DYNEX CAPITAL INC
Form 10-Q
August 08, 2017

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549
FORM 10-Q
x Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended June 30, 2017
or
o Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
Commission File Number: 1-9819
DYNEX CAPITAL, INC.
(Exact name of registrant as specified in its charter)

Virginia	52-1549373
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
4991 Lake Brook Drive, Suite 100, Glen Allen, Virginia	23060-9245
(Address of principal executive offices)	(Zip Code)

(804) 217-5800
(Registrant's telephone number, including area code)

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

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

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

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o

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

On August 2, 2017, the registrant had 49,234,232 shares outstanding of common stock, $0.01 par value, which is the registrant's only class of common stock.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

DYNEX CAPITAL, INC.
CONSOLIDATED BALANCE SHEETS
(amounts in thousands except share data)

	June 30, 2017 (unaudited)	December 31, 2016
ASSETS		
Mortgage-backed securities (including pledged of $2,743,850 and $3,150,610, respectively)	$2,864,026	$3,212,084
Mortgage loans held for investment, net	17,345	19,036
Cash and cash equivalents	100,863	74,120
Restricted cash	45,377	24,769
Derivative assets	267	28,534
Principal receivable on investments	5,812	11,978
Accrued interest receivable	19,295	20,396
Other assets, net	7,235	6,814
Total assets	$3,060,220	$3,397,731
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities:		
Repurchase agreements	$2,540,759	$2,898,952
Non-recourse collateralized financing	5,892	6,440
Derivative liabilities	1,686	6,922
Accrued interest payable	1,524	3,156
Accrued dividends payable	11,121	12,268
Other liabilities	1,963	2,809
Total liabilities	2,562,945	2,930,547
Shareholders' equity:		
Preferred stock, par value $.01 per share; 50,000,000 shares authorized; 5,348,658 and 4,571,937 shares issued and outstanding, respectively ($133,716 and $114,298 aggregate liquidation preference, respectively)	$128,165	$110,005
Common stock, par value $.01 per share, 200,000,000 shares authorized; 49,234,493 and 49,153,463 shares issued and outstanding, respectively	492	492
Additional paid-in capital	728,124	727,369
Accumulated other comprehensive loss	(257)	(32,609)
Accumulated deficit	(359,249)	(338,073)
Total shareholders' equity	497,275	467,184
Total liabilities and shareholders' equity	$3,060,220	$3,397,731

See notes to the unaudited consolidated financial statements.

DYNEX CAPITAL, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(UNAUDITED)
(amounts in thousands except per share data)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2017	2016	2017	2016
Interest income	$24,856	$22,816	$47,275	47,905
Interest expense	8,714	6,100	16,233	12,410
Net interest income	16,142	16,716	31,042	35,495
Loss on derivative instruments, net	(15,802)	(16,297)	(15,627)	(64,561)
Loss on sale of investments, net	(3,709)	(297)	(5,417)	(4,238)
Fair value adjustments, net	30	28	40	51
Other income (loss), net	4	290	(42)	353
General and administrative expenses:				
Compensation and benefits	(2,041)	(1,875)	(4,286)	(4,093)
Other general and administrative	(2,056)	(1,796)	(4,091)	(3,669)
Net (loss) income	(7,432)	(3,231)	1,619	(40,662)
Preferred stock dividends	(2,641)	(2,294)	(5,077)	(4,588)
Net loss to common shareholders	$(10,073)	$(5,525)	$(3,458)	$(45,250)
Other comprehensive income:				
Unrealized gain on available-for-sale investments, net	$8,739	$22,730	$27,107	$60,491
Reclassification adjustment for loss on sale of investments, net	3,709	297	5,417	4,238
Reclassification adjustment for de-designated cash flow hedges	(73)	(80)	(172)	(53)
Total other comprehensive income	12,375	22,947	32,352	64,676
Comprehensive income to common shareholders	$2,302	$17,422	$28,894	$19,426
Net loss per common share-basic and diluted	$(0.20)	$(0.11)	$(0.07)	$(0.92)
Weighted average common shares-basic and diluted	49,218	49,119	49,197	49,080

See notes to the unaudited consolidated financial statements.

DYNEX CAPITAL, INC.
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
(UNAUDITED)
($ in thousands)

	Preferred Stock		Common Stock		Additional Paid-in Capital	Accumulated Other Comprehensive Loss	Accumulated Deficit	Total Shareholders' Equity
	Shares	Amount	Shares	Amount				
Balance as of December 31, 2016	4,571,937	$ 110,005	49,153,463	$ 492	$ 727,369	$ (32,609)	$ (338,073)	$ 467,184
Stock issuance	776,721	18,212	20,431	—	139	—	—	18,351
Restricted stock granted, net of amortization	—	—	138,166	1	1,177	—	—	1,178
Adjustments for tax withholding on share-based compensation	—	—	(77,567)	(1)	(520)	—	—	(521)
Stock issuance costs	—	(52)	—	—	(41)	—	—	(93)
Net income	—	—	—	—	—	—	1,619	1,619
Dividends on preferred stock	—	—	—	—	—	—	(5,077)	(5,077)
Dividends on common stock	—	—	—	—	—	—	(17,718)	(17,718)
Other comprehensive income	—	—	—	—	—	32,352	—	32,352
Balance as of June 30, 2017	5,348,658	$ 128,165	49,234,493	$ 492	$ 728,124	$ (257)	$ (359,249)	$ 497,275

See notes to the unaudited consolidated financial statements.

DYNEX CAPITAL, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)
($ in thousands)

	Six Months Ended June 30,	
	2017	2016
Operating activities:		
Net income (loss)	$ 1,619	$ (40,662)
Adjustments to reconcile net income (loss) to cash provided by operating activities:		
Decrease in accrued interest receivable	1,101	3,145
Decrease in accrued interest payable	(1,633)	(29)
Loss on derivative instruments, net	15,627	64,561
Loss on sale of investments, net	5,417	4,238
Fair value adjustments, net	(40)	(51)
Amortization of investment premiums, net	81,188	73,597
Other amortization and depreciation, net	682	850
Stock-based compensation expense	1,179	1,443
Decrease in other assets and liabilities, net	(2,120)	(881)
Net cash and cash equivalents provided by operating activities	103,020	106,211
Investing activities:		
Purchase of investments	(282,943)	(4,970)
Principal payments received on investments	183,636	187,437
Proceeds from sales of investments	399,483	94,033
Principal payments received on mortgage loans held for investment, net	1,876	2,319
Distributions received from limited partnership	—	10,835
Net receipts (payments) on derivatives, including terminations	7,405	(26,092)
Other investing activities	(212)	(55)
Net cash and cash equivalents provided by investing activities	309,245	263,507
Financing activities:		
Borrowings under repurchase agreements	39,007,126	11,394,652
Repayments of repurchase agreement borrowings and FHLB advances	(39,365,319)	(11,640,592)
Principal payments on non-recourse collateralized financing	(557)	(939)
Increase in restricted cash	(20,608)	(32,489)
Proceeds from issuance of preferred stock	18,212	—
Proceeds from issuance of common stock	139	77
Cash paid for stock issuance costs	(52)	—
Cash paid for repurchases of common stock	—	(310)
Payments related to tax withholding for stock-based compensation	(521)	(485)
Dividends paid	(23,942)	(26,670)
Net cash and cash equivalents used in financing activities	(385,522)	(306,756)
Net increase in cash and cash equivalents	26,743	62,962
Cash and cash equivalents at beginning of period	74,120	33,935
Cash and cash equivalents at end of period	$ 100,863	$ 96,897
Supplemental Disclosure of Cash Activity:		
Cash paid for interest	$ 18,029	$ 12,476

See notes to the unaudited consolidated financial statements.

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
DYNEX CAPITAL, INC.
(amounts in thousands except share data)

NOTE 1 –ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

Dynex Capital, Inc., ("Company") was incorporated in the Commonwealth of Virginia on December 18, 1987 and commenced operations in February 1988. The Company primarily earns income from investing on a leveraged basis in Agency and non-Agency mortgage-backed securities ("MBS") consisting of residential MBS ("RMBS"), commercial MBS ("CMBS") and CMBS interest-only ("IO") securities that are issued or guaranteed by the U.S. Government or U.S. Government sponsored agencies ("Agency MBS") and MBS issued by others ("non-Agency MBS"). We may also invest in other types of mortgage-related securities, such as to-be-announced ("TBA") forward contracts for the purchase or sale of generic Agency MBS.

Basis of Presentation

The accompanying unaudited consolidated financial statements of Dynex Capital, Inc. and its subsidiaries (together, "Dynex" or, as appropriate, the "Company") have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information and with the instructions to the Quarterly Report on Form 10-Q and Article 10, Rule 10-01 of Regulation S-X promulgated by the Securities and Exchange Commission (the "SEC"). Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, all significant adjustments, consisting of normal recurring accruals, considered necessary for a fair presentation of the consolidated financial statements have been included. Operating results for the three months ended June 30, 2017 are not necessarily indicative of the results that may be expected for any other interim periods or for the entire year ending December 31, 2017. The unaudited consolidated financial statements included herein should be read in conjunction with the audited financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2016 filed with the SEC.

Reclassifications

Certain items in the prior periods' consolidated financial statements have been reclassified to conform to the current period's presentation. The Company has reclassified amortization of stock issuance costs which was previously recorded in "proceeds from issuance of common stock, net of issuance costs" in the financing activities section of the Company's consolidated statements of cash flows for six months ended June 30, 2016. Amortization of stock issuance costs is now presented within "other operating activities" in the operating activities section of the Company's consolidated statements of cash flows. This presentation change had no effect on reported financial condition or results of operations and did not have a material impact on cash flows from operating or financing activities.

Consolidation

The consolidated financial statements include the accounts of the Company and the accounts of its majority owned subsidiaries and variable interest entities ("VIE") for which it is the primary beneficiary. As a primary beneficiary, the Company has both the power to direct the activities that most significantly impact the economic performance of the VIE and a right to receive benefits or absorb losses of the entity that could be potentially significant to the VIE. The Company is required to reconsider its evaluation of whether to consolidate a VIE each reporting period, based upon changes in the facts and circumstances pertaining to the VIE. The Company consolidates certain trusts through which it has securitized mortgage loans as a result of not meeting the sale criteria under GAAP at the time the financial assets were transferred to the trust. All intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements as well as the reported amounts of revenue and expenses during the reported period. Actual results could differ from those estimates. The most significant estimates used by management include, but are not limited to, amortization of premiums and discounts, fair value measurements of its investments, and other-than-temporary impairments. These items are discussed further below within this note to the consolidated financial statements.

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
DYNEX CAPITAL, INC.
(amounts in thousands except share data)

Income Taxes

The Company has elected to be taxed as a real estate investment trust ("REIT") under the Internal Revenue Code of 1986 and the corresponding provisions of state law. To qualify as a REIT, the Company must meet certain tests including investing in primarily real estate-related assets and the required distribution of at least 90% of its annual REIT taxable income to stockholders after consideration of its net operating loss ("NOL") carryforward and not including taxable income retained in its taxable subsidiaries. As a REIT, the Company generally will not be subject to federal income tax on the amount of its income or capital gains that is distributed as dividends to shareholders.

The Company assesses its tax positions for all open tax years and determines whether the Company has any material unrecognized liabilities in accordance with Accounting Standards Codification ("ASC") Topic 740. The Company records these liabilities, if any, to the extent they are deemed more likely than not to have been incurred.

Net Income (Loss) Per Common Share

The Company calculates basic net income (loss) per common share by dividing net income (loss) to common shareholders for the period by weighted-average shares of common stock outstanding for that period. The Company did not have any potentially dilutive securities outstanding during the three or six months ended June 30, 2017 or June 30, 2016.

Holders of unvested shares of the Company's issued and outstanding restricted common stock are eligible to receive non-forfeitable dividends. As such, these unvested shares are considered participating securities as per ASC Topic 260-10 and therefore are included in the computation of basic net income (loss) per common share using the two-class method. Upon vesting, restrictions on transfer expire on each share of restricted stock, and each such share of restricted stock represents one unrestricted share of common stock.

Because the Company's 8.50% Series A Cumulative Redeemable Preferred Stock (the “Series A Preferred Stock”) and 7.625% Series B Cumulative Redeemable Preferred Stock (the “Series B Preferred Stock”) are redeemable at the Company's option for cash only and may convert into shares of common stock only upon a change of control of the Company, the effect of those shares and their related dividends is excluded from the calculation of diluted net income (loss) per common share.

Cash and Cash Equivalents

Cash and cash equivalents include cash on hand and highly liquid investments with original maturities of three months or less.

Restricted Cash

Restricted cash consists of cash the Company has pledged to cover initial and variation margin with its financing and derivative counterparties.

Mortgage-Backed Securities

The Company's investments in Agency and non-Agency RMBS, CMBS, and CMBS IO securities are designated as available-for-sale ("AFS") and are recorded at fair value on the Company's consolidated balance sheet. Changes in unrealized gain (loss) on the Company's MBS are reported in other comprehensive income ("OCI") until each security is collected, disposed of, or determined to be other than temporarily impaired. Although the Company generally intends to hold its AFS securities until maturity, it may sell any of these securities as part of the overall management of its business. Upon the sale of an AFS security, any unrealized gain or loss is reclassified out of accumulated other comprehensive income ("AOCI") into net income as a realized "gain (loss) on sale of investments, net" using the specific identification method.

The Company’s MBS pledged as collateral against repurchase agreements and derivative instruments are included in MBS on the consolidated balance sheets with the fair value of the MBS pledged as collateral disclosed parenthetically.

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
DYNEX CAPITAL, INC.
(amounts in thousands except share data)

Interest Income, Premium Amortization, and Discount Accretion. Interest income on MBS is accrued based on the outstanding principal balance (or notional balance in the case of interest-only, or "IO", securities) and their contractual terms. Premiums and discounts on Agency MBS as well as any non-Agency MBS rated 'AA' and higher at the time of purchase are amortized or accreted into interest income over the expected life of such securities using the effective yield method and adjustments to premium amortization and discount accretion are made for actual cash payments as well as changes in projected future cash payments. The Company's projections of future cash payments are based on input and analysis received from external sources and internal models, and include assumptions about the amount and timing of loan prepayment rates, fluctuations in interest rates, credit losses, and other factors. On at least a quarterly basis, the Company reviews and makes any necessary adjustments to its cash flow projections and updates the yield recognized on these assets.

The Company holds certain non-Agency MBS that had credit ratings of less than 'AA' at the time of purchase or were not rated by any of the nationally recognized credit rating agencies. A portion of these non-Agency MBS were purchased at discounts to their par value, which management does not believe to be substantial. The discount is accreted into income over the security's expected life based on management's estimate of the security's projected cash flows. Future changes in the timing of projected cash flows or differences arising between projected cash flows and actual cash flows received may result in a prospective change in the effective yield on those securities.

Determination of MBS Fair Value. The Company estimates the fair value of the majority of its MBS based upon prices obtained from third-party pricing services and broker quotes. The remainder of the Company's MBS are valued by discounting the estimated future cash flows derived from cash flow models that utilize information such as the security's coupon rate, estimated prepayment speeds, expected weighted average life, collateral composition, estimated future interest rates, expected losses, and credit enhancements as well as certain other relevant information. Refer to Note 5 for further discussion of MBS fair value measurements.

Other-than-Temporary Impairment. An MBS is considered impaired when its fair value is less than its amortized cost. The Company evaluates all of its impaired MBS for other-than-temporary impairments ("OTTI") on at least a quarterly basis. An impairment is considered other-than-temporary if: (1) the Company intends to sell the MBS; (2) it is more likely than not that the Company will be required to sell the MBS before its fair value recovers; or (3) the Company does not expect to recover the full amortized cost basis of the MBS. If either of the first two conditions is met, the entire amount of the impairment is recognized in earnings. If the impairment is solely due to the inability to fully recover the amortized cost basis, the security is further analyzed to quantify any credit loss, which is the difference between the present value of cash flows expected to be collected on the MBS and its amortized cost. The credit loss, if any, is then recognized in earnings, while the balance of impairment related to other factors is recognized in other comprehensive income.

Following the recognition of an OTTI through earnings, a new cost basis is established for the security. Any subsequent recoveries in fair value may be accreted back into the amortized cost basis of the MBS on a prospective basis through interest income. Please see Note 2 for additional information related to the Company's evaluation for OTTI.

Repurchase Agreements

The Company's repurchase agreements, which are used to finance its purchases of MBS, are accounted for as secured borrowings under which the Company pledges its securities as collateral to secure a loan, which is equal in value to a specified percentage of the estimated fair value of the pledged collateral. The Company retains beneficial ownership of the pledged collateral. At the maturity of a repurchase agreement, the Company is required to repay the loan and concurrently receives back its pledged collateral from the lender or, with the consent of the lender, the Company may renew the agreement at the then prevailing financing rate. A repurchase agreement lender may require the Company to pledge additional collateral in the event of a decline in the fair value of the collateral pledged. Repurchase agreement financing is recourse to the Company and the assets pledged. Most of the Company's repurchase agreements are based on the September 1996 version of the Bond Market Association Master Repurchase Agreement, which generally provides that the lender, as buyer, is responsible for obtaining collateral valuations from a generally recognized source agreed to by both the Company and the lender, or, in an instance when such source is not available, the value determination is made by the lender.

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
DYNEX CAPITAL, INC.
(amounts in thousands except share data)

Derivative Instruments

The Company's derivative instruments include interest rate swaps and forward contracts for the purchase or sale of generic Agency RMBS, commonly referred to as "TBA securities" or "TBA contracts". Derivative instruments are accounted for at the fair value of their unit of account. Derivative instruments in a gain position are reported as derivative assets and derivative instruments in a loss position are reported as derivative liabilities on the Company's consolidated balance sheet. All periodic interest costs and changes in fair value of derivative instruments, including gains and losses realized upon termination, maturity, or settlement are recorded in "gain (loss) on derivative instruments, net" on the Company's consolidated statement of comprehensive income. Cash receipts and payments related to derivative instruments are classified in the investing activities section of our consolidated statements of cash flows in accordance with the underlying nature or purpose of the derivative transactions.

Our interest rate swap agreements are privately negotiated in the over-the-counter ("OTC") market and the majority of these agreements are centrally cleared through the Chicago Mercantile Exchange ("CME") with the rest being subject to bilateral agreements between the Company and the swap counterparty. The Company's CME cleared swaps require that the Company post initial margin as determined by the CME, and in addition, variation margin is exchanged, typically in cash, for changes in the fair value of the CME cleared swaps. Beginning in January 2017, as a result of a change in the CME's rulebook, the exchange of variation margin for CME cleared swaps is legally considered to be the settlement of the derivative itself as opposed to a pledge of collateral. Accordingly, beginning in 2017, the Company accounts for the daily exchange of variation margin associated with its CME cleared interest rate swaps as a direct increase or decrease to the carrying value of the related derivative asset or liability. The carrying value of CME cleared interest rate swaps on the Company's consolidated balance sheets is the unsettled fair value of those instruments.

A TBA security is a forward contract for the purchase or sale of a generic Agency MBS at a predetermined price with certain principal and interest terms and certain types of collateral, but the particular Agency securities to be delivered are not identified until shortly before the TBA settlement date. The Company executes TBA dollar roll transactions which effectively delay the settlement of a forward purchase of a TBA Agency RMBS by entering into an offsetting short position (referred to as a "pair off"), net settling the paired-off positions in cash, and simultaneously entering a similar TBA contract for a later settlement date. TBA securities purchased for a forward settlement month are generally priced at a discount relative to TBA securities sold for settlement in the current month. This discount, often referred to as “drop income” is the economic equivalent of net interest interest income on the underlying Agency securities over the roll period (interest income less implied financing cost).

The Company accounts for TBA securities as derivative instruments because the Company cannot assert that it is probable at inception and throughout the term of an individual TBA contract that its settlement will result in physical delivery of the underlying Agency RMBS, or the individual TBA contract will not settle in the shortest time period possible.

Please refer to Note 4 for additional information regarding the Company's derivative instruments as well as Note 5 for information on how the fair value of these instruments are calculated.

Share-Based Compensation

Pursuant to the Company’s 2009 Stock and Incentive Plan, the Company may grant share-based compensation to eligible employees, directors or consultants or advisers to the Company, including stock awards, stock options, stock appreciation rights, dividend equivalent rights, performance shares, and restricted stock units. The Company's restricted stock currently issued and outstanding under this plan may be settled only in shares of its common stock, and therefore are treated as equity awards with their fair value measured at the grant date and recognized as compensation cost over the requisite service period with a corresponding credit to shareholders' equity. The requisite service period is the period during which an employee is required to provide service in exchange for an award, which is equivalent to the vesting period specified in the terms of the time-based restricted stock award. None of the Company's restricted stock awards have performance based conditions. The Company does not currently have any share-based compensation issued or outstanding other than restricted stock issued to its employees, officers, and directors.

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
DYNEX CAPITAL, INC.
(amounts in thousands except share data)

Contingencies

In the normal course of business, there may be various lawsuits, claims, and other contingencies pending against the Company. On a quarterly basis, the Company evaluates whether to establish provisions for estimated losses from those matters. The Company recognizes a liability for a contingent loss when: (a) the underlying causal event has occurred prior to the balance sheet date; (b) it is probable that a loss has been incurred; and (c) there is a reasonable basis for estimating that loss. A liability is not recognized for a contingent loss when it is only possible or remotely possible that a loss has been incurred, however, possible contingent losses shall be disclosed. If the contingent loss (or an additional loss in excess of any accrual) is at least a reasonable possibility and material, then the Company discloses a reasonable estimate of the possible loss or range of loss, if such reasonable estimate can be made. If the Company cannot make a reasonable estimate of the possible material loss, or range of loss, then that fact is disclosed.

Recent Accounting Pronouncements

The Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2017-08, Receivables-Nonrefundable Fees and Other Costs, which shortens the amortization period for certain callable debt securities held at a premium, requiring the premium to be amortized to the earliest call date. The amendments in this ASU are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018 and early adoption is permitted. The amendments in this Update should be applied using the modified-retrospective transition approach and will require disclosures for the change in accounting principle. The Company is currently evaluating the impact of this ASU on its consolidated financial statements.

NOTE 2 – MORTGAGE-BACKED SECURITIES

The majority of the Company's MBS are pledged as collateral for the Company's secured borrowings. The following tables present the Company’s MBS by investment type as of the dates indicated:

	June 30, 2017						
	Par	Net Premium (Discount)	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value	WAC (1)
CMBS:							
Agency	$1,315,974	$14,110	1,330,084	$ 6,026	$(15,492)	1,320,618	3.04%
Non-Agency	41,142	(4,855)	36,287	3,280	—	39,567	5.53%
	1,357,116	9,255	1,366,371	9,306	(15,492)	1,360,185	
CMBS IO (2):							
Agency	—	413,368	413,368	6,719	(322)	419,765	0.63%
Non-Agency	—	339,493	339,493	5,401	(578)	344,316	0.62%
	—	752,861	752,861	12,120	(900)	764,081	
RMBS:							
Agency	715,015	29,074	744,089	1,959	(7,464)	738,584	2.98%
Non-Agency	1,156	—	1,156	46	(26)	1,176	6.75%
	716,171	29,074	745,245	2,005	(7,490)	739,760	
Total AFS securities: (1)	$2,073,287	$791,190	$2,864,477	$ 23,431	$(23,882)	$2,864,026	

The weighted average coupon ("WAC") is the gross interest rate of the pool of mortgages underlying the security weighted by the outstanding principal balance (or by notional balance in the case of an IO security).

(2) The notional balance for Agency CMBS IO and non-Agency CMBS IO was $14,248,128 and $11,126,737, respectively, as of June 30, 2017.

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	December 31, 2016						
	Par	Net Premium (Discount)	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value	WAC (1)
CMBS:							
Agency	$1,152,586	$13,868	$1,166,454	$ 6,209	$(28,108)	$1,144,555	3.12%
Non-Agency	79,467	(6,718)	72,749	5,467	—	78,216	4.72%
	1,232,053	7,150	1,239,203	11,676	(28,108)	1,222,771	
CMBS IO (2):							
Agency	—	411,737	411,737	3,523	(3,362)	411,898	0.67%
Non-Agency	—	346,155	346,155	1,548	(5,055)	342,648	0.61%
	—	757,892	757,892	5,071	(8,417)	754,546	
RMBS:							
Agency	$1,157,258	$57,066	$1,214,324	$ 2,832	$(15,951)	$1,201,205	3.05%
Non-Agency	33,572	(24)	33,548	64	(50)	33,562	3.58%
	1,190,830	57,042	1,247,872	2,896	(16,001)	1,234,767	
Total AFS securities:	$2,422,883	$822,084	$3,244,967	$ 19,643	$(52,526)	$3,212,084	

(1) The WAC is the gross interest rate of the pool of mortgages underlying the security weighted by the outstanding principal balance (or by notional balance in the case of an IO security).

(2) The notional balance for the Agency CMBS IO and non-Agency CMBS IO was $13,106,912 and $10,884,964, respectively, as of December 31, 2016.

Actual maturities of MBS are affected by the contractual lives of the underlying mortgage collateral, periodic payments of principal, prepayments of principal, and the payment priority structure of the security; therefore, actual maturities are generally shorter than the securities' stated contractual maturities.

The following table presents information regarding the sales included in "loss on sale of investments, net" on the Company's consolidated statements of comprehensive income for the periods indicated:

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	Three Months Ended June 30,			
	2017		2016	
	Proceeds Received	Realized Gain (Loss)	Proceeds Received	Realized Gain (Loss)
Agency RMBS	$265,893	$(5,524)	$10,287	$(297)
Agency CMBS	24,305	574	—	—
Non-Agency CMBS	35,705	1,199	—	—
Non-Agency RMBS	16,407	42	—	—
	$342,310	$(3,709)	$10,287	$(297)

	Six Months Ended June 30,			
	2017		2016	
	Proceeds Received	Realized Gain (Loss)	Proceeds Received	Realized Gain (Loss)
Agency RMBS	$323,057	$(7,232)	$54,178	$(3,010)
Agency CMBS	24,305	574	—	—
Non-Agency CMBS	35,705	1,199	33,640	(1,228)
Non-Agency RMBS	16,407	42	—	—
	$399,474	$(5,417)	$87,818	$(4,238)

The following table presents certain information for those MBS in an unrealized loss position as of the dates indicated:

	June 30, 2017			December 31, 2016		
	Fair Value	Gross Unrealized Losses	# of Securities	Fair Value	Gross Unrealized Losses	# of Securities
Continuous unrealized loss position for less than 12 months:						
Agency MBS	$1,254,502	$(20,694)	101	$1,738,094	$(38,469)	133
Non-Agency MBS	19,542	(154)	3	205,484	(2,773)	48
Continuous unrealized loss position for 12 months or longer:						
Agency MBS	$186,382	$(2,584)	28	$427,405	$(8,952)	72
Non-Agency MBS	40,122	(450)	16	81,660	(2,332)	26

Because the principal related to Agency MBS is guaranteed by the government-sponsored entities Fannie Mae and Freddie Mac which have the implicit guarantee of the U.S. government, the Company does not consider any of the unrealized losses on its Agency MBS to be credit related. Although the unrealized losses are not credit related, the Company assesses its ability and intent to hold any Agency MBS with an unrealized loss until the recovery in its value in accordance with GAAP. This assessment is based on the amount of the unrealized loss and significance of the related investment as well as the Company’s leverage and liquidity position. Based on this analysis, the Company has determined that the unrealized losses on its Agency MBS as of June 30, 2017 and December 31, 2016 were temporary.

The Company reviews any non-Agency MBS in an unrealized loss position to evaluate whether any decline in fair value represents an OTTI. The evaluation includes a review of the credit ratings of the non-Agency MBS, the credit characteristics

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of the mortgage loans collateralizing these securities, and the estimated future cash flows including projected collateral losses. The Company performed this evaluation for its non-Agency MBS in an unrealized loss position and has determined that there have not been any adverse changes in the timing or amount of estimated future cash flows that necessitate a recognition of OTTI amounts as of June 30, 2017 or December 31, 2016.

NOTE 3 – REPURCHASE AGREEMENTS

The Company's repurchase agreements outstanding as of June 30, 2017 and December 31, 2016 are summarized in the following tables:

	June 30, 2017				December 31, 2016			
Collateral Type	Balance	Weighted Average Rate		Fair Value of Collateral Pledged	Balance	Weighted Average Rate		Fair Value of Collateral Pledged
Agency CMBS	$1,192,447	1.21	%	$1,252,560	$1,005,726	0.82	%	$1,095,002
Non-Agency CMBS	31,407	2.23	%	38,934	66,881	1.63	%	77,840
Agency CMBS IO	353,922	2.04	%	415,988	346,892	1.57	%	407,481
Non-Agency CMBS IO	293,725	2.13	%	343,600	291,199	1.67	%	341,139
Agency RMBS	665,346	1.29	%	692,126	1,157,302	0.82	%	1,191,147
Non-Agency RMBS	—	—	%	—	26,149	1.98	%	31,952
Securitization financing bond	3,912	2.45	%	4,249	4,803	2.00	%	5,278
Total repurchase agreements	$2,540,759	1.47	%	$2,747,457	$2,898,952	1.03	%	$3,149,839

As of June 30, 2017, the weighted average remaining term to maturity of our repurchase agreements was 19 days compared to 20 days as of December 31, 2016. The following table provides a summary of the original term to maturity of our secured borrowings as of June 30, 2017 and December 31, 2016:

Original Term to Maturity	June 30, 2017	December 31, 2016
Less than 30 days	$1,215,553	$ 910,937
30 to 90 days	1,268,716	533,112
91 to 180 days	56,490	1,454,903
	$2,540,759	$ 2,898,952

The following table lists the counterparties with whom the Company had over 10% of its shareholders' equity at risk (defined as the excess of collateral pledged over the borrowings outstanding):

	June 30, 2017			
Counterparty Name	Balance	Weighted Average Rate		Equity at Risk
Wells Fargo Bank, N. A. and affiliates	$371,660	2.09	%	$65,366

Of the amount outstanding with Wells Fargo Bank, N.A. and affiliates, $359,263 is under a committed repurchase facility which has an aggregate maximum borrowing capacity of $400,000 and is scheduled to mature on May 12, 2019, subject to early termination provisions contained in the master repurchase agreement. The facility is collateralized primarily by CMBS IO, and its weighted average borrowing rate as of June 30, 2017 was 2.09%.

As of June 30, 2017, the Company had repurchase agreement amounts outstanding with 18 of its 34 available repurchase agreement counterparties. The Company's counterparties, as set forth in the master repurchase agreement with the counterparty, require the Company to comply with various customary operating and financial covenants, including, but not limited to, minimum net worth, maximum declines in net worth in a given period, and maximum leverage requirements as well as maintaining the Company's REIT status. In addition, some of the agreements contain cross default features, whereby default under an agreement with one lender simultaneously causes default under agreements with other lenders. To the extent that the Company fails to comply with the covenants contained in these financing agreements or is otherwise found to be in default under the terms of such agreements, the counterparty has the right to accelerate amounts due under the master repurchase agreement. The Company was in full compliance with all covenants as of June 30, 2017.

(amounts in thousands except share data)

The Company's repurchase agreements are subject to underlying agreements with master netting or similar arrangements, which provide for the right of offset in the event of default or in the event of bankruptcy of either party to the transactions. The Company reports its repurchase agreements to these arrangements on a gross basis. The following tables present information regarding the Company's repurchase agreements as if the Company had presented them on a net basis as of June 30, 2017 and December 31, 2016:

	Gross Amount of Recognized Liabilities	Gross Amount Offset in the Balance Sheet	Net Amount of Liabilities Presented in the Balance Sheet	Gross Amount Not Offset in the Balance Sheet (1)		Net Amount
				Financial Instruments Posted as Collateral	Cash Posted as Collateral	
June 30, 2017						
Repurchase agreements	$ 2,540,759	$ —	$ 2,540,759	$ (2,540,759)	$ —	$ —
December 31, 2016:						
Repurchase agreements	$ 2,898,952	$ —	$ 2,898,952	$ (2,898,952)	$ —	$ —

(1) Amounts disclosed for collateral received by or posted to the same counterparty include cash and the fair value of MBS up to and not exceeding the net amount of the asset or liability presented in the balance sheet. The fair value of the actual collateral received by or posted to the same counterparty may exceed the amounts presented.

Please see Note 4 for information related to the Company's derivatives which are also subject to underlying agreements with master netting or similar arrangements.

NOTE 4 – DERIVATIVES

As of June 30, 2017, the Company's derivative instruments include interest rate swaps and TBA securities. The Company utilizes interest rate swaps to economically hedge a portion of its exposure to interest rate risk. The objective of the Company's risk management strategy is to mitigate declines in book value resulting from fluctuations in the fair value of the Company's assets from changing interest rates and to protect some portion of the Company's earnings from rising interest rates.

During the second quarter of 2017, the Company began investing in TBA securities for the purchase or sale of Agency RMBS on a non-specified pool basis. TBA securities are forward contracts which are accounted for as derivative instruments, however, management views TBA securities as the economic equivalent of investing in and financing generic Agency fixed-rate RMBS through the repurchase agreement markets. Please refer to Note 1 for information related to the Company's accounting policy for its derivative instruments.

The table below summarizes information about the fair value by type of derivative instrument on the Company's consolidated balance sheets as of the dates indicated:

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Type of Derivative Instruments	Balance Sheet Location	June 30, 2017 Fair Value	December 31, 2016 Fair Value (1)
Interest rate swaps	Derivative assets	$267	$28,534
TBA securities	Derivative assets	—	—
		$267	$28,534
Interest rate swaps	Derivative liabilities	$(18)	$(6,922)
TBA securities	Derivative liabilities	(1,668)	—
		$(1,686)	$(6,922)

(1) Refer to Note 1 regarding information on a change in the CME rulebook. Amounts reported on the consolidated balance sheet as of June 30, 2017 for its interest rate swaps reflect the netting of the derivative asset or liability with the related collateral received or posted, respectively. The net amounts comparable to June 30, 2017 for the derivative asset and derivative liabilities as of December 31, 2016 were $104 and $(576), respectively.

The following tables present information about the Company's interest rate swaps as of the dates indicated:

	June 30, 2017			
		Weighted-Average:		
Years to Maturity:	Net Notional Amount (1)	Pay Rate (2)	Life Remaining (in Years)	Fair Value
< 3 years	$3,060,000	1.39%	1.1	$249
>3 and < 6 years	1,050,000	1.63%	4.3	—
>6 and < 10 years	1,175,000	2.45%	8.3	—
Total	$5,285,000	1.67%	3.4	$249

	December 31, 2016			
		Weighted-Average:		
Years to Maturity:	Net Notional Amount (1)	Pay Rate (2)	Life Remaining (in Years)	Fair Value
< 3 years	$595,000	0.73%	2.3	$4,348
>3 and < 6 years	1,185,000	1.47%	4.3	8,631
>6 and < 10 years	1,250,000	2.42%	8.9	8,633
Total	$3,030,000	1.58%	5.3	$21,612

(1) The net notional amounts included in the tables above represent pay-fixed interest rate swaps, net of receive-fixed interest rate swaps and include $2,425,000 and $2,725,000 of pay-fixed forward starting interest rate swaps as of June 30, 2017 and December 31, 2016, respectively.
(2) Excluding forward starting pay-fixed interest rate swaps, the weighted average pay rate was 1.31% and 0.73% as of June 30, 2017 and December 31, 2016, respectively.

The following table summarizes information about the Company's TBA securities as of June 30, 2017:

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By Coupon:	June 30, 2017 Notional Amount (1)	Cost Basis (2)	Market Value (3)	Net Carrying Value (4)
30-year TBA securities:				
3.0%	$100,000	$100,656	$99,867	$(789)
4.0%	300,000	315,656	314,777	(879)
Total 30-year TBA securities	$400,000	$416,312	$414,644	$(1,668)

(1) Notional amount represents the par value (or principal balance) of the underlying Agency MBS.
(2) Cost basis represents the forward price to be paid for the underlying Agency MBS as if settled.
(3) Market value is the current fair value of the TBA contract and represents the estimated fair value of the underlying Agency security as of the end of the period.
(4) Net carrying value represents the difference between the market value and the cost basis of the TBA contract as of the end of the period and is included on the consolidated balance sheets within "derivative assets (liabilities)".

The tables below summarize changes in our derivative instruments for the periods indicated:

Type of Derivative Instrument	Notional Amount as of December 31, 2016	Additions	Settlements, Terminations, or Pair-Offs	Notional Amount as of June 30, 2017
Receive-fixed interest rate swaps	$425,000	$ —	$(325,000)	$100,000
Pay-fixed interest rate swaps	3,455,000	2,750,000	(820,000)	5,385,000
TBA securities	—	1,300,000	(900,000)	400,000

The table below provides detail of the Company's "loss on derivative instruments, net" by type of derivative for the periods indicated:

	Three Months Ended June 30,		Six Months Ended June 30,	
Type of Derivative Instrument	2017	2016	2017	2016
Receive-fixed interest rate swaps	$979	$3,743	$845	$14,277
Pay-fixed interest rate swaps	(18,498)	(15,854)	(18,189)	(62,466)
TBA securities	1,717	—	1,717	—
Eurodollar futures	—	(4,186)	—	(16,372)
Loss on derivative instruments, net	$(15,802)	$(16,297)	$(15,627)	$(64,561)

There is a net unrealized gain of $499 remaining in AOCI on the Company's consolidated balance sheet as of June 30, 2017 which represents the activity related to interest rate swap agreements while they were previously designated as cash flow hedges, and this amount will be recognized in the Company's net income as an adjustment to "interest expense" over the remaining contractual life of the agreements. The Company estimates a credit of $193 will be reclassified to net income as a reduction of "interest expense" within the next 12 months.

A portion of the Company's interest rate swaps were entered into under bilateral agreements which contain cross-default provisions with other agreements between the parties. In addition, these bilateral agreements contain financial and operational covenants similar to those contained in our repurchase agreements as described in Note 3. The Company was in compliance with all covenants with respect to bilateral agreements under which interest rate swaps were entered into as of June 30, 2017.

The Company's derivatives are subject to underlying agreements with master netting or similar arrangements, which provide for the right of offset in the event of default or in the event of bankruptcy of either party to the transactions. The Company

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reports its derivative assets and liabilities subject to these arrangements on a gross basis. The following tables present information regarding those derivative assets and liabilities subject to such arrangements as if the Company had presented them on a net basis as of June 30, 2017 and December 31, 2016:

Offsetting of Assets

	Gross Amount of Recognized Assets	Gross Amount Offset in the Balance Sheet	Net Amount of Assets Presented in the Balance Sheet	Gross Amount Not Offset in the Balance Sheet [1] Financial Instruments Received as Collateral	Cash Received as Collateral	Net Amount
June 30, 2017						
Interest rate swaps	$267	$ —	$ 267	$(4)	$—	$ 263
TBA securities	—	—	—	—	—	—
Derivative assets	$267	$ —	$ 267	$(4)	$—	$ 263
December 31, 2016:						
Interest rate swaps	$28,534	$ —	$ 28,534	$(6,449)	$(22,085)	$ —
TBA securities	—	—	—	—	—	—
Derivative assets	$28,534	$ —	$ 28,534	$(6,449)	$(22,085)	$ —

Offsetting of Liabilities

	Gross Amount of Recognized Liabilities	Gross Amount Offset in the Balance Sheet	Net Amount of Liabilities Presented in the Balance Sheet	Gross Amount Not Offset in the Balance Sheet [1] Financial Instruments Posted as Collateral	Cash Posted as Collateral	Net Amount
June 30, 2017						
Interest rate swaps	$18	$ —	$ 18	$(18)	$ —	$ —
TBA securities	1,668	—	1,668	—	(961)	707
Derivative liabilities	$1,686	$ —	$ 1,686	$(18)	$ (961)	$ 707
December 31, 2016:						
Interest rate swaps	$6,922	$ —	$ 6,922	$(6,913)	$ —	$ 9
TBA securities	—	—	—	—	—	—
Derivative liabilities	$6,922	$ —	$ 6,922	$(6,913)	$ —	$ 9

(1) Amounts disclosed for collateral received by or posted to the same counterparty include cash and the fair value of MBS up to and not exceeding the net amount of the asset or liability presented in the balance sheet. The fair value of the actual collateral received by or posted to the same counterparty may exceed the amounts presented.

Please see Note 3 for information related to the Company's repurchase agreements which are also subject to underlying agreements with master netting or similar arrangements.

NOTE 5 – FAIR VALUE OF FINANCIAL INSTRUMENTS

ASC Topic 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC Topic 820 clarifies that fair value should be based on the assumptions market participants would use when pricing an asset or liability and also requires an entity to consider all aspects of nonperformance risk, including the entity's own credit standing, when measuring fair value of a liability. ASC Topic 820 established a valuation hierarchy of three levels as follows:

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- Level 1 – Inputs are unadjusted, quoted prices in active markets for identical assets or liabilities as of the measurement date.
- Level 2 – Inputs include quoted prices in active markets for similar assets or liabilities; quoted prices in inactive markets for identical or similar assets or liabilities; or inputs either directly observable or indirectly observable through correlation with market data at the measurement date and for the duration of the instrument's anticipated life.
- Level 3 – Unobservable inputs are supported by little or no market activity. The unobservable inputs represent management's best estimate of how market participants would price the asset or liability at the measurement date. Consideration is given to the risk inherent in the valuation technique and the risk inherent in the inputs to the model.

The Company reviews the classification of its financial instruments within the fair value hierarchy on a quarterly basis, and management may conclude that its financial instruments should be reclassified to a different level in the future if a change in type of inputs occurs.

The following table presents the fair value of the Company's financial instruments segregated by the hierarchy level of the fair value estimate that are measured at fair value on a recurring basis as of the dates indicated:

	June 30, 2017			
	Fair Value	Level 1 - Unadjusted Quoted Prices in Active Markets	Level 2 - Observable Inputs	Level 3 - Unobservable Inputs
Assets:				
Mortgage-backed securities	$2,864,026	$ —	$2,856,229	$ 7,797
Interest rate swaps	267	—	267	—
Total assets carried at fair value	$2,864,293	$ —	$2,856,496	$ 7,797
Liabilities:				
Interest rate swaps	$18	$ —	$18	$ —
TBA securities	1,668	—	1,668	—
Total liabilities carried at fair value	$1,686	$ —	$1,686	$ —

	December 31, 2016			
	Fair Value	Level 1 - Unadjusted Quoted Prices in Active Markets	Level 2 - Observable Inputs	Level 3 - Unobservable Inputs
Assets:				
Mortgage-backed securities	$3,212,084	$ —	$3,201,157	$ 10,927
Interest rate swaps	28,534	—	28,534	—
Total assets carried at fair value	$3,240,618	$ —	$3,229,691	$ 10,927
Liabilities:				

Interest rate swaps	$6,922	$ —	$6,922	$ —
Total liabilities carried at fair value	$6,922	$ —	$6,922	$ —

The fair value measurements for a majority of the Company's MBS are considered Level 2. These Level 2 securities are substantially similar to securities that either are actively traded or have been recently traded in their respective markets. The Company determines the fair value of its Level 2 securities based on prices received from the Company's primary pricing service as well as other pricing services and brokers. The Company evaluates the third party prices it receives to assess their reasonableness. Although the Company does not adjust third party prices, they may be excluded from use in the determination of a security's fair value if they are significantly different from other observable market data. In valuing a security, the primary pricing service uses either a market approach, which uses observable prices and other relevant information that is generated by market transactions of identical or similar securities, or an income approach, which uses valuation techniques to convert future amounts to a single, discounted present value amount. The Company also reviews the assumptions and inputs utilized in the valuation techniques of its primary pricing service. Examples of these observable inputs and assumptions include market interest rates, credit spreads, and projected prepayment speeds, among other things.

(amounts in thousands except share data)

The fair value of interest rate swaps are measured using the income approach with the primary input being the forward interest rate swap curve, which is considered an observable input, and thus their fair values are considered Level 2 measurements as of June 30, 2017 and December 31, 2016. The fair value of TBA securities are estimated using methods similar those used to fair value the Company's Level 2 MBS.

The Company owns certain non-Agency MBS for which there are not sufficiently recent trades of substantially similar securities, and their fair value measurements are thus considered Level 3. The Company determines the fair value of its Level 3 securities by discounting the estimated future cash flows derived from cash flow models using significant inputs which are determined by the Company when market observable inputs are not available. Information utilized in those pricing models include the security’s credit rating, coupon rate, estimated prepayment speeds, expected weighted average life, collateral composition, estimated future interest rates, expected credit losses, and credit enhancement as well as certain other relevant information. Significant changes in any of these inputs in isolation may result in a significantly different fair value measurement. Level 3 assets are generally most sensitive to the default rate and severity assumptions.

The activity of the instruments measured at fair value on a recurring basis using Level 3 inputs is presented in the following table for the period indicated:

	Level 3 Fair Value		
	Non-Agency CMBS	Non-Agency RMBS	Total
Balance as of December 31, 2016	$9,669	$ 1,258	$10,927
Unrealized loss included in OCI [(1)]	(1,250)	8	(1,242)
Principal payments	(3,535)	(90)	(3,625)
Accretion	1,737	—	1,737
Balance as of June 30, 2017	$6,621	$ 1,176	$7,797

(1) Amount included in "unrealized gain on available-for-sale investments, net" on consolidated statements of comprehensive income (loss).

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The following table presents a summary of the carrying value and estimated fair values of the Company’s financial instruments as of the dates indicated:

	June 30, 2017		December 31, 2016	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Assets:				
Mortgage-backed securities	$2,864,026	$2,864,026	$3,212,084	$3,212,084
Mortgage loans held for investment, net (1)	17,345	14,329	19,036	15,971
Derivative assets	267	267	28,534	28,534
Liabilities:				
Repurchase agreements (2)	$2,540,759	$2,540,759	$2,898,952	$2,898,952
Non-recourse collateralized financing (1)	5,892	5,873	6,440	6,357
Derivative liabilities	1,686	1,686	6,922	6,922

(1) The Company determines the fair value of its mortgage loans held for investment, net and its non-recourse collateralized financing using internally developed cash flow models with inputs similar to those used to estimate the fair value of the Company's Level 3 non-Agency MBS.
(2) The carrying value of repurchase agreements generally approximates fair value due to their short term maturities.

NOTE 6 – SHAREHOLDERS' EQUITY AND SHARE-BASED COMPENSATION

Preferred Stock

The Company's articles of incorporation authorize the issuance of up to 50,000,000 shares of preferred stock, par value $0.01 per share, of which the Company's Board of Directors has designated 8,000,000 shares of 8.50% Series A Preferred Stock and 7,000,000 shares of 7.625% Series B Preferred Stock, (the Series A Preferred Stock and the Series B Preferred Stock collectively, the "Preferred Stock"). The Company had 2,300,000 shares of its Series A Preferred Stock and 3,048,658 shares of its Series B Preferred Stock issued and outstanding as of June 30, 2017 compared to 2,300,000 shares of Series A Preferred Stock and 2,271,937 shares of Series B Preferred Stock as of December 31, 2016.

The Preferred Stock has no maturity and will remain outstanding indefinitely unless redeemed or otherwise repurchased or converted into common stock pursuant to the terms of the Preferred Stock. Except under certain limited circumstances, the Company may not redeem the Series A Preferred Stock prior to July 31, 2017 or the Series B Preferred Stock prior to April 30, 2018. On or after these dates, at any time and from time to time, the Preferred Stock may be redeemed in whole, or in part, at the Company's option at a cash redemption price of $25.00 per share plus any accumulated and unpaid dividends. Because the Preferred Stock is redeemable only at the option of the issuer, it is classified as equity on the Company's consolidated balance sheet. The Series A Preferred Stock pays a cumulative cash dividend equivalent to 8.50% of the $25.00 liquidation preference per share each year and the Series B Preferred Stock pays a cumulative cash dividend equivalent to 7.625% of the $25.00 liquidation preference per share each year. The Company paid its regular quarterly dividends on its Preferred Stock for the second quarter on July 17, 2017 to shareholders of record as of July 1, 2017.

Common Stock

The Company declared a second quarter common stock dividend of $0.18 per share that was paid on July 28, 2017 to shareholders of record as of July 6, 2017.

2009 Stock and Incentive Plan. Of the 2,500,000 shares of common stock authorized for issuance under its 2009 Stock and Incentive Plan, the Company had 785,962 available for issuance as of June 30, 2017. Total stock-based compensation expense recognized by the Company for the three and six months ended June 30, 2017 was $642 and $1,179, respectively, compared to $614 and $1,443 for the three and six months ended June 30, 2016, respectively.

The following table presents a rollforward of the restricted stock activity for the periods indicated:

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	Three Months Ended June 30,			
	2017		2016	
	Shares	Weighted Average Grant Date Fair Value Per Share	Shares	Weighted Average Grant Date Fair Value Per Share
Restricted stock outstanding as of beginning of period	386,151	$ 7.05	547,486	$ 7.63
Restricted stock granted	29,720	6.73	46,158	6.50
Restricted stock vested	(62,768)	7.14	(32,555)	7.68
Restricted stock outstanding as of end of period	353,103	$ 7.01	561,089	$ 7.54

	Six Months Ended June 30,			
	2017		2016	
	Shares	Weighted Average Grant Date Fair Value Per Share	Shares	Weighted Average Grant Date Fair Value Per Share
Restricted stock outstanding as of beginning of period	553,396	$ 7.55	696,597	$ 8.54
Restricted stock granted	138,166	6.76	214,878	6.28
Restricted stock vested	(338,459)	7.80	(350,386)	8.76
Restricted stock outstanding as of end of period	353,103	$ 7.01	561,089	$ 7.54

As of June 30, 2017, the grant date fair value of the Company’s remaining nonvested restricted stock is $1,892 which will be amortized into compensation expense over a weighted average period of 1.6 years.

NOTE 7 – SUBSEQUENT EVENTS

Management has evaluated events and circumstances occurring as of and through the date this Quarterly Report on Form 10-Q was filed with the SEC and has determined that there have been no significant events or circumstances that qualify as a "recognized" or "nonrecognized" subsequent event as defined by ASC Topic 855.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with our unaudited financial statements and the accompanying notes included in Part 1, Item 1. “Financial Statements” in this Quarterly Report on Form 10-Q and our audited financial statements and the accompanying notes included in Part II, Item 8 in our Annual Report on Form 10-K for the year ended December 31, 2016. References herein to “Dynex,” the “Company,” “we,” “us,” and “our” include Dynex Capital, Inc. a its consolidated subsidiaries, unless the context otherwise requires. In addition to current and historical information, the following discussion and analysis contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements relate to our future business, financial condition or results of operations. For a description of certain factors that may have a significant impact on our future business, financial condition or results of operations, see “Forward-Looking Statements” at the end of this discussion and analysis.

For more information about our business including our operating policies, investment philosophy and strategy, financing and hedging strategies, and other important information, please refer to Part I, Item 1 of our Annual Report on Form 10-K for the year ended December 31, 2016.

EXECUTIVE OVERVIEW

Company Overview

We are an internally managed mortgage real estate investment trust, or mortgage REIT, which invests in residential and commercial mortgage-backed securities on a leveraged basis. Our common stock is traded on the New York Stock Exchange ("NYSE") under the symbol "DX". Our objective is to provide attractive risk-adjusted returns to our shareholders over the long term that are reflective of a leveraged, high quality fixed income portfolio with a focus on capital preservation. We seek to provide returns to our shareholders primarily through regular quarterly dividends, and also through capital appreciation.

We also have two series of preferred stock outstanding, our 8.50% Series A Cumulative Redeemable Preferred Stock (the "Series A Preferred Stock") which is traded on the NYSE under the symbol "DXPRA", and our 7.625% Series B Cumulative Redeemable Preferred Stock (the "Series B Preferred Stock") which is traded on the NYSE under the symbol "DXPRB".

We invest in Agency and non-Agency mortgage-backed securities (“MBS”) consisting of residential MBS (“RMBS”), commercial MBS (“CMBS”) and CMBS interest-only ("IO") securities. Agency MBS have a guaranty of principal payment by an agency of the U.S. government or a U.S. government-sponsored entity ("GSE") such as Fannie Mae and Freddie Mac. Non-Agency MBS have no such guaranty of payment. Our investments in non-Agency MBS are generally higher quality senior or mezzanine classes (typically rated 'A' or better by one or more of the nationally recognized statistical rating organizations) because they are typically more liquid (i.e., they are more easily converted into cash either through sales or pledges as collateral for repurchase agreement borrowings) and have less exposure to credit losses than lower-rated non-Agency MBS.

We invest and manage our capital pursuant to Operating Policies approved by our Board of Directors. We use leverage to enhance the returns on our invested capital by pledging our investments as collateral for borrowings such as repurchase agreements as discussed further below. We also use derivative instruments to attempt to mitigate our exposure to adverse changes in interest rates as discussed further below.

RMBS. Our Agency RMBS investments include MBS collateralized by adjustable-rate mortgage loans ("ARMs"), which have interest rates that generally will adjust at least annually to an increment over a specified interest rate index, and hybrid adjustable-rate mortgage loans ("hybrid ARMs"), which are loans that have a fixed rate of interest for a specified period (typically three to ten years) and then adjust their interest rate at least annually to an increment over a specified interest rate index. Agency ARMs also include hybrid Agency ARMs that are past their fixed-rate periods or within twelve months of their initial reset period. Substantially all of our ARMs reset based on the one-year LIBOR index. We sold the majority of our non-Agency RMBS during the second quarter of 2017 because these investments were within a year of their maturity.

In the second quarter of 2017, we began entering into forward contracts for the purchase of TBA securities as a means of investing in and financing non-specified Agency RMBS. A TBA security is a forward contract for the purchase or sale of a fixed-rate Agency MBS at a predetermined price with certain principal and interest terms and certain types of collateral, but the particular Agency securities to be delivered are not identified until shortly before the TBA settlement date. The Company executes TBA dollar roll transactions which effectively delay the settlement of a forward purchase of an Agency MBS by entering into an offsetting short position, net settling the paired-off positions in cash, and simultaneously entering a similar TBA contract for a later settlement date. TBA securities purchased for a forward settlement month are generally priced at a discount relative to TBA securities sold for settlement in the current month. This discount, often referred to as “drop income,” is the economic equivalent of net interest income on the underlying Agency securities over the roll period (interest income less implied financing cost). Consequently, TBA dollar roll transactions represent a form of off-balance sheet financing. We account for TBA securities as derivative instruments because we cannot assert that it is probable at inception and throughout the term of an individual TBA contract that its settlement will result in physical delivery of the underlying Agency RMBS, or the individual TBA contract will not settle in the shortest time period possible.

CMBS. The majority of our CMBS investments are primarily fixed-rate Agency-issued securities backed by multifamily housing loans. The remainder of our CMBS portfolio contains both Agency and non-Agency issued securities backed by other commercial real estate property types such as office building, retail, hospitality, and health care. Loans underlying CMBS generally are geographically diverse, are fixed-rate, mature in eight to eighteen years and have amortization terms of up to 30 years. Typically these loans have some form of prepayment protection provisions (such as prepayment lock-out) or prepayment compensation provisions (such as yield maintenance or prepayment penalty). Yield maintenance and prepayment penalty requirements are intended to create an economic disincentive for the loans to prepay.

CMBS IO. CMBS IO are interest-only securities issued as part of a CMBS securitization and represent the right to receive a portion of the monthly interest payments (but not principal cash flows) on the unpaid principal balance of the underlying pool of commercial mortgage loans. We invest in both Agency-issued and non-Agency issued CMBS IO. The loans collateralizing CMBS IO pools are very similar in composition to the pools of loans that generally collateralize CMBS as discussed above. Since CMBS IO securities have no principal associated with them, the interest payments received are based on the unpaid principal balance of the underlying pool of mortgage loans, which is often referred to as the notional amount. Most loans in these securities have some form of prepayment protection from early repayment including absolute loan prepayment lock-outs, loan prepayment penalties, or yield maintenance requirements similar to CMBS described above. There are no prepayment protections, however, if the loan defaults and is partially or wholly repaid earlier as a result of loss mitigation actions taken by the underlying loan servicer, and therefore yields on CMBS IO investments are dependent upon the underlying loan performance. Because Agency-issued MBS generally contain higher credit quality loans, Agency CMBS IO are expected to have a lower risk of default than non-Agency CMBS IO. Our CMBS IO investments are investment grade-rated with the majority rated 'AAA' by at least one of the nationally recognized statistical rating organizations.

Financing. We finance our investments primarily through the use of uncommitted repurchase agreements which are provided principally by major financial institutions and broker-dealers. We pledge our MBS as collateral to secure the amounts borrowed from our counterparties. These repurchase agreements generally have original terms to maturity of overnight to six months, though in some instances we may enter into longer-dated maturities depending on market conditions. We pay interest on our repurchase agreement borrowings at a rate usually based on a spread to LIBOR and fixed for the term of the borrowing. Borrowings under these repurchase agreements are renewable at the discretion of our lenders and do not contain guaranteed roll-over terms. One of our repurchase agreement lenders provides a committed repurchase agreement financing facility to us with an aggregate borrowing capacity of $400.0 million that expires in May 2019.

As noted above, the Company enters into TBA forward contracts and dollar roll transactions as a form of off-balance sheet financing for generic 30-year fixed-rate Agency RMBS. TBA transactions require the us to post initial margin (though typically the amount is less than margin amount for repurchase agreements) and variation margin for fluctuations in fair value of the TBA securities. These dollar roll transactions have an implied financing rate which changes with market conditions, expected prepayment speeds and the underlying demand for Agency RMBS in a given delivery period.

Hedging. We currently use interest rate swaps to hedge our exposure to changes in interest rates. Such exposure results from our ownership of hybrid and fixed-rate investments that are financed with repurchase agreements which have significantly shorter maturities than the weighted average life of these investments. Changes in interest rates can impact the market value of our investments and our net interest income, thereby ultimately impacting book value per common share. We frequently adjust our hedging portfolio based on our expectation of future interest rates, including the absolute level of rates and the slope of the yield curve versus market expectations.

Factors that Affect Our Results of Operations and Financial Condition

Our financial performance is driven by the performance of our investment portfolio and related financing and hedging activity. Management focuses on net interest income, net income, comprehensive income, book value per common share, and core net operating income to common shareholders (a non-GAAP measure) as measurements of our financial performance. Our financial performance may be impacted by multiple factors, many of which are related to macroeconomic conditions, geopolitical conditions, central bank and government policy, and other factors beyond our control. These factors include, but are not limited to, the absolute level of interest rates, the relative slope of interest rate curves, changes in market expectations of future interest rates, actual and estimated future prepayment rates on our investments, competition for investments, economic conditions and their impact on the credit performance of our investments, and market required yields as reflected by market spreads. All of these factors are influenced by market forces and generally are exacerbated during periods of market volatility.

The performance of our investment portfolio, the cost and availability of financing and the availability of investments at acceptable risk-adjusted returns could also be influenced by regulatory actions and regulatory policy measures of the U.S. government including, but not limited to, the Federal Housing Finance Administration ("FHFA"), the U. S. Department of the Treasury (the "Treasury"), and the Board of Governors of the Federal Reserve System (the "Federal Reserve") and could also be influenced by reactions in U.S. markets from activities of central banks around the world.

Our business model may also be impacted by other factors such as the availability and cost of financing and the state of the overall credit markets. Reductions in or limitations of financing for our investments could force us to sell assets, potentially at losses. While repurchase agreement lending availability has generally recovered from the 2008 financial crisis, such lending by larger U.S. domiciled banks has declined due to increased regulation. Their repurchase market participation has been replaced by smaller independent broker dealers that are generally less regulated and by U.S. domiciled broker dealer subsidiaries of foreign financial institutions. It is uncertain how these new participants will react during periods of market stress. Other factors that could also impact our business include changes in regulatory requirements, including requirements to qualify for registration under the 1940 Act, and REIT requirements.

We believe that regulatory impacts on financial institutions, many of which are our trading and financing counterparties, continue to pose a threat to the overall liquidity in the capital markets. There remains uncertainty as to the outcome of certain regulations under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") and restrictions on market-making activities of large U.S. financial institutions could result in reduced liquidity in times of market stress. The Federal Reserve has also announced that it will soon begin curtailing its reinvestment of principal payments received on its Agency RMBS portfolio, which could result in volatile asset prices. Finally, the market liquidity of our investments and the financing markets could be negatively impacted if the Federal Reserve's Federal Open Market Committee (or "FOMC") suddenly changes market expectations of the target Federal Funds Rate or takes other actions which have the effect of tightening monetary policy.

To complement the performance of our investment portfolio, we regularly review our existing operations to determine whether our investment strategy or business model should change, including through a change in our investment portfolio, our targeted investments, and our risk position. We may also consider reallocating our capital resources to other assets or portfolios that better align with our long-term strategy, expanding our capital base, or merger, acquisition or divestiture opportunities. We analyze and evaluate potential business opportunities that we identify or are presented to us, including possible merger, acquisition, or divestiture transactions, that might be a strategic fit for our investment strategy or asset allocation or otherwise maximize value for our shareholders. Pursuing such an opportunity or transaction could require us to issue additional equity or debt securities.

As discussed above, investing in mortgage-related securities (including on a leveraged basis) subjects us to a number of risks including interest rate risk, prepayment and reinvestment risk, credit risk, spread risk, and liquidity risk, which are discussed in "Liquidity and Capital Resources" within this Item 2 and in Part I, Item 3 of this Quarterly Report on Form 10-Q as well as in Item 1A, "Risk Factors" of Part I of our Annual Report on Form 10-K for the year ended December 31, 2016. Please see these Items for a detailed discussion of these risks and the potential impact on our results of operations and financial condition.

Market Conditions and Recent Activity

During the second quarter of 2017, market volatility remained largely subdued as macroeconomic conditions continued to modestly improve. Market spreads modestly tightened or held steady across most asset classes except seasoned Agency hybrid ARMs for which market spreads widened due to market concerns over prepayment speeds. As of June 30, 2017, market spreads in general and in sectors in which we invest are at or near their tightest levels in the last year, with the result that asset prices are near their highs. In general, market spreads are tight despite the Federal Reserve and other central banks telegraphing a desire to reduce their purchases of Treasury securities and Agency RMBS in order to shrink their balance sheets. As a result of these tighter spread, we have concentrated our investments in high credit quality, highly liquid securities, which we believe will outperform other asset classes if there is a spike in market volatility.

Inflation remains well within the FOMC's target of 2%. As expected by the markets, the FOMC increased the target Federal Funds Rate by 0.25% in June 2017 and has now increased the target Federal Funds Rate a full 1.00% to a current targeted range of 1.00% - 1.25% since December 2015. The U.S. Treasury curve modestly flattened during the quarter, which management believes is a result of the FOMC increase coupled with modest economic growth and subdued inflation. The chart below shows the highest and lowest rates during the three months ended June 30, 2017 as well as the rates as of June 30, 2017 and March 31, 2017 for the indicated U.S. Treasury securities:

Similar to the U.S. Treasury curve, the interest rate swap curve was lower during the quarter and volatility was reasonably muted. The chart below shows the highest and lowest swap rates during the three months ended June 30, 2017 as well as the swap rates as of June 30, 2017 and March 31, 2017:

Despite recent improvement, the economic environment remains fragile in our view for a number of reasons, including high levels of global debt, the uncertain geopolitical environment, and the uncertain regulatory environment, including potential shifts in Federal Reserve policy that could result from leadership changes at the Federal Reserve including the potential replacement of Chair Janet Yellen.

Highlights of the Second Quarter of 2017

Given the flatter yield curve environment and the prospect for faster prepayments on hybrid ARMs, we reallocated capital away from short-duration lower yielding variable-rate investments and expanded our investment in 30-year fixed-rate Agency RMBS through the purchase of TBA securities during the second quarter of 2017. We believe fixed-rate investments offer better risk adjusted returns in the current interest rate environment, and investing in TBA contracts to purchase generic fixed-rate Agency RMBS offers a lower implied financing rate versus the repurchase agreement borrowing rate we would incur for financing specific fixed-rate Agency RMBS. As a result of our investment in TBA securities, our leverage including the implied off-balance sheet financing of TBA securities of $416.3 million as of June 30, 2017 increased to 6.0 times shareholders' equity as of June 30, 2017 from 5.8 times as of March 31, 2017 and as compared to 6.3 times as of December 31, 2016. We expect our leverage to increase further in the near term as we continue to expand our investment in fixed-rate MBS, including through TBA securities. During the second quarter of 2017, we also added interest rate swaps to adjust our hedging portfolio to an interest rate risk neutral position, given the projected increases in short-term interest rates remaining for 2017 and also given the increased interest rate risk we have assumed as a result of investing in fixed-rate Agency RMBS through the TBA market.

During the second quarter of 2017, comprehensive income to common shareholders of $2.3 million was comprised of net loss to common shareholders of $(10.1) million and other comprehensive income ("OCI") of $12.4 million. Net loss to common shareholders included net interest income of $16.1 million, an increase of approximately 8.3% from the first quarter of 2017. This increase in net interest income was driven primarily by an increase of $1.5 million in discount accretion resulting from principal payments received on a seasoned non-Agency CMBS and an increase of $0.7 million in net prepayment penalty compensation from CMBS and CMBS IO compared to the first quarter. These increases were partially offset by higher borrowing costs of $1.2 million as a result of increasing short-term interest rates. Net loss to common shareholders also included loss on derivative instruments, net of $(15.8) million driven primarily by a decrease in the fair value of our interest rate swaps as a result of lower swap rates which is discussed further in "Results of Operations" within this Item 2. Also included in loss on derivatives instruments, net is $1.7 million of income from TBA securities. The decline in the fair value of our derivative instruments was partially offset by an increase in the fair value of our MBS, which was recognized in OCI as an unrealized gain of $12.4 million.

Core net operating income to common shareholders (a non-GAAP measure) increased over 25% to $9.3 million for the second quarter of 2017 compared to $7.4 million for the first quarter of 2017 due to an increase of $1.9 million in adjusted net interest income (a non-GAAP measure). Adjusted net interest income benefited from the increase in prepayment penalty compensation from CMBS and CMBS IO, partially offset by higher borrowing costs, both as mentioned previously. Adjusted net interest income for the second quarter of 2017 also includes $1.4 million of drop income from our TBA securities, which is calculated as described above under “Company Overview”. Drop income was offset by $(1.4) million in net periodic interest costs from interest rate swaps. Net periodic interest costs increased $0.7 million for the second quarter of 2017 compared to the first quarter because we added effective interest rate swaps to mitigate the risk of higher funding costs for the remainder of 2017 as well as to mitigate increased interest rate risk related to our TBA securities. Management views drop income from TBA securities and net periodic interest costs from interest rate swaps as components of the net interest earnings from our investment portfolio. Please see "Non-GAAP Financial Measures" at the end of this "Executive Overview" for additional important information about these and other non-GAAP measures.

Book value per common share decreased $(0.14) to $7.38 as of June 30, 2017 from March 31, 2017 while increasing $0.20 from December 31, 2016. Book value for the second quarter of 2017 was negatively impacted by the under performance of assets versus our hedges, particularly our hybrid ARMs which tend to underperform in a flat yield curve environment. Book value during the first six months of 2017 has been favorably impacted by the increase in fair value of our CMBS and CMBS IO due to overall tighter credit spreads, which offset spread widening on RMBS during the same period. Economic return on book value was 0.5% for the second quarter of 2017 and 7.8% for the first half of 2017. Economic return on book value is calculated by dividing (i) the sum of dividends declared per common share and the change in book value per common share by (ii) beginning book value per common share.

Management Outlook

We expect our investment portfolio will continue growing during the remainder of 2017 as we believe investments in fixed-rate RMBS continue to offer more attractive risk-adjusted returns relative to other investments in the current environment. As our portfolio and leverage have increased (including the impact of the implied financing on our TBA investments), so has the risk to our capital in the event of increased market volatility or a rapid and sharp change in interest rates or the slope of the yield curve. We believe that global central bank policies are the dominating factors for interest rates and credit spreads, and global central banks are seeking to minimize market volatility to encourage recovery in global economic growth. Should market volatility increase, our book value is likely to decline, but we would view this volatility as a potential investment opportunity given our view regarding expected central bank behavior.

One potential cause of market volatility is the Federal Reserve's MBS and U.S. Treasury securities portfolio reinvestment strategy. The Federal Reserve has indicated that it will reduce reinvestment of proceeds that it receives on its Agency MBS and Treasury portfolios beginning in the near term. How the market will ultimately react to the reduced reinvestment activity is highly uncertain. The low volatility and tight market spread environment that exists today could potentially exacerbate the reaction to such an event.

Longer term we continue to believe that there are many tailwinds for our business model. Demographic trends in the U.S. are driving a significant increase in household formation, creating more demand in multifamily and single family housing. As government participation in the housing market shrinks, there will be an increased need for private capital and expertise in the housing finance system. Global demographic aging trends are driving demand for assets that generate income. Fundamentally, this supports the assets in which we invest and also could be a source of capital for us to potentially grow our portfolio. We also intend to capitalize on opportunities for investing capital as government and regulatory policies shift while realizing that such shifts may occur over a period of several years. We will also continue seeking ways to diversify funding sources if the regulatory environment becomes more favorable, and we will also actively manage our hedge instruments to attempt to mitigate the impact on our costs of funds if the Federal Funds rate continues to increase during 2017 as currently projected.

Non-GAAP Financial Measures

In addition to the Company's operating results presented in accordance with GAAP, the information presented within Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations" of this Quarterly Report on Form 10-Q contains the following non-GAAP financial measures: core net operating income to common shareholders (including per common share), adjusted interest expense, adjusted net interest income, and the related metrics adjusted cost of funds and adjusted net interest spread. Management views core net operating income to common shareholders as an estimate of the net interest earnings from our investments after operating expenses and preferred stock dividends. In addition to the reconciliation set forth below, which derives core net operating income to common shareholders from GAAP net income to common shareholders as the nearest GAAP equivalent measure, core net operating income to common shareholders can also be determined by adjusting net interest income to include interest rate swap periodic interest costs, drop income on TBA securities, general and administrative expenses (GAAP), and preferred dividends. Management includes drop income in core net operating income to common shareholders and in adjusted net interest income because TBA securities are viewed by management as economically equivalent to holding and financing Agency RMBS using short-term repurchase agreements. Management also includes periodic interest costs from its interest rate swaps, which are included in "gain (loss) on derivative instruments" on the Company's consolidated statements of comprehensive income, in adjusted net interest expense, and in adjusted net interest income because interest rate swaps are used by the Company to economically hedge the Company's borrowing costs from repurchase agreements, and including periodic interest costs from interest rate swaps is a helpful indicator of the Company's total cost of financing in addition to GAAP interest expense. Because these measures are used in the Company's internal analysis of financial and operating performance, management believes that they provide greater transparency to our investors of management's view of our economic performance. Management also believes the presentation of these measures, when analyzed in conjunction with the Company's GAAP operating results, allows investors to more effectively evaluate and compare the performance of the Company to that of its peers. Because these non-GAAP financial measures include or exclude, as applicable, certain items used to compute GAAP net income to common shareholders, GAAP net interest income, or GAAP interest expense, these non-GAAP financial measures should be considered as a supplement to, and not as a substitute for, the Company's GAAP results as reported on its consolidated statements of comprehensive income. In addition, because not all companies use identical calculations, the Company's presentation of non-GAAP financial measures may not be comparable to other similarly-titled measures of other companies.

Schedules reconciling adjusted interest expense and adjusted net interest income to their related GAAP financial measures are provided within "Results of Operations". The following table presents a reconciliation of our GAAP net (loss) income to common shareholders to our core net operating income to common shareholders for the periods presented:

($ in thousands, except per share amounts)	Three Months Ended June 30, 2017	March 31, 2017
GAAP net (loss) income to common shareholders	$(10,073)	$ 6,616
Less:		
Accretion of de-designated cash flow hedges [1]	(73)	(99)
Change in fair value of derivative instruments, net [2]	15,801	(790)
Loss on sale of investments, net	3,709	1,708
Fair value adjustments, net	(30)	(10)
Core net operating income to common shareholders	$9,334	$ 7,425
Weighted average common shares outstanding	49,218	49,176
Core net operating income per common share	$0.19	$ 0.15

(1) Included in GAAP interest expense and relates to the accretion of the balance remaining in accumulated other comprehensive income as a result of our discontinuation of cash flow hedge accounting effective June 30, 2013.

(2) Amount represents net realized and unrealized gains and losses on derivatives and excludes net periodic interest costs related to these instruments.

CRITICAL ACCOUNTING POLICIES

The discussion and analysis of our financial condition and results of operations are based in large part upon our consolidated financial statements, which have been prepared in accordance with GAAP. The preparation of our consolidated financial statements requires management to make estimates, judgments and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and disclosure of contingent assets and liabilities. We base these estimates and judgments on historical experience and assumptions believed to be reasonable under current facts and circumstances. Actual results, however, may differ from the estimated amounts we have recorded. Critical accounting policies are defined as those that require management's most difficult, subjective or complex judgments, and which may result in materially different results under different assumptions and conditions. Our accounting policies that require the most significant management estimates, judgments, or assumptions, or that management believes includes the most significant uncertainties, and are considered most critical to our results of operations or financial position relate to fair value measurements, amortization of investment premiums, and other-than-temporary impairments. Our critical accounting policies are discussed in Part II, Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations” of our Annual Report on Form 10-K for the year ended December 31, 2016 under “Critical Accounting Policies”. There have been no significant changes in our critical accounting policies during the three months ended June 30, 2017.

FINANCIAL CONDITION

As of June 30, 2017, our investment portfolio consisted of MBS with a fair value of $2.9 billion and a TBA position with a fair value of $414.6 million compared to an investment portfolio consisting entirely of MBS with a fair value of $3.2 billion as of December 31, 2016. The following table provides a summary of the amortized cost and fair value of our investment portfolio as of the periods indicated:

($ in thousands)	June 30, 2017 Amortized Cost	Fair Value	December 31, 2016 Amortized Cost	Fair Value
CMBS	$1,366,371	$1,360,185	$1,239,203	$1,222,771
CMBS IO	752,861	764,081	757,892	754,546
RMBS	745,245	739,760	1,247,872	1,234,767
Total MBS	2,864,477	2,864,026	3,244,967	3,212,084
TBA securities [(1)]	416,312	414,644	—	—
Total MBS including TBA securities	$3,280,789	$3,278,670	$3,244,967	$3,212,084

(1) TBA securities are accounted for as "derivative assets (liabilities)" on our consolidated balance sheet at their net carrying value which represents the difference between the market value and the cost basis of the TBA contract as of the end of the period.

CMBS

We increased our investment in Agency CMBS during the first six months of 2017 given the favorable return profile of fixed-rate investments in the current environment and their availability versus other investment opportunities. We sold approximately half of our non-Agency CMBS investments during the second quarter of 2017. These investments were collateralized with loans secured by single-family rental properties and were sold because of their lower returns on our invested capital given the net interest spread earned on these investments.

Activity related to our CMBS for the six months ended June 30, 2017 is as follows:

($ in thousands)	Agency CMBS	Non-Agency CMBS	Total
Balance as of December 31, 2016	$1,144,555	$ 78,216	$1,222,771
Purchases	214,224	—	214,224
Principal payments	(24,634)	(3,813)	(28,447)
Sales	(23,731)	(34,506)	(58,237)
Net (premium amortization) discount accretion	(2,320)	1,857	(463)
Change in fair value	12,524	(2,187)	10,337
Balance as of June 30, 2017	$1,320,618	$ 39,567	$1,360,185

Since Agency CMBS are guaranteed by the GSEs with respect to return of principal, our credit exposure is limited to any premium on those securities. Non-Agency CMBS are not guaranteed and therefore our entire investment is exposed to credit losses from the underlying loans collateralizing the CMBS. The following table presents the par value, amortized cost, and weighted average months to estimated maturity of our CMBS investments as of the dates indicated by year of origination:

($ in thousands)	June 30, 2017 Par Value	Amortized Cost	Months to Estimated Maturity [(1)]	December 31, 2016 Par Value	Amortized Cost	Months to Estimated Maturity [(1)]
Year of Origination:						
2008 and prior	$46,574	$43,225	38	$57,771	$53,161	34
2009 to 2012	157,162	161,265	28	193,061	198,916	33
2013 to 2014	20,408	20,799	88	42,760	43,176	95
2015	667,275	670,598	105	683,680	687,214	111
2016	254,509	256,353	116	254,781	256,736	122
2017	211,188	214,131	121	—	—	—
	$1,357,116	$1,366,371	98	$1,232,053	$1,239,203	97

(1) Months to estimated maturity is an average weighted by the amortized cost of the investment.

As of June 30, 2017, the majority of the collateral underlying our non-Agency CMBS is comprised of multifamily properties. As mentioned above, the portion of our non-Agency CMBS collateralized with single-family rental properties were sold during the second quarter of 2017. The collateral underlying our non-Agency CMBS investments is geographically dispersed in order to mitigate exposure to any particular region of the country. The U.S. state with the largest percentage of collateral underlying our non-Agency CMBS was Maryland at 16% as of June 30, 2017 and Texas at 16.0% as of December 31, 2016.

CMBS IO

Activity related to our CMBS IO for the six months ended June 30, 2017 is as follows:

($ in thousands) [1]	Agency CMBS IO	Non-Agency CMBS IO	Total
Balance as of December 31, 2016	$411,898	$ 342,648	$754,546
Purchases	45,654	23,065	68,719
Sales	—	—	—
Premium amortization, net	(44,023)	(29,727)	(73,750)
Change in fair value	6,236	8,330	14,566
Balance as of June 30, 2017	$419,765	$ 344,316	$764,081

(1) Amounts shown for CMBS IO represent premium only and exclude underlying notional balances.

Because income earned from CMBS IO is based on interest payments received on the underlying commercial mortgage loan pools, our return on these investments may be negatively impacted by any change in scheduled cash flows such as modifications of the mortgage loans or involuntary prepayments including defaults, foreclosures, and liquidations on or of the underlying mortgage loans prior to its contractual maturity date. In order to manage our exposure to credit performance, we generally invest in senior tranches of these securities and where we have evaluated the credit profile of the underlying loan pool and can monitor credit performance. In addition, to address changes in market fundamentals and the composition of mortgage loans collateralizing an investment, we consider the year of origination of the loans underlying CMBS IO in our selection of investments. The following table presents our CMBS IO investments as of June 30, 2017 by year of origination:

($ in thousands)	June 30, 2017			December 31, 2016		
	Amortized Cost	Fair Value	Remaining WAL [1]	Amortized Cost	Fair Value	Remaining WAL [1]
Year of Origination:						
2010	$7,908	$8,126	16	$9,456	$9,858	19
2011	30,355	31,956	21	35,130	36,897	23
2012	84,781	86,403	24	102,378	103,675	27
2013	116,392	117,934	30	128,891	129,011	33
2014	188,462	190,814	37	201,802	200,260	39
2015	185,886	188,502	43	198,016	194,886	45
2016	87,566	88,370	50	82,219	79,959	87
2017	51,511	51,976	55	—	—	—
	$752,861	$764,081	38	$757,892	$754,546	42

(1) Remaining weighted average life ("WAL") represents an estimate of the number of months of interest earnings remaining for the investments by year of origination.

Approximately 67% of the collateral underlying our non-Agency CMBS IO is comprised of retail, office, and multifamily properties as of June 30, 2017 and December 31, 2016. The following charts present the property type of the collateral underlying our non-Agency CMBS IO as of the dates indicated:
The collateral underlying our non-Agency CMBS IO investments is geographically dispersed in order to mitigate exposure to any particular region of the country. The U.S. state with the largest percentage of collateral underlying our non-Agency CMBS IO was California at 14% as of June 30, 2017, unchanged compared to December 31, 2016. The following charts present the geographic diversification of the collateral underlying our non-Agency CMBS IO by the top 5 states as of the dates indicated:

RMBS

Since December 31, 2016, we have sold approximately 27% of the amortized cost of our variable-rate Agency RMBS portfolio and began using TBA contracts as a means of investing in and financing fixed-rate Agency RMBS during the second quarter of 2017. We decreased our position in hybrid Agency RMBS as we expect these assets to underperform other asset classes in a flat yield-curve environment and to deploy available capital into investments with better risk adjusted returns such as TBA securities. We invested in TBA securities rather than specified fixed-rate pools because the financing rate implicit in the TBA securities was lower than the repurchase agreement borrowing rate for financing specified pools during the second quarter of 2017. We evaluate the economics of TBA securities versus specified pools on an on-going basis as we choose where to allocate our capital. We also sold the majority of our non-Agency RMBS portfolio during the second quarter of 2017 because these investments were generally within a year of their expected maturity. We will use the capital generated from these sales to invest in longer duration assets at higher yields.

The following table summarizes our RMBS investments including TBA securities as of the dates indicated:

	June 30, 2017			December 31, 2016		
($ in thousands)	Par Value	Amortized Cost/Cost Basis (1)(3)	Fair Value (2)(3)	Par Value	Amortized Cost	Fair Value
Variable-rate Agency RMBS by MTR:						
0-12 MTR	$155,692	$163,330	$164,059	$335,476	$355,069	$353,887
13-36 MTR	71,892	75,170	74,890	225,272	237,642	235,137
37-60 MTR	261,333	272,406	269,776	151,578	160,948	157,945
Greater than 60 MTR	226,098	233,183	229,859	444,932	460,665	454,236
Total variable-rate Agency RMBS	$715,015	$744,089	$738,584	$1,157,258	$1,214,324	$1,201,205
30-year fixed-rate TBA securities by coupon:						
3.0%	$100,000	$100,656	$99,867	$—	$—	$—
4.0%	300,000	315,656	314,777	—	—	—
Total TBA securities	$400,000	$416,312	$414,644	$—	$—	$—
Total RMBS including TBA securities	$1,115,015	$1,160,401	$1,153,228	$1,157,258	$1,214,324	$1,201,205