

TWO HARBORS INVESTMENT CORP.

Form 10-Q

November 03, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended: September 30, 2016

Commission File Number 001-34506

TWO HARBORS INVESTMENT CORP.

(Exact Name of Registrant as Specified in Its Charter)

Maryland 27-0312904
(State or Other Jurisdiction of (I.R.S. Employer
Incorporation or Organization) Identification No.)

590 Madison Avenue, 36th Floor 10022
New York, New York
(Address of Principal Executive Offices) (Zip Code)
(612) 629-2500
(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 No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§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 No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or 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 Accelerated filer Non-accelerated filer Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No
Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

As of November 2, 2016 there were 347,643,717 shares of outstanding common stock, par value \$.01 per share, issued and outstanding.

Table of Contents

TWO HARBORS INVESTMENT CORP.
INDEX

	Page
PART I - FINANCIAL INFORMATION	
<u>Item 1. Financial Statements (unaudited)</u>	<u>1</u>
<u>Condensed Consolidated Balance Sheets at September 30, 2016 and December 31, 2015</u>	<u>1</u>
<u>Condensed Consolidated Statements of Comprehensive Income (Loss) for the Three and Nine Months Ended September 30, 2016 and 2015</u>	<u>2</u>
<u>Condensed Consolidated Statements of Stockholders' Equity for the Nine Months Ended September 30, 2016 and 2015</u>	<u>4</u>
<u>Condensed Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2016 and 2015</u>	<u>5</u>
<u>Notes to the Condensed Consolidated Financial Statements</u>	<u>8</u>
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>52</u>
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	<u>85</u>
<u>Item 4. Controls and Procedures</u>	<u>90</u>
PART II - OTHER INFORMATION	
<u>Item 1. Legal Proceedings</u>	<u>91</u>
<u>Item 1A. Risk Factors</u>	<u>91</u>
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>91</u>
<u>Item 3. Defaults Upon Senior Securities</u>	<u>91</u>
<u>Item 4. Mine Safety Disclosures</u>	<u>91</u>
<u>Item 5. Other Information</u>	<u>91</u>
<u>Item 6. Exhibits</u>	<u>91</u>
<u>Signatures</u>	<u>92</u>
<u>Index of Exhibits</u>	<u>93</u>

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

TWO HARBORS INVESTMENT CORP.

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)

	September 30, 2016	December 31, 2015
	(unaudited)	
ASSETS		
Available-for-sale securities, at fair value	\$ 14,284,625	\$ 7,825,320
Residential mortgage loans held-for-sale, at fair value	723,174	811,431
Residential mortgage loans held-for-investment in securitization trusts, at fair value	3,620,037	3,173,727
Commercial real estate assets	1,114,548	660,953
Mortgage servicing rights, at fair value	455,629	493,688
Cash and cash equivalents	688,418	737,831
Restricted cash	264,872	262,562
Accrued interest receivable	67,089	49,970
Due from counterparties	56,095	17,206
Derivative assets, at fair value	199,013	271,509
Other assets	326,396	271,575
Total Assets ⁽¹⁾	\$ 21,799,896	\$ 14,575,772
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities		
Repurchase agreements	\$ 10,637,373	\$ 5,008,274
Collateralized borrowings in securitization trusts, at fair value	3,375,906	2,000,110
Federal Home Loan Bank advances	4,000,000	3,785,000
Revolving credit facilities	30,000	—
Derivative liabilities, at fair value	39,918	7,285
Due to counterparties	78,179	34,294
Dividends payable	79,956	92,016
Other liabilities	80,323	72,232
Total Liabilities ⁽¹⁾	18,321,655	10,999,211
Stockholders' Equity		
Preferred stock, par value \$0.01 per share; 50,000,000 shares authorized; no shares issued and outstanding	—	—
Common stock, par value \$0.01 per share; 900,000,000 shares authorized and 347,635,488 and 353,906,807 shares issued and outstanding, respectively	3,476	3,539
Additional paid-in capital	3,655,854	3,705,519
Accumulated other comprehensive income	538,443	359,061
Cumulative earnings	1,696,630	1,684,755
Cumulative distributions to stockholders	(2,416,162)	(2,176,313)
Total Stockholders' Equity	3,478,241	3,576,561
Total Liabilities and Stockholders' Equity	\$ 21,799,896	\$ 14,575,772

(1) The condensed consolidated balance sheets include assets of consolidated variable interest entities, or VIEs, that can only be used to settle obligations of these VIEs, and liabilities of the consolidated VIEs for which creditors do not have recourse to Two Harbors Investment Corp. At September 30, 2016 and December 31, 2015, assets of the VIEs totaled \$3,686,340 and \$3,237,918, and liabilities of the VIEs totaled \$3,398,215 and \$2,017,677,

respectively. See Note 3 - Variable Interest Entities for additional information.
The accompanying notes are an integral part of these condensed consolidated financial statements.

Table of Contents

TWO HARBORS INVESTMENT CORP.
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
 (in thousands, except share data)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2016	2015	2016	2015
	(unaudited)		(unaudited)	
Interest income:				
Available-for-sale securities	\$ 111,393	\$ 116,318	\$ 292,333	\$ 369,972
Trading securities	—	—	—	8,676
Residential mortgage loans held-for-sale	7,627	9,479	19,789	21,268
Residential mortgage loans held-for-investment in securitization trusts	33,495	24,841	100,765	64,908
Commercial real estate assets	15,907	1,947	40,279	2,841
Cash and cash equivalents	440	249	1,235	667
Total interest income	168,862	152,834	454,401	468,332
Interest expense:				
Repurchase agreements	27,056	18,235	65,782	58,198
Collateralized borrowings in securitization trusts	26,422	15,562	70,965	39,401
Federal Home Loan Bank advances	6,744	3,282	18,804	8,012
Revolving credit facilities	128	—	128	—
Total interest expense	60,350	37,079	155,679	105,611
Net interest income	108,512	115,755	298,722	362,721
Other-than-temporary impairments:				
Total other-than-temporary impairment losses	(1,015)	(238)	(1,822)	(535)
Other income (loss):				
Gain on investment securities	28,290	64,123	66,095	263,512
Gain (loss) on interest rate swap and swaption agreements	5,584	(171,656)	(132,608)	(253,147)
Loss on other derivative instruments	(12,028)	(455)	(44,064)	(2,972)
(Loss) gain on residential mortgage loans held-for-sale	(889)	16,040	17,648	18,300
Servicing income	38,708	32,010	108,657	94,613
Loss on servicing asset	(33,451)	(61,549)	(211,426)	(96,317)
Other income (loss)	5,757	2,201	(977)	(16,265)
Total other income (loss)	31,971	(119,286)	(196,675)	7,724
Expenses:				
Management fees	11,387	12,617	35,268	38,024
Securitization deal costs	2,080	2,676	6,241	7,771
Servicing expenses	9,073	7,234	24,510	19,849
Other operating expenses	14,780	16,150	47,280	48,032
Restructuring charges	1,189	—	1,189	—
Total expenses	38,509	38,677	114,488	113,676
Income (loss) before income taxes	100,959	(42,446)	(14,263)	256,234
Benefit from income taxes	(16,827)	(7,656)	(26,138)	(25,270)
Net income (loss)	\$ 117,786	\$ (34,790)	\$ 11,875	\$ 281,504
Basic and diluted earnings (loss) per weighted average common share	\$ 0.34	\$ (0.09)	\$ 0.03	\$ 0.77
Dividends declared per common share	\$ 0.23	\$ 0.26	\$ 0.69	\$ 0.78
	347,627,226	67,365,973	348,218,234	66,985,731

Basic and diluted weighted average number of shares of common
stock outstanding

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

2

Table of Contents

TWO HARBORS INVESTMENT CORP.
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS), continued
 (in thousands, except share data)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2016	2015	2016	2015
	(unaudited)		(unaudited)	
Comprehensive income (loss):				
Net income (loss)	\$ 117,786	\$(34,790)	\$ 11,875	\$ 281,504
Other comprehensive income (loss), net of tax:				
Unrealized gain (loss) on available-for-sale securities	18,746	(58,031)	179,382	(282,788)
Other comprehensive income (loss)	18,746	(58,031)	179,382	(282,788)
Comprehensive income (loss)	\$ 136,532	\$(92,821)	\$ 191,257	\$(1,284)

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

Table of Contents

TWO HARBORS INVESTMENT CORP.
 CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
 (in thousands, except share data)

	Common Stock						
	Shares	Amount	Additional Paid-in Capital	Accumulated Other Comprehensive Income (unaudited)	Cumulative Earnings	Cumulative Distributions to Stockholders	Total Stockholders' Equity
Balance, December 31, 2014	366,395,920	\$ 3,664	\$ 3,811,027	\$ 855,789	\$ 1,195,536	\$(1,797,974)	\$ 4,068,042
Cumulative effect of adoption of new accounting principle	—	—	—	—	(2,991)	—	(2,991)
Adjusted balance, January 1, 2015	366,395,920	3,664	3,811,027	855,789	1,192,545	(1,797,974)	4,065,051
Net income	—	—	—	—	281,504	—	281,504
Other comprehensive loss before reclassifications, net of tax							