

MFA FINANCIAL, INC.  
Form 10-Q  
May 05, 2015  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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FORM 10-Q

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

For the quarterly period ended March 31, 2015

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 1-13991

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

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|   |   |
|---|---|
| Maryland<br>(State or other jurisdiction of<br>incorporation or organization) | 13-3974868<br>(I.R.S. Employer<br>Identification No.) |
|---|---|

|   |                     |
|---|---------------------|
| 350 Park Avenue, 20th Floor, New York, New York<br>(Address of principal executive offices) | 10022<br>(Zip Code) |
|---|---------------------|

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

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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 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 a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting

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company” in Rule 12b-2 of the Exchange Act.

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 Exchange Act). Yes  No

370,390,756 shares of the registrant’s common stock, \$0.01 par value, were outstanding as of April 30, 2015.

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## MFA FINANCIAL, INC.

## CONSOLIDATED BALANCE SHEETS

| (In Thousands Except Per Share Amounts)   | March 31,<br>2015<br>(Unaudited) | December 31,<br>2014 |
|---|----------------------------------|----------------------|
| <b>Assets:</b>  |                                  |                      |
| Mortgage-backed securities (“MBS”) and credit risk transfer (“CRT”) securities:   |                                  |                      |
| Agency MBS, at fair value (\$5,302,714 and \$5,519,813 pledged as collateral, respectively)   | \$5,671,195                      | \$5,904,207          |
| Non-Agency MBS, at fair value (\$4,971,558 and \$2,377,343 pledged as collateral, respectively)   | 6,161,390                        | 3,358,426            |
| Non-Agency MBS transferred to consolidated variable interest entities (“VIEs”), at fair value (1)   | 693,933                          | 1,397,006            |
| CRT securities, at fair value (\$118,384 and \$94,610 pledged as collateral, respectively)  | 127,182                          | 102,983              |
| Securities obtained and pledged as collateral, at fair value  | 506,861                          | 512,105              |
| Residential whole loans, at carrying value (\$66,748 and \$67,536 pledged as collateral, respectively)  | 242,777                          | 207,923              |
| Residential whole loans, at fair value (\$142,438 and \$143,072 pledged as collateral, respectively)  | 144,507                          | 143,472              |
| Cash and cash equivalents   | 168,717                          | 182,437              |
| Restricted cash   | 93,287                           | 67,255               |
| Interest receivable   | 32,885                           | 31,257               |
| Derivative instruments:   |                                  |                      |
| MBS linked transactions, net (“Linked Transactions”), at fair value   | —                                | 398,336              |
| Interest rate swap agreements (“Swaps”), at fair value  | 1,051                            | 3,136                |
| Goodwill  | 7,189                            | 7,189                |
| Prepaid and other assets  | 50,781                           | 39,012               |
| <b>Total Assets</b>   | <b>\$13,901,755</b>              | <b>\$12,354,744</b>  |
| <b>Liabilities:</b>   |                                  |                      |
| Repurchase agreements   | \$9,809,586                      | \$8,267,388          |
| Securitized debt (2)  | 91,280                           | 110,574              |
| Obligation to return securities obtained as collateral, at fair value   | 506,861                          | 512,105              |
| 8% Senior Notes due 2042 (“Senior Notes”)   | 100,000                          | 100,000              |
| Accrued interest payable  | 12,341                           | 13,095               |
| Swaps, at fair value  | 92,480                           | 62,198               |
| Dividends and dividend equivalents rights (“DERs”) payable  | 74,581                           | 74,529               |
| Accrued expenses and other liabilities  | 6,454                            | 11,583               |
| <b>Total Liabilities</b>  | <b>\$10,693,583</b>              | <b>\$9,151,472</b>   |
| Commitments and contingencies (See Note 12)   |                                  |                      |
| <b>Stockholders’ Equity:</b>  |                                  |                      |
| Preferred stock, \$.01 par value; 7.50% Series B cumulative redeemable; 8,050 shares authorized; 8,000 shares issued and outstanding (\$200,000 aggregate liquidation preference) | \$80                             | \$80                 |
|   | 3,701                            | 3,701                |

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Common stock, \$.01 par value; 886,950 shares authorized; 370,134 and 370,084 shares issued and outstanding, respectively

|  |              |              |
|--|--------------|--------------|
| Additional paid-in capital, in excess of par | 3,014,594    | 3,013,634    |
| Accumulated deficit                          | (569,031 )   | (568,596 )   |
| Accumulated other comprehensive income       | 758,828      | 754,453      |
| Total Stockholders' Equity                   | \$3,208,172  | \$3,203,272  |
| Total Liabilities and Stockholders' Equity   | \$13,901,755 | \$12,354,744 |

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

(2) Securitized Debt represents third-party liabilities of consolidated VIEs and excludes liabilities of the VIEs acquired by the Company that eliminate on consolidation. The third-party beneficial interest holders in the VIEs have no recourse to the general credit of the Company. (See Notes 12 and 17 for further discussion.)

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

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CONSOLIDATED STATEMENTS OF OPERATIONS  
(UNAUDITED)

| (In Thousands, Except Per Share Amounts)                              | Three Months Ended |           |
|---|--------------------|-----------|
|   | March 31,<br>2015  | 2014      |
| Interest Income:  |                    |           |
| Agency MBS  | \$31,673           | \$39,329  |
| Non-Agency MBS  | 81,248             | 43,155    |
| Non-Agency MBS transferred to consolidated VIEs                       | 12,043             | 38,664    |
| CRT securities  | 1,360              | —         |
| Residential whole loans held at carrying value                        | 3,591              | —         |
| Cash and cash equivalent investments                                  | 27                 | 26        |
| Interest Income   | \$129,942          | \$121,174 |
| Interest Expense:   |                    |           |
| Repurchase agreements   | \$41,182           | \$36,729  |
| Securitized debt  | 750                | 2,185     |
| Senior Notes  | 2,008              | 2,007     |
| Interest Expense  | \$43,940           | \$40,921  |
| Net Interest Income   | \$86,002           | \$80,253  |
| Other-Than-Temporary Impairments:                                     |                    |           |
| Total other-than-temporary impairment losses                          | \$ (395)           | ) \$—     |
| Portion of loss reclassified from other comprehensive income          | (12)               | ) —       |
| Net Impairment Losses Recognized in Earnings                          | \$ (407)           | ) \$—     |
| Other Income, net:  |                    |           |
| Unrealized net gains and net interest income from Linked Transactions | \$—                | \$3,251   |
| Net income on residential whole loans held at fair value              | 2,576              | —         |
| Gain on sales of MBS  | 6,435              | 3,571     |
| Other, net  | 26                 | (416)     |
| Other Income, net   | \$9,037            | \$6,406   |
| Operating and Other Expense:  |                    |           |
| Compensation and benefits   | \$6,746            | \$6,507   |
| Other general and administrative expense                              | 3,457              | 3,964     |
| Other investment related operating expenses                           | 2,256              | —         |
| Operating and Other Expense   | \$12,459           | \$10,471  |
| Net Income  | \$82,173           | \$76,188  |
| Less Preferred Stock Dividends  | 3,750              | 3,750     |
| Net Income Available to Common Stock and Participating Securities     | \$78,423           | \$72,438  |
| Earnings per Common Share - Basic and Diluted                         | \$0.21             | \$0.20    |
| Dividends Declared per Share of Common Stock                          | \$0.20             | \$0.20    |

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

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

| (In Thousands)   | Three Months Ended |           |
|--|--------------------|-----------|
|  | March 31,          |           |
|  | 2015               | 2014      |
| Net income   | \$82,173           | \$76,188  |
| Other Comprehensive Income:  |                    |           |
| Unrealized gain on Agency MBS, net   | 12,885             | 17,843    |
| Unrealized gain on Non-Agency MBS, net   | 20,609             | 51,417    |
| Reclassification adjustment for MBS sales included in net income   | (6,423             | ) (2,950  |
| Reclassification adjustment for other-than-temporary impairments included in net income                    | (407               | ) —       |
| Unrealized gain on CRT securities, net   | 5,541              | —         |
| Unrealized loss on derivative hedging instruments, net   | (32,367            | ) (12,267 |
| Reclassification of unrealized loss on de-designated derivative hedging instruments                        | —                  | 447       |
| Cumulative effect adjustment on adoption of revised accounting standard for repurchase agreement financing | 4,537              | —         |
| Other Comprehensive Income   | 4,375              | 54,490    |
| Comprehensive income before preferred stock dividends  | \$86,548           | \$130,678 |
| Dividends declared on preferred stock  | (3,750             | ) (3,750  |
| Comprehensive Income Available to Common Stock and Participating Securities                                | \$82,798           | \$126,928 |

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



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

| (In Thousands,<br>Except Per Share Amounts)  | Three Months Ended March 31, 2015   |        |              |         |                                  |                        |   |             |
|--|---|--------|--------------|---------|----------------------------------|------------------------|---|-------------|
|  | Preferred<br>Stock<br>7.50% Series<br>B Cumulative<br>Redeemable -<br>Liquidation<br>Preference<br>\$25.00 per<br>Share |        | Common Stock |         | Additional<br>Paid-in<br>Capital | Accumulated<br>Deficit | Accumulated<br>Other<br>Comprehensive<br>Income | Total       |
|  | Shares  | Amount | Shares       | Amount  |                                  |                        |   |             |
| Balance at December 31, 2014   | 8,000   | \$80   | 370,084      | \$3,701 | \$3,013,634                      | \$(568,596)            | \$754,453                                       | \$3,203,272 |
| Cumulative effect<br>adjustment on adoption of<br>revised accounting standard<br>for repurchase agreement<br>financing | —   | —      | —            | —       | —                                | (4,537)                | 4,537   | —           |
| Net income   | —   | —      | —            | —       | —                                | 82,173                 | —   | 82,173      |
| Issuance of common stock,<br>net of expenses (1)   | —   | —      | 61           | —       | 312                              | —                      | —   | 312         |
| Repurchase of shares of<br>common stock (1)  | —   | —      | (11)         | —       | (151)                            | —                      | —   | (151)       |
| Equity based compensation<br>expense   | —   | —      | —            | —       | 912                              | —                      | —   | 912         |
| Accrued dividends<br>attributable to stock-based<br>awards   | —   | —      | —            | —       | (113)                            | —                      | —   | (113)       |
| Dividends declared on<br>common stock  | —   | —      | —            | —       | —                                | (74,072)               | —   | (74,072)    |
| Dividends declared on<br>preferred stock   | —   | —      | —            | —       | —                                | (3,750)                | —   | (3,750)     |
| Dividends attributable to<br>DERs  | —   | —      | —            | —       | —                                | (249)                  | —   | (249)       |
| Change in unrealized gains<br>on MBS and CRT<br>securities, net  | —   | —      | —            | —       | —                                | —                      | 32,205  | 32,205      |
| Change in unrealized losses<br>on derivative hedging<br>instruments, net   | —   | —      | —            | —       | —                                | —                      | (32,367)  | (32,367)    |
| Balance at March 31, 2015  | 8,000   | \$80   | 370,134      | \$3,701 | \$3,014,594                      | \$(569,031)            | \$758,828                                       | \$3,208,172 |

(1) For the three months ended March 31, 2015, includes approximately \$87,000 (11,074 shares) surrendered for tax purposes related to equity-based compensation awards.



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

| (In Thousands)  | Three Months Ended |                |
|---|--------------------|----------------|
|   | March 31,          |                |
|   | 2015               | 2014           |
| <b>Cash Flows From Operating Activities:</b>  |                    |                |
| Net income  | \$82,173           | \$76,188       |
| Adjustments to reconcile net income to net cash provided by operating activities:     |                    |                |
| Gain on sales of MBS  | (6,435             | ) (3,571       |
| Other-than-temporary impairment charges   | 407                | —              |
| Accretion of purchase discounts on MBS and CRT securities and residential whole loans | (25,254            | ) (27,434      |
| Amortization of purchase premiums on MBS  | 9,122              | 10,215         |
| Depreciation and amortization on real estate, fixed assets and other assets           | 115                | 327            |
| Equity-based compensation expense   | 912                | 1,484          |
| Unrealized gain on residential whole loans at fair value                              | (602               | ) —            |
| Unrealized gains on derivative instruments  | —                  | (2,076         |
| Increase in interest receivable   | (364               | ) (863         |
| Increase in prepaid and other assets  | (12,939            | ) (9,644       |
| Decrease in accrued expenses and other liabilities, and excise tax and interest       | (5,365             | ) (3,745       |
| Increase in accrued interest payable on financial instruments                         | 10,058             | 7,384          |
| Net cash provided by operating activities   | \$51,828           | \$48,265       |
| <b>Cash Flows From Investing Activities:</b>  |                    |                |
| Principal payments on MBS and CRT securities  | \$588,088          | \$438,149      |
| Proceeds from sale of MBS   | 10,845             | 15,501         |
| Purchases of MBS and CRT securities   | (518,127           | ) (888,106     |
| Purchases of residential whole loans  | (40,168            | ) —            |
| Principal payments on residential whole loans   | 6,260              | —              |
| Additions to leasehold improvements, furniture and fixtures                           | (158               | ) (85          |
| Net cash provided by/(used in) investing activities                                   | \$46,740           | \$(434,541)    |
| <b>Cash Flows From Financing Activities:</b>  |                    |                |
| Principal payments on repurchase agreements   | \$(25,536,927)     | \$(20,203,589) |
| Proceeds from borrowings under repurchase agreements                                  | 25,559,532         | 20,470,421     |
| Principal payments on securitized debt  | (19,186            | ) (73,262      |
| Cash disbursements on financial instruments underlying Linked Transactions            | —                  | (374,073       |
| Cash received from financial instruments underlying Linked Transactions               | —                  | 344,504        |
| Payments made for margin calls on repurchase agreements and Swaps                     | (98,000            | ) (29,000      |
| Proceeds from reverse margin calls on repurchase agreements and Swaps                 | 60,000             | 30,000         |
| Proceeds from issuances of common stock   | 312                | 7,616          |
| Dividends paid on preferred stock   | (3,750             | ) (3,750       |
| Dividends paid on common stock and DERs   | (74,269            | ) (73,289      |
| Net cash (used in)/provided by financing activities                                   | \$(112,288)        | \$95,578       |
| Net decrease in cash and cash equivalents   | \$(13,720)         | \$(290,698)    |
| Cash and cash equivalents at beginning of period                                      | \$182,437          | \$565,370      |

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|   |              |            |
|---|--------------|------------|
| Cash and cash equivalents at end of period  | \$ 168,717   | \$ 274,672 |
| Non-cash Investing and Financing Activities:  |              |            |
| MBS and CRT securities recorded upon adoption of revised accounting standard for repurchase agreement financing | \$ 1,917,813 | \$—        |
| Repurchase agreements recorded upon adoption of revised accounting standard for repurchase agreement financing  | \$ 1,519,593 | \$—        |
| Net increase in securities obtained as collateral/obligation to return securities obtained as collateral        | \$ 20,990    | \$ 47,768  |
| Transfer from residential whole loans to real estate owned  | \$ 3,448     | \$—        |
| Dividends and DERs declared and unpaid  | \$ 74,581    | \$ 73,875  |

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

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MFA FINANCIAL, INC.

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2015

1. Organization

MFA Financial, Inc. (the “Company”) was incorporated in Maryland on July 24, 1997 and began operations on April 10, 1998. The Company has elected to be treated as a real estate investment trust (“REIT”) for U.S. federal income tax purposes. In order to maintain its qualification as a REIT, the Company must comply with a number of requirements under federal tax law, including that it must distribute at least 90% of its annual REIT taxable income to its stockholders. The Company has elected to treat certain of its subsidiaries as a taxable REIT subsidiary (“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. (See Notes 2(o) and 13)

2. Summary of Significant Accounting Policies

(a) Basis of Presentation and Consolidation

The interim unaudited consolidated financial statements of the Company have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission (the “SEC”). Certain information and note disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) have been condensed or omitted according to these SEC rules and regulations. Management believes that the disclosures included in these interim unaudited consolidated financial statements are adequate to make the information presented not misleading. The accompanying consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2014. In the opinion of management, all normal and recurring adjustments necessary to present fairly the financial condition of the Company at March 31, 2015 and results of operations for all periods presented have been made. The results of operations for the three months ended March 31, 2015 should not be construed as indicative of the results to be expected for the full year.

The accompanying consolidated financial statements of the Company have been prepared on the accrual basis of accounting in accordance with GAAP. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although the Company’s estimates contemplate current conditions and how it expects them to change in the future, it is reasonably possible that actual conditions could be worse than anticipated in those estimates, which could materially impact the Company’s results of operations and its financial condition. Management has made significant estimates in several areas, including other-than-temporary impairment (“OTTI”) on MBS and CRT securities (Note 3), valuation of MBS and CRT securities (Notes 3 and 16), income recognition and valuation of residential whole loans (Notes 4 and 16), derivative instruments (Notes 6 and 16) and income recognition on certain Non-Agency MBS purchased at a discount (Note 3). In addition, estimates are used in the determination of taxable income used in the assessment of REIT compliance and contingent liabilities for related taxes, penalties and interest (Note 2(o)). Actual results could differ from those estimates.

The consolidated financial statements of the Company include the accounts of all subsidiaries; significant intercompany accounts and transactions have been eliminated. In addition, the Company consolidates the special purpose entities created to facilitate the securitization transactions completed in prior years and the acquisition of residential whole loans. Certain prior period amounts have been reclassified to conform to the current period presentation.

(b) MBS (including Non-Agency MBS transferred to consolidated VIEs) and CRT Securities

The Company has investments in residential MBS that are issued or guaranteed as to principal and/or interest by a federally chartered corporation, such as Fannie Mae or Freddie Mac, or any agency of the U.S. Government, such as Ginnie Mae (collectively, "Agency MBS"), and residential MBS that are not guaranteed by any U.S. Government agency or any federally chartered corporation ("Non-Agency MBS"). In addition, the Company has investments in CRT securities that are issued by Fannie Mae and Freddie Mac. The coupon payments on CRT securities are paid by Fannie Mae and Freddie Mac and the principal payments received are based on the performance of loans in a reference pool of recently securitized MBS. As the loans in the underlying reference pool are paid, the principal balance of the CRT securities is paid. CRT securities will experience losses if the loans in the underlying reference pool experience defaults exceeding a specified threshold.

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MFA FINANCIAL, INC.

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2015

Designation

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

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

Revenue Recognition, Premium Amortization and Discount Accretion

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

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

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

Determination of Fair Value for MBS and CRT Securities

In determining the fair value of the Company's MBS and CRT securities, management considers a number of observable market data points, including prices obtained from pricing services, brokers and repurchase agreement counterparties, dialogue with market participants, as well as management's observations of market activity. (See Note 16)

## Impairments/OTTI

When the fair value of an investment security is less than its amortized cost at the balance sheet date, the security is considered impaired. The Company assesses its impaired securities on at least a quarterly basis and designates such impairments as either “temporary” or “other-than-temporary.” If the Company intends to sell an impaired security, or it is more likely than not that it will be required to sell the impaired security before its anticipated recovery, then the Company must recognize an OTTI through charges to earnings equal to the entire difference between the investment’s amortized cost and its fair value at the balance sheet date. If the Company does not expect to sell an other-than-temporarily impaired security, only the portion of the OTTI related to credit losses is recognized through charges to earnings with the remainder recognized through AOCI on the consolidated balance sheets. Impairments recognized through other comprehensive income/(loss) (“OCI”) do not impact earnings. Following the recognition of an OTTI through earnings, a new cost basis is established for the security and may not be adjusted for subsequent recoveries in fair value through earnings. However, OTTIs recognized through charges to earnings may be accreted back to the



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amortized cost basis of the security on a prospective basis through interest income. The determination as to whether an OTTI exists and, if so, the amount of credit impairment recognized in earnings is subjective, as such determinations are based on factual information available at the time of assessment as well as the Company's estimates of the future performance and cash flow projections. As a result, the timing and amount of OTTIs constitute material estimates that are susceptible to significant change. (See Note 3)

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

Balance Sheet Presentation

The Company's MBS and CRT Securities pledged as collateral against repurchase agreements and Swaps are included on the consolidated balance sheets with the fair value of the securities pledged disclosed parenthetically. Purchases and sales of securities are recorded on the trade date.

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

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

(d) Residential Whole Loans

Residential whole loans included in the Company's consolidated balance sheets are comprised of pools of fixed and adjustable rate residential mortgage loans acquired through interests in consolidated trusts in secondary market

transactions at discounted purchase prices. The accounting model utilized by the Company is determined at the time the loans are initially acquired and is generally based on the delinquency status of the associated borrower at acquisition. The accounting model described below under “Residential Whole Loans at Carrying Value” is typically utilized by the Company for loans where the underlying borrower has a delinquency status of less than 60 days at the acquisition date. The accounting model described below under “Residential Whole Loans at Fair Value” is typically utilized by the Company for loans where the underlying borrower has a delinquency status of 60 days or more at the acquisition date. The accounting model initially applied is not subsequently changed.

The Company’s residential whole loans pledged as collateral against repurchase agreements are included in the consolidated balance sheets with the fair value of the loans pledged disclosed parenthetically. Purchases and sales of residential whole loans are recorded on the trade date, with amounts recorded reflecting management’s current estimate of assets that will be acquired or disposed at the closing of the transaction. This estimate is subject to revision at the closing of the transaction, pending the outcome of due diligence performed prior to closing.

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Residential Whole Loans at Carrying Value

Notwithstanding that these loans are considered to be performing in accordance with their current contractual terms and conditions, the Company has elected to account for these loans as credit impaired as they were acquired at discounted prices that reflect, in part, the impaired credit history of the borrower. Substantially all of the borrowers have previously experienced payment delinquencies and the amount owed on the mortgage loan may exceed the value of the property pledged as collateral. Consequently, the Company has assessed that these loans have a higher likelihood of default than newly originated mortgage loans with LTVs of 80% or less to credit worthy borrowers. The Company believes that amounts paid to acquire these loans represent fair market value at the date of acquisition. Such loans are initially recorded at fair value with no allowance for loan losses. Subsequent to acquisition, the recorded amount reflects the original investment amount, plus accretion of interest income, less principal and interest cash flows received. These loans are presented on the Company's consolidated balance sheets at carrying value, which reflects the recorded amount reduced by any allowance for loan losses established subsequent to acquisition.

Under the application of this accounting model the Company may aggregate into pools loans acquired in the same fiscal quarter that are assessed as having similar risk characteristics. For each pool established, or on an individual loans basis for loans not aggregated into pools, the Company estimates at acquisition and periodically on at least a quarterly basis, the principal and interest cash flows expected to be collected. The difference between the cash flows expected to be collected and the carrying amount of the loans is referred to as the "accretable yield." This amount is accreted as interest income over the life of the loans using an effective interest rate (level yield) methodology. Interest income recorded each period reflects the amount of accretable yield recognized and not the coupon interest payments received on the underlying loans. The difference between contractually required principal and interest payments and the cash flows expected to be collected, referred to as the "nonaccretable difference," includes estimates of both the impact of prepayments and expected credit losses over the life of the underlying loans.

A decrease in expected cash flows in subsequent periods may indicate impairment at the pool and/or individual loan level thus requiring the establishment of an allowance for loan losses by a charge to the provision for loan losses. The allowance for loan losses represents the present value of cash flows expected at acquisition that are no longer expected to be received at the relevant measurement date. A significant increase in expected cash flows in subsequent periods initially reduces any previously established allowance for loan losses by the increase in the present value of cash flows expected to be collected, and results in a recalculation of the amount of accretable yield. The adjustment of accretable yield due to a significant increase in expected cash flows is accounted for prospectively as a change in estimate and results in reclassification from nonaccretable difference to accretable yield. (See Notes 4 and 17)

Residential Whole Loans at Fair Value

Certain of the Company's residential whole loans are presented at fair value on its consolidated balance sheets as a result of a fair value election made at time of acquisition. Given the significant uncertainty associated with estimating the timing of and amount of cash flows associated with these loans that will be collected, and that the cash flows ultimately collected may be dependent on the value of the property securing the loan, the Company considers that accounting for these loans at fair value should result in a better reflection over time of the economic returns from these loans. The Company determines the fair value of its residential whole loans held at fair value after considering portfolio valuations obtained from a third-party who specializes in providing valuations of residential mortgage loans and trading activity observed in the market place. Subsequent changes in fair value are reported in current period earnings and presented in Net income on residential whole loans held at fair value on the Company's consolidated statements of operations.

Cash received reflecting coupon payments on residential whole loans held at fair value is not included in Interest Income, but rather is presented in Net income on residential whole loans held at fair value on the Company's consolidated statements of operations. (See Notes 4 and 16)

(e) Cash and Cash Equivalents

Cash and cash equivalents include cash on deposit with financial institutions and investments in money market funds, all of which have original maturities of three months or less. Cash and cash equivalents may also include cash pledged as collateral to the Company by its repurchase agreement and/or Swap counterparties as a result of reverse margin calls (i.e., margin calls made by the Company). The Company did not hold any cash pledged by its counterparties at March 31, 2015 or December 31, 2014. The Company's investments in overnight money market funds, which are not bank deposits and are not insured or guaranteed by

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the Federal Deposit Insurance Corporation or any other government agency, were \$149.4 million and \$168.0 million at March 31, 2015 and December 31, 2014, respectively. (See Notes 9 and 16)

(f) Restricted Cash

Restricted cash represents the Company's cash held by its counterparties as collateral or otherwise in connection with the Company's Swaps and/or repurchase agreements. Restricted cash is not available to the Company for general corporate purposes, but may be applied against amounts due to counterparties to the Company's repurchase agreements and/or Swaps, or returned to the Company when the collateral requirements are exceeded or at the maturity of the Swap or repurchase agreement. The Company had aggregate restricted cash held as collateral or otherwise in connection with its Swaps and repurchase agreements of \$93.3 million and \$67.3 million at March 31, 2015 and December 31, 2014, respectively. (See Notes 6, 8, 9 and 16)

(g) Goodwill

At March 31, 2015 and December 31, 2014, the Company had goodwill of \$7.2 million, which represents the unamortized portion of the excess of the fair value of its common stock issued over the fair value of net assets acquired in connection with its formation in 1998. Goodwill is tested for impairment at least annually, or more frequently under certain circumstances, at the entity level. Through March 31, 2015, the Company had not recognized any impairment against its goodwill.

(h) Real Estate Owned ("REO")

REO represents real estate acquired through foreclosure or deed in lieu of foreclosure and is initially recorded at fair value less estimated selling costs. Subsequent to acquisition, at each reporting date, REO is reported at the lower of the current carrying amount or fair value less estimated selling costs and for presentation purposes is included in Other assets on the Company's consolidated balance sheets. Changes in fair value that result in an adjustment to the reported amount of a REO property that has a fair value at or below its carrying amount are reported in Other income, net on the Company's consolidated statements of operations. (See Note 7)

(i) Depreciation

Leasehold Improvements and Other Depreciable Assets

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

(j) Resecuritization and Senior Notes Related Costs

Resecuritization related costs are costs associated with the issuance of beneficial interests by consolidated VIEs and incurred by the Company in connection with various resecuritization transactions completed by the Company. Senior Notes related costs are costs incurred by the Company in connection with the issuance of its Senior Notes in April, 2012. These costs may include underwriting, rating agency, legal, accounting and other fees. Such costs, which reflect deferred charges, are included on the Company's consolidated balance sheets in Prepaid and other assets. These deferred charges are amortized as an adjustment to interest expense using the effective interest method, based upon the

actual repayments of the associated beneficial interests issued to third parties and over the stated legal maturity of the Senior Notes. The Company periodically reviews the recoverability of these deferred costs and in the event an impairment charge is required, such amount shall be included within Operating and other expense on the Company's consolidated statement of operations.

(k) Repurchase Agreements and Reverse Repurchase Agreements

The Company finances the holdings of a significant portion of its MBS and CRT securities with repurchase agreements. Under repurchase agreements, the Company sells securities to a lender and agrees to repurchase the same securities in the future for a price that is higher than the original sale price. The difference between the sale price that the Company receives and the repurchase price that the Company pays represents interest paid to the lender. Although legally structured as sale and repurchase transactions, the Company accounts for repurchase agreements as secured borrowings. Under its repurchase agreements, the Company pledges its securities as collateral to secure the borrowing, which is equal in value to a specified percentage of the fair

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value of the pledged collateral, while the Company retains beneficial ownership of the pledged collateral. At the maturity of a repurchase financing, unless the repurchase financing is renewed with the same counterparty, the Company is required to repay the loan including any accrued interest and concurrently receives back its pledged collateral from the lender. With the consent of the lender, the Company may renew a repurchase financing at the then prevailing financing terms. Margin calls, whereby a lender requires that the Company pledge additional securities or cash as collateral to secure borrowings under its repurchase financing with such lender, are routinely experienced by the Company when the value of the MBS pledged as collateral declines as a result of principal amortization and prepayments or due to changes in market interest rates, spreads or other market conditions. The Company also may make margin calls on counterparties when collateral values increase.

The Company's repurchase financings typically have terms ranging from one month to six months at inception, but may also have longer or shorter terms. Should a counterparty decide not to renew a repurchase financing at maturity, the Company must either refinance elsewhere or be in a position to satisfy the obligation. If, during the term of a repurchase financing, a lender should default on its obligation, the Company might experience difficulty recovering its pledged assets which could result in an unsecured claim against the lender for the difference between the amount loaned to the Company plus interest due to the counterparty and the fair value of the collateral pledged by the Company to such lender, including accrued interest receivable or such collateral. (See Notes 8, 9 and 16)

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

(l) Equity-Based Compensation

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

During 2010, the Company granted certain restricted stock units ("RSUs") that vested after either two or four years of service and provided that certain criteria are met, which were based on a formula that included changes in the Company's closing stock price over a two- or four-year period and dividends declared on the Company's common stock during those periods. From 2011 through 2013, the Company granted certain RSUs that vested annually over a one or

three-year period, provided that certain criteria are met, which are based on a formula tied to the Company's achievement of average total stockholder return during that three-year period. During 2014 and the first quarter of 2015, the Company made grants of RSUs certain of which cliff vest after a three-year period and certain of which cliff vest after a three-year period, subject to the achievement of certain performance criteria based on a formula tied to the Company's achievement of average total stockholder return during that three-year period. The features in these awards related to the attainment of total stockholder return over a specified period constitute a "market condition" which impacts the amount of compensation expense recognized for these awards. Specifically, the uncertainty regarding the achievement of the market condition was reflected in the grant date fair valuation of the RSUs, which in addition to estimates regarding the amount of RSUs expected to be forfeited during the associated service period, determined the amount of compensation expense recognized. The amount of compensation expense recognized was not dependent on whether the market condition was or will be achieved, while differences in actual forfeiture experience relative to estimated forfeitures results in adjustments to the timing and amount of compensation expense recognized.



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The Company has awarded DERs that may be granted separately and/or in conjunction with other equity based awards. Compensation expense for separately awarded DERs is based on the grant date fair value of such awards and is recognized over the vesting period. Payments pursuant to these DERs are charged to stockholders' equity. Payments pursuant to DERs that are attached to equity based awards are charged to stockholders' equity to the extent that the attached equity awards are expected to vest. Compensation expense is recognized for payments made for DERs to the extent that the attached equity awards do not or are not expected to vest and grantees are not required to return payments of dividends or DERs to the Company. (See Notes 2(m) and 15)

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

Basic EPS is computed using the two-class method, which includes the weighted-average number of shares of common stock outstanding during the period and other securities that participate in dividends, such as the Company's unvested restricted stock and RSUs that have non-forfeitable rights to dividends and DERs attached to/associated with RSUs and vested stock options to arrive at total common equivalent shares. In applying the two-class method, earnings are allocated to both shares of common stock and securities that participate in dividends based on their respective weighted-average shares outstanding for the period. For the diluted EPS calculation, common equivalent shares are further adjusted for the effect of dilutive unexercised stock options and RSUs outstanding that are unvested and have dividends that are subject to forfeiture using the treasury stock method. Under the treasury stock method, common equivalent shares are calculated assuming that all dilutive common stock equivalents are exercised and the proceeds, along with future compensation expenses associated with such instruments, are used to repurchase shares of the Company's outstanding common stock at the average market price during the reported period. (See Note 14)

(n) Comprehensive Income/(Loss)

The Company's comprehensive income/(loss) available to common stock and participating securities includes net income, the change in net unrealized gains/(losses) on its MBS, CRT securities and derivative hedging instruments, (to the extent that such changes are not recorded in earnings), adjusted by realized net gains/(losses) reclassified out of AOCI for MBS, CRT securities and de-designated derivative hedging instruments and is reduced by dividends declared on the Company's preferred stock and issuance costs of redeemed preferred stock.

(o) U.S. Federal Income Taxes

The Company has elected to be taxed as a REIT under the provisions of the Internal Revenue Code of 1986, as amended, (the "Code") and the corresponding provisions of state law. The Company expects to operate in a manner that will enable it to satisfy the various requirements to maintain its status as a REIT. In order to maintain its status as a REIT, the Company must, among other things, distribute at least 90% of its REIT taxable income (excluding net long-term capital gains) to stockholders in the timeframe permitted by the Code. As long as the Company maintains its status as a REIT, the Company will not be subject to regular Federal income tax to the extent that it distributes 100% of its REIT taxable income (including net long-term capital gains) to its stockholders within the permitted timeframe. Should this not occur, the Company would be subject to federal taxes at prevailing corporate tax rates on the difference between its REIT taxable income and the amounts deemed to be distributed for that tax year. As the Company's objective is to distribute 100% of its REIT taxable income to its stockholders within the permitted timeframe, no provision for current or deferred income taxes has been made in the accompanying consolidated financial statements. Should the Company incur a liability for corporate income tax, such amounts would be recorded as REIT income tax expense on the Company's consolidated statements of operations. Furthermore, if the Company fails to distribute during each calendar year, or by the end of January following the calendar year in the case of

distributions with declaration and record dates falling in the last three months of the calendar year, at least the sum of (i) 85% its REIT ordinary income for such year; (ii) 95% of its REIT capital gain income for such year and; (iii) any undistributed taxable income from prior periods, the Company will be subject to a 4% nondeductible excise tax on the excess of such required distribution over the amounts actually distributed. To the extent that the Company incurs interest, penalties or related excise taxes in connection with its tax obligations, including as a result of its assessment of uncertain tax positions, such amounts shall be included within Operating and other expense on the Company's consolidated statements of operations.

In addition, the Company has elected to treat certain of its subsidiaries as a 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. Since a portion of the Company's business may be conducted through a TRS, its income earned by such TRS will be subject to corporate income taxation. To

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maintain the Company's REIT election, at the end of each quarter no more than 25% of the value of a REIT's assets may consist of TRS stock or securities.

Based on its analysis of any potential uncertain tax positions, the Company concluded that it does not have any material uncertain tax positions that meet the relevant recognition or measurement criteria as of March 31, 2015, December 31, 2014, or March 31, 2014. The Company filed its 2013 tax return prior to September 15, 2014. The Company's tax returns for tax years 2009 through 2013 are open to examination.

(p) Derivative Financial Instruments

The Company may use a variety of derivative instruments to economically hedge a portion of its exposure to market risks, including interest rate risk and prepayment risk. The objective of the Company's risk management strategy is to reduce fluctuations in net book value over a range of interest rate scenarios. In particular, the Company attempts to mitigate the risk of the cost of its variable rate liabilities increasing during a period of rising interest rates. The Company's derivative instruments are currently comprised of Swaps, which are designated as cash flow hedges against the interest rate risk associated with its borrowings. Prior to 2015, the Company's derivative financial instruments also included Linked Transactions, which were not designated as hedging instruments. New accounting guidance that was effective for the Company on January 1, 2015 prospectively eliminated the use of Linked Transaction accounting (see Note 6). During 2013, the Company also entered into forward contracts for the sale of Agency MBS securities on a generic pool, or to-be-announced basis ("TBA short positions") which were also not designated as hedging instruments.

Linked Transactions

Prior to 2015, it was presumed that the initial transfer of a financial asset (i.e., the purchase of an MBS or CRT security by the Company) and contemporaneous repurchase financing of such security with the same counterparty were considered part of the same arrangement, or a "linked transaction," unless certain criteria were met. The two components of a linked transaction (security purchase and repurchase financing) were not reported separately but were evaluated on a combined basis and reported as a forward (derivative) contract and were presented as "Linked Transactions" on the Company's consolidated balance sheets. Changes in the fair value of the assets and liabilities underlying Linked Transactions and associated interest income and expense were reported as "unrealized net gains/(losses) and net interest income from Linked Transactions" on the Company's consolidated statements of operations and were not included in OCI. However, if certain criteria were met, the initial transfer (i.e., the purchase of a security by the Company) and repurchase financing were not treated as a Linked Transaction and would have been evaluated and reported separately, as an MBS or CRT security purchase and repurchase financing. When or if a transaction was no longer considered to be linked, the security and repurchase financing was reported on a gross basis. In this case, the fair value of the MBS or CRT security at the time the transactions were no longer considered linked became the cost basis of the MBS or CRT security, and the income recognition yield for such MBS or CRT security was calculated prospectively using this new cost basis.

New accounting guidance that was effective for the Company on January 1, 2015 prospectively eliminated the use of Linked Transaction accounting as described above. This resulted in changes subsequent to January 1, 2015 to the presentation of assets and liabilities, and revenues and expenses of Non-Agency MBS and CRT securities and associated repurchase agreements that were accounted for as Linked Transactions prior to that date. The presentation changes include the presentation of Non-Agency MBS and CRT securities and associated repurchase agreements as separate assets and liabilities, rather than on a combined basis on the Company's consolidated balance sheets. In addition, starting in 2015, interest income related to the securities and interest expense related to the associated

repurchase agreements are separately presented and included in the determination of the Company's net interest income on its consolidated statement of operations. Further, the previous treatment of Linked Transactions as forward (derivative) instruments recorded at fair value at the end of each period with changes in fair value included in net income was discontinued and effective January 1, 2015 MBS that were previously accounted for as components of Linked Transactions are accounted for consistent with other MBS held by the Company as available for sale securities. (See Notes 2(t), 6 and 16)

#### Swaps

The Company documents its risk-management policies, including objectives and strategies, as they relate to its hedging activities and the relationship between the hedging instrument and the hedged liability for all Swaps designated as hedging transactions. The Company assesses, both at inception of a hedge and on a quarterly basis thereafter, whether or not the hedge is "highly effective."

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Swaps are carried on the Company's consolidated balance sheets at fair value, as assets, if their fair value is positive, or as liabilities, if their fair value is negative. Changes in the fair value of the Company's Swaps designated in hedging transactions are recorded in OCI provided that the hedge remains effective. Changes in fair value for any ineffective amount of a Swap are recognized in earnings. The Company has not recognized any change in the value of its existing Swaps designated as hedges through earnings as a result of hedge ineffectiveness.

The Company discontinues hedge accounting on a prospective basis and recognizes changes in the fair value through earnings when: (i) it is determined that the derivative is no longer effective in offsetting cash flows of a hedged item (including forecasted transactions); (ii) it is no longer probable that the forecasted transaction will occur; or (iii) it is determined that designating the derivative as a hedge is no longer appropriate.

Although permitted under certain circumstances, the Company does not offset cash collateral receivables or payables against its net derivative positions. (See Notes 6, 9 and 16)

TBA Short Positions

During 2013, the Company entered into TBA short positions as a means of managing interest rate risk and MBS basis risk associated with its investment and financing activities. A TBA short position is a forward contract for the sale of Agency MBS at a predetermined price, face amount, issuer, coupon and maturity on an agreed-upon future date. The specific Agency MBS that could be delivered into the contract upon the settlement date, published each month by the Securities Industry and Financial Markets Association ("SIFMA"), are not known at the time of the transaction.

The Company accounts for TBA short positions as derivative instruments since it cannot assert that it is probable at inception and throughout the term of the TBA contract that it will physically deliver the agency security upon settlement of the contract. The Company presents TBA short positions as either derivative assets or liabilities, at fair value on its consolidated balance sheets. Gains and losses associated with TBA short positions are reported in Other income, net on the Company's consolidated statements of operations. (See Note 6)

The Company did not have any TBA short positions at March 31, 2015 and December 31, 2014.

(q) Fair Value Measurements and the Fair Value Option for Financial Assets and Financial Liabilities

The Company's presentation of fair value for its financial assets and liabilities is determined within a framework that stipulates that the fair value of a financial asset or liability is an exchange price in an orderly transaction between market participants to sell the asset or transfer the liability in the market in which the reporting entity would transact for the asset or liability, that is, the principal or most advantageous market for the asset or liability. The transaction to sell the asset or transfer the liability is a hypothetical transaction at the measurement date, considered from the perspective of a market participant that holds the asset or owes the liability. This definition of fair value focuses on exit price and prioritizes the use of market-based inputs over entity-specific inputs when determining fair value. In addition, the framework for measuring fair value establishes a three-level hierarchy for fair value measurements based upon the observability of inputs to the valuation of an asset or liability as of the measurement date.

In addition to the financial instruments that it is required to report at fair value, the Company has elected the fair value option for certain of its residential whole loans at time of acquisition. Subsequent changes in the fair value of these loans are reported in Net income on residential whole loans held at fair value on the Company's consolidated statements of operations. A decision to elect the fair value option for an eligible financial instrument, which may be

made on an instrument by instrument basis, is irrevocable. (See Notes 2(d), 4 and 16)

(r) Variable Interest Entities

An entity is referred to as a VIE if it meets at least one of the following criteria: (i) the entity has equity that is insufficient to permit the entity to finance its activities without additional subordinated financial support of other parties; or (ii) as a group, the holders of the equity investment at risk lack (a) the power to direct the activities of an entity that most significantly impact the entity's economic performance; (b) the obligation to absorb the expected losses; or (c) the right to receive the expected residual returns; or (iii) have disproportional voting rights and the entity's activities are conducted on behalf of the investor that has disproportionately few voting rights.

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The Company consolidates a VIE when it has both the power to direct the activities that most significantly impact the economic performance of the VIE and a right to receive benefits or absorb losses of the entity that could be potentially significant to the VIE. The Company is required to reconsider its evaluation of whether to consolidate a VIE each reporting period, based upon changes in the facts and circumstances pertaining to the VIE.

The Company has entered into resecuritization transactions which result in the Company consolidating the VIEs that were created to facilitate the transactions and to which the underlying assets in connection with the resecuritizations were transferred. In determining the accounting treatment to be applied to these resecuritization transactions, the Company concluded that the entities used to facilitate these transactions were VIEs and that they should be consolidated. If the Company had determined that consolidation was not required, it would have then assessed whether the transfer of the underlying assets would qualify as a sale or should be accounted for as secured financings under GAAP.

Prior to the completion of its initial resecuritization transaction in October 2010, the Company had not transferred assets to VIEs or Qualifying Special Purpose Entities (“QSPEs”) and other than acquiring MBS issued by such entities, had no other involvement with VIEs or QSPEs. (See Note 17)

The Company also includes in its consolidated balance sheets certain financial assets and liabilities that are acquired/issued by trusts and /or other special purpose entities that have been evaluated as being required to be consolidated by the Company under the applicable accounting guidance.

(s) Offering Costs Related to Issuance and Redemption of Preferred Stock

Offering costs related to issuance of preferred stock are recorded as a reduction in Additional paid-in capital, a component of stockholders’ equity, at the time such preferred stock is issued. On redemption of preferred stock, any excess of the fair value of the consideration transferred to the holders of the preferred stock over the carrying amount of the preferred stock in the Company’s consolidated balance sheets is included in the determination of Net Income Available to Common Stock and Participating Securities in the calculation of EPS. (See Notes 13 and 14)

(t) New Accounting Standards and Interpretations

Accounting Standards Adopted in 2015

Receivables - Recognition of Residential Real Estate upon Foreclosure

In January 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2014-04, Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure, (“ASU 2014-04”). This ASU applies to all creditors who obtain physical possession (resulting from an in substance repossession or foreclosure) of residential real estate property collateralizing a consumer mortgage loan in satisfaction of a receivable. The ASU clarifies that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (i) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (ii) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendments require interim and annual disclosure of both (i) the amount of foreclosed residential real estate property held by the creditor

and (ii) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction.

ASU 2014-04 was effective for the Company for reporting periods beginning after December 15, 2014. The Company has elected to adopt the amendments in this ASU using a prospective transition method. The Company's adoption of ASU 2014-04 beginning on January 1, 2015, did not have a material impact on the Company's consolidated financial statements.



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Transfers and Servicing

In June 2014, the FASB issued ASU 2014-11, Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures, (“ASU 2014-11”). The amendments of ASU 2014-11 require two accounting changes. First, the amendments in this ASU change the accounting for repurchase-to-maturity transactions to secured borrowing accounting. Second, for repurchase financing arrangements, the amendments require separate accounting for a transfer of a financial asset executed contemporaneously with a repurchase agreement with the same counterparty, which will result in secured borrowing accounting for the repurchase agreement. In addition, the amendments in ASU 2014-11 require disclosures for certain transactions comprising (i) a transfer of a financial asset accounted for as a sale and (ii) an agreement with the same transferee entered into in contemplation of the initial transfer that results in the transferor retaining substantially all of the exposure to the economic return on the transferred asset throughout the term of the transaction. ASU 2014-11 also requires disclosures for repurchase agreements, securities lending transactions, and repurchase-to-maturity transactions that are accounted for as secured borrowings.

The accounting changes in ASU 2014-11 were effective for the Company for reporting periods beginning after December 15, 2014. An entity is required to present changes in accounting for transactions outstanding on the effective date as a cumulative-effect adjustment to retained earnings as of the beginning of the period of adoption. Accordingly, on adoption of the new standard on January 1, 2015, the Company reclassified \$1.913 billion of Non-Agency MBS and \$4.6 million of CRT securities, that were previously reported as a component of Linked Transactions to Non-Agency MBS and CRT securities respectively on the consolidated balance sheets. In addition, liabilities of \$1.520 billion that were previously presented as a component of Linked Transactions were reclassified to Repurchase Agreements on the consolidated balance sheets. Furthermore, an amount of \$4.5 million representing net unrealized gains on Non-Agency MBS and CRT securities previously reported as a component of Linked Transactions as of December 31, 2014 was reclassified from Accumulated Deficit to AOCI. These reclassification adjustments had no net impact on the Company’s overall Total Stockholders’ Equity. While the Company’s adoption of this new standard beginning on January 1, 2015, did not have a material impact on the Company’s consolidated financial statements, it did result in changes, subsequent to adoption, to the presentation of assets and liabilities and revenues and expenses of Non-Agency MBS and CRT securities and associated repurchase agreements that had been accounted for as MBS Linked Transactions prior to that date. These presentation changes include the presentation, as noted above, of Non-Agency MBS and CRT securities and associated repurchase agreements as separate assets and liabilities, rather than on a combined basis. In addition, subsequent to the date of adoption the interest income related to the securities and the interest expense related to the associated repurchase agreements are separately presented and included in the determination of the Company’s net interest income. Further, the prior accounting requirement for MBS Linked Transactions, which involved treating the combined transaction as a derivative that was recorded at fair value each period, with changes in fair value included in net income, was discontinued and effective January 1, 2015. MBS that were previously accounted for as components of Linked Transactions are accounted for consistent with other MBS held by the Company as available for sale securities.

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3. MBS and CRT Securities

Agency and Non-Agency MBS

The Company's MBS are comprised of Agency MBS and Non-Agency MBS which include MBS issued prior to 2008 ("Legacy Non-Agency MBS") and MBS backed by re-performing/non-performing loans ("RPL/NPL MBS"). These MBS are secured by: (i) hybrid mortgages ("Hybrids"), which have interest rates that are fixed for a specified period of time and, thereafter, generally adjust annually to an increment over a specified interest rate index; (ii) adjustable-rate mortgages ("ARMs"); (iii) mortgages that have interest rates that reset more frequently (collectively, "ARM-MBS"); and (iv) 15 year and longer-term fixed rate mortgages. MBS do not have a single maturity date, and further, the mortgage loans underlying ARM-MBS do not all reset at the same time.

The Company pledges a significant portion of its MBS as collateral against its borrowings under repurchase agreements and Swaps. Non-Agency MBS that were accounted for as components of Linked Transactions prior to 2015 are not reflected in the tables for prior periods set forth in this note, as they were accounted for as derivatives. New accounting guidance that was effective for the Company on January 1, 2015 prospectively eliminated the use of Linked Transaction accounting. (See Notes 2(t), 6 and 9)

**Agency MBS:** Agency MBS are guaranteed as to principal and/or interest by a federally chartered corporation, such as Fannie Mae or Freddie Mac, or an agency of the U.S. Government, such as Ginnie Mae. The payment of principal and/or interest on Ginnie Mae MBS is explicitly backed by the full faith and credit of the U.S. Government. Since the third quarter of 2008, Fannie Mae and Freddie Mac have been under the conservatorship of the Federal Housing Finance Agency, which significantly strengthened the backing for these government-sponsored entities.

**Non-Agency MBS (including Non-Agency MBS transferred to consolidated VIEs):** The Company's Non-Agency MBS are secured by pools of residential mortgages, which are not guaranteed by an agency of the U.S. Government or any federally chartered corporation. Credit risk associated with Non-Agency MBS is regularly assessed as new information regarding the underlying collateral becomes available and based on updated estimates of cash flows generated by the underlying collateral.

CRT Securities

CRT Securities are debt obligations issued by Fannie Mae and Freddie Mac. While the coupon payments are paid by Fannie Mae or Freddie Mac on a monthly basis, the payment of principal is dependent on the performance of loans in a reference pool of MBS recently securitized by Fannie Mae or Freddie Mac. As loans in the reference pool are paid, the principal balance of the securities are paid. Consequently, CRT Securities mirror the payment and prepayment behavior of the mortgage loans in the reference pool. As an investor in a CRT security, the Company may incur a loss if the loans in the reference pool experience delinquencies exceeding specified thresholds. The Company assesses the credit risk associated with CRT Securities by assessing the current performance of the associated reference pool. CRT securities that were accounted for as components of Linked Transactions prior to 2015 are not reflected in the tables for prior periods set forth in this note, as they were accounted for as derivatives. (See Notes 2(t), 6 and 9)

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The following tables present certain information about the Company's MBS and CRT Securities at March 31, 2015 and December 31, 2014:

March 31, 2015

| (In Thousands)                              | Principal/<br>Current<br>Face | Purchase<br>Premiums | Accretible<br>Purchase<br>Discounts | Discount<br>Designated<br>as Credit<br>Reserve<br>and<br>OTTI (1) | Amortized<br>Cost (2) | Fair Value   | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Net<br>Unrealized<br>Gain/(Loss) |
|---|-------------------------------|----------------------|-------------------------------------|---|-----------------------|--------------|------------------------------|-------------------------------|----------------------------------|
| Agency MBS:                                 |                               |                      |                                     |   |                       |              |                              |                               |                                  |
| Fannie Mae                                  | \$4,389,055                   | \$166,626            | \$(69)                              | \$—   | \$4,555,612           | \$4,643,862  | \$98,174                     | \$(9,924)                     | \$88,250                         |
| Freddie Mac                                 | 973,777                       | 37,449               | —                                   | —   | 1,011,987             | 1,016,464    | 11,214                       | (6,737)                       | 4,477                            |
| Ginnie Mae                                  | 10,415                        | 182                  | —                                   | —   | 10,597                | 10,869       | 272                          | —                             | 272                              |
| Total Agency<br>MBS                         | 5,373,247                     | 204,257              | (69)                                | —   | 5,578,196             | 5,671,195    | 109,660                      | (16,661)                      | 92,999                           |
| Non-Agency<br>MBS:                          |                               |                      |                                     |   |                       |              |                              |                               |                                  |
| Expected to<br>Recover Par<br>(3)(4)        | 2,624,690                     | 405                  | (36,178)                            | —   | 2,588,917             | 2,620,279    | 33,147                       | (1,785)                       | 31,362                           |
| Expected to<br>Recover Less<br>Than Par (3) | 4,738,962                     | —                    | (352,530)                           | (873,533)   | 3,512,899             | 4,235,044    | 724,028                      | (1,883)                       | 722,145                          |
| Total<br>Non-Agency<br>MBS (5)              | 7,363,652                     | 405                  | (388,708)                           | (873,533)   | 6,101,816             | 6,855,323    | 757,175                      | (3,668)                       | 753,507                          |
| Total MBS                                   | 12,736,899                    | 204,662              | (388,777)                           | (873,533)   | 11,680,012            | 12,526,518   | 866,835                      | (20,329)                      | 846,506                          |
| CRT securities                              | 128,000                       | —                    | (4,569)                             | —   | 123,431               | 127,182      | 4,038                        | (287)                         | 3,751                            |
| Total MBS and<br>CRT securities             | \$12,864,899                  | \$204,662            | \$(393,346)                         | \$(873,533)   | \$11,803,443          | \$12,653,700 | \$870,873                    | \$(20,616)                    | \$850,257                        |

December 31, 2014

| (In Thousands)      | Principal/<br>Current<br>Face | Purchase<br>Premiums | Accretible<br>Purchase<br>Discounts | Discount<br>Designated<br>as Credit<br>Reserve<br>and<br>OTTI (1) | Amortized<br>Cost (2) | Fair Value  | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Net<br>Unrealized<br>Gain/(Loss) |
|---------------------|-------------------------------|----------------------|-------------------------------------|---|-----------------------|-------------|------------------------------|-------------------------------|----------------------------------|
| Agency MBS:         |                               |                      |                                     |   |                       |             |                              |                               |                                  |
| Fannie Mae          | \$4,587,823                   | \$174,245            | \$(71)                              | \$—   | \$4,761,997           | \$4,843,084 | \$102,187                    | \$(21,100)                    | \$81,087                         |
| Freddie Mac         | 1,011,659                     | 38,895               | —                                   | —   | 1,051,096             | 1,049,854   | 11,280                       | (12,522)                      | (1,242)                          |
| Ginnie Mae          | 10,811                        | 189                  | —                                   | —   | 11,000                | 11,269      | 269                          | —                             | 269                              |
| Total Agency<br>MBS | 5,610,293                     | 213,329              | (71)                                | —   | 5,824,093             | 5,904,207   | 113,736                      | (33,622)                      | 80,114                           |

|                                       |              |           |             |             |             |              |           |            |           |  |
|---------------------------------------|--------------|-----------|-------------|-------------|-------------|--------------|-----------|------------|-----------|--|
| Non-Agency MBS:                       |              |           |             |             |             |              |           |            |           |  |
| Expected to Recover Par (3)(4)        | 431,788      | 461       | (29,501 )   | —           | 402,748     | 428,431      | 26,735    | (1,052 )   | 25,683    |  |
| Expected to Recover Less Than Par (3) | 4,888,113    | —         | (370,063 )  | (900,557 )  | 3,617,493   | 4,327,001    | 712,168   | (2,660 )   | 709,508   |  |
| Total Non-Agency MBS (5)              | 5,319,901    | 461       | (399,564 )  | (900,557 )  | 4,020,241   | 4,755,432    | 738,903   | (3,712 )   | 735,191   |  |
| Total MBS                             | 10,930,194   | 213,790   | (399,635 )  | (900,557 )  | 9,844,334   | 10,659,639   | 852,639   | (37,334 )  | 815,305   |  |
| CRT securities                        | 109,500      | —         | (4,727 )    | —           | 104,773     | 102,983      | 324       | (2,114 )   | (1,790 )  |  |
| Total MBS and CRT securities          | \$11,039,694 | \$213,790 | \$(404,362) | \$(900,557) | \$9,949,107 | \$10,762,622 | \$852,963 | \$(39,448) | \$813,515 |  |

(1) Discount designated as Credit Reserve and amounts related to OTTI are generally not expected to be accreted into interest income. Amounts disclosed at March 31, 2015 reflect Credit Reserve of \$850.9 million and OTTI of \$22.6 million. Amounts disclosed at December 31, 2014 reflect Credit Reserve of \$877.6 million and OTTI of \$23.0 million.

(2) Includes principal payments receivable of \$761,000 and \$542,000 at March 31, 2015 and December 31, 2014, respectively, which are not included in the Principal/Current Face.

(3) Based on management's current estimates of future principal cash flows expected to be received.

(4) At March 31, 2015 RPL/NPL MBS had a \$2.320 billion Principal/Current face, \$2.317 billion amortized cost and \$2.318 billion fair value. At December 31, 2014, RPL/NPL MBS had a \$161.0 million Principal/Current face, \$161.0 million amortized cost and \$161.0 million fair value (excludes RPL/NPL MBS with \$1.850 billion Principal/Current face, \$1.847 billion amortized cost and \$1.847 billion fair value that were presented as a component of Linked Transactions at December 31, 2014).

(5) At March 31, 2015 and December 31, 2014, the Company expected to recover approximately 88% and 83%, respectively, of the then-current face amount of Non-Agency MBS.

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## Unrealized Losses on MBS and CRT Securities

The following table presents information about the Company's MBS and CRT securities that were in an unrealized loss position at March 31, 2015:

## Unrealized Loss Position For:

| (Dollars in Thousands)                | Less than 12 Months |                   |                      | 12 Months or more |                   |                      | Total        | Unrealized Losses |
|---------------------------------------|---------------------|-------------------|----------------------|-------------------|-------------------|----------------------|--------------|-------------------|
|                                       | Fair Value          | Unrealized Losses | Number of Securities | Fair Value        | Unrealized Losses | Number of Securities | Fair Value   |                   |
| <b>Agency MBS:</b>                    |                     |                   |                      |                   |                   |                      |              |                   |
| Fannie Mae                            | \$217,621           | \$ 1,106          | 24                   | \$964,033         | \$ 8,818          | 108                  | \$1,181,654  | \$ 9,924          |
| Freddie Mac                           | 262,660             | 1,750             | 33                   | 361,001           | 4,987             | 64                   | 623,661      | 6,737             |
| Total Agency MBS                      | 480,281             | 2,856             | 57                   | 1,325,034         | 13,805            | 172                  | 1,805,315    | 16,661            |
| <b>Non-Agency MBS:</b>                |                     |                   |                      |                   |                   |                      |              |                   |
| Expected to Recover Par (1)           | 636,219             | 959               | 12                   | 19,608            | 826               | 8                    | 655,827      | 1,785             |
| Expected to Recover Less Than Par (1) | 71,290              | 816               | 8                    | 22,343            | 1,067             | 6                    | 93,633       | 1,883             |
| Total Non-Agency MBS                  | 707,509             | 1,775             | 20                   | 41,951            | 1,893             | 14                   | 749,460      | 3,668             |
| Total MBS                             | 1,187,790           | 4,631             | 77                   | 1,366,985         | 15,698            | 186                  | 2,554,775    | 20,329            |
| CRT securities                        | 4,713               | 287               | 1                    | —                 | —                 | —                    | 4,713        | 287               |
| Total MBS and CRT securities          | \$ 1,192,503        | \$ 4,918          | 78                   | \$ 1,366,985      | \$ 15,698         | 186                  | \$ 2,559,488 | \$ 20,616         |

(1) Based on management's current estimates of future principal cash flows expected to be received.

At March 31, 2015, the Company did not intend to sell any of its investments that were in an unrealized loss position, and it is "more likely than not" that the Company will not be required to sell these securities before recovery of their amortized cost basis, which may be at their maturity. With respect to Non-Agency MBS held by consolidated VIEs, the ability of any entity to cause the sale to a third-party by the VIE prior to the maturity of these Non-Agency MBS is either specifically precluded, or is limited to specified events of default, none of which have occurred to date.

Gross unrealized losses on the Company's Agency MBS were \$16.7 million at March 31, 2015. Agency MBS are issued by Government Sponsored Entities ("GSEs") that enjoy either the implicit or explicit backing of the full faith and credit of the U.S. Government. While the Company's Agency MBS are not rated by any rating agency, they are currently perceived by market participants to be of high credit quality, with risk of default limited to the unlikely event that the U.S. Government would not continue to support the GSEs. In addition, the GSEs are currently profitable on a stand-alone basis with such profits being remitted to the U.S. Treasury. Given the credit quality inherent in Agency MBS, the Company does not consider any of the current impairments on its Agency MBS to be credit related. In assessing whether it is more likely than not that it will be required to sell any impaired security before its anticipated recovery, which may be at its maturity, the Company considers for each impaired security, the significance of each investment, the amount of impairment, the projected future performance of such impaired securities, as well as the Company's current and anticipated leverage capacity and liquidity position. Based on these analyses, the Company determined that at March 31, 2015 any unrealized losses on its Agency MBS were temporary.

Unrealized losses on the Company's Non-Agency MBS (including Non-Agency MBS transferred to consolidated VIEs) and CRT securities were \$4.0 million at March 31, 2015. Based upon the most recent evaluation, the Company does not consider these unrealized losses to be indicative of OTTI and does not believe that these unrealized losses are credit related, but are rather a reflection of current market yields and/or market place bid-ask spreads. The Company has reviewed its Non-Agency MBS and CRT securities that are in an unrealized loss position to identify those securities with losses that are other-than-temporary based on an assessment of changes in expected cash flows for such securities, which considers recent bond performance and where possible expected future performance of either the underlying collateral (in the case of Non-Agency MBS) or the relevant reference pool of MBS (in the case of CRT securities).

The Company recognized credit-related OTTI losses through earnings related to its Non-Agency MBS of approximately \$407,000 during the three months ended March 31, 2015. The Company did not recognize any credit-related OTTI losses through earnings related to its MBS during the three months ended March 31, 2014.

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Non-Agency MBS on which OTTI is recognized have experienced, or are expected to experience, credit-related adverse cash flow changes. The Company's estimate of cash flows for its Non-Agency MBS is based on its review of the underlying mortgage loans securing these MBS. The Company considers information available about the structure of the securitization, including structural credit enhancement, if any, and the past and expected future performance of underlying mortgage loans, including timing of expected future cash flows, prepayment rates, default rates, loss severities, delinquency rates, percentage of non-performing loans, FICO scores at loan origination, year of origination, LTVs, geographic concentrations, as well as Rating Agency reports, general market assessments, and dialogue with market participants. Changes in the Company's evaluation of each of these factors impacts the cash flows expected to be collected at the OTTI assessment date. For Non-Agency MBS purchased at a discount to par that were assessed for OTTI, such cash flow estimates indicated that the amount of expected losses decreased compared to the previous OTTI assessment date. These positive cash flow changes are primarily driven by recent improvements in LTVs due to loan amortization and home price appreciation, which, in turn, positively impacts the Company's estimates of default rates and loss severities for the underlying collateral. In addition, voluntary prepayments (i.e., loans that prepay in full with no loss) have generally trended higher for these MBS which also positively impacts the Company's estimate of expected loss. Overall, the combination of higher voluntary prepayments and lower LTVs supports the Company's assessment that such MBS are not other-than-temporarily impaired.

For CRT securities in an unrealized loss position, based on the Company's assessment of the cash flows it expects to receive from its investments in CRT securities, which considers the current performance of the relevant reference pool of MBS underlying these investments, the Company believes that the decline in fair value below the amortized cost is not due to credit related factors. Accordingly, the Company has assessed that unrealized losses related to its investments in CRT securities at the end of the period reflects temporary impairment. Significant judgment is used in both the Company's analysis of the expected cash flows for its investments in Legacy Non-Agency MBS and CRT securities and any determination of the credit component of OTTI.

The following table presents the composition of OTTI charges recorded by the Company for the three months ended March 31, 2015 and 2014:

| (In Thousands)              | Three Months Ended<br>March 31, 2015 | Three Months Ended<br>March 31, 2014 |
|-----------------------------|--------------------------------------|--------------------------------------|
| Total OTTI losses           | \$(395)                              | ) \$—                                |
| OTTI reclassified from OCI  | (12)                                 | ) —                                  |
| OTTI recognized in earnings | \$(407)                              | ) \$—                                |

The following table presents a roll-forward of the credit loss component of OTTI on the Company's Non-Agency MBS for which a non-credit component of OTTI was previously recognized in OCI. Changes in the credit loss component of OTTI are presented based upon whether the current period is the first time OTTI was recorded on a security or a subsequent OTTI charge was recorded.

| (In Thousands)  | Three Months Ended<br>March 31, 2015 | Three Months Ended<br>March 31, 2014 |
|---|--------------------------------------|--------------------------------------|
| Credit loss component of OTTI at beginning of period        | \$36,115                             | \$36,115                             |
| Additions for credit related OTTI not previously recognized | 395                                  | —                                    |
| Subsequent additional credit related OTTI recorded          | 12                                   | —                                    |
| Credit loss component of OTTI at end of period              | \$36,522                             | \$36,115                             |





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## Purchase Discounts on Non-Agency MBS

The following tables present the changes in the components of the Company's purchase discount on its Legacy Non-Agency MBS between purchase discount designated as Credit Reserve and OTTI and accretable purchase discount for the three months ended March 31, 2015 and 2014:

| (In Thousands)   | Three Months Ended<br>March 31, 2015                    |                            | Three Months Ended<br>March 31, 2014                        |                               |
|--|---|----------------------------|---|-------------------------------|
|  | Discount<br>Designated as<br>Credit Reserve<br>and OTTI | Accretable<br>Discount (1) | Discount<br>Designated as<br>Credit Reserve<br>and OTTI (2) | Accretable<br>Discount (1)(2) |
| Balance at beginning of period   | \$(900,557  | ) \$(399,564               | ) \$(1,043,037  | ) \$(460,039                  |
| Cumulative effect adjustment on adoption of revised accounting standard for repurchase agreement financing | (15,543   | ) 1,832                    | —   | —                             |
| Accretion of discount  | —   | 24,800                     | —   | 27,431                        |
| Realized credit losses   | 19,624  | —                          | 25,037  | —                             |
| Purchases  | (34   | ) (3,410                   | ) (63,317   | ) 23,406                      |
| Sales  | 1,049   | 9,969                      | 3,487   | 2,943                         |
| Net impairment losses recognized in earnings   | (407  | ) —                        | —   | —                             |
| Transfers/release of credit reserve  | 22,335  | (22,335                    | ) 35,897  | (35,897                       |
| Balance at end of period   | \$(873,533  | ) \$(388,708               | ) \$(1,041,933  | ) \$(442,156                  |

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

(2) The Company reallocated \$115,000 of purchase discount designated as Credit Reserve to accretable purchase discount on Non-Agency MBS underlying Linked Transactions during the three months ended March 31, 2014.

## Impact of MBS and CRT securities on AOCI

The following table presents the impact of the Company's MBS and CRT securities on its AOCI for the three months ended March 31, 2015 and 2014:

| (In Thousands)   | Three Months Ended March 31, |           |
|--|------------------------------|-----------|
|  | 2015                         | 2014      |
| AOCI from MBS and CRT securities:  |                              |           |
| Unrealized gain on MBS and CRT securities at beginning of period   | \$813,515                    | \$752,912 |
| Unrealized gain on Agency MBS, net   | 12,885                       | 17,843    |
| Unrealized gain on Non-Agency MBS, net   | 20,609                       | 51,417    |
| Cumulative effect adjustment on adoption of revised accounting standard for repurchase agreement financing | 4,537                        | —         |
| Reclassification adjustment for MBS sales included in net income   | (6,423                       | ) (2,950  |
| Reclassification adjustment for OTTI included in net income  | (407                         | ) —       |
| Unrealized gain on CRT securities  | 5,541                        | —         |
| Change in AOCI from MBS and CRT securities   | 36,742                       | 66,310    |
| Balance at end of period   | \$850,257                    | \$819,222 |

Sales of MBS

During the three months ended March 31, 2015, the Company sold certain Non-Agency MBS for \$10.8 million, realizing gross gains of \$6.4 million. During the three months ended March 31, 2014, the Company sold certain Non-Agency MBS for \$15.5 million, realizing gross gains of \$3.6 million. The Company has no continuing involvement with any of the sold MBS.

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## Interest Income on MBS and CRT securities

The following table presents the components of interest income on the Company's Agency MBS for the three months ended March 31, 2015 and 2014:

| (In Thousands)                 | Three Months Ended March 31, |          |
|--------------------------------|------------------------------|----------|
|                                | 2015                         | 2014     |
| Coupon interest                | \$40,743                     | \$49,499 |
| Effective yield adjustment (1) | (9,070)                      | (10,170) |
| Agency MBS interest income     | \$31,673                     | \$39,329 |

(1) Includes amortization of premium paid net of accretion of purchase discount. For Agency MBS, interest income is recorded at an effective yield, which reflects net premium amortization based on actual prepayment activity.

The following table presents components of interest income for the Company's Legacy Non-Agency MBS (including MBS transferred to consolidated VIEs) for the three months ended March 31, 2015 and 2014:

| (In Thousands)                        | Three Months Ended March 31, |          |
|---------------------------------------|------------------------------|----------|
|                                       | 2015                         | 2014     |
| Coupon interest                       | \$49,355                     | \$54,389 |
| Effective yield adjustment (1)        | 24,406                       | 27,389   |
| Legacy Non-Agency MBS interest income | \$73,761                     | \$81,778 |

(1) The effective yield adjustment is the difference between the net income calculated using the net yield, which is based on management's estimates of the amount and timing of future cash flows for Legacy Non-Agency MBS, less the current coupon yield.

The following table presents components of interest income for the Company's RPL/NPL MBS for the three months ended March 31, 2015 and 2014:

| (In Thousands)                 | Three Months Ended March 31, |      |
|--------------------------------|------------------------------|------|
|                                | 2015                         | 2014 |
| Coupon interest                | \$19,186                     | \$41 |
| Effective yield adjustment (1) | 344                          | —    |
| RPL/NPL MBS interest income    | \$19,530                     | \$41 |

(1) The effective yield adjustment is the difference between the net income calculated using the net yield, which is based on management's estimates of the timing of future cash flows for RPL/NPL MBS, less the current coupon yield.

The following table presents components of interest income for the Company's CRT securities for the three months ended March 31, 2015 and 2014:

| (In Thousands)                 | Three Months Ended March 31, |      |
|--------------------------------|------------------------------|------|
|                                | 2015                         | 2014 |
| Coupon interest                | \$1,202                      | \$—  |
| Effective yield adjustment (1) | 158                          | —    |

|                                |         |     |
|--------------------------------|---------|-----|
| CRT securities interest income | \$1,360 | \$— |
|--------------------------------|---------|-----|

(1) The effective yield adjustment is the difference between the net interest income calculated using the net yield, which is based on management's estimates of the timing of future cash flows for CRT securities, less the current coupon yield.

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## 4. Residential Whole Loans

Included on the Company's consolidated balance sheets at March 31, 2015 and December 31, 2014 is approximately \$387.3 million and \$351.4 million, respectively, in residential whole loans arising from the Company's 100% equity interest in certificates issued by certain trusts established to acquire the loans. Based on its evaluation of these interests and other factors, the Company has determined that the trusts are required to be consolidated for financial reporting purposes.

## Residential Whole Loans at Carrying Value

Residential whole loans at carrying value totaled approximately \$242.8 million and \$207.9 million at March 31, 2015 and December 31, 2014, respectively. The carrying value reflects the original investment amount, plus accretion of interest income, less principal and interest cash flows received. The carrying value is reduced by any allowance for loan losses established subsequent to acquisition.

The Company recorded an allowance for loan losses of approximately \$464,000 on its residential whole loan pools held at carrying value as of March 31, 2015. For the three months ended March 31, 2015 a net provision for loan losses of approximately \$327,000 was recorded, which is included in Operating and other expense on the Company's consolidated statement of operations.

The following table presents the activity in the Company's allowance for loan losses on its residential whole loan pools at carrying value for the three months ended March 31, 2015. The Company did not have any residential whole loans at carrying value during the three months ended March 31, 2014.

| (In Thousands)                     | Three Months<br>Ended<br>March 31, 2015 |
|------------------------------------|---|
| Balance at the beginning of period | \$ 137                                  |
| Provisions for loan losses         | 327                                     |
| Balance at the end of the period   | \$ 464                                  |

The following table presents information regarding the estimates of the contractually required payments, the cash flows expected to be collected, and the estimated fair value of the residential whole loans held at carrying value acquired by the Company for the three months ended March 31, 2015:

| (In Thousands)   | Three Months<br>Ended<br>March 31, 2015 |
|--|---|
| Contractually required principal and interest                              | \$78,799                                |
| Contractual cash flows not expected to be collected (non-accretable yield) | (13,357 )                               |
| Expected cash flows to be collected  | 65,442                                  |
| Interest component of expected cash flows (accretable yield)               | (26,840 )                               |
| Fair value at the date of acquisition                                      | \$38,602                                |

The following table presents accretable yield activity for the Company's residential whole loans held at carrying value for the three months ended March 31, 2015:

| (In Thousands)                                 | Three Months<br>Ended<br>March 31, 2015 |
|--|---|
| Balance at beginning of period                 | \$133,012                               |
| Additions                                      | 26,840                                  |
| Accretion                                      | (3,468 )                                |
| Reclassifications to non-accretable difference | (1,433 )                                |
| Balance at end of period                       | \$154,951                               |

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Accretable yield for residential whole loans is the excess of loan cash flows expected to be collected over the purchase price. The cash flows expected to be collected represents the Company's estimate, of the amount and timing of undiscounted principal and interest cash flows. Additions include accretable yield estimates for purchases made during the period and reclassification to accretable yield from nonaccretable yield. Accretable yield is reduced by accretion during the period. The reclassifications between accretable and nonaccretable yield and the accretion of interest income is based on changes in estimates regarding loan performance and the value of the underlying real estate securing the loans. In future periods, as the Company updates estimates of cash flows expected to be collected from the loans and the underlying collateral, the accretable yield may change. Therefore, the amount of accretable income recorded during the three months ended March 31, 2015 is not necessarily indicative of future results.

## Residential Whole Loans at Fair Value

Certain of the Company's residential whole loans are presented at fair value on its consolidated balance sheets as a result of a fair value election made at time of acquisition. Subsequent changes in fair value are reported in current period earnings and presented in Net income on residential whole loans held at fair value on the Company's consolidated statements of operations.

The following table presents information regarding the Company's residential whole loans at fair value at March 31, 2015 and December 31, 2014:

| (Dollars in Thousands)        | March 31, 2015 | December 31, 2014 |
|-------------------------------|----------------|-------------------|
| Outstanding principal balance | \$188,906      | \$182,613         |
| Aggregate fair value          | \$144,507      | \$143,472         |
| Number of loans               | 883            | 885               |

During the three months ended March 31, 2015, the Company recorded a net gain on these loans of \$2.6 million. The Company did not have any residential whole loans held at fair value during the three months ended March 31, 2014. The following table presents the components of Net income on residential whole loans held at fair value for the three months ended March 31, 2015:

| (In Thousands)                          | Three Months Ended<br>March 31, 2015 |
|---|--------------------------------------|
| Coupon payments received                | \$1,321                              |
| Net unrealized gains                    | 602                                  |
| Net gain on payoff/liquidation of loans | 368                                  |
| Net gain on transfers to REO            | 285                                  |
| Total                                   | \$2,576                              |

## 5. Interest Receivable

The following table presents the Company's interest receivable by investment category at March 31, 2015 and December 31, 2014:

| (In Thousands)           | March 31, 2015 | December 31, 2014 |
|--------------------------|----------------|-------------------|
| MBS interest receivable: |                |                   |
| Fannie Mae               | \$10,975       | \$11,761          |

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|                                    |          |          |
|------------------------------------|----------|----------|
| Freddie Mac                        | 2,486    | 2,598    |
| Ginnie Mae                         | 16       | 17       |
| Non-Agency MBS                     | 17,523   | 16,794   |
| Total MBS interest receivable      | 31,000   | 31,170   |
| Residential whole loans            | 1,763    | —        |
| CRT securities                     | 101      | 66       |
| Money market and other investments | 21       | 21       |
| Total interest receivable          | \$32,885 | \$31,257 |

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## 6. Derivative Instruments

The Company's derivative instruments are currently comprised of Swaps, which are designated as cash flow hedges against the interest rate risk associated with its borrowings. Prior to 2015, the Company had also entered into Linked Transactions, which were not designated as hedging instruments (see Notes 2(p), 2(t) and below). The following table presents the fair value of the Company's derivative instruments and their balance sheet location at March 31, 2015 and December 31, 2014:

| Derivative Instrument        | Designation | Balance Sheet Location | March 31, 2015<br>Notional Amount | March 31, 2015<br>Fair Value | December 31, 2014 |
|------------------------------|-------------|------------------------|-----------------------------------|------------------------------|-------------------|
| (In Thousands)               |             |                        |                                   |                              |                   |
| Linked Transactions          | Non-Hedging | Assets                 | N/A                               | N/A                          | \$398,336         |
| Non-cleared legacy Swaps (1) | Hedging     | Assets                 | \$400,000                         | \$1,051                      | \$3,136           |
| Non-cleared legacy Swaps (1) | Hedging     | Liabilities            | \$400,000                         | \$(1,320)                    | \$(4,263)         |
| Cleared Swaps (2)            | Hedging     | Liabilities            | \$2,550,000                       | \$(91,160)                   | \$(57,935)        |

(1) Non-cleared legacy Swaps include Swaps executed and settled bilaterally with counterparties without the use of an organized exchange or central clearing house.

(2) Cleared Swaps include Swaps executed bilaterally with a counterparty in the over-the-counter market but then novated to a central clearing house, whereby the central clearing house becomes the counterparty to both of the original counterparties.

## Linked Transactions

Prior to January 1, 2015, the Company's Linked Transactions had been evaluated on a combined basis, reported as forward (derivative) instruments and presented as assets on the Company's consolidated balance sheets at fair value. The fair value of Linked Transactions reflected the value of the underlying Non-Agency MBS, linked repurchase agreement borrowings and accrued interest receivable/payable on such instruments. The Company's Linked Transactions were not designated as hedging instruments and, as a result, the change in the fair value and net interest income from Linked Transactions had been reported in other income on the Company's consolidated statements of operations.

New accounting guidance that was effective for the Company on January 1, 2015 prospectively eliminated the use of Linked Transaction accounting. An entity is required to present changes in accounting for transactions outstanding on the effective date as a cumulative-effect adjustment to retained earnings as of the beginning of the period of adoption. Accordingly, on adoption of the new standard on January 1, 2015, the Company reclassified \$1.913 billion of Non-Agency MBS and \$4.6 million of CRT securities that were previously reported as a component of Linked Transactions to Non-Agency MBS and CRT securities, respectively on the consolidated balance sheet. In addition, liabilities of \$1.520 billion that were previously presented as a component of Linked Transactions were reclassified to Repurchase Agreements on the consolidated balance sheet. Furthermore, an amount of \$4.5 million representing net unrealized gains on Non-Agency MBS and CRT securities previously reported as a component of Linked Transactions as of December 31, 2014 was reclassified from Accumulated Deficit to AOCI. These reclassification adjustments had no net impact on the Company's overall Total Stockholders' Equity.



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The following tables present certain information about the Legacy Non-Agency MBS, RPL/NPL MBS, CRT securities and repurchase agreements underlying the Company's Linked Transactions at December 31, 2014:

## Linked Transactions at December 31, 2014

| Linked Repurchase Agreements |             | Linked MBS/CRT Securities               |                          |                      |                      |                      |                                       |
|------------------------------|-------------|---|--------------------------|----------------------|----------------------|----------------------|---------------------------------------|
| Maturity or Repricing        | Balance     | Weighted<br>Average<br>Interest<br>Rate |                          | Fair Value           | Amortized<br>Cost    | Par/Current<br>Face  | Weighted<br>Average<br>Coupon<br>Rate |
| (Dollars in Thousands)       |             | (Dollars in Thousands)                  |                          |                      |                      |                      |                                       |
| Within 30 days               | \$1,514,393 | 1.47 %                                  | Legacy Non-Agency<br>MBS | \$66,382             | \$61,658             | \$72,513             | 4.20 %                                |
| >30 days to 90 days          | 5,200       | 1.35                                    | RPL/NPL MBS              | 1,846,807            | 1,847,118            | 1,849,974            | 3.49 %                                |
| Total                        | \$1,519,593 | 1.47 %                                  | CRT securities<br>Total  | 4,624<br>\$1,917,813 | 4,500<br>\$1,913,276 | 4,500<br>\$1,926,987 | 4.56 %<br>3.52 %                      |

At December 31, 2014, Linked Transactions also included approximately \$1.3 million of associated accrued interest receivable and \$1.1 million of accrued interest payable.

The following table presents certain information about the components of the unrealized net gains and net interest income from Linked Transactions included in the Company's consolidated statements of operations for the three months ended March 31, 2014:

| (In Thousands)   | Three Months<br>Ended March 31,<br>2014 |
|--|---|
| Interest income attributable to MBS underlying Linked Transactions                                     | \$2,041                                 |
| Interest expense attributable to linked repurchase agreement borrowings underlying Linked Transactions | (551)                                   |
| Change in fair value of Linked Transactions included in earnings                                       | 1,761                                   |
| Unrealized net gains and net interest income from Linked Transactions                                  | \$3,251                                 |

## Swaps

Consistent with market practice, the Company has agreements with its Swap counterparties that provide for the posting of collateral based on the fair values of its derivative contracts. Through this margining process, either the Company or its derivative counterparty may be required to pledge cash or securities as collateral. In addition, Swaps novated to and cleared by a central clearing house are subject to initial margin requirements. Certain derivative contracts provide for cross collateralization with repurchase agreements with the same counterparty.

A number of the Company's Swap contracts include financial covenants, which, if breached, could cause an event of default or early termination event to occur under such agreements. Such financial covenants include minimum net worth requirements and maximum debt-to-equity ratios. If the Company were to cause an event of default or trigger an early termination event pursuant to one of its Swap contracts, the counterparty to such agreement may have the option to terminate all of its outstanding Swap contracts with the Company and, if applicable, any close-out amount due to the counterparty upon termination of the Swap contracts would be immediately payable by the Company. The

Company was in compliance with all of its financial covenants through March 31, 2015. At March 31, 2015, the aggregate fair value of assets needed to immediately settle Swap contracts that were in a liability position to the Company, if so required, was approximately \$94.3 million, including accrued interest payable of approximately \$1.8 million.

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The following table presents the assets pledged as collateral against the Company's Swap contracts at March 31, 2015 and December 31, 2014:

| (In Thousands)                     | March 31, 2015 | December 31,<br>2014 |
|------------------------------------|----------------|----------------------|
| Agency MBS, at fair value          | \$60,346       | \$57,247             |
| Restricted cash                    | 92,530         | 66,486               |
| Total assets pledged against Swaps | \$152,876      | \$123,733            |

The use of derivative hedging instruments exposes the Company to counterparty credit risk. In the event of a default by a derivative counterparty, the Company may not receive payments to which it is entitled under its derivative agreements, and may have difficulty recovering its assets pledged as collateral against such agreements. If, during the term of a derivative contract, a counterparty should file for bankruptcy, the Company may experience difficulty recovering its assets pledged as collateral which could result in the Company having an unsecured claim against such counterparty's assets for the difference between the fair value of the derivative and the fair value of the collateral pledged to such counterparty.

The Company's derivative hedging instruments, or a portion thereof, could become ineffective in the future if the associated repurchase agreements that such derivatives hedge fail to exist or fail to have terms that match those of the derivatives that hedge such borrowings. At March 31, 2015, all of the Company's derivatives were deemed effective for hedging purposes and no derivatives were terminated during the three months ended March 31, 2015.

The Company's Swaps designated as hedging transactions have the effect of modifying the repricing characteristics of the Company's repurchase agreements and cash flows for such liabilities. To date, no cost has been incurred at the inception of a Swap (except for certain transaction fees related to entering in to Swaps cleared through a central clearing house), pursuant to which the Company agrees to pay a fixed rate of interest and receive a variable interest rate, generally based on one-month or three-month London Interbank Offered Rate ("LIBOR"), on the notional amount of the Swap. The Company did not recognize any change in the value of its existing Swaps designated as hedges through earnings as a result of hedge ineffectiveness during the three months ended March 31, 2015 and 2014.

At March 31, 2015, the Company had Swaps designated in hedging relationships with an aggregate notional amount of \$3.350 billion, which had net unrealized losses of \$91.4 million, and extended 50 months on average with a maximum term of approximately 101 months.

The following table presents certain information with respect to the Company's Swap activity during the three months ended March 31, 2015:

| (Dollars in Thousands)          | Three Months Ended<br>March 31, 2015 |   |
|---------------------------------|--------------------------------------|---|
| New Swaps:                      |                                      |   |
| Aggregate notional amount       | \$—                                  |   |
| Weighted average fixed-pay rate | —                                    | % |
| Initial maturity date           | N/A                                  |   |
| Number of new Swaps             | —                                    |   |
| Swaps amortized/expired:        |                                      |   |
| Aggregate notional amount       | \$410,170                            |   |

|                                 |      |   |
|---------------------------------|------|---|
| Weighted average fixed-pay rate | 1.90 | % |
|---------------------------------|------|---|

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The following table presents information about the Company's Swaps at March 31, 2015 and December 31, 2014:

| Maturity (1)                | March 31, 2015  |  |   | December 31, 2014 |  |   |
|-----------------------------|-----------------|--|---|-------------------|--|---|
|                             | Notional Amount | Weighted Average Fixed-Pay Interest Rate | Weighted Average Variable Interest Rate (2) | Notional Amount   | Weighted Average Fixed-Pay Interest Rate | Weighted Average Variable Interest Rate (2) |
| (Dollars in Thousands)      |                 |  |   |                   |  |   |
| Within 30 days              | \$200,000       | 2.05                                     | % 0.18                                      | % \$22,290        | 3.63                                     | % 0.23                                      |
| Over 30 days to 3 months    | 100,000         | 2.07                                     | 0.18  | 387,880           | 1.80                                     | 0.16  |
| Over 3 months to 6 months   | —               | —  | —   | 300,000           | 2.06                                     | 0.17  |
| Over 6 months to 12 months  | 50,000          | 2.13                                     | 0.17  | —                 | —  | —   |
| Over 12 months to 24 months | 150,000         | 0.54                                     | 0.17  | 150,000           | 1.03                                     | 0.16  |
| Over 24 months to 36 months | 300,000         | 0.57                                     | 0.17  | 350,000           | 0.58                                     | 0.16  |
| Over 36 months to 48 months | 650,000         | 1.53                                     | 0.18  | 550,000           | 1.49                                     | 0.16  |
| Over 48 months to 60 months | 100,000         | 1.71                                     | 0.17  | 200,000           | 1.71                                     | 0.17  |
| Over 60 months to 72 months | 1,600,000       | 2.22                                     | 0.18  | 1,500,000         | 2.22                                     | 0.16  |
| Over 72 months to 84 months | 100,000         | 2.21                                     | 0.18  | 200,000           | 2.20                                     | 0.17  |
| Over 84 months (3)          | 100,000         | 2.75                                     | 0.18  | 100,000           | 2.75                                     | 0.16  |
| Total Swaps                 | \$3,350,000     | 1.84                                     | % 0.18                                      | % \$3,760,170     | 1.85                                     | % 0.16                                      |

(1) Each maturity category reflects contractual amortization and/or maturity of notional amounts.

(2) Reflects the benchmark variable rate due from the counterparty at the date presented, which rate adjusts monthly or quarterly based on one-month or three-month LIBOR, respectively.

(3) Reflects one Swap with a maturity date of July 2023.

The following table presents the net impact of the Company's derivative hedging instruments on its interest expense and the weighted average interest rate paid and received for such Swaps for the three months ended March 31, 2015 and 2014:

| (Dollars in Thousands)                 | Three Months Ended March 31, |          |   |
|--|------------------------------|----------|---|
|  | 2015                         | 2014     |   |
| Interest expense attributable to Swaps | \$15,382                     | \$17,563 |   |
| Weighted average Swap rate paid        | 1.84                         | % 1.92   | % |
| Weighted average Swap rate received    | 0.17                         | % 0.16   | % |

## Impact of Derivative Hedging Instruments on AOCI

The following table presents the impact of the Company's derivative hedging instruments on its AOCI for the three months ended March 31, 2015 and 2014:

| (In Thousands) | Three Months Ended March 31, |      |
|----------------|------------------------------|------|
|                | 2015                         | 2014 |
|                |                              |      |

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AOCI from derivative hedging instruments:

|  |            |   |            |   |
|--|------------|---|------------|---|
| Balance at beginning of period                             | \$ (59,062 | ) | \$ (15,217 | ) |
| Unrealized loss on Swaps, net                              | (32,367    | ) | (12,267    | ) |
| Reclassification of unrealized loss on de-designated Swaps | —          |   | 447        |   |
| Balance at end of period                                   | \$ (91,429 | ) | \$ (27,037 | ) |

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## Counterparty Credit Risk from Use of Swaps

By using Swaps, the Company is exposed to counterparty credit risk if counterparties to the derivative contracts do not perform as expected. If a counterparty fails to perform, the Company's counterparty credit risk is equal to the amount reported as a derivative asset on its consolidated balance sheets to the extent that amount exceeds collateral obtained from the counterparty or, if in a net liability position, the extent to which collateral posted exceeds the liability to the counterparty. The amounts reported as a derivative asset/(liability) are derivative contracts in a gain/(loss) position, and to the extent subject to master netting arrangements, net of derivatives in a loss/(gain) position with the same counterparty and collateral received/(pledged). The Company attempts to minimize counterparty credit risk through credit approvals, limits, monitoring procedures, executing master netting arrangements and obtaining collateral, where appropriate. Counterparty credit risk related to the Company's Swaps is considered in determining fair value of such derivatives and its assessment of hedge effectiveness.

## 7. Real Estate Owned

At March 31, 2015, the Company had 66 REO properties with an aggregate carrying value of \$8.3 million. At December 31, 2014, the Company had 46 REO properties with an aggregate carrying value of \$5.5 million. During the three months ended March 31, 2015, the Company did not acquire any residential properties in connection with the acquisition of residential whole loans.

During the three months ended March 31, 2015, the Company transferred 25 mortgage loans to REO at an aggregate fair value of \$4.0 million. Such transfers occur when the Company takes possession of the property by foreclosing on the borrower or completes a "deed-in-lieu of foreclosure" transaction. At March 31, 2015 the aggregate carrying value of these assets based on management's estimate of fair value less estimated selling costs was \$3.4 million. In connection with these transfers, the Company recorded a net gain of approximately \$285,000 in Net income on residential whole loans held at fair value on the Company's consolidated statements of operations.

At March 31, 2015, \$6.3 million of residential real estate property was held by the Company that was acquired either through a completed foreclosure proceeding or from completion of a deed in lieu of foreclosure or similar legal agreement. In addition, formal foreclosure proceedings were in process with respect to \$9.8 million of residential whole loans at carrying value and \$82.8 million of residential whole loans at fair value at March 31, 2015.

During the three months ended March 31, 2015, the Company sold five REO properties for consideration of \$581,000, realizing a net loss of \$26,000 which is included in Other, net on the Company's consolidated statement of operations.

The following table presents the activity in the Company's REO for the three months ended March 31, 2015. The Company did not have REO during the three months ended March 31, 2014.

| (In Thousands)                            | Three Months Ended<br>March 31, 2015 |
|---|--------------------------------------|
| Balance at beginning of period            | \$5,492                              |
| Transfer from residential whole loans (1) | 3,448                                |
| Disposals                                 | (607)                                |
| Balance at end of period                  | \$8,333                              |

(1) Includes gain recorded on transfer of approximately \$285,000.

Real estate owned is included in Prepaid and other assets in the Company's consolidated balance sheets.

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## 8. Repurchase Agreements

The Company's repurchase agreements are accounted for as secured borrowings and are collateralized by the Company's MBS, U.S. Treasury securities (obtained as part of a reverse repurchase agreement), CRT securities and cash, and bear interest that is generally LIBOR-based. (See Notes 2(k) and 9) At March 31, 2015, the Company's borrowings under repurchase agreements had a weighted average remaining term-to-interest rate reset of 29 days and an effective repricing period of 17 months, including the impact of related Swaps. At December 31, 2014, the Company's borrowings under repurchase agreements had a weighted average remaining term-to-interest rate reset of 25 days and an effective repricing period of 21 months, including the impact of related Swaps.

The following table presents information with respect to the Company's borrowings under repurchase agreements and associated assets pledged as collateral at March 31, 2015 and December 31, 2014:

| (Dollars in Thousands)   | March 31,<br>2015 | December 31,<br>2014 |  |   |
|--|-------------------|----------------------|--|---|
| Repurchase agreement borrowings secured by Agency MBS  | \$4,982,381       | \$5,177,835          |  |   |
| Fair value of Agency MBS pledged as collateral under repurchase agreements                   | \$5,242,368       | \$5,462,566          |  |   |
| Weighted average haircut on Agency MBS (1)   | 4.66              | % 4.79               |  | % |
| Repurchase agreement borrowings secured by Legacy Non-Agency MBS (2)                         | \$2,228,517       | \$2,233,236          |  |   |
| Fair value of Legacy Non-Agency MBS pledged as collateral under repurchase agreements (2)(3) | \$3,242,911       | \$3,491,312          |  |   |
| Weighted average haircut on Legacy Non-Agency MBS (1)  | 25.80             | % 28.88              |  | % |
| Repurchase agreement borrowings secured by RPL/NPL MBS (2)                                   | \$1,870,625       | \$130,919            |  |   |
| Fair value of RPL/NPL MBS pledged as collateral under repurchase agreements (2)              | \$2,317,938       | \$160,688            |  |   |
| Weighted average haircut on RPL/NPL MBS (1)  | 20.99             | % 20.00              |  | % |
| Repurchase agreements secured by U.S. Treasuries   | \$497,469         | \$507,114            |  |   |
| Fair value of U.S. Treasuries pledged as collateral under repurchase agreements              | \$506,861         | \$512,105            |  |   |
| Weighted average haircut on U.S. Treasuries (1)  | 1.64              | % 1.62               |  | % |
| Repurchase agreements secured by CRT securities (2)  | \$91,689          | \$75,960             |  |   |
| Fair value of CRT securities pledged as collateral under repurchase agreements (2)           | \$118,384         | \$94,610             |  |   |
| Weighted average haircut on CRT securities (1)   | 25.18             | % 25.00              |  | % |
| Repurchase agreements secured by residential whole loans                                     | \$138,905         | \$142,324            |  |   |
| Fair value of residential whole loans pledged as collateral under repurchase agreements      | \$209,468         | \$212,986            |  |   |
| Weighted average haircut on residential whole loans (1)                                      | 33.52             | % 33.43              |  | % |

(1) Haircut represents the percentage amount by which the collateral value is contractually required to exceed the loan amount on the Company's repurchase agreements borrowings.

Does not reflect Legacy Non-Agency MBS, RPL/NPL MBS, CRT securities and repurchase agreement borrowings that were components of Linked Transactions at December 31, 2014. As previously discussed, new accounting guidance effective January 1, 2015 prospectively eliminated the use of Linked Transaction accounting. (See Note 6)

(2) Includes \$589.3 million and \$1.275 billion of Legacy Non-Agency MBS acquired from consolidated VIEs at March 31, 2015, and December 31, 2014, respectively, that are eliminated from the Company's consolidated balance sheets.



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The following table presents repricing information about the Company's borrowings under repurchase agreements, which does not reflect the impact of associated derivative hedging instruments, at March 31, 2015 and December 31, 2014:

| Time Until Interest Rate Reset | March 31, 2015 |                                | December 31, 2014 |                                |   |
|--------------------------------|----------------|--------------------------------|-------------------|--------------------------------|---|
|                                | Balance        | Weighted Average Interest Rate | Balance (1)       | Weighted Average Interest Rate |   |
| (Dollars in Thousands)         |                |                                |                   |                                |   |
| Within 30 days                 | \$7,949,936    | 0.85                           | % \$7,144,737     | 0.72                           | % |
| Over 30 days to 3 months       | 1,502,606      | 1.16                           | 1,000,313         | 1.12                           |   |
| Over 3 months to 12 months     | 357,044        | 1.95                           | 122,338           | 1.98                           |   |
| Total                          | \$9,809,586    | 0.94                           | % \$8,267,388     | 0.79                           | % |

(1) At December 31, 2014, the Company had repurchase agreements of \$1.520 billion that were linked to securities purchased and accounted for as Linked Transactions, and as such, the linked repurchase agreements are not included in the above table. As previously discussed, new accounting guidance effective January 1, 2015 prospectively eliminated the use of Linked Transaction accounting. (See Note 6)

The following table presents contractual maturity information about the Company's borrowings under repurchase agreements, all of which are accounted for as secured borrowings, at March 31, 2015 and does not reflect the impact of derivative contracts that hedge such repurchase agreements:

| Contractual Maturity      | March 31, 2015 |                       |             |                 |                |                         |             | Weighted Average Interest Rate |
|---------------------------|----------------|-----------------------|-------------|-----------------|----------------|-------------------------|-------------|--------------------------------|
|                           | Agency MBS     | Legacy Non-Agency MBS | RPL/NPL MBS | U.S. Treasuries | CRT Securities | Residential Whole Loans | Total       |                                |
| (Dollars in Thousands)    |                |                       |             |                 |                |                         |             |                                |
| Overnight                 | \$—            | \$—                   | \$—         | \$—             | \$—            | \$—                     | \$—         | — %                            |
| Within 30 days            | 4,982,381      | 934,794               | 956,381     | —               | 72,048         | —                       | 6,945,604   | 0.70                           |
| Over 30 days to 90 days   | —              | 256,595               | 694,498     | 497,469         | 19,641         | —                       | 1,468,203   | 1.15                           |
| Over 90 days to 12 months | —              | 1,037,128             | 219,746     | —               | —              | 138,905                 | 1,395,779   | 1.91                           |
| Total                     | \$4,982,381    | \$2,228,517           | \$1,870,625 | \$497,469       | \$91,689       | \$138,905               | \$9,809,586 | 0.94 %                         |

Gross amount of recognized liabilities for repurchase agreements in Note 10 \$9,809,586  
Amounts related to repurchase agreements not included in offsetting disclosure in Note 10 \$—

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The Company had repurchase agreements with 26 and 25 counterparties March 31, 2015 and December 31, 2014, respectively. The following table presents information with respect to any counterparty for repurchase agreements for which the Company had greater than 5% of stockholders' equity at risk in the aggregate at March 31, 2015:

| Counterparty           | March 31, 2015             |                       | Weighted<br>Average Months<br>to Maturity for<br>Repurchase<br>Agreements | Percent of<br>Stockholders'<br>Equity |   |
|------------------------|----------------------------|-----------------------|---|---------------------------------------|---|
|                        | Counterparty<br>Rating (1) | Amount<br>at Risk (2) |   |                                       |   |
| (Dollars in Thousands) |                            |                       |   |                                       |   |
| Credit Suisse          | BBB+/A/Aa2                 | \$440,194             | 1   | 13.7                                  | % |
| Wells Fargo (3)        | AA-/Aa3/AA-                | 352,943               | 6   | 11.0                                  |   |
| RBC (4)                | AA-/Aa3/AA                 | 342,449               | 5   | 10.7                                  |   |
| UBS (5)                | A/A2/A                     | 214,192               | 10  | 6.7                                   |   |

(1) As rated at March 31, 2015 by S&P, Moody's and Fitch, Inc., respectively. The counterparty rating presented is the lowest published for these entities.

(2) The amount at risk reflects the difference between (a) the amount loaned to the Company through repurchase agreements, including interest payable, and (b) the cash and the fair value of the securities pledged by the Company as collateral, including accrued interest receivable on such securities.

(3) Includes \$285.2 million at risk with Wells Fargo Bank, NA and \$67.7 million at risk with Wells Fargo Securities LLC.

(4) Includes \$189.9 million at risk with RBC Barbados, \$142.4 million at risk with Royal Bank of Canada and \$10.1 million at risk with RBC Capital Markets LLC. Counterparty ratings are not published for RBC Barbados and RBC Capital Markets LLC.

(5) Includes Non-Agency MBS pledged as collateral with contemporaneous repurchase and reverse repurchase agreements.

## 9. Collateral Positions

The Company pledges securities or cash as collateral to its counterparties pursuant to its borrowings under repurchase agreements and its derivative contracts that are in an unrealized loss position, and it receives securities or cash as collateral pursuant to financing provided under reverse repurchase agreements and certain of its derivative contracts in an unrealized gain position. The Company exchanges collateral with its counterparties based on changes in the fair value, notional amount and term of the associated repurchase and reverse repurchase agreements and derivative contracts, as applicable. Through this margining process, either the Company or its counterparty may be required to pledge cash or securities as collateral. In addition, Swaps novated to and cleared by a central clearing house are subject to initial margin requirements. When the Company's pledged collateral exceeds the required margin, the Company may initiate a reverse margin call, at which time the counterparty may either return the excess collateral, or provide collateral to the Company in the form of cash or equivalent securities.

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The following table summarizes the fair value of the Company's collateral positions, which includes collateral pledged and collateral held, with respect to its borrowings under repurchase agreements, reverse repurchase agreements and derivative hedging instruments at March 31, 2015 and December 31, 2014:

| (In Thousands)                          | March 31, 2015      |                  | December 31, 2014   |                  |
|---|---------------------|------------------|---------------------|------------------|
|   | Assets Pledged      | Collateral Held  | Assets Pledged      | Collateral Held  |
| <b>Derivative Hedging Instruments:</b>  |                     |                  |                     |                  |
| Agency MBS                              | \$60,346            | \$—              | \$57,247            | \$—              |
| Cash (1)                                | 92,530              | —                | 66,486              | —                |
|   | 152,876             | —                | 123,733             | —                |
| <b>Repurchase Agreement Borrowings:</b> |                     |                  |                     |                  |
| Agency MBS                              | 5,242,368           | —                | 5,462,566           | —                |
| Legacy Non-Agency MBS (2)(3)            | 3,242,911           | —                | 3,491,312           | —                |
| RPL/NPL MBS                             | 2,317,938           | —                | 160,688             | —                |
| U.S. Treasury securities                | 506,861             | —                | 512,105             | —                |
| CRT securities                          | 118,384             | —                | 94,610              | —                |
| Residential whole loans                 | 209,468             | —                | 212,986             | —                |
| Cash (1)                                | 757                 | —                | 769                 | —                |
|   | 11,638,687          | —                | 9,935,036           | —                |
| <b>Reverse Repurchase Agreements:</b>   |                     |                  |                     |                  |
| U.S. Treasury securities                | —                   | 506,861          | —                   | 512,105          |
|   | —                   | 506,861          | —                   | 512,105          |
| <b>Total</b>                            | <b>\$11,791,563</b> | <b>\$506,861</b> | <b>\$10,058,769</b> | <b>\$512,105</b> |

(1) Cash pledged as collateral is reported as "restricted cash" on the Company's consolidated balance sheets.

(2) Includes \$589.3 million and \$1.275 billion of Legacy Non-Agency MBS acquired in connection with securitization transactions from consolidated VIEs at March 31, 2015 and December 31, 2014, respectively, that are eliminated from the Company's consolidated balance sheets.

(3) In addition, \$735.2 million and \$731.0 million of Legacy Non-Agency MBS are pledged as collateral in connection with contemporaneous repurchase and reverse repurchase agreements entered into with a single counterparty at March 31, 2015 and December 31, 2014, respectively.

The following table presents detailed information about the Company's assets pledged as collateral pursuant to its borrowings under repurchase agreements and derivative hedging instruments at March 31, 2015:

| (In Thousands)               | March 31, 2015                             |             |  | Assets Pledged Against Derivative Hedging Instruments |                |  | Total Fair Value of Assets Pledged and Accrued Interest |
|------------------------------|--|-------------|--|---|----------------|--|---|
|                              | Assets Pledged Under Repurchase Agreements |             | Accrued Interest on Pledged Securities | Fair Value/Carrying Value                             | Amortized Cost | Accrued Interest on Pledged Securities |   |
| Agency MBS                   | \$5,242,368                                | \$5,157,054 | \$12,474                               | \$60,346  | \$60,863       | \$126                                  | \$5,315,314   |
| Legacy Non-Agency MBS (1)(2) | 3,242,911                                  | 2,602,140   | 11,567                                 | —   | —              | —                                      | 3,254,478   |
| RPL/NPL MBS                  | 2,317,938                                  | 2,316,539   | 1,275                                  | —   | —              | —                                      | 2,319,213   |
| U.S. Treasuries              | 506,861                                    | 506,861     | —                                      | —   | —              | —                                      | 506,861   |
| CRT securities               | 118,384                                    | 115,126     | 93                                     | —   | —              | —                                      | 118,477   |

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|                         |              |              |          |           |           |       |              |
|-------------------------|--------------|--------------|----------|-----------|-----------|-------|--------------|
| Residential whole loans | 209,468      | 207,674      | —        | —         | —         | —     | 209,468      |
| Cash (3)                | 757          | 757          | —        | 92,530    | 92,530    | —     | 93,287       |
| Total                   | \$11,638,687 | \$10,906,151 | \$25,409 | \$152,876 | \$153,393 | \$126 | \$11,817,098 |

(1) Includes \$589.3 million of Legacy Non-Agency MBS acquired in connection with resecuritization transactions from consolidated VIEs at March 31, 2015, that are eliminated from the Company's consolidated balance sheets.

In addition, \$735.2 million of Legacy Non-Agency MBS are pledged as collateral in connection with (2) contemporaneous repurchase and reverse repurchase agreements entered into with a single counterparty at March 31, 2015.

(3) Cash pledged as collateral is reported as "restricted cash" on the Company's consolidated balance sheets.



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## 10. Offsetting Assets and Liabilities

The following tables present information about certain assets and liabilities that are subject to master netting arrangements (or similar agreements) and can potentially be offset on the Company's consolidated balance sheets at March 31, 2015 and December 31, 2014:

## Offsetting of Financial Assets and Derivative Assets

| (In Thousands)       | Gross Amounts of Recognized Assets | Gross Amounts Offset in the Consolidated Balance Sheets | Net Amounts of Gross Amounts Not Offset in the Consolidated Balance Sheets |                       |                          |  | Net Amount |
|----------------------|------------------------------------|---|--|-----------------------|--------------------------|--|------------|
|                      |                                    |   | Assets Presented in the Consolidated Balance Sheets                        | Financial Instruments | Cash Collateral Received |  |            |
| March 31, 2015       |                                    |   |  |                       |                          |  |            |
| Swaps, at fair value | \$ 1,051                           | \$ —  | \$ 1,051   | \$ (1,051 )           | \$ —                     |  | \$—        |
| Total                | \$ 1,051                           | \$ —  | \$ 1,051   | \$ (1,051 )           | \$ —                     |  | \$—        |
| December 31, 2014    |                                    |   |  |                       |                          |  |            |
| Swaps, at fair value | \$ 3,136                           | \$ —  | \$ 3,136   | \$ (3,136 )           | \$ —                     |  | \$—        |
| Total                | \$ 3,136                           | \$ —  | \$ 3,136   | \$ (3,136 )           | \$ —                     |  | \$—        |

## Offsetting of Financial Liabilities and Derivative Liabilities

| (In Thousands)            | Gross Amounts of Recognized Liabilities | Gross Amounts Offset in the Consolidated Balance Sheets | Net Amounts of Gross Amounts Not Offset in the Consolidated Balance Sheets |                           |                             |  | Net Amount |
|---------------------------|---|---|--|---------------------------|-----------------------------|--|------------|
|                           |   |   | Liabilities Presented in the Consolidated Balance Sheets                   | Financial Instruments (1) | Cash Collateral Pledged (1) |  |            |
| March 31, 2015            |   |   |  |                           |                             |  |            |
| Swaps, at fair value (2)  | \$ 92,480                               | \$ —  | \$ 92,480  | \$ —                      | \$ (92,480 )                |  | \$—        |
| Repurchase agreements (3) | 9,809,586                               | —   | 9,809,586  | (9,808,829 )              | (757 )                      |  | —          |
| Total                     | \$ 9,902,066                            | \$ —  | \$ 9,902,066   | \$ (9,808,829 )           | \$ (93,237 )                |  | \$—        |
| December 31, 2014         |   |   |  |                           |                             |  |            |
| Swaps, at fair value (2)  | \$ 62,198                               | \$ —  | \$ 62,198  | \$ —                      | \$ (62,198 )                |  | \$—        |
| Repurchase agreements (3) | 8,267,388                               | —   | 8,267,388  | (8,266,619 )              | (769 )                      |  | —          |
| Total                     | \$ 8,329,586                            | \$ —  | \$ 8,329,586   | \$ (8,266,619 )           | \$ (62,967 )                |  | \$—        |

(1) Amounts disclosed in the Financial Instruments column of the table above represent collateral pledged that is available to be offset against liability balances associated with repurchase agreement and derivative transactions. Amounts disclosed in the Cash Collateral Pledged column of the table above represent amounts pledged as collateral against derivative transactions and repurchase agreements, and exclude excess collateral of \$50,000 and \$4.3 million at March 31, 2015 and December 31, 2014, respectively.

(2) The fair value of securities pledged against the Company's Swaps was \$60.3 million and \$57.2 million at March 31, 2015 and December 31, 2014, respectively.

(3) The fair value of securities pledged against the Company's repurchase agreements was \$11.638 billion and \$9.934 billion at March 31, 2015 and December 31, 2014, respectively.

#### Nature of Setoff Rights

In the Company's consolidated balance sheets, all balances associated with the repurchase agreement and derivatives transactions are presented on a gross basis.

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. For one repurchase agreement counterparty, the underlying agreements provide for an unconditional right of setoff.

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11. Senior Notes

On April 11, 2012 the Company issued \$100.0 million in aggregate principal amount of its Senior Notes in an underwritten public offering. The total net proceeds to the Company from the offering of the Senior Notes were approximately \$96.6 million, after deducting offering expenses and the underwriting discount. The Senior Notes bear interest at a fixed rate of 8.00% per year, paid quarterly in arrears on January 15, April 15, July 15 and October 15 of each year and will mature on April 15, 2042. The Company may redeem the Senior Notes, in whole or in part, at any time on or after April 15, 2017 at a redemption price equal to 100% of the principal amount redeemed plus accrued and unpaid interest to, but not excluding, the redemption date.

The Senior Notes are the Company's senior unsecured obligations and are subordinate to all of the Company's secured indebtedness, which includes the Company's repurchase agreements, obligation to return securities obtained as collateral, and other financing arrangements, to the extent of the value of the collateral securing such indebtedness.

12. Commitments and Contingencies

(a) Lease Commitments

The Company pays monthly rent pursuant to two operating leases. The lease term for the Company's headquarters in New York, New York extends through May 31, 2020. The lease provides for aggregate cash payments ranging over time from approximately \$2.4 million to \$2.5 million per year, paid on a monthly basis, exclusive of escalation charges. In addition, as part of this lease agreement, the Company has provided the landlord a \$785,000 irrevocable standby letter of credit fully collateralized by cash. The letter of credit may be drawn upon by the landlord in the event that the Company defaults under certain terms of the lease. In addition, the Company has a lease through December 31, 2016 for its off-site back-up facility located in Rockville Centre, New York, which provides for, among other things, cash payments ranging over time from \$29,000 to \$30,000 per year, paid on a monthly basis.

(b) Representations and Warranties in Connection with Resecuritization Transactions

In connection with the res securitization transactions engaged in by the Company (See Note 17 for further discussion), the Company has the obligation under certain circumstances to repurchase assets from its VIEs upon breach of certain representations and warranties.

13. Stockholders' Equity

(a) Preferred Stock

Redemption of 8.50% Series A Cumulative Redeemable Preferred Stock ("Series A Preferred Stock")

On May 16, 2013 (the "Redemption Date"), the Company redeemed all 3,840,000 outstanding shares of its Series A Preferred Stock at an aggregate redemption price of approximately \$97.0 million, or \$25.27153 per share, including all accrued and unpaid dividends to the Redemption Date. The redemption value of the Series A Preferred Stock exceeded its carrying value by \$3.9 million, which represents the original offering costs for the Series A Preferred Stock. This amount was included in the determination of net income available to common stock and participating securities from the Redemption Date through the year ended December 31, 2013. In addition, as part of the redemption price on its Series A Preferred Stock, the Company paid a dividend of \$0.27153 per share, which reflected

accrued and unpaid dividends for the period from April 1, 2013, through and including the Redemption Date.

**Issuance of 7.50% Series B Cumulative Redeemable Preferred Stock (“Series B Preferred Stock”)**

On April 15, 2013, the Company amended its charter through the filing of articles supplementary to its charter to reclassify 8,050,000 shares of the Company’s authorized but unissued common stock as shares of the Company’s Series B Preferred Stock. On April 15, 2013, the Company completed the issuance of 8.0 million shares of its Series B Preferred Stock, with a par value of \$0.01 per share and a liquidation preference \$25.00 per share, plus accrued and unpaid dividends, in an underwritten public offering. The aggregate net proceeds to the Company from the offering of the Series B Preferred Stock were approximately \$193.3 million, after deducting the underwriting discount and related offering expenses. The Company used a portion of such net proceeds to redeem all of its outstanding Series A Preferred Stock (as discussed above), and used the remaining net proceeds of the offering

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for general corporate purposes, including, without limitation, to acquire additional MBS consistent with its investment policy, and for working capital, which included, among other things, the repayment of its repurchase agreements. The Company's Series B Preferred Stock, which is redeemable at \$25.00 per share plus accrued and unpaid dividends (whether or not authorized or declared) exclusively at the Company's option commencing on April 15, 2018 (subject to the Company's right under limited circumstances to redeem the Series B Preferred Stock prior to that date in order to preserve its qualification as a REIT and upon certain specified change in control transactions in which the Company's common stock and the acquiring or surviving entity common securities would not be listed on the New York Stock Exchange (the "NYSE"), the NYSE MKT or NASDAQ, or any successor exchanges), is entitled to receive a dividend at a rate of 7.50% per year on the \$25.00 liquidation preference before the Company's common stock is paid any dividends and is senior to the Company's common stock with respect to distributions upon liquidation, dissolution or winding up.

Dividends on the Series B Preferred Stock are payable quarterly in arrears on or about March 31, June 30, September 30 and December 31 of each year. On May 20, 2013, the Company declared the first dividend payable on the Series B Preferred Stock, which was paid on July 1, 2013 to preferred stockholders of record as of June 3, 2013. The amount of such dividend payable was \$0.39583 per share, and was paid in respect of the partial period commencing on April 15, 2013, the date of original issue of the Series B Preferred Stock, and ending on, and including, June 30, 2013.

The Series B Preferred Stock generally does not have any voting rights, subject to an exception in the event the Company fails to pay dividends on such stock for six or more quarterly periods (whether or not consecutive). Under such circumstances, the Series B Preferred Stock will be entitled to vote to elect two additional directors to the Company's Board of Directors (the "Board"), until all unpaid dividends have been paid or declared and set apart for payment. In addition, certain material and adverse changes to the terms of the Series B Preferred Stock cannot be made without the affirmative vote of holders of at least 66 2/3% of the outstanding shares of Series B Preferred Stock. The following table presents cash dividends declared by the Company on its Series B Preferred Stock from January 1, 2015 through March 31, 2015:

| Declaration Date  | Record Date       | Payment Date   | Dividend Per Share |
|-------------------|-------------------|----------------|--------------------|
| February 13, 2015 | February 27, 2015 | March 31, 2015 | \$ 0.46875         |

## (b) Dividends on Common Stock

The following table presents cash dividends declared by the Company on its common stock from January 1, 2015 through March 31, 2015:

| Declaration Date (1) | Record Date    | Payment Date   | Dividend Per Share |
|----------------------|----------------|----------------|--------------------|
| March 13, 2015       | March 27, 2015 | April 30, 2015 | \$ 0.20 (1)        |

(1) At March 31, 2015, the Company had accrued dividends and DERs payable of \$74.6 million related to the common stock dividend declared on March 13, 2015.

## (c) Discount Waiver, Direct Stock Purchase and Dividend Reinvestment Plan ("DRSPP")

On August 8, 2013, the Company filed a shelf registration statement on Form S-3 with the SEC under the Securities Act of 1933, as amended (the "1933 Act"), for the purpose of registering additional common stock for sale through its DRSPP. Pursuant to Rule 462(e) of the 1933 Act, this shelf registration statement became effective automatically upon filing with the SEC and, when combined with the unused portion of the Company's previous DRSPP shelf registration statements, registered an aggregate of 15 million shares of common stock. The Company's DRSPP is

designed to provide existing stockholders and new investors with a convenient and economical way to purchase shares of common stock through the automatic reinvestment of dividends and/or optional cash investments. At March 31, 2015, 7.0 million shares of common stock remained available for issuance pursuant to the DRSPF shelf registration statement.

During the three months ended March 31, 2015, the Company issued 39,784 shares of common stock through the DRSPF, raising net proceeds of approximately \$313,000. From the inception of the DRSPF in September 2003 through March 31, 2015, the Company issued 27,133,333 shares pursuant to the DRSPF, raising net proceeds of \$229.3 million.

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## (d) Stock Repurchase Program

As previously disclosed, in August 2005, the Company's Board authorized a stock repurchase program (the "Repurchase Program"), to repurchase up to 4.0 million shares of its outstanding common stock under the Repurchase Program. The Board reaffirmed such authorization in May 2010. In December 2013, the Board increased the number of shares authorized for repurchase to an aggregate of 10.0 million. Such authorization does not have an expiration date and, at present, there is no intention to modify or otherwise rescind such authorization. Subject to applicable securities laws, repurchases of common stock under the Repurchase Program are made at times and in amounts as the Company deems appropriate, (including, in our discretion, through the use of one or more plans adopted under Rule 10b5-1 promulgated under the Securities Exchange Act of 1934, as amended (the "1934 Act")) using available cash resources. Shares of common stock repurchased by the Company under the Repurchase Program are cancelled and, until reissued by the Company, are deemed to be authorized but unissued shares of the Company's common stock. The Repurchase Program may be suspended or discontinued by the Company at any time and without prior notice. The Company did not repurchase any shares of its common stock during the three months ended March 31, 2015. At March 31, 2015, 6,616,355 shares remained authorized for repurchase under the Repurchase Program.

## (e) Accumulated Other Comprehensive Income/(Loss)

The following table presents changes in the balances of each component of the Company's AOCI for the three months ended March 31, 2015:

| (In Thousands)  | Three Months Ended<br>March 31, 2015  |                                    |             |
|---|---|------------------------------------|-------------|
|   | Net Unrealized<br>Gain/(Loss) on<br>Available-for-Sale<br>MBS and CRT<br>Securities | Net<br>Unrealized Loss<br>on Swaps | Total AOCI  |
| Balance at beginning of period  | \$813,515   | \$(59,062)                         | ) \$754,453 |
| OCI before reclassifications  | 39,035  | (32,367)                           | ) 6,668     |
| Amounts reclassified from AOCI (1)  | (6,830)   | ) —                                | (6,830)     |
| Cumulative effect adjustment on adoption of revised<br>accounting standard for repurchase agreement financing | 4,537   | —                                  | 4,537       |
| Net OCI during the period (2)   | 36,742  | (32,367)                           | ) 4,375     |
| Balance at end of period  | \$850,257   | \$(91,429)                         | ) \$758,828 |

The following table presents changes in the balances of each component of the Company's AOCI for the three months ended March 31, 2014:

| (In Thousands) | Three Months Ended<br>March 31, 2014                          |  |            |
|----------------|---|--|------------|
|                | Net Unrealized<br>Gain/(Loss) on<br>Available-for-Sale<br>MBS | Net<br>Unrealized<br>Gain/(Loss)<br>on Swaps | Total AOCI |

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|                                    |           |            |             |
|------------------------------------|-----------|------------|-------------|
| Balance at beginning of period     | \$752,912 | \$ (15,217 | ) \$737,695 |
| OCI before reclassifications       | 69,260    | (12,267    | ) 56,993    |
| Amounts reclassified from AOCI (1) | (2,950    | ) 447      | (2,503 )    |
| Net OCI during the period (2)      | 66,310    | (11,820    | ) 54,490    |
| Balance at end of period           | \$819,222 | \$ (27,037 | ) \$792,185 |

(1) See separate table below for details about these reclassifications.

(2) For further information regarding changes in OCI, see the Company's consolidated statement of comprehensive income/(loss).



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The following table presents information about the significant amounts reclassified out of the Company's AOCI for the three months ended March 31, 2015:

| Details about AOCI Components       | Three Months<br>Ended<br>March 31, 2015<br>Amounts<br>Reclassified<br>from AOCI | Affected Line Item in the Statement<br>Where Net Income is Presented |
|-------------------------------------|---|--|
| (In Thousands)                      |   |  |
| Available-for-sale MBS:             |   |  |
| Realized gain on sale of securities | \$(6,423  | ) Gain on sales of MBS, net  |
| OTTI recognized in earnings         | (407  | ) Net impairment losses recognized<br>in earnings                    |
| Total Available-for-sale MBS        | (6,830  | )  |
| Total reclassifications for period  | \$(6,830  | )  |

The following table presents information about the significant amounts reclassified out of the Company's AOCI for the three months ended March 31, 2014:

| Details about AOCI Components         | Three Months<br>Ended<br>March 31, 2014<br>Amounts<br>Reclassified<br>from AOCI | Affected Line Item in the Statement<br>Where Net Income is Presented |
|---------------------------------------|---|--|
| (In Thousands)                        |   |  |
| Available-for-sale MBS:               |   |  |
| Realized gain on sale of securities   | \$(2,950  | ) Gain on sales of MBS, net  |
| Swaps designated as cash flow hedges: |   |  |
| De-designated Swaps                   | \$447   | ) Other, net   |
| Total reclassifications for period    | \$(2,503  | )  |

At March 31, 2015 and December 31, 2014, the Company had OTTI recognized in AOCI of \$584,000 and \$629,000, respectively.

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## 14. EPS Calculation

The following table presents a reconciliation of the earnings and shares used in calculating basic and diluted EPS for the three months ended March 31, 2015 and 2014:

| (In Thousands, Except Per Share Amounts)   | Three Months Ended |          |
|--|--------------------|----------|
|  | March 31,<br>2015  | 2014     |
| Numerator:   |                    |          |
| Net income   | \$82,173           | \$76,188 |
| Dividends declared on preferred stock  | (3,750             | ) (3,750 |
| Dividends, DERs and undistributed earnings allocated to participating securities | (395               | ) (278   |
| Net income to common stockholders - basic and diluted                            | \$78,028           | \$72,160 |
| Denominator:   |                    |          |
| Weighted average common shares for basic and diluted earnings per share (1)      | 371,910            | 365,848  |
| Basic and diluted earnings per share   | \$0.21             | \$0.20   |

(1) At March 31, 2015, the Company had an aggregate of 2.0 million equity instruments outstanding that were not included in the calculation of diluted EPS for the three months ended March 31, 2015, as their inclusion would have been anti-dilutive. These equity instruments were comprised of approximately 223,000 shares of restricted common stock with a weighted average grant date fair value of \$7.48 and approximately 1.8 million RSUs with a weighted average grant date fair value of \$6.84. These equity instruments may have a dilutive impact on future EPS.

## 15. Equity Compensation, Employment Agreements and Other Benefit Plans

## (a) 2010 Equity Compensation Plan

In accordance with the terms of the Company's Amended and Restated 2010 Equity Compensation Plan (the "2010 Plan"), directors, officers and employees of the Company and any of its subsidiaries and other persons expected to provide significant services for the Company and any of its subsidiaries are eligible to receive grants of stock options ("Options"), restricted stock, RSUs, DERs and other stock-based awards under the 2010 Plan.

Subject to certain exceptions, stock-based awards relating to a maximum of 13.5 million shares of common stock may be granted under the 2010 Plan; forfeitures and/or awards that expire unexercised do not count towards such limit. At March 31, 2015, approximately 8.5 million shares of common stock remained available for grant in connection with stock-based awards under the 2010 Plan. A participant may generally not receive stock-based awards in excess of 1,500,000 shares of common stock in any one year and no award may be granted to any person who, assuming exercise of all Options and payment of all awards held by such person, would own or be deemed to own more than 9.8% of the outstanding shares of the Company's common stock. Unless previously terminated by the Board, awards may be granted under the 2010 Plan until May 20, 2020.

## DERs

A DER is a right to receive a distribution equal to the dividend distributions that would be paid on a share of the Company's common stock. DERs may be granted separately and/or in conjunction with other awards and are paid in cash or other consideration at such times and in accordance with such rules, as the Compensation Committee of the Board (the "Compensation Committee") shall determine at its discretion. Payments made on the Company's existing DERs are charged to stockholders' equity when the common stock dividends are declared to the extent that such DERs are expected to vest. The Company made DER payments of approximately \$5,000 and \$44,000 during the three months ended March 31, 2015 and 2014. At March 31, 2015, the Company had 24,402 DERs outstanding that were awarded separately from, but in connection with prior year grants of RSUs. A 0% forfeiture rate was assumed with respect to such DERs outstanding at March 31, 2015. At March 31, 2015, the Company had unrecognized compensation expense of approximately \$105,000 related to such DERs, which are scheduled to elapse over a weighted average period of 1.3 years.

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Options

Pursuant to Section 422(b) of the Code, in order for Options granted under the 2010 Plan and vesting in any one calendar year to qualify as an incentive stock option ("ISO") for tax purposes, the market value of the common stock to be received upon exercise of such Options as determined on the date of grant shall not exceed \$100,000 during such calendar year. The exercise price of an ISO may not be lower than 100% (110% in the case of an ISO granted to a 10% stockholder) of the fair market value of the Company's common stock on the date of grant. The exercise price for any other type of Option issued under the 2010 Plan may not be less than the fair market value on the date of grant. Each Option is exercisable after the period or periods specified in the award agreement, which will generally not exceed ten years from the date of grant.

The Company did not grant any stock options during the three months ended March 31, 2015 and 2014. At March 31, 2015, the Company had no stock options outstanding.

Restricted Stock

The Company did not award any shares of restricted common stock during the three months ended March 31, 2015 and 2014. At March 31, 2015 and December 31, 2014, the Company had unrecognized compensation expense of \$1.5 million and \$1.8 million, respectively, related to the unvested shares of restricted common stock. The Company had accrued dividends payable of approximately \$294,000 and \$354,000 on unvested shares of restricted stock at March 31, 2015 and December 31, 2014, respectively. The unrecognized compensation expense at March 31, 2015 is expected to be recognized over a weighted average period of 1.9 years.

Restricted Stock Units

Under the terms of the 2010 Plan, RSUs are instruments that provide the holder with the right to receive, subject to the satisfaction of conditions set by the Compensation Committee at the time of grant, a payment of a specified value, which may be a share of the Company's common stock, the fair market value of a share of the Company's common stock, or such fair market value to the extent in excess of an established base value, on the applicable settlement date. Although the 2010 Plan permits the Company to issue RSUs that can settle in cash, all of the Company's outstanding RSUs as of March 31, 2015 are designated to be settled in shares of the Company's common stock. The Company granted 590,000 and 610,621 RSUs during the three months ended March 31, 2015 and 2014, respectively. There were no forfeitures of RSUs during the three months ended March 31, 2015. During the three months ended March 31, 2014, an aggregate of 97,164 previously awarded RSUs were forfeited by the holders' thereof in connection with the negotiation of such holders' respective new employment agreements. All RSUs outstanding at March 31, 2015 may be entitled to receive dividend equivalent payments depending on the terms and conditions of the award either in cash at the time dividends are paid by the Company, or for certain performance-based RSU awards, as a grant of stock at the time such awards are settled. At March 31, 2015 and December 31, 2014, the Company had unrecognized compensation expense of \$6.1 million and \$2.7 million, respectively, related to RSUs. The unrecognized compensation expense at March 31, 2015 is expected to be recognized over a weighted average period of 2.4 years. A 0% forfeiture rate was assumed with respect to unvested RSUs at March 31, 2015.

Expense Recognized for Equity-Based Compensation Instruments

The following table presents the Company's expenses related to its equity-based compensation instruments for the three months ended March 31, 2015 and 2014:

| (In Thousands)                    | Three Months Ended |         |     |
|-----------------------------------|--------------------|---------|-----|
|                                   | March 31,          |         |     |
|                                   | 2015               | 2014    |     |
| Restricted shares of common stock | \$246              | \$367   |     |
| RSUs                              | 646                | 1,080   | (1) |
| DERs                              | 20                 | 37      |     |
| Total                             | \$912              | \$1,484 |     |

(1) RSU expense for the three months ended March 31, 2014 includes approximately \$500,000 for a one-time grant to the Company's chief executive officer.

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## (b) Employment Agreements

At March 31, 2015, the Company had employment agreements with four of its officers, with varying terms that provide for, among other things, base salary, bonus and change-in-control payments upon the occurrence of certain triggering events.

## (c) Deferred Compensation Plans

The Company administers deferred compensation plans for its senior officers and non-employee directors (collectively, the “Deferred Plans”), pursuant to which participants may elect to defer up to 100% of certain cash compensation. The Deferred Plans are designed to align participants’ interests with those of the Company’s stockholders.

Amounts deferred under the Deferred Plans are considered to be converted into “stock units” of the Company. Stock units do not represent stock of the Company, but rather are a liability of the Company that changes in value as would equivalent shares of the Company’s common stock. Deferred compensation liabilities are settled in cash at the termination of the deferral period, based on the value of the stock units at that time. The Deferred Plans are non-qualified plans under the Employee Retirement Income Security Act of 1974 and, as such, are not funded. Prior to the time that the deferred accounts are settled, participants are unsecured creditors of the Company.

The Company’s liability for stock units in the Deferred Plans is based on the market price of the Company’s common stock at the measurement date. The following table presents the Company’s expenses related to its Deferred Plans for its non-employee directors and senior officers for the three months ended March 31, 2015 and 2014:

| (In Thousands)         | Three Months Ended |        |
|------------------------|--------------------|--------|
|                        | March 31,          |        |
|                        | 2015               | 2014   |
| Non-employee directors | \$(8               | ) \$36 |
| Total                  | \$(8               | ) \$36 |

The following table presents the aggregate amount of income deferred by participants of the Deferred Plans through March 31, 2015 and December 31, 2014 that had not been distributed and the Company’s associated liability for such deferrals at March 31, 2015 and December 31, 2014:

| (In Thousands)         | March 31, 2015                          |                                   | December 31, 2014                       |                                   |
|------------------------|---|-----------------------------------|---|-----------------------------------|
|                        | Undistributed<br>Income<br>Deferred (1) | Liability Under<br>Deferred Plans | Undistributed<br>Income Deferred<br>(1) | Liability Under<br>Deferred Plans |
| Non-employee directors | \$264                                   | \$330                             | \$324                                   | \$446                             |
| Total                  | \$264                                   | \$330                             | \$324                                   | \$446                             |

(1) Represents the cumulative amounts that were deferred by participants through March 31, 2015 and December 31, 2014, which had not been distributed through such date.

## (d) Savings Plan

The Company sponsors a tax-qualified employee savings plan (the “Savings Plan”), in accordance with Section 401(k) of the Code. Subject to certain restrictions, all of the Company’s employees are eligible to make tax deferred contributions to the Savings Plan subject to limitations under applicable law. Participant’s accounts are self-directed and the Company bears the costs of administering the Savings Plan. The Company matches 100% of the first 3% of eligible compensation deferred by employees and 50% of the next 2%, subject to a maximum as provided by the Code. The Company has elected to operate the Savings Plan under the applicable safe harbor provisions of the Code, whereby among other things, the Company must make contributions for all participating employees and all matches contributed by the Company immediately vest 100%. For the three months ended March 31, 2015 and 2014, the Company recognized expenses for matching contributions of \$75,000 and \$65,000, respectively.

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16. Fair Value of Financial Instruments

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The three levels of valuation hierarchy are defined as follows:

Level 1 — inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 — inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level 3 — inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The following describes the valuation methodologies used for the Company's financial instruments measured at fair value on a recurring basis, as well as the general classification of such instruments pursuant to the valuation hierarchy.

Securities Obtained and Pledged as Collateral/Obligation to Return Securities Obtained as Collateral

The fair value of U.S. Treasury securities obtained as collateral and the associated obligation to return securities obtained as collateral are based upon prices obtained from a third-party pricing service, which are indicative of market activity. Securities obtained as collateral are classified as Level 1 in the fair value hierarchy.

MBS and CRT securities

The Company determines the fair value of its Agency MBS, based upon prices obtained from third-party pricing services, which are indicative of market activity and repurchase agreement counterparties.

For Agency MBS, the valuation methodology of the Company's third-party pricing services incorporate commonly used market pricing methods, trading activity observed in the marketplace and other data inputs. The methodology also considers the underlying characteristics of each security, which are also observable inputs, including: collateral vintage; coupon; maturity date; loan age; reset date; collateral type; periodic and life cap; geography; and prepayment speeds. Management analyzes pricing data received from third-party pricing services and compares it to other indications of fair value including data received from repurchase agreement counterparties and its own observations of trading activity observed in the marketplace.

In determining the fair value of its Non-Agency MBS and CRT securities, management considers a number of observable market data points, including prices obtained from pricing services and brokers as well as dialogue with market participants. In valuing Non-Agency MBS, the Company understands that pricing services use observable inputs that include, in addition to trading activity observed in the marketplace, loan delinquency data, credit enhancement levels and vintage, which are taken into account to assign pricing factors such as spread and prepayment assumptions. For tranches of Legacy Non-Agency MBS that are cross-collateralized, performance of all collateral groups involved in the tranche are considered. The Company collects and considers current market intelligence on all major markets, including benchmark security evaluations and bid-lists throughout the day from various sources, when available.



The Company's MBS and CRT securities are valued using various market data points as described above, which management considers directly or indirectly observable parameters. Accordingly, the Company's MBS and CRT securities are classified as Level 2 in the fair value hierarchy.

#### Residential Whole Loans, at Fair Value

The Company determines the fair value of its residential whole loans held at fair value after considering portfolio valuations obtained from a third-party who specializes in providing valuations of residential mortgage loans trading activity observed in the market place. The Company's residential whole loans held at fair value are classified as Level 3 in the fair value hierarchy

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## Swaps

The Company determines the fair value of non-centrally cleared Swaps considering valuations obtained from a third-party pricing service. For Swaps that are cleared by a central clearing house valuations provided by the clearing house are used. All valuations obtained are tested with internally developed models that apply readily observable market parameters. 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 Swaps are subject either to bilateral collateral arrangements, or for cleared Swaps, to the clearing house's margin requirements. Consequently, no credit valuation adjustment was made in determining the fair value of such instruments. Swaps are classified as Level 2 in the fair value hierarchy.

The following table presents the Company's financial instruments carried at fair value on a recurring basis as of March 31, 2015, on the consolidated balance sheet by the valuation hierarchy, as previously described:

## Fair Value at March 31, 2015

| (In Thousands)   | Level 1   | Level 2      | Level 3   | Total        |
|--|-----------|--------------|-----------|--------------|
| Assets:  |           |              |           |              |
| Agency MBS   | \$—       | \$5,671,195  | \$—       | \$5,671,195  |
| Non-Agency MBS, including MBS transferred to consolidated VIEs | —         | 6,855,323    | —         | 6,855,323    |
| CRT securities   | —         | 127,182      | —         | 127,182      |
| Securities obtained and pledged as collateral                  | 506,861   | —            | —         | 506,861      |
| Residential whole loans, at fair value                         | —         | —            | 144,507   | 144,507      |
| Swaps  | —         | 1,051        | —         | 1,051        |
| Total assets carried at fair value                             | \$506,861 | \$12,654,751 | \$144,507 | \$13,306,119 |
| Liabilities:   |           |              |           |              |
| Swaps  | \$—       | \$92,480     | \$—       | \$92,480     |
| Obligation to return securities obtained as collateral         | 506,861   | —            | —         | 506,861      |
| Total liabilities carried at fair value                        | \$506,861 | \$92,480     | \$—       | \$599,341    |

The following table presents additional information for the three months ended March 31, 2015 about the Company's residential whole loans which are classified as Level 3 and measured at fair value on a recurring basis. The Company did not own any residential whole loans during the three months ended March 31, 2014.

## Changes in Level 3 Assets Measured at Fair Value on a Recurring Basis

| (In Thousands)   | Three Months Ended March 31, 2015      |
|--|--|
|  | Residential Whole Loans, at Fair Value |
| Balance at beginning of period   | \$143,472                              |
| Purchases and capitalized advances   | 4,725                                  |
| Amortization of premiums and (discounts)   | 368                                    |
| Changes in fair value recorded in Net income on residential whole loans held at fair value | 602                                    |
| Collection of principal  | (2,544)                                |

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|                          |           |   |
|--------------------------|-----------|---|
| Capitalized advances     | 1,047     |   |
| Transfer to REO          | (3,163    | ) |
| Balance at end of period | \$144,507 |   |

The Company did not transfer any assets or liabilities from one level to another during the three months ended March 31, 2015.

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The following table presents a summary of quantitative information about the significant unobservable inputs used in the fair value measurement of the Company's residential whole loans held at fair value for which it has utilized Level 3 inputs to determine fair value as of March 31, 2015:

## Fair Value Methodology for Level 3 Financial Instruments

| (Dollars<br>in Thousands)                 | March 31, 2015 |                         | Unobservable Input                        | Range        | Weighted<br>Average |   |
|---|----------------|-------------------------|---|--------------|---------------------|---|
|   | Fair Value     | Valuation<br>Technique  |   |              |                     |   |
| Residential whole<br>loans, at fair value | \$41,566       | Discounted cash<br>flow | Discount rate                             | 6.00-7.75%   | 7.10                | % |
|   |                |                         | Prepayment rate                           | 0.25-8.60%   | 5.46                | % |
|   |                |                         | Default rate                              | 0.00-8.40%   | 3.50                | % |
|   |                |                         | Loss severity                             | 10.00-73.12% | 18.63               | % |
|   | \$102,941      | Liquidation model       | Discount rate                             | 7.00-7.00%   | 7.00                | % |
|   |                |                         | Annual change in home<br>prices           | (4.00)-6.30% | 0.75                | % |
|   |                |                         | Liquidation timeline (in<br>years)        | 1.25-4.42    | 2.07                |   |
|   |                |                         | Current value of<br>underlying properties | \$30-\$3,800 | \$471               |   |
| Total                                     | \$144,507      |                         |   |              |                     |   |

The following table presents the difference between the fair value and the aggregate unpaid principal balance of the Company's residential whole loans for which the fair value option was elected, at March 31, 2015 and December 31, 2014.

| (In Thousands)                         | March 31, 2015 |                                |             | December 31, 2014 |                                |             |
|--|----------------|--------------------------------|-------------|-------------------|--------------------------------|-------------|
|  | Fair Value     | Unpaid<br>Principal<br>Balance | Difference  | Fair Value        | Unpaid<br>Principal<br>Balance | Difference  |
| Residential whole loans, at fair value |                |                                |             |                   |                                |             |
| Total loans                            | \$144,507      | \$182,368                      | \$(37,861 ) | \$143,472         | \$182,613                      | \$(39,141 ) |
| Loans 90 days or more past due         | \$107,227      | \$140,002                      | \$(32,775 ) | \$128,591         | \$165,358                      | \$(36,767 ) |

Changes to the valuation methodologies used with respect to the Company's financial instruments are reviewed by management to ensure any such changes result in appropriate exit price valuations. The Company will refine its valuation methodologies as markets and products develop and pricing methodologies evolve. The methods described above may produce fair value estimates that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Company believes its valuation methods are appropriate and consistent with those used by market participants, the use of different methodologies, or assumptions, to determine the fair value of certain financial instruments could 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. The Company reviews the classification of its financial instruments within the fair value hierarchy on a quarterly basis, and management may conclude that its financial instruments should be reclassified to a different level in the future.

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The following table presents the carrying values and estimated fair values of the Company's financial instruments at March 31, 2015 and December 31, 2014:

| (In Thousands)   | March 31, 2015 |                      | December 31, 2014 |                      |
|--|----------------|----------------------|-------------------|----------------------|
|  | Carrying Value | Estimated Fair Value | Carrying Value    | Estimated Fair Value |
| <b>Financial Assets:</b>                                       |                |                      |                   |                      |
| Agency MBS   | \$5,671,195    | \$5,671,195          | \$5,904,207       | \$5,904,207          |
| Non-Agency MBS, including MBS transferred to consolidated VIEs | 6,855,323      | 6,855,323            | 4,755,432         | 4,755,432            |
| CRT securities   | 127,182        | 127,182              | 102,983           | 102,983              |
| Securities obtained and pledged as collateral                  | 506,861        | 506,861              | 512,105           | 512,105              |
| Residential whole loans, at carrying value                     | 242,777        | 259,853              | 207,923           | 217,386              |
| Residential whole loans, at fair value                         | 144,507        | 144,507              | 143,472           | 143,472              |
| Cash and cash equivalents                                      | 168,717        | 168,717              | 182,437           | 182,437              |
| Restricted cash  | 93,287         | 93,287               | 67,255            | 67,255               |
| Linked Transactions  | —              | —                    | 398,336           | 398,336              |
| Swaps  | 1,051          | 1,051                | 3,136             | 3,136                |
| <b>Financial Liabilities:</b>                                  |                |                      |                   |                      |
| Repurchase agreements  | 9,809,586      | 9,813,609            | 8,267,388         | 8,266,699            |
| Securitized debt   | 91,280         | 91,521               | 110,574           | 110,791              |
| Obligation to return securities obtained as collateral         | 506,861        | 506,861              | 512,105           | 512,105              |
| Senior Notes   | 100,000        | 104,320              | 100,000           | 104,720              |
| Swaps  | 92,480         | 92,480               | 62,198            | 62,198               |

In addition to the methodologies used to determine the fair value of the Company's financial assets and liabilities reported at fair value on a recurring basis, as previously described, the following methods and assumptions were used by the Company in arriving at the fair value of the Company's other financial instruments presented in the above table:

**Residential Whole Loans at Carrying Value:** The Company determines the fair value of its residential whole loans held at carrying value after considering portfolio valuations obtained from a third-party who specializes in providing valuations of residential mortgage loans and trading activity observed in the market place. The Company's residential whole loans held at carrying value are classified as Level 3 in the fair value hierarchy.

**Cash and Cash Equivalents and Restricted Cash:** Cash and cash equivalents and restricted cash are comprised of cash held in overnight money market investments and demand deposit accounts. At March 31, 2015 and December 31, 2014, the Company's money market funds were invested in securities issued by the U.S. Government, or its agencies, instrumentalities, and sponsored entities, and repurchase agreements involving the securities described above. Given the overnight term and assessed credit risk, the Company's investments in money market funds are determined to have a fair value equal to their carrying value.

**Linked Transactions:** As previously discussed, new accounting guidance that was effective for the Company on January 1, 2015 prospectively eliminated the use of Linked Transaction accounting, and as a result, the Company did not have any Linked Transactions at March 31, 2015. The Non-Agency MBS that prior to January 1, 2015 were accounted for as a component of Linked Transactions were valued using similar techniques to those used for the Company's other Non-Agency MBS. The value of the underlying MBS was then netted against the carrying amount

(which approximates fair value) of the repurchase agreement borrowing at the valuation date. The fair value of Linked Transactions also included accrued interest receivable on the MBS and accrued interest payable on the underlying repurchase agreement borrowings. The Company's Linked Transactions were classified as Level 2 in the fair value hierarchy at December 31, 2014.

Repurchase Agreements: The fair value of repurchase agreements reflects the present value of the contractual cash flows discounted at market interest rates at the valuation date for repurchase agreements with a term equivalent to the remaining term to interest rate repricing, which may be at maturity. Such interest rates are estimated based on LIBOR rates observed in the market. The Company's repurchase agreements are classified as Level 2 in the fair value hierarchy.

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Securitized Debt: In determining the fair value of securitized debt, management considers a number of observable market data points, including prices obtained from pricing services and brokers as well as dialogue with market participants. Accordingly, the Company's securitized debt is classified as Level 2 in the fair value hierarchy.

Senior Notes: The fair value of the Senior Notes is determined using the end of day market price quoted on the NYSE at the reporting date. The Company's Senior Notes are classified as Level 1 in the fair value hierarchy.

## 17. Use of Special Purpose Entities and Variable Interest Entities

A Special Purpose Entity ("SPE") is an entity designed to fulfill a specific limited need of the company that organized it. SPEs are often used to facilitate transactions that involve securitizing financial assets or resecuritizing previously securitized financial assets. The objective of such transactions may include obtaining non-recourse financing, obtaining liquidity or refinancing the underlying securitized financial assets on improved terms. Securitization involves transferring assets to a SPE to convert all or a portion of those assets into cash before they would have been realized in the normal course of business, through the SPE's issuance of debt or equity instruments. Investors in an SPE usually have recourse only to the assets in the SPE and depending on the overall structure of the transaction, may benefit from various forms of credit enhancement, such as over-collateralization in the form of excess assets in the SPE, priority with respect to receipt of cash flows relative to holders of other debt or equity instruments issued by the SPE, or a line of credit or other form of liquidity agreement that is designed with the objective of ensuring that investors receive principal and/or interest cash flow on the investment in accordance with the terms of their investment agreement.

## Resecuritization transactions

The Company has entered into several resecuritization transactions that resulted in the Company consolidating as VIEs the SPEs that were created to facilitate the transactions and to which the underlying assets in connection with the resecuritizations were transferred. See Note 2(r) for a discussion of the accounting policies applied to the consolidation of VIEs and transfers of financial assets in connection with resecuritization transactions.

The following table summarizes the key details of the resecuritization transactions the Company is involved in as of March 31, 2015:

| (Dollars in Thousands)  | February 2012 | October 2010                   |
|---|---------------|--------------------------------|
| Name of Trust (Consolidated as a VIE)   | WFMLT Series  | DMSI                           |
|   | 2012-RR1      | 2010-RS2                       |
| Principal value of Non-Agency MBS sold  | \$433,347     | \$985,228                      |
| Face amount of Bonds issued by the VIE and purchased by 3rd party investors (1) | \$186,691     | \$373,577                      |
| Outstanding amount of Senior Bonds at March 31, 2015                            | \$50,842      | \$40,438                       |
| Pass-through rate for Senior Bonds issued                                       | 2.85          | % Weighted Average Coupon Rate |
| Face amount of Senior Support Certificates received by the Company (2)          | \$219,140     | \$477,800                      |
| Cash received   | \$186,691     | \$375,621                      |
| Notional amount acquired of non-rated, interest only senior certificates (1)    | \$186,691     | \$—                            |
| Unamortized deferred costs  | \$437         | \$—                            |



(1) Amount disclosed reflects principal balance on the DMSI 2010-RS A1, A2 and A3 bonds. The DMSI 2010-RS2 A2 and A3 bond were sold to third party investors during 2013. The principal balance for the DMSI 2010-RS2 A1 Bond and associated interest only Senior certificate was paid off during 2013. The principal balance for the DMSI 2010-RS2 A2 Bond was paid off in January 2015.

(2) Provides credit support for the sequential Senior Non-Agency MBS sold to third-party investors in resecuritization transactions (“Senior Bonds”).

The Company engaged in these transactions primarily for the purpose of obtaining non-recourse financing on a portion of its Non-Agency MBS portfolio, as well as refinancing a portion of its Non-Agency MBS portfolio on improved terms. As a result

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of engaging in these transactions, the risks facing the Company are largely unchanged as the Company remains economically exposed to the first loss position on the underlying MBS transferred to the VIEs.

The activities that can be performed by an entity created to facilitate a resecuritization transaction are predominantly specified in the entity's formation documents. Those documents do not permit the entity, any beneficial interest holder in the entity, or any other party associated with the entity to cause the entity to sell or replace the assets held by the entity, or limit such ability to specific events of default.

The Company concluded that the entities created to facilitate these resecuritization transactions are VIEs. The Company then completed an analysis of whether each VIE created to facilitate the resecuritization transaction should be consolidated by the Company, based on consideration of its involvement in each VIE, including the design and purpose of the SPE, and whether its involvement reflected a controlling financial interest that resulted in the Company being deemed the primary beneficiary of each VIE. In determining whether the Company would be considered the primary beneficiary, the following factors were assessed:

- Whether the Company has both the power to direct the activities that most significantly impact the economic performance of the VIE; and
- Whether the Company has a right to receive benefits or absorb losses of the entity that could be potentially significant to the VIE.

Based on its evaluation of the factors discussed above, including its involvement in the purpose and design of the entity, the Company determined that it was required to consolidate each VIE created to facilitate these resecuritization transactions.

As of March 31, 2015 and December 31, 2014, the aggregate fair value of the Non-Agency MBS that were resecuritized as described above was \$693.9 million and \$1.397 billion, respectively. These assets are included in the Company's consolidated balance sheets and disclosed as "Non-Agency MBS transferred to consolidated VIEs". As of March 31, 2015 and December 31, 2014, the aggregate outstanding balance of Senior Bonds issued by consolidated VIEs was \$91.3 million and \$110.6 million, respectively. These Senior Bonds are included in the Company's consolidated balance sheets and disclosed as "Securitized debt". The holders of the Senior Bonds have no recourse to the general credit of the Company, but the Company does have the obligation, under certain circumstances to repurchase assets from the VIE upon the breach of certain representations and warranties in relation to the Non-Agency MBS sold to the VIE. In the absence of such a breach, the Company has no obligation to provide any other explicit or implicit support to any VIE.

During 2015 and subsequent to the repayment of the outstanding balance of Senior Bonds issued by the CSMC Series 2011-1R Trust (the "Trust"), this resecuritization financing structure was terminated. The termination was effected through an exchange of the remaining beneficial interests previously issued by the Trust and held by the Company for the underlying securities that were previously transferred to and held by the Trust at the date of termination. Following the exchange, the beneficial interests were cancelled by the trustee and the Trust was terminated. The exchange and termination of this financing structure did not result in any gain or loss to the Company. As a result of the termination, the underlying securities originally transferred as part of this resecuritization are reported as Non-Agency MBS in the Company's consolidated balance sheets at March 31, 2015 and interest income from the underlying securities from the date of termination through March 31, 2015 is reported as Interest income from Non-Agency MBS in the Company's consolidated statements of operations.

Prior to the completion of the Company's first resecuritization transaction in October 2010, the Company had not transferred assets to VIEs or QSPEs and other than acquiring MBS issued by such entities, had no other involvement with VIEs or QSPEs.

#### Residential Whole Loans

Included on the Company's consolidated balance sheets as of March 31, 2015 is a total of \$387.3 million of residential whole loans, of which approximately \$242.8 million are reported at carrying value and \$144.5 million are reported at fair value. The inclusion of these assets arises from the Company's 100% equity interest in certificates issued by certain trusts established to acquire the loans. Based on its evaluation of its 100% interest in these trusts and other factors, the Company has determined that the trusts are required to be consolidated for financial reporting purposes. During the three months ended March 31, 2015, approximately \$3.6 million of interest income was recognized from residential whole loans reported at carrying value which is included in Interest income on the Company's consolidated statements of operations. In addition, the Company recognized net income of \$2.6 million on residential whole loans held at fair value during the three months ended March 31, 2015, which is included in Other Income, net on the Company's consolidated statements of operations. (See Note 4)

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

In this Quarterly Report on Form 10-Q, we refer to MFA Financial, Inc. and its subsidiaries as "the Company," "MFA," "we," "us," or "our," unless we specifically state otherwise or the context otherwise indicates.

The following discussion should be read in conjunction with our financial statements and accompanying notes included in Item 1 of this Quarterly Report on Form 10-Q as well as our Annual Report on Form 10-K for the year ended December 31, 2014.

Forward Looking Statements

When used in this Quarterly Report on Form 10-Q, in future filings with the SEC or in press releases or other written or oral communications, statements which are not historical in nature, including those containing words such as "will," "believe," "expect," "anticipate," "estimate," "plan," "continue," "intend," "should," "could," "would," "may" or similar expressions, are intended to identify "forward-looking statements" within the meaning of Section 27A of the 1933 Act and Section 21E of the 1934 Act, and, as such, may involve known and unknown risks, uncertainties and assumptions.

These forward-looking statements include information about possible or assumed future results with respect to our business, financial condition, liquidity, results of operations, plans and objectives. Statements regarding the following subjects, among others, may be forward-looking: changes in interest rates and the market value of our MBS; changes in the prepayment rates on the mortgage loans securing our MBS, an increase of which could result in a reduction of the yield on MBS in our portfolio and an increase of which could require us to reinvest the proceeds received by us as a result of such prepayments in MBS with lower coupons; changes in the default rates and management's assumptions regarding default rates on the mortgage loans securing our Non-Agency MBS; our ability to borrow to finance our assets and the terms, including the cost, maturity and other terms, of any such borrowings; implementation of or changes in government regulations or programs affecting our business; our estimates regarding taxable income the actual amount of which is dependent on a number of factors, including, but not limited to, changes in the amount of interest income and financing costs, the method elected by us to accrete the market discount on Non-Agency MBS and the extent of prepayments, realized losses and changes in the composition of our Agency MBS and Non-Agency MBS portfolios that may occur during the applicable tax period, including gain or loss on any MBS disposals; the timing and amount of distributions to stockholders, which are declared and paid at the discretion of our Board and will depend on, among other things, our taxable income, our financial results and overall financial condition and liquidity, maintenance of our REIT qualification and such other factors as the Board deems relevant; our ability to maintain our qualification as a REIT for federal income tax purposes; our ability to maintain our exemption from registration under the Investment Company Act of 1940, as amended (or the Investment Company Act), including statements regarding the concept release issued by the SEC relating to interpretive issues under the Investment Company Act with respect to the status under the Investment Company Act of certain companies that are engaged in the business of acquiring mortgages and mortgage-related interests; our ability to successfully implement our strategy to grow our residential whole loan portfolio; and risks associated with investing in real estate assets, including changes in business conditions and the general economy. These and other risks, uncertainties and factors, including those described in the annual, quarterly and current reports that we file with the SEC, could cause our actual results to differ materially from those projected in any forward-looking statements we make. All forward-looking statements are based on beliefs, assumptions and expectations of our future performance, taking into account all information currently available. Readers are cautioned not to place undue reliance on these forward-looking statements, which 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 us. Except as required by law, we are not obligated to, and do not intend to, update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Business/General

We are a REIT primarily engaged in the business of investing, on a leveraged basis, in residential mortgage assets, including Agency MBS, Non-Agency MBS and residential whole loans. Our principal business objective is to deliver shareholder value through the generation of distributable income and through asset performance linked to residential mortgage credit fundamentals. We selectively invest in residential mortgage assets with a focus on credit analysis, projected prepayment rates, interest rate sensitivity and expected return.

At March 31, 2015, we had total assets of approximately \$13.902 billion, of which \$12.527 billion, or 90.1%, represented our MBS portfolio. At such date, our MBS portfolio was comprised of \$5.671 billion of Agency MBS and \$6.855 billion of Non-Agency MBS which includes \$4.537 billion of Legacy Non-Agency MBS and \$2.318 billion of RPL/NPL MBS. In addition, at March 31, 2015, we had approximately \$387.3 million in residential whole loans acquired through our interests in consolidated trusts, which represented approximately 2.8% of our total assets. Our remaining investment-related assets were primarily comprised

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of collateral obtained in connection with reverse repurchase agreements, cash and cash equivalents, CRT securities, restricted cash, MBS-related receivables and derivative instruments.

The results of our business operations are affected by a number of factors, many of which are beyond our control, and primarily depend on, among other things, the level of our net interest income, the market value of our assets, which is driven by numerous factors, including the supply and demand for residential mortgage assets in the marketplace, the terms and availability of adequate financing, general economic and real estate conditions (both on national and local level), the impact of government actions in the real estate and mortgage sector, and the credit performance of our credit sensitive residential mortgage assets. Our net interest income varies primarily as a result of changes in interest rates, the slope of the yield curve (i.e., the differential between long-term and short-term interest rates), borrowing costs (i.e., our interest expense) and prepayment speeds on our MBS, the behavior of which involves various risks and uncertainties. Interest rates and conditional prepayment rates (or CPRs) (which measure the amount of unscheduled principal prepayment on a bond as a percentage of the bond balance), vary according to the type of investment, conditions in the financial markets, competition and other factors, none of which can be predicted with any certainty.

With respect to our business operations, increases in interest rates, in general, may over time cause: (i) the interest expense associated with our borrowings to increase; (ii) the value of our MBS portfolio and, correspondingly, our stockholders' equity to decline; (iii) coupons on our ARM-MBS to reset, on a delayed basis, to higher interest rates; (iv) prepayments on our MBS to decline, thereby slowing the amortization of our MBS purchase premiums and the accretion of our purchase discounts; and (v) the value of our derivative hedging instruments and, correspondingly, our stockholders' equity to increase. Conversely, decreases in interest rates, in general, may over time cause: (i) the interest expense associated with our borrowings to decrease; (ii) the value of our MBS portfolio and, correspondingly, our stockholders' equity to increase; (iii) coupons on our ARM-MBS to reset, on a delayed basis, to lower interest rates; (iv) prepayments on our MBS to increase, thereby accelerating the amortization of our MBS purchase premiums and the accretion of our purchase discounts; and (v) the value of our derivative hedging instruments and, correspondingly, our stockholders' equity to decrease. In addition, our borrowing costs and credit lines are further affected by the type of collateral we pledge and general conditions in the credit market.

We are exposed to credit risk in our Non-Agency MBS and residential whole loans, generally meaning that we are subject to credit losses in these portfolios that correspond to the risk of delinquency, default and foreclosure on the underlying real estate collateral. We believe the discounted purchase prices paid on certain of these investments effectively mitigates our risk of loss in the event that, as we expect on most such investments, we receive less than 100% of the par value of these securities or loans. Our investment process for credit sensitive assets involves analysis focused primarily on quantifying and pricing credit risk.

As of March 31, 2015, approximately \$6.307 billion or 61.8%, of our MBS portfolio was in its contractual fixed-rate period or were fixed-rate MBS and approximately \$3.900 billion, or 38.2%, was in its contractual adjustable-rate period, or were floating rate MBS with interest rates that reset monthly. Our ARM-MBS in their contractual adjustable-rate period primarily include MBS collateralized by Hybrids for which the initial fixed-rate period has elapsed, such that the interest rate will typically adjust on an annual or semiannual basis.

Premiums arise when we acquire MBS at a price in excess of the principal balance of the mortgages securing such MBS (i.e., par value). Conversely, discounts arise when we acquire MBS at a price below the principal balance of the mortgages securing such MBS or acquire residential whole loans at a price below the principal balance of the mortgage. Premiums paid on our MBS are amortized against interest income and accretible purchase discounts on these investments are accreted to interest income. Purchase premiums on our MBS, which are primarily carried on our Agency MBS, are amortized against interest income over the life of each security using the effective yield method, adjusted for actual prepayment activity. An increase in the prepayment rate, as measured by the CPR, will typically accelerate the amortization of purchase premiums, thereby reducing the IRR/interest income earned on such

assets. Generally, if prepayments on these investments are less than anticipated, we expect that the income recognized on such assets would be reduced and MBS impairments and/or loan loss reserves could result.

CPR levels are impacted by, among other things, conditions in the housing market, new regulations, government and private sector initiatives, interest rates, availability of credit to home borrowers, underwriting standards and the economy in general. In particular, CPR reflects the conditional repayment rate (or CRR), which measures voluntary prepayments of mortgages collateralizing a particular MBS, and the conditional default rate (or CDR), which measures involuntary prepayments resulting from defaults. CPRs on Agency MBS and Legacy Non-Agency MBS may differ significantly. For the three months ended March 31, 2015, our Agency MBS portfolio experienced a weighted average CPR of 10.9%, and our Legacy Non-Agency MBS portfolio experienced a weighted average CPR of 11.1%. Over the last consecutive eight quarters, ending with March 31, 2015, the monthly fair value weighted average CPR on our Agency and Legacy Non-Agency MBS portfolios ranged from a high of 19.7% experienced during the month ended August 31, 2013 to a low of 10.4%, experienced during the month ended March 31, 2014, with an average CPR over such quarters of 15.9%.

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When we purchase Non-Agency MBS at significant discounts to par value, we make certain assumptions with respect to each security. These assumptions include, but are not limited to, future interest rates, voluntary prepayment rates, default rates, mortgage modifications and loss severities. As part of our Non-Agency MBS surveillance process, we track and compare each security's actual performance over time to the performance expected at the time of purchase or, if we have modified our original purchase assumptions, to our revised performance expectations. To the extent that actual performance or our expectation of future performance of our Non-Agency MBS deviates materially from our expected performance parameters, we may revise our performance expectations, such that the amount of purchase discount designated as credit discount may be increased or decreased over time. Nevertheless, credit losses greater than those anticipated or in excess of the recorded purchase discount could occur, which could materially adversely impact our operating results.

It is our business strategy to hold our MBS as long-term investments. On at least a quarterly basis, we assess our ability and intent to continue to hold each security and, as part of this process, we monitor our securities for other-than-temporary impairment. A change in our ability and/or intent to continue to hold any of our securities that are in an unrealized loss position, or a deterioration in the underlying characteristics of these securities, could result in our recognizing future impairment charges or a loss upon the sale of any such security. At March 31, 2015, we had net unrealized gains of \$93.0 million on our Agency MBS, comprised of gross unrealized gains of \$109.7 million and gross unrealized losses of \$16.7 million, net unrealized gains on our Non-Agency MBS of \$753.5 million, comprised of gross unrealized gains of \$757.2 million and gross unrealized losses of \$3.7 million and net unrealized gains on our CRT securities of \$3.8 million, comprised of gross unrealized gains of \$4.0 million and gross unrealized losses of \$287,000. At March 31, 2015, we did not intend to sell any of our MBS or CRT securities that were in an unrealized loss position, and we believe it is more likely than not that we will not be required to sell those securities before recovery of their amortized cost basis, which may be at their maturity.

We rely primarily on borrowings under repurchase agreements to finance our Agency MBS and Non-Agency MBS. Our MBS have longer-term contractual maturities than our borrowings under repurchase agreements. We have also engaged in resecuritization transactions with respect to our Non-Agency MBS, which provide access to non-recourse financing. Even though the majority of our MBS have interest rates that adjust over time based on short-term changes in corresponding interest rate indices (typically following an initial fixed-rate period for our Hybrids), the interest rates we pay on our borrowings and securitized debt will typically change at a faster pace than the interest rates we earn on our MBS. In order to reduce this interest rate risk exposure, we may enter into derivative instruments, which at March 31, 2015 were comprised of Swaps.

Our Swap derivative instruments are designated as cash-flow hedges against a portion of our current and forecasted LIBOR-based repurchase agreements. Our Swaps do not extend the maturities of our repurchase agreements; they do, however, lock in a fixed rate of interest over their term for the notional amount of the Swap corresponding to the hedged item. During the three months ended March 31, 2015, we did not enter into any new Swaps and had Swaps with an aggregate notional amount of \$410.2 million and a weighted average fixed-pay rate of 1.90% amortize and/or expire. At March 31, 2015, we had Swaps designated in hedging relationships with an aggregate notional amount of \$3.350 billion with a weighted average fixed-pay rate of 1.84% and a weighted average variable interest rate received of 0.18%.

### Recent Market Conditions and Our Strategy

During the first quarter of 2015, we continued to invest in residential mortgage assets, including both MBS and, through interests in consolidated trusts, residential whole loans. At March 31, 2015, our combined MBS portfolio was approximately \$12.527 billion compared to \$12.573 billion (including \$1.913 billion MBS reported as components of Linked Transactions) at December 31, 2014.



At March 31, 2015, \$5.671 billion, or 45.3% of our MBS portfolio, was invested in Agency MBS. During the three months ended March 31, 2015, the fair value of our Agency MBS decreased by \$233.0 million. This was due to \$236.8 million of principal repayments and \$9.1 million of premium amortization, which was partially offset by a \$12.9 million increase in net unrealized gains.

At March 31, 2015, \$6.855 billion, or 54.7% of our MBS portfolio, was invested in Non-Agency MBS. During the three months ended March 31, 2015, the fair value of our Non-Agency MBS holdings increased by \$2.100 billion. The primary components of the change during the quarter in these Non-Agency MBS include the reclassification of \$1.913 billion of Non-Agency MBS that were previously reported as a component of Linked Transactions, \$504.1 million of RPL/NPL MBS purchases (at a weighted average purchase price of 99.9%) and an increase reflecting Non-Agency MBS price changes of \$40.0 million. Partially offsetting these increases were \$346.5 million of Non-Agency principal reductions and the sale of Non-Agency MBS with a fair value of \$10.8 million.

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In addition to our investments in Agency MBS and Non-Agency MBS, we invested in CRT securities, which are debt obligations issued by Fannie Mae and Freddie Mac. At March 31, 2015 our investments in these securities totaled \$127.2 million.

New accounting guidance that was effective at the beginning of the year prospectively eliminated the use of Linked Transaction accounting. Accordingly, on adoption of the new standard on January 1, 2015, we reclassified \$1.913 billion of Non-Agency MBS and \$4.6 million of CRT securities that were previously reported as a component of Linked Transactions to Non-Agency MBS and CRT securities respectively on the consolidated balance sheets. In addition, liabilities of \$1.520 billion that were previously presented as a component of Linked Transactions were reclassified to Repurchase Agreements on the consolidated balance sheets. Furthermore, an amount of \$4.5 million representing net unrealized gains on Non-Agency MBS and CRT securities previously reported as a component of Linked Transactions as of December 31, 2014 was reclassified from Accumulated Deficit to AOCI (see Notes 2(t) and 6 to the accompanying consolidated financial statements, included under Item 1 of this Quarterly Report on Form 10-Q).

Our book value per common share was \$8.13 as of March 31, 2015, largely unchanged from \$8.12 as of December 31, 2014.

At the end of the first quarter of 2015, the average coupon on mortgages underlying our Agency MBS was slightly lower compared to the end of the first quarter of 2014, due to prepayments on higher yielding assets and downward resets on Hybrid and ARM-MBS within the portfolio. As a result, the coupon yield on our Agency MBS portfolio declined to 2.99% for the three months ended March 31, 2015 from 3.01% for the three months ended March 31, 2014. The net Agency MBS yield decreased to 2.22% for the three months ended March 31, 2015, from 2.39% for the three months ended March 31, 2014. The net yield for our Legacy Non-Agency MBS portfolio was 7.64% for the three months ended March 31, 2015 compared to 7.80% for the three months ended March 31, 2014. The decrease in the net yield on our Legacy Non-Agency MBS portfolio is primarily due to the impact of decreases in estimated future interest rates since the first quarter of the prior year partially offset by an increase in accretable discount due the impact of credit reserve releases, in the current and prior year, that have occurred as a result of the improved credit performance of loans underlying the Legacy Non-Agency MBS portfolio. The net yield for our RPL/NPL MBS portfolio was 3.62% for the three months ended March 31, 2015 compared to 4.30% for the three months ended March 31, 2014. The decrease in the net yield on our RPL/NPL MBS portfolio is primarily due to the addition since the first quarter of 2014 of lower yielding RPL/NPL MBS.

We continue to believe that loss-adjusted returns we currently earn on our existing portfolio of Legacy Non-Agency MBS are attractive. We believe that our \$873.5 million Credit Reserve and OTTI appropriately factors in remaining uncertainties regarding underlying mortgage performance and the potential impact on future cash flows for our existing Legacy Non-Agency MBS portfolio. Home price appreciation and underlying mortgage loan amortization have decreased the LTV for many of the mortgages underlying our Legacy Non-Agency portfolio. Home price appreciation during the past few years has generally been driven by a combination of limited housing supply, low mortgage rates, capital flows into own-to-rent foreclosure purchases and demographic-driven U.S. household formation. We estimate that the average LTV of mortgage loans underlying our Legacy Non-Agency MBS has declined from approximately 105% as of January 2012 to approximately 77% as of March 31, 2015. In addition, we estimate that the percentage of non-delinquent loans underlying our Legacy Non-Agency MBS that are underwater (with LTVs greater than 100%), has declined from approximately 52% as of January 2012 to 13% at March 31, 2015. Lower LTVs lessen the likelihood of defaults and simultaneously decrease loss severities. Additionally, current to 60-days delinquent transition rates continue to be low relative to their 2009 peak. Further, during 2014 and the first three months of 2015, we have also observed faster voluntary prepayment (i.e., prepayment of loans in full with no loss) speeds than originally projected. The yields on our Legacy Non-Agency MBS that were purchased at a discount are generally positively impacted if prepayment rates on these securities exceed our prepayment assumptions. Based

on these current conditions, we have reduced estimated future losses within our Legacy Non-Agency portfolio. As a result, during the three months ended March 31, 2015, \$22.3 million was transferred from Credit Reserve to accretable discount. This increase in accretable discount is expected to increase the interest income realized over the remaining life of our Legacy Non-Agency MBS. The remaining average contractual life of such assets is approximately 21 years, but based on scheduled loan amortization and prepayments (both voluntary and involuntary), loan balances will decline substantially over time. Consequently, we believe that the majority of the impact on interest income from the reduction in Credit Reserve will occur over the next ten years.

During the three months ended March 31, 2015, we purchased, through interests in consolidated trusts, approximately \$43.3 million of residential whole loans with an unpaid principal balance of approximately \$54.2 million. At March 31, 2015, our total recorded investment in residential whole loans was \$387.3 million. Of this amount, \$242.8 million is presented as residential whole loans at carrying value and \$144.5 million as residential whole loans at fair value in our consolidated balance sheet. For the three months ended March 31, 2015, we recognized approximately \$3.6 million of income on residential whole loans held at carrying value in Interest income on our consolidated statement of operations, representing an effective yield of 6.47% excluding servicing costs. In addition, we recorded net income on residential whole loans held at fair value of \$2.6 million in Other income, net in our consolidated statement of operations for the three months ended March 31, 2015.

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At March 31, 2015, we have access to various sources of liquidity which we estimate exceeds \$859.8 million. This includes (i) \$168.7 million of cash and cash equivalents; (ii) \$375.4 million in estimated financing available from unpledged Agency MBS and other Agency MBS collateral that is currently pledged in excess of contractual requirements; and (iii) \$315.7 million in estimated financing available from unpledged Non-Agency MBS. Consequently, we believe that we are positioned to continue to take advantage of investment opportunities within the residential mortgage marketplace. During the remainder of 2015, we intend to continue to selectively acquire MBS and residential whole loans. In addition, while the majority of the Legacy Non-Agency MBS in our portfolio will not return their full face value due to loan defaults, we believe that they will deliver attractive loss adjusted yields due to our discounted average amortized cost of 75% of face value at March 31, 2015.

Repurchase agreement funding for both Agency MBS and Non-Agency MBS continues to be available to us from multiple counterparties. Typically, repurchase agreement funding involving Non-Agency MBS is available from fewer counterparties, at terms requiring higher collateralization and higher interest rates, than for repurchase agreement funding involving Agency MBS. At March 31, 2015, our debt consisted of borrowings under repurchase agreements with 26 counterparties, securitized debt, Senior Notes outstanding and obligation to return securities obtained as collateral, resulting in a debt-to-equity multiple of 3.3 times. (See table on page 69 under Results of Operations that presents our quarterly leverage multiples since March 31, 2014.)

## Information About Our Assets

The tables below present certain information about our asset allocation at March 31, 2015:

## ASSET ALLOCATION

|                            | Agency<br>MBS | Legacy<br>Non-Agency<br>MBS | RPL/NPL<br>MBS (1) | MBS<br>Portfolio | Residential<br>Whole<br>Loans, at<br>Carrying<br>Value (2) | Residential<br>Whole<br>Loans, at<br>Fair Value | Other,<br>net (3) | Total      |
|----------------------------|---------------|-----------------------------|--------------------|------------------|--|---|-------------------|------------|
| (Dollars in Thousands)     |               |                             |                    |                  |  |   |                   |            |
| Fair Value/Carrying Value  | \$5,671,195   | \$4,537,132                 | \$2,318,191        | \$12,526,518     | \$242,777  | \$144,507                                       | \$386,665         | \$13,300,4 |
| Less Repurchase Agreements | (4,982,381 )  | (2,756,814 )                | (1,839,797 )       | (9,578,992 )     | (46,814 )  | (92,091 )                                       | (91,689 )         | (9,809,58  |
| Less Securitized Debt      | —             | (91,280 )                   | —                  | (91,280 )        | —  | —   | —                 | (91,280    |
| Less Senior Notes          | —             | —                           | —                  | —                | —  | —   | (100,000 )        | (100,000   |
| Equity Allocated           | \$688,814     | \$1,689,038                 | \$478,394          | \$2,856,246      | \$195,963  | \$52,416  | \$194,976         | \$3,299,60 |
| Less Swaps at Market Value | —             | —                           | —                  | —                | —  | —   | (91,429 )         | (91,429    |
| Net Equity Allocated       | \$688,814     | \$1,689,038                 | \$478,394          | \$2,856,246      | \$195,963  | \$52,416  | \$103,547         | \$3,208,17 |
| Debt/Net Equity Ratio (4)  | 7.23          | x 1.69                      | x 3.85             | x                | 0.24   | x 1.76  | x                 | 3.28       |

Represents private-label MBS issued in 2013, 2014 and 2015 in which the underlying collateral consists of (1) re-performing/non-performing loans that were originated in prior years. Included with the balance of Non-Agency MBS reported on our consolidated balance sheets.

(2) The carrying value of such loans reflects the purchase price, accretion of income, cash received and provision for loan losses since acquisition. At March 31, 2015, the fair value of such loans is estimated to be \$259.9 million.

(3)

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Includes cash and cash equivalents and restricted cash, securities obtained and pledged as collateral, CRT securities, interest receivable, goodwill, prepaid and other assets, obligation to return securities obtained as collateral of \$506.9 million, interest payable, dividends payable and accrued expenses and other liabilities.

Represents the sum of borrowings under repurchase agreements, payable for unsettled MBS purchases and (4) securitized debt as a multiple of net equity allocated. The numerator of our Total Debt/Net Equity ratio also includes the obligation to return securities obtained as collateral of \$506.9 million and Senior Notes.

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## Agency MBS

The following table presents certain information regarding the composition of our Agency MBS portfolio as of March 31, 2015 and December 31, 2014:

## March 31, 2015

| (Dollars in Thousands)     | Current Face | Weighted Average Purchase Price | Weighted Average Market Price | Fair Value (1) | Weighted Average Loan Age (Months) (2) | Weighted Average Coupon (2) | 3 Month Average CPR |
|----------------------------|--------------|---------------------------------|-------------------------------|----------------|--|-----------------------------|---------------------|
| 15-Year Fixed Rate:        |              |                                 |                               |                |  |                             |                     |
| Low Loan Balance (3)       | \$1,641,746  | 104.3                           | % 104.6                       | % \$1,717,415  | 35                                     | 3.01                        | % 7.4               |
| HARP (4)                   | 171,603      | 104.7                           | 104.7                         | 179,597        | 34                                     | 2.99                        | 5.1                 |
| Other (Post June 2009) (5) | 180,060      | 103.9                           | 107.0                         | 192,671        | 54                                     | 4.15                        | 15.0                |
| Other (Pre June 2009) (6)  | 1,043        | 104.9                           | 107.3                         | 1,120          | 70                                     | 4.50                        | 0.8                 |
| Total 15-Year Fixed Rate   | \$1,994,452  | 104.3                           | % 104.8                       | % \$2,090,803  | 37                                     | 3.11                        | % 7.9               |
| Hybrid:                    |              |                                 |                               |                |  |                             |                     |
| Other (Post June 2009) (5) | \$2,226,233  | 104.4                           | % 105.7                       | % \$2,352,565  | 47                                     | 3.05                        | % 14.9              |
| Other (Pre June 2009) (6)  | 1,016,370    | 101.7                           | 106.7                         | 1,084,409      | 100                                    | 2.69                        | 7.9                 |
| Total Hybrid               | \$3,242,603  | 103.5                           | % 106.0                       | % \$3,436,974  | 63                                     | 2.94                        | % 12.7              |
| CMO/Other                  | \$136,192    | 102.5                           | % 104.7                       | % \$142,657    | 167                                    | 2.41                        | % 8.9               |
| Total Portfolio            | \$5,373,247  | 103.8                           | % 105.5                       | % \$5,670,434  | 56                                     | 2.99                        | % 10.9              |

## December 31, 2014

| (Dollars in Thousands)     | Current Face | Weighted Average Purchase Price | Weighted Average Market Price | Fair Value (1) | Weighted Average Loan Age (Months) (2) | Weighted Average Coupon (2) | 3 Month Average CPR |
|----------------------------|--------------|---------------------------------|-------------------------------|----------------|--|-----------------------------|---------------------|
| 15-Year Fixed Rate:        |              |                                 |                               |                |  |                             |                     |
| Low Loan Balance (3)       | \$1,705,386  | 104.3                           | % 104.0                       | % \$1,773,255  | 32                                     | 3.01                        | % 7.7               |
| HARP (4)                   | 177,193      | 104.7                           | 104.0                         | 184,192        | 31                                     | 2.99                        | 6.5                 |
| Other (Post June 2009) (5) | 192,325      | 103.9                           | 107.2                         | 206,132        | 51                                     | 4.15                        | 13.0                |
| Other (Pre June 2009) (6)  | 1,069        | 104.9                           | 107.7                         | 1,151          | 67                                     | 4.50                        | 0.8                 |
| Total 15-Year Fixed Rate   | \$2,075,973  | 104.3                           | % 104.3                       | % \$2,164,730  | 34                                     | 3.12                        | % 8.1               |
| Hybrid:                    |              |                                 |                               |                |  |                             |                     |
| Other (Post June 2009) (5) | \$2,343,186  | 104.4                           | % 105.4                       | % \$2,469,714  | 44                                     | 3.15                        | % 17.9              |
| Other (Pre June 2009) (6)  | 1,049,495    | 101.7                           | 106.8                         | 1,120,830      | 97                                     | 2.82                        | 8.8                 |
| Total Hybrid               | \$3,392,681  | 103.6                           | % 105.8                       | % \$3,590,544  | 60                                     | 3.04                        | % 15.1              |
| CMO/Other                  | \$141,639    | 102.5                           | % 104.8                       | % \$148,391    | 163                                    | 2.41                        | % 8.9               |
| Total Portfolio            | \$5,610,293  | 103.8                           | % 105.2                       | % \$5,903,665  | 53                                     | 3.06                        | % 12.3              |

- (1) Does not include principal payments receivable of \$761,000 and \$542,000 at March 31, 2015 and December 31, 2014, respectively.
- (2) Weighted average is based on MBS current face at March 31, 2015 and December 31, 2014, respectively.
- (3) Low loan balance represents MBS collateralized by mortgages with original loan balance of less than or equal to \$175,000.
- (4) Home Affordable Refinance Program (or HARP) MBS are backed by refinanced loans with LTVs greater than or equal to 80% at origination.
- (5) MBS issued in June 2009 or later. Majority of underlying loans are ineligible to refinance through the HARP program.
- (6) MBS issued before June 2009.

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The following table presents certain information regarding our 15-year fixed-rate Agency MBS as of March 31, 2015 and December 31, 2014:

March 31, 2015

| Coupon                   | Current Face | Weighted Average Purchase Price | Weighted Average Market Price | Fair Value (1) | Weighted Average Loan Age (Months) (2) | Weighted Average Loan Rate | Low Loan Balance and/or HARP (3) | Loan 3 Month Average CPR |
|--------------------------|--------------|---------------------------------|-------------------------------|----------------|--|----------------------------|----------------------------------|--------------------------|
| (Dollars in Thousands)   |              |                                 |                               |                |  |                            |                                  |                          |
| 15-Year Fixed Rate:      |              |                                 |                               |                |  |                            |                                  |                          |
| 2.5%                     | \$939,253    | 104.0 %                         | 103.1 %                       | \$968,189      | 27                                     | 3.04 %                     | 100 %                            | 5.4 %                    |
| 3.0%                     | 406,656      | 105.9                           | 105.1                         | 427,258        | 33                                     | 3.49                       | 100                              | 6.2                      |
| 3.5%                     | 11,411       | 103.5                           | 106.4                         | 12,138         | 53                                     | 4.17                       | 100                              | 10.6                     |
| 4.0%                     | 543,848      | 103.5                           | 107.2                         | 583,271        | 52                                     | 4.40                       | 79                               | 12.3                     |
| 4.5%                     | 93,284       | 105.2                           | 107.1                         | 99,947         | 56                                     | 4.88                       | 32                               | 14.2                     |
| Total 15-Year Fixed Rate | \$1,994,452  | 104.3 %                         | 104.8 %                       | \$2,090,803    | 37                                     | 3.59 %                     | 91 %                             | 7.9 %                    |

December 31, 2014

| Coupon                   | Current Face | Weighted Average Purchase Price | Weighted Average Market Price | Fair Value (1) | Weighted Average Loan Age (Months) (2) | Weighted Average Loan Rate | Low Loan Balance and/or HARP (3) | Loan 3 Month Average CPR |
|--------------------------|--------------|---------------------------------|-------------------------------|----------------|--|----------------------------|----------------------------------|--------------------------|
| (Dollars in Thousands)   |              |                                 |                               |                |  |                            |                                  |                          |
| 15-Year Fixed Rate:      |              |                                 |                               |                |  |                            |                                  |                          |
| 2.5%                     | \$969,213    | 104.0 %                         | 102.2 %                       | \$990,328      | 24                                     | 3.04 %                     | 100 %                            | 6.1 %                    |
| 3.0%                     | 420,623      | 105.9                           | 104.2                         | 438,377        | 30                                     | 3.49                       | 100                              | 4.4                      |
| 3.5%                     | 11,990       | 103.5                           | 106.0                         | 12,706         | 50                                     | 4.17                       | 100                              | 11.7                     |
| 4.0%                     | 575,040      | 103.5                           | 107.2                         | 616,662        | 49                                     | 4.40                       | 79                               | 12.4                     |
| 4.5%                     | 99,107       | 105.2                           | 107.6                         | 106,657        | 53                                     | 4.88                       | 32                               | 16.9                     |
| Total 15-Year Fixed Rate | \$2,075,973  | 104.3 %                         | 104.3 %                       | \$2,164,730    | 34                                     | 3.60 %                     | 91 %                             | 8.1 %                    |

(1) Does not include principal payments receivable of \$761,000 and \$542,000 at March 31, 2015 and December 31, 2014, respectively.

(2) Weighted average is based on MBS current face at March 31, 2015 and December 31, 2014, respectively.

(3) Low Loan Balance represents MBS collateralized by mortgages with original loan balance less than or equal to \$175,000. HARP MBS are backed by refinanced loans with LTVs greater than or equal to 80% at origination.



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The following table presents certain information regarding our Hybrid Agency MBS as of March 31, 2015 and December 31, 2014:

## March 31, 2015

| (Dollars in Thousands)       | Current Face | Weighted Average Purchase Price | Weighted Average Market Price | Fair Value (1) | Weighted Average Coupon (2) | Weighted Average Loan Age (Months) (2) | Weighted Average Months to Reset (3) | Interest Only (4) | 3 Month Average CPR |
|------------------------------|--------------|---------------------------------|-------------------------------|----------------|-----------------------------|--|--------------------------------------|-------------------|---------------------|
| Hybrid Post June 2009:       |              |                                 |                               |                |                             |  |                                      |                   |                     |
| Agency 5/1                   | \$895,738    | 104.2 %                         | 106.4 %                       | \$953,213      | 2.99 %                      | 54                                     | 10                                   | 22 %              | 18.1 %              |
| Agency 7/1                   | 1,041,428    | 104.5                           | 105.1                         | 1,094,881      | 3.07                        | 43                                     | 40                                   | 21                | 13.6                |
| Agency 10/1                  | 289,067      | 104.7                           | 105.3                         | 304,471        | 3.21                        | 38                                     | 81                                   | 60                | 9.8                 |
| Total Hybrids Post June 2009 | \$2,226,233  | 104.4 %                         | 105.7 %                       | \$2,352,565    | 3.05 %                      | 47                                     | 33                                   | 26 %              | 14.9 %              |
| Hybrid Pre June 2009:        |              |                                 |                               |                |                             |  |                                      |                   |                     |
| Coupon < 4.5% (5)            | \$878,085    | 101.8 %                         | 106.7 %                       | \$936,602      | 2.29 %                      | 102                                    | 5                                    | 59 %              | 7.1 %               |
| Coupon >= 4.5% (6)           | 138,285      | 101.0                           | 106.9                         | 147,807        | 5.25                        | 87                                     | 13                                   | 75                | 12.7                |
| Total Hybrids Pre June 2009  | \$1,016,370  | 101.7 %                         | 106.7 %                       | \$1,084,409    | 2.69 %                      | 100                                    | 6                                    | 61 %              | 7.9 %               |
| Total Hybrids                | \$3,242,603  | 103.5 %                         | 106.0 %                       | \$3,436,974    | 2.94 %                      | 63                                     | 25                                   | 37 %              | 12.7 %              |

## December 31, 2014

| (Dollars in Thousands)       | Current Face | Weighted Average Purchase Price | Weighted Average Market Price | Fair Value (1) | Weighted Average Coupon (2) | Weighted Average Loan Age (Months) (2) | Weighted Average Months to Reset (3) | Interest Only (4) | 3 Month Average CPR |
|------------------------------|--------------|---------------------------------|-------------------------------|----------------|-----------------------------|--|--------------------------------------|-------------------|---------------------|
| Hybrid Post June 2009:       |              |                                 |                               |                |                             |  |                                      |                   |                     |
| Agency 5/1                   | \$953,410    | 104.2 %                         | 106.4 %                       | \$1,014,865    | 3.21 %                      | 51                                     | 11                                   | 22 %              | 22.9 %              |
| Agency 7/1                   | 1,091,645    | 104.5                           | 104.7                         | 1,143,315      | 3.07                        | 40                                     | 43                                   | 20                | 14.8                |
| Agency 10/1                  | 298,131      | 104.7                           | 104.5                         | 311,534        | 3.22                        | 36                                     | 83                                   | 59                | 12.7                |
| Total Hybrids Post June 2009 | \$2,343,186  | 104.4 %                         | 105.4 %                       | \$2,469,714    | 3.15 %                      | 44                                     | 35                                   | 26 %              | 17.9 %              |
| Hybrid Pre June 2009:        |              |                                 |                               |                |                             |  |                                      |                   |                     |
| Coupon < 4.5% (5)            | \$864,414    | 101.8 %                         | 106.7 %                       | \$922,639      | 2.29 %                      | 99                                     | 6                                    | 57 %              | 7.2 %               |
| Coupon >= 4.5% (6)           | 185,081      | 101.2                           | 107.1                         | 198,191        | 5.26                        | 84                                     | 13                                   | 80                | 15.6                |
| Total Hybrids Pre June 2009  | \$1,049,495  | 101.7 %                         | 106.8 %                       | \$1,120,830    | 2.82 %                      | 97                                     | 7                                    | 61 %              | 8.8 %               |
| Total Hybrids                | \$3,392,681  | 103.6 %                         | 105.8 %                       | \$3,590,544    | 3.04 %                      | 60                                     | 26                                   | 37 %              | 15.1 %              |

(1) Does not include principal payments receivable of \$761,000 and \$542,000 at March 31, 2015 and December 31, 2014, respectively.

(2) Weighted average is based on MBS current face at March 31, 2015 and December 31, 2014, respectively.

(3) Weighted average months to reset is the number of months remaining before the coupon interest rate resets. At reset, the MBS coupon will adjust based upon the underlying benchmark interest rate index, margin and periodic or

lifetime caps. The months to reset do not reflect scheduled amortization or prepayments.

(4) Interest only represents MBS backed by mortgages currently in their interest only period. Percentage is based on MBS current face at March 31, 2015 and December 31, 2014, respectively.

(5) Agency 3/1, 5/1, 7/1 and 10/1 Hybrid ARM-MBS with coupon less than 4.5%.

(6) Agency 3/1, 5/1, 7/1 and 10/1 Hybrid ARM-MBS with coupon greater than or equal to 4.5%.

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## Non-Agency MBS

The following table presents information with respect to our Non-Agency MBS at March 31, 2015 and December 31, 2014. As previously discussed, new accounting guidance that was effective on January 1, 2015 prospectively eliminated the use of Linked Transaction accounting and as a result we did not have any Linked Transactions effective January 1, 2015. Accordingly, on adoption of the new standard on January 1, 2015, we reclassified \$1.913 billion of Non-Agency MBS and \$4.6 million of CRT securities that were previously reported as a component of Linked Transactions to Non-Agency MBS and CRT securities respectively on the consolidated balance sheets. Non-Agency MBS at December 31, 2014 is presented: (i) excluding Linked Transactions and reported in accordance with GAAP; (ii) underlying our Linked Transactions and reflected consistent with GAAP reporting requirements (effective on such date); and (iii) on a combined basis (Non-GAAP).

| (In Thousands)  | March 31, 2015 | December 31,<br>2014 |
|---|----------------|----------------------|
| (i) Non-Agency MBS (GAAP - excluding Linked Transactions)                       |                |                      |
| Face/Par  | \$7,363,652    | \$5,319,901          |
| Fair Value  | 6,855,323      | 4,755,432            |
| Amortized Cost  | 6,101,816      | 4,020,241            |
| Purchase Discount Designated as Credit Reserve and OTTI                         | (873,533       | ) (1) (900,557       |
| Purchase Discount Designated as Accretable                                      | (388,708       | ) (399,564           |
| Purchase Premiums   | 405            | 461                  |
| (ii) Non-Agency MBS Underlying Linked Transactions                              |                |                      |
| Face/Par  |                | \$1,922,487          |
| Fair Value  |                | 1,913,189            |
| Amortized Cost  |                | 1,908,776            |
| Purchase Discount Designated as Credit Reserve                                  |                | (15,543              |
| Purchase Discount Designated as Accretable                                      |                | ) 1,832              |
| (iii) Combined Non-Agency MBS and MBS Underlying Linked Transactions (Non-GAAP) |                |                      |
| Face/Par  |                | \$7,242,388          |
| Fair Value  |                | 6,668,621            |
| Amortized Cost  |                | 5,929,017            |
| Purchase Discount Designated as Credit Reserve and OTTI                         |                | (916,100             |
| Purchase Discount Designated as Accretable                                      |                | ) (3) (397,732       |
| Purchase Premiums   |                | ) 461                |

(1) Includes discount designated as Credit Reserve of \$850.9 million and OTTI of \$22.6 million.

(2) Includes discount designated as Credit Reserve of \$877.6 million and OTTI of \$23.0 million.

(3) Includes discount designated as Credit Reserve of \$893.1 million and OTTI of \$23.0 million.

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## Purchase Discounts on Non-Agency MBS and Securities Underlying Linked Transactions

The following table presents the changes in the components of purchase discount on Non-Agency MBS with respect to purchase discount designated as Credit Reserve and OTTI, and accretable purchase discount for the three months ended March 31, 2015 and March 31, 2014. As previously discussed, new accounting guidance that was effective for us on January 1, 2015 prospectively eliminated the use of Linked Transaction accounting and as a result we did not have any Linked Transactions effective January 1, 2015. The information presented for the three months ended March 31, 2014 includes securities underlying Linked Transactions and is presented on both a GAAP and Non-GAAP basis (effective on such date):

| GAAP Basis   | Three Months Ended<br>March 31, 2015                    |                            | Three Months Ended<br>March 31, 2014                    |                            |
|--|---|----------------------------|---|----------------------------|
|  | Discount<br>Designated as<br>Credit Reserve and<br>OTTI | Accretable<br>Discount (1) | Discount<br>Designated as<br>Credit Reserve and<br>OTTI | Accretable<br>Discount (1) |
| (In Thousands)   |   |                            |   |                            |
| Balance at beginning of period   | \$ (900,557   | ) \$ (399,564              | ) \$ (1,043,037   | ) \$ (460,039              |
| Cumulative effect adjustment on adoption of revised accounting standard for repurchase agreement financing | (15,543   | ) 1,832                    | —   | —                          |
| Accretion of discount  | —   | 24,800                     | —   | 27,431                     |
| Realized credit losses   | 19,624  | —                          | 25,037  | —                          |
| Purchases  | (34   | ) (3,410                   | ) (63,317   | ) 23,406                   |
| Sales  | 1,049   | 9,969                      | 3,487   | 2,943                      |
| Net impairment losses recognized in earnings   | (407  | ) —                        | —   | —                          |
| Transfers/release of credit reserve  | 22,335  | (22,335                    | ) 35,897  | (35,897                    |
| Balance at the end of period   | \$ (873,533   | ) \$ (388,708              | ) \$ (1,041,933   | ) \$ (442,156              |
|  |   |                            | Three Months Ended<br>March 31, 2014                    |                            |
| Non-GAAP Adjustments   |   |                            | Discount  |                            |
|  |   |                            | Designated as   | Accretable                 |
|  |   |                            | Credit Reserve and                                      | Discount (1)               |
|  |   |                            | OTTI  |                            |
| (In Thousands)   |   |                            |   |                            |
| Balance at beginning of period   |   |                            | \$ (4,721   | ) \$ (3,212                |
| Accretion of discount  |   |                            | —   | 315                        |
| Realized credit losses   |   |                            | 120   | —                          |
| Purchases  |   |                            | (6,219  | ) 835                      |
| Transfers/release of credit reserve  |   |                            | 115   | (115                       |
| Balance at the end of period   |   |                            | \$ (10,705  | ) \$ (2,177                |
|  |   |                            | Three Months Ended<br>March 31, 2014                    |                            |
| Non-GAAP Basis   |   |                            | Discount  |                            |
|  |   |                            | Designated as   | Accretable                 |
|  |   |                            | Credit Reserve and                                      | Discount (1)               |
|  |   |                            | OTTI  |                            |
| (In Thousands)   |   |                            |   |                            |
| Balance at beginning of period   |   |                            | \$ (1,047,758   | ) \$ (463,251              |
| Accretion of discount  |   |                            | —   | 27,746                     |

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|                                     |              |                |
|-------------------------------------|--------------|----------------|
| Realized credit losses              | 25,157       | —              |
| Purchases                           | (69,536      | ) 24,241       |
| Sales                               | 3,487        | 2,943          |
| Transfers/release of credit reserve | 36,012       | (36,012 )      |
| Balance at the end of period        | \$(1,052,638 | ) \$(444,333 ) |

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

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The following tables present information with respect to the yield components of our Non-Agency MBS for the three months ended March 31, 2015 and March 31, 2014:

| Legacy Non-Agency MBS          | Three Months Ended |   |                |   |
|--------------------------------|--------------------|---|----------------|---|
|                                | March 31, 2015     |   | March 31, 2014 |   |
| Coupon Yield (1)               | 5.11               | % | 5.19           | % |
| Effective Yield Adjustment (2) | 2.53               |   | 2.61           |   |
| Net Yield                      | 7.64               | % | 7.80           | % |

(1) Reflects the annualized coupon interest income divided by the average amortized cost. The discounted purchase price on Legacy Non-Agency MBS causes the coupon yield to be higher than the pass-through coupon interest rate.

(2) The effective yield adjustment is the difference between the net yield, calculated utilizing management's estimates of timing and amount of future cash flows for Legacy Non-Agency MBS, less the current coupon yield.

| RPL/NPL MBS                    | Three Months Ended |   |                |   |
|--------------------------------|--------------------|---|----------------|---|
|                                | March 31, 2015     |   | March 31, 2014 |   |
| Coupon Yield (1)               | 3.56               | % | 4.30           | % |
| Effective Yield Adjustment (2) | 0.06               |   | —              |   |
| Net Yield                      | 3.62               | % | 4.30           | % |

(1) Reflects the annualized coupon interest income divided by the average amortized cost.

(2) The effective yield adjustment is the difference between the net yield, calculated utilizing management's estimates of timing future cash flows for RPL/NPL MBS, less the current coupon yield.

The information presented as of December 31, 2014 and for the three months ended March 31, 2014 in the above tables, on pages 56-57, includes certain underlying Non-Agency MBS and the associated repurchase agreement borrowings that were disclosed both separately and/or on a combined basis with our Non-Agency MBS portfolio. Prior to January 1, 2015, for GAAP financial reporting purposes, these items were required to be accounted for by us as Linked Transactions. Consequently, the presentation of this information in the above tables constitutes Non-GAAP financial measures within the meaning of Regulation G, as promulgated by the SEC.

In assessing the performance of the Non-Agency MBS portfolio prior to January 1, 2015, we did not view these transactions as linked, but rather viewed the performance of the underlying Non-Agency MBS and the related repurchase agreement borrowings as we would any other Non-Agency MBS that was not part of a linked transaction. Accordingly, as Linked Transactions accounting was discontinued on January 1, 2015, we consider that the Non-GAAP information disclosed in the above tables for prior periods provides appropriate comparability to current period disclosures for our Non-Agency MBS portfolio.

Actual maturities of MBS are generally shorter than stated contractual maturities because actual maturities of MBS are affected by the contractual lives of the underlying mortgages, periodic payments of principal, and prepayments of principal. The following table presents certain information regarding the amortized costs, weighted average yields and contractual maturities of our MBS at March 31, 2015 and does not reflect the effect of prepayments or scheduled principal amortization on our MBS:

| (Dollars in Thousands) | One to Five Years |                        | Five to Ten Years |                        | Over Ten Years |                        | Total MBS (1)        |                  |                        |
|------------------------|-------------------|------------------------|-------------------|------------------------|----------------|------------------------|----------------------|------------------|------------------------|
|                        | Amortized Cost    | Weighted Average Yield | Amortized Cost    | Weighted Average Yield | Amortized Cost | Weighted Average Yield | Total Amortized Cost | Total Fair Value | Weighted Average Yield |
| Agency MBS:            |                   |                        |                   |                        |                |                        |                      |                  |                        |
| Fannie Mae             | \$200             | 3.48 %                 | \$26,689          | 3.23 %                 | \$4,528,723    | 2.22 %                 | \$4,555,612          | \$4,643,862      | 2.22 %                 |
| Freddie Mac            | —                 | —                      | 27,614            | 2.31 %                 | 984,373        | 2.16                   | 1,011,987            | 1,016,464        | 2.16                   |

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|                  |           |        |          |        |              |        |              |              |        |
|------------------|-----------|--------|----------|--------|--------------|--------|--------------|--------------|--------|
| Ginnie Mae       | —         | —      | —        | —      | 10,597       | 1.56   | 10,597       | 10,869       | 1.56   |
| Total Agency MBS | \$200     | 3.48 % | \$54,303 | 2.76 % | \$5,523,693  | 2.20 % | \$5,578,196  | \$5,671,195  | 2.21 % |
| Non-Agency MBS   | \$276,420 | 4.19 % | \$16,371 | 6.04 % | \$5,809,025  | 6.36 % | \$6,101,816  | \$6,855,323  | 6.26 % |
| Total MBS        | \$276,620 | 4.19 % | \$70,674 | 3.52 % | \$11,332,718 | 4.33 % | \$11,680,012 | \$12,526,518 | 4.33 % |

(1) We did not have any MBS with contractual maturities of less than one year at March 31, 2015.

At March 31, 2015, our CRT securities had an amortized cost of \$123.4 million, a fair value of \$127.2 million, a weighted average yield of 4.75% and weighted average time to maturity of 9.3 years.

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## Residential Whole Loans

The following table presents the contractual maturities of our residential whole loans at March 31, 2015 and does not reflect estimated prepayments or scheduled amortization. For residential whole loans at carrying value, amounts presented are estimated based on the underlying loan contractual amounts.

| (In Thousands)                | Residential Whole<br>Loans,<br>at Carrying Value | Residential Whole<br>Loans,<br>at Fair Value |
|-------------------------------|--|--|
| Amount due:                   |  |  |
| Within one year               | \$1,396  | \$202  |
| After one year:               |  |  |
| Over one to five years        | 2,166  | 600  |
| Over five years               | 239,215  | 143,705                                      |
| Total due after one year      | \$241,381  | \$144,305                                    |
| Total residential whole loans | \$242,777  | \$144,507                                    |

The following table presents at March 31, 2015, the dollar amount of our residential whole loans at fair value, contractually maturing after one year, and whether such loans have fixed interest rates or adjustable interest rates:

| (In Thousands)  | Residential Whole<br>Loans,<br>at Fair Value |
|-----------------|--|
| Interest rates: |  |
| Fixed           | \$78,455                                     |
| Adjustable      | 65,850                                       |
| Total           | \$144,305                                    |

Information is not presented for residential whole loans at carrying value as income is recognized based on pools of assets with similar risk characteristics using an estimated yield based on cash flows expected to be collected over the life of the loans in such pools rather than the contractual coupon of the underlying loans.

The following table presents additional information regarding our residential whole loans at fair value at March 31, 2015 and December 31, 2014:

| (Dollars in Thousands)          | Residential Whole Loans,<br>at Fair Value |                      |
|---------------------------------|---|----------------------|
|                                 | March 31, 2015                            | December 31,<br>2014 |
| Loans 90 days or more past due: |   |                      |
| Number of Loans                 | 625                                       | 779                  |
| Aggregate Amount Outstanding    | \$107,227                                 | \$128,591            |

No residential whole loans at carrying value are considered 90 days or more past due as income on such loans is recognized based on pools of assets with similar credit risk characteristics using an estimated yield based on cash flows expected to be collected over the life of the loans in such pools, rather than the contractual coupon of the underlying loans.





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## Exposure to Financial Counterparties

We finance a significant portion of our MBS with repurchase agreements. In connection with these financing arrangements, we pledge our securities as collateral to secure the borrowing. The amount of collateral pledged will typically exceed the amount of the financing with the extent of over-collateralization ranging from 1% - 6% of the amount borrowed (U.S. Treasury and Agency MBS collateral) to up to 64% (Non-Agency MBS collateral). Consequently, while repurchase agreement financing results in us recording a liability to the counterparty in our consolidated balance sheets, we are exposed to the counterparty, if during the term of the repurchase agreement financing, a lender should default on its obligation and we are not able to recover our pledged assets. The amount of this exposure is the difference between the amount loaned to us plus interest due to the counterparty and the fair value of the collateral pledged by us to the lender including accrued interest receivable on such collateral.

In addition, we use interest rate Swaps to manage interest rate risk exposure in connection with our repurchase agreement financings. We will make cash payments or pledge securities as collateral as part of a margin arrangement in connection with interest rate Swaps that are in an unrealized loss position. In the event that a counterparty for a Swap that is not subject to central clearing were to default on its obligation, we would be exposed to a loss to a Swap counterparty to the extent that the amount of cash or securities pledged exceeded the unrealized loss on the associated Swaps and we were not able to recover the excess collateral.

The table below summarizes our exposure to our counterparties at March 31, 2015, by country:

| Country                     | Number of Counterparties | Repurchase Agreement Financing | Swaps at Fair Value | Exposure (1)  | Exposure as a Percentage of MFA Total Assets |   |
|-----------------------------|--------------------------|--------------------------------|---------------------|---------------|--|---|
| (Dollars in Thousands)      |                          |                                |                     |               |  |   |
| European Countries: (2)     |                          |                                |                     |               |  |   |
| Switzerland                 | 2                        | \$2,381,763                    | \$—                 | \$681,230     | 4.90   | % |
| United Kingdom              | 2                        | 438,442                        | (277                | ) 59,005      | 0.42   |   |
| France                      | 1                        | 441,365                        | —                   | 39,835        | 0.29   |   |
| Holland                     | 1                        | 228,557                        | 321                 | 10,929        | 0.08   |   |
| Germany                     | 1                        | —                              | 255                 | 448           | —  |   |
| Total                       | 7                        | 3,490,127                      | 299                 | 791,447       | 5.69   | % |
| Other Countries:            |                          |                                |                     |               |  |   |
| United States (3)           | 12                       | \$5,072,057                    | \$(91,728           | ) \$927,626   | 6.67   | % |
| Canada (4)                  | 3                        | 946,946                        | —                   | 385,479       | 2.77   |   |
| Japan                       | 4                        | 662,156                        | —                   | 37,664        | 0.27   |   |
| China                       | 1                        | 138,300                        | —                   | 7,616         | 0.05   |   |
| Total                       | 20                       | 6,819,459                      | (91,728             | ) 1,358,385   | 9.76   | % |
| Total Counterparty Exposure | 27                       | \$10,309,586                   | (5) \$(91,429       | ) \$2,149,832 | 15.45  | % |

(1) Represents for each counterparty the amount of cash and/or securities pledged as collateral less the aggregate of repurchase agreement financing, Swaps at fair value, and net interest receivable/payable on all such instruments.

(2) Includes European-based counterparties as well as U.S.-domiciled subsidiaries of the European parent entity.

(3) Includes one counterparty that is a central clearing house for our Swaps.

(4) Includes exposure to foreign based affiliates of the Canadian parent entity

(5) Includes \$500.0 million of repurchase agreements entered into in connection with contemporaneous repurchase and reverse repurchase agreements with a single counterparty.

At March 31, 2015, we did not use credit default Swaps or other forms of credit protection to hedge the exposures summarized in the table above.

Weak economic conditions in Europe could potentially impact our major European financial counterparties, with the possibility that this would also impact the operations of their U.S. domiciled subsidiaries. This could adversely affect our financing and operations as well as those of the entire mortgage sector in general. Management monitors our exposure to our repurchase agreement and Swap counterparties on a regular basis, using various methods, including review of recent rating agency actions or other developments and by monitoring the amount of cash and securities collateral pledged and the associated loan amount under repurchase agreements and/or the fair value of Swaps with our counterparties. We intend to make reverse margin calls on our counterparties to recover excess collateral as permitted by the agreements governing our financing arrangements, or take other necessary actions to reduce the amount of our exposure to a counterparty when such actions are considered necessary.

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### Tax Considerations

#### Key differences between GAAP net income and REIT Taxable Income for Non-Agency MBS and Residential Whole Loans

Our total Non-Agency MBS portfolio for tax differs from our portfolio reported for GAAP primarily due to the fact that for tax purposes; (i) certain of the MBS contributed to the VIEs used to facilitate resecuritization transactions were deemed to be sold; and (ii) the tax portfolio includes certain securities issued by these VIEs. In addition, for our Non-Agency MBS tax portfolio, potential timing differences arise with respect to the accretion of market discount into income and recognition of realized losses for tax purposes as compared to GAAP. Consequently, our REIT taxable income calculated in a given period may differ significantly from our GAAP net income.

The determination of taxable income attributable to Non-Agency MBS and residential whole loans is dependent on a number of factors, including principal payments, defaults, loss mitigation efforts and loss severities. In projecting taxable income for Non-Agency MBS and residential whole loans during the year, management considers estimates of the amount of discount expected to be accreted. Such estimates require significant judgment and actual results may differ from these estimates. Moreover, the deductibility of realized losses from Non-Agency MBS and residential whole loans, and their effect on market discount accretion is analyzed on an asset-by-asset basis and while they will result in a reduction of taxable income, this reduction tends to occur gradually and primarily in periods after the realized losses are reported.

#### Resecuritization transactions result in differences between GAAP net income and REIT Taxable Income

For tax purposes, depending on the transaction structure, a resecuritization transaction may be treated either as a sale or a financing of the underlying MBS. Income recognized from resecuritization transactions will differ for tax and GAAP. For tax purposes, we own and may in the future acquire interests in resecuritization trusts, in which several of the classes of securities are or will be issued with Original Issue Discount (or OID). As the holder of the retained interests in the trust, we generally will be required to include OID in our current gross interest income over the term of the applicable securities as the OID accrues. The rate at which the OID is recognized into taxable income is calculated using a constant rate of yield to maturity, with realized losses impacting the amount of OID recognized in REIT taxable income once they are actually incurred. For tax purposes, REIT taxable income may be recognized in excess of economic income (i.e., OID) or in advance of the corresponding cash flow from these assets, thereby effecting our dividend distribution requirement to stockholders.

We estimate that for the three months ended March 31, 2015, our taxable income was approximately \$76.9 million. Based on dividends paid or declared during the three months ended March 31, 2015, we have undistributed taxable income of approximately \$10.1 million, or \$0.03 per share. We have until the filing of our 2015 tax return (due not later than September 15, 2016) to declare the distribution of any 2015 REIT taxable income not previously distributed.

### Regulatory Developments

The U.S. Congress, Board of Governors of the Federal Reserve System, U.S. Treasury, Federal Deposit Insurance Corporation, SEC and other governmental and regulatory bodies have taken and continue to consider additional actions in response to the financial crisis. In particular, the Dodd-Frank Wall Street Reform and Consumer Protection Act (or the Dodd-Frank Act) created a new regulator housed within the Federal Reserve System, an independent bureau known as the Consumer Financial Protection Bureau (or the CFPB), which has broad authority over a wide range of consumer financial products and services, including mortgage lending. Another section of the Dodd-Frank Act, the Mortgage Reform and Anti-Predatory Lending Act (or the Mortgage Reform Act), contains new underwriting and servicing standards for the mortgage industry, as well as restrictions on compensation for mortgage originators.

In addition, the Mortgage Reform Act grants broad discretionary regulatory authority to the CFPB to prohibit or condition terms, acts or practices relating to residential mortgage loans that the CFPB finds abusive, unfair, deceptive or predatory, as well as to take other actions that the CFPB finds are necessary or proper to ensure responsible affordable mortgage credit remains available to consumers. The Dodd-Frank Act also affects the securitization of mortgages (and other assets) with requirements for risk retention by securitizers and requirements for regulating credit rating agencies.

The Dodd-Frank Act requires numerous regulations, many of which (including those mentioned above regarding underwriting and mortgage originator compensation) have only recently been implemented and operationalized. As a result, we are unable to fully predict at this time how the Dodd-Frank Act, as well as other laws that may be adopted in the future, will impact our business, results of operations and financial condition, or the environment for repurchase financing and other forms of borrowing, the investing environment for Agency MBS, Non-Agency MBS and/or residential mortgage loans, the securitization industry, Swaps and other derivatives. However, at a minimum, we believe that the Dodd-Frank Act and the regulations promulgated thereunder are likely to continue to increase the economic and compliance costs for participants in the mortgage and securitization industries, including us.

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In addition to the regulatory actions being implemented under the Dodd-Frank Act, on August 31, 2011, the SEC issued a concept release under which it is reviewing interpretive issues related to Section 3(c)(5)(C) of the Investment Company Act. Section 3(c)(5)(C) excludes from the definition of “investment company” entities that are primarily engaged in, among other things, “purchasing or otherwise acquiring mortgages and other liens on and interests in real estate.” Many companies that engage in the business of acquiring mortgages and mortgage-related instruments seek to rely on existing interpretations of the SEC Staff with respect to Section 3(c)(5)(C) so as not to become an investment company for the purpose of regulation under the Investment Company Act. In connection with the concept release, the SEC requested comments on, among other things, whether it should reconsider its existing interpretation of Section 3(c)(5)(C). To date the SEC has not taken or otherwise announced any further action in connection with the concept release.

Congress also continues to consider legislation that would significantly reform the country’s mortgage finance system, including, among other things, eliminating Freddie Mac and Fannie Mae and replacing them with a single new MBS insurance agency. Many details remain unsettled, including the scope of the agency’s guarantee and its affordable housing mission. While the likelihood of enactment of major mortgage finance system reform in the short term remains uncertain, it is possible that the adoption of any such reforms could adversely affect the types of assets we can buy and our business operations. As the Federal Housing Finance Agency and both houses of Congress continue to consider various measures intended to dramatically restructure the U.S. housing finance system and the operations of Fannie Mae and Freddie Mac, we expect debate and discussion on the topic to continue throughout 2015.

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## Results of Operations

Quarter Ended March 31, 2015 Compared to the Quarter Ended March 31, 2014

## General

For the first quarter of 2015, we had net income available to our common stock and participating securities of \$78.4 million, or \$0.21 per basic and diluted common share, compared to net income available to common stock and participating securities of \$72.4 million, or \$0.20 per basic and diluted common share, for the first quarter of 2014. The increase in net income available to our common stock and participating securities, and the increase of this item on a per share basis primarily reflects an increase in net interest income, higher gains on sales of MBS, net income on residential whole loans held at fair value, partially offset by other investment related operating expenses which were not incurred in the first quarter of 2014. In addition, the comparable prior period includes net unrealized gains on Linked Transactions which were not repeated in the current period as the Company adopted revised accounting standards on January 1, 2015 that prospectively eliminated Linked Transactions accounting.

## Net Interest Income

Net interest income represents the difference between income on interest-earning assets and expense on interest-bearing liabilities. Net interest income depends primarily upon the volume of interest-earning assets and interest-bearing liabilities and the corresponding interest rates earned or paid. Our net interest income varies primarily as a result of changes in interest rates, the slope of the yield curve (i.e., the differential between long-term and short-term interest rates), borrowing costs (i.e., our interest expense) and prepayment speeds on our MBS. Interest rates and CPRs (which measure the amount of unscheduled principal prepayment on a bond as a percentage of the bond balance), vary according to the type of investment, conditions in the financial markets, and other factors, none of which can be predicted with any certainty.

The changes in average interest-earning assets and average interest-bearing liabilities and their related yields and costs are discussed in greater detail below under “Interest Income” and “Interest Expense.”

For the first quarter of 2015, our net interest spread and margin were 2.44% and 2.77%, respectively, compared to a net interest spread and margin of 2.44% and 2.84%, respectively, for the first quarter of 2014. Our net interest income increased by \$5.7 million, or 7.2% to \$86.0 million from \$80.3 million for the first quarter of 2014. Current quarter net interest income from Agency and Non-Agency MBS declined compared to the first quarter of 2014 by approximately \$12.6 million, primarily due to lower average balances of these MBS and associated repurchase agreement financings. This was offset by higher net interest income on RPL/NPL MBS and CRT Securities of approximately \$14.0 million. Prior to January 1, 2015, the majority of these assets and associated repurchase agreement financings were reported as components of Linked Transactions with net income reported in Other income in our Statement of Operations. In addition, net interest income for the current quarter compared to the first quarter of 2014 was approximately \$4.3 million higher due to higher investments in Residential whole loans at carrying value and lower outstanding balances of securitized debt. The net interest spread on our Agency MBS portfolio decreased to 1.09% for the first quarter of 2015 compared to 1.18% for the first quarter of 2014. The net interest spread on our Legacy Non-Agency MBS portfolio increased to 4.79% for the first quarter of 2015 compared to 4.76% for the first quarter of 2014. The net interest spread on our RPL/NPL MBS portfolio decreased to 2.10% for the first quarter of 2015 compared to 4.30% for the first quarter of 2014.





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## Analysis of Net Interest Income

The following table sets forth certain information about the average balances of our assets and liabilities and their related yields and costs for the three months ended March 31, 2015 and 2014. Average yields are derived by dividing annualized interest income by the average amortized cost of the related assets and average costs are derived by dividing annualized interest expense by the daily average balance of the related liabilities, for the periods shown. The yields and costs include premium amortization and purchase discount accretion which are considered adjustments to interest rates.

| (Dollars in Thousands)                               | Three Months Ended March 31, |          |                    |                 |          |                    |  |  |
|--|------------------------------|----------|--------------------|-----------------|----------|--------------------|--|--|
|  | 2015                         |          | 2014               |                 |          |                    |  |  |
|  | Average Balance              | Interest | Average Yield/Cost | Average Balance | Interest | Average Yield/Cost |  |  |
| Assets:  |                              |          |                    |                 |          |                    |  |  |
| Interest-earning assets:                             |                              |          |                    |                 |          |                    |  |  |
| Agency MBS (1)                                       | \$5,718,372                  | \$31,673 | 2.22 %             | \$6,582,184     | \$39,329 | 2.39 %             |  |  |
| Legacy Non-Agency MBS (1)                            | 3,861,297                    | 73,762   | 7.64               | 4,194,516       | 81,778   | 7.80               |  |  |
| RPL/NPL MBS (1)                                      | 2,156,778                    | 19,529   | 3.62               | 3,811           | 41       | 4.30               |  |  |
| Total MBS  | 11,736,447                   | 124,964  | 4.26               | 10,780,511      | 121,148  | 4.50               |  |  |
| CRT securities (1)                                   | 114,616                      | 1,360    | 4.75               | —               | —        | —                  |  |  |
| Residential whole loans, at carrying value (2)       | 222,105                      | 3,591    | 6.47               | —               | —        | —                  |  |  |
| Cash and cash equivalents (3)                        | 245,557                      | 27       | 0.04               | 443,086         | 26       | 0.02               |  |  |
| Total interest-earning assets                        | 12,318,725                   | 129,942  | 4.22               | 11,223,597      | 121,174  | 4.32               |  |  |
| Total non-interest-earning assets (2)                | 1,622,049                    |          |                    | 1,377,740       |          |                    |  |  |
| Total assets   | \$13,940,774                 |          |                    | \$12,601,337    |          |                    |  |  |
| Liabilities and stockholders' equity:                |                              |          |                    |                 |          |                    |  |  |
| Interest-bearing liabilities:                        |                              |          |                    |                 |          |                    |  |  |
| Agency repurchase agreements (4)                     | \$5,115,270                  | \$14,205 | 1.13               | \$5,823,463     | \$17,328 | 1.21               |  |  |
| Legacy Non-Agency repurchase agreements (4)          | 2,763,098                    | 19,430   | 2.85               | 2,588,582       | 19,401   | 3.04               |  |  |
| RPL/NPL repurchase agreements                        | 1,718,092                    | 6,428    | 1.52               | —               | —        | —                  |  |  |
| CRT securities repurchase agreements                 | 83,040                       | 352      | 1.72               | —               | —        | —                  |  |  |
| Residential whole loan repurchase agreements         | 141,048                      | 767      | 2.20               | —               | —        | —                  |  |  |
| Total repurchase agreements                          | 9,820,548                    | 41,182   | 1.70               | 8,412,045       | 36,729   | 1.77               |  |  |
| Securitized debt                                     | 103,688                      | 750      | 2.94               | 336,893         | 2,185    | 2.63               |  |  |
| Senior Notes   | 100,000                      | 2,008    | 8.03               | 100,000         | 2,007    | 8.03               |  |  |
| Total interest-bearing liabilities                   | 10,024,236                   | 43,940   | 1.78               | 8,848,938       | 40,921   | 1.88               |  |  |
| Total non-interest-bearing liabilities               | 714,118                      |          |                    | 568,592         |          |                    |  |  |
| Total liabilities                                    | 10,738,354                   |          |                    | 9,417,530       |          |                    |  |  |
| Stockholders' equity                                 | 3,202,420                    |          |                    | 3,183,807       |          |                    |  |  |
| Total liabilities and stockholders' equity           | \$13,940,774                 |          |                    | \$12,601,337    |          |                    |  |  |
| Net interest income/ net interest rate spread (5)    |                              | \$86,002 | 2.44 %             |                 | \$80,253 | 2.44 %             |  |  |
| Net interest-earning assets/ net interest margin (6) | \$2,294,489                  |          | 2.77 %             | \$2,374,659     |          | 2.84 %             |  |  |
| Ratio of interest-earning assets to                  | 1.23                         | x        |                    | 1.27            | x        |                    |  |  |

interest-bearing liabilities

Yields presented throughout this Quarterly Report on Form 10-Q are calculated using average amortized cost data for securities which excludes unrealized gains and losses and includes principal payments receivable on securities.

- (1) For GAAP reporting purposes, purchases and sales are reported on the trade date. Average amortized cost data used to determine yields is calculated based on the settlement date of the associated purchase or sale as interest income is not earned on purchased assets and continues to be earned on sold assets until settlement date. Includes Non-Agency MBS transferred to consolidated VIEs.
- (2) Excludes residential whole loans held at fair value which are reported as a component of total non-interest-earning assets.
- (3) Includes average interest-earning cash, cash equivalents and restricted cash.
- (4) Average cost of repurchase agreements includes the cost of Swaps allocated based on the proportionate share of the overall estimated weighted average portfolio duration.
- (5) Net interest rate spread reflects the difference between the yield on average interest-earning assets and average cost of funds.
- (6) Net interest margin reflects annualized net interest income divided by average interest-earning assets.

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## Rate/Volume Analysis

The following table presents the extent to which changes in interest rates (yield/cost) and changes in the volume (average balance) of interest-earning assets and interest-bearing liabilities have affected our interest income and interest expense during the periods indicated. Information is provided in each category with respect to: (i) the changes attributable to changes in volume (changes in average balance multiplied by prior rate); (ii) the changes attributable to changes in rate (changes in rate multiplied by prior average balance); and (iii) the net change. The changes attributable to the combined impact of volume and rate have been allocated proportionately, based on absolute values, to the changes due to rate and volume.

| (In Thousands)  | Three Months Ended March 31, 2015<br>Compared to<br>Three Months Ended March 31, 2014 |             |  |
|---|---|-------------|--|
|   | Increase/(Decrease) due to  |             | Total Net<br>Change in<br>Interest<br>Income/Expense |
|   | Volume  | Rate        |  |
| <b>Interest-earning assets:</b>                             |   |             |  |
| Agency MBS  | \$ (4,919   | ) \$ (2,737 | ) \$ (7,656 )  |
| Legacy Non-Agency MBS                                       | (6,351  | ) (1,665    | ) (8,016 )   |
| RPL/NPL MBS   | 19,317  | 171         | 19,488   |
| CRT securities  | 1,360   | —           | 1,360  |
| Residential whole loans, at carrying value (1)              | 3,591   | —           | 3,591  |
| Cash and cash equivalents                                   | (14   | ) 15        | 1  |
| Total net change in income from interest-earning assets     | \$ 12,984   | \$ (4,216   | ) \$ 8,768   |
| <b>Interest-bearing liabilities:</b>                        |   |             |  |
| Agency repurchase agreements                                | \$ (1,990   | ) \$ (1,133 | ) \$ (3,123 )  |
| Legacy Non-Agency repurchase agreements                     | 1,267   | (1,239      | ) 28   |
| RPL/NPL repurchase agreements                               | 6,429   | —           | 6,429  |
| CRT securities repurchase agreements                        | 352   | —           | 352  |
| Residential whole loan repurchase agreements                | 767   | —           | 767  |
| Securitized debt  | (1,662  | ) 227       | (1,435 )   |
| Senior Notes  | —   | 1           | 1  |
| Total net change in expense of interest-bearing liabilities | \$ 5,163  | \$ (2,144   | ) \$ 3,019   |
| Net change in net interest income                           | \$ 7,821  | \$ (2,072   | ) \$ 5,749   |

(1) Excludes residential whole loans held at fair value which are reported as a component of non-interest-earning assets.

The following table presents certain quarterly information regarding our net interest spread and net interest margin for the quarterly periods presented:

| Quarter Ended     | Total Interest-Earning Assets and Interest-Bearing Liabilities |                            |
|-------------------|--|----------------------------|
|                   | Net Interest<br>Spread (1)                                     | Net Interest<br>Margin (2) |
| March 31, 2015    | 2.44   | % 2.77                     |
| December 31, 2014 | 2.41   | 2.76                       |

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|                    |      |      |
|--------------------|------|------|
| September 30, 2014 | 2.30 | 2.67 |
| June 30, 2014      | 2.42 | 2.80 |
| March 31, 2014     | 2.44 | 2.84 |

- (1) Reflects the difference between the yield on average interest-earning assets and average cost of funds.  
(2) Reflects annualized net interest income divided by average interest-earning assets.

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The following table presents the components of the net interest spread earned on our Agency MBS, Legacy Non-Agency MBS and RPL/NPL MBS for the quarterly periods presented:

| Quarter Ended      | Agency MBS    |                     |                              | Legacy Non-Agency MBS |                     |                              | RPL/NPL MBS   |                     |                              | Total MBS     |                     |                              |
|--------------------|---------------|---------------------|------------------------------|-----------------------|---------------------|------------------------------|---------------|---------------------|------------------------------|---------------|---------------------|------------------------------|
|                    | Net Yield (1) | Cost of Funding (2) | Net Interest Rate Spread (3) | Net Yield (1)         | Cost of Funding (2) | Net Interest Rate Spread (3) | Net Yield (1) | Cost of Funding (2) | Net Interest Rate Spread (3) | Net Yield (1) | Cost of Funding (2) | Net Interest Rate Spread (3) |
| March 31, 2015     | 2.22 %        | 1.13 %              | 1.09 %                       | 7.64 %                | 2.85 %              | 4.79 %                       | 3.62 %        | 1.52 %              | 2.10 %                       | 4.26 %        | 1.69 %              | 2.57 %                       |
| December 31, 2014  | 2.17          | 1.12                | 1.05                         | 7.68                  | 2.95                | 4.73                         | 3.19          | 1.60                | 1.59                         | 4.33          | 1.76                | 2.57                         |
| September 30, 2014 | 2.09          | 1.14                | 0.95                         | 7.70                  | 2.97                | 4.73                         | 3.51          | 1.50                | 2.01                         | 4.28          | 1.75                | 2.53                         |
| June 30, 2014      | 2.26          | 1.13                | 1.13                         | 7.72                  | 3.14                | 4.58                         | 4.16          | —                   | 4.16                         | 4.36          | 1.77                | 2.59                         |
| March 31, 2014     | 2.39          | 1.21                | 1.18                         | 7.80                  | 3.04                | 4.76                         | 4.30          | —                   | 4.30                         | 4.50          | 1.80                | 2.70                         |

(1) Reflects annualized interest income on MBS divided by average amortized cost of MBS.

(2) Reflects annualized interest expense divided by average balance of repurchase agreements, including the cost of swaps allocated based on the proportionate share of the overall estimated weighted average portfolio duration and securitized debt. Agency cost of funding includes 78, 79, 82, 81 and 85 basis points and Legacy Non-Agency cost of funding includes 78, 84, 89, 88 and 74 basis points associated with Swaps to hedge interest rate sensitivity on these assets for the quarters ended March 31, 2015, December 31, 2014, September 30, 2014, June 30, 2014 and March 31, 2014, respectively.

(3) Reflects the difference between the net yield on average MBS and average cost of funds on MBS.

## Interest Income

Interest income on our Agency MBS for the first quarter of 2015 decreased by \$7.7 million, or 19.5% to \$31.7 million from \$39.3 million for the first quarter of 2014. This change primarily reflects a \$863.8 million decrease in the average amortized cost of our Agency MBS portfolio to \$5.718 billion for the first quarter of 2015 from \$6.582 billion for the first quarter of 2014. In addition, the net yield on our Agency MBS decreased to 2.22% for the first quarter of 2015 from 2.39% for the first quarter of 2014. At the end of the first quarter of 2015, the average coupon on mortgages underlying our Agency MBS was slightly lower compared to the end of the first quarter of 2014, as a result of prepayments on higher yielding assets and downward resets on Hybrid and ARM-MBS within the portfolio. As a result, the coupon yield on our Agency MBS portfolio decreased to 2.99% for the first quarter of 2015 from 3.01% for the first quarter of 2014. During the first quarter of 2015, our Agency MBS portfolio experienced a 10.9% CPR and we recognized \$9.1 million of net premium amortization compared to a CPR of 11.5% and \$10.2 million of net premium amortization for the first quarter of 2014. At March 31, 2015, we had net purchase premiums on our Agency MBS of \$204.2 million, or 3.8% of current par value, compared to net purchase premiums of \$213.3 million and 3.8% of par value at December 31, 2014.

Interest income on our Non-Agency MBS (which includes Non-Agency MBS transferred to consolidated VIEs) increased \$11.5 million, or 14.0%, for the first quarter of 2015 to \$93.3 million compared to \$81.8 million for the first quarter of 2014. For the first quarter 2015 Non-Agency MBS interest income reflects the inclusion of MBS that, prior to January 1, 2015, were accounted for as components of Linked Transactions and income from such securities was reported in other income in prior periods. In addition, primarily due to the accounting change for Linked Transactions,

the average amortized cost of our Non-Agency MBS increased by \$1.820 billion or 43.3%, to \$6.018 billion from \$4.198 billion for the first quarter of 2014. Our Legacy Non-Agency MBS portfolio yielded 7.64% for the first quarter of 2015 compared to 7.80% for the first quarter of 2014. The decrease in the yield on our Legacy Non-Agency MBS is primarily due to prepayments on higher yielding assets in the portfolio, offset by increases in accretable discount due to the impact of credit reserve releases, in the current and prior year, that have occurred as a result of the improved credit performance of loans underlying the Legacy Non-Agency MBS portfolio. Our RPL/NPL MBS portfolio yielded 3.62% for the first quarter of 2015 compared to 4.30% for the first quarter of 2014. The decrease in the yield on our RPL/NPL MBS is primarily due to the addition lower yielding RPL/NPL MBS since the first quarter of 2014. During the first quarter of 2015, we recognized net purchase discount accretion of \$24.8 million on our Non-Agency MBS, compared to \$27.4 million for the first quarter of 2014. At March 31, 2015, we had net purchase discounts of \$1.262 billion, including Credit Reserve and previously recognized OTTI of \$873.5 million, on our Legacy Non-Agency MBS, or 25.0% of par value. During the first quarter of 2015 we reallocated \$22.3 million of purchased discount designated as Credit Reserve to accretable purchase discount.

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The following table presents the components of the coupon yield and net yields earned on our Agency MBS, Legacy Non-Agency MBS and RPL/NPL MBS and weighted average CPR experienced for such MBS for the quarterly periods presented:

| Quarter Ended      | Agency MBS       |               |                         | Legacy Non-Agency MBS |               |                         | RPL/NPL MBS      |               |                              |
|--------------------|------------------|---------------|-------------------------|-----------------------|---------------|-------------------------|------------------|---------------|------------------------------|
|                    | Coupon Yield (1) | Net Yield (2) | 3 Month Average CPR (3) | Coupon Yield (1)      | Net Yield (2) | 3 Month Average CPR (3) | Coupon Yield (1) | Net Yield (2) | 3 Month Average Bond CPR (4) |
| March 31, 2015     | 2.99             | % 2.22        | % 10.9                  | % 5.11                | % 7.64        | % 11.1                  | % 3.56           | % 3.62        | % 19.6                       |
| December 31, 2014  | 2.91             | 2.17          | 12.3                    | 5.13                  | 7.68          | 12.5                    | 3.91             | 3.19          | 17.6                         |
| September 30, 2014 | 2.94             | 2.09          | 15.1                    | 5.18                  | 7.70          | 12.7                    | 3.51             | 3.51          | 19.7                         |
| June 30, 2014      | 2.99             | 2.26          | 13.0                    | 5.27                  | 7.72          | 12.1                    | 4.16             | 4.16          | 15.8                         |
| March 31, 2014     | 3.01             | 2.39          | 11.5                    | 5.19                  | 7.80          | 11.9                    | 4.30             | 4.30          | 16.0                         |

(1) Reflects the annualized coupon interest income divided by the average amortized cost. The discounted purchase price on Legacy Non-Agency MBS causes the coupon yield to be higher than the pass-through coupon interest rate.

(2) Reflects annualized interest income on MBS divided by average amortized cost of MBS.

(3) 3 month average CPR weighted by positions as of the beginning of each month in the quarter.

(4) All principal payments are considered to be prepayments for CPR purposes. Excludes RPL/NPL MBS that have not had a principal payment.

## Interest Expense

Our interest expense for the first quarter of 2015 increased by \$3.0 million, or 7.4% to \$43.9 million, from \$40.9 million for the first quarter of 2014. This increase primarily reflects an increase in our average borrowings to finance Non-Agency MBS (primarily due to the reclassification of repurchase agreements previously reported as a component of Linked Transactions as discussed above), residential whole loans and CRT securities, which was partially offset by the lower effective interest rate paid on borrowings to finance both Non-Agency and Agency MBS, a decrease in our average borrowings to finance Agency MBS, and a decrease in the average balance of securitized debt.

At March 31, 2015, we had repurchase agreement borrowings of \$9.810 billion of which \$3.350 billion was hedged with Swaps, and securitized debt of \$91.3 million. At March 31, 2015, our Swaps designated in hedging relationships had a weighted average fixed-pay rate of 1.84% and extended 50 months on average with a maximum remaining term of approximately 101 months.

The following table presents information about our securitized debt at March 31, 2015:

| Benchmark Interest Rate<br>(Dollars in Thousands) | At March 31, 2015<br>Securitized Debt Interest Rate |      |   |
|---|---|------|---|
|   |   |      |   |
| Fixed Rate  | \$50,842  | 2.85 | % |
| Weighted Average Coupon Rate                      | 40,438  | 3.71 |   |
| Total   | \$91,280  | 3.23 | % |

The effective interest rate paid on our borrowings decreased to 1.78% for the quarter ended March 31, 2015 from 1.88% for the quarter ended March 31, 2014. This decrease reflects the lower effective interest rate paid on repurchase agreement financings associated with our Non-Agency MBS (including the allocation of Swap expense) and Agency MBS portfolios, the lower average balance of securitized debt and the lower average balance of Agency repurchase agreements partially offset by the increase in our average balance to finance Non-Agency repurchase agreements.

Payments made and/or received on our Swaps are a component of our borrowing costs and accounted for interest expense of \$15.4 million or 62 basis points, for the first quarter of 2015, compared to interest expense of \$17.6 million, or 80 basis points, for the first quarter of 2014. The weighted average fixed-pay rate on our Swaps designated as hedges decreased to 1.84% for the quarter ended March 31, 2015 from 1.92% for the quarter ended March 31, 2014. The weighted average variable interest rate received on our Swaps designated as hedges increased slightly to 0.17% for the quarter ended March 31, 2015 from 0.16% for the quarter ended March 31, 2014. During the quarter ended March 31, 2015, we did not enter into any new Swaps and had Swaps with an aggregate notional amount of \$410.2 million and a weighted average fixed-pay rate of 1.90% amortize and/or expire.



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We expect that our interest expense and funding costs for the remainder of 2015 will be impacted by market interest rates, the amount of our borrowings and incremental hedging activity, our existing and future interest rates on our hedging instruments and the extent to which we execute additional longer-term structured financing transactions. As a result of these variables, our borrowing costs cannot be predicted with any certainty. (See Notes 6, 8 and 16 to the accompanying consolidated financial statements, included under Item 1 of this Quarterly Report on Form 10-Q.)

## OTTI

During the first quarter of 2015 we recognized OTTI charges through earnings of \$407,000 against certain of our Non-Agency MBS. These impairment charges reflected changes in our estimated cash flows for such securities based on an updated assessment of the estimated future performance of the underlying collateral, including the expected principal loss over the term of the security and changes in the expected timing of receipt of cash flows. During the first quarter of 2014, we did not recognize any OTTI charges through earnings against our Non-Agency MBS. At March 31, 2015, we had 229 Agency MBS with a gross unrealized loss of \$16.7 million and 35 Non-Agency MBS and CRT securities with a gross unrealized loss of \$4.0 million. Impairments on Agency MBS in an unrealized loss position at March 31, 2015 are considered temporary and not credit related. Unrealized losses on Non-Agency MBS and CRT securities for which no OTTI was recorded during the quarter are considered temporary based on an assessment of changes in the expected cash flows for such securities, which considers recent bond performance and expected future performance of the underlying collateral. Significant judgment is used both in our analysis of expected cash flows for our Legacy Non-Agency MBS and any determination of the credit component of OTTI.

## Other Income, net

For the first quarter of 2015, Other income, net increased by \$2.6 million to \$9.0 million from \$6.4 million for the first quarter of 2014. Other income, net for the first quarter of 2015 primarily reflects \$6.4 million of gross gains realized on the sale of \$10.8 million Non-Agency MBS and \$2.6 million in net income recorded on residential whole loans held at fair value. During the three months ended March 31, 2014, we sold Non-Agency MBS for \$15.5 million, realizing gross gains of \$3.6 million. In addition, the three months ended March 31, 2014 included unrealized net gains and net interest income on Linked Transactions of \$3.3 million, which included interest income of \$2.0 million on the underlying Non-Agency MBS, interest expense of \$551,000 on the borrowings under repurchase agreements and an increase of \$1.8 million in the fair value of the underlying securities. As previously mentioned, new accounting guidance effective on January 1, 2015 prospectively eliminated the use of Linked Transaction accounting and as a result we did not have any Linked Transactions effective January 1, 2015 (see Note 6 to the accompanying consolidated financial statements, included under Item 1 of this Quarterly Report on Form 10-Q.)

## Operating and Other Expense

For the first quarter of 2015, we had compensation and benefits and other general and administrative expense of \$10.2 million, or 1.19% of average equity, compared to \$10.5 million, or 1.32% of average equity, for the first quarter of 2014. The \$239,000 increase in our compensation and benefits expense to \$6.7 million for the first quarter of 2015, compared to \$6.5 million for the first quarter of 2014, primarily reflects increases in salary and bonus expenses partially offset by lower equity-based compensation expenses. Our other general and administrative expenses decreased by \$507,000 to \$3.5 million for the quarter ended March 31, 2015 compared to \$4.0 million for the quarter ended March 31, 2014. The decrease was primarily due to lower professional services. In addition, for the first quarter of 2015, we recorded \$2.3 million of other investment related operating expenses related to our residential whole loan activities.



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## Selected Financial Ratios

The following table presents information regarding certain of our financial ratios at or for the dates presented:

| At or for the Quarter Ended | Return on Average Total Assets (1) | Return on Average Total Stockholders' Equity (2) | Total Average Stockholders' Equity to Total Average Assets (3) | Dividend Payout Ratio (4) | Leverage Multiple (5) | Book Value per Share of Common Stock (6) |
|-----------------------------|------------------------------------|--|--|---------------------------|-----------------------|--|
| March 31, 2015              | 2.25 %                             | 9.80 %   | 22.97 %  | 0.95                      | 3.3                   | \$8.13                                   |
| December 31, 2014           | 2.44                               | 9.45   | 25.78  | 1.00                      | 2.8                   | 8.12                                     |
| September 30, 2014          | 2.41                               | 9.16   | 26.27  | 1.00                      | 2.7                   | 8.28                                     |
| June 30, 2014               | 2.38                               | 9.25   | 25.69  | 1.00                      | 2.8                   | 8.37                                     |
| March 31, 2014              | 2.30                               | 9.10   | 25.27  | 1.00                      | 2.9                   | 8.20                                     |

(1) Reflects annualized net income divided by average total assets. The decrease for the quarter ended March 31, 2015 compared to the quarter ended December 31, 2014 is primarily due to the reclassification of \$1.918 billion of MBS previously reported as a component of Linked Transactions.

(2) Reflects annualized net income divided by average total stockholders' equity.

(3) Reflects total average stockholders' equity divided by total average assets. The decrease for the quarter ended March 31, 2015 compared to the quarter ended December 31, 2014 is primarily due to the reclassification of \$1.918 billion of MBS previously reported as a component of Linked Transactions.

(4) Reflects dividends declared per share of common stock divided by earnings per share.

(5) Represents the sum of borrowings under repurchase agreements, securitized debt, payable for unsettled MBS purchases, and obligations to return securities obtained as collateral and Senior Notes divided by stockholders' equity. The increase in our leverage multiple for the quarter ended March 31, 2015 from the prior quarter is primarily due to the reclassification of \$1.520 billion of repurchase agreements previously reported as a component of Linked Transactions.

(6) Reflects total stockholders' equity less the preferred stock liquidation preference divided by total shares of common stock outstanding.

## Recent Accounting Standards to be Adopted in Future Periods

## Interest - Imputation of Interest - Simplifying the Presentation of Debt Issuance Costs

In April 2015, the FASB issued ASU 2015-03, Simplifying the Presentation of Debt Issuance Costs, (or ASU 2015-03). The amendments in this ASU require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with the presentation of debt issued at a discount. The recognition and measurement guidance of debt issuance costs are not affected by the amendments in this ASU. ASU 2015-03 is effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted for financial statements that have not previously been issued and entities should apply the new guidance on a retrospective basis. We do not expect adoption of ASU 2015-03 to have a significant impact on our financial position or financial statement disclosures.

## Consolidation - Amendments to the Consolidation Analysis

In February 2015, the FASB issued ASU 2015-02, Amendments to the Consolidation Analysis, (or ASU 2015-02). The amendments in this ASU change the way reporting enterprises evaluate whether (a) they should consolidate limited partnerships and similar entities, (b) fees paid to a decision maker or service provider are variable interests in a

VIE, and (c) variable interests in a VIE held by related parties of the reporting enterprise require the reporting enterprise to consolidate the VIE. It also eliminates the VIE consolidation model based on majority exposure to variability that applied to certain investment companies and similar entities. ASU 2015-02 is effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. At the effective date, all previous consolidation analyses that the guidance affects must be reconsidered. Early adoption is permitted, including adoption in an interim period. If an entity adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. A reporting entity may apply the amendments in this ASU using a modified retrospective approach by recording a cumulative-effect adjustment to equity as of the beginning of the fiscal year of adoption. A reporting entity also may apply the amendments retrospectively. We are currently evaluating the effect that ASU 2015-02 will have on our consolidated financial statements and related disclosures. While we have not yet selected a transition method, we do not expect adoption of ASU 2015-2 to have a significant impact on our financial position.

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### Revenue from Contracts with Customers

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers, (or ASU 2014-09). The ASU requires an entity to recognize revenue in an amount that reflects the consideration to which it expects to be entitled for the transfer of promised goods or services to customers. ASU 2014-09 will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. ASU 2014-09 is effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2016. Early application is not permitted. The standard permits the use of either the retrospective or cumulative effect transition method. On April 29, 2015, the FASB proposed a one-year deferral of the effective date for ASU 2014-09. As a result, public entities would apply the new revenue standard to annual reporting periods beginning after December 15, 2017 and interim periods therein. The FASB would also permit entities to adopt the standard early, but not before the original public entity effective date. We are currently evaluating the effect that ASU 2014-09 will have on our consolidated financial statements and related disclosures. We have not yet selected a transition method nor have we determined the effect of the standard on our ongoing financial reporting.

### Presentation of Financial Statements - Going Concern

In August 2014, the FASB issued ASU 2014-15, Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern, (or ASU 2014-15). The amendments in this ASU provide guidance in GAAP about management's responsibility to evaluate whether there is a substantial doubt about an entity's going concern and to provide related footnote disclosures. In connection with preparing financial statements for each annual and interim reporting period, an entity's management should evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued when applicable). The amendments in ASU 2014-15 are effective for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter. Early application is permitted. We do not expect adoption of ASU 2014-15 to have a significant impact on our financial position or financial statement disclosures.

### Proposed Accounting Standards

The FASB has recently issued or discussed a number of proposed standards on such topics as measurement of credit impairment, financial instrument measurement and classification, leases, hedging, and disclosures about liquidity risk and interest rate risk. Some of the proposed changes are potentially significant and could have a material impact on our reporting. We have not yet fully evaluated the potential impact of these proposals but will make such an evaluation as the standards are finalized.

### Liquidity and Capital Resources

#### General

Our principal sources of cash generally consist of borrowings under repurchase agreements, payments of principal and interest we receive on our MBS portfolio, cash generated from our operating results and, to the extent such transactions are entered into, proceeds from capital market and securitization transactions. Our most significant uses of cash are generally to pay principal and interest on our borrowings under repurchase agreements and securitized debt, to purchase MBS, to make dividend payments on our capital stock, to fund our operations and to make other investments that we consider appropriate.

We seek to employ a diverse capital raising strategy under which we may issue capital stock and other types of securities. To the extent we raise additional funds through capital market transactions, we currently anticipate using

the net proceeds from such transactions to acquire additional MBS and residential whole loans, consistent with our investment policy, and for working capital which may include, among other things, the repayment of our repurchase agreements. There can be no assurance, however, that we will be able to access the capital markets at any particular time or on any particular terms. We have available for issuance an unlimited amount (subject to the terms and limitations of our charter) of common stock, preferred stock, depositary shares representing preferred stock, warrants, debt securities, rights and/or units pursuant to our automatic shelf registration statement and, at March 31, 2015, we had 7.0 million shares of common stock available for issuance pursuant to our DRSPS shelf registration statement. During the three months ended March 31, 2015, we issued 39,784 shares of common stock through our DRSPS, raising net proceeds of approximately \$313,000.

Our borrowings under repurchase agreements are uncommitted and renewable at the discretion of our lenders and, as such, our lenders could determine to reduce or terminate our access to future borrowings at virtually any time. The terms of the repurchase transaction borrowings under our master repurchase agreements as such terms related to repayment, margin requirements and the

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segregation of all securities that are the subject of repurchase transactions generally conform to the terms in the standard master repurchase agreement as published by SIFMA or the global master repurchase agreement published by SIFMA and the International Capital Market Association. In addition, each lender typically requires that we include supplemental terms and conditions to the standard master repurchase agreement. Typical supplemental terms and conditions, which differ by lender, may include changes to the margin maintenance requirements, required haircuts (as defined below), purchase price maintenance requirements, requirements that all controversies related to the repurchase agreement be litigated in a particular jurisdiction and cross default and setoff provisions.

With respect to margin maintenance requirements for repurchase agreements with Non-Agency MBS as collateral, margin calls are typically determined by our counterparties based on their assessment of changes in the fair value of the underlying collateral and in accordance with the agreed upon haircuts specified in the transaction confirmation with the counterparty. We address margin call requests in accordance with the required terms specified in the applicable repurchase agreement and such requests are typically satisfied by posting additional cash or collateral on the same business day. We review margin calls made by counterparties and assess them for reasonableness by comparing the counterparty valuation against our valuation determination. When we believe that a margin call is unnecessary because our assessment of collateral value differs from the counterparty valuation, we typically hold discussions with the counterparty and are able to resolve the matter. In the unlikely event that resolution cannot be reached, we will look to resolve the dispute based on the remedies available to us under the terms of the repurchase agreement, which in some instances may include the engagement of a third party to review collateral valuations. For other agreements that do not include such provisions, we could resolve the matter by substituting collateral as permitted in accordance with the agreement or otherwise request the counterparty to return the collateral in exchange for cash to unwind the financing.

The following table presents information regarding the margin requirements, or the percentage amount by which the collateral value is contractually required to exceed the loan amount (this difference is referred to as the "haircut"), on our repurchase agreements at March 31, 2015 and December 31, 2014:

| At March 31, 2015                           | Weighted<br>Average<br>Haircut | Low    | High   |
|---|--------------------------------|--------|--------|
| Repurchase agreement borrowings secured by: |                                |        |        |
| Agency MBS                                  | 4.66                           | % 3.00 | % 6.00 |
| Legacy Non-Agency MBS                       | 25.80                          | 10.00  | 63.50  |
| RPL/NPL MBS                                 | 20.99                          | 20.00  | 30.00  |
| U.S. Treasury securities                    | 1.64                           | 1.00   | 2.00   |
| CRT securities                              | 25.18                          | 25.00  | 30.00  |
| Residential whole loans                     | 33.52                          | 30.00  | 35.00  |
|   |                                |        |        |
| At December 31, 2014                        | Weighted<br>Average<br>Haircut | Low    | High   |
| Repurchase agreement borrowings secured by: |                                |        |        |
| Agency MBS                                  | 4.79                           | % 3.00 | % 6.00 |
| Legacy Non-Agency MBS                       | 28.88                          | 10.00  | 60.00  |
| RPL/NPL MBS                                 | 20.00                          | 20.00  | 20.00  |
| U.S. Treasury securities                    | 1.62                           | 1.00   | 2.00   |
| CRT securities                              | 25.00                          | 25.00  | 25.00  |
| Residential whole loans                     | 33.43                          | 33.43  | 33.43  |

The weighted average haircut requirements for the respective underlying collateral types for our repurchase agreements have not significantly changed since December 31, 2014.

During the first three months of 2015, the financial market environment was impacted by continued accommodative monetary policy. Repurchase agreement funding for both Agency MBS and Non-Agency MBS has been available to us at generally attractive market terms from multiple counterparties. Typically, due to the credit risk inherent to Non-Agency MBS, repurchase agreement funding involving Non-Agency MBS is available from fewer counterparties, at terms requiring higher collateralization and higher interest rates, than repurchase agreement funding secured by Agency MBS and U.S. Treasury securities. Therefore, we generally expect to be able to finance our acquisitions of Agency MBS on more favorable terms than financing for Non-Agency MBS.



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We maintain cash and cash equivalents, unpledged Agency and Non-Agency MBS and collateral in excess of margin requirements held by our counterparties (or collectively, “cash and other unpledged collateral”) to meet routine margin calls and protect against unforeseen reductions in our borrowing capabilities. Our ability to meet future margin calls will be impacted by our ability to use cash or obtain financing from unpledged collateral, which can vary based on the market value of such collateral, our cash position and margin requirements. Our cash position fluctuates based on the timing of our operating, investing and financing activities and is managed based on our anticipated cash needs. (See our Consolidated Statements of Cash Flows, included under Item 1 of this Quarterly Report on Form 10-Q and “Interest Rate Risk” included under Item 3 of this Quarterly Report on Form 10-Q.)

At March 31, 2015, we had a total of \$11.698 billion of MBS, U.S. Treasury securities, CRT securities and residential whole loans and \$93.3 million of restricted cash pledged against our repurchase agreements and Swaps. At March 31, 2015, we have access to various sources of liquidity which we estimate exceeds \$859.8 million. This includes (i) \$168.7 million of cash and cash equivalents; (ii) \$375.4 million in estimated financing available from unpledged Agency MBS and other Agency MBS collateral that is currently pledged in excess of contractual requirements; and (iii) \$315.7 million in estimated financing available from unpledged Non-Agency MBS.

The table below presents certain information about our borrowings under repurchase agreements and securitized debt:

| Quarter Ended (1)  | Repurchase Agreements     |                       |                                  | Securitized Debt          |                       |                                  |
|--------------------|---------------------------|-----------------------|----------------------------------|---------------------------|-----------------------|----------------------------------|
|                    | Quarterly Average Balance | End of Period Balance | Maximum Balance at Any Month-End | Quarterly Average Balance | End of Period Balance | Maximum Balance at Any Month-End |
| (In Thousands)     |                           |                       |                                  |                           |                       |                                  |
| March 31, 2015     | \$9,820,548 (2)           | \$ 9,809,586 (2)      | \$ 9,863,779 (2)                 | \$ 103,688 (2)            | \$ 91,280             | \$ 104,299                       |
| December 31, 2014  | 8,190,491                 | 8,267,388             | 8,271,123                        | 137,503                   | 110,574               | 138,026                          |
| September 30, 2014 | 8,267,905                 | 8,125,723             | 8,272,039                        | 190,753                   | 156,276               | 190,423                          |
| June 30, 2014      | 8,464,135                 | 8,384,101             | 8,501,978                        | 264,806                   | 214,048               | 267,740                          |
| March 31, 2014     | 8,412,045                 | 8,606,129             | 8,606,129                        | 336,893                   | 292,526               | 338,965                          |

(1) The information presented in the table above excludes Senior Notes. The outstanding balance of Senior Notes has been unchanged at \$100.0 million since issuance.

(2) Increase from December 31, 2014 reflects reclassification of \$1.520 billion of repurchase agreements previously presented as components of Linked Transactions.

#### Cash Flows and Liquidity For the Three Months Ended March 31, 2015

Our cash and cash equivalents decreased by \$13.7 million during the three months ended March 31, 2015, reflecting: \$112.3 million used in our financing activities; \$46.7 million provided by our investing activities; and \$51.8 million provided by our operating activities.

At March 31, 2015, our debt-to-equity multiple was 3.3 times, as compared to 2.8 times at December 31, 2014. After adjusting the reported debt-to-equity ratio at December 31, 2014 to reflect new accounting standards that became effective January 1, 2015, which eliminated Linked Transaction accounting and resulted in the reclassification of \$1.520 billion of liabilities relating to repurchase agreements that had been previously reported as a component of Linked Transactions, the debt to equity ratio at December 31, 2014 would have been 3.3 times. At March 31, 2015, we had borrowings under repurchase agreements of \$9.810 billion with 26 counterparties, of which \$4.982 billion was secured by Agency MBS, \$2.229 billion was secured by Legacy Non-Agency MBS, \$1.871 billion was secured by RPL/NPL MBS, \$497.5 million was secured by U.S. Treasuries, \$91.7 million was secured by CRT securities and \$138.9 million was secured by residential whole loans. We continue to have available capacity under our repurchase

agreement credit lines. At December 31, 2014, we had borrowings under repurchase agreements of \$8.267 billion with 25 counterparties, of which \$5.178 billion was secured by Agency MBS, \$2.364 billion was secured by Non-Agency MBS, \$507.1 million was secured by U.S. Treasuries, \$94.6 million by CRT securities and \$142.3 million was secured by residential whole loans.

At March 31, 2015, outstanding securitized debt was \$91.3 million, which had a weighted average expected remaining term of 0.54 years. During the three months ended March 31, 2015, securitized debt was reduced by principal payments of \$19.2 million.

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During the three months ended March 31, 2015, \$46.7 million was provided through our investing activities. We received cash of \$588.1 million from prepayments and scheduled amortization on our MBS and CRT securities, of which \$236.8 million was attributable to Agency MBS and \$351.3 million was from Non-Agency MBS. We purchased \$504.1 million of RPL/NPL MBS and \$14.0 million of CRT securities funded with cash and repurchase agreement borrowings. While we generally intend to hold our MBS and CRT securities as long-term investments, we may sell certain of our securities in order to manage our interest rate risk and liquidity needs, meet other operating objectives and adapt to market conditions. In addition, during the three months ended March 31, 2015 we sold certain of our Non-Agency MBS for \$10.8 million, realizing gross gains of \$6.4 million.

In connection with our repurchase agreement borrowings and Swaps, we routinely receive margin calls/reverse margin calls from our counterparties and make margin calls to our counterparties. Margin calls and reverse margin calls, which requirements vary over time, may occur daily between us and any of our counterparties when the value of collateral pledged changes from the amount contractually required. The value of securities pledged as collateral fluctuates reflecting changes in: (i) the face (or par) value of our MBS; (ii) market interest rates and/or other market conditions; and (iii) the market value of our Swaps. Margin calls/reverse margin calls are satisfied when we pledge/receive additional collateral in the form of additional securities and/or cash.

The table below summarizes our margin activity with respect to our repurchase agreement financings and derivative hedging instruments for the quarterly periods presented.

| For the Quarter Ended (1) | Collateral Pledged to Meet Margin Calls |              | Aggregate Assets Pledged For Margin Calls | Cash and Securities Received for Reverse Margin Calls | Net Assets Received/(Pledged) for Margin Activity |
|---------------------------|---|--------------|---|---|---|
|                           | Fair Value of Securities Pledged        | Cash Pledged |   |   |   |
| (In Thousands)            |   |              |   |   |   |
| March 31, 2015            | \$309,114                               | \$98,000     | \$407,114                                 | \$350,036   | \$ (57,078 )                                      |
| December 31, 2014         | 295,962                                 | 96,800       | 392,762                                   | 319,881   | (72,881 )   |
| September 30, 2014        | 340,341                                 | 24,100       | 364,441                                   | 315,594   | (48,847 )   |
| June 30, 2014             | 248,163                                 | 58,700       | 306,863                                   | 281,233   | (25,630 )   |
| March 31, 2014            | 238,306                                 | 29,000       | 267,306                                   | 285,544   | 18,238  |

(1) Information presented for the 2014 periods include repurchase agreement financings underlying Linked Transactions. New accounting guidance that was effective on January 1, 2015 prospectively eliminated the use of Linked Transaction accounting and as a result we did not have any Linked Transactions effective January 1, 2015.

We are subject to various financial covenants under our repurchase agreements and derivative contracts, which include minimum net worth and/or profitability requirements, maximum debt-to-equity ratios and minimum market capitalization requirements. We have maintained compliance with all of our financial covenants through March 31, 2015.

During the three months ended March 31, 2015, we paid \$74.3 million for cash dividends on our common stock and DERs and paid cash dividends of \$3.8 million on our preferred stock. On March 13, 2015, we declared our first quarter 2015 dividend on our common stock of \$0.20 per share; on April 30, 2015, we paid this dividend, which totaled approximately \$74.3 million, including DERs of approximately \$249,000.

We believe that we have adequate financial resources to meet our current obligations, including margin calls, as they come due, to fund dividends we declare and to actively pursue our investment strategies. However, should the value of our MBS suddenly decrease, significant margin calls on our repurchase agreement borrowings could result and our

liquidity position could be materially and adversely affected. Further, should market liquidity tighten, our repurchase agreement counterparties may increase our margin requirements on new financings, reducing our ability to use leverage. Access to financing may also be negatively impacted by the ongoing volatility in the world financial markets, potentially adversely impacting our current or potential lenders' ability or willingness to provide us with financing. In addition, there is no assurance that favorable market conditions will continue to permit us to consummate additional securitization transactions if we determine to seek that form of financing.

#### Off-Balance Sheet Arrangements

We do not have any material off-balance-sheet arrangements.

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### Inflation

Substantially all of our assets and liabilities are financial in nature. As a result, changes in interest rates and other factors impact our performance far more than does inflation. Our financial statements are prepared in accordance with GAAP and dividends declared are based upon net ordinary income as calculated for tax purposes. In each case, our results of operations and reported assets, liabilities and equity are measured with reference to historical cost or fair value without considering inflation.

### Other Matters

#### Investment Company Act of 1940

Commencing in the second quarter of 2014, we have organized ourselves as a holding company and conduct our real estate businesses primarily through wholly-owned subsidiaries. We conduct our real estate business so that we are not subject to regulation under the Investment Company Act by maintaining less than 40% of the value of our total assets, exclusive of U.S. Government securities and cash items (which we refer to as our adjusted total assets for Investment Company Act purposes), on an unconsolidated basis consist of “investment securities” as defined by the Investment Company Act. We refer to this test as the “40% Test”.

Certain of the subsidiaries through which we operate our business rely upon the exclusion from the definition of investment company provided by Section 3(c)(5)(C) of the Investment Company Act. Section 3(c)(5)(C), as interpreted by the staff of the SEC, requires an entity to invest at least 55% of its assets in “mortgages and other liens on and interests in real estate,” which we refer to as “qualifying real estate assets,” and at least 80% of its assets in qualifying real estate assets plus “real estate-related assets.” In satisfying the 55% requirement, the entity may treat securities issued with respect to an underlying pool of mortgage loans in which it holds all of the certificates issued by the pool as qualifying real estate assets. We treat the whole pool Agency certificates in which we invest as qualifying real estate assets for purposes of the 55% requirement.

We also have formed, and may in the future form, certain other wholly-owned or majority-owned subsidiaries that rely upon the exclusion from the definition of investment company under the Investment Company Act provided by Section 3(c)(1) or 3(c)(7) of the Investment Company Act. The securities issued by any wholly-owned or majority-owned subsidiary that relies on the exclusion from the definition of investment company provided by Section 3(c)(1) or 3(c)(7), together with any other investment securities we may own, may not have a value in excess of 40% of the value of our adjusted total assets on an unconsolidated basis. We monitor our compliance with the 40% Test and the operations of our subsidiaries so that we and each of our subsidiaries may maintain compliance with an exclusion from registration as an investment company under the Investment Company Act.

On August 31, 2011, the SEC issued a “concept release” under which it announced that it is reviewing interpretive issues related to the Section 3(c)(5)(C) exclusion, including requesting comments on whether it should reconsider whether whole pool certificates may be treated as qualifying real estate assets and whether companies, such as certain of our subsidiaries, whose primary business consists of investing in whole pool certificates, are the type of entities that Congress intended to be covered by the exclusion provided by Section 3(c)(5)(C).

The potential timetable and outcome of the SEC’s review are unclear. However, if the SEC determines that whole pool certificates are not qualifying real estate assets, adopts an otherwise adverse interpretation with respect to whole pool certificates, issues different guidance regarding any of the matters bearing upon the exclusion under Section 3(c)(5)(C) or otherwise believes we do not satisfy an Investment Company Act exclusion, we would be required to significantly restructure our operations in order to maintain our investment company exclusion. Under these circumstances, our ability to use leverage and our access to more favorable methods of financing would be substantially reduced, and we

would be unable to conduct our business as we currently conduct it. We may also be required to sell certain of our assets and/or limit the types of assets we acquire. Under the circumstances described above, it is likely that our net interest income would be significantly reduced, which would materially and adversely affect our business.

#### Implementation of 2013 COSO Internal Control Framework

In May of 2013 the Committee of Sponsoring Organizations of the Treadway Commission (or COSO) released an updated version of the internal control framework (or 2013 COSO Framework) that we and many other organizations use to assess internal control over financial reporting. The 2013 COSO Framework is intended to address changes in the business, operating and regulatory environment that have occurred since COSO issued its original internal control framework in 1992 (or 1992 COSO Framework).

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While the 2013 COSO Framework officially superseded the 1992 COSO Framework on December 15, 2014 and was available for use in connection with our assessment of internal control as of December 31, 2014, we did not transition to the 2013 COSO Framework during 2014. We plan to transition to the 2013 COSO Framework during 2015. To date, neither COSO, the Securities and Exchange Commission or any other regulatory body has mandated adoption of the 2013 COSO Framework by a specified date.

We are currently in the process of performing an analysis to evaluate what changes to our control environment, if any, would be needed to successfully implement the 2013 COSO Framework. We believe that adopting the 2013 COSO Framework during 2015 will provide management and our Audit Committee sufficient opportunity to analyze the required incremental effort and understand and address any Company specific or industry related practice issues associated with the implementation of the 2013 Framework.

Until such time as our transition to the 2013 Framework is complete, we will continue to use the 1992 COSO Framework in connection with our assessment of internal control.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk.

We seek to manage our risks related to interest rates, liquidity, prepayment speeds, market value and the credit quality of our assets while, at the same time, seeking to provide an opportunity to stockholders to realize attractive total returns through ownership of our capital stock. While we do not seek to avoid risk, we seek, consistent with our investment policies, to: assume risk that can be quantified based on management's judgment and experience and actively manage such risk; earn sufficient returns to justify the taking of such risks; and maintain capital levels consistent with the risks that we undertake.

Interest Rate Risk

We generally acquire interest-rate sensitive assets and fund them with interest-rate sensitive liabilities, a portion of which are hedged with Swaps. We are exposed to interest rate risk on our residential mortgage assets, and our liabilities, repurchase agreements and securitized debt. Changes in interest rates can affect our net interest income and the fair value of our assets and liabilities.

We finance the majority of our investments in Agency, Legacy Non-Agency and RPL/NPL MBS with short-term repurchase agreements. In general, the borrowing cost of our repurchase agreements (net of the impact of Swaps) changes more quickly, than the yield on our assets when interest rates change. In a rising interest rate environment the borrowing cost of our repurchase agreements may increase faster than the interest income on our assets, lowering our net income. In order to mitigate compression in net income based on such interest rate movements, we use Swaps and other hedging instruments to lock in a portion of the net interest spread between assets and liabilities.

The fair value of our residential mortgage assets could change at a different rate than the fair value of our liabilities when interest rates change. We measure the sensitivity of our portfolio to changes in interest rates by estimating the duration of our assets and liabilities. Duration is the approximate percentage change in fair value for a 100 basis point parallel shift in the yield curve. In general, our assets have higher duration than our liabilities and in order to reduce this exposure we use Swaps and other hedging instruments to reduce the gap in duration between our assets and liabilities.

In calculating the duration of our Agency MBS we take into account the characteristics of the underlying mortgage loans including whether the underlying loans are fixed rate, adjustable or hybrid; coupon, expected prepayment rates and lifetime and periodic caps. We use third-party financial models, combined with management's assumptions and observed empirical data when estimating the duration of our Agency MBS.

Prices of our Legacy Non-Agency MBS have generally trended up over the last several years and at these higher prices and therefore lower yields, we believe that our Legacy Non-Agency MBS have become more interest rate sensitive and exhibit positive duration. In analyzing the interest rate sensitivity of our Legacy Non-Agency MBS we take into account the characteristics of the underlying mortgage loans including credit quality and whether the underlying loans are fixed-rate, adjustable or hybrid. We estimate the duration of our Legacy Non-Agency MBS using management's assumptions.

Our RPL/NPL MBS deal structures contain interest rate step-up features such that the original coupon increases by 300 basis points if the bond is not redeemed by the issuer after 36 months. Therefore, we believe their fair value exhibits little sensitivity to changes in interest rates. We estimate the duration of our RPL/NPL MBS using management's assumptions.

The fair value of our re-performing residential whole loans is dependent on the value of the underlying real estate collateral, past and expected delinquency status of the borrower as well as the level of interest rates. Because the borrower is not delinquent on their mortgage payments but is less likely to prepay the loan due to weak credit history



and/or high LTV, we believe our re-performing residential whole loans exhibit positive duration. We estimate the duration of our re-performing residential whole loans using management's assumptions.

The fair value of our non-performing residential whole loans is primarily dependent on the value of the underlying real estate collateral and the time until collateral liquidation. Since neither the value of the collateral nor the liquidation timeline are generally sensitive to interest rates, we believe their fair value exhibits little sensitivity to interest rates. We estimate the duration of our non-performing residential whole loans using management's assumptions.

We use Swaps as part of our overall interest rate risk management strategy. Such derivative financial instruments are intended to act as a hedge against future interest rate increases on our repurchase agreement financings, which rates are typically highly correlated with LIBOR. While our derivatives do not extend the maturities of our borrowings under repurchase agreements, they do, however, in effect, lock in a fixed rate of interest over their term for a corresponding amount of our repurchase agreements that are hedged.

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At March 31, 2015, MFA's \$10.208 billion of Agency MBS and Legacy Non-Agency MBS, were backed by Hybrid, adjustable and fixed-rate mortgages. Additional information about these MBS, including average months to reset and three-month average CPR, is presented below:

| Time to Reset          | Agency MBS     |  |                       | Legacy Non-Agency MBS (1) |  |                       | Total (1)      |  |                       |
|------------------------|----------------|--|-----------------------|---------------------------|--|-----------------------|----------------|--|-----------------------|
|                        | Fair Value (2) | Average <sub>3</sub> Months to Reset (3) | Month Average CPR (4) | Fair Value                | Average <sub>3</sub> Months to Reset (3) | Month Average CPR (4) | Fair Value (2) | Average <sub>3</sub> Months to Reset (3) | Month Average CPR (4) |
| (Dollars in Thousands) |                |  |                       |                           |  |                       |                |  |                       |
| < 2 years (5)          | \$2,154,606    | 6  | 12.5 %                | \$2,920,465               | 6  | 10.4 %                | \$5,075,071    | 6  | 11.3 %                |
| 2-5 years              | 1,108,902      | 41                                       | 14.8                  | 175,736                   | 27                                       | 4.2                   | 1,284,638      | 39                                       | 13.1                  |
| > 5 years              | 316,123        | 80                                       | 8.9                   | —                         | —  | —                     | 316,123        | 80                                       | 8.9                   |
| ARM-MBS Total          | \$3,579,631    | 24                                       | 12.6 %                | \$3,096,201               | 7  | 10.3 %                | \$6,675,832    | 16                                       | 11.4 %                |
| 15-year fixed (6)      | \$2,090,803    |  | 7.9 %                 | \$10,606                  |  | 7.3 %                 | \$2,101,409    |  | 7.9 %                 |
| 30-year fixed (6)      | —              |  | —                     | 1,424,823                 |  | 13.0                  | 1,424,823      |  | 13.0                  |
| 40-year fixed (6)      | —              |  | —                     | 5,502                     |  | 7.9                   | 5,502          |  | 7.9                   |
| Fixed-Rate Total       | \$2,090,803    |  | 7.9 %                 | \$1,440,931               |  | 12.8 %                | \$3,531,734    |  | 10.1 %                |
| MBS Total              | \$5,670,434    |  | 10.9 %                | \$4,537,132               |  | 11.1 %                | \$10,207,566   |  | 11.0 %                |

(1) Excludes \$2.318 billion of RPL/NPL MBS. Refer to table below for further information on RPL/NPL MBS.

(2) Does not include principal payments receivable of \$761,000.

Months to reset is the number of months remaining before the coupon interest rate resets. At reset, the MBS

(3) coupon will adjust based upon the underlying benchmark interest rate index, margin and periodic or lifetime caps.

The months to reset do not reflect scheduled amortization or prepayments.

(4) 3 month average CPR weighted by positions as of the beginning of each month in the quarter.

(5) Includes floating rate MBS that may be collateralized by fixed-rate mortgages.

(6) Information presented based on data available at time of loan origination.

The following table presents certain information about our RPL/NPL MBS portfolio at March 31, 2015:

|                        | Fair Value  | Net Coupon | Months to Step-Up (1) | Current Credit Support (2) | Original Credit Support | 3 Month Average Bond CPR (3) |
|------------------------|-------------|------------|-----------------------|----------------------------|-------------------------|------------------------------|
| (Dollars in Thousands) |             |            |                       |                            |                         |                              |
| Re-Performing MBS      | \$513,103   | 3.66 %     | 24                    | 45                         | % 41                    | % 14.9                       |
| Non-Performing MBS     | 1,805,088   | 3.51       | 30                    | 51                         | 51                      | 20.1                         |
| Total RPL/NPL MBS      | \$2,318,191 | 3.54 %     | 29                    | 50                         | % 49                    | % 19.6                       |

(1) Months to step-up is the weighted average number of months remaining before the coupon interest rate increases a cumulative 300 basis points. We anticipate that the securities will be redeemed prior to the step-up date.

(2) Credit Support for a particular security is expressed as a percentage of all outstanding mortgage loan collateral. A particular security will not be subject to principal loss as long as credit enhancement is greater than zero.

(3) All principal payments are considered to be prepayments for CPR purposes. Excludes RPL/NPL MBS that have not had a principal payment.

At March 31, 2015 our CRT securities had a fair value of \$127.2 million and reset monthly based on one-month LIBOR.

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The information presented in the following “Shock Table” projects the potential impact of sudden parallel changes in interest rates on our net interest income and portfolio value, including the impact of Swaps, over the next 12 months based on the assets in our investment portfolio at March 31, 2015. All changes in income and value are measured as the percentage change from the projected net interest income and portfolio value at the base interest rate scenario at March 31, 2015.

## Shock Table

| Change in Interest Rates  | Estimated Value of Assets (1) | Estimated Value of Swaps | Estimated Value of Financial Instruments | Change in Estimated Value | Percentage Change in Interest Income | Percentage Change in Net Portfolio Value |
|---------------------------|-------------------------------|--------------------------|--|---------------------------|--------------------------------------|--|
| (Dollars in Thousands)    |                               |                          |  |                           |                                      |  |
| +100 Basis Point Increase | \$ 13,109,323                 | \$ 31,471                | \$ 13,140,794                            | \$(87,838 )               | (6.82 )%                             | (0.66 )%                                 |
| + 50 Basis Point Increase | \$ 13,219,157                 | \$(29,979 )              | \$ 13,189,178                            | \$(39,454 )               | (4.10 )%                             | (0.30 )%                                 |
| Actual at March 31, 2015  | \$ 13,320,061                 | \$(91,429 )              | \$ 13,228,632                            | \$—                       | —                                    | —  |
| - 50 Basis Point Decrease | \$ 13,412,033                 | \$(152,878 )             | \$ 13,259,155                            | \$30,523                  | (3.43 )%                             | 0.23 %                                   |
| -100 Basis Point Decrease | \$ 13,495,075                 | \$(214,327 )             | \$ 13,280,748                            | \$52,116                  | (9.92 )%                             | 0.39 %                                   |

(1) Such assets include MBS and CRT securities, residential whole loans, cash and cash equivalents and restricted cash.

Certain assumptions have been made in connection with the calculation of the information set forth in the Shock Table and, as such, there can be no assurance that assumed events will occur or that other events will not occur that would affect the outcomes. The base interest rate scenario assumes interest rates at March 31, 2015. The analysis presented utilizes assumptions and estimates based on management’s judgment and experience. Furthermore, while we generally expect to retain the majority of such assets and the associated interest rate risk to maturity, future purchases and sales of assets could materially change our interest rate risk profile. It should be specifically noted that the information set forth in the above table and all related disclosure constitute forward-looking statements within the meaning of Section 27A of the 1933 Act and Section 21E of the 1934 Act. Actual results could differ significantly from those estimated in the Shock Table above.

The Shock Table quantifies the potential changes in net interest income and portfolio value, which includes the value of our Swaps (which are carried at fair value), should interest rates immediately change (i.e., shocked). The Shock Table presents the estimated impact of interest rates instantaneously rising 50 and 100 basis points, and falling 50 and 100 basis points. The cash flows associated with our portfolio of MBS for each rate shock are calculated based on assumptions, including, but not limited to, prepayment speeds, yield on replacement assets, the slope of the yield curve and composition of our portfolio. Assumptions made on the interest rate sensitive liabilities, which are assumed to be repurchase financings and securitized debt, include anticipated interest rates, collateral requirements as a percent of the repurchase agreement, amount and term of borrowing. At March 31, 2015, we applied a floor of 0% for all anticipated interest rates included in our assumptions. Due to this floor, it is anticipated that any hypothetical interest rate shock decrease would have a limited positive impact on our funding costs; however, because prepayments speeds are unaffected by this floor, it is expected that any increase in our prepayment speeds (occurring as a result of any interest rate shock decrease or otherwise) could result in an acceleration of our premium amortization on our Agency MBS and discount accretion on our Non-Agency MBS and the reinvestment of principal repayments in lower yielding assets. As a result, because the presence of this floor limits the positive impact of interest rate decrease on our funding costs, hypothetical interest rate shock decreases could cause the fair value of our financial instruments and our net interest income to decline.

At March 31, 2015, the impact on portfolio value was approximated using estimated effective duration (i.e., the price sensitivity to changes in interest rates), including the effect of Swaps, of 0.53 which is the weighted average of 1.84 for our Agency MBS, 1.20 for our Non-Agency investments, (3.77) for our Swaps and zero for our cash and cash equivalents. Estimated convexity (i.e., the approximate change in duration relative to the change in interest rates) of the portfolio was (0.27), which is the weighted average of (0.63) for our Agency MBS, zero for our Swaps, zero for our Non-Agency MBS and zero for our cash and cash equivalents. The impact on our net interest income is driven mainly by the difference between portfolio yield and cost of funding of our repurchase agreements, which includes the cost and/or benefit from Swaps. Our asset/liability structure is generally such that an increase in interest rates would be expected to result in a decrease in net interest income, as our borrowings are generally shorter in term than our interest-earning assets. When interest rates are shocked, prepayment assumptions are adjusted based on management's expectations along with the results from the prepayment model.

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Credit Risk

Although we do not believe that we are exposed to credit risk in our Agency MBS portfolio, we are exposed to credit risk through our credit-sensitive residential mortgage investments, in particular Legacy Non-Agency MBS and residential whole loans and to a lesser extent our investments in RPL/NPL MBS and CRT securities. Our exposure to credit risk from our credit sensitive investments is discussed in more details below:

Legacy Non-Agency MBS

In the event of the return of less than 100% of par on our Legacy Non-Agency MBS, credit support contained in the MBS deal structures and the discount purchase prices we paid mitigate our risk of loss on these investments. Over time, we expect the level of credit support remaining in certain MBS deal structures to decrease, which will result in an increase in the amount of realized credit loss experienced by our Legacy Non-Agency MBS portfolio. Our investment process for Legacy Non-Agency MBS involves analysis focused primarily on quantifying and pricing credit risk. When we purchase Legacy Non-Agency MBS, we assign certain assumptions to each of the MBS, including but not limited to, future interest rates, voluntary prepayment rates, mortgage modifications, default rates and loss severities, and generally allocate a portion of the purchase discount as a Credit Reserve which provides credit protection for such securities. As part of our surveillance process, we review our Legacy Non-Agency MBS by tracking their actual performance compared to the security's expected performance at purchase or, if we have modified our original purchase assumptions, compared to our revised performance expectations. To the extent that actual performance of a Legacy Non-Agency MBS is less favorable than the expected performance of the security, we may revise our performance expectations. As a result, we could reduce the accretable discount on such security and/or recognize an other-than-temporary impairment through earnings, which could have a material adverse impact on our operating results.

In evaluating our asset/liability management and Legacy Non-Agency MBS credit performance, we consider the credit characteristics underlying our Legacy Non-Agency MBS. The following table presents certain information about our Legacy Non-Agency MBS portfolio at March 31, 2015. Information presented with respect to the weighted average FICO scores and other information aggregated based on information reported at the time of mortgage origination are historical and, as such, does not reflect the impact of the general decline in home prices or changes in a borrower's credit score or the current use of the mortgaged property.

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The information in the table below is presented as of March 31, 2015:

| Year of Securitization<br>(2)<br>(Dollars in<br>Thousands)  | Securities with Average Loan FICO<br>of 715 or Higher (1) |              |                   | Securities with Average Loan FICO<br>Below 715 (1) |             |                   | Total         |   |
|---|---|--------------|-------------------|--|-------------|-------------------|---------------|---|
|   | 2007  | 2006         | 2005<br>and Prior | 2007   | 2006        | 2005<br>and Prior |               |   |
| Number of securities  | 100   | 89           | 105               | 22   | 53          | 61                | 430           |   |
| MBS current face (3)  | \$1,431,755   | \$1,035,096  | \$1,129,184       | \$208,279  | \$597,503   | \$641,690         | \$5,043,507   |   |
| Total purchase<br>discounts, net (3)  | \$(360,742 )  | \$(288,964 ) | \$(194,732 )      | \$(64,210 )  | \$(190,864) | \$(158,964)       | \$(1,258,476) |   |
| Purchase discount<br>designated as Credit<br>Reserve and OTTI<br>(3)(4)                           | \$(238,648 )  | \$(163,171 ) | \$(98,768 )       | \$(60,216 )  | \$(202,358) | \$(110,372)       | \$(873,533 )  |   |
| Purchase discount<br>designated as Credit<br>Reserve and OTTI as<br>percentage of current<br>face | 16.7  | % 15.8       | % 8.7             | % 28.9   | % 33.9      | % 17.2            | % 17.3        | % |
| MBS amortized cost<br>(3)   | \$1,071,011   | \$746,133    | \$934,452         | \$144,069  | \$406,639   | \$482,727         | \$3,785,031   |   |
| MBS fair value (3)  | \$1,289,228   | \$908,330    | \$1,052,691       | \$180,322  | \$511,732   | \$594,830         | \$4,537,133   |   |
| Weighted average<br>fair value to current<br>face   | 90.0  | % 87.8       | % 93.2            | % 86.6   | % 85.6      | % 92.7            | % 90.0        | % |
| Weighted average<br>coupon (6)  | 3.94  | % 3.52       | % 3.20            | % 4.62   | % 4.89      | % 4.31            | % 3.87        | % |
| Weighted average<br>loan age (months)<br>(5)(6)   | 96  | 105          | 119               | 100  | 107         | 120               | 108           |   |
| Weighted average<br>current loan size<br>(5)(6)   | \$524   | \$490        | \$324             | \$407  | \$279       | \$266             | \$406         |   |
| Percentage<br>amortizing (7)  | 44  | % 57         | % 77              | % 48   | % 57        | % 75              | % 60          | % |
| Weighted average<br>FICO score at<br>origination (5)(8)   | 731   | 729          | 727               | 706  | 704         | 704               | 722           |   |
| Owner-occupied<br>loans   | 89.7  | % 90.0       | % 85.7            | % 85.9   | % 85.6      | % 84.0            | % 87.5        | % |
| Rate-term<br>refinancings   | 28.3  | % 19.5       | % 15.3            | % 20.5   | % 15.9      | % 14.0            | % 20.0        | % |
| Cash-out refinancings   | 33.4  | % 34.5       | % 27.0            | % 46.4   | % 42.5      | % 37.8            | % 34.4        | % |
| 3 Month CPR (6)   | 11.3  | % 12.5       | % 11.0            | % 9.1  | % 10.2      | % 12.3            | % 11.4        | % |
| 3 Month CRR (6)(9)  | 8.9   | % 9.6        | % 8.9             | % 5.7  | % 6.9       | % 10.2            | % 8.8         | % |
| 3 Month CDR (6)(9)  | 2.6   | % 3.3        | % 2.4             | % 3.6  | % 3.4       | % 2.5             | % 2.8         | % |
| 3 Month loss severity   | 55.0  | % 51.7       | % 48.7            | % 58.7   | % 70.0      | % 54.9            | % 55.3        | % |

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|  |      |        |        |        |        |        |        |   |
|--|------|--------|--------|--------|--------|--------|--------|---|
| 60+ days delinquent (8)                                | 13.7 | % 14.1 | % 11.5 | % 21.5 | % 20.4 | % 16.1 | % 14.7 | % |
| Percentage of always current borrowers (Lifetime) (10) | 43.3 | % 42.3 | % 49.2 | % 34.0 | % 31.1 | % 36.5 | % 41.7 | % |
| Percentage of always current borrowers (12M) (11)      | 75.8 | % 75.1 | % 77.8 | % 63.9 | % 64.8 | % 68.3 | % 73.4 | % |
| Weighted average credit enhancement (8)(12)            | 0.3  | % 0.8  | % 4.3  | % 0.2  | % 1.1  | % 5.3  | % 2.0  | % |

(1) FICO score is used by major credit bureaus to indicate a borrower's creditworthiness at time of loan origination.

Information presented based on the initial year of securitization of the underlying collateral. Certain of our

(2) Non-Agency MBS have been resecuritized. The historical information presented in the table is based on the initial securitization date and data available at the time of original securitization (and not the date of resecuritized). No information has been updated with respect to any MBS that have been resecuritized.

Excludes Non-Agency MBS issued in 2013, 2014 and 2015 in which the underlying collateral consists of (3) RPL/NPL MBS. These Non-Agency MBS have a current face of \$2.320 billion, amortized cost of \$2.317 billion, fair value of \$2.318 billion and purchase discounts of \$3.4 million at March 31, 2015.

(4) Purchase discounts designated as Credit Reserve and OTTI are not expected to be accreted into interest income.

(5) Weighted average is based on MBS current face at March 31, 2015.

(6) Information provided is based on loans for individual groups owned by us.

(7) Percentage of face amount for which the original mortgage note contractually calls for principal amortization in the current period.

(8) Information provided is based on loans for all groups that provide credit enhancement for MBS with credit enhancement.

(9) CRR represents voluntary prepayments and CDR represents involuntary prepayments.

(10) Percentage of face amount of loans for which the borrower has not been delinquent since origination.

(11) Percentage of face amount of loans for which the borrower has not been delinquent in the last twelve months.

(12) Credit enhancement for a particular security is expressed as a percentage of all outstanding mortgage loan collateral. A particular security will not be subject to principal loss as long as its credit enhancement is greater than zero. As of March 31, 2015, a total of 289 Non-Agency MBS in our portfolio representing approximately \$3.554 billion or 70% of the current face amount of the portfolio had no credit enhancement.



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The mortgages securing our Legacy Non-Agency MBS are located in many geographic regions across the United States. The following table presents the five largest geographic concentrations of the mortgages collateralizing our Legacy Non-Agency MBS at March 31, 2015:

| Property Location | Percent |
|-------------------|---------|
| California        | 44.2 %  |
| Florida           | 7.7 %   |
| New York          | 5.5 %   |
| Virginia          | 3.9 %   |
| Maryland          | 3.6 %   |

**RPL/NPL MBS**

Our RPL/NPL MBS were purchased primarily through new issue at prices at or around par and represent the senior tranches in these securitizations. These RPL/NPL MBS are structured with significant credit enhancement (typically approximately 50%) and the subordinate tranches absorb all credit losses (until extinguished) and typically receive no cash flow (interest or principal) until the senior tranche is paid off. Prior to purchase we analyze the deal structure in order to assess the credit risk associated with the deal. Subsequent to purchase the ongoing credit risk associated with the deal is evaluated by analyzing the extent to which actual credit losses have occurred which result in a reduction in the amount of subordination enjoyed by our bond. Based on the recent performance of the collateral underlying our RPL/NPL MBS and the current subordination levels, we do not believe that we are currently exposed to significant risk of credit loss on these investments.

**CRT Securities**

We are exposed to potential credit losses from our investments in CRT securities issued by Fannie Mae and Freddie Mac. While CRT securities are debt obligations of these GSEs, payment of principal on these securities is not guaranteed. As an investor in a CRT security, we may incur a loss if the loans in the associated reference pool experience delinquencies exceeding specified thresholds. We assess the credit risk associated with our investment in CRT securities by assessing the current performance of the loans in the associated reference pool.

Furthermore, as discussed in Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations," of this Quarterly Report on Form 10-Q, we are potentially exposed to repurchase agreement counterparties should they default on their obligations and we are unable to recover any excess collateral pledged to them.

**Residential Whole Loans**

We are also exposed to credit risk from our investments in residential whole loans. Our investment process for residential whole loans is similar in nature to that used for Legacy Non-Agency MBS in that it is focused on quantifying and pricing credit risk. Consequently, these loans are acquired at purchase prices that are discounted (often substantially) to the contractual loan balance reflecting a number of factors, including the impaired credit history of the borrower and the value of the collateral securing the loan. In addition, as the owner of the servicing rights, our process is also focused on selecting a servicer with the appropriate expertise to mitigate losses and maximize our overall return. This involves, among other things, performing due diligence on the sub-servicer prior to their engagement as well as ongoing oversight and surveillance. To the extent that loan delinquencies and defaults are higher than our expectation at the time the loans were purchased, the discounted purchase price at which the asset is acquired is intended to provide a level of protection against financial loss.

**Liquidity Risk**

The primary liquidity risk we face arises from financing long-maturity assets with shorter-term borrowings primarily in the form of repurchase agreements. We pledge residential mortgage assets and cash to secure our repurchase agreements and Swaps. At March 31, 2015, we had access to various sources of liquidity which we estimate exceeds \$859.8 million. This includes (i) \$168.7 million of cash and cash equivalents; (ii) \$375.4 million in estimated financing available from unpledged Agency MBS and other Agency MBS collateral that is currently pledged in excess of contractual requirements; and (iii) \$315.7 million in estimated financing available from unpledged Non-Agency MBS. Should the value of our residential mortgage assets pledged as collateral suddenly decrease, margin calls relating to our repurchase agreements could increase, causing an adverse change in our liquidity position. As such, we cannot be assured that we will always be able to roll over our repurchase agreements. Further, should market liquidity tighten, our repurchase agreement counterparties may increase our margin requirements on new financings, including repurchase agreement borrowings that we roll with the same counterparty, reducing our ability to use leverage.

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Prepayment Risk

Premiums arise when we acquire MBS at a price in excess of the principal balance of the mortgages securing such MBS (i.e., par value). Conversely, discounts arise when we acquire MBS at a price below the principal balance of the mortgages securing such MBS or acquire residential whole loans at a price below the principal balance of the mortgage. Premiums paid on our MBS are amortized against interest income and accretible purchase discounts on these investments are accreted to interest income. Purchase premiums on our MBS, which are primarily carried on our Agency MBS, are amortized against interest income over the life of each security using the effective yield method, adjusted for actual prepayment activity. An increase in the prepayment rate, as measured by the CPR, will typically accelerate the amortization of purchase premiums, thereby reducing the IRR/interest income earned on such assets. Generally, if prepayments on Non-Agency MBS and residential whole loans purchased at significant discounts and not accounted for at fair value are less than anticipated, we expect that the income recognized on such assets would be reduced and impairments and/or loan loss reserves could result.

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

Management, under the direction of its Chief Executive Officer and Chief Financial Officer, is responsible for maintaining disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the 1934 Act, that are designed to ensure that information required to be disclosed in reports filed or submitted under the 1934 Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and that such information is accumulated and communicated to management, including the Company's Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosures.

In connection with the preparation of this Quarterly Report on Form 10-Q, the Company's management reviewed and evaluated the Company's disclosure controls and procedures. The evaluation was performed under the direction of the Company's Chief Executive Officer and Chief Financial Officer to determine the effectiveness, as of March 31, 2015, of the design and operation of the Company's disclosure controls and procedures. Based on that review and evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures, as designed and implemented, were effective as of March 31, 2015. Notwithstanding the foregoing, a control system, no matter how well designed, implemented and operated, can provide only reasonable, not absolute, assurance that it will detect or uncover failures within the Company to disclose material information otherwise required to be set forth in our periodic reports.

(b) Changes in Internal Control Over Financial Reporting

There have been no changes in our internal control over financial reporting that occurred during the quarter ended March 31, 2015 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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## PART II. OTHER INFORMATION

## Item 1. Legal Proceedings

There are no material pending legal proceedings to which we are a party or any of our assets are subject.

## Item 1A. Risk Factors

For a discussion of the Company's risk factors, see Part 1, Item 1A. "Risk Factors" of the Company's Annual Report on Form 10-K for the year ended December 31, 2014. There are no material changes from the risk factors set forth in such Annual Report on Form 10-K. However, the risks and uncertainties that the Company faces are not limited to those set forth in the Company's Annual Report on Form 10-K for the year ended December 31, 2014. Additional risks and uncertainties not presently known to the Company or that it currently believes to be immaterial may also adversely affect the Company's business and the trading price of our securities.

## Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

## Purchases of Equity Securities

As previously disclosed, in August 2005, the Company's Board authorized a Repurchase Program, to repurchase up to 4.0 million shares of the Company's outstanding common stock. The Board reaffirmed such authorization in May 2010. In December 31, 2013, the Company's Board increased the number of shares authorized for repurchase to an aggregate of 10.0 million shares. Such authorization does not have an expiration date and, at present, there is no intention to modify or otherwise rescind such authorization. Subject to applicable securities laws, repurchases of common stock under the Repurchase Program may be made at times and in amounts as we deem appropriate (including, in our discretion, through the use of one or more plans adopted under Rule 10b-5-1 promulgated under the 1934 Act), using available cash resources. Shares of common stock repurchased by the Company under the Repurchase Program are cancelled and, until reissued by the Company, are deemed to be authorized but unissued shares of the Company's common stock. The Repurchase Program may be suspended or discontinued by the Company at any time and without prior notice.

The Company engaged in no share repurchase activity during the first quarter of 2015 pursuant to the Repurchase program. The Company did, however, withhold restricted shares (under the terms of grants under our 2010 Plan) to offset tax withholding obligations that occur upon the vesting and release of restricted stock awards and/or RSUs. The following table presents information with respect to (i) such withheld restricted shares, and (ii) eligible shares remaining for repurchase under the Repurchase Program:

| Month                 | Total<br>Number of<br>Shares<br>Purchased | Weighted<br>Average Price<br>Paid Per<br>Share (1) | Total Number of<br>Shares Repurchased as<br>Part of Publicly<br>Announced<br>Repurchase Program<br>or Employee Plan | Maximum Number of<br>Shares that May Yet be<br>Purchased Under the<br>Repurchase Program or<br>Employee Plan |
|-----------------------|---|--|---|--|
| January 1-31, 2015:   |   |  |   |  |
| Repurchase Program    | (2) —                                     | \$—  | —   | 6,616,355  |
| Employee Transactions | (3) —                                     | —  | N/A   | N/A  |
| February 1-28, 2015:  |   |  |   |  |
| Repurchase Program    | (2) —                                     | —  | —   | 6,616,355  |
| Employee Transactions | (3) —                                     | —  | N/A   | N/A  |
| March 1-31, 2015:     |   |  |   |  |

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|                             |     |        |        |     |           |
|-----------------------------|-----|--------|--------|-----|-----------|
| Repurchase Program          | (2) | —      | —      | —   | 6,616,355 |
| Employee Transactions       | (3) | 11,074 | \$7.86 | N/A | N/A       |
| Total Repurchase Program    | (2) | —      | \$—    | —   | 6,616,355 |
| Total Employee Transactions | (3) | 11,074 | \$7.86 | N/A | N/A       |

(1) Includes brokerage commissions.

(2) As of March 31, 2015, the Company had repurchased an aggregate of 3,383,645 shares under the Repurchase Program.

(3) The Company's 2010 Plan provides that the value of the shares delivered or withheld be based on the price of its common stock on the date the relevant transaction occurs.

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Item 6. Exhibits

The list of exhibits required to be filed as exhibits to this report are listed on page E-1 hereof, under “Exhibit Index,” which is incorporated herein by reference.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: May 5, 2015

MFA FINANCIAL, INC.  
(Registrant)

By: /s/ William S. Gorin  
William S. Gorin  
Chief Executive Officer

By: /s/ Stephen D. Yarad  
Stephen D. Yarad  
Chief Financial Officer  
(Principal Financial Officer)

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EXHIBIT INDEX

The following exhibits are filed as part of this Quarterly Report:

| Exhibit  | Description  |
|----------|--|
| 10.1     | Employment Agreement, entered into as of March 1, 2010, by and between the Company and Gudmundur Kristjansson (incorporated herein by reference to Exhibit 10.3 to the Company's Annual Report on Form 10-K for the year ended December 31, 2014 (Commission File No. 1-13991)).   |
| 10.2     | Amendment No. 1, dated February 9, 2015, to Employment Agreement, entered into as of March 1, 2010, by and between the Company and Gudmundur Kristjansson (incorporated herein by reference to Exhibit 10.4 to the Company's Annual Report on Form 10-K for the year ended December 31, 2014 (Commission File No. 1-13991)). |
| 10.3     | Employment Agreement, entered into as of March 1, 2010, by and between the Company and Sunil Yadav (incorporated herein by reference to Exhibit 10.5 to the Company's Annual Report on Form 10-K for the year ended December 31, 2014 (Commission File No. 1-13991)).  |
| 10.4     | Amendment No. 1, dated February 9, 2015, to Employment Agreement, entered into as of March 1, 2010, by and between the Company and Sunil Yadav (incorporated herein by reference to Exhibit 10.6 to the Company's Annual Report on Form 10-K for the year ended December 31, 2014 (Commission File No. 1-13991)).            |
| 31.1     | Certification of the Chief Executive Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.  |
| 31.2     | Certification of the Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.  |
| 32.1     | Certification of the Chief Executive Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.  |
| 32.2     | Certification of the Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.  |
| 101.INS* | XBRL Instance Document   |
| 101.SCH* | XBRL Taxonomy Extension Schema Document  |
| 101.CAL* | XBRL Taxonomy Extension Calculation Linkbase Document  |
| 101.DEF* | XBRL Taxonomy Extension Definition Linkbase Document   |
| 101.LAB* | XBRL Taxonomy Extension Label Linkbase Document  |
| 101.PRE* | XBRL Taxonomy Extension Presentation Linkbase Document   |



\*These interactive data files are furnished and deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.

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