Invesco Mortgage Capital Inc.
Form 10-Q
May 09, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2012

OR

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

For the transition period from to

Commission file number 001-34385

INVESCO MORTGAGE CAPITAL INC.

(Exact Name of Registrant as Specified in Its Charter)

Maryland	**26-2749336**
(State or Other Jurisdiction of	**(I.R.S. Employer**
Incorporation or Organization)	**Identification No.)**
1555 Peachtree Street, N.E., Suite 1800	
Atlanta, Georgia	**30309**
(Address of Principal Executive Offices)	**(Zip Code)**

(404) 892-0896

(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 ¨

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

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

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

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

As of May 9, 2012, there were 115,404,893 outstanding shares of common stock of Invesco Mortgage Capital Inc.

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INVESCO MORTGAGE CAPITAL INC.

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PART I

ITEM 1. FINANCIAL STATEMENTS

INVESCO MORTGAGE CAPITAL INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

$ in thousands, except per share amounts	As of	
	March 31, 2012 (Unaudited)	December 31, 2011
ASSETS		
Mortgage-backed securities, at fair value	15,577,764	14,214,149
Cash	155,803	197,224
Restricted cash	16,068	74,496
Investment related receivable	35,081	160,424
Investments in unconsolidated ventures, at fair value	52,187	68,793
Accrued interest receivable	56,176	54,167
Derivative assets, at fair value	1,171	1,339
Other assets	1,425	1,575
Total assets	15,895,675	14,772,167
LIABILITIES AND EQUITY		
Liabilities:		
Repurchase agreements	13,006,380	12,253,038
Derivative liability, at fair value	380,200	396,780
Dividends and distributions payable	75,939	75,933
Investment related payable	259,468	107,032
Accrued interest payable	12,084	12,377
Accounts payable and accrued expenses	796	556
Due to affiliate	8,944	9,038
Total liabilities	13,743,811	12,854,754
Equity:		
Preferred Stock: par value $0.01 per share; 50,000,000 shares authorized, 0 shares issued and outstanding		
Common Stock: par value $0.01 per share; 450,000,000 shares authorized, 115,403,555 and 115,395,695 shares issued and outstanding, at March 31, 2012 and December 31, 2011, respectively	1,154	1,154
Additional paid in capital	2,299,661	2,299,543
Accumulated other comprehensive income (loss)	(169,887)	(393,291)
Distributions in excess of earnings	(6,998)	(15,068)
Total shareholders equity	2,123,930	1,892,338
Non-controlling interest	27,934	25,075
Total equity	2,151,864	1,917,413
Total liabilities and equity	15,895,675	14,772,167

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

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INVESCO MORTGAGE CAPITAL INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

$ in thousands, except per share data	**Three Months Ended March 31, 2012**	**2011**
Revenues		
Interest income	141,960	68,536
Interest expense	55,285	15,578
Net interest income	86,675	52,958
Other income		
Gain on sale of investments	6,045	1,200
Equity in earnings and fair value change in unconsolidated ventures	1,009	1,858
Unrealized loss on interest rate swaps	(509)	(5)
Realized and unrealized credit default swap income	657	2,532
Total other income	7,202	5,585
Expenses		
Management fee related party	8,639	3,975
General and administrative	1,130	868
Total expenses	9,769	4,843
Net income	84,108	53,700
Net income attributable to non-controlling interest	1,026	1,452
Net income attributable to common shareholders	83,082	52,248
Earnings per share:		
Net income attributable to common shareholders (basic/diluted)	0.72	1.01
Dividends declared per common share	0.65	1.00
Weighted average number of shares of common stock:		
Basic	115,398	51,857
Diluted	116,846	53,287

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

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INVESCO MORTGAGE CAPITAL INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

$ in thousands, except per share data	Three Months Ended March 31, 2012	2011
Net income	84,108	53,700
Other comprehensive income		
Unrealized gains on available for sale securities, net	209,073	9,949
Unrealized gains on derivatives, net	17,089	30,200
Other comprehensive income	226,162	40,149
Comprehensive income	310,270	93,849
Less: comprehensive income attributable to non-controlling interest	(3,784)	(2,353)
Comprehensive income attributable to common shareholders	306,486	91,496

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

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INVESCO MORTGAGE CAPITAL INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF EQUITY

For the three months ended March 31, 2012

(Unaudited)

$ in thousands, except per share amounts	Common Stock Shares	Common Stock Amount	Attributable to Common Shareholders: Additional Paid in Capital	Accumulated Other Comprehensive Income (loss)	Distributions in excess of earnings	Total Shareholders Equity	Non-Controlling Interest	Total Equity
Balance at January 1, 2012	115,395,695	1,154	2,299,543	(393,291)	(15,068)	1,892,338	25,075	1,917,413
Net income					83,082	83,082	1,026	84,108
Other comprehensive income				223,404		223,404	2,758	226,162
Net proceeds from issuance of common stock, net of of offering costs	2,496		42			42		42
Stock awards	5,364							
Common stock dividends					(75,012)	(75,012)		(75,012)
Common unit dividends							(926)	(926)
Amortization of equity-based compensation			76			76	1	77
Balance at March 31, 2012	115,403,555	1,154	2,299,661	(169,887)	(6,998)	2,123,930	27,934	2,151,864

The accompanying notes are an integral part of this consolidated financial statement.

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INVESCO MORTGAGE CAPITAL INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

$ in thousands	Three Months Ended March 31, 2012	2011
Cash Flows from Operating Activities		
Net income	84,108	53,700
Adjustments to reconcile net income to net cash provided by operating activities		
Amortization of mortgage-backed securities premiums and discounts, net	25,402	5,173
Unrealized loss on interest swap	509	5
Unrealized (gain) loss on credit default swap	168	(1,445)
Gain on sale of mortgage-backed securities	(6,045)	(1,200)
Equity in earnings and fair value change in unconsolidated ventures	(1,009)	(1,858)
Amortization of equity-based compensation	77	30
Changes in operating assets and liabilities		
Increase in accrued interest	(2,009)	(8,602)
(Increase) decrease in other assets	150	(121)
(Decrease) increase in accrued interest payable	(293)	2,810
(Decrease) increase in due to affiliate	(57)	908
(Decrease) increase in accounts payable and accrued expenses	281	(102)
Net cash provided by operating activities	101,282	49,298
Cash Flows from Investing Activities		
Purchase of mortgage-backed securities	(2,005,516)	(1,905,329)
Distributions from investment in unconsolidated ventures, net	17,615	1,839
Principal payments from mortgage-backed securities	540,608	223,615
Investment related receivable	(274)	
Proceeds from sale of mortgage-backed securities	570,409	42,466
Net cash used in investing activities	(877,158)	(1,637,409)
Cash Flows from Financing Activities		
Proceeds from issuance of common stock	(36)	470,138
Restricted cash	57,082	(35,152)
Proceeds from repurchase agreements	33,933,342	11,852,390
Principal repayments of repurchase agreements	(33,180,000)	(10,445,888)
Investment related payable		13,056
Payments of dividends and distributions	(75,933)	(49,741)
Net cash provided by financing activities	734,455	1,804,803
Net change in cash	(41,421)	216,692
Cash, beginning of period	197,224	63,552
Cash, end of period	155,803	280,244
Supplement disclosure of cash flow information		
Interest paid	55,577	12,763

Non-cash investing and financing activities information		
Net change in unrealized gain on available-for-sale securities and derivatives	226,163	40,149
Net change in unconsolidated ventures		3,469
Net change in restricted cash	1,346	(5,949)
Dividends and distributions declared not paid	75,939	51,729
Payable for mortgage-backed securities purchased	(279,399)	

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

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INVESCO MORTGAGE CAPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

Note 1 Organization and Business Operations

Invesco Mortgage Capital Inc. (the Company) is a Maryland corporation focused on investing in, financing and managing residential and commercial mortgage-backed securities and mortgage loans. The Company invests in residential mortgage-backed securities (RMBS) for which a U.S. Government Agency such as the Government National Mortgage Association (Ginnie Mae), the Federal National Mortgage Association (Fannie Mae) or the Federal Home Loan Mortgage Corporation (Freddie Mac) guarantees payments of principal and interest on the securities (collectively Agency RMBS). The Company s Agency RMBS investments include mortgage pass-through securities and collateralized mortgage obligations (CMOs). The Company also invests in RMBS that are not issued or guaranteed by a U.S. government Agency (non-Agency RMBS), commercial mortgage-backed securities (CMBS), and residential and commercial mortgage loans. The Company is externally managed and advised by Invesco Advisers, Inc. (the Manager), a registered investment adviser and an indirect, wholly-owned subsidiary of Invesco Ltd. (Invesco), a global investment management company.

The Company conducts its business through IAS Operating Partnership LP (the Operating Partnership) as its sole general partner. As of March 31, 2012, the Company owned 98.8% of the Operating Partnership and Invesco Investments (Bermuda) Ltd., a direct, wholly-owned subsidiary of Invesco, owned the remaining 1.2%.

The Company finances its Agency RMBS, non-Agency RMBS and CMBS investments through short-term borrowings structured as repurchase agreements. The Company has secured commitments for the Company with a number of repurchase agreement counterparties. The Company also finances its investments in certain non-Agency RMBS, CMBS and residential and commercial mortgage loans by contributing capital to the Invesco Mortgage Recovery Feeder Fund that invests in public-private investment funds (PPIF) managed by the Company s Manager (Invesco IMRF Fund) as part of the Public-Private Investment Program (PPIP) created by the U.S. Treasury in conjunction with the Federal Deposit Insurance Corporation (the FDIC) and the Federal Reserve. In addition, the Company may use other sources of financing including committed borrowing facilities and other private financing.

The Company elected to be taxed as a real estate investment trust (REIT) for U.S. federal income tax purposes under the provisions of the Internal Revenue Code of 1986, as amended (Code), commencing with the Company s taxable year ended December 31, 2009. To maintain the Company s REIT qualification, the Company is generally required to distribute at least 90% of its taxable income to its shareholders annually.

Note 2 Summary of Significant Accounting Policies

Basis of Quarterly Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. In the opinion of management, all adjustments (consisting of normal recurring adjustments) necessary for a fair presentation of the financial position and the results of operations of the Company for the interim periods presented have been included. Certain disclosures included in the Company s annual report are not required to be included on an interim basis in the company s quarterly reports on Forms 10-Q. The Company has condensed or omitted these disclosures. The interim consolidated financial statements should be read in conjunction with the Company s consolidated financial statements and related notes thereto included in the Company s annual report on Form 10-K for the year ended December 31, 2011 which was filed with the Securities and Exchange Commission (the SEC) on February 29, 2012. The results of operations for the period ended March 31, 2012 are not necessarily indicative of the results to be expected for the full year or any other future period.

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Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its subsidiaries. All intercompany balances and transactions have been eliminated.

Use of Estimates

The accounting and reporting policies of the Company conform to U.S. GAAP. The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Examples of estimates include, but are not limited to, estimates of the fair values of financial instruments, interest income on mortgage-backed securities (MBS) and other-than-temporary impairment charges. Actual results may differ from those estimates.

Cash and Cash Equivalents

The Company considers all highly liquid investments that have original or remaining maturity dates of three months or less when purchased to be cash equivalents. At March 31, 2012, the Company had cash and cash equivalents, including amounts restricted, in excess of the FDIC deposit insurance limit of $250,000 per institution. The Company mitigates its risk of loss by actively monitoring the counterparties.

Underwriting Commissions and Offering Costs

Underwriting commissions and direct costs incurred in connection with the Company s initial public offering (IPO) and subsequent follow-on common stock offerings are reflected as a reduction of additional paid-in-capital.

Repurchase Agreements

The Company finances its Agency RMBS, non-Agency RMBS and its CMBS investment portfolio through the use of repurchase agreements. Repurchase agreements are treated as collateralized financing transactions and are carried at their contractual amounts, including accrued interest, as specified in the respective agreements.

In instances where the Company acquires Agency RMBS, non-Agency RMBS or CMBS through repurchase agreements with the same counterparty from whom such assets were purchased, the Company accounts for the purchase commitment and repurchase agreement on a net basis and records a forward commitment to purchase such assets as a derivative instrument if the transaction does not comply with the criteria for gross presentation. All of the following criteria must be met for gross presentation in the circumstance where the repurchase assets are financed with the same counterparty:

- the initial transfer of and repurchase financing cannot be contractually contingent;
- the repurchase financing entered into between the parties provides full recourse to the transferee and the repurchase price is fixed;
- the financial asset has an active market and the transfer is executed at market rates; and
- the repurchase agreement and financial asset do not mature simultaneously.

If the transaction complies with the criteria for gross presentation, the Company records the assets and the related financing on a gross basis on its balance sheet, and the corresponding interest income and interest expense in its statements of operations. Such forward commitments are recorded at fair value with subsequent changes in fair value recognized in income. Additionally, the Company records the cash portion of its investment in Agency RMBS and non-Agency RMBS as a mortgage related receivable from the counterparty on its balance sheet.

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Fair Value Measurements

In January 2010, the FASB updated guidance entitled, Improving Disclosures about Fair Value Measurements. The guidance required a number of additional disclosures regarding fair value measurements. Specifically, entities should disclose: (i) the amount of significant transfers between Level 1 and Level 2 of the fair value hierarchy and the reasons for these transfers; (ii) the reasons for any transfers in or out of Level 3; and (iii) information in the reconciliation of recurring Level 3 measurements about purchases, sales, issuances and settlements on a gross basis. Except for the requirement to disclose information about purchases, sales, issuances, and settlements in the reconciliation of recurring Level 3 measurements on a gross basis, all the amendments are effective for interim and annual reporting periods beginning after December 15, 2009. The Company adopted these provisions in preparing its Consolidated Financial Statements for the period ended March 31, 2010.

In May 2011, the FASB issued Accounting Standards Update 2011-04, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS (ASU 2011-04). The guidance clarifies the Board s intent about the application of existing fair value measurement requirements, and changes to a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements. The company adopted these provisions for the period ended March 31, 2012.

The adoption of these provisions only affected the disclosure requirements for fair value measurements and as a result had no impact on the Company s consolidated statements of operations and consolidated balance sheets.

The Company discloses the fair value of its financial instruments according to a fair value hierarchy (Levels 1, 2, and 3, as defined). In accordance with U.S. GAAP, the Company is required to provide enhanced disclosures regarding instruments in the Level 3 category (which require significant management judgment), including a separate reconciliation of the beginning and ending balances for each major category of assets and liabilities.

Additionally, U.S. GAAP permits entities to choose to measure many financial instruments and certain other items at fair value (the fair value option). Unrealized gains and losses on items for which the fair value option has been elected are irrevocably recognized in earnings at each subsequent reporting date.

The Company elected the fair value option for its investments in unconsolidated ventures. The Company has the one-time option to elect fair value for these financial assets on the election date. The changes in the fair value of these instruments are recorded in equity in earnings and fair value change in unconsolidated ventures in the consolidated statements of operations.

For assets representing available-for-sale investment securities any change in fair value is reported through consolidated other comprehensive income (loss) with the exception of impairment losses, which are recorded in the consolidated statement of operations.

Securities

The Company designates securities as held-to-maturity, available-for-sale, or trading depending on its ability and intent to hold such securities to maturity. Trading and securities available-for-sale are reported at fair value, while securities held-to-maturity are reported at amortized cost. Although the Company generally intends to hold most of its RMBS and CMBS until maturity, the Company may, from time to time, sell any of its RMBS or CMBS as part of its overall management of its investment portfolio and classifies its RMBS and CMBS as available-for-sale securities.

All securities classified as available-for-sale are reported at fair value, based on market prices from third-party sources, with unrealized gains and losses excluded from earnings and reported as a separate component of shareholders equity. When applicable, included with available-for-sale securities are forward purchase commitments on to be announced securities (TBA). The Company records TBA purchases on the trade date and the corresponding payable is recorded as an outstanding liability as a payable for investments purchased until the settlement date of the transaction. This payable is presented in the Investment related payable line item on the consolidated balance sheet.

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The Company evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market conditions warrant such evaluation. The determination of whether a security is other-than-temporarily impaired involves judgments and assumptions based on subjective and objective factors. Consideration is given to (i) the length of time and the extent to which the fair value has been less than cost, (ii) the financial condition and near-term prospects of recovery, in fair value of the security, and (iii) the Company s intent and ability to retain its investment in the security for a period of time sufficient to allow for any anticipated recovery in fair value.

For debt securities, the amount of the other-than-temporary impairment related to a credit loss or impairments on securities that the Company has the intent or for which it is more likely than not that the Company will need to sell before recovery are recognized in earnings and reflected as a reduction in the cost basis of the security. The amount of the other-than-temporary impairment on debt securities related to other factors is recorded consistent with changes in the fair value of all other available-for-sale securities as a component of consolidated shareholders equity in other comprehensive income or loss with no change to the cost basis of the security.

Interest Income Recognition

Interest income on available-for-sale MBS, which includes accretion of discounts and amortization of premiums on such MBS, is recognized over the life of the investment using the effective interest method. Management estimates, at the time of purchase, the future expected cash flows and determines the effective interest rate based on these estimated cash flows and the Company s purchase price. As needed, these estimated cash flows are updated and a revised yield is computed based on the current amortized cost of the investment. In estimating these cash flows, there are a number of assumptions subject to uncertainties and contingencies, including the rate and timing of principal payments (prepayments, repurchases, defaults and liquidations), the pass through or coupon rate and interest rate fluctuations. In addition, management must use its judgment to estimate interest payment shortfalls due to delinquencies on the underlying mortgage loans. These uncertainties and contingencies are difficult to predict and are subject to future events that may impact management s estimates and its interest income. Security transactions are recorded on the trade date. Realized gains and losses from security transactions are determined based upon the specific identification method and recorded as gain (loss) on sale of available-for-sale securities in the consolidated statement of operations.

Investments in Unconsolidated Ventures

The Company has investments in unconsolidated ventures. In circumstances where the Company has a non-controlling interest but is deemed to be able to exert significant influence over the affairs of the enterprise the Company utilizes the equity method of accounting. Under the equity method of accounting, the initial investment is increased each period for additional capital contributions and a proportionate share of the entity s earnings and decreased for cash distributions and a proportionate share of the entity s losses.

The Company elected the fair value option for its investments in unconsolidated ventures. The election for investments in unconsolidated ventures was made upon their initial recognition in the financial statements. The Company has elected the fair value option for the investments in unconsolidated ventures for the purpose of enhancing the transparency of its financial condition.

The Company measures the fair value of the investments in unconsolidated ventures on the basis of the net asset value per share of the investments.

Dividends and Distributions Payable

Dividends and distributions payable represent dividends declared at the balance sheet date which are payable to common shareholders and distributions declared at the balance sheet date which are payable to non-controlling interest common unit holders of the Operating Partnership, respectively.

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Earnings per Share

The Company calculates basic earnings per share by dividing net income for the period by weighted-average shares of the Company s common stock outstanding for that period. Diluted earnings per share takes into account the effect of dilutive instruments, such as units of limited partnership interest in the Operating Partnership (OP Units), and unvested restricted stock, but use the average share price for the period in determining the number of incremental shares that are to be added to the weighted-average number of shares outstanding.

Comprehensive Income (Loss)

Comprehensive income is comprised of net income, as presented in the consolidated statements of operations, adjusted for changes in unrealized gains or losses on available for sale securities and changes in the fair value of derivatives accounted for as cash flow hedges.

Accounting for Derivative Financial Instruments

U.S. GAAP provides disclosure requirements for derivatives and hedging activities with the intent to provide users of financial statements with an enhanced understanding of: (i) how and why an entity uses derivative instruments; (ii) how derivative instruments and related hedged items are accounted for; and (iii) how derivative instruments and related hedged items affect an entity s financial position, financial performance, and cash flows. U.S. GAAP requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about the fair value of and gains and losses on derivative instruments, and disclosures about credit-risk-related contingent features in derivative instruments.

The Company records all derivatives on the balance sheet at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative, whether the Company has elected to designate a derivative in a hedging relationship and apply hedge accounting and whether the hedging relationship has satisfied the criteria necessary to apply hedge accounting. Derivatives designated and qualifying as a hedge of the exposure to changes in the fair value of an asset, liability, or firm commitment attributable to a particular risk, such as interest rate risk, are considered fair value hedges. Derivatives designated and qualifying as a hedge of the exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges. Derivatives may also be designated as hedges of the foreign currency exposure of a net investment in a foreign operation. Hedge accounting generally provides for the matching of the timing of gain or loss recognition on the hedging instrument with the recognition of the changes in the fair value of the hedged asset or liability that are attributable to the hedged risk in a fair value hedge or the earnings effect of the hedged forecasted transactions in a cash flow hedge. The Company may enter into derivative contracts, such as credit default swaps, that are intended to economically hedge certain of its risk, even though hedge accounting does not apply or the Company elects not to apply hedge accounting under U.S. GAAP.

Income Taxes

The Company elected to be taxed as a REIT, commencing with the Company s taxable year ended December 31, 2009. Accordingly, the Company will generally not be subject to U.S. federal and applicable state and local corporate income tax to the extent that the Company makes qualifying distributions to its shareholders, and provided the Company satisfies on a continuing basis, through actual investment and operating results, the REIT requirements including certain asset, income, distribution and stock ownership tests. If the Company fails to qualify as a REIT, and does not qualify for certain statutory relief provisions, it will be subject to U.S. federal, state and local income taxes and may be precluded from qualifying as a REIT for the subsequent four taxable years following the year in which the Company lost its REIT qualification. Accordingly, the Company s failure to qualify as a REIT could have a material adverse impact on its results of operations and amounts available for distribution to its shareholders.

A REIT s dividend paid deduction for qualifying dividends to the Company s shareholders is computed using its taxable income as opposed to net income reported on the consolidated financial statements. Taxable income, generally, will differ from net income reported on the consolidated financial statements because the determination of taxable income is based on tax regulations and not financial accounting principles.

The Company may elect to treat certain of its future subsidiaries as taxable REIT subsidiaries (TRS). In general, a TRS may hold assets and engage in activities that the Company cannot hold or engage in directly and generally may engage in any real estate or non-real estate-related business. A TRS is subject to U.S. federal, state and local corporate income taxes.

While a TRS will generate net income, a TRS can declare dividends to the Company which will be included in its taxable income and necessitate a distribution to its shareholders. Conversely, if the Company retains earnings at a TRS level, no distribution is required and the Company can increase book equity of the consolidated entity. The Company has no adjustments regarding its tax accounting treatment of any uncertainties. The Company expects to recognize interest and penalties related to uncertain tax positions, if any, as income tax expense, which will be included in general and administrative expense.

Share-Based Compensation

The Company has adopted an equity incentive plan under which its independent directors, as part of their compensation for serving as directors, are eligible to receive quarterly restricted stock awards. In addition, the Company may compensate the officers and employees of the Manager and its affiliates under this plan pursuant to the management agreement.

Share-based compensation arrangements include share options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. Compensation costs relating to share-based payment transactions are recognized in the consolidated financial statements, based on the fair value of the equity or liability instruments issued on the date of grant, for awards to the Company s independent directors. Compensation related to stock awards to officers and employees of the Manager and its affiliates are recorded at the estimated fair value of the award during the vesting period. The Company makes an upward or downward adjustment to compensation expense for the difference in the fair value at the date of grant and the date the award was earned.

Dividend Reinvestment Plan

The Company has implemented a dividend reinvestment and stock purchase plan (the Plan). Under the terms of the Plan, shareholders who participate in the Plan may purchase shares of common stock directly from the Company. Plan participants may also automatically reinvest all or a portion of their dividends for additional shares of stock.

Recent Accounting Pronouncements

In April 2011, the FASB issued Accounting Standards Update 2011-03, Reconsideration of Effective Control for Repurchase Agreements (ASU 2011-03). ASU 2011-03 simplifies the accounting for financial assets transferred under repurchase agreements (repos) and similar arrangements, by eliminating the transferor s ability criterion from the assessment of effective control over those assets. This guidance is effective for fiscal years and interim periods beginning after December 15, 2011.

In May 2011, the FASB issued Accounting Standards Update 2011-04, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS (ASU 2011-04). ASU 2011-04 amends Topic 820 and does not modify the requirements for when fair value measurements apply; rather, it clarifies the Board s intent about the application of existing fair value measurement requirements, and changes to a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements. For public entities, this guidance is effective for fiscal years and interim periods beginning after December 15, 2011. Early application by public entities was not permitted. The additional disclosure requirements were incorporated in Note 3, Mortgage-Backed Securities and Note 7, Financial Instruments .

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Recent Accounting Pronouncements Not Yet Adopted

In December 2011, the FASB issued Accounting Standards Updated 2011-11, Disclosures about Offsetting Assets and Liabilities (ASU 2011-11). ASU 2011-11 amends Topic 210 to require additional disclosure information about offsetting and related arrangements. Entities will be required to disclose both gross information and net information about both instruments and transactions eligible for offset in the statement of financial position and instruments and transaction subject to an agreement similar to a master netting arrangement. This scope would include derivatives, sale and repurchase agreements and reverse sale and repurchase agreements. The objective of this disclosure is to facilitate comparison between those entities that prepare their financial statements on a basis of US GAAP and those entities that prepare their financial statements on the basis of International Financial Reporting Standards (IFRS). The guidance is effective for periods beginning on or after January 1, 2013, and interim periods within those annual periods. The Company does not believe that the adoption of the amended guidance will have a significant effect on its consolidated financial statements.

Note 3 Mortgage-Backed Securities

All of the Company s MBS are classified as available-for-sale and, as such, are reported at fair value, which is determined by obtaining valuations from an independent source. If the fair value of a security is not available from a dealer or third-party pricing service, or such data appears unreliable, the Company may estimate the fair value of the security using a variety of methods including other pricing services, repurchase agreement pricing, discounted cash flow analysis, matrix pricing, option adjusted spread models and other fundamental analysis of observable market factors. At March 31, 2012 and December 31, 2011, all of the Company s MBS values were based on values obtained from third-party pricing services. The following tables present certain information about the Company s investment portfolio at March 31, 2012 and December 31, 2011.

March 31, 2012

$ in thousands	Principal Balance	Unamortized Premium (Discount)	Amortized Cost	Unrealized Gain/ (Loss), net	Fair Value	Net Weighted Average Coupon (1)	Weighted Average Yield (2)
Agency RMBS:							
15 year fixed-rate	2,348,425	124,930	2,473,355	50,995	2,524,350	4.12 %	2.80 %
30 year fixed-rate	6,822,262	462,516	7,284,778	133,154	7,417,932	4.83 %	3.63 %
ARM	170,196	4,591	174,787	3,009	177,796	3.22 %	2.77 %
Hybrid ARM	1,402,233	34,345	1,436,578	29,387	1,465,965	3.26 %	2.68 %
Total Agency pass-through	10,743,116	626,382	11,369,498	216,545	11,586,043	4.44 %	3.31 %
Agency-CMO (3)	1,162,414	(709,323)	453,091	3,724	456,815	2.83 %	3.05 %
Non-Agency RMBS(4)	2,573,956	(236,118)	2,337,838	(39,912)	2,297,926	4.33 %	4.97 %
CMBS	1,228,371	(18,889)	1,209,482	27,498	1,236,980	5.38 %	5.57 %
Total	15,707,857	(337,948)	15,369,909	207,855	15,577,764	4.38 %	3.73 %

(1) Net weighted average coupon (WAC) is presented net of servicing and other fees.
(2) Average yield incorporates future prepayment and loss assumptions.
(3) The Agency CMO held by the Company is 13.6% interest-only securities and 86.4% CMO.
(4) The non-Agency RMBS held by the Company is 10.1% fixed rate, 5.4% floating rate and 84.5% variable rate based on fair value.

December 31, 2011

$ in thousands	Principal Balance	Unamortized Premium (Discount)	Amortized Cost	Unrealized Gain/ (Loss), net	Fair Value	Net Weighted Average Coupon (1)	Weighted Average Yield (2)
Agency RMBS:							
15 year fixed-rate	2,289,495	123,610	2,413,105	36,454	2,449,559	4.18 %	2.85 %
30 year fixed-rate	6,055,045	410,257	6,465,302	116,309	6,581,611	4.95 %	3.66 %
ARM	113,413	2,398	115,811	2,065	117,876	3.40 %	3.07 %
Hybrid ARM	1,321,339	30,516	1,351,855	22,630	1,374,485	3.29 %	2.59 %
Total Agency pass-through	9,779,292	566,781	10,346,073	177,458	10,523,531	4.53 %	3.33 %
Agency-CMO (3)	765,172	(592,342)	172,830	(4,368)	168,462	2.86 %	3.52 %
Non-Agency RMBS(4)	2,719,797	(252,135)	2,467,662	(108,434)	2,359,228	4.57 %	5.07 %
CMBS	1,250,607	(21,805)	1,228,802	(65,874)	1,162,928	5.38 %	5.60 %
Total	14,514,868	(299,501)	14,215,367	(1,218)	14,214,149	4.52 %	3.83 %

(1) Net weighted average coupon (WAC) is presented net of servicing and other fees.
(2) Average yield incorporates future prepayment and loss assumptions.
(3) The Agency CMO held by the Company is 28.3% interest-only securities and 71.7% CMO.
(4) The non-Agency RMBS held by the Company is 9.8% fixed rate, 5.2% floating rate and 85.0% variable rate based on fair value.

The following table summarizes our non-Agency RMBS portfolio by asset type as of March 31, 2012 and December 31, 2011, respectively:

$ in thousands	March 31,2012	% of Non-Agency	December 31,2011	% of Non-Agency
Re-REMIC Senior	1,589,723	69.2 %	1,634,376	69.3 %
Prime	471,864	20.5 %	482,113	20.4 %
Alt-A	226,500	9.9 %	231,936	9.8 %
Subprime	9,839	0.4 %	10,803	0.5 %
Total Non-Agency	2,297,926	100.0 %	2,359,228	100.0 %

The components of the carrying value of the Company s investment portfolio at March 31, 2012 and December 31, 2011 are presented below.

$ in thousands	March 31, 2012	December 31, 2011
Principal balance	15,707,857	14,514,868
Unamortized premium	648,514	587,430
Unamortized discount	(986,462)	(886,931)
Gross unrealized gains	304,796	203,965
Gross unrealized losses	(96,941)	(205,183)
Fair value	15,577,764	14,214,149

The following table summarizes certain characteristics of the Company s investment portfolio, at fair value, according to estimated weighted average life classifications as of March 31, 2012 and December 31, 2011:

$ in thousands	March 31, 2012	December 31, 2011
Less than one year	106,894	68,217
Greater than one year and less than five years	10,255,694	12,150,472
Greater than or equal to five years	5,215,176	1,995,460
Total	15,577,764	14,214,149

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The following tables present the gross unrealized losses and estimated fair value of the Company s MBS by length of time that such securities have been in a continuous unrealized loss position at March 31, 2012 and December 31, 2011, respectively:

March 31, 2012	**Less than 12 Months**		**12 Months or More**		**Total**	
$ in thousands	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
Agency RMBS:						
15 year fixed-rate	229,918	(585)			229,918	(585)
30 year fixed-rate	1,144,850	(7,079)			1,144,850	(7,079)
ARM	49,953	(36)			49,953	(36)
Hybrid ARM	20,964	(7)			20,964	(7)
Total Agency pass-through	1,445,685	(7,707)			1,445,685	(7,707)
Agency-CMO	103,870	(5,121)			103,870	(5,121)
Non-Agency RMBS	1,006,684	(44,764)	203,080	(18,680)	1,209,764	(63,444)
CMBS	339,579	(20,669)			339,579	(20,669)
Total	2,895,818	(78,261)	203,080	(18,680)	3,098,898	(96,941)

December 31, 2011	**Less than 12 Months**		**12 Months or More**		**Total**	
$ in thousands	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
Agency RMBS:						
15 year fixed-rate	149,092	(754)			149,092	(754)
30 year fixed-rate	844,272	(5,563)			844,272	(5,563)
ARM	25,508	(179)	13,062	(52)	38,570	(231)
Hybrid ARM	24,929	(73)			24,929	(73)
Total Agency pass-through	1,043,801	(6,569)	13,062	(52)	1,056,863	(6,621)
Agency-CMO	50,084	(8,362)			50,084	(8,362)
Non-Agency RMBS	1,981,046	(104,813)	46,193	(11,622)	2,027,239	(116,435)
CMBS	796,965	(73,765)			796,965	(73,765)
Total	3,871,896	(193,509)	59,255	(11,674)	3,931,151	(205,183)

Gross unrealized losses on the Company s Agency RMBS were $7.7 million at March 31, 2012. Due to the inherent credit quality of Agency RMBS, the Company determined that at March 31, 2012, any unrealized losses on its Agency RMBS portfolio were temporary.

Gross unrealized losses on the Company s Agency-CMO, non-Agency RMBS, and CMBS were $89.2 million at March 31, 2012. The Company does not consider these unrealized losses to be credit related, but rather due to non-credit related factors such as interest rate spreads, prepayment speeds, and market fluctuations. These investment securities are included in the Company s assessment for other-than-temporary impairment on at least a quarterly basis.

The following table presents the impact of the Company s MBS on its accumulated other comprehensive income for the three months ended March 31, 2012 and 2011.

$ in thousands

	Three Months ended March 31, 2012	Three Months ended March 31, 2011
Accumulated other comprehensive income from investment securities:		
Unrealized gain (loss) on MBS at beginning of period	(1,218)	31,267
Unrealized gain on MBS, net	209,073	9,949
Balance at the end of period	207,855	41,216

During the three months ended March 31, 2012, the Company reclassified $3.2 million of net unrealized gains from other comprehensive income into gain (loss) on sale of investments as a result of the Company selling certain investments.

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The Company assesses its investment securities for other-than-temporary impairment on at least a quarterly basis. When the fair value of an investment is less than its amortized cost at the balance sheet date of the reporting period for which impairment is assessed, the impairment is designated as either temporary or other-than-temporary. In deciding on whether or not a security is other than temporarily impaired, the Company considers several factors, including the nature of the investment, communications from the trustees of securitizations regarding the credit quality of the security, the severity and duration of the impairment, the cause of the impairment, and the Company s intent that it is more likely than not that the Company can hold the security until recovery of its cost basis.

The Company did not have other-than-temporary impairments for the three months ended March 31, 2012 and 2011.

The following table presents a roll-forward of the credit loss component of other-than-temporary impairments for the three months ended March 31, 2012 and 2011.

$ in thousands	Three Months ended March 31, 2012	Three Months ended March 31, 2011
Cumulative credit loss amount at the beginning of the period		510
Additions for credit losses for which other-than-temporary impairment		
Reductions for securities sold		