	3,864,990	0.94%	0.90%
Non-Agency RMBS		96,639	1.85	1.85
Total: Excluding Linked Transactions	$	3,961,629	0.96%	0.91%
Agency RMBS Linked Transactions			0.38	0.38
Non-Agency RMBS Linked Transactions		3,286	1.78	1.80
Total	$	3,964,915	0.96%	0.91%

(1) The effective cost of funds for the three and six months ended June 30, 2013, are calculated on an annualized basis and include interest expense for the periods and net payments on interest rate swaps of approximately $5.2 million and $9.7 million, respectively, interest payments on Agency linked transactions of approximately $6 thousand and $6 thousand, respectively and interest payments on Non-Agency linked transactions of approximately $99 thousand and $188 thousand, respectively. While swaps are not accounted for using hedge accounting, such instruments are viewed by us as an economic hedge against increases in interest rates and are classified as hedges for purposes of satisfying the REIT tax requirements. In addition, although certain securities and their respective repurchase borrowings are classified as derivatives, we view the interest expense attributed to these borrowings as additional cost of funds. See Non GAAP Financial Measures .

The following table presents our average borrowings, by type of collateral pledged, on a GAAP and Non-GAAP basis for the three and six months ended June 30, 2014 and 2013 (in thousands):

Collateral		For the three months ended June 30, 2014		For the three months ended June 30, 2013		For the six months ended June 30, 2014		For the six months ended June 30, 2013
Agency RMBS	$	3,438,511	$	3,959,424	$	2,896,627	$	4,243,261
Non-Agency RMBS		412,897		80,375		309,530		65,543
Agency and Non-Agency CMBS		207,596				112,459		
Other securities		62,812				42,472		
Total: Excluding Linked Transactions (GAAP)	$	4,121,816	$	4,039,799	$	3,361,088	$	4,308,804
Agency RMBS Linked Transactions (Non-GAAP)				6,301				3,200
Non-Agency RMBS Linked Transactions (Non-GAAP)		12,501		22,370		32,227		21,050
Non-Agency CMBS Linked Transactions (Non-GAAP), including Non U.S.		234				119		
Total (Non-GAAP)	$	4,134,551	$	4,068,470	$	3,393,434	$	4,333,054
Maximum borrowings during the period (Non-GAAP)(1)		4,254,145		4,231,087		4,254,145		4,808,778

(1) Amount represents the maximum borrowings at month-end during each of the respective periods.

Derivative Instruments. As of June 30, 2014, we had entered into swaps designed to mitigate the effects of increases in interest rates under a portion of our repurchase agreements as such repurchase agreements are renewed and/or extended. The swaps generally provide for fixed interest rates that are indexed off of LIBOR and are viewed by us to effectively fix the floating interest rates, net of variable-rate payment swaps, on approximately $2.9 billion of borrowings under our repurchase agreements, excluding forward starting swaps of $1.3 billion as of June 30, 2014.

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The following table presents information about our fixed pay rate interest rate swaps as of June 30, 2014 and December 31, 2013 (dollars in thousands):

	June 30, 2014			
Remaining Interest Rate interest rate swap Term	Notional Amount	Average Fixed Pay Rate	Average Maturity (Years)	Forward Starting
1 year or less	$ 215,900	0.4%	0.3	%
Greater than 1 year and less than 3 years	1,129,100	0.8	2.1	35.4
Greater than 3 years and less than 5 years	2,297,800	1.7	4.6	
Greater than 5 years	3,206,050	2.7	10.3	31.6
Total	$ 6,848,850	2.0%	6.7	20.6%

	December 31, 2013			
Remaining Interest Rate interest rate swap Term	Notional Amount	Average Fixed Pay Rate	Average Maturity (Years)	Forward Starting
1 year or less	$ 215,900	0.4%	0.8	%
Greater than 1 year and less than 3 years	179,100	0.5	1.9	
Greater than 3 years and less than 5 years	574,200	1.3	4.4	
Greater than 5 years	1,718,650	2.4	10.8	28.6
Total	$ 2,687,850	1.9%	8.0	18.3%

The following table presents information about our variable pay rate interest rate swaps as of June 30, 2014 and December 31, 2013 (dollars in thousands):

	June 30, 2014			
Remaining Interest Rate interest rate swap Term	Notional Amount	Average Variable Pay Rate	Average Maturity (Years)	Forward Starting
Greater than 3 years and less than 5 years	$ 1,520,000	0.2%	4.9	%
Greater than 5 years	1,132,100	0.2	10.4	9.7
Total	$ 2,652,100	0.2%	7.2	4.1%

	December 31, 2013			
Remaining Interest Rate interest rate swap Term	Notional Amount	Average Variable Pay Rate	Average Maturity (Years)	Forward Starting
Greater than 3 years and less than 5 years	$ 81,000	0.2%	4.8	%
Greater than 5 years	46,000	0.2	24.1	
Total	$ 127,000	0.2%	11.8	%

The following tables present information about our interest rate swaptions as of June 30, 2014 and December 31, 2013 (dollars in thousands):

	June 30, 2014			
	Option		Underlying Swap	
Fixed-Pay Rate for Underlying Swap	**Fair Value**	**Weighted Average Months Until Option Expiration**	**Notional Amount**	**Weighted Average Swap Term (Years)**
2.26 2.50%	$ 276	23.8	$ 105,000	1.0
3.51 3.75%	61	3.6	200,000	10.0
	$ 337	10.6	$ 305,000	6.9

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	December 31, 2013			
	Option		Underlying Swap	
Fixed-Pay Rate for Underlying Swap	Fair Value	Weighted Average Months Until Option Expiration	Notional Amount	Weighted Average Swap Term (Years)
2.51 2.75%	$ 1,889	4.4	$ 150,000	7.0
2.76 3.00%	2,762	4.3	250,000	7.0
3.01 3.25%	1,192	4.6	1,500,000	10.0
3.26 3.50%	971	4.0	100,000	10.0
3.51 3.75%	4,363	9.6	200,000	10.0
	$ 11,177	5.0	$ 2,200,000	9.5

	December 31, 2013			
	Option		Underlying Swap	
Fixed-Receive Rate for Underlying Swap	Fair Value	Weighted Average Months Until Option Expiration	Notional Amount	Weighted Average Swap Term (Years)
3.76 4.00%	$ (264)	4.0	$ 100,000	10
	$ (264)	4.0	$ 100,000	10

We also purchased or sold TBAs. As of June 30, 2014 and December 31, 2013, we had contracts to purchase (long position) and sell (short position) TBAs on a forward basis. Following is a summary of our long and short TBA positions reported in Derivative assets, at fair value on the Balance Sheet as of June 30, 2014 and December 31, 2013 (dollars in thousands):

	June 30, 2014		December 31, 2013	
	Notional Amount	Fair Value	Notional Amount	Fair Value
Purchase contracts, asset	$ 2,173,400	$ 8,036	$ 13,600	$ 35
Sale contracts, asset				
TBA securities, asset	2,173,400	8,036	13,600	35
Purchase contracts, liability	200,000	(863)	176,400	(1,207)
Sale contracts, liability	(1,693,000)	(5,713)		
TBA securities, liability	(1,493,000)	(6,576)	176,400	(1,207)
TBA securities, net	$ 680,400	$ 1,460	$ 190,000	$ (1,172)

The following table presents additional information about our contracts to purchase and sell TBAs for the six months ended June 30, 2014 (dollars in thousands):

	Notional Amount as of December 31, 2013	Additions	Settlement, Termination, Expiration or Exercise	Notional Amount as of June 30, 2014
Purchase of TBAs	$ 190,000	11,811,896	$ (9,628,496)	$ 2,373,400

Sale of TBAs	$	11,321,496	$	(9,628,496)	$	1,693,000

We also entered into Eurodollar futures during the six months ended June 30, 2014. As of June 30, 2014, we had purchase contracts (long position), representing a notional amount of $592.0 million with a fair value of $437 thousand and an expiration date of June 2016. In addition, as of June 30, 2014, we had contracts to sell (short position), representing a notional amount of $592.0 million with a fair value in a liability position of $548 thousand and an expiration date of June 2018.

The following is a summary of our foreign currency forwards with a fair value in a liability position of $138 thousand at June 30, 2014:

Derivative Type	**Notional Amount**		**Notional (USD Equivalent)**	**Maturity**
Sell EUR/Buy USD Currency forward	11,100	$	15,199	July 2014
Buy EUR/Sell USD Currency forward	11,100	$	15,205	September 2014

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The following is a summary of our foreign currency swaps with a fair value of $15 thousand at June 30, 2014:

Date entered	Maturity	Fixed Rate	Denomination	Notional Amount
June 2014	July 2024	7.25%	EUR	18,500
June 2014	July 2024	9.005%	USD	25,160

Net Interest Income

We earned interest income, net of premium amortization and amortization/recovery of basis, and inclusive of discount accretion of approximately $44.6 million and $68.0 million for the three and six months ended June 30, 2014, respectively, and approximately $32.8 million and $66.5 million for the three and six months ended June 30, 2013, respectively, which represents interest earned on our assets. We incurred interest expense of approximately $6.0 million and $9.4 million for the three and six months ended June 30, 2014, respectively, and approximately $4.5 million and $9.7 million for the three and six months ended June 30, 2013, respectively, which was related to borrowings from repurchase agreements. Yields on Agency RMBS decreased in 2014 corresponding to the decrease on the yield on the ten-year U.S. Treasury. Yields on Non-Agency RMBS generally decreased as result of continuing home price appreciation and market demand for such securities, however, the yield on our Non-Agency RMBS portfolio increased due higher expected recoveries and changes in the composition of such portfolio. Yields on our Agency and Non-Agency CMBS portfolio generally decreased due to the tightening of credit spreads in that sector. Cost of repurchase financing remained relatively constant as the Federal Reserve continues to maintain its accommodative monetary policy. Our effective gross yield, a non-GAAP measure, increased for the quarter due to the change in composition of our portfolio. Our effective cost of funds, a non-GAAP measure, for the quarter was 1.17%, a 0.60% decrease from the prior quarter ended March 31, 2014. The reduction in our effective cost of funds for the quarter ended June 30, 2014, primarily resulted from lower net interest expense associated with our hedging costs as the amount of interest rate swaps for which we incurred a current payment obligation was lower relative to our outstanding borrowings than in the prior quarter ended March 31, 2014.

	For the three months ended June 30, 2014				
(dollars in thousands)	Agency RMBS	Non-Agency RMBS	Agency and Non-Agency CMBS	Other securities	Total
Average amortized cost of securities	$ 3,751,050	$ 596,871	$ 286,678	$ 79,960	$ 4,714,559
Total interest income (1)	$ 30,749	$ 8,809	$ 3,985	$ 1,061	$ 44,604
Yield on average securities	3.29%	5.92%	5.58%	5.32%	3.79%
Average balance of repurchase agreements	$ 3,438,511	$ 412,897	$ 207,596	$ 62,812	$ 4,121,816
Total interest expense	$ 3,230	$ 1,688	$ 802	$ 251	$ 5,971
Average cost of funds (2)	0.38%	1.64%	1.55%	1.60%	0.58%

Net interest income	$ 27,519	$ 7,121	$ 3,183	$ 810	$ 38,633
Net interest rate spread	2.91%	4.28%	4.03%	3.72%	3.21%

(1)Amount includes net (amortization of premiums), accretion of discounts and (amortization/recovery of basis) of approximately $(13.9) million for Agency RMBS, approximately $(516) thousand for Non-Agency RMBS, approximately $291 thousand for Agency and Non-Agency CMBS, and approximately $114 thousand for other securities for three months ended June 30, 2014. In accordance with GAAP, interest income does not include $251 thousand for linked transactions for the three and months ended June 30, 2014; instead such amounts are included in gain (loss) on linked transactions.

(2) For the three months ended June 30, 2014, cost of funds does not include accrual and settlement of interest associated with derivative instruments and linked transactions of approximately $6.1 million and $50 thousand, respectively. In accordance with GAAP, such costs are included in gain (loss) on derivative instruments and gain (loss) on linked transactions, respectively, in the Statement of Operations.

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(dollars in thousands)	For the six months ended June 30, 2014 Agency RMBS	Non-Agency RMBS	Agency and Non-Agency CMBS	Other securities	Total
Average amortized cost of securities	$ 3,161,100	$ 452,857	$ 149,945	$ 53,169	$ 3,817,071
Total interest income (1)	$ 48,458	$ 13,812	$ 4,210	$ 1,554	$ 68,034
Yield on average securities	3.09%	6.15%	5.66%	5.89%	3.59%
Average balance of repurchase agreements	$ 2,896,627	$ 309,530	$ 112,459	$ 42,472	$ 3,361,088
Total interest expense	$ 5,621	$ 2,544	$ 854	$ 342	$ 9,361
Average cost of funds (2)	0.39%	1.66%	1.53%	1.62%	0.56%
Net interest income	$ 42,837	$ 11,268	$ 3,356	$ 1,212	$ 58,673
Net interest rate spread	2.70%	4.49%	4.13%	4.27%	3.03%

(1)Amount includes net (amortization of premiums), accretion of discounts and (amortization/recovery of basis) of approximately $(26.0) million for Agency RMBS, approximately $121 thousand for Non-Agency RMBS, approximately $468 thousand for Agency and Non-Agency CMBS and approximately $215 thousand for other securities for the six months ended June 30, 2014. In accordance with GAAP, interest income does not include approximately $1.2 million for linked transactions for the six months ended June 30, 2014; instead such amounts are included in gain (loss) on linked transactions.

(2) For the six months ended June 30, 2014, cost of funds does not include accrual and settlement of interest of approximately $13.9 million and $275 thousand associated with derivative instruments and linked transactions, respectively. In accordance with GAAP, such costs are included in gain (loss) on derivative instruments and gain (loss) on linked transactions, respectively, in the Statement of Operations.

(dollars in thousands)	For the three months ended June 30, 2013			For the six months ended June 30, 2013		
	Agency	Non-agency	Total	Agency	Non-agency	Total
Average amortized cost of RMBS	$ 4,274,504	$ 157,025	$ 4,431,529	$ 4,415,030	$ 133,107	$ 4,548,137
Total interest income (1)	$ 30,409	$ 2,333	$ 32,742	$ 62,578	$ 3,914	$ 66,492
Yield on average RMBS	2.85%	5.96%	2.96%	2.86%	5.93%	2.95%
Average balance of repurchase agreements	$ 3,959,424	$ 80,375	$ 4,039,799	$ 4,243,261	$ 65,543	$ 4,308,804
Total interest expense	$ 4,151	$ 371	$ 4,522	$ 9,102	$ 601	$ 9,703
	0.42%	1.85%	0.45%	0.43%	1.85%	0.45%

Average cost of funds (2)												
Net interest income	$	26,258	$	1,962	$	28,220	$	53,476	$	3,313	$	56,789