Western Asset Mortgage Capital Corp
Form 10-Q
November 04, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q
(Mark One)
ý Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended September 30, 2016

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

For the transition period from to

Commission File Number: 001-35543
Western Asset Mortgage Capital Corporation
(Exact name of Registrant as specified in its charter)

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

Western Asset Mortgage Capital Corporation
385 East Colorado Boulevard
Pasadena, California 91101
(Address of Registrant's principal executive offices)

(626) 844-9400
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act (check one).

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

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

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

As of November 2, 2016, there were 41,919,801 shares, par value $0.01, of the registrant's common stock issued and outstanding.

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Part I
ITEM I. Financial Statements

Western Asset Mortgage Capital Corporation and Subsidiaries
Consolidated Balance Sheets
(in thousands—except share and per share data)

	September 30, 2016 (Unaudited)	December 31, 2015
Assets:		
Cash and cash equivalents	$ 30,965	$ 24,711
Mortgage-backed securities and other securities, at fair value ($2,660,129 and $2,777,717 pledged as collateral, at fair value, respectively)	2,692,672	2,851,127
Residential Whole-Loans, at fair value ($204,882 and $218,538 pledged as collateral, at fair value, respectively)	204,882	218,538
Securitized commercial loan, at fair value	24,138	25,000
Investment related receivable	12,123	572
Accrued interest receivable	25,285	22,621
Due from counterparties	270,398	249,563
Derivative assets, at fair value	127,862	21,915
Other assets	756	382
Total Assets (1)	$ 3,389,081	$ 3,414,429
Liabilities and Stockholders' Equity:		
Liabilities:		
Borrowings under repurchase agreements, net	$ 2,523,480	$ 2,585,667
Securitized debt, at fair value	10,621	11,000
Accrued interest payable	18,311	20,431
Investment related payables	—	66,146
Due to counterparties	6,047	9,950
Derivative liability, at fair value	330,799	180,177
Accounts payable and accrued expenses	2,689	2,078
Payable to related party	2,714	3,019
Dividend payable	12,995	24,313
Total Liabilities (2)	2,907,656	2,902,781
Commitments and contingencies		
Stockholders' Equity:		
Common stock: $0.01 par value, 500,000,000 shares authorized, 41,919,801 shares issued and outstanding, respectively	419	419
Preferred stock, $0.01 par value, 100,000,000 shares authorized and no shares outstanding	—	—
Additional paid-in capital	764,678	763,283
Retained earnings (accumulated deficit)	(283,672)	(252,054)
Total Stockholders' Equity	481,425	511,648
Total Liabilities and Stockholders' Equity	$ 3,389,081	$ 3,414,429

See notes to unaudited consolidated financial statements.

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Western Asset Mortgage Capital Corporation and Subsidiaries
Consolidated Balance Sheets (Continued)
(in thousands—except share and per share data)

	September 30, 2016 (unaudited)	December 31, 2015
(1) Assets of consolidated VIEs included in the total assets above:		
Residential Whole-Loans, at fair value ($204,882 and $218,538 pledged as collateral, at fair value, respectively)	$ 204,882	$ 218,538
Securitized commercial loan, at fair value	24,138	25,000
Investment related receivable	3,230	—
Accrued interest receivable	1,745	1,836
Total assets of consolidated VIEs	$ 233,995	$ 245,374
(2) Liabilities of consolidated VIEs included in the total liabilities above:		
Securitized debt, at fair value	$ 10,621	$ 11,000
Accrued interest payable	82	85
Accounts payable and accrued expenses	2	2
Total liabilities of consolidated VIEs	$ 10,705	$ 11,087

See notes to unaudited consolidated financial statements.

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Western Asset Mortgage Capital Corporation and Subsidiaries
Consolidated Statements of Operations
(in thousands—except share and per share data)
(Unaudited)

	For the three months ended September 30, 2016	For the three months ended September 30, 2015	For the nine months ended September 30, 2016	For the nine months ended September 30, 2015
Net Interest Income				
Interest income	$ 29,154	$ 35,821	$ 87,992	$ 117,656
Interest expense	7,685	6,981	23,391	19,960
Net Interest Income	21,469	28,840	64,601	97,696
Other Income (Loss)				
Realized gain (loss) on sale of investments, net	1,439	(2,482)	(4,968)	9,267
Other than temporary impairment	(4,978)	(5,917)	(22,131)	(14,884)
Unrealized gain (loss), net	15,292	24,723	47,571	10,284
Gain (loss) on derivative instruments, net	6,121	(41,363)	(53,214)	(76,511)
Other, net	(60)	(29)	(158)	1,744
Other Income (Loss)	17,814	(25,068)	(32,900)	(70,100)
Expenses				
Management fee to affiliate	2,604	2,761	7,945	8,133
Other operating expenses	188	799	809	1,472
General and administrative expenses:				
Compensation expense (including non-cash stock based compensation of $433, $509, $1,351 and $1,969, respectively)	868	857	2,254	3,006
Professional fees	723	882	3,947	3,261
Other general and administrative expenses	379	325	1,226	1,123
Total general and administrative expenses	1,970	2,064	7,427	7,390
Total Expenses	4,762	5,624	16,181	16,995
Income (loss) before income taxes	34,521	(1,852)	15,520	10,601
Income tax provision (benefit)	2,239	—	2,239	—
Net income (loss)	$ 32,282	$ (1,852)	$ 13,281	$ 10,601
Net income (loss) per Common Share — Basic	$ 0.77	$ (0.05)	$ 0.31	$ 0.24
Net income (loss) per Common Share — Diluted	$ 0.77	$ (0.05)	$ 0.31	$ 0.24
Dividends Declared per Share of Common Stock	$ 0.31	$ 0.60	$ 1.07	$ 1.91

See notes to unaudited consolidated financial statements.

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Western Asset Mortgage Capital Corporation and Subsidiaries
Consolidated Statements of Changes in Stockholders' Equity
(in thousands—except shares and share data)

	Common Stock		Additional Paid-In Capital	Retained Earnings (Accumulated) Deficit	Total
	Shares	Par			
Balance at December 31, 2014	41,719,801	$417	$ 760,925	$ (138,130)	$623,212
Grants of restricted stock	200,000	2	(2)	—	—
Vesting of restricted stock	—	—	2,301	—	2,301
Net loss	—	—	—	(9,484)	(9,484)
Dividends declared on common stock	—	—	59	(104,440)	(104,381)
Balance at December 31, 2015	41,919,801	$419	$ 763,283	$ (252,054)	$511,648
Vesting of restricted stock	—	—	1,351	—	1,351
Net income	—	—	—	13,281	13,281
Dividends declared on common stock	—	—	44	(44,899)	(44,855)
Balance at September 30, 2016 (unaudited)	41,919,801	$419	$ 764,678	$ (283,672)	$481,425

See notes to unaudited consolidated financial statements.

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Western Asset Mortgage Capital Corporation and Subsidiaries
Consolidated Statements of Cash Flows (Unaudited)
(in thousands)

	For the nine months ended September 30, 2016	For the nine months ended September 30, 2015
Cash flows from operating activities:		
Net income	$ 13,281	$ 10,601
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Premium amortization and (discount accretion) on investments, net	2,355	5,645
Interest income earned added to principal of securities	(300)	(141)
Amortization of deferred financing costs	135	295
Restricted stock amortization	1,351	1,969
Premium amortization for MAC interest rate swaps	(492)	(1,075)
Interest payments and basis recovered on MAC interest rate swaps	491	1,443
Premium on purchase of Residential Whole-Loans	(573)	(2,390)
Unrealized (gain) loss, net	(47,571)	(10,284)
Mark-to-market adjustments on derivative instruments	46,073	82,952
Other than temporary impairment	22,131	14,884
Realized (gain) loss on sale of securities, net	4,968	(9,267)
Realized (gain) loss on derivatives, net	(40,263)	14,558
(Gain) loss on foreign currency transactions, net	905	(1,664)
Changes in operating assets and liabilities:		
(Increase) decrease in accrued interest receivable	(2,664)	5,894
Increase in other assets	(374)	(279)
Increase (decrease) in accrued interest payable	(2,120)	4,146
Increase in accounts payable and accrued expenses	911	468
Increase (decrease) in payable to related party	(305)	92
Net cash (used in) provided by operating activities	(2,061)	117,847
Cash flows from investing activities:		
Purchase of securities	(1,450,137)	(570,441)
Proceeds from sale of securities	1,295,969	2,087,678
Principal payments and basis recovered on securities	252,076	315,106
Purchase of Residential Whole-Loans	(28,825)	(147,336)
Principal payments on Residential Whole-Loans	39,597	9,077
Purchase of Commercial Whole-Loans	—	(8,750)
Principal payments on Commercial Whole-Loans	—	8,750
Payment of premium for option derivatives	(17,951)	(10,864)
Premium received from option derivatives	22,707	11,548
Net settlements of TBAs	12,166	466
Net payments on termination of futures	19,253	(627)
Proceeds from sale of interest rate swaptions	2,075	27,899
Premium for MAC interest rate swaps	465	(3,595)
Payments on termination of MAC interest rate swaps	—	(190)
Interest payments and basis recovered on MAC interest rate swaps	(491)	(1,041)

Due from counterparties	(9,719)	—
Payment on termination of foreign currency swaps	5,351	—
Payments on total return swaps	17	—
Proceeds from (payments made) on reverse repurchase agreements, net	—	(758,467)
Premium for interest rate swaptions, net	—	(34,751)
Net cash provided by investing activities	142,553	924,462

Cash flows from financing activities:

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Western Asset Mortgage Capital Corporation and Subsidiaries
Consolidated Statements of Cash Flows (Unaudited) (Continued)
(in thousands)

	For the nine months ended September 30, 2016	For the nine months ended September 30, 2015
Proceeds from repurchase agreement borrowings	10,675,773	13,645,855
Repayments of repurchase agreement borrowings	(10,738,416)	(14,541,717)
Proceeds from (repayment of) cash overdraft	(300)	—
Proceeds from forward contracts	82,020	206,240
Repayments of forward contracts	(82,110)	(207,220)
Payments on termination of MAC interest rate swaps	—	(18,655)
Interest payments and basis recovered on MAC interest rate swaps containing an other-than-insignificant financing element	—	(402)
Payments made for deferred financing costs	(58)	(463)
Due from counterparties, net	(11,116)	(51,768)
Due to counterparties, net	(3,903)	2,251
Dividends paid on common stock	(56,173)	(84,119)
Net cash used in financing activities	(134,283)	(1,049,998)
Effect of exchange rate changes on cash and cash equivalents	45	170
Net increase (decrease) in cash and cash equivalents	6,254	(7,519)
Cash and cash equivalents beginning of period	24,711	47,222
Cash and cash equivalents end of period	$ 30,965	$ 39,703
Supplemental disclosure of operating cash flow information:		
Interest paid	$ 22,850	$ 20,363
Income taxes paid	$ 1,567	$ —
Supplemental disclosure of non-cash financing/investing activities:		
Securities sold, not settled	$ 8,893	$ —
Obligation to return collateral used to settle short sales	$ —	$ (757,353)
Net unsettled TBAs	$ —	$ (8)
Dividends and distributions declared, not paid	$ 12,995	$ 25,152
Principal payments of Residential Whole-Loans, not settled	$ 3,230	$ —

See notes to unaudited consolidated financial statements.

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Western Asset Mortgage Capital Corporation and Subsidiaries
Notes to Consolidated Financial Statements (Unaudited)
(in thousands- except share and per share data)

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

Note 1 — Organization

Western Asset Mortgage Capital Corporation a Delaware corporation and its subsidiaries (the "Company") commenced operations in May 2012. The Company invests in, finances and manages a diversified portfolio of real estate related securities, whole-loans and other financial assets. The Company's portfolio is comprised of Agency RMBS (including TBAs as defined herein), Non-Agency RMBS, Agency and Non-Agency CMBS and Whole-Loans. In addition, and to a significantly lesser extent, the Company has invested in other securities including certain Agency obligations that are not technically MBS as well as certain Non U.S. CMBS and in asset-backed securities ("ABS") investments secured by a portfolio of private student loans. The Company's investment strategy is based on Western Asset Management Company's (the "Manager") perspective of which mix of portfolio assets it believes provides the Company with the best risk-reward opportunities at any given time. The Manager will vary the allocation among various asset classes subject to maintaining the Company's qualification as a REIT and maintaining its exemption from the Investment Company Act of 1940 (the "1940 Act"). These restrictions limit the Company's ability to invest in non-qualifying MBS, non-real estate assets and/or assets which are not secured by real estate. Accordingly, the Company's portfolio will continue to be principally invested in qualifying MBS and other real estate related assets.

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

Note 2 — Summary of Significant Accounting Policies

Basis of Presentation and Consolidation

The accompanying unaudited financial statements and related notes have been prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP") for interim financial reporting in accordance with Article 10 of Regulation S-X and the instructions to Form 10-Q. Certain prior period amounts have been reclassified to conform to the current period's presentation. In the opinion of management, all adjustments (which include only normal recurring adjustments) necessary have been made to present fairly the Company's financial position, results of operations and cash flows. The results of operations for the period ended September 30, 2016 are not necessarily indicative of the results to be expected for the full year or any future period. These consolidated

financial statements should be read in conjunction with the Company's annual report on Form 10-K for the year ended December 31, 2015, filed with the Securities and Exchange Commission ("SEC") on March 11, 2016.

The consolidated financial statements include the accounts of the Company, its wholly-owned subsidiaries and variable interest entities ("VIEs") in which we are considered the primary beneficiary. Refer to Note 5 - "Variable Interest Entities" for additional information regarding the impact of consolidating these VIEs. All intercompany amounts between the Company and its subsidiary and consolidated VIEs have been eliminated in consolidation.

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Variable Interest Entities

VIEs are defined as entities that by design either lack sufficient equity for the entity to finance its activities without additional subordinated financial support or are unable to direct the entity's activities or are not exposed to the entity's losses or entitled to its residual returns. The Company evaluates all of its interests in VIEs for consolidation. When the interests are determined to be variable interests, the Company assesses whether it is deemed the primary beneficiary. The primary beneficiary of a VIE is determined to be the party that has both the power to direct the activities of a VIE that most significantly impact the VIE's economic performance and the obligation to absorb losses or the right to receive benefits of the VIE that could potentially be significant to the VIE.

To assess whether the Company has the power to direct the activities of a VIE that most significantly impact the VIE's economic performance, it considers all facts and circumstances, including its role in establishing the VIE and its ongoing rights and responsibilities. This assessment includes first, identifying the activities that most significantly impact the VIE's economic performance; and second, identifying which party, if any, has power over those activities. In general, the parties that make the most significant decisions affecting the VIE or have the right to unilaterally remove those decision makers is deemed to have the power to direct the activities of a VIE.

To assess whether the Company has the obligation to absorb losses of the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE, it considers all of its economic interests. This assessment requires the Company to apply judgment in determining whether these interests, in the aggregate, are considered potentially significant to the VIE. Factors considered in assessing significance include: the design of the VIE, including its capitalization structure; subordination of interests; payment priority; relative share of interests held across various classes within the VIE's capital structure; and the reasons why the interests are held by the Company.

In instances when a VIE is owned by both the Company and related parties, the Company considers whether there is a single party in the related party group that meets both the power and losses or benefits criteria on its own as though no related party relationship existed. If one party within the related party group meets both these criteria, such reporting entity is the primary beneficiary of the VIE and no further analysis is needed. If no party within the related party group on its own meets both the power and losses or benefits criteria, but the related party group does as a whole meets these two criteria, the determination of primary beneficiary within the related party group is based upon an analysis of the facts and circumstances with the objective of determining which party is most closely associated with the VIE. Determining the primary beneficiary within the related party group requires significant judgment.

In instances when the Company is required to consolidate a VIE that is determined to be a qualifying collateralized financing entity, under GAAP, the Company will measure both the financial assets and financial liabilities of the VIE using the fair value of either the VIE's financial assets or financial liabilities, whichever is more observable.

Ongoing assessments of whether an enterprise is the primary beneficiary of a VIE are required.

Use of Estimates

The preparation of consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Cash and Cash Equivalents

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

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Fair Value Election

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

Valuation of financial instruments

The Company discloses the fair value of its financial instruments according to a fair value hierarchy (Levels I, II, and III, as defined below) in accordance with GAAP. GAAP establishes a framework for measuring fair value and expands financial statement disclosure requirements for fair value measurements. GAAP further specifies a hierarchy of valuation techniques, which is based on whether the inputs into the valuation technique are observable or unobservable. The hierarchy is as follows:

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

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

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

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

When available, the Company uses quoted market prices to determine the fair value of an asset or liability. If quoted market prices are not available, the Company will use independent pricing services and if the independent pricing service cannot price a particular asset or liability, the Company will obtain third party broker quotes. The Manager's pricing group, which functions independently from its portfolio management personnel, reviews the third party broker quotes for reasonableness using alternate sources when available. If independent pricing service, or third party broker quotes are not available, the Company determines the fair value of the securities using valuation techniques that use, when possible, current market-based or independently-sourced market parameters, such as interest rates and when applicable, estimates of prepayment and credit losses.

Mortgage-Backed Securities and Other Securities

The Company's purchases and sales of mortgage-backed securities and other securities are recorded on the trade date, which results in an investment related payable (receivable) for MBS and other securities purchased (sold) for which settlement has not taken place as of the balance sheet date. In addition, the Company's TBAs (as defined herein) which have matured but have not settled as of the balance sheet date result in an investment related payable (receivable). The Company's MBS and other securities are pledged as collateral against borrowings under repurchase agreements. The Company's MBS and other securities are included in Mortgage-backed securities and other securities at fair value and Investment related receivables in the Consolidated Balance Sheets, with the fair value of such MBS and other securities pledged disclosed parenthetically.

Residential Whole- Loans

The Company records its purchases of residential loans on settlement date as the amount paid to the seller plus any fees paid or less any fees received. All other costs incurred in connection with acquiring residential and commercial loans or committing to purchase residential and commercial loans are charged to expense as incurred. The Company amortizes or accretes any premium or discount over the life of the related loan utilizing the effective interest method, based on the contractual payment terms of the loan. On at least a quarterly basis, the Company evaluates the collectability of both interest and principal of each loan, if circumstances warrant, to determine whether such loan is impaired. A loan is impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the existing contractual terms. When a loan is impaired, the Company does not record an allowance for loan loss as the Company has elected the fair value option. However, income recognition is suspended for loans at the earlier of the date at which payments become 90-days past due or when,

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in the opinion of management, a full recovery of income and principal becomes doubtful. When the ultimate collectability of the principal of an impaired loan is in doubt, all payments are applied to principal under the cost recovery method. When the ultimate collectability of the principal of an impaired loan is not in doubt, contractual interest is recorded as interest income when received, under the cash basis method until an accrual is resumed when the loan becomes contractually current and performance is demonstrated to be resumed. A loan is written off when it is no longer realizable and/or legally discharged.

Interest income recognition and Impairment

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

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

The Company assesses its Agency MBS, Non-Agency MBS and other securities, excluding Interest-Only Strips, rated AA and higher at the time of purchase, for other-than-temporary impairment ("OTTI") on at least a quarterly basis. The determination of whether a security is other-than-temporarily impaired involves judgment and assumptions based on subjective and objective factors. When the fair value of an investment is less than its amortized cost at the balance sheet date, during a reporting period, the security is considered impaired and the impairment is designated as either "temporary" or "other-than-temporary." In deciding on whether or not a security is other-than-temporarily impaired, the Company considers several factors, including the nature of the investment, communications (if any) from the trustee of securitization regarding the credit quality of the security, the severity and duration of the impairment and the cause of the impairment. When a security is impaired an OTTI is considered to have occurred if there is an adverse change in the expected cash flows (principal or interest) to be received and the fair value of the security is less than its carrying amount and either the Company intends to sell the security or it is more likely than not that the Company will be required to sell the security before recovery of its amortized cost. In determining whether an adverse change in cash flows occurred, the present value of the remaining cash flows, as estimated at the initial transaction date (or the last date previously revised), is compared to the present value of the expected cash flows at the current reporting date. The estimated cash flows reflect those a "market participant" would use and are discounted at a rate equal to the current yield used to accrete interest income. The OTTI is recorded in the Company's Consolidated Statements of Operations.

The determination as to whether OTTI exists is subjective given that such determination is based on information available at the time of assessment as well as the Company's estimates of the future performance and cash flow projections on the security. As a result, the timing and amount of an OTTI constitutes an accounting estimate that may change materially over time.

Finally, certain of the Company's MBS and other securities that are in an unrealized loss position at the end of the reporting period are not considered other-than-temporarily impaired because the Company has the ability and intent to hold the securities to maturity or for a period of time sufficient for a price recovery up to or above the amortized cost of the investment and the Company is not required to sell the security for regulatory or other reasons.

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

Interest income on Non-Agency MBS and other securities that are rated below AA at the time of purchase and Interest-Only Strips that are not classified as derivatives are recognized based on the effective yield method. The effective yield on these securities is based on the projected cash flows from each security, which is estimated based on the Company's observation of the then current information and events, where applicable, and will include assumptions related to interest rates, prepayment rates and the timing and amount of credit losses. On at least a quarterly basis, the Company reviews and, if appropriate, makes adjustments to its cash flow projections based on input and analysis received from external sources, internal models, and its judgment about interest rates, prepayment rates, the timing and amount of credit losses, and other factors. Where appropriate, the Company may include in its cash flow projections the U.S. Department of Justice's settlements with the major residential mortgage originators, regarding certain lending practices. Changes in cash flows from those originally projected, or from those estimated at the last evaluation, may result in a prospective change in the yield/interest income recognized on such securities. Actual maturities of the

securities are affected by the contractual lives of the underlying collateral, periodic payments of scheduled principal, and prepayments of principal. Therefore, actual maturities of the securities will generally be shorter than stated contractual maturities.

Based on the projected cash flow of such securities purchased at a discount to par value, the Company may designate a portion of such purchase discount as credit protection against future credit losses and, therefore, not accrete such amount into interest income. The amount designated as credit discount may be adjusted over time, based on the actual performance of the security, its underlying collateral, actual and projected cash flow from such collateral, economic conditions and other factors. If the performance of a security with a credit discount is more favorable than forecasted, a portion of the amount designated as credit discount may be accreted into interest income prospectively.

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

Securities denominated in a foreign currency contain additional risk in that the amortized cost basis for those securities may not be recovered due to declines in currency exchange rates. The Company considers the length of time that the security’s fair value has declined due to the decline in foreign exchange rates, when assessing OTTI.

The determination as to whether OTTI exists is subjective given that such determination is based on information available at the time of assessment as well as the Company’s estimates of the future performance and cash flow projections on the security. As a result, the timing and amount of an OTTI constitutes an accounting estimate that may change materially over time.

Finally, certain of the Company’s MBS and other securities that are in an unrealized loss position at the end of the reporting period are not considered other-than-temporarily impaired because the Company has the ability and intent to hold the securities to maturity or for a period of time sufficient for a price recovery up to or above the amortized cost of the investment and the Company is not required to sell the security for regulatory or other reasons.

Sales of Investments

Sales of investments are driven by the Company’s portfolio management process. The Company seeks to mitigate risks including those associated with prepayments, defaults and severities, amongst others and will opportunistically rotate the portfolio into securities and/or other investments the Company’s Manager believes have more favorable attributes. Strategies may also be employed to manage net capital gains, which need to be distributed for tax purposes.

Realized gains or losses on sales of investments, including Agency Interest-Only Strips not characterized as derivatives, are included in Realized gain (loss) on sale of investments, net in the Consolidated Statements of Operations, and are recorded at the time of disposition. Realized gains or losses on Interest-Only Strips which are characterized as derivatives are included in Gain (loss) on derivative instruments, net in the Consolidated Statements of Operations. The cost of positions sold is calculated using the specific identification method.

Foreign currency transactions

The Company has and expects to continue to enter into transactions denominated in foreign currency from time to time. At the date the transaction is recognized, the asset and/or liability will be measured and recorded using the exchange rate in effect at the date of the transaction. At each balance sheet date, such foreign currency assets and liabilities are re-measured using the exchange rate in effect at the date of the balance sheet, resulting in unrealized foreign currency gains or losses. Unrealized foreign currency gains or losses on MBS and other assets are recorded in Unrealized gain (loss), net in the Consolidated Statement of Operations. In addition, the Company evaluates whether an OTTI is deemed to have occurred on MBS and other assets denominated in a foreign currency. Cash flows from MBS and other assets denominated in foreign currencies are received in a foreign currency, and as a result, the Company may incur a loss due to changes in foreign exchange rates even when all contractual cash flows are received. These adjustments are reflected in the Consolidated Statements of Operations as Other than temporary impairment. Unrealized and realized foreign currency gains or losses on borrowings under repurchase agreements are recorded in Other, net in the Consolidated Statement of Operations. Interest income from investments denominated in a foreign currency and interest expense on borrowings denominated in a foreign currency are recorded at the average rate of exchange during the period.

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Due from counterparties/Due to counterparties

Due from counterparties represents cash posted by the Company with its counterparties as collateral for the Company's interest rate and/or currency derivative financial instruments, repurchase agreements, and TBAs. Due to counterparties represents cash posted with the Company by its counterparties as collateral under the Company's interest rate and/or currency derivative financial instruments, repurchase agreements, and TBAs. Included in the due from counterparties and/or due to counterparties are daily variation margin settlement amounts with counterparties which are based on the price movement of the Company's futures contracts. In addition, as provided below, Due to counterparties may include non-cash collateral in which the Company has the obligation to return and which the Company has either sold or pledged. To the extent the Company receives collateral other than cash from its counterparties such assets are not included in the Company's Consolidated Balance Sheets. Notwithstanding the foregoing, if the Company either rehypothecates such assets or pledges the assets as collateral pursuant to a repurchase agreement, the cash received and the corresponding liability are reflected in the Consolidated Balance Sheets.

Derivatives and hedging activities

Subject to maintaining its qualification as a REIT for U.S. federal income tax purposes, the Company utilizes derivative financial instruments, including interest rate swaps, interest rate swaptions, mortgage put options, currency forwards, futures contracts, TBAs and Agency and Non-Agency Interest-Only Strips to hedge the interest rate and currency risk associated with its portfolio and related borrowings. Derivatives, subject to REIT requirements, are used for hedging purposes rather than speculation. The Company has also entered into a total return swap, which transfers the total return of a referenced security to the Company. The Company determines the fair value of its derivative positions and obtains quotations from third parties, including the Chicago Mercantile Exchange or CME, to facilitate the process of determining such fair values. If the Company's hedging activities do not achieve the desired results, reported earnings may be adversely affected.

GAAP requires an entity to recognize all derivatives as either assets or liabilities on the balance sheet and to measure those instruments at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative. The fair value adjustment will affect either other comprehensive income in stockholders' equity until the hedged item is recognized in earnings or net income depending on whether the derivative instrument is designated and qualifies as a for hedge for accounting purposes and if so, the nature of the hedging activity. The Company elected not to apply hedge accounting for its derivative instruments. Accordingly, the Company records the change in fair value of its derivative instruments, which includes net interest rate swap payments/receipts (including accrued amounts) and net currency payments (including accrued amounts) related to interest rate swaps and currency swaps, respectively, in Gain (loss) on derivative instruments, net in its Consolidated Statements of Operations.

In the Company's Consolidated Statements of Cash Flows, premiums received or paid on termination of its interest rate swaps, excluding interest rate swaps containing an other-than-insignificant financing element and the unamortized premium of market agreed coupon ("MAC") interest rate swaps, are included in cash flows from operating activities. Notwithstanding the foregoing, proceeds and payments on settlement of swaptions, mortgage put options, futures contracts and TBAs are included in cash flows from investing activities. Proceeds and payments on settlement of forward contracts are reflected in cash flows from financing activities in the Company's Consolidated Statements of Cash Flows. While payments made at the time of entering MAC interest rate swaps are included in cash flows from investing activities, payments received by the Company upon entering MAC interest rate swaps are included in either cash flows from investing activities or cash flows financing activities, depending on whether or not the derivative instrument includes an other-than-insignificant financing element. For MAC interest rate swaps containing an other-than-insignificant financing element, all cash flows over the life of the derivative are treated as cash flows from financing activities. Return and recovery of basis activity for MAC interest rate swaps is included in cash flows from

investing activities for swaps not containing an other-than-insignificant financing element in the Company's Consolidated Statements of Cash Flows. For Agency and Non-Agency Interest-Only Strips accounted for as derivatives, the purchase, sale and recovery of basis activity is included with MBS and other securities under cash flows from investing activities in the Company's Consolidated Statements of Cash Flows.

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

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Repurchase agreements and Reverse Repurchase agreements

The Company pledges its investments as collateral under repurchase agreements, which are treated as collateralized financing transactions, unless they meet sales treatment. The terms and conditions of the repurchase agreements are negotiated on a transaction by transaction basis. The borrowed amounts are dependent upon the fair value of the investment pledged as collateral, which fluctuates with changes in interest rates, type of investment and liquidity in the real estate markets. Declines in fair value of pledged investments may result in lenders requiring the Company to post additional collateral or pay down borrowings to re-establish borrowing limits. Interest paid and accrued in connection with the Company's repurchase agreements is recorded as interest expense in the Consolidated Statements of Operations.

The Company may borrow securities under reverse repurchase agreements to deliver a security owned and sold by the Company but pledged to a different counterparty under a separate repurchase agreement when in the Manager's view terminating the outstanding repurchase agreement is not in the Company's interest. Cash paid to the borrower is recorded in the Company's Consolidated Balance Sheets as an asset. Interest receivable in accordance with reverse repurchase agreements is recorded as accrued interest receivable in the Consolidated Balance Sheets. The Company reflects all proceeds on reverse repurchase agreement and repayment of reverse repurchase agreement, on a net basis in the Consolidated Statements of Cash Flows. Upon sale of a pledged security, the Company recognizes an obligation to return the borrowed security in the Consolidated Balance Sheets in Due to Counterparties. The Company establishes haircuts to ensure the market value of the underlying asset remains sufficient to protect the Company in the event of default by the counterparty. Realized gains and losses associated with the sale of the security are recognized in Realized gain (loss) on sale of investments, net in the Consolidated Statement of Cash Flows.

Securitized debt

Securitized debt was issued at par by a consolidated securitization trust. The Company elected the fair value option for the debt and as a result all changes in fair value are reflected in Unrealized gain (loss), net in the Consolidated Statement of Operations.

Share-based compensation

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

Warrants

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

Income taxes

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

The dividends paid deduction for qualifying dividends paid to stockholders is computed using the Company's taxable income as opposed to net income reported in the consolidated financial statements. Taxable income, generally, will differ from

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net income reported in the consolidated financial statements because the determination of taxable income is based on tax regulations and not GAAP.

The Company has elected to treat a wholly-owned subsidiary as a domestic Taxable REIT Subsidiary (“TRS”) and in the future may create and elect other subsidiaries as either a domestic or foreign 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 domestic TRS is subject to U.S. federal, state and local corporate income taxes, and its value may not exceed 25% of the value of the Company. While a TRS may generate net income, a TRS can declare dividends to the Company, which will be included in the Company’s taxable income and necessitate a distribution to its stockholders. Conversely, if the Company retains earnings at the TRS level, no distribution is required and it can increase book equity of the consolidated entity.

Current and deferred taxes are recorded on earnings (losses) recognized by the Company's TRS. Deferred income tax assets and liabilities are calculated based upon temporary differences between the Company's U.S. GAAP consolidated financial statements and the federal and state basis of assets and liabilities as of the consolidated balance sheet date. The Company evaluates the realizability of its deferred tax assets and recognizes a valuation allowance if, based on available evidence, it is more likely than not that some or all of its deferred tax assets will not be realized. In evaluating the realizability of the deferred tax asset, the Company will consider the expected future taxable income, existing and projected book to tax differences as well as tax planning strategies. This analysis is inherently subjective, as it is based on forecasted earning and business and economic activity. Changes in estimates of deferred tax asset realizability, if any, are included in the provision for income tax provision (benefit) in the Consolidated Statement of Operations.

Offering costs

Offering costs borne by the Company in connection with common stock offerings and private placements are reflected as a reduction of additional paid-in-capital.

Earnings per share

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

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

Comprehensive Income (Loss)

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

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Accounting standards applicable to emerging growth companies

The JOBS Act contains provisions that relax certain requirements for “emerging growth companies”, which includes the Company. For as long as the Company is an emerging growth company, which may be up to five full fiscal years, unlike other public companies, the Company will not be required to: (i) comply with any new or revised financial accounting standards applicable to public companies until such standards are also applicable to private companies under Section 102(b)(1) of the JOBS Act; (ii) provide an auditor’s attestation report on management’s assessment of the effectiveness of the Company’s system of internal control over financial reporting pursuant to Section 404 of the Sarbanes-Oxley Act; (iii) comply with any new requirements adopted by the PCAOB requiring mandatory audit firm rotation or a supplement to the auditor’s report in which the auditor would be required to provide additional information about the audit and the financial statements of the issuer; or (iv) comply with any new audit rules adopted by the PCAOB after April 5, 2012, unless the SEC determines otherwise. The Company currently takes advantage of some of these exemptions. The Company’s qualification for remaining an emerging growth company under the five full fiscal years expires on December 31, 2017. However, the Company will no longer qualify for such exemption if its gross revenue for any year equals or exceeds $1.0 billion, the Company issues more than $1.0 billion in non-convertible debt during the three previous years, or if the Company is deemed to be a large accelerated filer.

Recent accounting pronouncements

Accounting Standards Adopted in 2016

In January 2015, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2015-1, “Income Statement - Extraordinary and Unusual Items.” The guidance simplifies income statement presentation by eliminating the concept of extraordinary items. U.S. GAAP currently requires that a company separately classify, disclose and present extraordinary events and transactions. The guidance eliminates the concept of extraordinary items from U.S. GAAP. Under the existing guidance, an entity is required to separately disclose extraordinary items, net of tax, in the income statement after income from continuing operations if an event or transaction is of an unusual nature and occurs infrequently. This separate, net-of-tax presentation (and corresponding earnings per share impact) will no longer be allowed. The existing requirement to separately present items that are of an unusual nature or occur infrequently on a pre-tax basis within income from continuing operations has been retained. The new guidance also requires similar separate presentation of items that are both unusual and infrequent. The standard is effective for periods beginning after December 15, 2015. The effective date is the same for both public companies and all other entities. The 2016 adoption of the new guidance did not have a material impact on the Company’s consolidated financial statements.

In February 2015, the FASB issued ASU 2015-2, “Consolidation - Amendments to the Consolidation Analysis.” The guidance simplifies and reduces the number of consolidation models through the elimination of an indefinite deferral for certain entities and by placing more emphasis on risk of loss when determining a controlling financial interest. The guidance affects reporting entities that are required to evaluate whether they should consolidate certain legal entities. All legal entities are subject to reevaluation under the revised consolidation model. The standard is effective for a public company for fiscal years, and for interim periods within fiscal years beginning after December 15, 2015. The 2016 adoption of the new guidance did not have a material impact on the Company’s consolidated financial statements.

In April 2015, the FASB issued ASU 2015-3, “Interest - Imputation of Interest - Simplifying the Presentation of Debt Issuance Costs.” The guidance amends the presentation of debt issuance cost related to a recognized debt liability. Under the new guidance, the debt issuance costs were presented in the balance sheet as a direct deduction from the carrying amount of the recognized debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected under the new guidance. The standard is effective for a public

company for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. The guidance should be applied on a retrospective basis. The Company's December 31, 2015 balance sheet was adjusted to reflect the effects of applying the new guidance on a retrospective basis and resulted in a $134 thousand reduction in Borrowings under repurchase agreements and a corresponding reduction in Other assets. Upon adoption, an entity is required to comply with the applicable disclosures for a change in an accounting principle. These disclosures include the nature of and reason for the change in accounting principle, the transition method, a description of the prior-period information that has been retrospectively adjusted, and the effect of the change on the financial statement line items (i.e., debt issuance cost asset and the debt liability). The 2016 adoption of the new guidance did not have a material impact on the Company's consolidated financial statements.

Accounting Standards to be Adopted in Future Periods

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In May 2014, the FASB issued ASU 2014-9, "Revenue from Contracts with Customers (Topic 606)." The guidance changes an entity's recognition of revenue from contracts with customers. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In addition, the new guidance requires improved disclosures to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. In March 2016, the FASB issued implementation guidance which clarifies principal versus agent considerations in reporting revenue gross versus net (ASU 2016-8). In April 2016, the FASB issued implementation guidance which clarifies the identification of performance obligations (ASU 2016-10). In applying the new guidance, an entity may use either a retrospective approach to each prior reporting period or a retrospective approach with the cumulative effect recognized at the date of initial application. For a public company, the standard is effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. Early adoption is not permitted for a public entity. The new guidance is not expected to have a material impact on the Company's consolidated financial statements.

In August 2014, the FASB issued ASU 2014-15, "Presentation of Financial Statements — Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern." The guidance requires an entity's management to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures. According to the new guidance, substantial doubt exists when conditions and events, considered in the aggregate, indicate that it is probable that the entity will be unable to meet its obligations as they become due within one year after the date the financial statements are issued. The term "probable" is used consistently with its current use in U.S. GAAP for loss contingencies. Disclosures will be required if conditions give rise to substantial doubt about the entity's ability to continue as a going concern, including whether management's plans that are intended to mitigate those conditions will alleviate the substantial doubt when implemented. The guidance is effective for annual periods ending after December 15, 2016. The effective date is the same for both public companies and all other entities. Early application is permitted. The Company's first assessment under the new guidance will be completed for the year ending December 31, 2016.

In January 2016, the FASB issued ASU 2016-1, "Financial Instruments — Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities." The guidance improves certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. The standard is effective for a public company for fiscal years beginning after December 15, 2017, and for interim periods within those fiscal years. Early adoption by public companies for fiscal years or interim periods that have not yet been issued or, by all other entities, that have not yet been made available for issuance of this guidance are permitted as of the beginning of the fiscal year of adoption, under certain restrictions. The Company should apply the guidance by means of a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption. The guidance related to equity securities without readily determinable fair values should be applied prospectively to equity investments that exist at the date of adoption. The Company is currently assessing the impact that this guidance will have on its consolidated financial statements when adopted.

In March 2016, the FASB issued ASU 2016-9, "Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting." The guidance changes the accounting for certain aspects of share-based payments to employees. The guidance requires the recognition of the income tax effects of awards in the income statement when the awards vest or are settled, thus eliminating additional paid in capital pools. The guidance also allows for the employer to repurchase more of an employee's shares for tax withholding purposes without triggering liability accounting. In addition, the guidance allows for a policy election to account for forfeitures as they occur rather than on an estimated basis. For a public company, the standard is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Early adoption is permitted in any interim or annual period. The Company is currently assessing the impact that this guidance will have

on its consolidated financial statements when adopted.

In June 2016, the FASB issued ASU 2016-13, “Financial Instruments — Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.” The guidance requires financial assets measured at amortized cost basis to be presented at the net amount expected to be collected by deducting an allowance for credit losses from the amortized cost basis of the financial assets. For available-for-sale debt securities, the new guidance aligns the income statement recognition of credit losses with the reporting period in which changes occur by recording credit losses through an allowance rather than a write-down and allowing subsequent reversals in credit loss estimates to be recognized in current income. The measurement of expected credit losses will be based on historical experience, current conditions and reasonable and supportable forecasts. An entity must use judgment in determining the relevant information and estimation methods that are appropriate in its circumstances. For a public company, the standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Early adoption will be permitted for fiscal years beginning after December 15, 2018. The guidance should be applied through a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective. For certain

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assets, a prospective transition approach is required. The Company is currently assessing the impact that this guidance will have on its consolidated financial statements when adopted.

In August 2016, the FASB issued ASU 2016-15, "Statement of Cash Flows - Classification of Certain Cash Receipts and Cash Payments (Topic 230)." The guidance is intended to reduce diversity in practice in how certain transactions are classified on the statement of cash flows. The Company is required to adopt the new guidance in the first quarter of 2018. Early adoption is permitted, provided that all of the amendments are adopted at the same time. The Company is currently assessing the impact that this guidance will have on its consolidated financial statements when adopted.

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Note 3 — Fair Value of Financial Instruments

The following tables present the Company's financial instruments carried at fair value as of September 30, 2016 and December 31, 2015, based upon the valuation hierarchy (dollars in thousands):

	September 30, 2016			
	Fair Value			
	Level I	Level II	Level III	Total
Assets				
Agency RMBS:				
20-Year mortgage	$—	$544,483	$—	$544,483
30-Year mortgage	—	1,253,640	—	1,253,640
Agency RMBS Interest-Only Strips	—	28,007	—	28,007
Agency RMBS Interest-Only Strips accounted for as derivatives, included in MBS	—	25,438	—	25,438
Agency CMBS	—	4,283	—	4,283
Agency CMBS Interest-Only Strips	—	605	—	605
Agency CMBS Interest-Only Strips accounted for as derivatives, included in MBS	—	8,850	—	8,850
Subtotal Agency MBS	—	1,865,306	—	1,865,306
Non-Agency RMBS	—	234,885	74,610	309,495
Non-Agency RMBS Interest-Only Strips	—	—	81,477	81,477
Non-Agency Interest-Only Strips accounted for as derivatives, included in MBS	—	—	4,170	4,170
Non-Agency CMBS	—	351,726	17,172	368,898
Subtotal Non-Agency MBS	—	586,611	177,429	764,040
Other securities	—	32,962	30,364	63,326
Total mortgage-backed securities and other securities	—	2,484,879	207,793	2,692,672
Residential Whole-Loans	—	—	204,882	204,882
Securitized commercial loan	—	—	24,138	24,138
Derivative assets	69	127,793	—	127,862
Total	$69	$2,612,672	$436,813	$3,049,554
Liabilities				
Derivative liabilities	$—	$328,628	$2,171	$330,799
Securitized debt	—	—	10,621	10,621
Total	$—	$328,628	$12,792	$341,420

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	December 31, 2015			
	Fair Value			
	Level	Level II	Level III	Total
Assets				
Agency RMBS:				
20-Year mortgage	$—	$687,272	$—	$687,272
30-Year mortgage	—	926,459	—	926,459
Agency RMBS Interest-Only Strips	—	71,954	—	71,954
Agency RMBS Interest-Only Strips accounted for as derivatives, included in MBS	—	45,362	—	45,362
Agency CMBS	—	—	24,690	24,690
Agency CMBS Interest-Only Strips	—	2,113	—	2,113
Agency CMBS Interest-Only Strips accounted for as derivatives, included in MBS	—	11,069	—	11,069
Subtotal Agency MBS	—	1,744,229	24,690	1,768,919
Non-Agency RMBS	—	278,885	166,564	445,449
Non-Agency RMBS Interest-Only Strips	—	—	81,189	81,189
Non-Agency RMBS Interest-Only Strips accounted for as derivatives, included in MBS	—	—	3,556	3,556
Non-Agency CMBS	—	332,574	118,341	450,915
Subtotal Non-Agency MBS	—	611,459	369,650	981,109
Other securities	—	29,103	71,996	101,099
Total mortgage-backed securities and other securities	—	2,384,791	466,336	2,851,127
Residential Whole-Loans	—	—	218,538	218,538
Securitized commercial loan	—	—	25,000	25,000
Derivative assets	63	21,852	—	21,915
Total	$63	$2,406,643	$709,874	$3,116,580
Liabilities				
Derivative liabilities	$698	$179,479	$—	$180,177
Securitized debt	—	—	11,000	11,000
Total	$698	$179,479	$11,000	$191,177

When available, the Company uses quoted market prices to determine the fair value of an asset or liability. If quoted market prices are not available, the Company will use independent pricing services and if the independent pricing service cannot price a particular asset or liability, the Company will obtain third party broker quotes. The Manager's pricing group, which functions independently from its portfolio management personnel, reviews the third party broker quotes for reasonableness to alternate sources when available. If independent pricing service, or third party broker quotes are not available, the Company determines the fair value of the securities using valuation techniques that use, when possible, current market-based or independently-sourced market parameters, such as interest rates and when applicable, estimates of prepayments and credit losses.

Mortgage-backed securities and other securities

In determining the proper fair value hierarchy or level, all securities are initially classified in Level III. The Company further determined, given the amount of available observable market data, Agency RMBS should be classified in

Level II. For Non-Agency RMBS, CMBS and other securities, to determine whether a security should be a Level II, the securities are grouped by security type and the Manager reviews the internal trade history, for the quarter, for each security type. If there is sufficient

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trade data above a predetermined threshold of a security type, the Manager determines it has sufficient observable market data and the security will be categorized as a Level II.

Values for the Company's securities are based upon prices obtained from independent third party pricing services. The valuation methodology of the third party pricing services incorporates a commonly used market pricing method. Depending on the type of asset and the underlying collateral, the primary inputs to the model include yields for TBAs, Agency RMBS, the U.S. Treasury market and floating rate indices such as LIBOR, the Constant Maturity Treasury rate and the prime rate as a benchmark yield. In addition, the model may incorporate the current weighted average maturity and additional pool level information such as prepayment speeds, default frequencies and default severities, if applicable. When the third party pricing service cannot adequately price a particular security, the Company utilizes a broker's quote which is reviewed for reasonableness by the Manager's pricing group.

Residential Whole-Loans

Values for the Company's residential whole-loans are based upon prices obtained from an independent third party pricing service that specializes in whole loans, utilizing a trade based valuation model. Their valuation methodology incorporates commonly used market pricing methods, including loan to value ("LTV"), debt to income, maturity, interest rates, collateral location, and unpaid principal balance, prepayment penalties, FICO scores, lien position and times late. Due to the inherent uncertainty of such valuation, the fair values established for residential loans held by the Company may differ from the fair values that would have been established if a ready market existed for these loans. Accordingly, the Company's loans are classified as Level III.

Securitized commercial loan and securitized debt

Values for the Company's securitized commercial loan and securitized debt are based on the fair value that is more observable. Since there is an extremely limited market for the securitized commercial loan, the Company determined the fair value of the securitized debt was more observable. The fair value of the securitized debt was based upon a third party broker quote, which is validated by the Manager's pricing group. Due to the inherent uncertainty of such valuation the Company classifies its securitized commercial loan and securitized debt as Level III.

Derivatives

Values for the Company derivatives are based upon prices from third party pricing services, whose pricing is subject to review by the Manager's pricing committee. In valuing its over-the-counter interest rate derivatives, such as swaps and swaptions, its currency derivatives, such as swaps and forwards and credit derivatives such as total return swaps, 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. The majority of the Company's interest rate swaps are cleared through a central clearing house and subject to the clearing house margin requirements. The Company's agreements with its derivative counterparties also contain netting provisions; however the Company has elected to report its interest rate swaps and swaptions and currency swaps and forwards on a gross basis. No credit valuation adjustment was made in determining the fair value of interest rate and/or currency derivatives for the periods ended September 30, 2016 and December 31, 2015.

The Company performs quarterly reviews of the independent third party pricing data. These reviews may consist of a review of the daily change in the prices provided by the independent pricing vendor which exceed established tolerances or comparisons to executed transaction prices, utilizing the Manager's pricing group. The Manager's pricing group, which functions independently from its portfolio management personnel, reviews the price differences or changes in price by comparing the vendor price to alternate sources including other independent pricing services or broker quotations. If the price change or difference cannot be corroborated, the Manager's pricing group consults with

the portfolio management team for market color in reviewing such pricing data as warranted. To the extent that the Manager has information, typically in the form of broker quotations that would indicate that a price received from the independent pricing service is outside of a tolerance range, the Manager generally challenges the independent pricing service price.

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

$ in thousands	Three months ended September 30, 2016			Nine months ended September 30, 2016		
	Mortgage-backed securities and other securities	Residential Whole-Loans	Securitized commercial loan	Mortgage-backed securities and other securities	Residential Whole-Loans	Securitized commercial loan
Beginning balance	$226,826	$ 189,696	$ 23,688	$466,336	$ 218,538	$ 25,000
Transfers into Level III from Level II	—	—	—	—	—	—
Transfers from Level III into Level II	—	—	—	(158,567)	—	—
Purchases	—	29,404	—	94	29,404	—
Sales and settlements	(9,194)	—	—	(78,104)	—	—
Principal repayments	(4,366)	(14,493)	—	(15,452)	(42,828)	—
Total net gains / (losses) included in net income						
Realized gains/(losses), net	(1,696)	—	—	(8,131)	—	—
Other than temporary impairment	(251)	—	—	(5,306)	—	—
Unrealized gains/(losses), net(1)	(996)	819	450	14,862	1,403	(862)
Premium and discount amortization, net	(2,530)	(544)	—	(7,939)	(1,635)	—
Ending balance	$207,793	$ 204,882	$ 24,138	$207,793	$ 204,882	$ 24,138

(1) For Mortgage-backed securities and other securities, Residential Whole-Loans and Securitized commercial loans classified as Level III at September 30, 2016, the Company recorded gross unrealized gains of approximately $3.0 million, $1.4 million and $450 thousand, respectively, and gross unrealized losses of approximately $4.2 million, $350 thousand and $0, respectively, for the three months ended September 30, 2016. For Mortgage-backed securities and other securities, Residential Whole-Loans and Securitized commercial loans classified as Level III at September 30, 2016, the Company recorded gross unrealized gains of approximately $20.3 million, $2.2 million and $0, respectively, and gross unrealized losses of approximately $2.2 million, $271 thousand and $862 thousand, respectively, for the nine months ended September 30, 2016. These gains and losses are included in Unrealized gain (loss), net on the Consolidated Statements of Operations.

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$ in thousands	Three months ended September 30, 2016 Derivative Liability	Securitized debt	Nine months ended September 30, 2016 Derivative Liability	Securitized debt
Beginning balance	$ 2,160	10,423	$ —	$ 11,000
Transfers into Level III from Level II	—	—	—	—
Transfers from Level III into Level II	—	—	—	—
Purchases	—	—	—	—
Sales and settlements	—	—	—	—
Principal repayments	—	—	—	—
Total net gains / (losses) included in net income				
Realized gains/(losses), net	—	—	—	—
Other than temporary impairment	—	—	—	—
Unrealized (gains)/losses, net(1)	11	198	2,171	(379)
Premium and discount amortization, net	—	—	—	—
Ending balance	$ 2,171	$ 10,621	$ 2,171	$ 10,621

(1) For Derivative liability and Securitized debt classified as Level III at September 30, 2016, the Company recorded gross unrealized gains of $11 thousand and $198 thousand, respectively, and gross unrealized losses of $0 and $0, respectively, for the three months ended September 30, 2016. For Derivative liability and Securitized debt classified as Level III at September 30, 2016, the Company recorded gross unrealized gains of $2.2 million and $0, respectively, and gross unrealized losses of $0 and $379 thousand, respectively, for the nine months ended September 30, 2016. These gains and losses are included in Gain (loss) on derivative instruments, net and Unrealized gain (loss), net in the Consolidated Statements of Operations, respectively.

$ in thousands	Three months ended September 30, 2015 Mortgage-backed securities and other securities	Residential Whole-Loans	Commercial Whole-Loan
Beginning balance	$452,387	$ 22,184	$ 8,743
Fair value of securities previously accounted for as linked transactions(1)	—	—	—
Fair value of financial instruments previously accounted for as linked transactions(1)	—	—	—
Transfers into Level III from Level II	—	—	—
Transfers from Level III into Level II	—	—	—
Purchases	34,568	129,026	—
Sales and settlements	(14,149)	—	—
Principal repayments	(4,259)	(3,192)	(8,750)
Total net gains / (losses) included in net income			
Realized gains/(losses), net	(113)	—	—
Other than temporary impairment	(2,616)	—	—
Unrealized gains/(losses), net(2)	(138)	2,786	7
Premium and discount amortization, net	(1,418)	(318)	—
Ending balance	$464,262	$ 150,486	$ —

(1) Resulting from the implementation of guidance issued by the FASB which eliminated the requirement to account for certain financial instruments as linked transactions.

(2)

For Mortgage-backed securities and other securities, Residential Whole-Loans and Commercial Whole-Loan classified as Level III at September 30, 2015, the Company recorded gross unrealized gains of approximately $5.2 million, $2.8 million and $0, respectively, and gross unrealized losses of approximately $5.3 million, $11 thousand and $0, respectively, for the three months ended September 30, 2015. These gains and losses are included in Unrealized gain (loss), net in the Consolidated Statements of Operations.

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$ in thousands	Nine months ended September 30, 2015			
	Mortgage-backed securities and other securities	Residential Whole-Loans	Commercial Whole-Loan	Linked Transactions
Beginning balance	$291,407	$ 7,220	$ —	$ 20,627
Fair value of securities previously accounted for as linked transactions(1)	52,484	—	—	—
Fair value of financial instruments previously accounted for as linked transactions(1)	—	—	—	(20,627)
Transfers into Level III from Level II	37,499	—	—	—
Transfers from Level III into Level II	(3,996)	—	—	—
Purchases	190,893	145,562	—	—
Sales and settlements	(86,396)	—	—	—
Principal repayments	(8,968)	(4,983)	—	—
Total net gains / (losses) included in net income				
Realized gains/(losses), net	4,348	—	—	—
Other than temporary impairment	(5,357)	—	—	—
Unrealized gains/(losses), net(2)	(965)	3,100	—	—
Premium and discount amortization, net	(6,687)	(413)	—	—
Ending balance	464,262	150,486	—	—

(1) Resulting from the implementation of guidance issued by the FASB which eliminated the requirement to account for certain financial instruments as linked transactions.

(2) For Mortgage-backed securities and other securities, Residential Whole-Loans and Commercial Whole-Loan classified as Level III at September 30, 2015, the Company recorded for the nine months ended gross unrealized gains of approximately $9.6 million, $3.2 million and $0, respectively, and gross unrealized losses of approximately $9.7 million, $7 thousand and $0, respectively, for the nine months ended September 30, 2015. These gains and losses are included in Unrealized gain (loss), net in the Consolidated Statements of Operations.

Transfers between hierarchy levels for the nine months ended September 30, 2016 and September 30, 2015 were based on the availability of sufficient observable inputs to meet Level II versus Level III criteria. The leveling of these assets was based on information received from a third party pricing service which, along with the back-testing of historical sales transactions performed by the Manager provided the sufficient observable data for the movement from Level III to Level II. The Company did not have transfers between Level I and Level II for the nine months ended September 30, 2016 and September 30, 2015.

Other Fair Value Disclosures

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

The fair value of the repurchase agreements is based on a net present value technique. This method discounts future estimated cash flows using rates the Company determined best estimates current market interest rates that would be offered for loans with similar characteristics and credit quality. The use of different market assumptions or estimation methodologies could have a material effect on the fair value amounts. At September 30, 2016, the Company’s borrowings under repurchase agreements had a carrying value which approximates its fair value. Inputs used to arrive at the fair value of the repurchase agreement borrowings and receivables under reverse repurchase agreements are generally observable, and therefore, they would be considered a Level II fair value measurement.

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Note 4 – Mortgage-Backed Securities and other securities

The following tables present certain information about the Company's investment portfolio at September 30, 2016 and December 31, 2015 (dollars in thousands).

	September 30, 2016							
	Principal Balance	Unamortized Premium (Discount), net	Discount Designated as Credit Reserve and OTTI	Amortized Cost	Unrealized Gain	Unrealized Loss	Estimated Fair Value	Net Weighted Average Coupon (1)
Agency RMBS:								
20-Year mortgage	$503,023	$26,175	$—	$529,198	$15,285	$—	$544,483	3.9 %
30-Year mortgage	1,153,269	76,897	—	1,230,166	23,841	(367)	1,253,640	3.9 %
Agency RMBS Interest-Only Strips (2)	N/A	N/A	N/A	27,188	1,258	(439)	28,007	3.0 % (2)
Agency RMBS Interest-Only Strips, accounted for as derivatives (2) (3)	N/A	N/A	N/A	N/A	N/A	N/A	25,438	3.4 % (2)
Agency CMBS	4,553	—	—	4,553	—	(270)	4,283	4.5 %
Agency CMBS Interest-Only Strips(2)	N/A	N/A	N/A	557	48	—	605	4.6 % (2)
Agency CMBS Interest-Only Strips accounted for as derivatives(2) (3)	N/A	N/A	N/A	N/A	N/A	N/A	8,850	0.6 % (2)
Subtotal Agency MBS	1,660,845	103,072	—	1,791,662	40,432	(1,076)	1,865,306	3.4 %
Non-Agency RMBS	422,498	(15,476)	(112,801)	294,221	17,555	(2,281)	309,495	4.0 %
Non-Agency RMBS Interest- Only Strips (2)	N/A	N/A	N/A	59,025	22,452	—	81,477	5.8 % (2)
Non-Agency RMBS Interest-Only Strips, accounted for as derivatives (2) (3)	N/A	N/A	N/A	N/A	N/A	N/A	4,170	4.8 % (2)
Non-Agency CMBS	479,405	(69,557)	(15,854)	393,994	4,780	(29,876)	368,898	5.0 %
Subtotal Non-Agency MBS	901,903	(85,033)	(128,655)	747,240	44,787	(32,157)	764,040	4.8 %
Other securities (4)	42,384	(404)	—	64,384	898	(1,956)	63,326	7.7 %
Total	$2,605,132	$17,635	$(128,655)	$2,603,286	$86,117	$(35,189)	$2,692,672	3.9 %

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	December 31, 2015							
	Principal Balance	Unamortized Premium (Discount), net	Discount Designated as Credit Reserve and OTTI	Amortized Cost	Unrealized Gain	Unrealized Loss	Estimated Fair Value	Net Weighted Average Coupon (1)
Agency RMBS:								
20-Year mortgage	$645,313	$35,216	$—	$680,529	$8,562	$(1,819)	$687,272	3.9 %
30-Year mortgage	856,014	71,342	—	927,356	10,827	(11,724)	926,459	4.2 %
Agency RMBS Interest-Only Strips (2)	N/A	N/A	N/A	71,632	2,499	(2,177)	71,954	3.1 % (2)
Agency RMBS Interest-Only Strips, accounted for as derivatives (2) (3)	N/A	N/A	N/A	N/A	N/A	N/A	45,362	3.6 % (2)
Agency CMBS	24,450	—	—	24,450	240	—	24,690	5.2 %
Agency CMBS Interest-Only Strips(2)	N/A	N/A	N/A	1,915	198	—	2,113	4.7 % (2)
Agency CMBS Interest-Only Strips accounted for as derivatives(2) (3)	N/A	N/A	N/A	N/A	N/A	N/A	11,069	0.7 % (2)
Subtotal Agency MBS	1,525,777	106,558	—	1,705,882	22,326	(15,720)	1,768,919	3.5 %
Non-Agency RMBS	601,233	(16,669)	(141,014)	443,550	9,345	(7,446)	445,449	3.7 %
Non-Agency RMBS Interest- Only Strips (2)	N/A	N/A	N/A	66,600	14,589	—	81,189	5.9 % (2)
Non-Agency RMBS Interest-Only Strips, accounted for as derivatives (2) (3)	N/A	N/A	N/A	N/A	N/A	N/A	3,556	5.0 % (2)
Non-Agency CMBS	550,901	(73,835)	(9,017)	468,049	4,049	(21,183)	450,915	5.0 %
Subtotal Non-Agency MBS	1,152,134	(90,504)	(150,031)	978,199	27,983	(28,629)	981,109	4.7 %
Other securities (4)	81,518	1,135	(2,719)	102,778	1,233	(2,912)	101,099	4.8 %
Total	$2,759,429	$17,189	$(152,750)	$2,786,859	$51,542	$(47,261)	$2,851,127	3.9 %

(1) Net weighted average coupon as of September 30, 2016 and December 31, 2015 is presented, net of servicing and other fees.

(2) Agency RMBS IOs and IIOs, Non-Agency RMBS IOs and IIOs, Agency and Non-Agency RMBS IOs and IIOs, accounted for as derivatives, Agency CMBS IOs and IIOs, and Agency CMBS IOs and IIOs, accounted for as derivatives have no principal balances and bear interest based on a notional balance. The notional balance is used solely to determine interest distributions on interest-only class of securities. At September 30, 2016, the notional balance for Agency RMBS IOs and IIOs, Non-Agency RMBS IOs and IIOs, Agency RMBS IOs and IIOs, accounted for as derivatives, Non-Agency RMBS IOs and IIOs, accounted for as derivatives, Agency CMBS IOs

and IIOs, accounted for as derivatives and Agency CMBS IOs and IIOs was $270.4 million, $289.9 million, $287.8 million $21.6 million, $227.3 million and $36.5 million, respectively. At December 31, 2015, the notional balance for Agency RMBS IOs and IIOs, Non-Agency RMBS IOs and IIOs, Agency RMBS IOs and IIOs, accounted for as derivatives, Non-Agency RMBS IOs and IIOs, accounted for as derivatives, Agency CMBS IOs and IIOs, accounted for as derivatives and Agency CMBS IOs and IIOs was $593.4 million, $321.0 million, $384.1 million, $24.9 million, $246.6 million and $43.2 million, respectively.

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

(4) Other securities include residual interests in asset-backed securities which have no principal balance and an amortized cost of approximately $22.4 million and $22.8 million, as of September 30, 2016 and December 31, 2015, respectively.

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As of September 30, 2016 and December 31, 2015 the weighted average expected remaining term of the MBS and other securities investment portfolio was 6.0 years and 7.1 years, respectively.

The following tables present the changes in the components of the Company’s purchase discount and amortizable premium on its Non-Agency RMBS, Non-Agency CMBS and other securities for the three and nine months ended September 30, 2016 and September 30, 2015 (dollars in thousands):

	Three months ended September 30, 2016			Nine months ended September 30, 2016		
	Discount Designated as Credit Reserve and OTTI	Accretable Discount(1)	Amortizable Premium(1)	Discount Designated as Credit Reserve and OTTI	Accretable Discount(1)	Amortizable Premium(1)
Balance at beginning of period	$(129,162)	$(139,675)	$ 43,402	$(152,750)	$(145,532)	$ 56,163
Accretion of discount	—	4,151	—	—	13,381	—
Amortization of premium	—	—	(1,132)	—	—	(4,242)
Realized credit losses	2,623	—	—	5,765	—	—
Purchases	(1,216)	—	2,246	(15,482)	(2,265)	4,366
Sales	1,947	8,573	(1,323)	33,610	22,986	(11,752)
Net impairment losses recognized in earnings	(4,526)	—	—	(18,340)	—	—
Transfers/release of credit reserve(2)	1,679	(254)	(1,425)	18,542	(15,775)	(2,767)
Balance at end of period	$(128,655)	$(127,205)	$ 41,768	$(128,655)	$(127,205)	$ 41,768

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

(2) Subsequent reductions of a security’s non-accretable discount results in a corresponding reduction in its amortizable premium.

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	Three months ended September 30, 2015			Nine months ended September 30, 2015		
	Discount Designated as Credit Reserve and OTTI	Accretable Discount(1)	Amortizable Premium(1)	Discount Designated as Credit Reserve and OTTI	Accretable Discount(1)	Amortizable Premium(1)
Balance at beginning of period	$(164,931)	$(133,407)	$ 86,831	$(182,007)	$(105,804)	$ 82,228
Securities previously accounted for as linked transactions(3)	—	—	—	(2,320)	(1,393)	4,587
Accretion of discount	—	4,328	—	—	13,594	—
Amortization of premium	—	—	(2,217)	—	—	(7,096)
Realized credit losses	2,002	—	—	6,997	—	—
Purchases	—	(23,903)	—	(34,096)	(87,376)	6,808
Sales	6,932	6,608	(4,784)	60,747	43,783	(15,802)
Net impairment losses recognized in earnings	(5,102)	—	—	(10,493)	—	—
Transfers/release of credit reserve(2)	21,808	(7,250)	(14,558)	21,881	(16,428)	(5,453)
Balance at end of period	$(139,291)	$(153,624)	$ 65,272	$(139,291)	$(153,624)	$ 65,272

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

(2) Subsequent reductions of a security's non-accretable discount results in a corresponding reduction in its amortizable premium.

(3) Resulting from the implementation of guidance issued by the FASB which eliminated the requirement to account for certain financial instruments as linked transactions.

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The following tables present the fair value and contractual maturities of the Company's investment securities at September 30, 2016 and December 31, 2015 (dollars in thousands):

	September 30, 2016				
	< or equal to 10 years	> 10 years and < or equal to 20 years	> 20 years and < or equal to 30 years	> 30 years	Total
Agency RMBS:					
20-Year mortgage	$—	$ 544,483	$ —	$—	$544,483
30-Year mortgage	—	—	1,253,640	—	1,253,640
Agency RMBS Interest-Only Strips	—	14,731	13,276	—	28,007
Agency RMBS Interest-Only Strips, accounted for as derivatives	2,104	8,129	15,205	—	25,438
Agency CMBS	4,283	—	—	—	4,283
Agency CMBS Interest-Only Strips	605	—	—	—	605
Agency CMBS Interest-Only Strips accounted for as derivatives	—	—	—	8,850	8,850
Subtotal Agency	6,992	567,343	1,282,121	8,850	1,865,306
Non-Agency RMBS	14	69,129	65,986	174,366	309,495
Non-Agency RMBS Interest- Only Strips	—	5,047	14,830	61,600	81,477
Non-Agency RMBS Interest-Only Strips, accounted for as derivatives	—	—	1,338	2,832	4,170
Non-Agency CMBS	15,042	39,439	140,253	174,164	368,898
Subtotal Non-Agency	15,056	113,615	222,407	412,962	764,040
Other securities	—	37,008	5,347	20,971	63,326
Total	$22,048	$ 717,966	$ 1,509,875	$442,783	$2,692,672

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	December 31, 2015				
	< or equal to 10 years	> 10 years and < or equal to 20 years	> 20 years and < or equal to 30 years	> 30 years	Total
Agency RMBS:					
20-Year mortgage	$—	$ 687,272	$ —	$—	$687,272
30-Year mortgage	—	—	926,459	—	926,459
Agency RMBS Interest-Only Strips	—	40,900	31,054	—	71,954
Agency RMBS Interest-Only Strips, accounted for as derivatives	1,310	10,081	33,971	—	45,362
Agency CMBS	24,690	—	—	—	24,690
Agency CMBS Interest-Only Strips(2)	2,113	—	—	—	2,113
Agency CMBS Interest-Only Strips accounted for as derivatives(2) (3)	—	—	—	11,069	11,069
Subtotal Agency	28,113	738,253	991,484	11,069	1,768,919
Non-Agency RMBS	15	86,172	59,502	299,760	445,449
Non-Agency RMBS Interest- Only Strips	—	—	20,639	60,550	81,189
Non-Agency RMBS Interest-Only Strips, accounted for as derivatives	—	—	1,248	2,308	3,556
Non-Agency CMBS	40,523	27,849	167,355	215,188	450,915
Subtotal Non-Agency	40,538	114,021	248,744	577,806	981,109
Other securities	29,102	11,088	39,256	21,653	101,099
Total	$97,753	$ 863,362	$ 1,279,484	$610,528	$2,851,127

The following tables present the gross unrealized losses and estimated fair value of the Company's MBS and other securities by length of time that such securities have been in a continuous unrealized loss position at September 30, 2016 and December 31, 2015 (dollars in thousands):

	September 30, 2016								
	Less than 12 Months			12 Months or More			Total		
	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses	Number of Securities
Agency RMBS:									
30-Year mortgage	$49,090	$(201)	4	$25,042	$(166)	13	$74,132	$(367)	17
Agency RMBS Interest-Only Strips	13,419	(317)	10	1,586	(122)	1	15,005	(439)	11
Agency CMBS	4,282	(270)	1	—	—	—	4,282	(270)	1
Non-Agency RMBS	24,630	(674)	4	56,684	(1,607)	12	81,314	(2,281)	16
Non-Agency CMBS	123,844	(8,928)	28	166,706	(20,948)	36	290,550	(29,876)	64
Other securities	17,274	(711)	2	13,090	(1,245)	1	30,364	(1,956)	3
Total	$232,539	$(11,101)	49	$263,108	$(24,088)	63	$495,647	$(35,189)	112

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	December 31, 2015								
	Less than 12 Months			12 Months or More			Total		
	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses	Number of Securities
Agency RMBS:									
20-Year mortgage	$113,919	$(1,229)	35	$44,470	$(590)	10	$158,389	$(1,819)	45
30-Year mortgage	68,890	(1,325)	17	329,716	(10,399)	55	398,606	(11,724)	72
Agency RMBS Interest-Only Strips	39,091	(2,177)	18	—	—	—	39,091	(2,177)	18
Non-Agency RMBS	234,897	(6,928)	36	19,656	(519)	5	254,553	(7,447)	41
Non-Agency CMBS	298,369	(19,888)	55	27,755	(1,294)	7	326,124	(21,182)	62
Other securities	59,610	(1,746)	5	11,334	(1,166)	1	70,944	(2,912)	6
Total	$814,776	$(33,293)	166	$432,931	$(13,968)	78	$1,247,707	$(47,261)	244

At September 30, 2016, the Company did not intend to sell any of its MBS and other securities that were in an unrealized loss position, and it is "more likely than not" that the Company will not be required to sell these MBS and other securities before recovery of their amortized cost basis, which may be at their maturity.

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

For Non-Agency MBS and other securities rated below AA at the time of purchase and Agency and Non-Agency Interest-Only Strips, excluding Interest-Only Strips classified as derivatives, an other-than-temporary impairment is deemed to have occurred when there is an adverse change in the expected cash flows (principal or interest) to be received and the fair value of the beneficial interest is less than its carrying amount. Other than for "plain-vanilla" variable rate Non-Agency MBS, the Company does not bifurcate the loss between credit loss and loss attributed to change in interest rates, therefore, the entire loss is recorded as other-than-temporary. These adjustments are reflected in the Company's Consolidated Statement of Operations as Other than temporary impairment. In determining whether an adverse change in cash flows occurred, the present value of the remaining cash flows, as estimated at the initial transaction date (or the last date previously revised), is compared to the present value of the expected cash flows at the current reporting date. The estimated cash flows reflect those a "market participant" would use and are discounted at a rate equal to the current yield used to accrete interest income. If an other-than-temporary impairment is recognized as a result of this analysis, the yield is maintained at the current accretion rate. The last revised estimated cash flows are then used for future impairment analysis purposes. The Company's prepayment speed estimate was the primary

assumption used to determine other-than temporary-impairments for Interest-Only Strips, excluding Agency and Non-Agency Interest-Only Strips accounted for as derivatives, for the three and nine months ended September 30, 2016, and September 30, 2015.

With respect to the Company's security portfolio, OTTI is generally recorded when the credit quality of the underlying collateral deteriorates and or the schedule payments are faster than previously projected. The credit deterioration could be as a result of, but not limited to, increased projected realized losses, foreclosures, delinquencies and the likelihood of the borrower being able to make payments in the future. Generally, a prepayment occurs when a loan has a higher interest rate relative to current interest rates and

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lenders are willing to extend credit at the lower current interest rate of the underlying collateral for the loan is sold or transferred. OTTI is reported in the Company's Consolidated Statement of Operations.

The following table presents the OTTI the Company recorded on its securities portfolio (dollars in thousands):

	For the three months ended September 30, 2016	For the three months ended September 30, 2015	For the nine months ended September 30, 2016	For the nine months ended September 30, 2015
Agency RMBS	$ 202	$ 626	$ 1,226	$ 3,804
Non-Agency RMBS	852	3,716	8,081	6,746
Non-Agency CMBS	3,674	271	9,213	2,369
Other securities	250	1,304	3,611	1,965
Total	$ 4,978	$ 5,917	$ 22,131	$ 14,884

The Company has made investments in certain Non-Agency RMBS inverse floaters. The coupon rate on these securities has an inverse relationship to a benchmark rate. When the benchmark interest rate increases the coupon payment rate will decrease because the benchmark interest rate is deducted from the coupon payment. The Company has generally purchased these securities at a premium. Accelerated prepayments on these securities could result in an economic loss, as the Company would not recover the upfront premium. The premiums are amortized into income using the effective interest rate method. As of September 30, 2016 and September 30, 2015, the Company held $74.0 million and $84.7 million, respectively, in Non-Agency RMBS inverse floaters.

The following tables present components of interest income on the Company's MBS and other securities (dollars in thousands) for the three and nine months ended September 30, 2016 and September 30, 2015, respectively:

	For the three months ended September 30, 2016			For the nine months ended September 30, 2016		
	Coupon Interest	Net (Premium Amortization/Amortization Basis) Discount Amortization	Interest Income	Coupon Interest	Net (Premium Amortization/Amortization Basis) Discount Amortization	Interest Income
Agency RMBS	$16,525	$ (6,255)	$10,270	$50,693	$ (22,220)	$28,473
Agency CMBS	677	(505)	172	2,194	(1,358)	836
Non-Agency RMBS	8,575	(1,172)	7,403	27,098	(4,106)	22,992
Non-Agency CMBS	6,021	1,954	7,975	19,270	5,513	24,783
Other securities	464	732	1,196	1,656	2,284	3,940
Total	$32,262	$ (5,246)	$27,016	$100,911	$ (19,887)	$81,024

	For the three months ended September 30, 2015			Nine months ended September 30, 2015		
	Coupon Interest	Net (Premium Amortization/Amortization Basis) Discount Amortization	Interest Income	Coupon Interest	Net (Premium Amortization/Amortization Basis) Discount Amortization	Interest Income
Agency RMBS	$26,511	$ (11,582)	$14,929	$98,000	$ (39,494)	$58,506
Agency CMBS	977	(592)	385	2,768	(1,686)	1,082

Non-Agency RMBS	11,134	(2,294)	8,840	34,436	(6,602)	27,834
Non-Agency CMBS	7,072	603	7,675	19,635	2,222	21,857
Other securities	1,923	770	2,693	4,729	1,864	6,593
Total	$47,617	$ (13,095)	$34,522	$159,568	$ (43,696)	$115,872

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

	For the three months ended September 30, 2016				For the nine months ended September 30, 2016			
	Proceeds	Gross Gains	Gross Losses	Net Gain (Loss)	Proceeds	Gross Gains	Gross Losses	Net Gain (Loss)
Agency RMBS (1)	$42,427	$ —	$ (138)	$ (138)	$358,029	$ 5,250	$ (5,764)	$ (514)
Agency CMBS	8,216	45	—	45	18,637	54	(55)	(1)
Non-Agency RMBS	15,209	1,306	—	1,306	120,649	3,100	(4,559)	(1,459)
Non-Agency CMBS	9,194	—	(1,452)	(1,452)	34,188	—	(4,381)	(4,381)
Other securities	14,485	1,678	—	1,678	764,711	3,496	(2,109)	1,387
Total	$89,531	$ 3,029	$ (1,590)	$ 1,439	$1,296,214	$ 11,900	$ (16,868)	$ (4,968)

(1) For the nine months ended September 30, 2016, excludes proceeds for Agency Interest-Only Strips, accounted for as derivatives, of approximately $8.6 million, gross realized gains of $300 thousand and gross realized losses of $455 thousand. There were no sales of Agency Interest-Only Strips, accounted for as derivatives for the three months ended September 30, 2016.

	For the three months ended September 30, 2015				For the nine months ended September 30, 2015			
	Proceeds	Gross Gains	Gross Losses	Net Gain (Loss)	Proceeds	Gross Gains	Gross Losses	Net Gain (Loss)
Agency RMBS (1)	$416,070	$ 2,408	$ (4,094)	$ (1,686)	$926,051	$ 6,243	$ (7,671)	$ (1,428)
Non-Agency RMBS	25,663	1,305	—	1,305	233,257	11,066	(174)	10,892
Non-Agency CMBS	55,637	772	(71)	701	146,525	2,123	(80)	2,043
Other securities	760,199	59	(2,861)	(2,802)	776,564	621	(2,861)	(2,240)
Total	$1,257,569	$ 4,544	$ (7,026)	$ (2,482)	$2,082,397	$ 20,053	$ (10,786)	$ 9,267

(1) For the three and nine months ended September 30, 2015, excludes Agency Interest-Only Strips, accounted for as derivatives of approximately $5.3 million and $5.3 million, respectively, gross realized gains of $628 thousand and $626 thousand, respectively, and gross realized losses of $2 thousand for both the three and nine months ended September 30, 2015.

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Note 5 — Variable Interest Entities

Residential Whole-Loan Trusts

The consolidated financial statements also include the consolidation of certain trusts that each meet the definition of a VIE related to the acquisition of Residential Whole-Loans in which the Company has determined itself to be the primary beneficiary of each such trust. The Company determined that it was the primary beneficiary of the two residential Whole-Loan trusts, which were merged into one trust during the first quarter of 2016, because it was involved in certain aspects of the design of each trust, has certain oversight rights on defaulted assets and has other significant decision making powers. In addition, the Company has the obligation to absorb losses and the right to receive benefits from the trust that could potentially be significant to the trust. The trust has issued a trust certificate to the Company, which represents the beneficial interest in pools of Residential Whole-Loans held by such trust. As of September 30, 2016, the Company financed the trust certificates with $167.1 million of repurchase borrowings, which is a liability held outside the trusts. The Company classifies the underlying Residential Whole-Loans owned by the trusts in Residential Whole-Loans at fair value in the Consolidated Balance Sheets and has eliminated the intercompany trust certificates in consolidation.

Commercial Loan Trust

In November 2015, the Company acquired a $14.0 million interest in the trust certificate issued by CMSC Trust 2015 - Longhouse MZ ("CMSC Trust"), with a fair value of $13.5 million at September 30, 2016, which is financed with $6.8 million of repurchase borrowings. The Company determined that CMSC Trust was a VIE and itself the primary beneficiary because it was involved in certain aspects of the design of the trust, has certain oversight rights on defaulted assets and has other significant decision making powers. In addition, the Company has the obligation to absorb losses and the right to receive benefits from the trust that could potentially be significant to the trust. The CMSC Trust holds a $25.0 million mezzanine loan collateralized by interests in commercial real estate. The mezzanine loan serves as collateral for the $25.0 million of trust certificates issued. As of September 30, 2016, the Company classified the mezzanine loan at fair value in Securitized commercial loan in the Consolidated Balance Sheets. The $25.0 million of trust certificates, of which $14.0 million was eliminated in consolidation and the remaining $11.0 million held by an affiliate is carried at a fair value of $10.6 million and classified as Securitized debt in the Consolidated Balance Sheets.

The Company assesses modifications to VIEs on an ongoing basis to determine if a significant reconsideration event has occurred that would change the Company's initial consolidation assessment. The two consolidated trusts hold 506 performing Residential Whole-Loans and 1 performing commercial loan. The following table presents a summary of the assets and liabilities of the residential and commercial loan trusts included in the Consolidated Balance Sheets as of September 30, 2016 and December 31, 2015 (dollars in thousands).

	September 30, 2016	December 31, 2015
Residential Whole-Loans, at fair value	$ 204,882	$ 218,538
Securitized commercial loan, at fair value	24,138	25,000
Investment related receivable	3,230	—
Accrued interest receivable	1,745	1,836
Total assets	$ 233,995	$ 245,374
Securitized debt	$ 10,621	$ 11,000
Accrued interest payable	82	85
Accounts payable and accrued expenses	2	2
Total liabilities	$ 10,705	$ 11,087

The Company's risk with respect to its investment in each trust is limited to its direct ownership in the trust. The Residential Whole-Loans and securitized commercial loan held by the consolidated trusts are held solely to satisfy the liabilities of the trust, and creditors of the trust have no recourse to the general credit of the Company for the trust certificates issued by the trusts. The assets of a consolidated trust can only be used to satisfy the obligations of that trust. The Company is not contractually required

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and has not provided any additional financial support to the trusts for the three and nine months ended September 30, 2016 and September 30, 2015. The Company did not deconsolidate any trusts during the three and nine months ended September 30, 2016 and September 30, 2015.

The following table presents the components of the carrying value of Residential Whole-Loans and securitized commercial loan as of September 30, 2016 and December 31, 2015 (dollars in thousands):

	Residential Whole-Loans		Securitized Commercial Loan	
	September 30, 2016	December 31, 2015	September 30, 2016	December 31, 2015
Principal balance	$ 198,651	$ 212,647	$ 25,000	$ 25,000
Unamortized premium	1,584	2,410	—	—
Unamortized discount	(403)	(161)	—	—
Gross unrealized gains	5,078	3,642	—	—
Gross unrealized losses	(28)	—	(862)	—
Fair value	$ 204,882	$ 218,538	$ 24,138	$ 25,000

The Residential Whole-Loans are comprised of non-qualifying, mostly adjustable rate mortgages with low loan to values (or "LTV"). The following tables present certain information about the Company's Residential Whole-Loans investment portfolio at September 30, 2016 and December 31, 2015 (dollars in thousands):

September 30, 2016

			Weighted Average				
Current Coupon Rate	Number of Loans	Principal Balance	Original LTV	Original FICO Score(1)	Expected Life (years)	Contractual Maturity (years)	Coupon Rate
3.01 – 4.00%	106	$38,223	56.6%	735	1.3	26.6	4.0 %
4.01– 5.00%	114	45,722	57.7%	728	1.6	28.0	4.7 %
5.01 – 6.00%	281	111,610	55.2%	722	1.5	27.3	5.1 %
6.01 – 7.00%	5	3,096	71.2%	738	1.3	21.3	6.3 %
Total	506	$198,651	56.3%	726	1.5	27.3	4.8 %

(1) The original FICO score is not available for 157 loans with a principal balance of approximately $68.3 million at September 30, 2016. The Company has excluded those loans from the weighted average computation.

December 31, 2015

			Weighted Average				
Current Coupon Rate	Number of Loans	Principal Balance	Original LTV	Original FICO Score(1)	Expected Life (years)	Contractual Maturity (years)	Coupon Rate
3.01 – 4.00%	2	$698	35.7%	766	1.9	29.4	3.9 %
4.01– 5.00%	211	79,696	56.6%	728	1.4	27.5	4.5 %
5.01 – 6.00%	302	128,204	55.1%	723	1.6	27.9	5.1 %
6.01 – 7.00%	9	4,049	71.0%	723	1.4	23.4	6.4 %
Total	524	$212,647	55.9%	725	1.5	27.6	4.9 %

(1) The original FICO score is not available for 139 loans with a principal balance of approximately $58.7 million at December 31, 2015. The Company has excluded those loans from the weighted average computation.

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The following tables present the U.S. states in which the collateral securing the Company's Residential Whole-Loans at September 30, 2016 and December 31, 2015, based on principal balance, is located (dollars in thousands):

	September 30, 2016			
	State Concentration		Principal Balance	
California	84.9	%	$	168,889
Washington	5.9	%		11,785
Massachusetts	5.4	%		10,753
New York	2.3	%		4,479
Georgia	0.8	%		1,521
Other	0.7	%		1,224
Total	100.0	%	$	198,651

	December 31, 2015			
	State Concentration		Principal Balance	
California	83.1	%	$	176,611
Washington	6.8	%		14,442
Massachusetts	5.6	%		12,000
New York	2.5	%		5,399
Georgia	0.9	%		1,813
Other	1.1	%		2,382
Total	100.0	%	$	212,647

As of September 30, 2016, the aggregate fair value of the securitized debt issued by the consolidated VIE was $10.6 million which is classified as Securitized debt, at fair value in the Company's Consolidated Balance sheets. The cost of financing the securitized debt is approximately 8.9%.

Unconsolidated VIEs

As of September 30, 2016 and December 31, 2015, the Company had three investments in VIEs in which it was not the primary beneficiary, and accordingly, the VIEs were not consolidated in the Company's consolidated financial statements. As of September 30, 2016 and December 31, 2015, the Company's maximum exposure to loss from these investments did not exceed the sum of the $61.8 million and $58.2 million carrying value of the investments, respectively, which are classified in Mortgage-backed securities and other securities, at fair value in the Company's Consolidated Balance sheets.

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Note 6 — Borrowings under Repurchase Agreements

As of September 30, 2016, the Company had master repurchase agreements with 28 counterparties. As of September 30, 2016, the Company had borrowings under repurchase agreements with 18 counterparties. The following tables summarize certain characteristics of the Company's repurchase agreements at September 30, 2016 and December 31, 2015 (dollars in thousands):

	September 30, 2016			
Securities Pledged	Repurchase Agreement Borrowings	Weighted Average Interest Rate on Borrowings Outstanding at end of period		Weighted Average Remaining Maturity (days)
Agency RMBS	$1,784,448	0.75	%	31
Agency CMBS	10,725	1.66	%	31
Non-Agency RMBS	270,060	2.32	%	33
Non-Agency CMBS	256,544	2.36	%	33
Whole-Loans and securitized commercial loan(1)	173,901	2.78	%	15
Other securities	27,858	3.05	%	22
Borrowings under repurchase agreements	2,523,536	1.25	%	30
Less unamortized debt issuance cost	56	N/A		N/A
Borrowings under repurchase agreements, net	$2,523,480	1.25	%	30

(1) Repurchase agreement borrowings on Whole-Loans and securitized commercial loan owned through trust certificates. The trust certificates are eliminated upon consolidation.

	December 31, 2015			
Securities Pledged	Repurchase Agreement Borrowings	Weighted Average Interest Rate on Borrowings Outstanding at end of period		Weighted Average Remaining Maturity (days)
Agency RMBS	$1,601,713	0.66	%	41
Agency CMBS	32,699	1.80	%	21
Non-Agency RMBS	380,177	1.91	%	44
Non-Agency CMBS	323,670	1.84	%	37
Whole-Loans and securitized commercial loan(1)	180,892	2.38	%	26
Other securities	66,650	2.33	%	60
Borrowings under repurchase agreements	2,585,801	1.17	%	38
Less unamortized debt issuance cost	134	N/A		N/A
Borrowings under repurchase agreements, net	$2,585,667	1.17	%	38

(1) Repurchase agreement borrowings on Whole-Loans and securitized commercial loan owned through trust certificates. The trust certificates are eliminated upon consolidation.

For the nine months ended September 30, 2016 and the year ended December 31, 2015, the Company had average borrowings under its repurchase agreements of approximately $2.4 billion and $3.4 billion, respectively, and had a maximum month-end balance during the periods of approximately $2.5 billion and $4.0 billion, respectively. The Company had accrued interest payable at September 30, 2016 and December 31, 2015 of approximately $3.4 million and $3.0 million, respectively.

The repurchase agreements bear interest at a contractually agreed-upon rate and typically have terms ranging from one month to three months. The Company’s repurchase agreement borrowings are accounted for as secured borrowings when the

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Company maintains effective control of the financed assets. Under the repurchase agreements, the respective counterparties retain the right to determine the fair value of the underlying collateral. A reduction in the value of pledged assets requires the Company to post additional securities as collateral, pay down borrowings or establish cash margin accounts with the counterparties in order to re-establish the agreed-upon collateral requirements, and is referred to as a margin call. The inability of the Company to post adequate collateral for a margin call by a counterparty, in a timeframe as short as the close of the same business day, could result in a condition of default under the Company's repurchase agreements, thereby enabling the counterparty to liquidate the collateral pledged by the Company, which may have a material adverse effect on the Company's financial position, results of operations and cash flows. The Company may rehypothecate pledged U.S. Treasury securities it receives from its repurchase agreement and interest rate swap counterparties as incremental collateral in order to increase the Company's cash position. At September 30, 2016 and December 31, 2015, the Company did not have any rehypothecated U.S. Treasury securities.

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

Further, if the Company is unable to renew, replace or expand repurchase financing with other sources of financing on substantially similar terms it may have a material adverse effect on the Company's financial position, results of operations and cash flow, due to the long term nature of the Company's investments and relatively short-term maturities of the Company's repurchase agreements. Certain of the repurchase agreements provide the counterparty with the right to terminate the agreement if the Company does not maintain certain equity and leverage metrics, the most restrictive of which include a limit on leverage based on the composition of the Company's portfolio. The Company was in compliance with the terms of such financial tests as of September 30, 2016.

At September 30, 2016 and December 31, 2015, repurchase agreements collateralized by investments had the following remaining maturities:

(dollars in thousands)	September 30, 2016(1)	December 31, 2015(1)
Overnight	$ —	$ —
1 to 29 days	1,536,733	1,335,119
30 to 59 days	605,881	362,940
60 to 89 days	380,922	847,781
90 to 119 days	—	—
Greater than or equal to 120 days	—	39,961
Total	$ 2,523,536	$ 2,585,801

(1) Excludes unamortized debt issuance costs of $56 thousand and $134 thousand at September 30, 2016 and December 31, 2015, respectively.

At September 30, 2016, the following table reflects amounts of collateral at risk under its repurchase agreements greater than 10% of the Company's equity with any counterparty (dollars in thousands):

September 30, 2016

Counterparty	Amount of Collateral at Risk, at fair value	Weighted Average Remaining Maturity (days)	Percentage of Stockholders' Equity	
RBC (Barbados) Trading Bank Corporation	$75,890	42	15.8	%
Credit Suisse Securities (USA) LLC	61,137	22	12.7	%

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Note 7 — Collateral Positions

The following tables summarize the Company's collateral positions, with respect to its borrowings under repurchase agreements, securitized debt, derivatives and clearing margin account at September 30, 2016 and December 31, 2015 (dollars in thousands):

	September 30, 2016		
	Assets Pledged- Fair Value	Accrued Interest	Fair Value of Assets Pledged and Accrued Interest
Assets pledged for borrowings under repurchase agreements:			
Agency RMBS	$1,841,935	$6,593	$ 1,848,528
Agency CMBS	13,737	259	13,996
Non-Agency RMBS	395,064	722	395,786
Non-Agency CMBS	358,481	2,038	360,519
Whole-Loans and securitized commercial loan(1)	218,399	1,644	220,043
Other securities	50,912	46	50,958
Cash (2)	30,476	—	30,476
Securitized commercial loan pledged for securitized debt	10,621	83	10,704
Cash collateral for derivatives (2):	239,922	—	239,922
Total	$3,159,547	$11,385	$ 3,170,932

(1) Whole-Loans and securitized commercial loan owned through trust certificates are pledged as collateral. The trust certificates are eliminated upon consolidation.
(2) Cash posted as collateral is included in Due from counterparties on the Company's Consolidated Balance Sheets.

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	December 31, 2015		
	Assets Pledged- Fair Value	Accrued Interest	Fair Value of Assets Pledged and Accrued Interest
Assets pledged for borrowings under repurchase agreements:			
Agency RMBS	$1,658,865	$7,366	$ 1,666,231
Agency CMBS	37,872	342	38,214
Non-Agency RMBS	530,110	1,053	531,163
Non-Agency CMBS	449,771	2,949	452,720
Whole-Loans and securitized commercial loan(1)	232,538	1,750	234,288
Other securities	101,099	270	101,369
Cash (2)	38,300	—	38,300
Securitized commercial loan pledged for securitized debt	11,000	85	11,085
Cash collateral for derivatives (2):	211,263	—	211,263
Total	$3,270,818	$13,815	$ 3,284,633

(1) Whole-Loans and securitized commercial loan owned through trust certificates are pledged as collateral. The trust certificates are eliminated upon consolidation.
(2) Cash posted as collateral is included in Due from counterparties on the Company's Consolidated Balance Sheets.

A reduction in the value of pledged assets typically results in the repurchase agreement counterparties, derivative counterparties and clearing margin counterparty initiating a daily margin call. At September 30, 2016 and December 31, 2015, investments held by counterparties as security for repurchase agreements totaled approximately $2.9 billion and approximately $3.0 billion, respectively. Cash collateral held by counterparties at September 30, 2016 and December 31, 2015 was approximately $270.4 million and approximately $249.6 million, respectively. Cash posted by counterparties at September 30, 2016 and December 31, 2015, was approximately $6.0 million and approximately $10.0 million, respectively. In addition, at September 30, 2016 and December 31, 2015, the Company held securities of approximately $1.7 million and $0, respectively, as collateral from its repurchase agreement counterparties. The Company has the ability to repledge collateral received from its repurchase counterparties.

Note 8 — Derivative Instruments

The Company's derivatives currently include interest rate swaps, interest rate swaptions, futures contracts, TBAs, currency swaps and forwards, Agency and Non-Agency Interest-Only Strips that are classified as derivatives, and total return swaps.

Interest rate swaps and interest rate swaptions

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

liabilities, the Company on occasion will enter into interest rate swaps which involve the receipt of fixed-rate amounts from a counterparty in exchange for the Company making variable-rate payments over the life of the interest rate swap without exchange of the underlying notional amount. The Company also enters into forward starting swaps and interest rate swaptions to help mitigate the effects of changes in interest rates on a portion of its borrowings under repurchase agreements. Interest rate swaptions provide the Company the option to enter into an interest rate swap agreement for a predetermined notional amount, stated term and pay and receive interest rates in the future. On occasion the Company may enter into a MAC interest rate swap

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in which it may receive or make a payment at the time of entering such interest rate swap to compensate for the out of the market nature of such interest rate swap. Similar to all other interest rate swaps, these interest rate swaps are also subject to margin requirements as previously described.

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

Currency Swaps and Forwards

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

Interest-Only Strips

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

To-Be-Announced Securities

The Company has also purchased or sold TBAs. As of September 30, 2016 and December 31, 2015, the Company had contracts to purchase (“long position”) and sell (“short position”) TBAs on a forward basis. TBAs having the characteristics of a derivative are accounted for at fair value with such changes recognized in Gain (loss) on derivatives, net in the Consolidated Statement of Operations.

Futures Contracts

The Company may enter into Eurodollar, Volatility Index, and U.S. Treasury futures. As of September 30, 2016, the Company had entered into contracts to buy (“long position”) U.S. Treasury futures with a notional amount of $3.6 million, a fair value in an asset position of $54 thousand and an expiration date of December 2016. In addition, as of September 30, 2016, the Company had entered into contracts to sell (“short position”) U.S. Treasury Futures with a

notional amount of $32.0 million, a fair value in an asset position of $15 thousand and an expiration date of December 2016. As of December 31, 2015, the Company had entered into contracts to buy (“long position”) U.S. Treasuries with a notional amount of $480.8 million, a fair value in a liability position of $635 thousand and an expiration date of March 2016.

Total Return Swap

In 2016, the Company has entered into a total return swap and in the future may continue to enter into these types of credit derivatives. This swap transfers the total return of the referenced asset, including interim cash flows and capital appreciation

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or depreciation from a specified price to the Company. The total return swap has a referenced asset which is a security collateralized by residential loans with a notional of €51.0 million. The Company receives interest from the referenced asset equal to EURIBOR plus 2.75% and is required to pay the counterparty EURIBOR plus 0.50% through June 23, 2019, with the spread decreasing to 0.25% through December 2019, with the spread further decreasing to 0% through the maturity date of the referenced asset in December 2020. The Company was required to post $9.7 million in cash collateral which is recorded in Due from counterparties in the Consolidated Balance Sheets.

The following tables summarize the Company's derivative instruments at September 30, 2016 and December 31, 2015 (dollars in thousands):

			September 30, 2016		
Derivative Instrument	Accounting Designation	Consolidated Balance Sheets Location	Notional Amount	Fair Value, excluding accrued interest	Accrued Interest Payable (receivable)
Interest rate swaps, assets	Non-Hedge	Derivative assets, at fair value	$4,184,100	$ 122,324	$ (11,519)
Futures, assets	Non-Hedge	Derivative assets, at fair value	28,400	69	—
Foreign currency swaps, asset	Non-Hedge	Derivative assets, at fair value	5,576	1,285	(42)
Foreign currency forward contracts, asset	Non-Hedge	Derivative assets, at fair value	8,213	111	—
TBA securities, assets	Non-Hedge	Derivative assets, at fair value	1,104,500	4,073	—
Total derivative instruments, assets				127,862	(11,561)
Interest rate swaps, liability	Non-Hedge	Derivative liability, at fair value	5,252,300	(326,360)	12,847
Total return swaps - liability	Non-Hedge	Derivative liability, at fair value	53,575	(2,171)	(104)
Foreign currency forward contracts, liability	Non-Hedge	Derivative liability, at fair value	5,950	(82)	—
TBA securities, liabilities	Non-Hedge	Derivative liability, at fair value	814,500	(2,186)	—
Total derivative instruments, liabilities				(330,799)	12,743
Total derivative instruments, net				$ (202,937)	$ 1,182

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Derivative Instrument	Accounting Designation	Consolidated Balance Sheets Location	December 31, 2015 Notional Amount	Fair Value, excluding accrued interest	Accrued Interest Payable (receivable)
Interest rate swaps, assets	Non-Hedge	Derivative assets, at fair value	$2,808,700	$ 9,635	$ 1,287
Interest rate swaptions, assets	Non-Hedge	Derivative assets, at fair value	1,105,000	1,479	—
Futures contract, asset	Non-Hedge	Derivative assets, at fair value	201,600	63	—
Foreign currency swaps, asset	Non-Hedge	Derivative assets, at fair value	25,160	7,168	(398)
Foreign currency forward contracts, asset	Non-Hedge	Derivative assets, at fair value	5,825	302	—
TBA securities, assets	Non-Hedge	Derivative assets, at fair value	1,650,000	3,268	—
Total derivative instruments, assets				21,915	889
Interest rate swaps, liability	Non-Hedge	Derivative liability, at fair value	5,631,800	(178,305)	7,875
Futures contract, liability	Non-Hedge	Derivative liability, at fair value	279,200	(698)	—
Foreign currency forward contracts, liability	Non-Hedge	Derivative liability, at fair value	7,671	(281)	—
TBA securities, liabilities	Non-Hedge	Derivative liability, at fair value	825,000	(893)	—
Total derivative instruments, liabilities				(180,177)	7,875
Total derivative instruments, net				$ (158,262)	$ 8,764

Interest Rate Swaps

The following tables summarize the average fixed pay rate and average maturity for the Company's interest rate swaps as of September 30, 2016 and December 31, 2015 (excludes interest rate swaptions) (dollars in thousands):

Remaining Interest Rate Swap Term	September 30, 2016 Notional Amount	Fair Value – Asset (Liability), net	Average Fixed Pay Rate	Average Maturity (Years)	Forward Starting
Greater than 1 year and less than 3 years	$1,098,900	$ (2,971)	1.1 %	1.6	79.6 %
Greater than 3 years and less than 5 years	2,006,200	(52,187)	1.8 %	4.2	33.9
Greater than 5 years	2,358,300	(266,847)	2.6 %	9.9	10.7
Total	$5,463,400	$ (322,005)	2.0 %	6.1	33.1 %

Remaining Interest Rate Swap Term	December 31, 2015 Notional Amount	Fair Value – Asset (Liability), net	Average Fixed Pay Rate	Average Maturity (Years)	Forward Starting
1 year or less	$1,286,000	$ 163	0.6 %	0.6	— %
Greater than 1 year and less than 3 years	1,131,800	(1,450)	1.1 %	1.4	—
Greater than 3 years and less than 5 years	1,345,200	(22,705)	2.1 %	4.6	—
Greater than 5 years	2,404,600	(131,744)	2.8 %	10.2	29.5

Total	$6,167,600	$ (155,736)	1.9 %	5.4	11.5 %

As of September 30, 2016 and December 31, 2015, the Company has entered into fixed-pay forward starting interest rate swaps of approximately $1.8 billion and $710.0 million, respectively.

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The following tables summarize the average variable pay-rate and average maturity for the Company's interest rate swaps as of September 30, 2016 and December 31, 2015 (excludes interest rate swaptions) (dollars in thousands):

	September 30, 2016						
Remaining Interest Rate swap Term	Notional Amount	Fair Value – Asset (Liability), net		Average Variable Pay Rate		Average Maturity (Years)	Forward Starting
Greater than 3 years and less than 5 years	$2,036,500	$ 21,227		0.7	%	4.1	—%
Greater than 5 years	1,936,500	96,742		0.8	%	10.1	—
Total	$3,973,000	$ 117,969		0.8	%	7.0	—%

	December 31, 2015						
Remaining Interest Rate swap Term	Notional Amount	Fair Value – Asset (Liability), net		Average Variable Pay Rate		Average Maturity (Years)	Forward Starting
Greater than 3 years and less than 5 years	$1,170,700	$ (8,902	)	0.4	%	4.5	—%
Greater than 5 years	1,102,200	(4,032	)	0.4	%	12.3	—
Total	$2,272,900	$ (12,934	)	0.4	%	8.2	—%

The Company's agreements with certain of its bilateral interest rate swap counterparties may be terminated at the option of the counterparty, and settled at fair value, if the Company does not maintain certain equity and leverage metrics. The most restrictive of which contain provisions which become more restrictive based upon portfolio composition. As of September 30, 2016, the Company was in compliance with the terms of such financial tests.

Interest Rate Swaptions

At September 30, 2016, the Company did not have any swaptions in its derivative holdings. The following tables present information about the Company's interest rate swaptions as of December 31, 2015 (dollars in thousands):

	December 31, 2015			
	Option		Underlying Swap	
Fixed-Pay Rate for Underlying Swap	Fair Value	Weighted Average Months Until Option Expiration	Notional Amount	Weighted Average Swap Term (Years)
1.76 – 2.00%	$890	2.1	$400,000	5.0
2.01 – 2.25%	129	2.1	100,000	5.0
2.26 – 2.50%	1	5.8	105,000	1.0
Total	$1,020	2.7	$605,000	4.3

	December 31, 2015			
	Option		Underlying Swap	
Variable-Pay Rate for Underlying Swap	Fair Value	Weighted Average Months Until Option Expiration	Notional Amount	Weighted Average Swap Term (Years)
1.26 – 1.50%	$459	2.1	$500,000	5.0
Total	$459	2.1	$500,000	5.0

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Derivative Collateral

The Company has minimum collateral posting thresholds with certain of its derivative counterparties, including with its clearing broker for cleared swaps, for which it typically pledges cash. The Company may rehypothecate some of the U.S. Treasury securities it receives as incremental collateral on its repurchase borrowings, swaps and swaptions, effectively entering into repurchase agreements with such securities, in order to increase its cash position. At September 30, 2016, no U.S. Treasury securities were rehypothecated. As of September 30, 2016 and December 31, 2015, the Company had cash pledged as collateral for derivatives of approximately $239.9 million and approximately $211.3 million, respectively, which is reported in the Consolidated Balance Sheets as Due from counterparties. The Company held cash of approximately $5.3 million and approximately $9.4 million as collateral against derivatives at September 30, 2016 and December 31, 2015, respectively, which is reported in the Consolidated Balance Sheets as Due to counterparties.

As of September 30, 2016, the Company has swaps with two counterparties that are based in England and Switzerland, with fair values in an asset position of approximately $1.3 million and with fair values in a liability position of approximately $3.0 million and notional balances of $5.6 million and $123.9 million, respectively. As of December 31, 2015, the Company has swaps with two counterparties that are based in England and Switzerland, with fair values in an asset position of approximately $7.6 million and with fair values in a liability position of approximately $183 thousand and notional balances of $25.2 million and $123.9 million, respectively. Included in the $239.9 million and $211.3 million pledged by the Company is cash pledged to the counterparty based in Switzerland of $4.2 million and $1.4 million at September 30, 2016 and December 31, 2015, respectively. Included in the $5.3 million and $9.4 million received by the Company is cash posted as collateral by the counterparty based in England of approximately $1.4 million and $7.4 million at September 30, 2016 and December 31, 2015, respectively.

Foreign Currency Forwards and Swaps

The following is a summary of the Company's foreign currency forwards at September 30, 2016 and December 31, 2015 (dollars and euros in thousands):

	September 30, 2016			
Derivative Type	Notional Amount	Notional (USD Equivalent)	Maturity	Fair Value
Buy EUR/Sell USD currency forward	€6,542	$ 7,253	October 2016	$ 105
Buy USD/Sell EUR currency forward	€750	$ 849	October 2016	$ 6
Buy EUR/Sell USD Currency forward	€98	$ 111	November 2016	$ —
Currency forwards, assets	€7,390	$ 8,213	n/a	$ 111
Buy EUR/Sell USD currency forward	€280	$ 316	November 2016	$ (1)
Buy USD/Sell EUR currency forward	€5,083	$ 5,634	October 2016	$ (81)
Currency forwards, liabilities	€5,363	$ 5,950	n/a	$ (82)
Total currency forwards	€12,753	$ 14,163	n/a	$ 29

	December 31, 2015			
Derivative Type	Notional Amount	Notional (USD Equivalent)	Maturity	Fair Value
Buy USD/Sell EUR currency forward	€5,083	$ 5,825	January 2016	$ 302
Currency forwards, assets	€5,083	$ 5,825	n/a	$ 302
Buy EUR/Sell USD currency forward	€6,800	$ 7,671	January 2016	$ (281)
Currency forwards, liabilities	€6,800	$ 7,671	n/a	$ (281)
Total currency forwards	€11,883	$ 13,496	n/a	$ 21

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The following is a summary of the Company's foreign currency swaps with a fair value of $1.3 million and $7.2 million at September 30, 2016 and December 31, 2015, respectively (dollars and euros in thousands):

September 30, 2016

	Date entered	Maturity	Fixed Rate	Denomination	Notional Amount
Payer	June 2014	July 2024	7.25 %	EUR	4,100
Receiver	June 2014	July 2024	9.005 %	USD	5,576

December 31, 2015

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

To- Be- Announced Securities

The following table presents additional information about the Company's contracts to purchase and sell TBAs for the nine months ended September 30, 2016 (dollars in thousands):

	Notional Amount as of December 31, 2015	Additions	Settlement, Termination, Expiration or Exercise	Notional Amount as of September 30, 2016
Purchase of TBAs	$1,650,000	$9,704,500	$ (9,950,000)	$ 1,404,500
Sale of TBAs	$825,000	$9,639,500	$ (9,950,000)	$ 514,500

Gain (loss) on derivative instruments

The below tables summarize the effects of the Company's derivative instruments, including Agency and Non-Agency Interest-Only Strips characterized as derivatives and TBAs, reported in Gain (loss) on derivative instruments, net in the Consolidated Statements of Operations for the three and nine months ended September 30, 2016 and September 30, 2015 (dollars in thousands):

	Three months ended September 30, 2016				
Description	Realized Gain (Loss), net	Contractual interest income (expense), net(1)	Return (Recovery) of Basis	Mark-to-market adjustments	Total
Interest rate swaps	$(25,179)	$ (6,904)	$ 168	$ 35,878	$3,963
Agency and Non-Agency Interest-Only Strips—accounted for as derivatives	—	3,503	(2,827)	446	1,122
Futures contracts	5,844	—	—	(8,792)	(2,948)
Foreign currency forwards	103	—	—	(62)	41
Foreign currency swaps	1,409	61	—	(1,852)	(382)
Total return swaps	2	308	—	(11)	299
TBAs	3,579	—	—	447	4,026
Total	$(14,242)	$ (3,032)	$ (2,659)	$ 26,054	$6,121

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Description	Nine months ended September 30, 2016				
	Realized Gain (Loss), net	Contractual interest income (expense), net(1)	Return (Recovery) of Basis	Mark-to-market adjustments	Total
Interest rate swaps	$(28,784)	$ (22,409)	$ 502	$ (35,393)	$(86,084)
Interest rate swaptions	(1,035)	—	—	1,631	596
Agency and Non-Agency Interest-Only Strips—accounted for as derivatives	(155)	11,113	(8,930)	(4,480)	(2,452)
Options	4,756	—	—	—	4,756
Futures contracts	19,253	—	—	704	19,957
Foreign currency forwards	(90)	—	—	8	(82)
Foreign currency swaps	5,351	268	—	(5,883)	(264)
Total return swaps	17	836	—	(2,171)	(1,318)
TBAs	12,166	—	—	(489)	11,677
Total	$11,479	$ (10,192)	$ (8,428)	$ (46,073)	$(53,214)

Description	Three months ended September 30, 2015				
	Realized Gain (Loss), net	Contractual interest income (expense), net(1)	Return (Recovery) of Basis	Mark-to-market adjustments	Total
Interest rate swaps	$28,291	$ (5,561)	$ 337	$ (64,701)	$(41,634)
Interest rate swaptions	(150)	—	—	71	(79)
Agency and Non-Agency Interest-Only Strips—accounted for as derivatives	626	5,437	(4,164)	(1,799)	100
Options	684	—	—	—	684
Futures contracts	(168)	—	—	(38)	(206)
Foreign currency forwards	(134)	—	—	114	(20)
Foreign currency swaps	—	190	—	652	842
TBAs	(8,205)	—	—	7,155	(1,050)
Total	$20,944	$ 66	$ (3,827)	$ (58,546)	$(41,363)

Description	Nine months ended September 30, 2015				
	Realized Gain (Loss), net	Contractual interest income (expense), net(1)	Return (Recovery) of Basis	Mark-to-market adjustments	Total
Interest rate swaps	$18,729	$ (11,871)	$ 1,075	$ (83,209)	$(75,276)
Interest rate swaptions	(3,873)	—	—	(72)	(3,945)
Agency and Non-Agency Interest-Only Strips—accounted for as derivatives	624	16,700	(12,877)	(1,966)	2,481
Options	684	—	—	—	684
Futures contracts	(627)	—	—	683	56
Foreign currency forwards	(980)	—	—	452	(528)
Foreign currency swaps	—	585	—	3,944	4,529
TBAs	(1,728)	—	—	(2,784)	(4,512)
Total	$12,829	$ 5,414	$ (11,802)	$ (82,952)	$(76,511)

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

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Note 9 — Offsetting Assets and Liabilities

The following tables present information about certain assets and liabilities that are subject to master netting agreements (or similar agreements) and can potentially be offset on the Company's Consolidated Balance Sheets at September 30, 2016 and December 31, 2015:

Offsetting of Derivative Assets as of September 30, 2016

$ in thousands Description	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Consolidated Balance Sheets	Net Amounts of Assets presented in the Consolidated Balance Sheets	Gross Amounts Not Offset in the Consolidated Balance Sheets: Financial Instruments (1)	Gross Amounts Not Offset in the Consolidated Balance Sheets: Cash Collateral Received	Net Amount
Agency and Non-Agency Interest-Only Strips, accounted for as derivatives included in MBS	$ 38,458	$ —	$ 38,458	$ (33,932)	$ —	$ 4,526
Derivative asset, at fair value(2)	127,862	—	127,862	(118,275)	(4,067)	5,520
Total	$ 166,320	$ —	$ 166,320	$ (152,207)	$ (4,067)	$ 10,046

Offsetting of Derivative Liabilities and Repurchase Agreements as of September 30, 2016

$ in thousands Description	Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Consolidated Balance Sheets	Net Amounts of Liabilities presented in the Consolidated Balance Sheets	Gross Amounts Not Offset in the Consolidated Balance Sheets: Financial Instruments (1)	Gross Amounts Not Offset in the Consolidated Balance Sheets: Cash Collateral Received	Net Amount
Derivative liability, at fair value(2)(3)	$ 330,799	$ —	$ 330,799	$ (118,275)	$ (210,998)	$ 1,526
Repurchase Agreements(4)	2,523,480	—	2,523,480	(2,523,480)	—	—
	$ 2,854,279	$ —	$ 2,854,279	$ (2,641,755)	$ (210,998)	$ 1,526

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

(2) Derivative asset, at fair value and Derivative liability, at fair value includes interest rate swaps, interest rate swaptions, mortgage put options, currency forwards, futures contracts, foreign currency swaps, total return swaps and TBAs.

(3) Cash collateral pledged against the Company's derivative counterparties was approximately $239.9 million as of September 30, 2016.

(4) The fair value of investments pledged against the Company's repurchase agreements was approximately $2.9 billion as of September 30, 2016.

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Offsetting of Derivative Assets as of December 31, 2015

$ in thousands Description	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Consolidated Balance Sheets	Net Amounts of Assets presented in the Consolidated Balance Sheets	Gross Amounts Not Offset in the Consolidated Balance Sheets Financial Instruments (1)	Cash Collateral Received	Net Amount
Agency and Non-Agency Interest-Only Strips, accounted for as derivatives included in MBS	$ 59,987	$ —	$ 59,987	$ (55,372)	$ —	$ 4,615
Derivative asset, at fair value(2)	21,915	—	21,915	(10,177)	(8,647)	3,091
Total	$ 81,902	$ —	$ 81,902	$ (65,549)	$ (8,647)	$ 7,706

Offsetting of Derivative Liabilities and Repurchase Agreements as of December 31, 2015

$ in thousands Description	Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Consolidated Balance Sheets	Net Amounts of Liabilities presented in the Consolidated Balance Sheets	Gross Amounts Not Offset in the Consolidated Balance Sheets Financial Instruments (1)	Cash Collateral Received	Net Amount
Derivative liability, at fair value(2)(3)	$ 180,177	$ —	$ 180,177	$ (10,177)	$ (169,887)	$ 113
Repurchase Agreements(4)	2,585,801	—	2,585,801	(2,585,801)	—	—
	$ 2,765,978	$ —	$ 2,765,978	$ (2,595,978)	$ (169,887)	$ 113

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

(2) Derivative asset, at fair value and Derivative liability, at fair value includes interest rate swaps, interest rate swaptions, mortgage put options, currency forwards, futures contracts, foreign currency swaps and TBAs.

(3) Cash collateral pledged against the Company’s derivative counterparties was approximately $211.3 million as of December 31, 2015.

(4) The fair value of investments pledged against the Company’s repurchase agreements was approximately $3.0 billion as of December 31, 2015.

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

Note 10 — Related Party Transactions

Management Agreement

In connection with the Company's IPO in May 2012, the Company entered into a management agreement (the "Management Agreement") with the Manager, which describes the services to be provided by the Manager and compensation for such services. The Manager is responsible for managing the Company's operations, including: (i) performing all of its day-to-day functions; (ii) determining investment criteria in conjunction with the Board of Directors; (iii) sourcing, analyzing and executing investments, asset sales and financings; (iv) performing asset management duties; and (v) performing financial and accounting management, subject to the direction and oversight of the Company's Board of Directors. Pursuant to the terms of the Management Agreement, the Manager is paid a management fee equal to 1.50% per annum of the Company's stockholders' equity (as defined in the Management Agreement), calculated and payable (in cash) quarterly in arrears. For purposes of calculating the management fee, "stockholders' equity" means the sum of the net proceeds from any issuances of the Company's equity securities since inception (allocated on a pro rata daily basis for such issuances during the fiscal quarter of any such issuance), plus retained earnings,

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calculated in accordance with GAAP, at the end of the most recently completed fiscal quarter (without taking into account any non-cash equity compensation expense incurred in current or prior periods), less any amount paid for repurchases of the Company's shares of common stock, excluding any unrealized gains, losses or other non-cash items (including OTTI charges, prior to January 1, 2016); unrealized gain (loss), net; and the non-cash portion of gain (loss) on derivative instruments, that have impacted stockholder's equity as reported in the Company's consolidated financial statements prepared in accordance with GAAP, regardless of whether such items are included in other comprehensive income or loss, or in net income, and excluding one-time events pursuant to changes in GAAP and certain other non-cash charges after discussions between the Manager and the Company's independent directors and after approval by a majority of the Company's independent directors. However, if the Company's stockholders' equity for any given quarter is negative based on the calculation described above, the Manager will not be entitled to receive any management fee for that quarter.

On August 3, 2016, the Company and the Manager entered into an amendment to the Management Agreement that amended the definition of "Equity" in the Management Agreement. Under the new definition, for all periods beginning on January 1, 2016, OTTI will reduce the Company's "Equity" for any completed fiscal quarter that OTTI was recognized, which in turn will reduce the Company's management fee from what would have been payable before the amendment.

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

The Management Agreement may be amended, supplemented or modified by agreement between the Company and the Manager. The Management Agreement expires on May 16, 2017. It is automatically renewed for one-year terms on each May 15th unless previously terminated as described below. The Company's independent directors review the Manager's performance and any fees payable to the Manager annually and, the Management Agreement may be terminated annually upon the affirmative vote of at least two-thirds (2/3) of the Company's independent directors, based upon: (i) the Manager's unsatisfactory performance that is materially detrimental to the Company; or (ii) the Company's determination that any fees payable to the Manager are not fair, subject to the Manager's right to prevent such termination due to unfair fees by accepting a reduction of management fees agreed to by at least two-thirds (2/3) of the Company's independent directors. The Company will provide the Manager 180 days prior notice of any such termination. Unless terminated for cause, the Company will pay the Manager a termination fee equal to three times the average annual management fee earned by the Manager during the prior 24-month period immediately preceding the date of termination, calculated as of the end of the most recently completed fiscal quarter prior to the date of termination.

The Company may also terminate the Management Agreement at any time, without the payment of any termination fee, with 30 days prior written notice from the Company's Board of Directors for cause, which will be determined by at least two-thirds (2/3) of the Company's independent directors, which is defined as: (i) the Manager's continued material breach of any provision of the Management Agreement (including the Manager's failure to comply with the Company's investment guidelines); (ii) the Manager's fraud, misappropriation of funds, or embezzlement against the Company; (iii) the Manager's gross negligence in the performance of its duties under the Management Agreement; (iv) the occurrence of certain events with respect to the bankruptcy or insolvency of the Manager, including an order for relief in an involuntary bankruptcy case or the Manager authorizing or filing a voluntary bankruptcy petition;

(v) the Manager is convicted (including a plea of nolo contendere) of a felony; or (vi) the dissolution of the Manager.

For the three and nine months ended September 30, 2016, the Company incurred approximately $2.6 million and approximately $7.9 million in management fees, respectively. For the three and nine months ended September 30, 2015, the Company incurred approximately $2.8 million and approximately $8.1 million in management fees, respectively.

In addition to the management fee, the Company is also responsible for reimbursing the Manager for certain expenses paid by the Manager on behalf of the Company as defined in the Management Agreement. For the three and nine months ended September 30, 2016, the Company recorded expenses included in compensation expense totaling approximately $186 thousand and approximately $550 thousand, respectively, related to reimbursable employee costs. For the three and nine months ended

September 30, 2015, the Company recorded expenses included in compensation expense totaling approximately $127 thousand and approximately $921 thousand, respectively, related to reimbursable employee costs. Any such expenses incurred by the Manager and reimbursed by the Company, including the employee compensation expense, are typically included in the Company's operating expenses in its Consolidated Statements of Operations, or may be reflected in the Consolidated Balance Sheets and associated Consolidated Statement of Changes in Stockholders' Equity, based on the nature of the item. At September 30, 2016 and December 31, 2015, approximately $2.6 million and approximately $2.7 million, respectively, for management fees incurred but not yet paid was included in Payable to related party in the Consolidated Balance Sheets. In addition, at September 30, 2016 and December 31, 2015, approximately $109 thousand and approximately $277 thousand, respectively, of reimbursable costs incurred but not yet paid was included in Payable to related party in the Consolidated Balance Sheets.

Securitized debt

At September 30, 2016, the Company had securitized debt related to the consolidated VIEs, with a principal balance of $11.0 million (and a fair value of $10.6 million) which was held by an affiliate. The securitized debt of the VIEs can only be settled with the commercial loans that serve as collateral for the securitized debt of the VIE and is non-recourse to the Company.

Note 11 — Share-Based Payments

In conjunction with the Company's IPO and concurrent private placement, the Company's Board of Directors approved the Western Asset Mortgage Capital Corporation Equity Plan (the "Equity Plan") and the Western Asset Manager Equity Plan (the "Manager Equity Plan" and collectively the "Equity Incentive Plans"). The Equity Incentive Plans include provisions for grants of restricted common stock and other equity-based awards to the Manager, its employees and employees of its affiliates and to the Company's directors, officers and employees. The Company can issue up to 3.0% of the total number of issued and outstanding shares of its common stock (on a fully diluted basis) at the time of each award (other than any shares previously issued or subject to awards made pursuant to one of the Company's Equity Incentive Plans) under these Equity Incentive Plans. At May 15, 2012, there were 308,335 shares of common stock initially reserved for issuance under the Equity Incentive Plans. Upon the completion of the October 3, 2012 follow-on common stock offering, the stock portion of the Company's dividend declared on December 19, 2013, and the April 9, 2014 follow-on offering (which includes the partial exercise of the overallotment option on May 7, 2014) and private placement of common stock, the number of shares of common stock available for issuance under the Equity Incentive Plans increased to 1,237,711, inclusive of 681,970 shares of restricted stock granted and 25,367 shares of restricted stock issued as a result of the stock portion of the dividend declared on December 19, 2013 and restricted stock attributed to dividends on restricted stock under the Director Deferred Fee Plan. As of September 30, 2016, 530,374 shares remained available for issuance under the Equity Incentive Plans.

The Company made the following grants under the Equity Plan for the nine months ended September 30, 2016 and the year ended December 31, 2015:

On March 1, 2015, the Company granted 200,000 shares of restricted common stock to the Manager under the Manager Equity Plan. One-third of the shares vested on March 1, 2016, one-third will vest on March 1, 2017 and the remaining one-third will vest on March 1, 2018.

On June 4, 2015, the Company granted a total of 10,500 (2,625 each) of restricted common stock under the Equity Plan to the Company's four independent directors. These restricted shares vested in full on June 4, 2016, the first anniversary of the grant date. Each of the independent directors has elected to defer the shares granted to him under the Company's Director Deferred Fee Plan (the "Director Deferred Fee Plan"). The Director Deferred Fee Plan permits eligible members of the Company's board of directors to defer certain stock awards made under its director

compensation programs. The Director Deferred Fee Plan allows directors to defer issuance of their stock awards and therefore defer payment of any tax liability until the deferral is terminated, pursuant to the election form executed each year by each eligible director.

On June 2, 2016, the Company granted a total of 17,132 (4,283 each) of restricted common stock under the Equity Plan to the Company's four independent directors. These restricted shares will vest in full on June 2, 2017, the first anniversary of the grant date. Each of the independent directors has elected to defer the shares granted to him under the Director Deferred Fee Plan. The Director Deferred Fee Plan permits eligible members of the Company's board of directors to defer certain stock awards made under its director compensation programs. The Director Deferred Fee Plan allows directors to defer issuance of their stock awards

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and therefore defer payment of any tax liability until the deferral is terminated, pursuant to the election form executed each year by each eligible director.

On December 8, 2015, the Company's then chief financial officer passed away and the board of directors approved the accelerated vesting of 13,980 shares of restricted common stock.

During the nine months ended September 30, 2016 and September 30, 2015, 200,983 and 160,510 restricted common shares vested, respectively, including shares whose issuance has been deferred under the Director Deferred Fee Plan. The Company recognized stock-based compensation expense of approximately $433 thousand and approximately $1.4 million for the three and nine months ended September 30, 2016, respectively, and approximately $509 thousand and approximately $2.0 million for the three and nine months ended September 30, 2015, respectively. In addition, the Company had unamortized compensation expense of $106 thousand for equity awards and approximately $1.3 million for liability awards and $67 thousand for equity awards and approximately $2.4 million for liability awards at September 30, 2016 and December 31, 2015, respectively.

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

The following is a summary of restricted common stock vesting dates as of September 30, 2016 and December 31, 2015, including shares whose issuance has been deferred under the Director Deferred Fee Plan:

Vesting Date	September 30, 2016 Shares Vesting	December 31, 2015 Shares Vesting
March 2016	—	188,184
June 2016	—	11,528
March 2017	133,334	133,334
June 2017	17,672	—
March 2018	66,667	66,667
	217,673	399,713

The following table presents information with respect to the Company's restricted stock for the nine months ended September 30, 2016 including shares whose issuance has been deferred under the Director Deferred Fee Plan: