

Western Asset Mortgage Capital Corp  
Form 10-Q  
November 07, 2018  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q  
(Mark One)

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the quarterly period ended September 30, 2018

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

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

Commission File Number: 001-35543  
Western Asset Mortgage Capital Corporation  
(Exact name of Registrant as specified in its charter)  
Delaware 27-0298092  
(State or other jurisdiction of (IRS Employer  
incorporation or organization) Identification Number)

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

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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 (check one).

Large accelerated filer  Accelerated filer

Non-accelerated filer  Smaller reporting company

Emerging growth company

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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.

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

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

As of November 6, 2018 there were 48,116,379 shares, par value \$0.01, of the registrant's common stock outstanding.

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## Part I

## ITEM I. Financial Statements

## Western Asset Mortgage Capital Corporation and Subsidiaries

## Consolidated Balance Sheets

(in thousands—except share and per share data)

(Unaudited)

	September 30, 2018	December 31, 2017
Assets:		
Cash and cash equivalents	\$ 12,817	\$ 48,024
Restricted cash	100,138	—
Agency mortgage-backed securities, at fair value (\$2,325,859 and \$2,833,595 pledged as collateral, at fair value, respectively)	2,475,533	2,858,600
Non-Agency mortgage-backed securities, at fair value (\$351,032 and \$266,189 pledged as collateral, at fair value, respectively)	365,710	378,158
Other securities, at fair value (\$92,391 and \$89,823 pledged as collateral, at fair value, respectively)	92,528	122,065
Residential Whole-Loans, at fair value (\$684,463 and \$237,423 pledged as collateral, at fair value, respectively)	684,463	237,423
Residential Bridge Loans (\$234,747 and \$64,526 at fair value and \$249,471 and \$106,673 pledged as collateral, respectively)	249,471	106,673
Securitized commercial loans, at fair value	1,191,048	24,876
Commercial Loans, at fair value (\$123,677 and \$0 pledged as collateral, at fair value, respectively)	143,951	—
Investment related receivable (\$34,559 and \$0 pledged as collateral, respectively)	113,341	7,665
Interest receivable	21,869	13,603
Due from counterparties	81,513	86,930
Derivative assets, at fair value	2,700	728
Other assets	2,903	2,161
Total Assets <sup>(1)</sup>	\$ 5,537,985	\$ 3,886,906
Liabilities and Stockholders' Equity:		
Liabilities:		
Repurchase agreements, net	\$ 3,469,319	\$ 3,251,686
Convertible senior unsecured notes, net	109,731	108,743
Securitized debt, at fair value (includes \$313,143 and \$10,945 held by affiliates, respectively)	1,119,089	10,945
Interest payable (includes \$891 and \$70 on securitized debt held by affiliates, respectively)	10,027	8,322
Investment related payables	169,499	17,217
Due to counterparties	1,068	1,490
Derivative liability, at fair value	2,159	4,346
Accounts payable and accrued expenses	3,513	3,118
Payable to affiliate	2,489	2,041
Dividend payable	14,916	12,960
Other liabilities	100,530	—
Total Liabilities <sup>(2)</sup>	5,002,340	3,420,868

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Commitments and contingencies

Stockholders' Equity:

Common stock: \$0.01 par value, 500,000,000 shares authorized, 48,116,379 and 41,794,079 outstanding, respectively	481	419
Preferred stock, \$0.01 par value, 100,000,000 shares authorized and no shares outstanding	—	—
Treasury stock, at cost, 0 and 125,722 shares held, respectively	—	(1,232 )
Additional paid-in capital	833,840	768,763
Retained earnings (accumulated deficit)	(298,676 )	(301,912 )
Total Stockholders' Equity	535,645	466,038
Total Liabilities and Stockholders' Equity	\$ 5,537,985	\$ 3,886,906

See notes to unaudited consolidated financial statements.

Western Asset Mortgage Capital Corporation and Subsidiaries

Consolidated Balance Sheets (Continued)

(in thousands—except share and per share data)

(Unaudited)

	September 30, 2018	December 31, 2017
(1) Assets of consolidated VIEs included in the total assets above:		
Restricted cash	\$ 100,138	\$ —
Residential Whole-Loans, at fair value (\$684,463 and \$237,423 pledged as collateral, at fair value, respectively)	684,463	237,423
Residential Bridge Loans (\$234,747 and \$64,526 at fair value and \$249,471 and \$106,673 pledged as collateral, respectively)	249,471	106,673
Securitized commercial loans, at fair value	1,191,048	24,876
Commercial Loans, at fair value (\$123,677 and \$0 pledged as collateral, at fair value, respectively)	123,677	—
Investment related receivable	33,430	7,665
Interest receivable	12,418	3,358
Other assets	203	—
Total assets of consolidated VIEs	\$ 2,394,848	\$ 379,995
(2) Liabilities of consolidated VIEs included in the total liabilities above:		
Securitized debt, at fair value (includes \$313,143 and \$10,945 held by affiliates, respectively)	\$ 1,119,089	\$ 10,945
Interest payable (includes \$891 and \$70 on securitized debt held by affiliates, respectively)	2,487	70
Accounts payable and accrued expenses	737	189
Other liabilities	100,531	—
Total liabilities of consolidated VIEs	\$ 1,222,844	\$ 11,204

See notes to unaudited consolidated financial statements.

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

	For the three months ended September 30, 2018	For the three months ended September 30, 2017	For the nine months ended September 30, 2018	For the nine months ended September 30, 2017
Net Interest Income				
Interest income	\$ 54,461	\$ 30,928	\$ 151,342	\$ 89,413
Interest expense (includes \$4,465, \$251, \$9,672 and \$745 on securitized debt held by affiliates, respectively)	38,517	12,363	97,348	31,507
Net Interest Income	15,944	18,565	53,994	57,906
Other Income (Loss)				
Realized gain (loss) on sale of investments, net	(24,229 )	1,830	(29,262 )	20,600
Other than temporary impairment	(2,533 )	(7,225 )	(8,423 )	(19,901 )
Unrealized gain (loss), net	13,128	5,249	(87,526 )	35,126
Gain (loss) on derivative instruments, net	24,625	7,217	132,697	(16,035 )
Other, net	(2 )	216	(100 )	841
Other Income (Loss)	10,989	7,287	7,386	20,631
Expenses				
Management fee to affiliate	2,284	1,853	6,723	6,159
Other operating expenses	1,609	702	4,133	1,855
General and administrative expenses:				
Compensation expense	552	660	1,634	2,064
Professional fees	1,065	781	3,178	2,501
Other general and administrative expenses	335	244	1,093	993
Total general and administrative expenses	1,952	1,685	5,905	5,558
Total Expenses	5,845	4,240	16,761	13,572
Income before income taxes	21,088	21,612	44,619	64,965
Income tax provision (benefit)	206	(1,155 )	555	1,272
Net income	\$ 20,882	\$ 22,767	\$ 44,064	\$ 63,693
Net income per Common Share — Basic	\$ 0.50	\$ 0.54	\$ 1.05	\$ 1.52
Net income per Common Share — Diluted	\$ 0.50	\$ 0.54	\$ 1.05	\$ 1.52

See notes to unaudited consolidated financial statements.

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

	Common Stock Outstanding		Additional Paid-In Capital	Retained Earnings (Accumulated Deficit)	Treasury Stock	Total
	Shares	Par				
Balance at December 31, 2016	41,919,801	\$419	\$ 765,042	\$ (334,979 )	\$—	\$430,482
Vesting of restricted stock	—	—	981	—	—	981
Equity component of convertible senior unsecured notes	—	—	2,656	—	—	2,656
Treasury stock	(125,722 )	—	—	—	(1,232 )	(1,232 )
Net income	—	—	—	85,097	—	85,097
Dividends declared on common stock	—	—	84	(52,030 )	—	(51,946 )
Balance at December 31, 2017	41,794,079	\$419	\$ 768,763	\$ (301,912 )	\$(1,232)	\$466,038
Proceeds from public offerings of common stock	6,196,578	62	64,818	—	—	64,880
Offering costs, public offerings of common stock	—	—	(239 )	—	—	(239 )
Vesting of restricted stock	—	—	195	—	—	195
Treasury stock	125,722	—	213	—	1,232	1,445
Net income	—	—	—	44,064	—	44,064
Dividends declared on common stock	—	—	90	(40,828 )	—	(40,738 )
Balance at September 30, 2018	48,116,379	\$481	\$ 833,840	\$ (298,676 )	\$—	\$535,645

See notes to unaudited consolidated financial statements.

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Consolidated Statements of Cash Flows (in thousands)  
(Unaudited)

	For the nine months ended September 30, 2018	For the nine months ended September 30, 2017
Cash flows from operating activities:		
Net income	\$ 44,064	\$ 63,693
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Premium amortization and (discount accretion), net	2,884	(2,658 )
Interest income earned added to principal of securities	—	(46 )
Amortization of deferred financing costs	576	—
Amortization of discount on convertible senior notes	412	—
Restricted stock amortization	195	795
Interest payments and basis recovered on MAC interest rate swaps	1,064	358
Premium on purchase of Residential Whole-Loans	(8,863 )	(354 )
Premium on purchase of Residential Bridge Loans	(3,191 )	(425 )
Premium on purchase of securitized commercial loans	(3,019 )	—
Unrealized (gain) loss, net	87,526	(35,126 )
Unrealized (gain) loss on derivative instruments, net	1,460	(156,098 )
Other than temporary impairment	8,423	19,901
Realized (gain) loss on sale of securities, net	29,262	(20,600 )
(Gain) loss on derivatives, net	(12,905 )	156,655
Loss on foreign currency transactions, net	—	1
Changes in operating assets and liabilities:		
(Increase) decrease in interest receivable	(8,266 )	5,787
(Increase) decrease in other assets	(599 )	(3,736 )
Increase (decrease) in interest payable	1,705	(11,182 )
Increase (decrease) in accounts payable and accrued expenses	221	(667 )
Increase (decrease) in payable to affiliate	448	(664 )
Net cash provided by operating activities	141,397	15,634
Cash flows from investing activities:		
Purchase of securities	(846,680 )	(2,473,379)
Proceeds from sale of securities	1,111,547	1,189,824
Principal repayments and basis recovered on securities	109,938	187,157
Purchase of Residential Whole-Loans	(493,365 )	(35,323 )
Principal repayments on Residential Whole-Loans	42,867	32,287
Purchase of Commercial Loans	(164,570 )	—
Principal repayments on commercial loans	20,638	—
Purchase of securitized commercial loans	(1,350,000)	—
Principal repayments on securitized commercial loans	196,007	59
Purchase of Residential Bridge Loans	(356,584 )	(73,565 )
Principal repayments on Residential Bridge Loans	197,099	16,251
Payment of premium for option derivatives	(829 )	(14,995 )
Premium received from option derivatives	298	13,721



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Premium received from credit default swaps	(174	)	—
Net settlements of TBAs	136		3,135
Proceeds from (Payments on) termination of futures, net	8,823	(9,230	)
Interest payments and basis recovered on MAC interest rate swaps	(1,064	)	(358
Due from counterparties	—		8,449
Payments on total return swaps, net	—		(552
Premium for interest rate swaptions, net	—		(115
Net cash used in investing activities	(1,525,913)	(1,156,634)	

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Consolidated Statements of Cash Flows (Continued) (in thousands)  
(Unaudited)

	For the nine months ended September 30, 2018	For the nine months ended September 30, 2017
Cash flows from financing activities:		
Proceeds from issuance of common stock	64,880	—
Payment of offering costs	(65 )	—
Repurchase of common stock	(1,733 )	—
Proceeds from sale of treasury stock	3,177	—
Proceeds from repurchase agreement borrowings	15,469,118	13,054,995
Repayments of repurchase agreement borrowings	(15,251,485 )	(11,874,382 )
Proceeds from securitized debt	1,285,219	—
Repayments of securitized debt	(186,015 )	(26 )
Proceeds from forward contracts	—	6,875
Repayments of forward contracts	—	(6,850 )
Due from counterparties, net	5,417	(11,709 )
Due to counterparties, net	(422 )	1,580
Increase in other liabilities	100,138	—
Dividends paid on common stock	(38,782 )	(38,985 )
Net cash provided by financing activities	1,449,447	1,131,498
Effect of exchange rate changes on cash and cash equivalents	—	(1 )
Net increase (decrease) in cash, cash equivalents and restricted cash	64,931	(9,503 )
Cash, cash equivalents and restricted cash, beginning of period	48,024	46,172
Cash, cash equivalents and restricted cash, end of period	\$ 112,955	\$ 36,669
Supplemental disclosure of operating cash flow information:		
Interest paid	\$ 96,030	\$ 30,010
Income taxes paid	\$ 1,635	\$ 4,966
Supplemental disclosure of non-cash financing/investing activities:		
Underwriting and offering costs payable	\$ 174	\$ —
Principal payments of securities, not settled	\$ 42	\$ 16
Securities sold, not settled	\$ 34,559	\$ —
Securities purchased, not settled	\$(124,036 )	\$(293,959 )
Net unsettled TBAs	\$(10 )	\$(2 )
Dividends and distributions declared, not paid	\$ 14,916	\$ 12,995
Principal payments of Residential Whole-Loans, not settled	\$ 11,061	\$ 4,580
Principal payments of Residential Bridge Loans, not settled	\$ 22,227	\$ 2,598
Derivative collateral offset against derivatives	\$ —	\$(157,913 )
Other assets	\$ 143	\$ —
See notes to unaudited consolidated financial statements.		



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

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

Note 1 — Organization

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

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

Note 2 — Basis of Presentation and Summary of Significant Accounting Policies

Basis of Presentation and Consolidation

The accompanying unaudited financial statements and related notes have been prepared in conformity with generally accepted accounting principles in the United States of America (“GAAP”) for interim financial reporting in accordance with Article 10 of Regulation S-X and the instructions to Form 10-Q. Certain prior period amounts have been reclassified to conform to the current period’s presentation. In the opinion of management, all adjustments (which include only normal recurring adjustments) necessary have been made to state fairly the Company’s financial position, results of operations and cash flows. The results of operations for the period ended September 30, 2018, are not

necessarily indicative of the results to be expected for the full year or any future period. These consolidated financial statements should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2017, filed with the SEC on March 29, 2018.

The consolidated financial statements include the accounts of the Company, its wholly-owned subsidiary and variable interest entities ("VIEs") in which it is considered the primary beneficiary. All intercompany amounts between the Company and its subsidiary and consolidated VIEs have been eliminated in consolidation.

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### Variable Interest Entities

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

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

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

In instances where the Company and its related parties have variable interests in a VIE, the Company considers whether there is a single party in the related party group that meets both the power and losses or benefits criteria on its own as though no related party relationship existed. If one party within the related party group meets both these criteria, such reporting entity is the primary beneficiary of the VIE and no further analysis is needed. If no party within the related party group on its own meets both the power and losses or benefits criteria, but the related party group as a whole meets these two criteria, the determination of primary beneficiary within the related party group requires significant judgment. The analysis is based upon qualitative as well as quantitative factors, such as the relationship of the VIE to each of the members of the related-party group, as well as the significance of the VIE's activities to those members, with the objective of determining which party is most closely associated with the VIE.

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

### Use of Estimates

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

### Significant Accounting Policies

There have been no changes to our accounting policies included in Note 2 to the consolidated financial statements of our Annual Report on Form 10-K for the year ended December 31, 2017, other than the significant accounting policies disclosed below.

Restricted Cash

Restricted cash represents cash held by the trustee or servicer for mortgage escrows in connection with the Company's securitized loan and commercial loan investments held in two consolidated VIEs. These escrows consist of principal and interest escrows, capital improvement reserves, repair reserves, real estate tax and insurance reserves and tenant reserves. The corresponding liability is recorded in "Other liabilities" in the Consolidated Balance Sheets. The restricted cash is not available for general corporate use.

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### Securitized Commercial Loans

Securitized commercial loans are comprised of commercial loans of consolidated variable interest entities which were sponsored by third parties. These loans are recorded in accordance with ASC 310-20, "Nonrefundable Fees and Other Costs". The Company has chosen to make the fair value election pursuant to ASC 825. Accordingly, these loans are recorded at fair value with periodic changes in fair value being recorded in earnings as a component of "Unrealized gain (loss), net".

The securitized commercial loans are typically collateralized by commercial real estate. As a result, the Company regularly evaluates the extent and impact of any credit migration associated with the performance and/or value of the underlying collateral property as well as the financial and operating capability of the borrower on a loan by loan basis. On a quarterly basis, the Company evaluates the collectability of both interest and principal of each loan, if circumstances warrant, to determine whether such loan is impaired. A loan is impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the existing contractual terms. When a loan is impaired, the Company does not record an allowance for loan loss as the Company has elected the fair value option. However, income recognition is suspended for loans at the earlier of the date at which payments become 90-days past due or when, in the opinion of management, a full recovery of income and principal becomes doubtful. When the ultimate collectability of the principal of an impaired loan is in doubt, all payments are applied to principal under the cost recovery method. When the ultimate collectability of the principal of an impaired loan is not in doubt, contractual interest is recorded as interest income when received, under the cash basis method until an accrual is resumed. Interest income accrual is resumed when the loan becomes contractually current and performance is demonstrated. A loan is written off when it is no longer realizable and/or legally discharged.

### Commercial Loans

Investments in Commercial Loans, which are comprised of first lien commercial mortgage loans and commercial mezzanine loans, are recorded in accordance with ASC 310-20, "Nonrefundable Fees and Other Costs". The Company has chosen to make the fair value election pursuant to ASC 825 for its Commercial Loan portfolio. Accordingly, these loans are recorded at fair value with periodic changes in fair value being recorded in earnings as a component of "Unrealized gain (loss), net". All other costs incurred in connection with acquiring the Commercial Loans or committing to purchase these loans are charged to expense as incurred.

The Company's loans are typically collateralized by commercial real estate. As a result, the Company regularly evaluates the extent and impact of any credit migration associated with the performance and or value of the underlying collateral property as well as the financial and operating capability of the borrower on a loan by loan basis. On a quarterly basis, the Company evaluates the collectability of both interest and principal of each loan, if circumstances warrant, to determine whether such loan is impaired. A loan is impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the existing contractual terms. When a loan is impaired, the Company does not record an allowance for loan loss as the Company has elected the fair value option. However, income recognition is suspended for loans at the earlier of the date at which payments become 90-days past due or when, in the opinion of management, a full recovery of income and principal becomes doubtful. When the ultimate collectability of the principal of an impaired loan is in doubt, all payments are applied to principal under the cost recovery method. When the ultimate collectability of the principal of an impaired loan is not in doubt, contractual interest is recorded as interest income when received, under the cash basis method until an accrual is resumed. Interest income accrual is resumed when the loan becomes contractually current and performance is demonstrated. A loan is written off when it is no longer realizable and/or legally discharged.



Interest Income Recognition

Loan Portfolio

Interest income on the Company's residential loan portfolio and commercial loan portfolio is recorded using the effective interest method based on the contractual payment terms of the loan. Any premium amortization or discount accretion will be reflected as a component of "Interest income" in the Consolidated Statements of Operations.

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## Recently adopted accounting pronouncements

Description	Adoption Date	Effect on Financial Statements
<p>In May 2014, the FASB issued ASU 2014-9, "Revenue from Contracts with Customers (Topic 606)." The guidance changes an entity's recognition of revenue from contracts with customers. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In addition, the new guidance requires improved disclosures to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. In March 2016, the FASB issued implementation guidance which clarifies principal versus agent considerations in reporting revenue gross versus net (ASU 2016-8). In April 2016, the FASB issued implementation guidance which clarifies the identification of performance obligations (ASU 2016-10). In May 2016, the FASB issued amendments that affect only the narrow aspects of Topic 606 (ASU2016-12).</p>	First quarter 2018.	<p>The Company's revenue is mainly derived from interest income on our investments and to a lesser extent gains on sales of investments, which are not impacted by this standard. Therefore, the adoption of this standard did not have a material impact on the Company's consolidated financial statements.</p>
<p>In January 2016, the FASB issued ASU 2016-1, "Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities." The guidance improves certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. In February 2018, the FASB issued a separate Update for technical corrections and improvements related to the ASU 2016-01 to increase stakeholders' awareness of the amendments and to expedite the improvements (ASU 2018-3).</p>	First quarter 2018.	<p>The standard does not change the guidance for classifying and measuring investments in debt securities and loans as well nonrecourse liabilities of consolidated collateralized financing entities. Therefore, the adoption of this standard did not have a material impact on the Company's consolidated financial statements.</p>
<p>In August 2016, the FASB issued ASU 2016-15, "Statement of Cash Flows - Classification of Certain Cash Receipts and Cash Payments (Topic 230)." The guidance is intended to reduce diversity in practice in how certain transactions are classified on the statement of cash flows.</p>	First quarter 2018 and requires retrospective adoption.	<p>The adoption of this standard did not have a material impact on its Consolidated Statements of Cash Flows.</p>
<p>In November 2016, the FASB issued ASU 2016-18 "Statement of Cash Flows (Topic 230): Restricted Cash, a consensus of the FASB's Emerging Issues Task Force." The guidance requires that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents as well as disclose information about the</p>	First quarter 2018 and requires retrospective adoption.	<p>The adoption of this standard did not have a material impact on its Consolidated Statements of Cash Flows.</p>

nature of the restrictions on its cash and cash equivalents.

In January 2017, the FASB issued ASU 2017-01 "Business Combinations (Topic 805): Clarifying the Definition of a Business." This ASU provides a more robust framework to use in determining when a set of assets and activities constitutes a business.

First quarter 2018. The guidance should be applied prospectively on or after the effective date.

The adoption of this standard did not have a material impact on its Consolidated Statements of Cash Flows.

In May 2017, the FASB issued ASU 2017-09 "Compensation-Stock Compensation (Topic 718): Scope of Modification Accounting." The amendments in this update provide guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting in Topic 718.

First quarter 2018.

There are no changes to the terms and conditions of the Company's share-based compensation. The adoption of this standard did not have a material impact on the Company's consolidated financial statements.

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## Recently issued accounting pronouncements

Description	Effective Date	Effect on Financial Statements
<p>In June 2016, the FASB issued ASU 2016-13, "Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments." This standard significantly changes how an entity will measure credit losses for most financial assets and certain other instruments that aren't measured at fair value through the income statement. The standard will replace the current "incurred loss" approach with an "expected loss" model for instruments measured at amortized cost. For available for sale debt securities, entities will be required to record an allowance rather than reduce the carrying amount, as is currently done under the other than temporary impairment model. It also simplifies the accounting model for purchased credit impaired debt securities and loans.</p>	First quarter 2020.	<p>The Company is currently evaluating the impact the standard may have on its consolidated financial statements when adopted.</p>
<p>In July 2017, the FASB issued ASU 2017-11, "Earnings Per Share (Topic 260), Distinguishing Liabilities from Equity (Topic 480), Derivative and Hedges (Topic 815): Part I - Accounting for Certain Financial Instruments with Down Round Features and Part II - Replacement of the Indefinite Deferral for Mandatory Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatory Redeemable Noncontrolling Interest with a Scope Exception". Part I of this update changes the classification analysis of certain financial instruments (such as warrants and convertible instruments) with down round features. Down round features are features of certain equity-linked financial instruments (or embedded features) that result in the strike price being reduced on the basis of the pricing of future equity offerings. When determining whether certain financial instruments should be classified as liabilities or equity instruments, a down round feature no longer precludes equity classification when assessing whether the instrument is indexed to an entity's own stock. Entities that present earnings per share are required to recognize the effect of the down round feature when it is triggered. The amendments in Part II of this update recharacterize the indefinite deferral of certain provisions of Topic 480 that now are presented as pending content in the Codification, to a scope exception. Those amendments do not have an accounting effect.</p>	First quarter 2019.	<p>The Company is evaluating the impact this standard may have on its consolidated financial statements.</p>
<p>In June 2018, the FASB issued ASU 2018-07, "Compensation-Stock Compensation (Topic 718), Improvements to Nonemployee Share-Based Payment Accounting." The amendments in this update expand the scope of Topic 718 to include share-based payment transactions for acquiring goods and services from nonemployees.</p>	First quarter 2019.	<p>The Company is evaluating the impact this standard may have on its consolidated financial statements.</p>
<p>In July 2018, the FASB issued ASU 2018-09, "Codification Improvements." The amendments in this update affect a wide variety of Topics in the Codification including derivatives and hedging, stock compensation-income taxes, distinguishing liabilities from equity, debt modification and extinguishment, reporting comprehensive income, business combinations-income taxes, financial services and Plan accounting.</p>	First quarter 2019.	<p>The Company is evaluating the impact this standard may have on its consolidated</p>

financial  
statements.

In August 2018, the FASB issued ASU 2018-13, "Fair Value Measurement (Topic 820), Disclosure Framework-Changes to the Disclosure Requirements for Fair Value Measurement." The amendments in this update modify the disclosure requirements on fair value measurements including the consideration of costs and benefits.

First  
quarter  
2020.

The Company is  
evaluating the  
impact this  
standard may  
have on its  
consolidated  
financial  
statements.

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## Note 3 — Fair Value of Financial Instruments

The following tables present the Company's financial instruments carried at fair value as of September 30, 2018 and December 31, 2017, based upon the valuation hierarchy (dollars in thousands):

	September 30, 2018			Total
	Fair Value			
	Level I	Level II	Level III	
<b>Assets</b>				
Agency RMBS	\$—	\$385,008	\$—	\$385,008
Agency RMBS Interest-Only Strips	—	—	12,203	12,203
Agency RMBS Interest-Only Strips accounted for as derivatives, included in MBS	—	—	8,006	8,006
Agency CMBS	—	1,958,951	107,124	2,066,075
Agency CMBS Interest-Only Strips accounted for as derivatives, included in MBS	—	4,241	—	4,241
Subtotal Agency MBS	—	2,348,200	127,333	2,475,533
<b>Non-Agency RMBS</b>				
Non-Agency RMBS	—	26,076	57,274	83,350
Non-Agency RMBS Interest-Only Strips	—	—	15,513	15,513
Non-Agency CMBS	—	266,847	—	266,847
Subtotal Non-Agency MBS	—	292,923	72,787	365,710
<b>Other securities</b>				
Other securities	—	82,820	9,708	92,528
Total mortgage-backed securities and other securities	—	2,723,943	209,828	2,933,771
<b>Residential Whole-Loans</b>				
Residential Whole-Loans	—	—	684,463	684,463
Residential Bridge Loans	—	—	234,747	234,747
Securitized commercial loans	—	—	1,191,048	1,191,048
Commercial Loans	—	—	143,951	143,951
Derivative assets	1,812	888	—	2,700
Total Assets	\$1,812	\$2,724,831	\$2,464,037	\$5,190,680
<b>Liabilities</b>				
Derivative liabilities	\$—	\$2,159	\$—	\$2,159
Securitized debt	—	1,116,483	2,606	1,119,089
Total Liabilities	\$—	\$1,118,642	\$2,606	\$1,121,248

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	December 31, 2017			
	Fair Value			
	Level I	Level II	Level III	Total
<b>Assets</b>				
Agency RMBS	\$—	\$672,177	\$—	\$672,177
Agency RMBS Interest-Only Strips	—	15,437	—	15,437
Agency RMBS Interest-Only Strips accounted for as derivatives, included in MBS	—	10,419	—	10,419
Agency CMBS	—	2,137,583	17,217	2,154,800
Agency CMBS Interest-Only Strips	—	10	—	10
Agency CMBS Interest-Only Strips accounted for as derivatives, included in MBS	—	5,757	—	5,757
Subtotal Agency MBS	—	2,841,383	17,217	2,858,600
Non-Agency RMBS	—	90,819	13	90,832
Non-Agency RMBS Interest-Only Strips	—	—	8,722	8,722
Non-Agency CMBS	—	278,604	—	278,604
Subtotal Non-Agency MBS	—	369,423	8,735	378,158
Other securities	—	112,826	9,239	122,065
Total mortgage-backed securities and other securities	—	3,323,632	35,191	3,358,823
Residential Whole-Loans	—	—	237,423	237,423
Residential Bridge Loans	—	—	64,526	64,526
Securitized commercial loan	—	—	24,876	24,876
Derivative assets	728	—	—	728
Total Assets	\$728	\$3,323,632	\$362,016	\$3,686,376
<b>Liabilities</b>				
Derivative liabilities	\$50	\$4,296	\$—	\$4,346
Securitized debt	—	—	10,945	10,945
Total Liabilities	\$50	\$4,296	\$10,945	\$15,291

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

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

Mortgage-backed securities and other securities

In determining the proper fair value hierarchy or level, the Company considers the amount of available observable market data for each security. Agency RMBS, given the amount of available observable market data, are classified in Level II. For Non-Agency RMBS, CMBS and other securities, to determine whether a security should be a Level II, the securities are grouped by

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security type and the Manager reviews the internal trade history, for the quarter, for each security type. If there is sufficient trade data above a predetermined threshold of a security type, the Manager determines it has sufficient observable market data and the security will be categorized as a Level II.

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

### Residential Whole-Loans and Residential Bridge Loans

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

### Commercial Loans

Values for the Company's Commercial Loans are based upon either prices obtained from an independent third party pricing service that specializes in loan valuation, utilizing a valuation model that is calibrated to recent loan trade execution or a broker quote. The third party pricing service uses a discounted cash flow valuation methodology that incorporates commonly used market pricing methods, including LTV, debt to income, maturity, interest rates, collateral location, and unpaid principal balance, prepayment penalties, lien position and times late. Due to the inherent uncertainty of such valuation, the fair values established for commercial loans held by the Company may differ from the fair values that would have been established if a readily available market existed for these loans. Accordingly, the Company's commercial loans are classified as a Level III.

### Securitized commercial loans

Values for the Company's securitized commercial loans are based on the CFE valuation methodology. Since there is an extremely limited market for the securitized commercial loans, the Company determined the securitized debt is more actively traded and therefore was more observable. Due to the inherent uncertainty of such valuation, the Company classifies its securitized commercial loans as Level III.

### Securitized debt

In determining the proper fair value hierarchy or level, the Company considers the amount of available observable market data for each security. Since the securitized debt represents traded debt securities, the Manager's pricing team reviews the trade activity during the quarter for each security to determine the appropriate level within the fair value hierarchy. If there is sufficient trade data above a predetermined threshold, the Manager determines it has sufficient observable market data and the debt security will be categorized as a Level II. If there is not sufficient observable

market data the debt security will be categorized as a Level III.

#### Derivatives

Values for the Company's derivatives are based upon prices from third party pricing services, whose pricing is subject to review by the Manager's pricing committee. In valuing its over-the-counter interest rate derivatives, such as swaps and swaptions, its currency derivatives, such as swaps and forwards and credit derivatives such as total return swaps, the Company considers the creditworthiness of both the Company and its counterparties, along with collateral provisions contained in each derivative agreement, from the perspective of both the Company and its counterparties. No credit valuation adjustment was made in determining the fair value of interest rate and/or currency derivatives for the periods ended September 30, 2018 and December 31, 2017.

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The Company performs quarterly reviews of the independent third party pricing data. These reviews may consist of a review of the daily change in the prices provided by the independent pricing vendor which exceed established tolerances or comparisons to executed transaction prices, utilizing the Manager's pricing group. The Manager's pricing group, which functions independently from its portfolio management personnel, reviews the price differences or changes in price by comparing the vendor price to alternate sources including other independent pricing services or broker quotations. If the price change or difference cannot be corroborated, the Manager's pricing group consults with the portfolio management team for market color in reviewing such pricing data as warranted. To the extent that the Manager has information, typically in the form of broker quotations that would indicate that a price received from the independent pricing service is outside of a tolerance range, the Manager generally challenges the independent pricing service price.

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

Three months ended September 30, 2018

\$ in thousands	Agency MBS	Non-Agency MBS	Other Securities	Residential Whole-Loans	Residential Bridge Loans	Commercial Loans	Securitized commercial loans	Securitized debt
Beginning balance	\$75,043	\$ 16,307	\$ 8,955	\$ 335,149	\$236,359	\$70,717	\$1,309,195	\$ 2,870
Transfers into Level III from Level II	—	57,275	9,708	—	—	—	—	—
Transfers from Level III into Level II	(51,976 )	—	(8,697 )	—	—	—	—	—
Purchases	107,034	—	—	372,348	70,465	94,313	—	—
Principal repayments	(42 )	(14 )	(285 )	(21,258 )	(70,341 )	(20,638 )	(117,100 )	—
Total net gains / losses included in net income								
Other than temporary impairment	(384 )	(142 )	—	—	—	—	—	—
Unrealized gains/(losses), net on assets <sup>(1)</sup>	(1,007 )	(95 )	(15 )	(1,469 )	(1,103 )	(575 )	282	—
Unrealized (gains)/losses, net on liabilities <sup>(2)</sup>	—	—	—	—	—	—	—	(330 )
Premium and discount amortization, net	(1,335 )	(544 )	42	(307 )	(633 )	134	(1,329 )	66
Ending balance	\$127,333	\$ 72,787	\$ 9,708	\$ 684,463	\$234,747	\$143,951	\$1,191,048	\$ 2,606
Unrealized gains/(losses), net on assets held at the end of the period <sup>(1)</sup>	\$ (668 )	\$ (94 )	\$ —	\$ (1,231 )	\$ (844 )	\$ (618 )	\$ 282	\$ —
Unrealized gains/(losses), net on liabilities held at the end of the period <sup>(2)</sup>	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 330

Three months ended September 30, 2017

\$ in thousands	Agency MBS	Non-Agency MBS	Other Securities	Residential Whole-Loans	Securitized commercial loan	Securitized debt	Derivative liability
Beginning balance	\$—	\$ 14,326	\$ 22,405	\$ 203,540	\$ 24,875	\$ 10,945	\$ 329
Transfers into Level III from Level II	—	—	9,470	—	—	—	—
Transfers from Level III into Level II	—	—	(23,852 )	—	—	—	—
Purchases	2,009	—	—	—	—	—	—
Sales and settlements	—	—	—	—	—	—	(53 )
Principal repayments	—	(388 )	—	(11,264 )	(59 )	(26 )	—
Total net gains / losses included in net income	—	—	0	—	—	—	53

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Realized (gains)/losses, net on liabilities								
Other than temporary impairment	—	—	(121	) —	—	—	—	
Unrealized gains/(losses), net on assets <sup>(1)</sup>	—	291	1,094	(575	) 136	—	—	
Unrealized (gains)/losses, net on liabilities <sup>(2)</sup>	—	—	—	—	—	60	(329	)
Premium and discount amortization, net	—	33	474	(262	) —	—	—	
Ending balance	\$2,009	\$ 14,262	\$9,470	\$ 191,439	\$ 24,952	\$ 10,979	\$ —	
Unrealized gains/(losses), net on assets held at the end of the period <sup>(1)</sup>	\$—	\$ 291	\$—	\$ (356	) \$ 136	\$—	\$ —	
Unrealized gains/(losses), net on liabilities held at the end of the period <sup>(2)</sup>	\$—	\$ —	\$—	\$—	\$—	\$(60	) \$ —	

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Nine months ended September 30, 2018

\$ in thousands	Agency MBS	Non-Agency MBS	Other Securities	Residential Whole-Loans	Residential Bridge Loans	Commercial Loans	Securitized commercial loans	Securitized debt
Beginning balance	\$ 17,217	\$ 8,735	\$ 9,239	\$ 237,423	\$ 64,526	\$—	\$ 24,876	\$ 10,945
Transfers into Level III from Level II	22,794	57,275	9,708	—	—	—	—	—
Transfers from Level III into Level II	(16,805 )	—	(8,697 )	—	—	—	—	(10,899 )
Purchases	109,002	8,602	—	486,354	221,619	144,035	1,353,019	—
Sales and settlements	—	—	—	—	—	—	—	12
Principal repayments	(53 )	(14 )	(604 )	(36,092 )	(49,503 )	—	(196,007 )	(44 )
Total net gains / losses included in net income								
Other than temporary impairment	(590 )	(191 )	—	—	—	—	—	—
Unrealized gains/(losses), net on assets <sup>(1)</sup>	(1,447 )	(149 )	(68 )	(2,644 )	(1,217 )	(159 )	11,152	—
Unrealized (gains)/losses, net on liabilities <sup>(2)</sup>	—	—	—	—	—	—	—	2,502
Premium and discount amortization, net	(2,785 )	(1,471 )	130	(578 )	(678 )	75	(1,992 )	90
Ending balance	\$ 127,333	\$ 72,787	\$ 9,708	\$ 684,463	\$ 234,747	\$ 143,951	\$ 1,191,048	\$ 2,606
Unrealized gains/(losses), net on assets held at the end of the period <sup>(1)</sup>	\$ (1,089 )	\$ (148 )	\$ —	\$ (2,101 )	\$ (832 )	\$ (159 )	\$ 11,152	\$ —
Unrealized gains/(losses), net on liabilities held at the end of the period <sup>(2)</sup>	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ (2,504 )

Nine months ended September 30, 2017

\$ in thousands	Agency MBS	Non-Agency MBS	Other Securities	Residential Whole-Loans	Securitized commercial loan	Securitized debt	Derivative liability
Beginning balance	\$ 73,059	\$ 75,576	\$ 31,356	\$ 192,136	\$ 24,225	\$ 10,659	\$ 1,673
Transfers into Level III from Level II	—	15,610	9,470	—	—	—	—
Transfers from Level III into Level II	(73,715 )	(7,434 )	(33,080 )	—	—	—	—
Purchases	2,009	—	—	33,718	—	—	—
Sales and settlements	—	(60,132 )	—	—	—	—	(552 )
Principal repayments	—	(2,463 )	(172 )	(33,718 )	(59 )	(26 )	—

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Total net gains / losses included in net income							
Realized gains/(losses), net on assets	—	2,623	—	—	—	—	—
Realized (gains)/losses, net on liabilities	—	—	—	—	—	—	552
Other than temporary impairment	—	—	(1,823 )	—	—	—	—
Unrealized gains/(losses), net on assets <sup>(1)</sup>	636	(8,715 )	1,550	97	786	—	—
Unrealized (gains)/losses, net on liabilities <sup>(2)</sup>	—	—	—	—	—	346	(1,673 )
Premium and discount amortization, net	20	(803 )	2,169	(794 )	—	—	—
Ending balance	\$2,009	\$ 14,262	\$ 9,470	\$ 191,439	\$ 24,952	\$ 10,979	\$ —
Unrealized gains/(losses), net on assets held at the end of the period <sup>(1)</sup>	\$—	\$ 684	\$ 72	\$ 347	\$ 786	\$—	\$—
Unrealized gains/(losses), net on liabilities held at the end of the period <sup>(2)</sup>	\$—	\$—	\$—	\$—	\$—	\$(346 )	\$—

(1) Gains and losses are included in "Unrealized gain (loss), net" in the Consolidated Statements of Operations.

(2) Gains and losses on securitized debt and derivative liability are included in "Unrealized gain (loss), net" and "Gain (loss) on derivative instruments, net" in the Consolidated Statements of Operations, respectively.

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Transfers between hierarchy levels during operations for the three and nine months ended September 30, 2018 and September 30, 2017 were based on the availability of sufficient observable inputs. Movements from Level II to Level III was based on information received from a third party pricing service which, along with the back-testing of historical sales transactions performed by the Manager, which did not provide sufficient observable data to meet Level II versus Level III criteria, resulting in the movement from Level II to Level III. Movements from Level III to Level II was based on information received from a third party pricing service which, along with the back-testing of historical sales transactions performed by the Manager, which provided the sufficient observable data for the movement from Level III to Level II. The Company did not have transfers between either Level I and Level II or Level I and Level III for the three and nine months ended September 30, 2018 and September 30, 2017.

## Other Fair Value Disclosures

Certain Residential Bridge Loans, repurchase agreement borrowings and convertible senior unsecured notes are not carried at fair value in the consolidated financial statements. The following table presents the carrying value and estimated fair value of the Company's financial instruments that are not carried at fair value as of September 30, 2018 and December 31, 2017 in the consolidated financial statements (dollars in thousands):

	September 30, 2018		December 31, 2017	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
<b>Assets</b>				
Residential Bridge Loans	\$ 14,724	\$ 14,479	\$ 42,147	\$ 42,881
Total	\$ 14,724	\$ 14,479	\$ 42,147	\$ 42,881
<b>Liabilities</b>				
Borrowings under repurchase agreements	\$ 3,469,319	\$ 3,591,751	\$ 3,251,686	\$ 3,257,956
Convertible senior unsecured notes	109,731	115,385	108,743	114,819
Total	\$ 3,579,050	\$ 3,707,136	\$ 3,360,429	\$ 3,372,775

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

## Residential Bridge Loans

The fair values of the Residential Bridge Loans are based upon prices obtained from an independent third party pricing service that specializes in loan valuation, utilizing a valuation model that is calibrated to recent loan trade execution. Their valuation methodology uses a discounted cash flow model and incorporates commonly used market pricing methods, including LTV debt to income, maturity, interest rates, collateral location, and unpaid principal balance, prepayment penalties, FICO scores, lien position and times late. Due to the inherent uncertainty of such valuation, the fair values established for residential bridge loans held by the Company may differ from the fair values that would have been established if a readily available market existed for these loans. Accordingly, the Company's loans are classified as Level III.

## Borrowings under repurchase agreements

The fair values of the borrowings under repurchase agreements are based on a net present value technique. This method discounts future estimated cash flows using rates the Company determined best estimates current market interest rates that would be offered for loans with similar characteristics and credit quality. The use of different market assumptions or estimation methodologies could have a material effect on the fair value amounts. This fair value measurement is based on observable inputs, and as such, are classified as Level II.



Convertible senior unsecured notes

The fair value of the convertible senior unsecured notes is based on quoted market prices. Accordingly, the Company's convertible senior unsecured notes are classified as Level I.

Note 4 – Mortgage-Backed Securities and other securities

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The following tables present certain information about the Company's investment portfolio at September 30, 2018 and December 31, 2017 (dollars in thousands):

	September 30, 2018							Net Weighted Average Coupon
	Principal Balance	Unamortized Premium (Discount), net	Designated as Credit Reserv and OTTI	Amortized Cost	Unrealized Gain	Unrealized Loss	Estimated Fair Value	
Agency RMBS	\$389,756	\$13,133	\$—	\$402,889	\$—	\$(17,881)	\$385,008	3.6 %
Agency RMBS Interest-Only Strips <sup>(2)</sup>	N/A	N/A	N/A	12,377	724	(898)	12,203	2.3 % (1)
Agency RMBS Interest-Only Strips, accounted for as derivatives <sup>(1)(2)</sup>	N/A	N/A	N/A	N/A	N/A	N/A	8,006	2.8 % (1)
Subtotal Agency RMBS	389,756	13,133	—	415,266	724	(18,779)	405,217	3.2 %
Agency CMBS	2,124,942	4,970	—	2,129,912	563	(64,400)	2,066,075	3.2 %
Agency CMBS Interest-Only Strips accounted for as derivatives <sup>(1)(2)</sup>	N/A	N/A	N/A	N/A	N/A	N/A	4,241	0.4 % (1)
Subtotal Agency CMBS	2,124,942	4,970	—	2,129,912	563	(64,400)	2,070,316	3.0 %
Total Agency MBS	2,514,698	18,103	—	2,545,178	1,287	(83,179)	2,475,533	3.0 %
Non-Agency RMBS	113,606	5,568	(39,585)	79,589	4,344	(583)	83,350	4.4 %
Non-Agency RMBS Interest-Only Strips <sup>(1)</sup>	N/A	N/A	N/A	15,677	—	(164)	15,513	0.5 % (1)
Subtotal Non-Agency RMBS	113,606	5,568	(39,585)	95,266	4,344	(747)	98,863	1.0 %
Non-Agency CMBS	322,255	(29,014)	(24,976)	268,265	3,959	(5,377)	266,847	5.9 %
Total Non-Agency MBS	435,861	(23,446)	(64,561)	363,531	8,303	(6,124)	365,710	2.2 %
Other securities <sup>(3)</sup>	71,420	2,116	(9,891)	82,349	10,247	(68)	92,528	9.0 %
Total	\$3,021,979	\$(3,227)	\$(74,452)	\$2,991,058	\$19,837	\$(89,371)	\$2,933,771	2.9 %

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	December 31, 2017							
	Principal	Unamortized	Discount		Unrealized	Unrealized	Estimated	Net
	Balance	Premium	Designated	as	Cost	Gain	Loss	Weighted
		(Discount),	Credit Reserv	Amortized			Fair Value	Average
		net	and OTTI	Cost				Coupon
Agency RMBS	\$641,044	\$28,876	\$—	\$669,920	\$4,571	\$(2,314)	\$672,177	3.9 %
Agency RMBS Interest-Only Strips <sup>(1)</sup>	N/A	N/A	N/A	14,750	878	(191)	15,437	2.9 % (1)
Agency RMBS Interest-Only Strips, accounted for as derivatives <sup>(1)(2)</sup>	N/A	N/A	N/A	N/A	N/A	N/A	10,419	2.9 % (1)
Subtotal Agency RMBS	641,044	28,876	—	684,670	5,449	(2,505)	698,033	3.6 %
Agency CMBS	2,145,139	2,142	—	2,147,281	16,913	(9,394)	2,154,800	2.9 %
Agency CMBS Interest-Only Strips <sup>(1)</sup>	N/A	N/A	N/A	—	10	—	10	3.2 % (1)
Agency CMBS Interest-Only Strips accounted for as derivatives <sup>(1)(2)</sup>	N/A	N/A	N/A	N/A	N/A	N/A	5,757	0.5 % (1)
Subtotal Agency CMBS	2,145,139	2,142	—	2,147,281	16,923	(9,394)	2,160,567	2.7 %
Total Agency MBS	2,786,183	31,018	—	2,831,951	22,372	(11,899)	2,858,600	3.0 %
Non-Agency RMBS	119,748	5,263	(39,491)	85,520	5,473	(161)	90,832	3.8 %
Non-Agency RMBS Interest-Only Strips <sup>(1)</sup>	N/A	N/A	N/A	8,738	—	(16)	8,722	0.9 % (1)
Subtotal Non-Agency RMBS	119,748	5,263	(39,491)	94,258	5,473	(177)	99,554	1.8 %
Non-Agency CMBS	379,183	(59,129)	(28,020)	292,034	1,702	(15,132)	278,604	4.8 %
Total Non-Agency MBS	498,931	(53,866)	(67,511)	386,292	7,175	(15,309)	378,158	3.3 %
Other securities <sup>(3)</sup>	86,305	6,300	(5,404)	110,091	12,161	(187)	122,065	7.8 %
Total	\$3,371,419	\$(16,548)	\$(72,915)	\$3,328,334	\$41,708	\$(27,395)	\$3,358,823	3.1 %

IOs and IIOs have no principal balances and bear interest based on a notional balance. The notional balance is used solely to determine interest distributions on interest-only class of securities. At September 30, 2018, the notional balance for Agency RMBS IOs and IIOs, Non-Agency RMBS IOs and IIOs, Agency RMBS IOs and IIOs, accounted for as derivatives and Agency CMBS IOs and IIOs, accounted for as derivatives was \$166.4 million, \$822.0 million, \$96.2 million and \$173.9 million, respectively. At December 31, 2017, the notional balance for Agency RMBS IOs and IIOs, Non-Agency RMBS IOs and IIOs, Agency RMBS IOs and IIOs, accounted for as derivatives, Agency CMBS IOs and IIOs, accounted for as derivatives and Agency CMBS IOs and IIOs was \$165.5 million, \$278.4 million, \$122.0 million, \$192.5 million and \$3.3 million, respectively.

(2)

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

Other securities include residual interests in asset-backed securities which have no principal balance and an (3) amortized cost of approximately \$18.7 million and \$22.9 million, as of September 30, 2018 and December 31, 2017, respectively.

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As of September 30, 2018 and December 31, 2017 the weighted average expected remaining term of the MBS and other securities investment portfolio was 9.0 years and 8.6 years, respectively.

The following tables present the changes in the components of the Company's purchase discount and amortizable premium on its Non-Agency RMBS, Non-Agency CMBS and other securities for the three and nine months ended September 30, 2018 and September 30, 2017 (dollars in thousands):

	Three months ended September 30, 2018			Three months ended September 30, 2017		
	Discount Designated as Credit Reserve and OTTI	Accretable Discount <sup>(1)</sup>	Amortizable Premium <sup>(1)</sup>	Discount Designated as Credit Reserve and OTTI	Accretable Discount <sup>(1)</sup>	Amortizable Premium <sup>(1)</sup>
Balance at beginning of period	\$(78,837)	\$(68,677 )	\$ 21,723	\$(49,830)	\$(76,778 )	\$ 15,186
Accretion of discount	—	1,314	—	—	2,588	—
Amortization of premium	—	—	(97 )	—	—	(87 )
Realized credit losses	3,305	—	—	25	—	—
Purchases	—	—	—	—	—	—
Sales	2,334	25,624	(400 )	187	1,931	(18 )
Net impairment losses recognized in earnings	(2,071 )	—	—	(2,345 )	—	—
Transfers/release of credit reserve <sup>(2)</sup>	817	8	(825 )	(866 )	953	(87 )
Balance at end of period	\$(74,452)	\$(41,731 )	\$ 20,401	\$(52,829)	\$(71,306 )	\$ 14,994
	Nine months ended September 30, 2018			Nine months ended September 30, 2017		
	Discount Designated as Credit Reserve and OTTI	Accretable Discount <sup>(1)</sup>	Amortizable Premium <sup>(1)</sup>	Discount Designated as Credit Reserve and OTTI	Accretable Discount <sup>(1)</sup>	Amortizable Premium <sup>(1)</sup>
Balance at beginning of period	\$(72,915)	\$(68,438 )	\$ 20,872	\$(130,484)	\$(109,822 )	\$ 44,527
Accretion of discount	—	6,483	—	—	8,542	—
Amortization of premium	—	—	(461 )	—	—	(776 )
Realized credit losses	5,526	—	—	1,854	—	—
Purchases	(7,182 )	(6,473 )	435	(1,724 )	(668 )	1,522
Sales	5,673	29,352	(1,084 )	89,628	32,016	(31,060 )
Net impairment losses recognized in earnings	(7,570 )	—	—	(12,696 )	—	—
Transfers/release of credit reserve <sup>(2)</sup>	2,016	(2,655 )	639	593	(1,374 )	781
Balance at end of period	\$(74,452)	\$(41,731 )	\$ 20,401	\$(52,829)	\$(71,306 )	\$ 14,994

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

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

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The following tables present the fair value and contractual maturities of the Company's investment securities at September 30, 2018 and December 31, 2017 (dollars in thousands):

	September 30, 2018				Total
	< or equal to 10 years	> 10 years and < or equal to 20 years	> 20 years and < or equal to 30 years	> 30 years	
Agency RMBS	\$—	\$ —	\$ 57,572	\$ 327,436	\$ 385,008
Agency RMBS Interest-Only Strips	3,937	2,436	5,830	—	12,203
Agency RMBS Interest-Only Strips, accounted for as derivatives	1,223	4,104	2,679	—	8,006
Agency CMBS	1,507,428	558,647	—	—	2,066,075
Agency CMBS Interest-Only Strips accounted for as derivatives	—	—	—	4,241	4,241
Subtotal Agency	1,512,588	565,187	66,081	331,677	2,475,533
Non-Agency RMBS	—	24,752	16,757	41,841	83,350
Non-Agency RMBS Interest- Only Strips	—	—	7,900	7,613	15,513
Non-Agency CMBS	28,752	80,180	104,617	53,298	266,847
Subtotal Non-Agency	28,752	104,932	129,274	102,752	365,710
Other securities	3,782	59,908	—	28,838	92,528
Total	\$ 1,545,122	\$ 730,027	\$ 195,355	\$ 463,267	\$ 2,933,771
	December 31, 2017				Total
	< or equal to 10 years	> 10 years and < or equal to 20 years	> 20 years and < or equal to 30 years	> 30 years	
Agency RMBS	\$—	\$ 56,228	\$ 239,197	\$ 376,752	\$ 672,177
Agency RMBS Interest-Only Strips	3,926	991	6,926	—	15,437
Agency RMBS Interest-Only Strips, accounted for as derivatives	1,686	639	3,594	—	10,419
Agency CMBS	1,535,620	—	—	—	2,154,800
Agency CMBS Interest-Only Strips	10	—	—	—	10
Agency CMBS Interest-Only Strips accounted for as derivatives	—	—	—	5,757	5,757
Subtotal Agency	1,605,238	625,858	249,717	382,509	2,858,600