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Ellington Residential Mortgage REIT  
Form 10-K  
March 14, 2018

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended December 31, 2017

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 001-35896  
Ellington Residential Mortgage REIT  
(Exact Name of Registrant as Specified in Its Charter)

Maryland 46-0687599  
(State or Other Jurisdiction of Incorporation or Organization) (I.R.S. Employer Identification No.)

53 Forest Avenue, Old Greenwich, Connecticut 06870  
(Address of Principal Executive Office) (Zip Code)  
(203) 698-1200

(Registrant's Telephone Number, Including Area Code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Shares of Beneficial Interest, \$0.01 par value per share	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  
Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes  No

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 Website, 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 232.405 of this chapter) is not contained herein, and will not be contained to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer  Accelerated Filer

Non-Accelerated Filer  Smaller Reporting Company

Emerging Growth Company

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 of the Exchange Act). Yes " No x

As of June 30, 2017, the last business day of the Registrant's most recently completed second fiscal quarter, the aggregate market value of the registrant's common shares held by non-affiliates was \$137,874,647 based on the closing price as reported by the New York Stock Exchange on that date.

Number of the registrant's common shares outstanding as of March 9, 2018: 13,123,336

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the registrant's definitive Proxy Statement with respect to its 2018 Annual Meeting of Shareholders to be filed not later than 120 days after the end of the registrant's fiscal year are incorporated by reference into Part III hereof as noted therein.

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ELLINGTON RESIDENTIAL MORTGAGE REIT  
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## PART I

### Item 1. Business

Except where the context suggests otherwise, "EARN," "we," "us," and "our" refer to Ellington Residential Mortgage REIT and its consolidated subsidiaries, including Ellington Residential Mortgage LP, our operating partnership subsidiary, which we refer to as our "Operating Partnership." We hold all of our assets and conduct all of our operations through our Operating Partnership. "Manager" refers to Ellington Residential Mortgage Management LLC, our external manager, and "Ellington" refers to Ellington Management Group, L.L.C. and its affiliated investment advisory firms, including our Manager. In certain instances, references to our Manager and services to be provided to us by our Manager may also include services provided by Ellington and its other affiliates from time to time. In certain instances, references to our Manager and services to be provided to us by our Manager may also include services provided by Ellington and its other affiliates from time to time. References to "Blackstone" mean The Blackstone Group LP. The "Blackstone Funds" means the group of funds that are managed by an affiliate of Blackstone and that helped form, and have a substantial investment in, our company.

#### Special Note Regarding Forward-Looking Statements

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

Forward-looking statements are based on our beliefs, assumptions, and expectations of our future operations, business strategies, performance, financial condition, liquidity and prospects, taking into account all information currently available to us. These beliefs, assumptions, and expectations are subject to risks and uncertainties and can change as a result of many possible events or factors, not all of which are known to us. If a change occurs, our business, financial condition, liquidity, results of operations and strategies may vary materially from those expressed or implied in our forward-looking statements. The following factors are examples of those that could cause actual results to vary from our forward-looking statements: changes in interest rates and the market value of our securities; our use of and dependence on leverage; future changes with respect to the Federal National Mortgage Association, or "Fannie Mae," and Federal Home Loan Mortgage Corporation, or "Freddie Mac," and related events, including the lack of certainty as to the future roles of these entities and the U.S. Government in the mortgage market and changes to legislation and regulations affecting these entities; market volatility; changes in the prepayment rates on the mortgage loans underlying the securities we own and intend to acquire; changes in rates of default and/or recovery rates on our non-Agency assets; our ability to borrow to finance our assets; changes in government regulations affecting our business; our ability to maintain our exclusion from registration under the Investment Company Act of 1940, as amended, or the "Investment Company Act"; and risks associated with investing in real estate assets, including changes in business conditions and the general economy. These and other risks, uncertainties and factors, including the risk factors described under Item 1A of this Annual Report on Form 10-K, could cause our actual results to differ materially from those projected or implied in any forward-looking statements we make. All forward-looking statements speak only as of the date on which they are made. New risks and uncertainties arise over time, and it is not possible to predict those events or how they may affect us. Except as required by law, we are not obligated to, and do not intend to, update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise.

#### Our Company

Ellington Residential Mortgage REIT is a Maryland real estate investment trust formed in August 2012 that specializes in acquiring, investing in, and managing residential mortgage- and real estate-related assets. Our primary objective is to generate attractive current yields and risk-adjusted total returns for our shareholders by making investments that we believe compensate us appropriately for the risks associated with them. We seek to attain this objective by constructing and actively managing a portfolio consisting primarily of residential mortgage-backed securities, or "RMBS," for which the principal and interest payments are guaranteed by a U.S. government agency or a

U.S. government-sponsored entity, or "Agency RMBS," and, to a lesser extent, RMBS backed by prime jumbo, Alternative A-paper, or "Alt-A," manufactured housing, and subprime residential mortgage loans, or "non-Agency RMBS." We also may opportunistically acquire other types of residential mortgage- and real estate-related asset classes, such as residential mortgage loans, mortgage servicing rights, or "MSRs," and credit risk transfer securities, or "CRTs." We believe that being able to combine Agency RMBS with non-Agency RMBS and other residential mortgage- and real estate-related asset classes enables us to balance a range of mortgage-related risks.

We were formed through an initial strategic venture among affiliates of Ellington, an investment management firm and registered investment adviser with a 23-year history of investing in a broad spectrum of mortgage-backed securities, or "MBS," and related derivatives, and the Blackstone Funds. As of December 31, 2017, the Blackstone Funds owned approximately 20% of our outstanding common shares. We have elected to be taxed as a real estate investment trust, or "REIT," for U.S. federal income tax purposes. We intend to maintain our exclusion from registration under the Investment Company Act.

#### Our Manager and Ellington

We are externally managed and advised by our Manager, an affiliate of Ellington, pursuant to a management agreement. Our Manager was formed solely to serve as our manager and does not have any other clients. In addition, our Manager does not have any employees of its own and instead relies on the employees of Ellington to perform its obligations to us.

The members of our management team are Michael Vranos, founder and Chief Executive Officer of Ellington, who serves as our Co-Chief Investment Officer and as a member of our Board of Trustees; Laurence Penn, Vice Chairman and Chief Operating Officer of Ellington, who serves as our President and Chief Executive Officer and as a member of our Board of Trustees; Mark Tecotzky, a Managing Director of Ellington, who serves as our Co-Chief Investment Officer; Lisa Mumford, who serves as our Chief Financial Officer; Daniel Margolis, General Counsel of Ellington, who serves as our General Counsel; JR Herlihy, a Director of Ellington, who serves as our Treasurer; Chris Smernoff, who serves as our Controller; and Jason Frank, Associate General Counsel of Ellington, who serves as our Secretary. Mr. Smernoff is expected to become our Chief Financial Officer upon Ms. Mumford's retirement from her position with our company on or about March 30, 2018, at which time Mr. Herlihy is expected to become our Chief Operating Officer. Each of these individuals is an officer of our Manager.

Our Manager is responsible for administering our business activities and day-to-day operations and, pursuant to a services agreement between our Manager and Ellington, relies on the resources of Ellington to support our operations. Ellington has well-established portfolio management resources for each of our targeted asset classes and an established infrastructure supporting those resources. Through our relationship with our Manager, we benefit from Ellington's highly analytical investment processes, broad-based deal flow, extensive relationships in the financial community, financial and capital structuring skills, investment surveillance capabilities, and operational expertise. Ellington's analytic approach to the investment process involves collection of substantial amounts of data regarding historical performance of RMBS collateral and RMBS market transactions. Ellington analyzes this data to identify possible relationships and trends and develops financial models used to support our investment and risk management process. In addition, throughout Ellington's 23-year history of investing in RMBS and related derivatives, it has developed strong relationships with a wide range of dealers and other market participants that provide Ellington access to a broad range of trading opportunities and market information. As a result, Ellington provides us with access to a wide variety of asset acquisition and disposition opportunities and information that assist us in making asset management decisions across our targeted asset classes, which we believe provides us with a significant competitive advantage. We also benefit from Ellington's finance, accounting, operational, legal, compliance, and administrative functions.

As of December 31, 2017, Ellington employed over 160 employees and had assets under management of approximately \$6.6 billion, of which (i) approximately \$5.1 billion consisted of our company, as well as Ellington Financial LLC, a specialty finance company listed on the New York Stock Exchange, or "NYSE," under the ticker "EFC," and various hedge funds and other alternative investment vehicles that employ financial leverage, and (ii) approximately \$1.5 billion consisted of accounts that do not employ financial leverage.

#### Our Strategy

We intend to capitalize on current market opportunities by utilizing an opportunistic strategy that we believe will enable us to generate attractive current yields and risk-adjusted total returns for our shareholders. In particular, our strategy consists of:

- utilizing an investment model that focuses on security selection and allocates capital to assets that balance a range of mortgage-related risks;
- constructing and actively managing a hybrid investment portfolio consisting primarily of Agency RMBS and, to a lesser extent, non-Agency RMBS, designed to:

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take advantage of opportunities in the Agency RMBS market by acquiring Agency RMBS on a leveraged basis; and  
take advantage of opportunities in the non-Agency residential mortgage market by purchasing investment grade and  
non-investment grade non-Agency RMBS, including senior and subordinated securities;  
opportunistically acquiring and managing other mortgage- and real estate-related assets, such as MSRs, CRTs, and  
residential mortgage loans, that we would hold for appreciation and/or current income; and

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opportunistically mitigating our interest rate and prepayment risk and, to a lesser extent, credit risk, by using a variety of hedging instruments.

Our strategy is adaptable to changing market environments, subject to compliance with the income and other tests that will allow us to maintain our qualification as a REIT for U.S. federal income tax purposes and to maintain our exclusion from registration as an investment company under the Investment Company Act. As a result, although we intend to focus on the acquisition and management primarily of Agency RMBS, and to a lesser extent, non-Agency RMBS, residential mortgage loans, MSRs and CRTs, our acquisition and management decisions will depend on prevailing market conditions and our targeted asset classes may vary over time in response to market conditions. To the extent that we acquire MSRs, it may be necessary to hold such assets through a taxable REIT subsidiary, or "TRS." The income from such assets held through a TRS will be subject to U.S. federal corporate income tax. Our Manager is authorized to follow very broad investment guidelines and, as a result, we cannot predict our portfolio composition. We may change our strategy and policies without a vote of our shareholders. Moreover, although our independent trustees may periodically review our investment guidelines and our portfolio, they generally do not review our proposed asset acquisitions or asset management decisions.

With respect to MBS, Ellington's investment philosophy primarily revolves around the pursuit of value across various types of MBS and related assets. Ellington seeks investments across a wide range of MBS sectors without any restriction as to ratings, structure, or position in the capital structure. Over time and through market cycles, opportunities will present themselves in varying sectors and in varying forms. By rotating between and allocating among various sectors of the RMBS markets and adjusting the extent to which it hedges interest rate, prepayment, and credit risks, Ellington believes that it will be able to capitalize on the disparities between these RMBS sectors as well as on overall trends in the marketplace, and therefore provide better and more consistent returns. Disparities between RMBS sectors vary from time to time and are driven by a combination of factors. For example, as various RMBS sectors fall in and out of favor, the relative yields that the market demands for those sectors may vary. In addition, Ellington's performance projections for certain sectors may differ from those of other market participants and such disparities will naturally cause us, from time to time, to gravitate towards certain sectors and away from others. Disparities between RMBS sectors and individual securities within such sectors may also be driven by differences in collateral performance, in servicer behavior and in the structure of particular investments (for example, in the timing of cash flows), and our Manager may believe that other market participants are overestimating or underestimating the value of these differences. Furthermore, we believe that risk management, including opportunistic portfolio hedging and prudent financing and liquidity management, is essential for consistent generation of attractive current yields and risk-adjusted total returns.

Ellington's continued emphasis on and development of proprietary RMBS, interest rate, prepayment, and credit models, as well as other proprietary research and analytics, underscores the importance it places on a disciplined and analytical approach to fixed income investing, especially in RMBS. Our Manager uses Ellington's proprietary models to identify attractive assets, value these assets, monitor and forecast the performance of these assets, and (subject to qualifying and maintaining our qualification as a REIT) opportunistically hedge our interest rate risk, hedge our prepayment risk, and hedge our credit risk. We leverage these skills and resources for purposes of attaining our objectives.

We believe that our Manager is uniquely qualified to implement our strategy. Our strategy is consistent with Ellington's investment approach, which is based on its distinctive strengths in sourcing, analyzing, trading, and hedging for complex MBS and other mortgage- and non-mortgage-related products. Furthermore, we believe that Ellington's extensive experience in buying, selling, analyzing, and structuring fixed income securities, coupled with its broad access to market information and trading flows, provides us with a steady flow of opportunities to acquire assets with favorable trade executions.



Our Targeted Assets

Asset Class	Principal Assets
Agency RMBS	<p>Agency RMBS collateralized by fixed rate mortgage loans, adjustable rate mortgage loans, or "ARMs," or hybrid mortgage loans, reverse mortgages, or derivatives thereof, including:</p> <ul style="list-style-type: none"> <li>. whole and partial pool mortgage pass-through certificates;</li> <li>Agency collateralized mortgage obligations, or "CMOs," including interest only securities, or "IOs,"</li> <li>. principal only securities, or "POs," inverse interest only securities, or "IIOs," and inverse floaters;</li> <li>and</li> <li>. To-Be-Announced mortgage pass-through certificates, or "TBAs."</li> </ul>
Non-Agency RMBS	<ul style="list-style-type: none"> <li>. RMBS backed by prime jumbo, Alt-A, manufactured housing, and subprime mortgages;</li> <li>RMBS backed by fixed rate mortgages, ARMs, Option-ARMs, and residential mortgage loans that</li> <li>. have interest rates that are fixed for a specified period of time (typically three, five, seven, or ten years) and, thereafter, adjust to an increment over a specified interest rate index, or "hybrid ARMs";</li> <li>. RMBS backed by first lien and second lien mortgages;</li> <li>. Investment grade and non-investment grade securities;</li> <li>. Senior and subordinated securities; and</li> <li>. Non-Agency CMOs, including IOs, POs, IIOs, and inverse floaters.</li> </ul>
Other	<ul style="list-style-type: none"> <li>. Residential mortgage loans;</li> <li>. MSR's;</li> <li>. CRTs; and</li> <li>Other mortgage- and real estate-related assets, including asset-backed securities and certain hedging transactions.</li> </ul>

Agency RMBS

Residential Mortgage Pass-Through Certificates—Residential mortgage pass-through certificates represent interests in "pools" of mortgage loans secured by residential real property where payments of both interest and principal, plus prepayments, on the underlying residential mortgage loans are made monthly to holders of the certificates, in effect "passing through" monthly payments made by the individual borrowers on the mortgage loans that underlie the securities, net of fees paid to the issuer/guarantor and servicers of the securities.

Collateralized Mortgage Obligations—CMOs are structured instruments representing interests in specified mortgage loan collateral. CMO securitizations consist of multiple classes, or "tranches," of securities, with each tranche having specified characteristics based on the rules described in the securitization documents governing the division of the monthly principal and interest distributions, including prepayments, from the underlying mortgage collateral among the various tranches. IOs are CMOs that only receive interest payments while POs receive only principal payments.

TBAs—In addition to investing in specific pools of Agency RMBS, subject to our satisfying the requirements for qualification as a REIT, we utilize forward-settling purchases and sales of Agency RMBS where the underlying pools of mortgage loans are TBAs. Pursuant to these TBA transactions, we agree to purchase or sell, for future delivery, Agency RMBS with certain principal and interest terms and certain types of underlying collateral, but the particular Agency RMBS to be delivered is not identified until shortly before the TBA settlement date. TBAs are generally liquid and have quoted market prices and represent the most actively traded class of RMBS. We use TBAs primarily for hedging purposes. TBA trading is based on the assumption that mortgage pools that are eligible to be delivered at TBA settlement are fungible and thus the specific mortgage pools to be delivered do not need to be explicitly identified at the time a trade is initiated.

We primarily engage in TBA transactions for purposes of managing interest rate risk associated with our liabilities under repurchase agreements, or "repos." We generally treat such TBA purchases and sales as hedging transactions that hedge indebtedness incurred to acquire or carry real estate assets, or "qualifying liability hedges," for REIT purposes. Alternatively, we may, from time to time, opportunistically engage in TBA transactions because we find them attractive in their own right, from a relative value perspective or otherwise. Our ability to engage in TBA transactions may be limited by our intention to remain qualified as a REIT. In accordance with generally accepted accounting principles in the United States of America, or "U.S. GAAP," we treat TBAs as derivative transactions.



### Non-Agency RMBS

We acquire non-Agency RMBS backed by prime jumbo, Alt-A, manufactured housing, and subprime residential mortgage loans. Our non-Agency RMBS holdings can include investment grade and non-investment grade classes, including non-rated classes.

Non-Agency RMBS are debt obligations issued by private originators of, or investors in, residential mortgage loans. Non-Agency RMBS generally are issued as CMOs and are backed by pools of whole mortgage loans or by mortgage pass-through certificates. Non-Agency RMBS generally are in the form of senior/subordinated structures, or in the form of excess spread/over-collateralization structures. In senior/subordinated structures, the subordinated tranches generally absorb all losses on the underlying mortgage loans before any losses are borne by the senior tranches. In excess spread/over-collateralization structures, losses are first absorbed by any existing over-collateralization, then are borne by subordinated tranches and excess spread, which represents the difference between the interest payments received on the mortgage loans backing the RMBS and the interest due on the RMBS debt tranches, and finally are borne by senior tranches and any remaining excess spread.

### Other Assets

We also may from time to time opportunistically acquire other mortgage- and real estate-related assets that may include, among others, residential mortgage loans MSRMs and CRTs.

### Investment Process

Our investment process benefits from the resources and professionals of our Manager and Ellington. The process is managed by an investment and risk management committee, which includes, among others, the following three officers of our Manager: Messrs. Vranos, Penn, and Tecotzky. These officers of our Manager also serve as our Co-Chief Investment Officer, President and Chief Executive Officer, and Co-Chief Investment Officer, respectively. The investment and risk management committee operates under investment guidelines and meets periodically to develop a set of preferences for the composition of our portfolio. The primary focus of the investment and risk management committee is to review and approve our investment policies and our portfolio composition and related compliance with our investment policies and guidelines. Under the management agreement between us and our Manager, our Manager has the authority to enter into transactions consistent with our investment guidelines, subject to the oversight of our Board of Trustees.

Ellington has a focused investment team for each of our targeted asset classes. Each team evaluates acquisition opportunities consistent with our investment guidelines. Our asset acquisition process includes sourcing and screening of asset acquisition opportunities, credit analysis, due diligence, structuring, financing, and hedging, each as appropriate, to seek attractive current yields and total returns commensurate with our risk tolerance. We also screen and monitor potential asset acquisitions to determine their impact on maintaining our exclusion from registration as an investment company under the Investment Company Act and our qualification as a REIT.

### Valuation of Assets

Our Manager's valuation process is subject to the oversight of our Manager's Valuation Committee as well as the oversight of the independent members of our Board of Trustees. See Note 2 of the notes to consolidated financial statements included in this report for a complete discussion of our valuation process.

### Risk Management

Risk management is a cornerstone of Ellington's portfolio management process. Ellington's risk management infrastructure system includes "ELLiN," a proprietary portfolio management system that Ellington uses for its accounts, which provides real-time and batch reporting to all departments at Ellington, including trading, research, risk management, finance, operations, accounting, and compliance. We benefit from Ellington's comprehensive risk management infrastructure and ongoing assessment of both portfolio and operational risks. In addition, we utilize derivatives and other hedging instruments to opportunistically manage our interest rate risk.

### Interest Rate Hedging

We opportunistically manage our interest rate risk by using various hedging strategies to mitigate such risks, subject to maintaining our qualification as a REIT and maintaining our exclusion from registration as an investment company under the Investment Company Act. The interest rate hedging instruments that we use and may use in the future include, without limitation:

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interest rate swaps (including floating-to-fixed, fixed-to-floating, or more complex swaps such as floating-to-inverse floating, callable or non-callable);

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TBAs;

CMOs;

U.S. Treasury securities;

futures and forward contracts; and

other derivatives on interest rates, including swaptions and other options on any of the foregoing.

Because fluctuations in short-term interest rates may expose us to fluctuations in the spread between the interest we earn on our investments and the interest we pay on our borrowings, we may seek to manage such exposure by entering into short positions in interest rate swaps. An interest rate swap is an agreement to exchange interest rate cash flows, calculated on a notional principal amount, at specified payment dates during the life of the agreement. Typically, one party pays a fixed interest rate and receives a floating interest rate and the other party pays a floating interest rate and receives a fixed interest rate. Each party's payment obligation is computed using a different interest rate. In an interest rate swap, the notional principal is generally not exchanged.

We also utilize TBAs. Pursuant to a TBA transaction, we agree to purchase or sell, for future delivery, Agency RMBS with certain principal and interest terms and certain types of underlying collateral, but the particular Agency RMBS to be delivered is not identified until shortly before the TBA settlement date. We primarily engage in TBA transactions for purposes of managing interest rate risk associated with our liabilities under repurchase agreements. Alternatively, we may, from time to time, opportunistically engage in TBA transactions because we find them attractive on their own, from a relative value perspective or otherwise. Our ability to engage in TBA transactions may be limited by our intention to remain qualified as a REIT.

#### Credit Risk Hedging

Although we do not operate our non-Agency RMBS investment strategy on a credit-hedged basis in general, we may from time to time opportunistically enter into short positions using credit default swaps to protect against adverse credit events with respect to our non-Agency RMBS, subject to maintaining our qualification as a REIT and maintaining our exclusion from registration as an investment company under the Investment Company Act. We may use credit default swaps to hedge non-Agency RMBS credit risk by buying protection on various MBS indices. We may also enter into other derivative contracts for credit hedging purposes, including contracts referencing the unsecured corporate credit, or the equity of, certain corporations, including indices on corporate debt and equity.

#### Liquidity Management

As part of the risk management and liquidity management functions that our Manager performs for us, our Manager computes a "cash buffer," which, at any given point in time, represents the amount of our free cash in excess of what our Manager estimates would conservatively be required, especially in times of market dislocation, to support our particular assets and liabilities at such time. Thus, rather than focusing solely on our leverage, our Manager typically seeks to maintain a positive cash buffer. However, our Manager is not required to maintain a positive cash buffer and may choose not to maintain a positive cash buffer at certain times, for example, if it believes there are compelling market opportunities to pursue.

#### Our Financing Strategies and Use of Leverage

We finance our assets with what we believe to be a prudent amount of leverage, which will vary from time to time based upon the particular characteristics of our portfolio, availability of financing and market conditions. As of December 31, 2017, all of our debt financings consisted of repos. In a repo, we sell an asset to a counterparty at a discounted value, or the loan amount, and simultaneously agree to repurchase the same asset from such counterparty at a future date at a price equal to the loan amount plus an interest factor. Despite being legally structured as sales and subsequent repurchases, repurchase agreements are accounted for as collateralized borrowings. During the term of a repurchase agreement, we generally receive the income and other payments distributed with respect to the underlying assets, and pay interest to the counterparty. While the proceeds of our repurchase agreements are often used to purchase the asset subject to the transaction, our financing arrangements do not restrict our ability to use proceeds from these arrangements to support our other liquidity needs. Our repurchase agreement arrangements are typically documented under the standard form master repurchase agreement of the Securities Industry and Financial Markets Association, with the ability for both parties to request margin (i.e., to demand that the other party post additional collateral or repay a portion of the funds advanced) should the value of the underlying assets and posted collateral change. As the value of our collateral fluctuates, we and our repurchase agreement counterparties are required to post

additional margin collateral to each other from time to time as part of the normal course of our business. Our repurchase agreement financing counterparties generally have the right, to varying degrees, to determine the value of the underlying collateral for margining purposes, subject to the terms and conditions of our agreement with the counterparty, including in

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certain cases our right to dispute the counterparty's valuation determination. As of December 31, 2017, we had approximately \$1.6 billion outstanding under repos with fifteen counterparties, and given that we had approximately \$192.7 million of shareholders' equity as of December 31, 2017, our debt-to-equity ratio was 8.3 to 1. Our debt-to-equity ratio does not account for liabilities other than debt financings.

We may utilize other types of borrowings in the future, including term facilities or other more complex financing structures. We also may raise capital by issuing unsecured debt, preferred or common shares, or depositary shares. Our use of leverage, especially in order to increase the amount of assets supported by our capital base, may have the effect of increasing losses when these assets underperform. Our investment policies require no minimum or maximum leverage and our Manager's investment and risk management committee has the discretion, without the need for further approval by our Board of Trustees, to change both our overall leverage and the leverage used for individual asset classes. Because our strategy is flexible, dynamic, and opportunistic, our overall leverage will vary over time. As a result, we do not have a targeted debt-to-equity ratio.

#### Management Agreement

Upon our inception in September 2012, we entered into a management agreement with our Manager pursuant to which our Manager provides for the day-to-day management of our operations. The management agreement, as amended, requires our Manager to manage our business affairs in conformity with policies and investment guidelines that are approved and monitored by our Board of Trustees. Our Manager is subject to the direction and oversight of our Board of Trustees. Our Manager is responsible for, among other things:

- the selection, purchase, and sale of our portfolio investments;
- our financing and risk management activities;
- providing us with advisory services; and
- providing us with a management team, inclusive of a dedicated or partially dedicated Chief Financial Officer and appropriate support personnel as necessary.

Our Manager is responsible for our day-to-day operations and performs (or causes to be performed) such services and activities relating to the management, operation, and administration of our assets and liabilities, and business as may be appropriate.

Under the management agreement, we pay our Manager a management fee quarterly in arrears, and we reimburse certain expenses of our Manager.

Although we have not done so to date, if we invest in any other investment fund or other investment for which Ellington or one of its affiliates receives management, origination, or structuring fees, the management fees payable by us to our Manager will be reduced by (or our Manager will otherwise rebate to us) an amount equal to the applicable portion of any such related management, origination, or structuring fees.

#### Management Fees

Under the management agreement, we pay our Manager a management fee quarterly in arrears in an amount equal to 1.50% per annum of our shareholders' equity, with shareholders' equity being calculated, as of the end of any fiscal quarter, as (a) the sum of (1) the net proceeds from any issuances of common shares or other equity securities of our company or our Operating Partnership (without double counting) since inception, plus (2) our and our Operating Partnership's (without double counting) retained earnings (expressed as a positive number) or accumulated deficit (expressed as a negative number), as the case may be, calculated in accordance with U.S. GAAP at the end of the most recently completed fiscal quarter (without taking into account any non-cash equity compensation expense incurred in current or prior periods), less (b) any amount that we or our Operating Partnership has paid to repurchase our common shares, limited partnership interests in our Operating Partnership, or other equity securities since inception.

Shareholders' equity excludes (1) non-cash equity compensation expenses that have impacted shareholders' equity as reported in our financial statements prepared in accordance with U.S. GAAP, and (2) one-time events pursuant to changes in U.S. GAAP, and certain non-cash items not otherwise described above in each case, after discussions between our Manager and our independent trustees and approval by a majority of the independent trustees. Our shareholders' equity, for purposes of calculating the management fee, could be greater or less than the amount of shareholders' equity shown on our financial statements.





#### Reimbursement of Expenses

We do not maintain an office or employ personnel. We rely on the facilities and resources of our Manager to conduct our operations. We pay all of our direct operating expenses, except those specifically required to be borne by our Manager under the management agreement. Our Manager is responsible for all costs incident to the performance of its duties under the management agreement, including compensation of Ellington's employees and other related expenses, other than our allocable portion of the costs incurred by our Manager for certain dedicated or partially dedicated employees, including a Chief Financial Officer, one or more controllers, an in-house legal counsel, an investor relations professional, certain internal audit staff in connection with Sarbanes-Oxley compliance initiatives and certain other personnel performing duties for us, based on the portion of their working time and efforts spent on our matters and subject to approval of the reimbursed amounts by the Compensation Committee of our Board of Trustees. In addition, other than as expressly described in the management agreement, we are not required to pay any portion of rent, telephone, utilities, office furniture, equipment, machinery, and other office, internal and overhead expenses of our Manager and its affiliates. Expense reimbursements to our Manager are made within 60 days following delivery of the expense statement by our Manager.

#### Term and Termination

The current term of the management agreement will expire in September 2018 and will be automatically renewed for a one-year term on such date and on each anniversary of such date thereafter unless terminated as described below. Either we or our Manager may elect not to renew the management agreement upon expiration of its initial term or any renewal term by providing written notice of non-renewal at least 180 days, but not more than 270 days, before expiration. In the event we elect not to renew the term, we will be required to pay our Manager a termination fee equal to 5% of our Shareholders' Equity as of the end of the month preceding the date of the notice of termination or non-renewal of the management agreement. No termination fee will be due to the Manager if the Manager decides not to renew the management agreement.

We have the right to terminate the management agreement for cause, as defined in the management agreement, at any time during the term upon 30 days' prior written notice, without payment of any termination fee.

Our Board of Trustees reviews our Manager's performance annually and, as a result of such review, upon the affirmative vote of at least two-thirds of the members of our Board of Trustees or of the holders of a majority of our outstanding common shares, we may terminate the management agreement based either upon unsatisfactory performance by our Manager that is materially detrimental to us or upon a determination by our independent trustees that the management fees payable to our Manager are not fair, subject to the right of our Manager to prevent such a fee-based termination by agreeing to a reduction of the management fees payable to our Manager. Upon any termination of the management agreement based on unsatisfactory performance or unfair management fees, we are required to pay our Manager the termination fee described above.

Our Manager may terminate the management agreement, without payment of the termination fee, in the event we become regulated as an investment company under the Investment Company Act. Our Manager may also terminate the management agreement upon 60 days written notice if we default in the performance of any material term of the management agreement and the default continues for a period of 30 days after written notice to us, whereupon we would be required to pay our Manager the termination fee described above.

Our Manager may generally only assign the management agreement with the written approval of a majority of our independent trustees. However, our Manager may assign to one or more of its affiliates the performance of any of its responsibilities under the management agreement without the approval of our independent trustees so long as our Manager remains liable for any such affiliate's performance and such assignment does not require our approval under the Investment Advisers Act of 1940, as amended, or the "Advisers Act."

#### Conflicts of Interest; Equitable Allocation of Opportunities

Ellington manages various other clients that have strategies that are similar to, or overlap with, our strategy, including Ellington Financial LLC, a specialty finance company listed on the NYSE. As of December 31, 2017, Ellington managed various funds, accounts, and other vehicles that have strategies that are similar to, or that overlap with, our strategy, that had approximately \$5.7 billion of total assets under management, excluding our assets but including \$1.5 billion of accounts that do not employ financial leverage. Ellington makes available to our Manager all opportunities to acquire assets that it determines, in its reasonable and good faith judgment, based on our objectives, policies and

strategies, and other relevant factors, are appropriate for us in accordance with Ellington's written investment allocation policy, subject to the exception that we might not participate in each such opportunity, but will on an overall basis equitably participate with Ellington's other accounts in all such opportunities. Ellington's investment and risk management committee and its compliance committee (headed by its Chief

Compliance Officer) are responsible for monitoring the administration of, and facilitating compliance with, Ellington's investment allocation procedures and policies.

Because Agency pass-through certificates, Agency and non-Agency CMOs, and certain other asset classes in which we invest are typically available only in specified quantities and are also targeted assets for certain other Ellington accounts, Ellington often is not able to buy as much of any given asset as required to satisfy the needs of all its accounts. In these cases, Ellington's investment allocation procedures and policies typically allocate such assets to multiple accounts in proportion to their needs and available capital. Ellington may at times allocate opportunities on a preferential basis to accounts that are in a "start-up" or "ramp-up" phase. The policies permit departure from such proportional allocation under certain other circumstances, including, for example, when such allocation would result in an inefficiently small amount of the security being purchased for an account. In that case, the policies allow for a protocol of allocating assets so that, on an overall basis, each account is treated equitably. In addition, as part of these policies, we may be excluded from specified allocations of assets for tax, regulatory, risk management, or similar reasons.

Other policies of Ellington that our Manager applies to the management of our company include controls for:

**Cross Transactions**—defined as transactions between us or one of our subsidiaries, on the one hand, and an account (other than us or one of our subsidiaries) managed by Ellington or our Manager, on the other hand. It is Ellington's policy to engage in a cross transaction only when the transaction is in the best interests of, and is consistent with the objectives and policies of, both accounts involved in the transaction. Pursuant to the terms of the management agreement, Ellington or our Manager may enter into cross transactions where it acts both on our behalf and on behalf of the other party to the transaction; provided, however, that our Manager will not enter into any cross transactions on our behalf unless the cross transaction involves a "level one" asset for U.S. GAAP accounting purposes which is being crossed at market prices, or the cross transaction has received approval of a majority of our independent trustees.

Although we believe such restrictions on our Manager's ability to engage in cross transactions on our behalf mitigate many risks, cross transactions, even at market prices, may potentially create a conflict of interest between our Manager's and our officers' duties to and interests in us and their duties to and interests in the other party. Subject to our Board of Trustees authorizing such action and upon written notice to our Manager, we may at any time revoke our consent to our Manager's executing cross transactions. Additionally, unless approved in advance by a majority of our independent trustees or pursuant to and in accordance with a policy that has been approved by a majority of our independent trustees, all cross transactions must be effected at the then-prevailing market prices. Pursuant to our Manager's current policies and procedures, assets for which there are no readily observable market prices may be purchased or sold in cross transactions (i) at prices based upon third-party bids received through auction, (ii) at the average of the highest bid and lowest offer quoted by third-party dealers, or (iii) according to another pricing methodology approved by our Manager's Chief Compliance Officer.

**Principal Transactions**—defined as transactions between Ellington or our Manager (or any related party of Ellington or our Manager, which includes employees of Ellington and our Manager and their families), on the one hand, and us or one of our subsidiaries, on the other hand. Certain cross transactions may also be considered principal transactions whenever our Manager or Ellington (or any related party of Ellington or our Manager, which includes employees of Ellington and our Manager and their families) have a substantial ownership interest in one of the transacting parties. Our Manager is only authorized to execute principal transactions with the prior approval of a majority of our independent trustees and in accordance with applicable law. Such prior approval includes approval of the pricing methodology to be used, including with respect to assets for which there are no readily observable market prices.

**Investment in Other Ellington Accounts**—pursuant to our management agreement, if we invest in any other investment fund or other investment for which Ellington or one of its affiliates receives management, origination, or structuring fees, then unless agreed otherwise by majority of the Company's independent trustees, the management fee payable by us to our Manager will be reduced by an amount equal to the applicable portion (as described in the management agreement) of any such management, origination, or structuring fees.

**Split Price Executions**—pursuant to our management agreement, our Manager is authorized to combine purchase or sale orders on our behalf together with orders for other accounts managed by Ellington, our Manager or their affiliates and allocate the securities or other assets so purchased or sold, on an average price basis or other fair and consistent basis, among such accounts.

To date, we have not entered into any cross transactions with other Ellington-managed accounts or principal transactions with Ellington, or invested in other Ellington accounts

Our Manager is authorized to follow very broad investment guidelines. Our independent trustees will periodically review our investment guidelines and our portfolio. However, our independent trustees generally will not review our proposed asset acquisitions, dispositions, or other management decisions. In addition, in conducting periodic reviews, our independent trustees

will rely primarily on information provided to them by our Manager. Furthermore, our Manager may arrange for us to use complex strategies or to enter into complex transactions that may be difficult or impossible to unwind by the time they are reviewed by our independent trustees. Our Manager has great latitude within our broad investment guidelines to determine the types of assets it may decide are proper for purchase by us. The management agreement with our Manager does not restrict the ability of its officers and employees from engaging in other business ventures of any nature, whether or not such ventures are competitive with our business. We may acquire assets from entities affiliated with our Manager, even where the assets were originated by such entities. Affiliates of our Manager may also provide services to entities in which we have invested.

Our executive officers and the officers and employees of our Manager are also officers and employees of Ellington, and we compete with other Ellington accounts for access to these individuals. We have not adopted a policy that expressly prohibits our trustees, officers, security holders, or affiliates from having a direct or indirect pecuniary interest in any asset to be acquired or disposed of by us or any of our subsidiaries or in any transaction to which we or any of our subsidiaries is a party or has an interest, nor do we have a policy that expressly prohibits any such persons from engaging for their own account in business activities of the types conducted by us. However, our code of business conduct and ethics contains a conflicts of interest policy that prohibits our trustees, officers, and employees, as well as employees of our Manager who provide services to us, from engaging in any transaction that involves an actual or apparent conflict of interest with us, absent approval by the Board of Trustees or except as expressly set forth above or as provided in the management agreement between us and our Manager. In addition, nothing in the management agreement binds or restricts our Manager or any of its affiliates, officers, or employees from buying, selling, or trading any securities or commodities for their own accounts or for the accounts of others for whom our Manager or any of its affiliates, officers, or employees may be acting.

#### Competition

In acquiring our assets, we compete with other mortgage REITs, specialty finance companies, savings and loan associations, banks, mortgage bankers, insurance companies, mutual funds, institutional investors, investment banking firms, financial institutions, governmental bodies, and other entities. Many of our competitors are significantly larger than us, have greater access to capital and other resources, and may have other advantages over us. Our competitors may include other investment vehicles managed by Ellington or its affiliates, including Ellington Financial LLC. In addition to existing companies, other companies may be organized for similar purposes in the future, including companies focused on purchasing mortgage assets. A proliferation of such companies may increase the competition for equity capital and thereby adversely affect the market price of our common shares. An increase in the competition for sources of funding could adversely affect the availability and cost of financing, and thereby adversely affect the market price of our common shares. In addition, some of our competitors may have higher risk tolerances or different risk assessments, which could allow them to consider a wider variety of assets, or pay higher prices, than we can. In the face of this competition, we believe that our access to our Manager's and Ellington's professionals and their industry expertise may provide us with a competitive advantage, including helping us to identify appropriate assets for acquisition and the appropriate prices to pay for such assets, and thereby to compete more effectively for attractive asset acquisition opportunities. However, we may not be able to achieve our business goals or expectations as a result of the competitive risks that we face.

#### Operating and Regulatory Structure

##### Tax Requirements

We have elected to be taxed as a REIT under the Internal Revenue Code of 1986, as amended, or "the Code," and have complied, and intend to continue to comply, with the provisions of the Code with respect thereto. Accordingly, we do not expect to be subject to U.S. federal income tax on our REIT taxable income that is currently distributed to our shareholders. REITs are subject to a number of organizational and operational requirements, including a requirement that they currently distribute at least 90% of their annual REIT taxable income, determined excluding any net capital gains and without regard to the deduction for dividends paid. We cannot assure you that we will be able to comply with such requirements. Failure to qualify as a REIT in any taxable year would cause us to be subject to U.S. federal income tax (and any applicable state and local taxes) on our taxable income at regular corporate rates. Even if we qualify for taxation as a REIT, we may be subject to certain federal, state, local, and non-U.S. taxes on our income. For example, if we form a TRS, the income generated by that subsidiary will be subject to U.S. federal, state, and

local income tax. Any taxes paid by a TRS will reduce the cash available for distribution to our shareholders.

**Investment Company Act Exclusion**

Both we and our Operating Partnership are organized as holding companies and conduct our businesses primarily through wholly-owned subsidiaries of our Operating Partnership in a manner such that neither we nor our subsidiaries are subject to

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registration under the Investment Company Act. Under Section 3(a)(1) of the Investment Company Act, a company is deemed to be an "investment company" if:

it is, or holds itself out as being, engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting, or trading in securities (Section 3(a)(1)(A)); or

it is engaged or proposes to engage in the business of investing, reinvesting, owning, holding, or trading in securities and does own or proposes to acquire "investment securities" having a value exceeding 40% of the value of its total assets (excluding U.S. government securities and cash) on an unconsolidated basis, or "the 40% Test" (Section 3(a)(1)(C)). "Investment securities" excludes U.S. government securities and securities of majority-owned subsidiaries that are not themselves investment companies and are not relying on the exception from the definition of investment company for private funds under Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act.

We believe we and our Operating Partnership will not be considered investment companies under Section 3(a)(1)(A) of the Investment Company Act because we and our Operating Partnership do not engage primarily or hold ourselves out as being engaged primarily in the business of investing, reinvesting, or trading in securities. Rather, through wholly-owned or majority-owned subsidiaries, we and our Operating Partnership are primarily engaged in the non-investment company businesses of these subsidiaries. In addition, we conduct our operations so that both we and our Operating Partnership satisfy the 40% Test.

Our Operating Partnership's direct and indirect subsidiaries, through which we operate our business, rely upon certain exclusions from the definition of investment company under the Investment Company Act including, in the case of our Operating Partnership's wholly-owned subsidiary, EARN Mortgage LLC, Section 3(c)(5)(C) of the Investment Company Act. Section 3(c)(5)(C), as interpreted by the staff of the SEC, requires an entity to invest at least 55% of its assets in "mortgages and other liens on and interests in real estate," which we refer to as "qualifying real estate interests," and at least 80% of its assets in qualifying real estate interests plus "real estate-related assets." In satisfying the 55% requirement, the entity may treat agency securities issued with respect to an underlying pool of mortgage loans in which it holds all of the certificates issued by the pool as qualifying real estate interests. The CMOs we acquire will not be treated as qualifying real estate interests for purposes of the 55% requirement.

We also have formed, and may in the future form, certain other wholly-owned or majority-owned subsidiaries that will invest in CMOs and, subject to our investment guidelines, other real estate-related assets. These subsidiaries will rely upon the exclusion from the definition of investment company under the Investment Company Act pursuant to Section 3(c)(1) or 3(c)(7) of the Investment Company Act. Investments in subsidiaries that rely on the exclusions from the definition of investment company under 3(c)(1) or 3(c)(7) of the Investment Company Act are considered investment securities for the purposes of the 40% Test. Therefore, our Operating Partnership's investments in its 3(c)(7) subsidiaries and its other investment securities cannot exceed 40% of the value of our Operating Partnership's total assets (excluding U.S. government securities and cash) on an unconsolidated basis.

We monitor our compliance with the 40% Test and the holdings of our subsidiaries to ensure that each of our subsidiaries is in compliance with an applicable exemption or exclusion from registration as an investment company under the Investment Company Act.

On August 31, 2011, the SEC published a concept release entitled "Companies Engaged in the Business of Acquiring Mortgages and Mortgage Related Instruments" (Investment Company Act Rel. No. 29778). This release notes that the SEC is reviewing the 3(c)(5)(C) exclusion relied upon by companies similar to us that invest in mortgage loans and mortgage-backed securities. There can be no assurance that the laws and regulations governing the Investment Company Act status of companies similar to ours, or the guidance from the Division of Investment Management of the SEC regarding the treatment of assets as qualifying real estate assets or real estate-related assets, will not change in a manner that adversely affects our operations as a result of this review. To the extent that the SEC staff provides more specific guidance regarding any of the matters bearing upon our exclusion from the need to register under the Investment Company Act, we may be required to adjust our strategy accordingly. Any additional guidance from the SEC staff could provide additional flexibility to us, or it could further inhibit our ability to pursue the strategies that we have chosen. Furthermore, although we monitor the assets of EARN Mortgage LLC regularly, there can be no assurance that EARN Mortgage LLC will be able to maintain this exclusion from registration. In that case, our investment in EARN Mortgage LLC would be classified as an investment security, and we might not be able to maintain our overall exclusion from registering as an investment company under the Investment Company Act.

The loss of our exclusion from registration pursuant to the Investment Company Act could require us to restructure our operations, sell certain of our assets, or abstain from the purchase of certain assets, which could have an adverse effect on our financial condition and results of operations. See "—Risk Factors—Maintenance of our exclusion from registration as an investment company under the Investment Company Act imposes significant limitations on our operations."



#### Investment Advisers Act of 1940

Both Ellington and our Manager are registered as investment advisers under the Advisers Act and are subject to the regulatory oversight of the Division of Investment Management of the SEC.

#### Staffing

We currently do not have any employees. All of our executive officers, and our partially dedicated personnel, which include our Chief Financial Officer, Treasurer, controllers, accounting staff, in-house legal counsel, investor relations professional, and internal audit staff, are employees of Ellington or one or more of its affiliates. See "—Management Agreement" above.

#### Additional Information

A copy of this Annual Report on Form 10-K, as well as our Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and any amendments to such reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act are available, free of charge, on our internet website at [www.earnreit.com](http://www.earnreit.com). All of these reports are made available on our internet website as soon as reasonably practicable after they are electronically filed with or furnished to the SEC. Our Corporate Governance Guidelines and Code of Business Conduct and Ethics and the charters of the Audit, Compensation and Nominating and Corporate Governance Committees of our Board of Trustees are also available at [www.earnreit.com](http://www.earnreit.com) and are available in print to any shareholder upon request in writing to Ellington Residential Mortgage REIT, c/o Investor Relations, 53 Forest Avenue, Old Greenwich, CT 06870. The information on our website is not, and shall not be deemed to be, a part of this report or incorporated into any other filing we make with the SEC.

All reports filed with the SEC may also be read and copied at the SEC's public reference room at 100 F Street, N.E., Washington, D.C. 20549. Further information regarding the operation of the public reference room may be obtained by calling 1-800-SEC-0330. In addition, all of our reports filed with or furnished to the SEC can be obtained at the SEC's website at [www.sec.gov](http://www.sec.gov).

#### Item 1A. Risk Factors

If any of the following risks occurs, our business, financial condition or results of operations could be materially and adversely affected. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us, or not presently deemed material by us, may also impair our operations and performance. In connection with the forward-looking statements that appear in our periodic reports on Form 10-Q and Form 10-K, our Current Reports on Form 8-K, our press releases and our other written and oral communications, you should also carefully review the cautionary statements referred to in such reports and other communications referred to under "Special Note Regarding Forward-Looking Statements."

#### Risks Related To Our Business

The federal conservatorship of Fannie Mae and Freddie Mac and related efforts, along with any changes in laws and regulations affecting the relationship between Fannie Mae, Freddie Mac, and Ginnie Mae and the U.S. Government, may materially adversely affect our business, financial condition and results of operations, and our ability to pay dividends to our shareholders.

The payments we receive on our Agency RMBS depend upon a steady stream of payments on the underlying mortgages and such payments are guaranteed by Fannie Mae, Freddie Mac, or the Government National Mortgage Association, within the U.S. Department of Housing and Urban Development, or "Ginnie Mae." Fannie Mae and Freddie Mac are government-sponsored enterprises, or "GSEs," but their guarantees are not backed by the full faith and credit of the United States. Ginnie Mae, which guarantees MBS backed by federally insured or guaranteed loans primarily consisting of loans insured by the Federal Housing Administration, or "FHA," or guaranteed by the Department of Veterans Affairs, or "VA," is part of a U.S. Government agency and its guarantees are backed by the full faith and credit of the United States.

In September 2008, in response to the deteriorating financial condition of Fannie Mae and Freddie Mac, the U.S. Government placed Fannie Mae and Freddie Mac into the conservatorship of the Federal Housing Finance Agency, or "FHFA," their federal regulator, pursuant to its powers under The Federal Housing Finance Regulatory Reform Act of 2008, a part of the Housing and Economic Recovery Act of 2008. Under this conservatorship, Fannie Mae and Freddie Mac are required to reduce the amount of mortgage loans they own or for which they provide guarantees on Agency RMBS.

Shortly after Fannie Mae and Freddie Mac were placed in federal conservatorship, the Secretary of the U.S. Treasury noted that the guarantee structure of Fannie Mae and Freddie Mac required examination and that changes in the structures of

the entities were necessary to reduce risk to the financial system. The future roles of Fannie Mae and Freddie Mac could be significantly reduced, and the nature of their guarantees could be considerably limited relative to historical measurements or even eliminated. The substantial financial assistance provided by the U.S. Government to Fannie Mae and Freddie Mac, especially in the course of their being placed into conservatorship and thereafter, together with the substantial financial assistance provided by the U.S. Government to the mortgage-related operations of other GSEs and government agencies, such as the FHA, VA, and Ginnie Mae, has stirred debate among many federal policymakers over the continued role of the U.S. Government in providing such financial support for the mortgage-related GSEs in particular, and for the mortgage and housing markets in general. To date, no definitive legislation has been enacted with respect to a possible unwinding of the GSEs or a material reduction in their roles in the U.S. mortgage market, and it is not possible at this time to predict the scope and nature of the actions that the U.S. Government will ultimately take with respect to these GSEs.

Fannie Mae, Freddie Mac, and Ginnie Mae could each be dissolved, and the U.S. Government could determine to stop providing liquidity support of any kind to the mortgage market. If Fannie Mae, Freddie Mac, or Ginnie Mae were eliminated, or their structures were to change radically, or the U.S. Government significantly reduced its support for any or all of them, we may be unable or significantly limited in our ability to acquire Agency RMBS, which would drastically reduce the amount and type of Agency RMBS available for purchase which, in turn, could materially adversely affect our ability to maintain our exclusion from registration as an investment company under the Investment Company Act. Moreover, any changes to the nature of the guarantees provided by, or laws affecting, Fannie Mae, Freddie Mac, and Ginnie Mae could materially adversely affect the credit quality of the guarantees, could increase the risk of loss on purchases of Agency RMBS issued by these GSEs and could have broad adverse market implications for the Agency RMBS they currently guarantee. Any action that affects the credit quality of the guarantees provided by Fannie Mae, Freddie Mac, and Ginnie Mae could materially adversely affect the value of our Agency RMBS. In addition, any market uncertainty that arises from such proposed changes could have a similar impact on us and our Agency RMBS.

In addition, we rely on our Agency RMBS as collateral for our financings under the reverse repos that we enter into. Any decline in their value, or perceived market uncertainty about their value, would make it more difficult for us to obtain financing on our Agency RMBS on acceptable terms or at all, or to maintain compliance with the terms of any financing transactions

Interest rate mismatches between our assets and our borrowings may reduce our income during periods of changing interest rates, and increases in interest rates could adversely affect the value of our assets.

Some of our assets are fixed rate securities or have a fixed rate component (such as RMBS backed by hybrid ARMs). This means that the interest we earn on these assets will not vary over time based upon changes in a short-term interest rate index. Although the interest we earn on our RMBS backed by ARMs generally will adjust for changing interest rates, such interest rate adjustments may not occur as quickly as the interest rate adjustments to any related borrowings, and such interest rate adjustments will generally be subject to interest rate caps, which potentially could cause such RMBS to acquire many of the characteristics of fixed rate securities if interest rates were to rise above the cap levels. We generally fund our targeted assets with borrowings whose interest rates reset frequently, and as a result we generally have an interest rate mismatch between our assets and liabilities. While our interest rate hedges are intended to mitigate a portion of this mismatch, the use of interest rate hedges also introduces the risk of other interest rate mismatches and exposures, as will the use of other financing techniques. Additionally, to the extent cash flows from RMBS we hold are reinvested in new RMBS, the spread between the yields of the new RMBS and available borrowing rates may decline, which could reduce our net interest margin or result in losses.

Fixed income assets, including many RMBS, typically decline in value if interest rates increase. If long-term rates were to increase significantly, not only would the market value of these assets be expected to decline, but these assets could lengthen in duration because borrowers would be less likely to prepay their mortgages.

Interest rates are highly sensitive to many factors, including governmental monetary and tax policies, domestic and international economic and political considerations, and other factors beyond our control. The U.S. Federal Reserve, or the "Federal Reserve," has been increasing the target range for the federal funds rate since December 2015, and has indicated that further interest rate increases may occur in the near future.

Subject to maintaining our qualification as a REIT, while we opportunistically hedge our exposure to changes in interest rates, there can be no assurances that our hedges will be successful, or that we will be able to enter into or maintain such hedges. As a result, interest rate fluctuations can cause significant losses, reductions in income, and can limit the cash available to pay dividends to our shareholders.

Certain actions by the U.S. Federal Reserve could materially adversely affect our business, financial condition and results of operations, and our ability to pay dividends to our shareholders.

In September 2012, the Federal Reserve announced a third round of quantitative easing, or "QE3," which was an open-ended program designed to expand the Federal Reserve's holdings of long-term securities by purchasing, at the time, an additional \$40 billion of Agency RMBS per month until key economic indicators show sufficient signs of improvement.

Since December 2013, the Federal Reserve announced and completed eight incremental reductions in its purchases of Agency RMBS and U.S. Treasury securities under its accommodative monetary policies, and concluded its QE3 asset buying program at the end of October 2014. While the Federal Reserve continues to reinvest principal payments from its U.S. Treasury security and Agency RMBS holdings, in October 2017, the Federal Reserve initiated its balance sheet normalization program, whereby it began tapering asset purchases of both U.S. Treasury securities and Agency RMBS. In addition, the Federal Reserve has been increasing the target range for the federal funds rate since December 2015, and has indicated that further interest rate increases may occur in the near future. See "—Increases in interest rates could adversely affect the value of our assets and cause our interest expense to increase, and increase the risk of default on our assets which could result in reduced earnings or losses and negatively affect our profitability as well as the cash available for distribution to shareholders." Should the U.S. economy begin to deteriorate, the Federal Reserve could decide to reinstate its asset purchase program or institute other measures designed to reduce interest rates. These measures could lead to a flattening in the yield curve, increased prepayment rates (resulting from lower long-term interest rates, including mortgage rates), and a narrowing of our net interest margin.

Prepayment rates can change, adversely affecting the performance of our assets.

The frequency at which prepayments (including both voluntary prepayments by borrowers and liquidations due to defaults and foreclosures) occur on mortgage loans underlying our RMBS, is affected by a variety of factors, including the prevailing level of interest rates as well as economic, demographic, tax, social, legal, and other factors. Generally, borrowers tend to prepay their mortgages when prevailing mortgage rates fall below the interest rates on their mortgage loans. When borrowers prepay their mortgage loans at rates that are faster or slower than expected, it results in prepayments that are faster or slower than expected on the related RMBS. These faster or slower than expected payments may adversely affect our profitability.

We may purchase securities or loans that have a higher interest rate than the then-prevailing market interest rate. In exchange for this higher interest rate, we may pay a premium to par value to acquire the security or loan. In accordance with U.S. GAAP, we amortize this premium as an expense over the expected term of the security or loan based on our prepayment assumptions. If a security or loan is prepaid in whole or in part at a faster than expected rate, however, we must expense all or a part of the remaining unamortized portion of the premium that was paid at the time of the purchase, which will adversely affect our profitability.

We also may purchase securities or loans that have a lower interest rate than the then-prevailing market interest rate. In exchange for this lower interest rate, we may pay a discount to par value to acquire the security or loan. We accrete this discount as income over the expected term of the security or loan based on our prepayment assumptions. If a security or loan is prepaid at a slower than expected rate, however, we must accrete the remaining portion of the discount at a slower than expected rate. This will extend the expected life of investment portfolio and result in a lower than expected yield on securities and loans purchased at a discount to par.

Prepayment rates generally increase when interest rates fall and decrease when interest rates rise. Since many RMBS, especially fixed rate RMBS, will be discount securities when interest rates are high, and will be premium securities when interest rates are low, these RMBS may be adversely affected by changes in prepayments in any interest rate environment. Prepayment rates are also affected by factors not directly tied to interest rates, and are difficult to predict. Prepayments can also occur when borrowers sell their properties, or when borrowers default on their mortgages and the mortgages are prepaid from the proceeds of a foreclosure sale of the underlying property and/or from the proceeds of a mortgage insurance policy or other guarantee. Fannie Mae and Freddie Mac will generally, among other conditions, purchase mortgages that are 120 days or more delinquent from the Agency RMBS pools that they have issued when the cost of guaranteed payments to security holders, including advances of interest at the security coupon rate, exceeds the cost of holding the non-performing loans in their portfolios. Consequently, prepayment rates also may be affected by conditions in the housing and financial markets, which may result in

increased delinquencies on mortgage loans. Prepayment rates can also be affected by actions of the GSEs and their cost of capital, general economic conditions, and the relative interest rates on fixed and adjustable rate loans. Additionally, changes in the GSEs' decisions as to when to repurchase delinquent loans can materially impact prepayment rates on Agency RMBS.

The adverse effects of prepayments may impact us in various ways. First, particular investments may experience outright losses, as in the case of IOs and IIOs in an environment of faster actual or anticipated prepayments. Second, particular investments may underperform relative to any hedges that our Manager may have constructed for these assets, resulting in a loss to us. In particular, prepayments (at par) may limit the potential upside of many RMBS to their principal or par amounts,

whereas their corresponding hedges often have the potential for unlimited loss. Furthermore, to the extent that faster prepayment rates are due to lower interest rates, the principal payments received from prepayments will tend to be reinvested in lower-yielding assets, which may reduce our income in the long run. Therefore, if actual prepayment rates differ from anticipated prepayment rates our business, financial condition and results of operations and ability to pay dividends to our shareholders could be materially adversely affected.

Interest rate caps on the ARMs and hybrid ARMs that back our RMBS may reduce our net interest margin during periods of rising or high interest rates.

ARMs and hybrid ARMs are typically subject to periodic and lifetime interest rate caps. Periodic interest rate caps limit the amount an interest rate can increase during any given period. Lifetime interest rate caps limit the amount an interest rate can increase through the maturity of the loan. Our borrowings typically are not subject to similar restrictions. Accordingly, in a period of rapidly increasing interest rates, our financing costs could increase without limitation while caps could limit the interest we earn on our RMBS backed by ARMs and hybrid ARMs. This problem is magnified for ARMs and hybrid ARMs that are not fully indexed because such periodic interest rate caps prevent the coupon on the security from fully reaching the specified rate in one reset. Further, some ARMs and hybrid ARMs may be subject to periodic payment caps that result in a portion of the interest being deferred and added to the principal outstanding. As a result, we may receive less cash income on RMBS backed by ARMs and hybrid ARMs than necessary to pay interest on our related borrowings. Interest rate caps on RMBS backed by ARMs and hybrid ARMs could reduce our net interest margin if interest rates were to increase beyond the level of the caps, which could materially adversely affect our business, financial condition and results of operations and our ability to pay dividends to our shareholders.

Mortgage loan modification programs and future legislative action may adversely affect the value of, and the returns on, our targeted assets.

The U.S. Government, through the U.S. Treasury, FHA, and the Federal Deposit Insurance Corporation, or "FDIC," commenced implementation of programs designed to provide homeowners with assistance in avoiding mortgage loan foreclosures, including the Home Affordable Refinance Program, or "HARP," which allows borrowers who are current on their mortgage payments to refinance and reduce their monthly mortgage payments at loan-to-value ratios up to 125% without new mortgage insurance. The programs may involve, among other things, the modification of mortgage loans to reduce the principal amount of the loans or the rate of interest payable on the loans, or to extend the payment terms of the loans.

Loan modification and refinance programs may adversely affect the performance of Agency and non-Agency RMBS. In the case of non-Agency RMBS, a significant number of loan modifications with respect to a given security, including those related to principal forgiveness and coupon reduction, could negatively impact the realized yields and cash flows on such security. In addition, it is also likely that loan modifications would result in increased prepayments on some RMBS. See above "—Prepayment rates can change, adversely affecting the performance of our assets," for information relating to the impact of prepayments on our business.

The U.S. Congress and various state and local legislatures are considering, and in the future may consider, mortgage-related legislation that would affect our business, including legislation that would permit limited assignee liability for certain violations in the mortgage loan origination process, and legislation that would allow judicial modification of loan principal in the event of personal bankruptcy. We cannot predict whether or in what form Congress or the various state and local legislatures may enact legislation affecting our business or whether any such legislation will require us to change our practices or make changes in our portfolio in the future. These changes, if required, could materially adversely affect our business, results of operations and financial condition, and our ability to pay dividends to our shareholders, particularly if we make such changes in response to new or amended laws, regulations or ordinances in any state where we acquire a significant portion of our mortgage loans, or if such changes result in us being held responsible for any violations in the mortgage loan origination process.

The existing loan modification programs, together with future legislative or regulatory actions, including possible amendments to the bankruptcy laws, which result in the modification of outstanding residential mortgage loans and/or changes in the requirements necessary to qualify for refinancing mortgage loans with Fannie Mae, Freddie Mac, or Ginnie Mae, may adversely affect the value of, and the returns on, our assets, which could materially adversely affect our business, financial condition and results of operations, and our ability to pay dividends to our shareholders.

Difficult conditions in the mortgage and residential real estate markets as well as general market concerns may adversely affect the value of the assets in which we invest and such conditions may persist for the foreseeable future. Our business is materially affected by conditions in the residential mortgage market, the residential real estate market, the financial markets, and the economy, including inflation, energy costs, unemployment, geopolitical issues, concerns over the creditworthiness of governments worldwide and the stability of the global banking system. In particular, the residential



mortgage market in the U.S. has experienced a variety of difficulties and challenging economic conditions in the past, including defaults, credit losses, and liquidity concerns. Certain commercial banks, investment banks, insurance companies, and mortgage-related investment vehicles incurred extensive losses from exposure to the residential mortgage market as a result of these difficulties and conditions. These factors have impacted investor perception of the risks associated with RMBS, other real estate-related securities and various other asset classes in which we may invest. As a result, values for RMBS, other real estate-related securities and various other asset classes in which we may invest have experienced, and may in the future experience, significant volatility. Any deterioration of the mortgage market and investor perception of the risks associated with RMBS, residential mortgage loans, real estate-related securities, and various other assets that we acquire could materially adversely affect our business, financial condition and results of operations, and our ability to pay dividends to our shareholders.

Our non-Agency RMBS assets include subordinated and lower-rated securities that generally have greater risks of loss than senior and higher-rated securities.

Certain non-Agency RMBS securities that we acquire are deemed by rating agencies to have substantial vulnerability to default in payment of interest and/or principal. Other securities we acquire have the lowest quality ratings or are unrated. Many securities that we acquire are subordinated in cash flow priority to other more "senior" securities of the same securitization. The exposure to defaults on the underlying mortgages is severely magnified in subordinated securities. Certain subordinated securities ("first loss securities") absorb all losses from default before any other class of securities is at risk. Such securities therefore are considered to be highly speculative investments. Also, the risk of declining real estate values, in particular, is amplified in subordinated RMBS, as are the risks associated with possible changes in the market's perception of the entity issuing or guaranteeing them, or by changes in government regulations and tax policies. Accordingly, the subordinated and lower-rated (or unrated) securities in which we invest may experience significant price and performance volatility relative to more senior or higher-rated securities, and they are subject to greater risk of loss than more senior or higher-rated securities which, if realized, could materially adversely affect our business, financial condition and results of operations, and our ability to pay dividends to our shareholders. Less stringent underwriting guidelines and the resultant potential for delinquencies or defaults on certain mortgage loans could lead to losses on many of the non-Agency RMBS we hold.

Many of the non-Agency RMBS in which we invest are collateralized by Alt-A and subprime mortgage loans, which are mortgage loans that were originated using less stringent underwriting guidelines than those used in underwriting prime mortgage loans (mortgage loans that generally conform to Fannie Mae or Freddie Mac underwriting guidelines). These underwriting guidelines were more permissive as to borrower credit history or credit score, borrower debt-to-income ratio, loan-to-value ratio, and/or as to documentation (such as whether and to what extent borrower income was required to be disclosed or verified). In addition, even when specific underwriting guidelines were represented by loan originators as having been used in connection with the origination of mortgage loans, these guidelines were in many cases not followed as a result of aggressive lending practices, fraud (including borrower or appraisal fraud), or other factors. Mortgage loans that were underwritten pursuant to less stringent or looser underwriting guidelines, or that were poorly underwritten to their stated guidelines, have experienced, and should be expected to experience in the future, substantially higher rates of delinquencies, defaults, and foreclosures than those experienced by mortgage loans that were underwritten in a manner more consistent with Fannie Mae or Freddie Mac guidelines. Thus, because of the higher delinquency rates and losses associated with Alt-A and subprime mortgage loans, the performance of RMBS backed by Alt-A and subprime mortgage loans that we may acquire could be correspondingly adversely affected, which could adversely impact our business, financial condition and results of operations, and our ability to pay dividends to our shareholders.

Investments in second lien mortgage loans could subject us to increased risk of losses.

We may invest in second-lien mortgage loans or RMBS backed by such loans. If a borrower defaults on a second lien mortgage loan or on its senior debt (i.e., a first-lien loan, in the case of a residential mortgage loan), or in the event of a borrower bankruptcy, such loan will be satisfied only after all senior debt is paid in full. As a result, if we invest in second-lien mortgage loans and the borrower defaults, we may lose all or a significant part of our investment.

The principal and interest payments on our non-Agency RMBS are not guaranteed by any entity, including any government entity or GSE, and therefore are subject to increased risks, including credit risk.

Our portfolio may include non-Agency RMBS which are backed by residential mortgage loans that do not conform to the Fannie Mae or Freddie Mac underwriting guidelines, including subprime, manufactured housing, Alt-A, and prime jumbo mortgage loans. Consequently, the principal and interest on non-Agency RMBS, unlike those on Agency RMBS, are not guaranteed by GSEs such as Fannie Mae and Freddie Mac or, in the case of Ginnie Mae, the U.S. Government.

Non-Agency RMBS are subject to many of the risks of the respective underlying mortgage loans. A residential mortgage loan is typically secured by single-family residential property and is subject to risks of delinquency and foreclosure and risk of loss. The ability of a borrower to repay a loan secured by a residential property is dependent upon the income or assets of the borrower. A number of factors, including a general economic downturn, unemployment, acts of God, terrorism, social unrest, and civil disturbances, may impair borrowers' abilities to repay their mortgage loans. In periods following home price declines, "strategic defaults" (decisions by borrowers to default on their mortgage loans despite having the ability to pay) also may become more prevalent.

In the event of defaults under mortgage loans backing any of our non-Agency RMBS, we will bear a risk of loss of principal to the extent of any deficiency between the value of the collateral and the principal and accrued interest of the mortgage loan. The recently enacted law informally known as the Tax Cuts and Jobs Act, or "TCJA," reduced the mortgage interest deduction and the state and local income and property tax deduction. These changes could adversely impact housing prices in markets to which we have exposure.

Additionally, in the event of the bankruptcy of a mortgage loan borrower, the mortgage loan to such borrower will be deemed to be secured only to the extent of the value of the underlying collateral at the time of bankruptcy (as determined by the bankruptcy court), and the lien securing the mortgage loan will be subject to the avoidance powers of the bankruptcy trustee or debtor-in-possession to the extent the lien is unenforceable under state law. Foreclosure of a mortgage loan can be an expensive and lengthy process which could have a substantial negative effect on our anticipated return on the foreclosed mortgage loan. If borrowers default on the mortgage loans backing our non-Agency RMBS and we are unable to recover any resulting loss through the foreclosure process, our business, financial condition and results of operations, and our ability to pay dividends to our shareholders, could be materially adversely affected.

Residential mortgage loans, including subprime, non-performing, and sub-performing residential mortgage loans, are subject to increased risks.

We may acquire and manage residential mortgage loans. Residential mortgage loans, including subprime, non-performing, and sub-performing mortgage loans, are subject to increased risk of loss. Unlike Agency RMBS, residential mortgage loans generally are not guaranteed by the U.S. Government or any GSE, though in some cases they may benefit from private mortgage insurance. Additionally, by directly acquiring residential mortgage loans, we do not receive the structural credit enhancements that benefit senior tranches of RMBS. A residential mortgage loan is directly exposed to losses resulting from default. Therefore, the value of the underlying property, the creditworthiness and financial position of the borrower, and the priority and enforceability of the lien will significantly impact the value of such mortgage loan. In the event of a foreclosure, we may assume direct ownership of the underlying real estate. The liquidation proceeds upon sale of such real estate may not be sufficient to recover our cost basis in the loan, and any costs or delays involved in the foreclosure or liquidation process may increase losses.

Residential mortgage loans are also subject to property damage caused by hazards, such as earthquakes or environmental hazards, not covered by standard property insurance policies or "special hazard risk," and to reduction in a borrower's mortgage debt by a bankruptcy court, or "bankruptcy risk." In addition, claims may be assessed against us on account of our position as a mortgage holder or property owner, including assignee liability, environmental hazards, and other liabilities. We could also be responsible for property taxes. In some cases, these liabilities may be "recourse liabilities" or may otherwise lead to losses in excess of the purchase price of the related mortgage or property.

To the extent that due diligence is conducted on potential assets, such due diligence may not reveal all of the risks associated with such assets and may not reveal other weaknesses in such assets, which could lead to losses.

Before making an investment, our Manager may decide to conduct (either directly or using third parties) certain due diligence. There can be no assurance that our Manager will conduct any specific level of due diligence, or that, among other things, our Manager's due diligence processes will uncover all relevant facts or that any purchase will be successful, which could result in losses on these assets, which, in turn, could adversely affect our business, financial condition and results of operations, and our ability to pay dividends to our shareholders.

We rely on mortgage servicers for our loss mitigation efforts, and we also may engage in our own loss mitigation efforts with respect to whole mortgage loans and loan pools we may purchase. Such loss mitigation efforts may be unsuccessful or not cost effective.

We depend on a variety of services provided by third-party service providers related to our non-Agency RMBS and whole mortgage loans and loan pools we may acquire. We rely on the mortgage servicers who service the mortgage loans backing our non-Agency RMBS to, among other things, collect principal and interest payments on the underlying mortgages and perform loss mitigation services. Our mortgage servicers and other service providers to our non-Agency RMBS, such as trustees, bond

insurance providers and custodians, may not perform in a manner that promotes our interests. In addition, legislation that has been enacted or that may be enacted in order to reduce or prevent foreclosures through, among other things, loan modifications, may reduce the value of mortgage loans backing our non-Agency RMBS or whole mortgage loans that we may acquire. Mortgage servicers may be incentivized by the U.S. Government to pursue such loan modifications, as well as forbearance plans and other actions intended to prevent foreclosure, even if such loan modifications and other actions are not in the best interests of the beneficial owners of the mortgage loans. In addition to legislation that creates financial incentives for mortgage loan servicers to modify loans and take other actions that are intended to prevent foreclosures, legislation has also been adopted that creates a safe harbor from liability to creditors for servicers that undertake loan modifications and other actions that are intended to prevent foreclosures. Finally, legislation has been adopted that delays the initiation or completion of foreclosure proceedings on specified types of residential mortgage loans or otherwise limit the ability of mortgage servicers to take actions that may be essential to preserve the value of the mortgage loans underlying the mortgage servicing rights. Any such limitations are likely to cause delayed or reduced collections from mortgagors and generally increase servicing costs. As a result of these legislative actions, the mortgage loan servicers on which we rely may not perform in our best interests or up to our expectations. If our third-party service providers including mortgage servicers do not perform as expected, our business, financial condition and results of operations and our ability to pay dividends to our shareholders may be materially adversely affected.

In addition, if we purchase pools of whole mortgage loans, we may engage in our own loss mitigation efforts over and above the efforts of the mortgage servicers, including more hands-on mortgage servicer oversight and management, borrower refinancing solicitations, as well as other efforts. Our loss mitigation efforts may be unsuccessful in limiting delinquencies, defaults and losses, or may not be cost effective, which may materially adversely affect our business, financial condition and results of operations and our ability to pay dividends to our shareholders.

We may be affected by deficiencies in foreclosure practices of third parties, as well as related delays in the foreclosure process.

One of the biggest risks overhanging the non-Agency RMBS market has been uncertainty around the timing and ability of servicers to foreclose on defaulted loans, so that they can liquidate the underlying properties and ultimately pass the liquidation proceeds through to RMBS holders. Given the magnitude of the housing crisis, and in response to the well-publicized failures of many servicers to follow proper foreclosure procedures, mortgage servicers are being held to much higher foreclosure-related documentation standards than they previously were. However, because many mortgages have been transferred and assigned multiple times (and by means of varying assignment procedures) throughout the origination, warehouse, and securitization processes, mortgage servicers are generally having much more difficulty furnishing the requisite documentation to initiate or complete foreclosures. This leads to stalled or suspended foreclosure proceedings, and ultimately additional foreclosure-related costs. Foreclosure-related delays also tend to increase ultimate loan loss severities as a result of property deterioration, amplified legal and other costs, and other factors. Many factors delaying foreclosure, such as borrower lawsuits and judicial backlog and scrutiny, are outside of a servicer's control and have delayed, and will likely continue to delay, foreclosure processing in both judicial states (where foreclosures require court involvement) and non-judicial states. The concerns about deficiencies in foreclosure practices of servicers and related delays in the foreclosure process may impact our loss assumptions and affect the values of, and our returns on, our investments in RMBS and residential whole loans.

Sellers of the mortgage loans that underlie the non-Agency RMBS in which we invest may be unable to repurchase defective mortgage loans, which could have a material adverse effect on the value of the loans held by the trust that issued the RMBS and could cause shortfalls in the payments due on the RMBS.

Sellers of mortgage loans to the trusts that issued the non-Agency RMBS in which we invest made various representations and warranties related to the mortgage loans sold by them to the trusts that issued the RMBS. If a seller fails to cure a material breach of its representations and warranties with respect to any mortgage loan in a timely manner, then the trustee or the servicer of the loans may have the right to require that the seller repurchase the defective mortgage loan (or in some cases substitute a performing mortgage loan). It is possible, however, that for financial or other reasons, the seller either may not be capable of repurchasing defective mortgage loans, or may dispute the validity of or otherwise resist its obligation to repurchase defective mortgage loans. The inability or unwillingness of a seller to repurchase defective mortgage loans from a non-Agency RMBS trust in which we invest

would likely cause higher rates of delinquencies, defaults and losses for the mortgage loans backing such non-Agency RMBS, and ultimately greater losses for our investment in such non-Agency RMBS.

If we acquire and subsequently resell any whole mortgage loans, we may be required to repurchase such loans or indemnify purchasers if we breach representations and warranties.

If we acquire and subsequently resell any whole mortgage loans, we would generally be required to make customary representations and warranties about such loans to the loan purchaser. Our residential mortgage loan sale agreements and terms

of any securitizations into which we sell loans will generally require us to repurchase or substitute loans in the event we breach a representation or warranty given to the loan purchaser. In addition, we may be required to repurchase loans as a result of borrower fraud or in the event of early payment default on a mortgage loan. The remedies available to a purchaser of mortgage loans are generally broader than those available to us against an originating broker or correspondent. Repurchased loans are typically worth only a fraction of the original price. Significant repurchase activity could materially adversely affect our business, financial condition and results of operations, and our ability to pay dividends to our shareholders.

We could be subject to liability for potential violations of predatory lending laws, which could materially adversely affect our business, financial condition and results of operations, and our ability to pay dividends to our shareholders. Residential mortgage loan originators and servicers are required to comply with various federal, state and local laws and regulations, including anti-predatory lending laws and laws and regulations imposing certain restrictions on requirements on high cost loans. Failure of residential mortgage loan originators or servicers to comply with these laws, to the extent any of their residential mortgage loans become part of our mortgage-related assets, could subject us, as an assignee or purchaser of the related residential mortgage loans, to monetary penalties and could result in the borrowers rescinding the affected residential mortgage loans. Lawsuits have been brought in various states making claims against assignees or purchasers of high cost loans for violations of state law. Named defendants in these cases have included numerous participants within the secondary mortgage market. If the loans are found to have been originated in violation of predatory or abusive lending laws, we could incur losses, which could materially adversely affect our business, financial condition and results of operations, and our ability to pay dividends to our shareholders. Our real estate-related assets are subject to the risks associated with real property.

We own assets secured by real estate and may own real estate directly in the future, either through direct acquisitions or upon a default of mortgage loans. Real estate assets are subject to various risks, including:

- continued declines in the value of real estate;
- acts of God, including earthquakes, floods, and other natural disasters, which may result in uninsured losses;
- acts of war or terrorism, including the consequences of terrorist attacks, such as those that occurred on September 11, 2001;
- adverse changes in national and local economic and market conditions;
- changes in governmental laws and regulations, fiscal policies and zoning ordinances and the related costs of compliance with laws and regulations, fiscal policies and zoning ordinances;
- costs of remediation and liabilities associated with environmental conditions such as indoor mold;
- potential liabilities for other legal actions related to property ownership including tort claims; and
- the potential for uninsured or under-insured property losses.

The occurrence of any of the foregoing or similar events may reduce our return from an affected property or asset and, consequently, materially adversely affect our business, financial condition and results of operations, and our ability to pay dividends to our shareholders.

We may be exposed to environmental liabilities with respect to properties in which we have an interest.

In the course of our business, we may take title to real estate, and, if we do take title, we could be subject to environmental liabilities with respect to these properties. In such a circumstance, we may be held liable to a governmental entity or to third parties for property damage, personal injury, investigation, and clean-up costs incurred by these parties in connection with environmental contamination, or may be required to investigate or clean up hazardous or toxic substances, or chemical releases at a property. The costs associated with investigation or remediation activities could be substantial. In addition, the presence of hazardous substances may adversely affect an owner's ability to sell real estate or borrow using real estate as collateral. To the extent that an owner of an underlying property becomes liable for removal costs, the ability of the owner to make debt payments may be reduced, which in turn may materially adversely affect the value of the relevant mortgage-related assets held by us.

We rely on analytical models and other data to analyze potential asset acquisition and disposition opportunities and to manage our portfolio. Such models and other data may be incorrect, misleading or incomplete, which could cause us to purchase assets that do not meet our expectations or to make asset management decisions that are not in line with our strategy.

Our Manager relies on the analytical models (both proprietary and third-party models) of Ellington and information and data supplied by third parties. These models and data may be used to value assets or potential asset acquisitions and dispositions and also in connection with our asset management activities. If Ellington's models and data prove to be incorrect, misleading, or incomplete, any decisions made in reliance thereon could expose us to potential risks. Our Manager's reliance on Ellington's models and data may induce it to purchase certain assets at prices that are too high, to sell certain other assets at prices that are too low, or to miss favorable opportunities altogether. Similarly, any hedging activities that are based on faulty models and data may prove to be unsuccessful.

Some of the risks of relying on analytical models and third-party data include the following:

- collateral cash flows and/or liability structures may be incorrectly modeled in all or only certain scenarios, or may be modeled based on simplifying assumptions that lead to errors;

- information about assets or the underlying collateral may be incorrect, incomplete, or misleading;

- asset, collateral or RMBS historical performance (such as historical prepayments, defaults, cash flows, etc.) may be

- incorrectly reported, or subject to interpretation (e.g., different RMBS issuers may report delinquency statistics based on different definitions of what constitutes a delinquent loan); and

- asset, collateral or RMBS information may be outdated, in which case the models may contain incorrect assumptions as to what has occurred since the date information was last updated.

Some models, such as prepayment models or default models, may be predictive in nature. The use of predictive models has inherent risks. For example, such models may incorrectly forecast future behavior, leading to potential losses. In addition, the predictive models used by our Manager may differ substantially from those models used by other market participants, with the result that valuations based on these predictive models may be substantially higher or lower for certain assets than actual market prices. Furthermore, because predictive models are usually constructed based on historical data supplied by third parties, the success of relying on such models may depend heavily on the accuracy and reliability of the supplied historical data, and, in the case of predicting performance in scenarios with little or no historical precedent (such as extreme broad-based declines in home prices, or deep economic recessions or depressions), such models must employ greater degrees of extrapolation and are therefore more speculative and of more limited reliability.

All valuation models rely on correct market data inputs. If incorrect market data is entered into even a well-founded valuation model, the resulting valuations will be incorrect. However, even if market data is input correctly, "model prices" will often differ substantially from market prices, especially for securities with complex characteristics or whose values are particularly sensitive to various factors. If our market data inputs are incorrect or our model prices differ substantially from market prices, our business, financial condition and results of operations, and our ability to pay dividends to our shareholders could be materially adversely affected.

Valuations of some of our assets are inherently uncertain, may be based on estimates, may fluctuate over short periods of time, and may differ from the values that would have been used if a ready market for these assets existed.

The values of some of the assets in our portfolio are not readily determinable. We value these assets monthly at fair value, as determined in good faith by our Manager, subject to the oversight of our Manager's valuation committee.

Because such valuations are inherently uncertain, may fluctuate over short periods of time and may be based on estimates, our Manager's determinations of fair value may differ from the values that would have been used if a ready market for these assets existed or from the prices at which trades occur. Furthermore, we may not obtain third party valuations for all of our assets. Changes in the fair value of our assets directly impact our net income through recording unrealized appreciation or depreciation of our investments and derivative instruments, and so our Manager's determination of fair value has a material impact on our net income.

While in many cases our Manager's determination of the fair value of our assets is based on valuations provided by third-party dealers and pricing services, our Manager can and does value assets based upon its judgment and such valuations may differ from those provided by third-party dealers and pricing services. Valuations of certain assets are often difficult to obtain or are unreliable. In general, dealers and pricing services heavily disclaim their valuations.



Additionally, dealers may claim to furnish valuations only as an accommodation and without special compensation, and so they may disclaim any and all liability for any direct, incidental, or consequential damages arising out of any inaccuracy or incompleteness in valuations, including any act of negligence or breach of any warranty. Depending on the complexity and illiquidity of an asset, valuations of the same

asset can vary substantially from one dealer or pricing service to another. Higher valuations of our assets have the effect of increasing the amount of management fees we pay to our Manager. Therefore, conflicts of interest exist because our Manager is involved in the determination of the fair value of our assets.

Our business, financial condition and results of operations, and our ability to pay dividends to our shareholders could be materially adversely affected if our Manager's fair value determinations of these assets were materially different from the values that would exist if a ready market existed for these assets.

The lack of liquidity in our assets may materially adversely affect our business, financial condition and results of operations, and our ability to pay dividends to our shareholders.

Certain of the assets and other instruments we acquire are not publicly traded, including privately placed RMBS. As such, these assets may be subject to legal and other restrictions on resale, transfer, pledge or other disposition, or will otherwise be less liquid than publicly-traded securities. Other assets that we acquire, while publicly traded, have limited liquidity on account of their complexity, turbulent market conditions, or other factors. In addition, mortgage-related assets from time to time have experienced extended periods of illiquidity, including during times of financial stress (such as during the 2008 financial crisis), which is often the time that liquidity is most needed. Illiquid assets typically experience greater price volatility, because a ready market does not exist, and they can be more difficult to value or sell if the need arises. In addition, if we are required to liquidate all or a portion of our portfolio quickly, we may realize significantly less than the value at which we have previously recorded our assets. We may also face other restrictions on our ability to liquidate any assets for which we or our Manager has or could be attributed with material non-public information. Furthermore, assets that are illiquid are more difficult to finance, and to the extent that we finance assets that are or become illiquid, we may lose that financing or have it reduced. If we are unable to sell our assets at favorable prices or at all, it could materially adversely affect our business, financial condition and results of operations, and our ability to pay dividends to our shareholders.

We are highly dependent on information systems and system failures could significantly disrupt our business, which may, in turn, materially adversely affect our business, financial condition and results of operations, and our ability to pay dividends to our shareholders.

Our business is highly dependent on communications and information systems. Any failure or interruption of our systems or cyber-attacks or security breaches of our networks or systems could cause delays or other problems in our securities trading activities, which could materially adversely affect our business, financial condition and results of operations, and our ability to pay dividends to our shareholders. In addition, we also face the risk of operational failure, termination or capacity constraints of any of the third parties with which we do business or that facilitate our business activities, including clearing agents or other financial intermediaries we use to facilitate our securities transactions, if their respective systems experience failure, interruption, cyber-attacks, or security breaches.

Computer malware, viruses, and computer hacking and phishing attacks have become more prevalent in the financial services industry and may occur on our systems in the future. We rely heavily on our financial, accounting and other data processing systems. Although we have not detected a breach to date, financial services institutions have reported breaches of their systems, some of which have been significant. Even with all reasonable security efforts, not every breach can be prevented or even detected. It is possible that we have experienced an undetected breach, and it is likely that other financial institutions have experienced more breaches than have been detected and reported. There is no assurance that we, or the third parties that facilitate our business activities, have not or will not experience a breach. It is difficult to determine what, if any, negative impact may directly result from any specific interruption or cyber-attacks or security breaches of our networks or systems (or the networks or systems of third parties that facilitate our business activities) or any failure to maintain performance, reliability and security of our technical infrastructure, but such computer malware, viruses, and computer hacking and phishing attacks may negatively affect our operations.

Our access to financing sources, which may not be available on favorable terms, or at all, may be limited, and this may materially adversely affect our business, financial condition and results of operations, and our ability to pay dividends to our shareholders.

We depend upon the availability of adequate capital and financing sources to fund our operations. Our lenders are primarily large global financial institutions, with exposures both to global financial markets and to more localized conditions. In addition to borrowing from large banks, we borrow from smaller non-bank financial institutions as well.

Whether because of a subsequent global or local financial crisis or other circumstances, if one or more of our lenders experiences severe financial difficulties, they or other lenders could become unwilling or unable to provide us with financing, could increase the costs of that financing, or could become insolvent, as was the case with Lehman Brothers in 2008. Moreover, we are currently party to short-term borrowings (in the form of repurchase agreements) and there can be no assurance that we will be able to replace

these borrowings, or "roll" them, as they mature on a continuous basis and it may be more difficult for us to obtain debt financing on favorable terms, or at all. In addition, if regulatory capital requirements imposed on our lenders change, they may be required to limit, or increase the cost of, the financing they provide to us. In general, this could potentially increase our financing costs and reduce our liquidity or require us to sell assets at an inopportune time or price. Consequently, depending on market conditions at the relevant time, we may have to rely on additional equity issuances to meet our capital and financing needs, which may be dilutive to our shareholders, or we may have to rely on less efficient forms of debt financing that consume a larger portion of our cash flow from operations, thereby reducing funds available for our operations, future business opportunities, cash distributions to our shareholders, and other purposes. We cannot assure you that we will have access to such equity or debt capital on favorable terms (including, without limitation, cost and term) at the desired times, or at all, which may cause us to curtail our asset acquisition activities and/or dispose of assets, which could materially adversely affect our business, financial condition and results of operations, and our ability to pay dividends to our shareholders.

Increases in interest rates could adversely affect the value of our assets and cause our interest expense to increase, and increase the risk of default on our assets which could result in reduced earnings or losses and negatively affect our profitability as well as the cash available for distribution to shareholders.

Our operating results will depend in large part on the difference between the income from our assets, net of credit losses, and financing costs. We anticipate that, in many cases, the income from our assets will respond more slowly to interest rate fluctuations than the cost of our borrowings. Consequently, changes in interest rates, particularly short-term interest rates, to the extent not offset by our interest rate hedges, may significantly influence our financial results.

We use leverage in executing our business strategy, which may adversely affect the return on our assets and may reduce cash available for distribution to our shareholders, as well as increase losses when economic conditions are unfavorable.

We use leverage to finance our investment activities and to enhance our financial returns. Currently, all of our leverage is in the form of short-term repurchase agreement financings for our RMBS assets. Other forms of leverage we may use in the future include credit facilities, including term loans and revolving credit facilities.

Through the use of leverage, we may acquire positions with market exposure significantly greater than the amount of capital committed to the transaction. For example, by entering into repurchase agreements with advance rates, or haircut levels (a haircut is the percentage discount that a repo lender applies to the market value of an asset serving as collateral for a repo borrowing, for the purpose of determining whether such reverse repo borrowing is adequately collateralized), of 5%, we could theoretically leverage capital allocated to Agency RMBS by a debt-to-equity ratio of as much as 20 to 1. There is no specific limit on the amount of leverage that we may use. Leverage can enhance our potential returns but can also exacerbate losses. Even if an asset increases in value, if the asset fails to earn a return that equals or exceeds our cost of borrowing, the leverage will diminish our returns.

Leverage also increases the risk of our being forced to precipitously liquidate our assets. See "—Our lenders and derivative counterparties may require us to post additional collateral, which may force us to liquidate assets, and if we fail to post sufficient collateral our debts may be accelerated and/or our derivative contracts terminated on unfavorable terms" below.

Our lenders and derivative counterparties may require us to post additional collateral, which may force us to liquidate assets, and if we fail to post sufficient collateral our debts may be accelerated and/or our derivative contracts terminated on unfavorable terms.

Our repurchase agreements and our derivative contracts allow, to varying degrees, our lenders and derivative counterparties (including clearinghouses) to determine an updated market value of our collateral and derivative contracts to reflect current market conditions. If the market value of our collateral or our derivative contracts with a particular lender or derivative counterparty declines in value, we generally will be required by the lender or derivative counterparty to provide additional collateral or repay a portion of the funds advanced on minimal notice, which is known as a margin call. Posting additional collateral will reduce our liquidity and limit our ability to leverage our assets. Additionally, in order to satisfy a margin call, we may be required to liquidate assets at a disadvantageous time, which could cause us to incur further losses and adversely affect our results of operations, financial condition, and may impair our ability to pay dividends to our shareholders. We receive margin calls from our lenders and derivative

counterparties from time to time in the ordinary course of business similar to other entities in the specialty finance business. In the event we default on our obligation to satisfy these margin calls, our lenders or derivative counterparties can accelerate our indebtedness, terminate our derivative contracts (potentially on unfavorable terms requiring additional payments, including additional fees and costs), increase our borrowing rates, liquidate our collateral and terminate our ability to borrow. In certain cases, a default on one repurchase agreement or derivative contract (whether caused by a failure to satisfy margin calls or another event of default) can trigger "cross defaults" on other such

agreements. A significant increase in margin calls could materially adversely affect our business, financial condition and results of operations, and our ability to pay dividends to our shareholders, and could increase our risk of insolvency.

To the extent we might be compelled to liquidate qualifying real estate assets to repay debts, our compliance with the REIT provisions regarding our assets and our sources of income could be negatively affected, which could jeopardize our qualification as a REIT. Losing our REIT qualification would cause us to be subject to U.S. federal income tax (and any applicable state and local taxes) on all of our income and decrease profitability and cash available to pay dividends to our shareholders.

Our rights under repurchase agreements are subject to the effects of the bankruptcy laws in the event of the bankruptcy or insolvency of us or our lenders.

In the event of our insolvency or bankruptcy, certain repurchase agreements may qualify for special treatment under the U.S. Bankruptcy Code, the effect of which, among other things, would be to allow the lender to avoid the automatic stay provisions of the U.S. Bankruptcy Code and to foreclose on and/or liquidate the collateral pledged under such agreements without delay. In the event of the insolvency or bankruptcy of a lender during the term of a repurchase agreement, the lender may be permitted, under applicable insolvency laws, to repudiate the contract, and our claim against the lender for damages may be treated simply as an unsecured creditor. In addition, if the lender is a broker or dealer subject to the Securities Investor Protection Act of 1970, or an insured depository institution subject to the Federal Deposit Insurance Act, our ability to exercise our rights to recover our securities under a repurchase agreement or to be compensated for any damages resulting from the lenders' insolvency may be further limited by those statutes. These claims would be subject to significant delay and costs to us and, if and when received, may be substantially less than the damages we actually incur.

Hedging against interest rate changes and other risks may materially adversely affect our business, financial condition and results of operations and our ability to pay dividends to our shareholders.

Subject to maintaining our qualification as a REIT and exclusion from registration as an investment company under the Investment Company Act, we may pursue various hedging strategies to seek to reduce our exposure to adverse changes in interest rates and, to a lesser extent, credit risk. Our hedging activity is expected to vary in scope based on the level and volatility of interest rates, the types of liabilities and assets held and other changing market conditions.

Hedging may fail to protect or could adversely affect us because, among other things:

- interest rate hedging can be expensive, particularly during periods of rising and volatile interest rates;
- available interest rate hedges may not correspond directly with the interest rate risk for which protection is sought;
- the duration of the hedge may not match the duration of the related assets or liabilities being hedged;
- most hedges are structured as over-the-counter contracts with private counterparties, raising the possibility that the hedging counterparty may default on their obligations;
- to the extent that the creditworthiness of a hedging counterparty deteriorates, it may be difficult or impossible to terminate or assign any hedging transactions with such counterparty to another counterparty;

to the extent hedging transactions do not satisfy certain provisions of the Code and are not made through a TRS, the amount of income that a REIT may earn from hedging transactions to offset interest rate losses is limited by U.S. federal tax provisions governing REITs;

the value of derivatives used for hedging may be adjusted from time to time in accordance with accounting rules to reflect changes in fair value. Downward adjustments, or "mark-to-market losses," would reduce our earnings and our shareholders' equity;

we may fail to correctly assess the degree of correlation between the performance of the instruments used in the hedging strategy and the performance of the assets in the portfolio being hedged;

our Manager may fail to recalculate, re-adjust, and execute hedges in an efficient and timely manner; and

the hedging transactions may actually result in poorer overall performance for us than if we had not engaged in the hedging transactions.

Although we do not intend to operate our non-Agency RMBS investment strategy on a credit-hedged basis in general, we may from time to time opportunistically enter into short positions using credit default swaps to protect against adverse credit events with respect to our non-Agency RMBS, provided that our ability to do so may be limited in order to maintain our qualification as a REIT and maintain our exclusion from registration as an investment company

under the Investment Company Act.

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Our hedging transactions, which would be intended to limit losses, may actually adversely affect our earnings, which could reduce our cash available for distribution to our shareholders.

Hedging instruments and other derivatives, including some credit default swaps, may not, in many cases, be traded on exchanges, or may not be guaranteed or regulated by any U.S. or foreign governmental authority and involve risks and costs that could result in material losses.

Hedging instruments and other derivatives, including certain types of credit default swaps, involve risk because they may not, in many cases, be traded on exchanges and may not be guaranteed or regulated by any U.S. or foreign governmental authorities. Consequently, for these instruments there may be less stringent requirements with respect to record keeping and compliance with applicable statutory and commodity and other regulatory requirements and, depending on the identity of the counterparty, applicable international requirements. Our Manager is not restricted from dealing with any particular counterparty or from concentrating any or all of its transactions with one counterparty. Furthermore, our Manager has only a limited internal credit function to evaluate the creditworthiness of its counterparties, mainly relying on its experience with such counterparties and their general reputation as participants in these markets. The business failure of a hedging counterparty with whom we enter into a hedging transaction will most likely result in a default under the agreement governing the hedging arrangement. Default by a party with whom we enter into a hedging transaction may result in losses and may force us to re-initiate similar hedges with other counterparties at the then-prevailing market levels. Generally, we will seek to reserve the right to terminate our hedging transactions upon a counterparty's insolvency, but absent an actual insolvency, we may not be able to terminate a hedging transaction without the consent of the hedging counterparty, and we may not be able to assign or otherwise dispose of a hedging transaction to another counterparty without the consent of both the original hedging counterparty and the potential assignee. If we terminate a hedging transaction, we may not be able to enter into a replacement contract in order to cover our risk. There can be no assurance that a liquid secondary market will exist for hedging instruments purchased or sold, and therefore we may be required to maintain any hedging position until exercise or expiration, which could adversely affect our business, financial condition and results of operations, and our ability to pay dividends to our shareholders.

The U.S. Commodity Futures Trading Commission, or "CFTC," and certain commodity exchanges have established limits referred to as speculative position limits or position limits on the maximum net long or net short position which any person or group of persons may hold or control in particular futures and options. Limits on trading in options contracts also have been established by the various options exchanges. It is possible that trading decisions may have to be modified and that positions held may have to be liquidated in order to avoid exceeding such limits. Such modification or liquidation, if required, could adversely affect our business, financial condition and results of operations and our ability to pay dividends to our shareholders.

Certain of our hedging instruments are regulated by the CFTC and such regulations may adversely impact our ability to enter into such hedging instruments and cause us to incur increased costs.

We enter into interest rate swaps to hedge risks associated with our portfolio. Entities entering into such swaps are exposed to credit losses in the event of non-performance by counterparties to these transactions. Effective October 12, 2012, the CFTC issued rules regarding such swaps under the authority granted to it pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act, or the "Dodd-Frank Act."

The rules primarily impacted our trading of these instruments in two ways. First, beginning on June 10, 2013, certain newly executed swaps, including many interest rate swaps, became subject to mandatory clearing through a central counterparty clearinghouse, or "CCP." It is the intent of the Dodd-Frank Act that, by mandating the clearing of swaps in this manner, swap counterparty risk would not become overly concentrated in any single entity, but rather would be spread and centralized among the CCP and its members. We are not a direct member of any CCP, so we must access the CCPs through a futures commission merchant, or "FCM," which acts as intermediary between us and the CCP with respect to all facets of the transaction, including the posting and receipt of required collateral. If we lost access to our FCMs or CCPs, we could potentially be unable to use interest rate swaps and credit default swaps to hedge our risks.

The second way that the rules impact our trading of these instruments is the Swap Execution Facility, or "SEF," mandate, which came into effect on October 2, 2013, and requires that we execute most interest rate swaps on an electronic platform, rather than over the phone or in some other manner. If we were to lose access to our selected



SEFs or we were otherwise unable to communicate with them, this would prevent us from being able to trade these instruments. If we were unable to execute our hedging trades in a timely manner, particularly in a volatile market environment, we may not be able to execute our strategies in the most advantageous manner.

In addition to subjecting our swap transactions to greater initial margin requirements and additional transaction fees charged by CCPs, FCMs, and SEFs, our swap transactions are now subjected to greater regulation by both the CFTC and the

SEC. These additional fees, costs, margin requirements, documentation, and regulation could adversely affect our business, financial condition and results of operations, and our ability to pay dividends to our shareholders. Additionally, for all interest rate swaps we entered into prior to June 10, 2013, we were not required to clear them through a CCP and as a result these swaps are still subject to the risks of nonperformance by any of the individual counterparties with whom we entered into these transactions described in "—Hedging instruments and other derivatives, including some credit default swaps, may not, in many cases, be traded on regulated exchanges, or may not be guaranteed or regulated by any U.S. or foreign governmental authority and involve risks and costs that could result in material losses" above.

Our use of derivatives may expose us to counterparty risk.

We have entered into interest rate swaps and other derivatives that have not been cleared by a CCP. If a derivative counterparty cannot perform under the terms of the derivative contract, we would not receive payments due under that agreement, we may lose any unrealized gain associated with the derivative, and the hedged liability would cease to be hedged by such instrument. If a derivative counterparty becomes insolvent or files for bankruptcy, we may also be at risk for any collateral we have pledged to such counterparty to secure our obligations under derivative contracts, and we may incur significant costs in attempting to recover such collateral.

We engage in short selling transactions, which may subject us to additional risks.

Many of our hedging transactions, and occasionally our investment transactions, are short sales. Short selling may involve selling securities that are not owned and typically borrowing the same securities for delivery to the purchaser, with an obligation to repurchase the borrowed securities at a later date. Short selling allows the investor to profit from declines in market prices to the extent such declines exceed the transaction costs and the costs of borrowing the securities. A short sale may create the risk of an unlimited loss, in that the price of the underlying security might theoretically increase without limit, thus increasing the cost of repurchasing the securities. There can be no assurance that securities sold short will be available for repurchase or borrowing. Repurchasing securities to close out a short position can itself cause the price of the securities to rise further, thereby exacerbating the loss.

We, Ellington, or its affiliates may be subject to adverse legislative or regulatory changes.

At any time, U.S. federal, state, local or foreign laws or regulations that impact our business, or the administrative interpretations of those laws or regulations, may be enacted or amended. For example, on July 21, 2010 the Dodd-Frank Act was enacted, which significantly revised many financial regulations. Certain portions of the Dodd-Frank Act were effective immediately, while other portions have become or will become effective following rulemaking and transition periods, but many of these changes could materially impact the profitability of our business or the business of our Manager or Ellington, our access to financing or capital, the value of the assets that we hold, expose us to additional costs, require changes to business practices, or adversely affect our ability to pay dividends. For example, the Dodd-Frank Act alters the regulation of commodity interests, imposes regulation on the over-the-counter derivatives market, places restrictions on residential mortgage loan originations, and reforms the asset-backed securitization markets most notably by imposing credit requirements. While there continues to be uncertainty about the exact impact of all of these changes, we do know that we and our Manager are subject to a more complex regulatory framework, and are incurring and will in the future incur costs to comply with new requirements as well as to monitor compliance in the future.

We cannot predict when or if any new law, regulation, or administrative interpretation, including those related to the Dodd-Frank Act, or any amendment to or repeal of any existing law, regulation, or administrative interpretation, will be adopted or promulgated or will become effective. Additionally, the adoption or implementation of any new law, regulation, or administrative interpretation, or any revisions in or repeals of these laws, regulations, or administrative interpretations, including those related to the Dodd-Frank Act, could cause us to change our portfolio, could constrain our strategy, or increase our costs. We could be adversely affected by any change in or any promulgation of new law, regulation, or administrative interpretation.

We may change our investment strategy, investment guidelines, hedging strategy, and asset allocation, operational, and management policies without notice or shareholder consent, which may materially adversely affect our business, financial condition and results of operations, and our ability to pay dividends to our shareholders. In addition, our declaration of trust provides that our Board of Trustees may authorize us to revoke or otherwise terminate our REIT election, without the approval of our shareholders.

We may change our investment strategy, investment guidelines, hedging strategy, and asset allocation, operational, and management policies at any time without notice to or consent from our shareholders. As a result, the types or mix of assets, liabilities, or hedging transactions in our portfolio may be different from, and possibly riskier than, the types or mix of assets,

liabilities, and hedging transactions that we have historically held, or that are otherwise described in this report. A change in our strategy may increase our exposure to real estate values, interest rates, and other factors. Our Board of Trustees determines our investment guidelines and our operational policies, and may amend or revise our policies, including those with respect to our acquisitions, growth, operations, indebtedness, capitalization, and dividends or approve transactions that deviate from these policies without a vote of, or notice to, our shareholders.

In addition, our declaration of trust provides that our Board of Trustees may authorize us to revoke or otherwise terminate our REIT election, without the approval of our shareholders, if it determines that it is no longer in our best interests to qualify as a REIT. These changes could materially adversely affect our business, financial condition and results of operations and our ability to pay dividends to our shareholders.

We operate in a highly competitive market.

Our profitability depends, in large part, on our ability to acquire targeted assets at favorable prices. We compete with a number of entities when acquiring our targeted assets, including other mortgage REITs, financial companies, public and private funds, commercial and investment banks and residential and commercial finance companies. We may also compete with (i) the Federal Reserve and the U.S. Treasury to the extent they purchase assets in our targeted asset classes and (ii) companies that partner with and/or receive financing from the U.S. Government. Many of our competitors are substantially larger and have considerably more favorable access to capital and other resources than we do. Furthermore, new companies with significant amounts of capital have been formed or have raised additional capital, and may continue to be formed and raise additional capital in the future, and these companies may have objectives that overlap with ours, which may create competition for assets we wish to acquire. Some competitors may have a lower cost of funds and access to funding sources that are not available to us, such as funding from the U.S. Government. In addition, some of our competitors may have higher risk tolerances or different risk assessments, which could allow them to consider a wider variety of assets to acquire or pay higher prices than we can. We also may have different operating constraints from those of our competitors including, among others, (i) tax-driven constraints such as those arising from our qualification as a REIT, (ii) restraints imposed on us by our attempt to comply with certain exclusions from the definition of an "investment company" or other exemptions under the Investment Company Act and (iii) restraints and additional costs arising from our status as a public company. Furthermore, competition for assets in our targeted asset classes may lead to the price of such assets increasing, which may further limit our ability to generate desired returns. We cannot assure you that the competitive pressures we face will not have a material adverse effect on our business, financial condition and results of operations, and our ability to pay dividends to our shareholders.

An increase in interest rates may cause a decrease in the issuance volumes of certain of our targeted assets, which could adversely affect our ability to acquire targeted assets that satisfy our investment objectives and to generate income and pay dividends.

Rising interest rates generally reduce the demand for mortgage loans due to the higher cost of borrowing. A reduction in the volume of mortgage loans originated may affect the volume of targeted assets available to us, which could adversely affect our ability to acquire assets that satisfy our investment objectives. If rising interest rates cause us to be unable to acquire a sufficient volume of our targeted assets with a yield that is above our borrowing cost, our ability to satisfy our investment objectives and to generate income and pay dividends to our shareholders may be materially and adversely affected.

Lack of diversification in the number of assets we acquire would increase our dependence on relatively few individual assets.

Our management objectives and policies do not place a limit on the amount of capital used to support, or the exposure to (by any other measure), any individual asset or any group of assets with similar characteristics or risks. As a result, our portfolio may be concentrated in a small number of assets or may be otherwise undiversified, increasing the risk of loss and the magnitude of potential losses to us and our shareholders if one or more of these assets perform poorly. For example, our portfolio of mortgage-related assets may at times be concentrated in certain property types that are subject to higher risk of foreclosure, or secured by properties concentrated in a limited number of geographic locations. To the extent that our portfolio is concentrated in any one region or type of security, downturns or other significant events or developments relating generally to such region or type of security may result in defaults on a number of our assets within a short time period, which may materially adversely affect our business, financial

condition and results of operations, and our ability to pay dividends to our shareholders.

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Our ability to pay dividends will depend on our operating results, our financial condition and other factors, and we may not be able to pay dividends at a fixed rate or at all under certain circumstances.

We intend to pay dividends to our shareholders in amounts such that we distribute all or substantially all of each year's taxable income (subject to certain adjustments). This distribution policy will enable us to avoid being subject to U.S. federal income tax on our REIT taxable income that we distribute to our shareholders. However, our ability to pay dividends will depend on our earnings, our financial condition and such other factors as our Board of Trustees may deem relevant from time to time. We will declare and pay dividends only to the extent approved by our Board of Trustees.

Failure to procure adequate funding and capital would adversely affect our results and may, in turn, negatively affect the value of our common shares and our ability to pay dividends to our shareholders.

We depend upon the availability of adequate funding and capital for our operations. To maintain our status as a REIT, we are required to distribute to our shareholders at least 90% of our REIT taxable income annually, determined excluding any net capital gains and without regard to the deduction for dividends paid. As a result, we are not able to retain much or any of our earnings for new investments. We cannot assure you that any, or sufficient, funding or capital will be available to us in the future on terms that are acceptable to us. In the event that we cannot obtain sufficient funding and capital on acceptable terms, there may be a negative impact on the value of our common shares and our ability to pay dividends to our shareholders, and you may lose part or all of your investment.

We may invest in securities in the developing CRT sector that are subject to mortgage credit risk.

We may invest in credit risk transfer securities, or "CRTs." CRTs are designed to transfer a portion of the mortgage credit risk on a pool of insured or guaranteed mortgage loans from the insurer or guarantor of such loans to CRT investors. In a CRT transaction, interest and/or principal of the CRT is written off following certain credit events, such as delinquencies, defaults, and/or realized losses, on the underlying mortgage pool. To date, the vast majority of CRTs consist of risk sharing transactions issued by the GSEs, namely Fannie Mae's Connecticut Avenue Securities program, or "CAS," and Freddie Mac's Structured Agency Credit Risk program, or "STACR." These securities have historically been structured as unsecured debt of the related GSE, but where the principal payments and principal write-offs are determined by the prepayments, delinquencies, and/or realized losses on a reference pool of mortgage loans guaranteed by such GSE. However, it is anticipated that in the future Fannie Mae and Freddie Mac will issue CRTs with a variety of other structures.

**Risks Related to our Relationship with our Manager and Ellington**

We cannot assure you that our Manager's past experience will be sufficient to successfully manage our business as a REIT.

Our Manager has operated us as a REIT since 2013. The REIT provisions of the Code are complex, and any failure to comply with those provisions in a timely manner could prevent us from maintaining our qualification as a REIT or force us to pay unexpected taxes and penalties. In such event, our net income would be reduced and we could incur a loss.

We are dependent on our Manager and certain key personnel of Ellington that are provided to us through our Manager and may not find a suitable replacement if our Manager terminates the management agreement or such key personnel are no longer available to us.

We do not have any employees of our own. Our officers are employees of Ellington or one or more of its affiliates. We have no separate facilities and are completely reliant on our Manager, which has significant discretion as to the implementation of our operating policies and execution of our business strategies and risk management practices. We also depend on our Manager's access to the professionals and principals of Ellington as well as information and deal flow generated by Ellington. The employees of Ellington identify, evaluate, negotiate, structure, close, and monitor our portfolio. The departure of any of the senior officers of our Manager, or of a significant number of investment professionals or principals of Ellington, could have a material adverse effect on our ability to achieve our objectives. We can offer no assurance that our Manager will remain our manager or that we will continue to have access to our Manager's senior management. We are subject to the risk that our Manager will terminate the management agreement or that we may deem it necessary to terminate the management agreement or prevent certain individuals from performing services for us and that no suitable replacement will be found to manage us.

The management fees payable to our Manager are payable regardless of the performance of our portfolio, which may reduce our Manager's incentive to devote the time and effort to seeking profitable opportunities for our portfolio. We pay our Manager management fees, which may be substantial, based on our shareholders' equity (as defined in the management agreement) regardless of the performance of our portfolio. The management fee takes into account the net issuance proceeds of both common and preferred share offerings. Our Manager's entitlement to non-performance-based compensation might reduce its incentive to devote the time and effort of its professionals to seeking profitable opportunities for

our portfolio, which could result in a lower performance of our portfolio and materially adversely affect our business, financial condition and results of operations, and our ability to pay dividends to our shareholders.

Our Board of Trustees has approved very broad investment guidelines for our Manager and will not approve each decision made by our Manager to acquire, dispose of, or otherwise manage an asset.

Our Manager is authorized to follow very broad guidelines in pursuing our strategy. While our Board of Trustees periodically reviews our guidelines and our portfolio and asset-management decisions, it generally does not review all of our proposed acquisitions, dispositions, and other management decisions. In addition, in conducting periodic reviews, our Board of Trustees relies primarily on information provided to them by our Manager. Furthermore, our Manager may arrange for us to use complex strategies or to enter into complex transactions that may be difficult or impossible to unwind by the time they are reviewed by our Board of Trustees. Our Manager has great latitude within the broad guidelines in determining the types of assets it may decide are proper for us to acquire and other decisions with respect to the management of those assets subject to our maintaining our qualification as a REIT. Poor decisions could have a material adverse effect on our business, financial condition and results of operations, and our ability to pay dividends to our shareholders.

We compete with Ellington's other accounts for access to Ellington.

Ellington has sponsored and/or currently manages accounts with a focus that overlaps with our investment focus, and expects to continue to do so in the future. Ellington is not restricted in any way from sponsoring or accepting capital from new accounts, even for investing in asset classes or strategies that are similar to, or overlapping with, our asset classes or strategies. Therefore, we compete for access to the benefits that our relationship with our Manager and Ellington provides us. For the same reasons, the personnel of Ellington and our Manager may be unable to dedicate a substantial portion of their time managing our assets.

We compete with other Ellington accounts for opportunities to acquire assets, which are allocated in accordance with Ellington's investment allocation policies.

Many, if not most, of our targeted assets are also targeted assets of other Ellington accounts and Ellington has no duty to allocate such opportunities in a manner that preferentially favors us. Ellington makes available to us all opportunities to acquire assets that it determines, in its reasonable and good faith judgment, based on our objectives, policies and strategies, and other relevant factors, are appropriate for us in accordance with Ellington's written investment allocation policy, it being understood that we might not participate in each such opportunity, but will on an overall basis equitably participate with Ellington's other accounts in all such opportunities.

Since many of our targeted assets are typically available only in specified quantities, Ellington often is not able to buy as much of any asset or group of assets as would be required to satisfy the needs of all of Ellington's accounts. In these cases, Ellington's investment allocation procedures and policies typically allocate such assets to multiple accounts in proportion to their needs and available capital. As part of these policies, accounts that are in a "start-up" or "ramp-up" phase may get allocations above their proportion of available capital, which could work to our disadvantage, particularly because there are no limitations surrounding Ellington's ability to create new accounts. In addition, the policies permit departure from proportional allocations under certain circumstances, for example when such allocation would result in an inefficiently small amount of the security being purchased for an account, which may also result in our not participating in certain allocations.

The Blackstone Funds have significant influence over us and may have conflicts of interest with us or you now or in the future.

The Blackstone Funds own a significant portion of our common shares, and one of our trustees is also an affiliate of Blackstone, while another of our trustees serves as a Senior Advisor to Blackstone and serves on other boards of companies that are affiliates of Blackstone. As a result, Blackstone may have influence over our ability to enter into any corporate transaction that requires the approval of shareholders regardless of whether shareholders believe that any such transactions are in their best interests. Similarly, Blackstone may have influence over transactions that we engage in, including transactions which require the approval of our trustees. Such items may include decisions related to future capital raises, investment strategy, dividend declarations, financing decisions and decisions regarding our Manager. Blackstone is also in the business of making investments in companies and may from time to time acquire and hold interests in businesses that compete directly or indirectly with us. Blackstone may also pursue acquisition opportunities that are complementary to our business, and, as a result, those acquisition opportunities may not be



available to us. As long as funds controlled by or associated with Blackstone continue to own a significant amount of our outstanding common shares, or Blackstone affiliates continue to serve as our trustees, Blackstone may continue to be able to influence our decisions.

There are conflicts of interest in our relationships with our Manager and Ellington, which could result in decisions that are not in the best interests of our shareholders.

We are subject to conflicts of interest arising out of our relationship with Ellington and our Manager. Currently, all of our executive officers, and two of our trustees, are employees of Ellington or one or more of its affiliates. As a result, our Manager and our officers may have conflicts between their duties to us and their duties to, and interests in, Ellington or our Manager. For example, Mr. Penn, our President and Chief Executive Officer and one of our trustees, also serves as the President and Chief Executive Officer of, and as a member of the Board of Directors of, Ellington Financial LLC, and Vice Chairman and Chief Operating Officer of Ellington, Ms. Mumford, our Chief Financial Officer, also serves as the Chief Financial Officer of Ellington Financial LLC, Mr. Tecotzky, our Co-Chief Investment Officer, also serves as the Co-Chief Investment Officer of Ellington Financial LLC, and a Managing Director of Ellington, and Mr. Vranos, our Co-Chief Investment Officer and one of our trustees, also serves as the Co-Chief Investment Officer of, and as a member of the Board of Directors of, Ellington Financial LLC, and Chairman of Ellington.

We may acquire or sell assets in which Ellington or its affiliates have or may have an interest. Similarly, Ellington or its affiliates may acquire or sell assets in which we have or may have an interest. Although such acquisitions or dispositions may present conflicts of interest, we nonetheless may pursue and consummate such transactions.

Additionally, we may engage in transactions directly with Ellington or its affiliates, including the purchase and sale of all or a portion of a portfolio asset.

Acquisitions made for entities with similar objectives may be different from those made on our behalf. Ellington may have economic interests in, or other relationships with, others in whose obligations or securities we may acquire. In particular, such persons may make and/or hold an investment in securities that we acquire that may be pari passu, senior, or junior in ranking to our interest in the securities or in which partners, security holders, officers, directors, agents, or employees of such persons serve on boards of directors or otherwise have ongoing relationships. Each of such ownership and other relationships may result in securities laws restrictions on transactions in such securities and otherwise create conflicts of interest. In such instances, Ellington may, in its sole discretion, make recommendations and decisions regarding such securities for other entities that may be the same as or different from those made with respect to such securities and may take actions (or omit to take actions) in the context of these other economic interests or relationships the consequences of which may be adverse to our interests.

In deciding whether to issue additional debt or equity securities, we will rely in part on recommendations made by our Manager. While such decisions are subject to the approval of our Board of Trustees, two of our trustees are also Ellington employees. Because our Manager earns management fees that are based on the total amount of our equity capital, our Manager may have an incentive to recommend that we issue additional equity securities. In addition, through its non-voting special membership interests in an affiliate of Ellington, the Blackstone Funds are entitled to receive distributions from such affiliate equal to a portion of the management fees that are paid to our Manager, and therefore our trustee affiliated with Blackstone may have a similar incentive for us to issue additional equity securities. See below for further discussion of the adverse impact future debt or equity offerings could have on our common shares. Future offerings of debt securities, which would rank senior to our common shares upon liquidation, and future offerings of equity securities which would dilute the common shares holdings of our existing shareholders and may be senior to our common shares for the purposes of dividend and liquidating distributions, may adversely affect the market price of our common shares.

The officers of our Manager and its affiliates devote as much time to us as our Manager deems appropriate; however, these officers may have conflicts in allocating their time and services among us and Ellington and its affiliates' accounts. During turbulent conditions in the mortgage industry, distress in the credit markets or other times when we will need focused support and assistance from our Manager and Ellington employees, other entities that Ellington advises or manages will likewise require greater focus and attention, placing our Manager and Ellington's resources in high demand. In such situations, we may not receive the necessary support and assistance we require or would otherwise receive if we were internally managed or if Ellington or its affiliates did not act as a manager for other entities.

We, directly or through Ellington, may obtain confidential information about the companies or securities in which we have invested or may invest. If we do possess confidential information about such companies or securities, there may

be restrictions on our ability to dispose of, increase the amount of, or otherwise take action with respect to the securities of such companies. Our Manager's and Ellington's management of other accounts could create a conflict of interest to the extent our Manager or Ellington is aware of material non-public information concerning potential investment decisions. We have implemented compliance procedures and practices designed to ensure that investment decisions are not made while in possession of material non-public information. We cannot assure you, however, that these procedures and practices will be effective. In addition, this conflict and these procedures and practices may limit the freedom of our Manager to make potentially profitable investments, which could have an adverse effect on our operations. These limitations imposed by access

to confidential information could therefore materially adversely affect our business, financial condition and results of operations, and our ability to pay dividends to our shareholders.

The management agreement with our Manager was not negotiated on an arm's-length basis and may not be as favorable to us as if it had been negotiated with an unaffiliated third party and may be costly and difficult to terminate. Our management agreement with our Manager was negotiated between related parties, and its terms, including fees payable, may not be as favorable to us as if it had been negotiated with an unaffiliated third party. Various potential and actual conflicts of interest may arise from the activities of Ellington and its affiliates by virtue of the fact that our Manager is controlled by Ellington.

Termination of our management agreement without cause, including termination for poor performance or non-renewal, is subject to several conditions which may make such a termination difficult and costly. The management agreement has a current term that expires on September 24, 2018, and will be automatically renewed for successive one-year terms thereafter unless notice of non-renewal is delivered by either party to the other party at least 180 days prior to the expiration of the then current term. The management agreement provides that it may be terminated by us based on performance upon the affirmative vote of at least two-thirds of our independent trustees, or by a vote of the holders of at least a majority of our outstanding common shares, based either upon unsatisfactory performance by our Manager that is materially detrimental to us or upon a determination by the Board of Trustees that the management fee payable to our Manager is not fair, subject to our Manager's right to prevent such a termination by accepting a mutually acceptable reduction of management fees. In the event we terminate the management agreement as discussed above or elect not to renew the management agreement, we will be required to pay our Manager a termination fee equal to 5% of our shareholders' equity as of the month-end preceding the date of the notice of termination or non-renewal. These provisions will increase the effective cost to us of terminating the management agreement, thereby adversely affecting our ability to terminate our Manager without cause.

Pursuant to the management agreement, our Manager will not assume any responsibility other than to render the services called for thereunder and will not be responsible for any action of our Board of Trustees in following or declining to follow its advice or recommendations. Under the terms of the management agreement, our Manager, Ellington, and their affiliates and each of their officers, directors, trustees, members, shareholders, partners, managers, investment and risk management committee members, employees, agents, successors and assigns, will not be liable to us for acts or omissions performed in accordance with and pursuant to the management agreement, except because of acts constituting bad faith, willful misconduct, gross negligence, fraud or reckless disregard of their duties under the management agreement. In addition, we will indemnify our Manager, Ellington, and their affiliates and each of their officers, directors, trustees, members, shareholders, partners, managers, investment and risk management committee members, employees, agents, successors and assigns, with respect to all expenses, losses, damages, liabilities, demands, charges and claims arising from acts of our Manager not constituting bad faith, willful misconduct, gross negligence, fraud or material breach or reckless disregard of duties, performed in good faith in accordance with and pursuant to the management agreement.

Our Manager's failure to identify and acquire assets that meet our asset criteria or perform its responsibilities under the management agreement could materially adversely affect our business, financial condition and results of operations, our ability to maintain our qualification as a REIT and our ability to pay dividends to our shareholders.

Our ability to achieve our objectives depends on our Manager's ability to identify and acquire assets that meet our asset criteria. Accomplishing our objectives is largely a function of our Manager's structuring of our investment process, our access to financing on acceptable terms, and general market conditions. Our shareholders do not have input into our investment decisions. All of these factors increase the uncertainty, and thus the risk, of investing in our common shares. The senior management team of our Manager has substantial responsibilities under the management agreement. In order to implement certain strategies, our Manager may need to hire, train, supervise, and manage new employees successfully. Any failure to manage our future growth effectively could have a material adverse effect on our business, financial condition and results of operations, our ability to maintain our qualification as a REIT and our ability to pay dividends to our shareholders.

If our Manager ceases to be our Manager pursuant to the management agreement or one or more of our Manager's key personnel ceases to provide services to us, our lenders and our derivative counterparties may cease doing business with us.

If our Manager ceases to be our Manager, or if one or more of our Manager's key personnel cease to provide services for us, it could constitute an event of default or early termination event under many of our repo financing and derivative hedging agreements, upon which our counterparties would have the right to terminate their agreements with us. If our Manager ceases to be our Manager for any reason, including upon the non-renewal of our management agreement and we are unable to obtain or renew financing or enter into or maintain derivative transactions, our business, financial condition and results of operations, and our ability to pay dividends to our shareholders may be materially adversely affected.

We do not own the Ellington brand or trademark, but may use the brand and trademark as well as our logo pursuant to the terms of a license granted by Ellington.

Ellington has licensed the "Ellington" brand, trademark, and logo to us for so long as our Manager or another affiliate of Ellington continues to act as our manager. We do not own the brand, trademark, or logo that we will use in our business and may be unable to protect this intellectual property against infringement from third parties. Ellington retains the right to continue using the "Ellington" brand and trademark. We will further be unable to preclude Ellington from licensing or transferring the ownership of the "Ellington" brand and trademark to third parties, some of whom may compete against us. Consequently, we will be unable to prevent any damage to goodwill that may occur as a result of the activities of Ellington or others. Furthermore, in the event our Manager or another affiliate of Ellington ceases to act as our manager, or in the event Ellington terminates the license, we will be required to change our name and trademark. Any of these events could disrupt our recognition in the marketplace, damage any goodwill we may have generated, and otherwise harm our business. Finally, the license is a domestic license in the United States only and does not give us any right to use the "Ellington" brand, trademark, and logo overseas even though we expect to use the brand, trademark, and logo overseas. Our use of the "Ellington" brand, trademark and logo overseas will therefore be unlicensed and could expose us to a claim of infringement.

We or Ellington or its affiliates may be subject to regulatory inquiries or proceedings.

At any time, industry-wide or company-specific regulatory inquiries or proceedings can be initiated and we cannot predict when or if any such regulatory inquiries or proceedings will be initiated that involve us or Ellington or its affiliates, including our Manager. For example, over the years, Ellington and its affiliates have received, and we expect in the future that we and they may receive, inquiries and requests for documents and information from various federal, state, and foreign regulators, including those identified under the caption Item 3. Legal Proceedings.

We can give no assurances that regulatory inquiries will not result in investigations of us or Ellington or its affiliates, or in enforcement actions, fines or penalties, or the assertion of private litigation claims against us or, Ellington or its affiliates. We believe that the heightened scrutiny of the financial services industry increases the risk of additional inquiries and requests from regulatory or enforcement agencies. In the event regulatory inquiries were to result in investigations, enforcement actions, fines, penalties, or the assertion of private litigation claims against us or Ellington or its affiliates, we, or our Manager's ability to perform its obligations to us under the management agreement between us and our Manager, or Ellington's ability to perform its obligations to our Manager under the services agreement between Ellington and our Manager, could be adversely impacted, which could in turn have a material adverse effect on our business, financial condition and results of operations, and our ability to pay dividends to our shareholders.

#### Risks Related to Our Common Shares

The market for our common shares may be limited, which may adversely affect the price at which our common shares trade and make it difficult to sell our common shares.

While our common shares are listed on the NYSE, such listing does not provide any assurance as to:

- whether the market price of our shares will reflect our actual financial performance;
- the liquidity of our common shares;
- the ability of any holder to sell common shares; or
- the prices that may be obtained for our common shares.

The market price and trading volume of our common shares may be volatile.

The market price of our common shares may be highly volatile and could be subject to wide fluctuations. In addition, the trading volume in our common shares may fluctuate and cause significant price variations to occur. We cannot assure you that the market price of our common shares will not fluctuate or decline significantly in the future. Some of the factors that could negatively affect our share price or result in fluctuations in the price or trading volume of our common shares include:

- actual or anticipated variations in our quarterly operating results or dividends;
- changes in our earnings estimates, failure to meet earnings or operating results expectations of public market analysts and investors, or publication of research reports about us or the real estate specialty finance industry;
- increases in market interest rates that lead purchasers of our common shares to demand a higher yield;
- repurchases and issuances by us of our common shares;
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passage of legislation, changes in applicable law, court rulings, enforcement actions or other regulatory developments that adversely affect us or our industry;

- changes in government policies or changes in timing of implementation of government policies, including with respect to Fannie Mae, Freddie Mac, and Ginnie Mae;
- changes in market valuations of similar companies;
- adverse market reaction to any increased indebtedness we incur in the future;
- additions or departures of key management personnel;
- actions by shareholders;
- speculation in the press or investment community;
- general market and economic conditions;
- our operating performance and the performance of other similar companies;
- changes in accounting principles; and
- the disposition by the Blackstone Funds of all or any portion of our common shares held by them in accordance with and subject to applicable securities laws.

For as long as we are an emerging growth company, we will not be required to comply with certain reporting requirements, including those relating to accounting standards and disclosure about our executive compensation, that apply to other public companies.

We are an "emerging growth company," as defined in Section 2(a) of the Securities Act, as modified by the Jumpstart our Business Startups Act of 2012, or the "JOBS Act." As such, we are eligible to take advantage of certain exemptions from various reporting requirements that are applicable to other public companies that are not "emerging growth companies," including, but not limited to, not being required to comply with the auditor attestation requirements of Section 404(b) of the Sarbanes-Oxley Act, reduced disclosure obligations regarding executive compensation in our periodic reports and proxy statements and exemptions from the requirements of holding a non-binding advisory vote on executive compensation and of shareholder approval of any golden parachute payments not previously approved. Since we take advantage of these exemptions, some investors may find our common shares less attractive as a result. The result may be a less active trading market for our common shares and our share price may be more volatile.

We expect to remain an emerging growth company through December 28, 2018.

We qualify as an "emerging growth company" and are taking advantage of an extended transition period to comply with new or revised accounting standards applicable to public companies.

We qualify as an emerging growth company as defined in the JOBS Act. Pursuant to Section 107 of the JOBS Act, as an "emerging growth company," we are permitted to take advantage of the extended transition period provided in Section 7(a)(2)(B) of the Securities Act for complying with new or revised accounting standards, which allows us to delay the adoption of certain accounting standards until those standards would otherwise apply to private companies.

We have elected to take advantage of the benefits of this extended transition period. As a result of our election to utilize the extended transition period, our financial statements may not be comparable to those of other public companies that comply with such new or revised accounting standards. Please refer to "Management's Discussion and Analysis of Financial Condition and Results of Operations—Critical Accounting Policies" for further discussion of our election to utilize the extended transition period for complying with new or revised accounting standards.

Future offerings of debt securities, which would rank senior to our common shares upon our bankruptcy liquidation, and future offerings of equity securities which would dilute the common share holdings of our existing shareholders and may be senior to our common shares for the purposes of dividend and liquidating distributions, may adversely affect the market price of our common shares.

In the future, we may attempt to increase our capital resources by making offerings of debt securities or additional offerings of equity securities. Upon bankruptcy or liquidation, holders of our debt securities and preferred shares, if any, and lenders with respect to other borrowings will receive a distribution of our available assets prior to the holders of our common shares. Our preferred shares, if issued, could have a preference on liquidating distributions or a preference on dividend payments or both that could limit our ability to pay a dividend or other distribution to the holders of our common shares. Because our decision to issue securities in any future offering will depend on market conditions and other factors beyond our control, we cannot predict or estimate the amount, timing or nature of our future offerings. Thus, holders of our common shares bear the risk of our future offerings reducing the market price of our common shares and diluting their share holdings in us.





Future sales of our common shares or other securities convertible into our common shares could cause the market value of our common shares to decline and could result in dilution of your shares.

Sales of substantial amounts of our common shares or other securities convertible into our common shares could cause the market price of our common shares to decrease significantly. We cannot predict the effect, if any, of future sales of our common shares or other securities convertible into our common shares, or the availability of such securities for future sales, on the market price of our common shares. Sales of substantial amounts of our common shares or other securities convertible into our common shares, or the perception that such sales could occur, may adversely affect prevailing market values for our common shares.

Our shareholders may not receive dividends or dividends may not grow over time.

We have not established a minimum dividend payment level and our ability to pay dividends may be adversely affected by a number of factors, including the risk factors described herein. All dividends will be declared at the discretion of our Board of Trustees and will depend on our earnings, our financial condition, and other factors as our Board of Trustees may deem relevant from time to time. Our Board of Trustees is under no obligation or requirement to declare a dividend. We cannot assure you that we will achieve results that will allow us to pay a specified level of dividends or to increase dividends from one year to the next. Among the factors that could materially adversely affect our business, financial condition and results of operations, and our ability to pay dividends to our shareholders are: our inability to realize positive or attractive returns on our portfolio, whether because of defaults in our portfolio, decreases in the value of our portfolio, or otherwise; margin calls or other expenditures that reduce our cash flow and impact our liquidity; and increases in actual or estimated operating expenses.

An increase in interest rates may have an adverse effect on the market price of our common shares and our ability to pay dividends to our shareholders.

One of the factors that investors may consider in deciding whether to buy or sell our common shares is our dividend rate (or expected future dividend rate) as a percentage of our common share price, relative to market interest rates. If market interest rates increase, prospective investors may demand a higher dividend rate on our common shares or seek alternative investments paying higher dividends or interest. As a result, interest rate fluctuations and capital market conditions can affect the market price of our common shares independent of the effects such conditions may have on our portfolio. For instance, if interest rates rise without an increase in our dividend rate, the market price of our common shares could decrease because potential investors may require a higher dividend yield on our common shares as market rates on interest-bearing instruments such as bonds rise. In addition, to the extent we have variable rate debt, such as our repurchase agreement financing, rising interest rates would result in increased interest expense on this variable rate debt, thereby adversely affecting our cash flow and our ability to service our indebtedness and pay dividends to our shareholders.

Investing in our common shares involves a high degree of risk.

The assets we purchase in accordance with our objectives may result in a higher amount of risk than other alternative asset acquisition options. The assets we acquire may be highly speculative and aggressive and may be subject to a variety of risks, including credit risk, prepayment risk, interest rate risk, and market risk. As a result, an investment in our common shares may not be suitable for investors with lower risk tolerance.

#### Risks Related to Our Organization and Structure

Maintenance of our exclusion from registration as an investment company under the Investment Company Act imposes significant limitations on our operations.

We have conducted and intend to continue to conduct our operations so that neither we nor any of our subsidiaries are required to register as an investment company under the Investment Company Act. Both we and our Operating Partnership are organized as holding companies and conduct our business primarily through wholly-owned subsidiaries of our Operating Partnership. Investments in subsidiaries that rely on the exclusions from the definition of investment company under 3(c)(1) or 3(c)(7) of the Investment Company Act are considered investment securities for the purposes of the 40% Test. Therefore, our Operating Partnership's investments in its 3(c)(7) subsidiaries and its other investment securities cannot exceed 40% of the value of our Operating Partnership's total assets (excluding U.S. government securities and cash) on an unconsolidated basis. This requirement limits the types of businesses in which we may engage and the assets we may hold. Certain of our Operating Partnership's subsidiaries rely on the exclusion

provided by Section 3(c)(5)(C) of the Investment Company Act. Section 3(c)(5)(C) of the Investment Company Act is designed for entities "primarily engaged in the business of purchasing or otherwise

acquiring mortgages and other liens on and interests in real estate." This exclusion generally requires that at least 55% of the entity's assets on an unconsolidated basis consist of qualifying real estate assets and at least 80% of the entity's assets on an unconsolidated basis consist of qualifying real estate assets or real estate-related assets. These requirements limit the assets those subsidiaries can own and the timing of sales and purchases of those assets.

To classify the assets held by our subsidiaries as qualifying real estate assets or real estate-related assets, we rely on no-action letters and other guidance published by the SEC staff regarding those kinds of assets, as well as upon our analyses (in consultation with outside counsel) of guidance published with respect to other types of assets. There can be no assurance that the laws and regulations governing the Investment Company Act status of companies similar to ours, or the guidance from the SEC staff regarding the treatment of assets as qualifying real estate assets or real estate-related assets, will not change in a manner that adversely affects our operations. In fact, in August 2011, the SEC published a concept release in which it asked for comments on this exclusion from registration. To the extent that the SEC staff provides more specific guidance regarding any of the matters bearing upon our exclusion from the definition of an investment company under the Investment Company Act, we may be required to adjust our strategy accordingly. Any additional guidance from the SEC staff could further inhibit our ability to pursue the strategies that we have chosen. Furthermore, although we monitor the assets of our subsidiaries regularly, there can be no assurance that our subsidiaries will be able to maintain their exclusion from registration. Any of the foregoing could require us to adjust our strategy, which could limit our ability to make certain investments or require us to sell assets in a manner, at a price or at a time that we otherwise would not have chosen. This could negatively affect the value of our common shares, the sustainability of our business model, and our ability to pay dividends to our shareholders. The ownership limits in our declaration of trust may discourage a takeover or business combination that may have benefited our shareholders.

To assist us in qualifying as a REIT, among other purposes, our declaration of trust restricts the beneficial or constructive ownership of our shares by any person to no more than 9.8% in value or the number of shares, whichever is more restrictive, of the outstanding shares of any class or series of our shares. This and other restrictions on ownership and transfer of our shares contained in our declaration of trust may discourage a change of control of us and may deter individuals or entities from making tender offers for our common shares on terms that might be financially attractive to you or which may cause a change in our management. In addition to deterring potential transactions that may be favorable to our shareholders, these provisions may also decrease your ability to sell our common shares. Our shareholders' ability to control our operations is severely limited.

Our Board of Trustees has approval rights with respect to our major strategies, including our strategies regarding investments, financing, growth, debt capitalization, REIT qualification and distributions. Our Board of Trustees may amend or revise these and other strategies without a vote of our shareholders.

Certain provisions of Maryland law could inhibit a change in our control.

Certain provisions of the Maryland General Corporation Law, or the MGCL, applicable to a Maryland real estate investment trust may have the effect of inhibiting a third party from making a proposal to acquire us or of impeding a change in our control under circumstances that otherwise could provide the holders of our common shares with the opportunity to realize a premium over the then prevailing market price of such shares. We are subject to the "business combination" provisions of the MGCL that, subject to limitations, prohibit certain business combinations between us and an "interested shareholder" (defined generally as any person who beneficially owns 10% or more of our then outstanding voting shares or an affiliate or associate of ours who, at any time within the two-year period prior to the date in question, was the beneficial owner of 10% or more of our then outstanding voting shares) or an affiliate thereof for five years after the most recent date on which the shareholder becomes an interested shareholder and, thereafter, imposes minimum price or supermajority shareholder voting requirements on these combinations. These provisions of the MGCL do not apply, however, to business combinations that are approved or exempted by the board of trustees of a real estate investment trust prior to the time that the interested shareholder becomes an interested shareholder.

Pursuant to the statute, our Board of Trustees has by resolution exempted business combinations between us and any other person, provided that the business combination is first approved by our Board of Trustees, including a majority of our trustees who are not affiliates or associates of such person. This resolution, however, may be altered or repealed in whole or in part at any time. If this resolution is repealed, or our Board of Trustees does not otherwise approve a business combination, this statute may discourage others from trying to acquire control of us and increase the

difficulty of consummating any offer.

The "control share" provisions of the MGCL provide that holders of "control shares" of a Maryland real estate investment trust (defined as shares which, when aggregated with all other shares controlled by the shareholder, entitle the shareholder to exercise one of three increasing ranges of voting power in the election of trustees) acquired in a "control share acquisition" (defined as the acquisition of "control shares," subject to certain exceptions) have no voting rights with respect to

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the control shares except to the extent approved by the Maryland real estate investment trust's shareholders by the affirmative vote of at least two-thirds of all the votes entitled to be cast on the matter, excluding votes entitled to be cast by the acquirer of control shares, its officers and its trustees who are also employees of the Maryland real estate investment trust. Our bylaws contain a provision exempting from the control share acquisition statute any and all acquisitions by any person of our shares. There can be no assurance that this provision will not be amended or eliminated at any time in the future.

The "unsolicited takeover" provisions of the MGCL permit our Board of Trustees, without shareholder approval and regardless of what is currently provided in our declaration of trust or bylaws, to implement certain provisions. These provisions may have the effect of inhibiting a third party from making an acquisition proposal for us or of delaying, deferring or preventing a change in our control under circumstances that otherwise could provide the holders of our common shares with the opportunity to realize a premium over the then current market price.

Our authorized but unissued common and preferred shares may prevent a change in our control.

Our declaration of trust authorizes us to issue additional authorized but unissued common shares and preferred shares. In addition, our Board of Trustees may, without shareholder approval, approve amendments to our declaration of trust to increase the aggregate number of our authorized shares or the number of shares of any class or series that we have authority to issue and may classify or reclassify any unissued common shares or preferred shares and may set the preferences, rights and other terms of the classified or reclassified shares. As a result, among other things, our Board of Trustees may establish a class or series of common shares or preferred shares that could delay or prevent a transaction or a change in our control that might involve a premium price for our common shares or otherwise be in the best interests of our shareholders.

Our rights and the rights of our shareholders to take action against our trustees and officers or against our Manager or Ellington are limited, which could limit your recourse in the event actions are taken that are not in your best interests.

Our declaration of trust limits the liability of our present and former trustees and officers to us and our shareholders for money damages to the maximum extent permitted under Maryland law. Under current Maryland law, our present and former trustees and officers will not have any liability to us or our shareholders for money damages other than liability resulting from:

• actual receipt of an improper benefit or profit in money, property or services; or

• active and deliberate dishonesty by the trustee or officer that was established by a final judgment and is material to the cause of action.

Our declaration of trust authorizes us to indemnify our present and former trustees and officers for actions taken by them in those and other capacities to the maximum extent permitted by Maryland law. Our bylaws require us to indemnify each present and former trustee or officer, to the maximum extent permitted by Maryland law, in the defense of any proceeding to which he or she is made, or threatened to be made, a party by reason of his or her service to us as a trustee or officer or in certain other capacities. In addition, we may be obligated to pay or reimburse the expenses incurred by our present and former trustees and officers without requiring a preliminary determination of their ultimate entitlement to indemnification.

As a result, we and our shareholders may have more limited rights against our present and former trustees and officers than might otherwise exist absent the current provisions in our declaration of trust and bylaws or that might exist with other companies, which could limit your recourse in the event of actions not in your best interest.

Our declaration of trust contains provisions that make removal of our trustees difficult, which could make it difficult for our shareholders to effect changes to our management.

Our declaration of trust provides that, subject to the rights of holders of any series of preferred shares, a trustee may be removed only for "cause" (as defined in our declaration of trust), and then only by the affirmative vote of at least two-thirds of the votes entitled to be cast generally in the election of trustees. Vacancies generally may be filled only by a majority of the remaining trustees in office, even if less than a quorum, for the full term of the class of trustees in which the vacancy occurred. These requirements make it more difficult to change our management by removing and replacing trustees and may prevent a change in our control that is in the best interests of our shareholders.

Our declaration of trust generally does not permit ownership in excess of 9.8% of any class or series of our shares of beneficial interest, and attempts to acquire our shares in excess of the share ownership limits will be ineffective unless an exemption is granted by our Board of Trustees.

Our declaration of trust generally prohibits beneficial or constructive ownership by any person of more than 9.8% in value or by number of shares, whichever is more restrictive, of any class or series of our outstanding shares and contains certain other limitations on the ownership and transfer of our shares. Our Board of Trustees, in its sole discretion, may grant an exemption to

certain of these prohibitions, subject to certain conditions and receipt by our board of certain representations and undertakings. Our Board of Trustees may from time to time increase this ownership limit for one or more persons and may increase or decrease such limit for all other persons. Any decrease in the ownership limit generally applicable to all shareholders will not be effective for any person whose percentage ownership of our shares is in excess of such decreased ownership limit until such time as such person's percentage ownership of our shares equals or falls below such decreased ownership limit, but any further acquisition of our shares in excess of such decreased ownership limit will be in violation of the decreased ownership limit. Our Board of Trustees may not increase the ownership limit (whether for one person or all shareholders) if such increase would allow five or fewer individuals to beneficially own more than 49.9% in value of our outstanding shares.

Our declaration of trust's constructive ownership rules are complex and may cause the outstanding shares owned by a group of related individuals or entities to be deemed to be constructively owned by one individual or entity. As a result, the acquisition of less than 9.8% of the outstanding shares of any class or series by an individual or entity could cause that individual or entity to own constructively in excess of 9.8% of the outstanding shares of such class or series and thus violate the ownership limit or other restrictions on ownership and transfer of our shares. Any attempt to own or transfer our common shares or preferred shares (if and when issued) in excess of such ownership limit without the consent of our board of trustees or in a manner that would cause us to be "closely held" under Section 856(h) of the Code (without regard to whether the shares are held during the last half of a taxable year) or otherwise fail to qualify as a REIT will result in the shares being automatically transferred to a trustee for a charitable trust or, if the transfer to the charitable trust is not automatically effective to prevent a violation of the share ownership limits or the restrictions on ownership and transfer of our shares, any such transfer of our shares will be void ab initio. Further, any transfer of our shares that would result in our shares being beneficially owned by fewer than 100 persons will be void ab initio.

#### U.S. Federal Income Tax Risks

Your investment has various U.S. federal, state, and local income tax risks.

We strongly urge you to consult your own tax advisor concerning the effects of U.S. federal, state, and local income tax law on an investment in our common shares and on your individual tax situation.

Our failure to qualify as a REIT would subject us to U.S. federal, state and local income taxes, which could adversely affect the value of our common shares and would substantially reduce the cash available for distribution to our shareholders.

We believe that, commencing with our short taxable year ended December 31, 2013, we have been organized in conformity with, and have operated in a manner that has enabled us to meet, the requirements for qualification as a REIT under the Code. While we intend to continue to operate in a manner that will enable us to remain qualified as a REIT, we cannot assure you that we will remain qualified as a REIT.

The U.S. federal income tax laws governing REITs are complex, and interpretations of the U.S. federal income tax laws governing qualification as a REIT are limited. Qualifying as a REIT requires us to meet various tests regarding the nature of our assets, our income and our earnings and profits, or "E&P" (calculated pursuant to Code Sections 316 and 857(d) and the regulations thereunder), the ownership of our outstanding stock, and the amount of our distributions on an ongoing basis. Our ability to satisfy the asset tests depends upon the characterization and fair market values of our assets, some of which are not susceptible to a precise determination. Our compliance with the REIT income and asset tests and the accuracy of our tax reporting to shareholders also depend upon our ability to successfully manage the calculation and composition of our gross and net taxable income, our E&P and our assets on an ongoing basis. Although we intend to operate so as to maintain our qualifications as a REIT, given the complex nature of the rules governing REITs, the ongoing importance of factual determinations, including the potential tax treatment of the investments we make, and the possibility of future changes in our circumstances, no assurance can be given that our actual results of operations for any particular taxable year will satisfy such requirements.

If we fail to qualify as a REIT in any calendar year, and do not qualify for certain statutory relief provisions, we would be required to pay U.S. federal income tax (and any applicable state and local taxes), including, for taxable years prior to 2018, any applicable alternative minimum tax, on our taxable income at regular corporate rates (for federal income tax purposes a maximum rate of 35% applies through 2017 and a 21% rate applies for 2018), and dividends paid to our shareholders would not be deductible by us in computing our taxable income (although such dividends received by certain non-corporate U.S. taxpayers generally would be subject to a preferential rate of taxation). Further, if we



fail to qualify as a REIT, we might need to borrow money or sell assets in order to pay any resulting tax. Our payment of income tax would decrease the amount of our income available for distribution to our shareholders. Furthermore, if we fail to maintain our qualification as a REIT, we no longer would be required under U.S. federal tax laws to distribute substantially all of our REIT taxable income to our shareholders. Unless our failure to qualify as a REIT was subject to relief under the U.S. federal tax laws, we could not re-elect to qualify as a REIT until the fifth calendar year following the year in which we failed to qualify.

Complying with REIT requirements may cause us to forego or liquidate otherwise attractive investments. To qualify as a REIT, we must continually satisfy various tests regarding the sources of our income, the nature and diversification of our assets, the amounts we distribute to our shareholders and the ownership of our shares of beneficial interest. In order to meet these tests, we may be required to forego investments we might otherwise make. We may be required to pay dividends to shareholders at disadvantageous times or when we do not have funds readily available for distribution, and may be unable to pursue investments that would be otherwise advantageous to us in order to satisfy the source of income or asset diversification requirements for qualifying as a REIT. Thus, compliance with the REIT requirements may hinder our investment performance.

In particular, we must ensure that at the end of each calendar quarter, at least 75% of the value of our total assets consists of cash, cash items, government securities and qualified REIT real estate assets, including RMBS. The remainder of our investment in securities (other than government securities and qualified REIT real estate assets) generally cannot include more than 10% of the outstanding voting securities of any one issuer or more than 10% of the total value of the outstanding securities of any one issuer. In addition, in general, no more than 5% of the value of our total assets (other than government securities, TRS securities and qualified REIT real estate assets) can consist of the securities of any one issuer, and no more than 20% of the value of our total assets can be represented by securities of one or more TRSs. Generally, if we fail to comply with these requirements at the end of any calendar quarter, we must correct the failure within 30 days after the end of the calendar quarter or qualify for certain statutory relief provisions to avoid losing our REIT qualification and becoming subject to U.S. federal income tax (at a 35% rate through 2017 and a 21% rate in 2018) and any applicable state and local taxes on all of our income. As a result, we may be required to liquidate from our portfolio otherwise attractive investments or contribute such investments to a TRS, in which event they will be subject to regular corporate U.S. federal, state and local taxes assuming that the TRS is organized in the United States. These actions could have the effect of reducing our income and amounts available for distribution to our shareholders.

Failure to make required distributions would subject us to tax, which would reduce the cash available for distribution to our shareholders.

To qualify as a REIT, we must distribute to our shareholders each calendar year at least 90% of our REIT taxable income (including certain items of non-cash income), determined excluding any net capital gains and without regard to the deduction for dividends paid. To the extent that we satisfy the 90% distribution requirement, but distribute less than 100% of our taxable income, we will be subject to U.S. federal corporate income tax (at a 35% rate through 2017 and a 21% rate in 2018) on our undistributed income. In addition, we will incur a 4% nondeductible excise tax on the amount, if any, by which our distributions in any calendar year are less than the sum of:

- 85% of our REIT ordinary income for that year;
- 95% of our REIT capital gain net income for that year; and
- any undistributed taxable income from prior years.

We intend to distribute our taxable income to our shareholders in a manner intended to satisfy the 90% distribution requirement and to avoid the corporate income tax. However, there is no requirement that TRSs distribute their after-tax net income to their parent REIT.

Our taxable income may substantially exceed our net income as determined based on GAAP, because, for example, realized capital losses will be deducted in determining our GAAP net income, but may not be deductible in computing our taxable income. In addition, we may invest in assets that generate taxable income in excess of economic income or in advance of the corresponding cash flow from the assets. As a result of the foregoing, we may generate less cash flow than taxable income in a particular year. To the extent that we generate such non-cash taxable income in a taxable year, we may incur corporate income tax and the 4% nondeductible excise tax on that income if we do not distribute such income to shareholders in that year. In that event, we may be required to use cash reserves, incur debt, sell assets, make taxable distributions of our shares or debt securities or liquidate non-cash assets at rates or at times that we regard as unfavorable to satisfy the distribution requirement and to avoid corporate income tax and the 4% nondeductible excise tax in that year.

Determination of our REIT taxable income involves the application of highly technical and complex Code provisions for which only limited judicial and administrative authorities exist. If the IRS disagrees with our determination, it could affect our satisfaction of the distribution requirement. Under certain circumstances, we may be able to correct a

failure to meet the distribution requirement for a year by paying "deficiency dividends" to our shareholders in a later year. We may include such deficiency dividends in our deduction for dividends paid for the earlier year. Although we may be able to avoid income tax on amounts distributed as deficiency dividends, we will be required to pay interest and a penalty to the IRS based upon the amount of any deduction we take for deficiency dividends.

Even if we qualify as a REIT, we may face other tax liabilities that reduce our cash flows.

Even if we qualify for taxation as a REIT, we may be subject to certain U.S. federal, state and local taxes on our income and assets, including taxes on any undistributed income, tax on income from some activities conducted as a result of a foreclosure, and state or local income, property and transfer taxes. In addition, any TRSs we form will be subject to regular corporate U.S. federal, state and local taxes. Any of these taxes would decrease cash available for distributions to shareholders.

The failure of RMBS subject to a repurchase agreement to qualify as real estate assets would adversely affect our ability to qualify as a REIT.

We have entered into repurchase agreements under which we nominally sell certain of our RMBS to a counterparty and simultaneously enter into an agreement to repurchase the sold assets. We believe that, for U.S. federal income tax purposes, these transactions will be treated as secured debt and we will be treated as the tax owner of the RMBS that are the subject of any such repurchase agreement, notwithstanding that such agreements may transfer record ownership of such assets to the counterparty during the term of the agreement. It is possible, however, that the IRS could successfully assert that we do not own the RMBS during the term of the repurchase agreement, in which case we could fail to qualify as a REIT.

Our ability to engage in TBA transactions could be limited by the requirements necessary to qualify as a REIT, and we could fail to qualify as a REIT as a result of these investments.

We purchase or sell TBAs primarily for purposes of managing interest rate risk associated with our liabilities under repurchase agreements. We generally treat such TBA purchases and sales as hedging transactions that hedge indebtedness incurred to acquire or carry real estate assets, or "qualifying liability hedges," for REIT purposes. We may, from time to time, opportunistically engage in TBA transactions because we find them attractive on their own. The law is unclear regarding whether income and gains from TBAs that are not qualifying liability hedges are qualifying income for the 75% gross income test and whether TBAs are qualifying assets for the 75% asset test.

To the extent that we engage in TBA transactions that are not qualifying liability hedges for REIT purposes, unless we receive a favorable private letter ruling from the IRS or we are advised by counsel that income and gains from such TBAs should be treated as qualifying income for purposes of the 75% gross income test, we will limit our income and gains from such TBAs and any non-qualifying income to no more than 25% of our gross income for each calendar year. Further, unless we receive a favorable private letter ruling from the IRS or we are advised by counsel that TBAs should be treated as qualifying assets for purposes of the 75% asset test, we will limit our investment in such TBAs and any non-qualifying assets to no more than 25% of our total assets at the end of any calendar quarter and will limit the TBAs held by us that are issued by any one issuer to no more than 5% of our total assets at the end of any calendar quarter. Accordingly, our ability to purchase and sell Agency RMBS through TBAs and to hold or dispose of TBAs, through roll transactions or otherwise, could be limited.

Moreover, even if we are advised by counsel that such TBAs should be treated as qualifying assets or that income and gains from such TBAs should be treated as qualifying income, it is possible that the IRS could successfully take the position that such assets are not qualifying assets and such income is not qualifying income. In that event, we could be subject to a penalty tax or we could fail to qualify as a REIT if (i) the value of our TBAs, together with our other non-qualifying assets for the 75% asset test, exceeded 25% of our total assets at the end of any calendar quarter, (ii) the value of our TBAs issued by any one issuer exceeds 5% of our total assets at the end of any calendar quarter, or (iii) our income and gains from our TBAs that are not qualifying liability hedges, together with our non-qualifying income for the 75% gross income test, exceeded 25% of our gross income for any taxable year.

Complying with REIT requirements may limit our ability to hedge effectively.

The REIT provisions of the Code substantially limit our ability to hedge. Our aggregate gross income from non-qualifying hedges, fees, and certain other non-qualifying sources cannot exceed 5% of our annual gross income. As a result, we might have to limit our use of advantageous hedging techniques or implement those hedges through a TRS. Any hedging income earned by a TRS would be subject to U.S. federal, state and local income tax at regular corporate rates. This could increase the cost of our hedging activities or expose us to greater risks associated with interest rate changes or other changes than we would otherwise want to bear.

Our ownership of and relationship with any TRSs that we form will be limited and a failure to comply with the limits would jeopardize our REIT status and may result in the application of a 100% excise tax.

A REIT may own up to 100% of the stock of one or more TRSs. A TRS may earn income that would not be qualifying income if earned directly by the parent REIT. Both the subsidiary and the REIT must jointly elect to treat the subsidiary as a TRS. A corporation (other than a REIT) of which a TRS directly or indirectly owns more than 35% of the voting power or value

of the stock will automatically be treated as a TRS. Overall, no more than 20% of the value of a REIT's total assets may consist of stock or securities of one or more TRSs. The TRS rules limit the deductibility of interest paid or accrued by a TRS to its parent REIT to assure that the TRS is subject to an appropriate level of corporate taxation. The rules also impose a 100% excise tax on certain transactions between a TRS and its parent REIT that are not conducted on an arm's-length basis. Any domestic TRS that we may form will pay U.S. federal, state and local income tax on its taxable income at regular corporate tax rates, and its after-tax net income will be available for distribution to us but is not required to be distributed to us. In certain circumstances, the ability to deduct interest expense by any TRS that we may form could be limited.

Our ownership limitation may restrict change of control or business combination opportunities in which our shareholders might receive a premium for their common shares.

In order for us to qualify as a REIT, no more than 50% in value of our outstanding shares may be owned, directly or indirectly, by five or fewer individuals during the last half of any calendar year. "Individuals" for this purpose include natural persons, private foundations, some employee benefit plans and trusts, and some charitable trusts. In order to help us qualify as a REIT, among other purposes, our declaration of trust generally prohibits any person from beneficially or constructively owning more than 9.8% in value or in number of shares, whichever is more restrictive, of the outstanding shares of any class or series of our shares.

The ownership limitation and other restrictions could have the effect of discouraging a takeover or other transaction in which holders of our common shares might receive a premium for their common shares over the then-prevailing market price or which holders might believe to be otherwise in their best interests.

Dividends payable by REITs do not qualify for the reduced tax rates available for "qualified dividend income." The maximum U.S. federal income tax rate applicable to "qualified dividend income" paid to U.S. taxpayers taxed at individual rates is currently 20%. Dividends payable by REITs, however, generally are not eligible for the reduced rates on qualified dividend income. For taxable years beginning after December 31, 2017 and before January 1, 2026, under the TCJA non-corporate taxpayers may deduct up to 20% of certain pass-through business income, including "qualified REIT dividends" (generally, dividends received by a REIT shareholder that are not designated as capital gain dividends or qualified dividend income), subject to certain limitations, resulting in an effective maximum U.S. federal income tax rate of 29.6% on such income. Although the reduced U.S. federal income tax rate applicable to qualified dividend income does not adversely affect the taxation of REITs or dividends payable by REITs, the more favorable rates applicable to regular corporate qualified dividends and the reduced corporate tax rate (21% beginning in 2018) could cause investors who are taxed at individual rates and regulated investment companies to perceive investments in the stocks of REITs to be relatively less attractive than investments in the stocks of non-REIT corporations that pay dividends treated as qualified dividend income, which could adversely affect the value of the stock of REITs, including our common shares.

We may be subject to adverse legislative or regulatory tax changes that could reduce the market price of our common shares.

At any time, the U.S. federal income tax laws or regulations governing REITs or the administrative interpretations of those laws or regulations may be amended. We cannot predict when or if any new U.S. federal income tax law, regulation or administrative interpretation, or any amendment to any existing U.S. federal income tax law, regulation or administrative interpretation, will be adopted, promulgated or become effective and any such law, regulation or interpretation may take effect retroactively. The TCJA significantly changes the U.S. federal income tax laws applicable to businesses and their owners, including REITs and their shareholders. Technical corrections or other amendments to the TCJA or administrative guidance interpreting the TCJA may be forthcoming at any time. We cannot predict the long-term effect of the TCJA or assure our shareholders that any such changes will not adversely affect the taxation of a shareholder. We and our shareholders could be adversely affected by any such change in, or any new, U.S. federal income tax law, regulation or administrative interpretation.

Certain financing activities may subject us to U.S. federal income tax and could have negative tax consequences for our shareholders.

We currently do not intend to enter into any transactions that could result in our, or a portion of our assets, being treated as a taxable mortgage pool for U.S. federal income tax purposes. If we enter into such a transaction in the future we will be taxable at the highest corporate income tax rate on a portion of the income arising from a taxable

mortgage pool, referred to as "excess inclusion income," that is allocable to the percentage of our shares held in record name by disqualified organizations (generally tax-exempt entities that are exempt from the tax on unrelated business taxable income, such as state pension plans and charitable remainder trusts and government entities). In that case, under our declaration of trust, we could reduce distributions to such shareholders by the amount of tax paid by us that is attributable to such shareholder's ownership.

If we were to realize excess inclusion income, IRS guidance indicates that the excess inclusion income would be allocated among our shareholders in proportion to our dividends paid. Excess inclusion income cannot be offset by losses of our shareholders. If the shareholder is a tax-exempt entity and not a disqualified organization, then this income would be fully taxable as unrelated business taxable income under Section 512 of the Code. If the shareholder is a foreign person, it would be subject to U.S. federal income tax at the maximum tax rate and withholding will be required on this income without reduction or exemption pursuant to any otherwise applicable income tax treaty. Our recognition of "phantom" income may reduce a shareholder's after-tax return on an investment in our common shares.

We may recognize taxable income in excess of our economic income, known as phantom income, in the first years that we hold certain investments, and experience an offsetting excess of economic income over our taxable income in later years. As a result, shareholders at times may be required to pay U.S. federal income tax on distributions taxable as dividends that economically represent a return of capital rather than a dividend. These distributions would be offset in later years by distributions that would be treated as returns of capital for U.S. federal income tax purposes. Taking into account the time value of money, this acceleration of U.S. federal income tax liabilities may reduce a shareholder's after-tax return on his or her investment to an amount less than the after-tax return on an investment with an identical before-tax rate of return that did not generate phantom income.

Liquidation of our assets may jeopardize our REIT qualification.

To maintain our qualification as a REIT, we must comply with requirements regarding our assets and our sources of income. If we are compelled to liquidate our assets to repay obligations to our lenders or for other reasons, we may be unable to comply with these requirements, thereby jeopardizing our qualification as a REIT, or we may be subject to a 100% tax on any resultant gain if we sell assets that are treated as inventory or property held primarily for sale to customers in the ordinary course of business.

Our qualification as a REIT and exemption from U.S. federal income tax with respect to certain assets may be dependent on the accuracy of legal opinions or advice rendered or given or statements by the issuers of assets that we acquire, and the inaccuracy of any such opinions, advice or statements may adversely affect our REIT qualification and result in significant corporate-level tax.

When purchasing securities, we may rely on opinions or advice of counsel for the issuer of such securities, or statements made in related offering documents, for purposes of determining whether such securities represent debt or equity securities for U.S. federal income tax purposes, the value of such securities, and also to what extent those securities constitute qualified real estate assets for purposes of the REIT asset tests and produce income which qualifies under the 75% gross income test. The inaccuracy of any such opinions, advice or statements may adversely affect our REIT qualification and result in significant corporate-level tax.

#### Item 1B. Unresolved Staff Comments

None.

#### Item 2. Properties

We do not own any properties. Our principal offices are located in leased space at 53 Forest Avenue, Old Greenwich, CT 06870. The offices of our Manager and Ellington are at the same location. As part of our management agreement, our Manager is responsible for providing offices necessary for all operations, and accordingly, all lease responsibilities belong to our Manager.

#### Item 3. Legal Proceedings

Neither we nor Ellington nor its affiliates (including our Manager) are currently subject to any legal proceedings that we or our Manager consider material. Nevertheless, we and Ellington and its affiliates operate in highly regulated markets that currently are under regulatory scrutiny, and Ellington and its affiliates have received, and we expect in the future that we and they may receive, inquiries and requests for documents and information from various federal, state and foreign regulators. For example, in January 2017, an affiliate of Ellington received a subpoena from the SEC requesting documents, communications, and other information relating primarily to a loan originator and the loans originated by such originator, such affiliate's analyses of such loans, the purchases and securitizations of such loans by such affiliate and by certain third parties, and the servicing of such loans. Ellington's affiliate has responded to the subpoena and intends to continue to cooperate with any further requests. Ellington has advised us that, at the present time, it is not aware that any material legal proceeding against us or Ellington or its





affiliates is contemplated in connection with any such inquiries or requests. We and Ellington cannot provide any assurance that these or any future such inquiries and requests will not result in further investigation of or the initiation of a proceeding against us or Ellington or its affiliates or that, if any such investigation or proceeding were to arise, it would not materially adversely affect us. For a discussion of certain risks to which we or Ellington or its affiliates could be exposed as a result of inquiries or requests for documents and information received by us or Ellington or its affiliates, see "Risk Factors—We or Ellington or its affiliates may be subject to regulatory inquiries or proceedings" included in Part 1A of our Annual Report on Form 10-K for the year ended December 31, 2017.

#### Item 4. Mine Safety Disclosures

Not applicable.

## PART II

### Item 5. Market for Registrant's Common Equity, Related Shareholders Matters, and Issuer Purchases of Equity Securities

#### Market Information

Our common shares have been listed on the New York Stock Exchange ("NYSE") under the symbol "EARN" since May 1, 2013. The following table sets forth, for the periods indicated, the high and low sales prices for our common shares:

	Common Stock Sales Price	
	High	Low
2017:		
First Quarter	\$ 14.83	\$ 12.82
Second Quarter	15.74	13.96
Third Quarter	14.96	13.44
Fourth Quarter	14.65	12.01
2016:		
First Quarter	\$ 12.90	\$ 9.57
Second Quarter	13.30	11.72
Third Quarter	14.43	12.84
Fourth Quarter	13.92	12.21

The closing price for our common shares on March 9, 2018, was \$11.20.

#### Holder of Our Common Shares

Based upon a review of a securities position listing as of March 9, 2018, we had an aggregate of 109 holders of record and holders of our common shares who are nominees for an undetermined number of beneficial owners.

#### Dividends

To qualify as a REIT, we must distribute annually to our shareholders an amount at least equal to 90% of our REIT taxable income, determined excluding any net capital gains and without regard to the deduction for dividends paid. We currently expect to distribute substantially all of our REIT taxable income to our shareholders. We will be subject to income tax on our taxable income that is not distributed and to an excise tax to the extent that certain percentages of our taxable income are not distributed by specified dates.

We pay dividends only upon the authorization of our Board of Trustees. Our ability to pay dividends to our shareholders will depend upon the performance of our investment portfolio, and, in turn, upon our Manager's management of our business. Dividends will be paid in cash to the extent that cash is available for distribution. We may not be able to generate sufficient net interest income to pay dividends to our shareholders. In addition, our Board of Trustees may change our distribution policy in the future.

To the extent that our cash available for distribution is less than the amount required to be distributed under the REIT provisions of the Code, we may consider various funding sources to cover any shortfall, including selling certain of our assets, borrowing funds, or using a portion of the net proceeds we receive from offerings of our common shares (and thus all or a



portion of such distributions may constitute a return of capital for U.S. federal income tax purposes). We also may elect to pay all or a portion of any dividend in the form of a taxable distribution of our shares or debt securities. The following table sets forth the dividends per share we have paid to our shareholders with respect to the periods indicated.

	Dividend Per Share	Record Date	Payment Date
For the year ended December 31, 2017:			
First Quarter	\$0.40	March 31, 2017	April 25, 2017
Second Quarter	0.40	June 30, 2017	July 25, 2017
Third Quarter	0.40	September 29, 2017	October 25, 2017
Fourth Quarter	0.37	December 29, 2017	January 25, 2018
For the year ended December 31, 2016:			
First Quarter	\$0.45	March 31, 2016	April 25, 2016
Second Quarter	0.40	June 30, 2016	July 27, 2016
Third Quarter	0.40	September 30, 2016	October 25, 2016
Fourth Quarter	0.40	December 30, 2016	January 25, 2017

We cannot assure you that we will pay any future dividends to our shareholders and the dividends set forth in the table above are not intended to be indicative of the amount and timing of future dividends, if any.

#### Equity Compensation Plan Information

The following table sets forth information as of December 31, 2017 with respect to compensation plans under which equity securities of our Company are authorized for issuance. We have no such plans that were not approved by our shareholders.

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of our outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders	15,945 <sup>(1)</sup>	N/A	340,461 <sup>(2)</sup>

(1) There are 15,945 restricted Common Shares outstanding pursuant to our 2013 Equity Incentive Plan.

The number of Common Shares that may be issued under the 2013 Equity Incentive Plan will be increased in an amount that results from multiplying 3% and the total number of Common Shares sold in any future public or private offering of our Common Shares, subject to a maximum of 1,500,000 shares.

#### Unregistered Sales of Equity Securities

Pursuant to our 2013 Equity Incentive Plan, on December 12, 2017, we granted 4,413 restricted common shares to our partially dedicated employees. The restricted common shares are subject to forfeiture restrictions that will lapse with respect to 2,630 of the common shares on December 12, 2018 and 1,783 of the common shares on December 12, 2019. Such grants were exempt from the registration requirements of the Securities Act based on the exemption provided in Section 4(a)(2) of the Securities Act.



Performance

This performance graph is furnished and shall not be deemed filed with the SEC or subject to Section 18 of the Exchange Act, nor shall it be deemed incorporated by reference in any of our filings under the Securities Act of 1933, as amended.

The following graph provides a comparison of the cumulative total return on our common shares to the cumulative total return on the Standard & Poor's 500 Composite Stock Price Index, or the "S&P 500," and the FTSE National Association of Real Estate Investment Trusts Mortgage REIT Index, or the "FTSE NAREIT MREIT." The comparison is for the period from May 1, 2013, the day our common shares commenced trading on the NYSE, to December 31, 2017, and assumes in each case, a \$100 investment on May 1, 2013 and the reinvestment of dividends. The actual cumulative total returns shown on the graph above are as follows:

		December 31,				
	May 1, 2013	2013	2014	2015	2016	2017
Ellington Residential Mortgage REIT	\$ 100.00	\$ 85.95	\$ 103.55	\$ 90.63	\$ 108.46	\$ 112.14
S&P 500	100.00	118.52	134.73	136.58	152.91	186.28
FTSE NAREIT MREIT	100.00	83.44	98.34	89.69	110.17	131.93

The performance information above has been obtained from sources believed to be reliable, but neither its accuracy or completeness can be guaranteed. The historical information set forth above is not necessarily indicative of future performance. Accordingly, we do not make or endorse any predictions as to future share performance.

## Item 6. Selected Financial Data

The following table presents selected consolidated financial information as of December 31, 2017, 2016, 2015, 2014, and 2013, and for the years ended December 31, 2017, 2016, 2015, 2014, and 2013. The consolidated financial information presented below as of December 31, 2017 and 2016 and for the years ended December 31, 2017, 2016, and 2015, has been derived from our audited financial statements included elsewhere in this Annual Report on Form 10-K. The consolidated financial information as of December 31, 2015, 2014 and 2013, and the year ended December 31, 2014 and 2013, was derived from our historical audited consolidated financial statements not included in this Annual Report on Form 10-K.

Since the information presented below is only selected financial data and does not provide all of the information contained in our historical consolidated financial statements included elsewhere in this Annual Report on Form 10-K, including the related notes, you should read it in conjunction with "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations," and our historical consolidated financial statements, including the related notes to our consolidated financial statements, included in this Annual Report on Form 10-K.

## Condensed Statement of Operations

(In thousands except for per share amounts)	Year Ended December 31,				
	2017	2016	2015	2014	2013
Net Interest Income					
Net interest income	\$30,143	\$24,224	\$34,515	\$42,313	\$24,810
Expenses					
Management fees	2,678	2,129	2,304	2,285	2,066
Professional fees	737	668	574	986	624
Compensation expense	775	599	621	678	401
Insurance expense <sup>(1)</sup>	304	361	408	476	330
Other operating expenses <sup>(1)</sup>	1,208	1,252	1,238	1,327	905
Total Expenses	5,702	5,009	5,145	5,752	4,326
Other Income (Loss)					
Net realized and change in net unrealized gains (losses) on securities	(7,175 )	(1,676 )	(9,327 )	51,007	(63,602 )
Net realized and change in net unrealized gains (losses) on financial derivatives	(6,478 )	(5,633 )	(20,013 )	(71,400 )	41,204
Total Other Income (Loss)	(13,653 )	(7,309 )	(29,340 )	(20,393 )	(22,398 )
Net Income (Loss)	\$10,788	\$11,906	\$30	\$16,168	\$(1,914 )
Net Income (Loss) Per Common Share	\$0.93	\$1.31	\$—	\$1.77	\$(0.29 )
Cash Dividends Declared Per Common Share	\$1.57	\$1.65	\$2.00	\$2.20	\$1.14

(1) Conformed to current period presentation.

## Condensed Consolidated Balance Sheet

(In thousands except for share amounts)	As of December 31,				
	2017	2016	2015	2014	2013
<b>Assets</b>					
Cash and cash equivalents	\$56,117	\$33,504	\$40,166	\$45,237	\$50,112
Mortgage-backed securities, at fair value	1,685,998	1,226,994	1,242,266	1,393,303	1,326,036
Due from brokers	26,754	49,518	33,297	18,531	18,347
Financial derivatives—assets, at fair value	8,792	6,008	2,183	3,072	34,963
Reverse repurchase agreements	81,461	75,012	78,632	13,987	—
Receivable for securities sold	21,606	33,199	155,526	41,834	76,692
Other assets	6,359	4,899	4,614	5,110	4,940
<b>Total Assets</b>	<b>\$1,887,087</b>	<b>\$1,429,134</b>	<b>\$1,556,684</b>	<b>\$1,521,074</b>	<b>\$1,511,090</b>
<b>Liabilities and Shareholders' Equity</b>					
<b>Liabilities</b>					
Repurchase agreements	\$1,597,206	\$1,197,973	\$1,222,719	\$1,323,080	\$1,310,347
Payable for securities purchased	3,830	5,516	98,949	4,227	2,776
Due to brokers	489	1,055	439	583	22,788
Financial derivatives—liabilities, at fair value	1,863	1,975	4,725	8,700	1,069
U.S. Treasury securities sold short, at fair value	81,289	74,194	78,447	13,959	—
Dividend payable	4,936	3,652	4,111	5,032	4,570
Other liabilities	4,771	3,092	2,439	2,128	2,360
<b>Total Liabilities</b>	<b>1,694,384</b>	<b>1,287,457</b>	<b>1,411,829</b>	<b>1,357,709</b>	<b>1,343,910</b>
<b>Shareholders' Equity</b>					
Preferred shares, par value \$0.01 per share, 100,000,000 shares authorized; (0 shares issued and outstanding, respectively)	—	—	—	—	—
Common shares, par value \$0.01 per share, 500,000,000 shares authorized; (13,340,217, 9,130,897, 9,135,103, 9,149,274, and 9,139,842 shares issued and outstanding, respectively)	134	92	92	91	91
Additional paid-in-capital	240,062	180,996	181,027	181,282	181,147
Accumulated deficit	(47,493)	(39,411)	(36,264)	(18,008)	(14,058)
<b>Total Shareholders' Equity</b>	<b>192,703</b>	<b>141,677</b>	<b>144,855</b>	<b>163,365</b>	<b>167,180</b>
<b>Total Liabilities and Shareholders' Equity</b>	<b>\$1,887,087</b>	<b>\$1,429,134</b>	<b>\$1,556,684</b>	<b>\$1,521,074</b>	<b>\$1,511,090</b>

## Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

## Executive Summary

We are a Maryland real estate investment trust, or "REIT," formed in August 2012 that specializes in acquiring, investing in, and managing residential mortgage- and real estate-related assets. Our primary objective is to generate attractive current yields and risk-adjusted total returns for our shareholders by making investments that we believe compensate us appropriately for the risks associated with them. We seek to attain this objective by constructing and actively managing a portfolio consisting primarily of residential mortgage-backed securities, or "RMBS," for which the principal and interest payments are guaranteed by a U.S. government agency or a U.S. government-sponsored entity, or "Agency RMBS," and, to a lesser extent, RMBS that do not carry such guarantees, or "non-Agency RMBS," such as RMBS backed by prime jumbo, Alternative A-paper, manufactured housing, and subprime residential mortgage loans. We also may opportunistically acquire and manage other types of residential mortgage-related and real estate-related asset classes, such as residential mortgage loans, mortgage servicing rights, or "MSRs," and credit risk transfer securities, or "CRTs." We believe that being able to combine Agency RMBS with non-Agency RMBS and other residential mortgage- and real estate-related asset classes enables us to balance a range of mortgage-related risks.

We were formed through an initial strategic venture among affiliates of Ellington Management Group, L.L.C., an





investment management firm and registered investment adviser with a 23-year history of investing in a broad spectrum of MBS and related derivatives, with an emphasis on the RMBS market, and the Blackstone Tactical Opportunity Funds, or the "Blackstone Funds." As of December 31, 2017, the Blackstone Funds owned approximately 20% of our outstanding common shares. We are externally managed and advised by Ellington Residential Mortgage Management LLC, or our "Manager," an affiliate of Ellington Management Group, L.L.C.

In the second quarter of 2017, we completed a follow-on common share offering whereby we sold 3,230,000 shares for net proceeds of \$45.0 million, after offering costs and underwriters' discounts.

Additionally we commenced an "at-the-market" offering program, or "ATM program," by entering into equity distribution agreements with third party sales agents under which we are authorized to offer and sell common shares from time to time with a maximum aggregate gross offering price of up to \$100.0 million. During the year ended December 31, 2017 we issued 964,968 common shares under the ATM program, generating net proceeds of \$14.0 million after third party agent commissions and fees of \$0.2 million.

As a result of the equity raises, we expanded our capital base by \$58.9 million year over year and correspondingly lowered our expense ratio by 0.2%.

We use leverage in our Agency RMBS strategy and, while we have not done so meaningfully to date, we may use leverage in our non-Agency RMBS strategy as well, although we expect such leverage to be lower. We have financed our purchases of Agency RMBS exclusively through repurchase agreements, which we account for as collateralized borrowings. As of December 31, 2017, we had outstanding borrowings under repurchase agreements in the amount of \$1.6 billion with fifteen counterparties.

We have elected to be taxed as a REIT for U.S. federal income tax purposes. Accordingly, we generally will not be subject to U.S. federal income taxes on our taxable income that we distribute currently to our shareholders as long as we maintain our qualification as a REIT. We intend to conduct our operations so that neither we nor any of our subsidiaries is required to register as an investment company under the Investment Company Act of 1940, as amended, or the "Investment Company Act."

As of December 31, 2017, our book value per share was \$14.45, as compared to \$15.52 as of December 31, 2016.

#### Trends and Recent Market Developments

The U.S. Federal Reserve, or "Federal Reserve," raised the target range for the federal funds rate three times in 2017, and ended the year with a target range of 1.25%–1.50%. The market is currently expecting several additional interest rate hikes in 2018.

During each quarter of 2017, the yield curve flattened. Over the course of the year, the 2-year U.S. Treasury yield increased 70 basis points and finished the year at 1.88%, while the 10-year U.S. Treasury yield decreased 4 basis points to 2.41%. At year end, the spread between the 2-year U.S. Treasury yield and 10-year U.S. Treasury yield was just 52 basis points, compared to 126 basis points at the end of 2016.

In October 2017, the Federal Reserve initiated its balance sheet normalization program, pursuant to which it began tapering asset purchases of both U.S. Treasury securities and Agency RMBS, with the objective that its securities portfolio will run off according to a well-defined schedule until reaching a level no larger "than necessary to implement monetary policy efficiently and effectively." For Agency RMBS, the pace of balance sheet reduction began at \$4 billion per month during the fourth quarter of 2017, for an aggregate Agency RMBS balance sheet reduction amount of \$12 billion in 2017. Beginning in January 2018, the monthly balance sheet reduction amount increased to \$8 billion, and is set to increase an additional \$4 billion at the beginning of each subsequent quarter of 2018, resulting in cumulative scheduled Agency RMBS balance sheet reductions of \$168 billion for 2018.

Mortgage rates decreased during the first nine months of 2017 before reversing course in the fourth quarter. The Freddie Mac survey 30-year mortgage rate fell 49 basis points between year-end 2016 and September 30, 2017, and then rose 16 basis points to end 2017 at 3.99%. Overall Agency RMBS prepayment rates were relatively stable during the year. The Mortgage Bankers Association's Refinance Index, which measures refinancing application volumes, finished 2017 almost exactly where it began the year and substantially below the multi-year high reached in mid-2016.

Data released by S&P Dow Jones Indices for its S&P CoreLogic Case-Shiller Indices for December 2017 showed, on average, a continuation of mid-single-digit home price appreciation nationally, with home prices posting a 6.3% year-over-year increase for its 20-City Composite and a 6.0% year-over-year increase for its 10-City Composite, after

seasonal adjustments.

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Data from the Federal Reserve Bank of New York's Quarterly Report on Household Debt and Credit indicated that aggregate household debt balances increased 4.5% year over year to \$13.15 trillion in 2017, which is \$473 billion higher than the previous peak of \$12.68 trillion reached in the third quarter of 2008. The University of Michigan's Index of Consumer Sentiment increased 5.3% in 2017, indicating consumers hold a favorable assessment of the economy and their current financial condition.

•The Tax Cuts and Jobs Act, or "TCJA," was enacted in December, resulting in significant changes to the U.S. tax code.

The year ended December 31, 2017 proved to be one of the least volatile years for interest rates on record, despite three interest rate hikes from the Federal Reserve, a new administration in Washington, significant geopolitical uncertainties, and the first pullback in quantitative easing in a decade. Over the course of the year, the 10-year U.S. Treasury yield traded within a 59-basis point range, which was the tightest annual range in over 50 years, and ended the year only 4 basis points lower than where it began. As long-term interest rates remained range-bound, short-term rates rose, and the yield curve consistently flattened each quarter in 2017.

Both the Merrill Lynch Option Volatility Estimate Index, or MOVE Index, and Chicago Board Options Exchange Volatility Index, known as the VIX, declined over the course of 2017 and reached all-time lows in the fourth quarter. Meanwhile, U.S. equities trended steadily upward in 2017, finishing the year near all-time highs after receiving a boost from the passage of the TCJA in December, and in particular from anticipation of the lowering of corporate income tax rates starting in 2018.

Credit spreads in most sectors declined over the course of 2017, and ended the year at or near the tightest points of their trailing three-year ranges. Demand remained strong throughout 2017 for floating-rate debt instruments, including CLOs and leveraged loans, as rising LIBOR rates throughout the year—including a particularly steep rise in LIBOR towards the end of the year—boosted coupons. CMBS yield spreads ended 2017 tighter than the prior year. Over the course of 2017, the CMBS market appeared to have successfully navigated—without much adverse impact—both the new risk retention regulations and the large volume of commercial mortgages that matured from pre-crisis CMBS. Legacy non-Agency RMBS also performed well throughout the year, although a large number of these bonds received reduced National Association of Insurance Commissioners, or "NAIC," ratings in December that caused price declines. The reduced NAIC ratings removed a strong technical factor that had been supporting the market for these bonds.

For the first eight months of the year, Agency RMBS yield spreads failed to tighten in sympathy with credit spreads. However, after the Federal Reserve's announcement in September of the initiation of its tapering program, Agency RMBS yield spreads tightened significantly, suggesting that many investors had been waiting for policy clarity before adding Agency RMBS exposure. On a year-over-year basis, Agency RMBS option adjusted spreads finished tighter as the market seemingly absorbed the initiation of the Federal Reserve's balance sheet runoff without issue.

Mortgage REIT buying of Agency RMBS also increased substantially following a number of equity raises, suggesting that private capital might be able to replace the Federal Reserve's footprint in this market. In 2017, residential mortgage REITs raised approximately \$8.3 billion of capital, representing over \$40 billion of Agency RMBS buying power. At the same time, low interest rate volatility and a muted prepayment environment provided a significant tailwind to the sector. As measured by the Bloomberg Barclays U.S. MBS Agency Fixed Rate Index, Agency RMBS generated an excess return over the Bloomberg Barclays U.S. Treasury Index of 52 basis points in 2017.

#### Portfolio Overview and Outlook

As of December 31, 2017, our mortgage-backed securities portfolio consisted of \$1.556 billion of fixed-rate Agency "specified pools," \$29.6 million of Agency RMBS backed by adjustable rate mortgages, or "Agency ARMs," \$70.6 million of Agency reverse mortgage pools, \$12.2 million of Agency interest only securities, or "Agency IOs," and \$18.0 million of non-Agency RMBS. Specified pools are fixed-rate Agency pools consisting of mortgages with special characteristics, such as mortgages with low loan balances, mortgages backed by investor properties, mortgages originated through the government-sponsored "Making Homes Affordable" refinancing programs, and mortgages with various other characteristics.

Our overall RMBS portfolio increased by approximately 37%, to \$1.686 billion, as of December 31, 2017, as compared to \$1.227 billion as of December 31, 2016. The increase in the size of our portfolio reflects the investment, on a leveraged basis, of the proceeds received through our follow-on equity offering and ATM program during 2017.

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Our debt-to-equity ratio as of December 31, 2017 and 2016 was 8.3:1 and 8.5:1, respectively. Our debt-to-equity ratio may fluctuate period over period based on portfolio management decisions, market conditions, and the timing of security purchase and sale transactions. In addition, separate from the net short TBA portfolio that we hold for hedging purposes, we increased our long TBA positions that we hold for investment purposes to \$113.1 million in notional amount at December 31, 2017, as compared to \$49.1 million at

December 31, 2016. TBAs are forward-settling Agency RMBS where the mortgage pass-through certificates to be delivered are "To-Be-Announced."

We view our net Agency pool assets-to-equity ratio—which we define as the net aggregate market value of our Agency pools and our net short TBA positions, divided by total shareholders' equity—as an important measure of our effective overall leverage. As of December 31, 2017 and 2016, our net Agency pool assets-to-equity ratio was 5.5:1 and 5.3:1, respectively. We believe that using TBA short positions to reduce our net Agency pool assets-to-equity ratio has several advantages, including: (i) reducing our risk and book value volatility, (ii) enabling us to take advantage of dislocations in specified pool pay-ups without increasing our overall net exposure to Agency yield spreads, and (iii) during times of increased volatility, allowing us to avoid the high rebalancing costs associated with interest rate swap hedges.

We were well positioned for the Agency RMBS spread tightening that started in September 2017, having deployed nearly all of the capital we had raised earlier in the year into Agency RMBS, and having reduced our TBA short position coming into the third quarter. However, although Agency RMBS spreads generally held firm during the fourth quarter, many shorter-duration RMBS (including higher-coupon pools and 15-year pools) underperformed longer-duration RMBS, which led to net unrealized losses on our portfolio for the fourth quarter.

Over the course of 2017, although the low interest rate volatility and muted prepayment environment provided a significant tailwind to the mortgage sector generally, this dynamic generated limited trading opportunities for us and bolstered the value of the TBA pools that we held short. For the year, our securities and TBA hedge positions generated net realized and unrealized losses, which were only partially offset by net realized and unrealized gains on our interest rate swaps. Nevertheless, these losses were more than offset by the strong interest income on our Agency RMBS portfolio, as net interest income drove our earnings. Compared to 2016, our net interest income increased by 24% in 2017, from \$24.2 million for the year ended December 31, 2016 to \$30.1 million for the year ended December 31, 2017, primarily as a result of our larger investment portfolio, which grew as we deployed the capital raised through our common share offerings.

Average pay-ups on our specified pools were virtually unchanged year over year, decreasing only 2 basis points to 0.68% as of December 31, 2017, as compared to 0.70% at December 31, 2016. Pay-ups are price premiums for specified pools relative to their TBA counterparts. Specified pools generally outperformed TBAs over the course of the year, thus marginally benefiting our portfolio as we continued to concentrate our long investments in specified pools and hold net short positions in TBAs as a significant component of our interest rate hedging strategy. Looking forward, we expect that the scheduled acceleration of the Federal Reserve's tapering will put downward pressure on TBA prices and thereby benefit our TBA short positions, because the Federal Reserve acquires its Agency pools through purchases of TBA contracts.

Our Agency RMBS portfolio turnover for the year was 98% (as measured by sales and excluding paydowns), with most of the turnover coming in the first half of the year as we actively traded our Agency RMBS portfolio in order to capitalize on sector rotation opportunities.

We expect to continue to target specified pools that, taking into account their particular composition and based on our prepayment projections, should: (1) generate attractive yields relative to other Agency RMBS and U.S. Treasury securities, (2) have less prepayment sensitivity to government policy shocks, and/or (3) create opportunities for trading gains once the market recognizes their value, which for newer pools may come only after several months, when actual prepayment experience can be observed. We believe that our research team, proprietary prepayment models, and extensive databases remain essential tools in our implementation of this strategy.

Our non-Agency RMBS performed well during the year, driven by strong interest income and net realized and unrealized gains. Fundamentals underlying non-Agency RMBS remain strong, led by a stable housing market. During the year we net sold assets at gains. Our total investment in non-Agency RMBS decreased to \$18.0 million as of December 31, 2017, as compared to \$19.4 million as of December 31, 2016. To the extent that more attractive entry points develop in non-Agency RMBS, we may increase our capital allocation to this sector.

The following table summarizes prepayment rates for our portfolio of fixed-rate specified pools (excluding those backed by reverse mortgages) for the three month periods ended December 31, 2017, September 30, 2017, June 30, 2017, March 31, 2017, and December, 31, 2016.

Three Month Period Ended

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	December 31, 2017	September 30, 2017	June 30, 2017	March 31, 2017	December 31, 2016
Three Month Constant Prepayment Rates <sup>(1)</sup>	9.6%	9.6 %	8.2%	12.7%	15.6 %

(1) Excludes Agency fixed-rate RMBS without any prepayment history.

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The following table provides details about the composition of our portfolio of fixed-rate specified pools (excluding those backed by reverse mortgages) as of December 31, 2017 and 2016.

	December 31, 2017			December 31, 2016			
	Coupon	Current Principal	Fair Value	Weighted Average Loan Age (Months)	Current Principal	Fair Value	Weighted Average Loan Age (Months)
	(In thousands)				(In thousands)		
Fixed-rate Agency RMBS:							
15-year fixed-rate mortgages:							
	2.50	\$612	\$613	52	\$—	\$—	—
	3.00	50,391	51,453	21	35,199	36,201	20
	3.50	110,748	115,001	24	97,018	101,868	21
	4.00	9,247	9,707	36	9,612	10,294	30
Total 15-year fixed-rate mortgages		170,998	176,774	24	141,829	148,363	22
20-year fixed-rate mortgages	4.00	8,712	9,230	36	10,488	11,185	18
30-year fixed-rate mortgages:							
	2.50	—	—	—	1,607	1,562	2
	3.00	15,580	15,612	29	16,000	15,970	29
	3.03	456	457	66	—	—	—
	3.25	1,100	1,115	12	—	—	—
	3.28	373	373	66	—	—	—
	3.50	433,348	447,904	22	255,122	263,743	18
	3.75	3,319	3,455	5	—	—	—
	4.00	522,981	551,217	18	391,677	415,251	17
	4.25	5,672	5,992	5	—	—	—
	4.50	281,412	300,833	20	173,689	188,083	22
	5.00	37,379	40,451	48	48,324	52,981	35
	5.50	1,228	1,347	131	1,670	1,854	119
	6.00	736	833	135	887	1,013	123
Total 30-year fixed-rate mortgages		1,303,584	1,369,589	21	888,976	940,457	20
Total fixed-rate Agency RMBS		\$1,483,294	\$1,555,593	21	\$1,041,293	\$1,100,005	20

For the year ended December 31, 2017, we had total net realized and unrealized losses of \$(9.0) million, or \$(0.77) per share, on our aggregate Agency RMBS portfolio. Although Agency RMBS prices remained firm during the year, many shorter-duration RMBS (including higher-coupon pools and 15-year pools) underperformed longer-duration RMBS, leading to net unrealized losses on our overall portfolio for the year. We had total net realized and unrealized gains for the year of \$2.5 million, or \$0.21 per share, on our non-Agency RMBS portfolio as underlying fundamentals remained strong.

During the year ended December 31, 2017, we continued to hedge interest rate risk, primarily through the use of interest rate swaps and short positions in TBAs, and to a lesser extent, short positions in U.S. Treasury securities. For the year, we had total net realized and unrealized losses of \$(7.1) million, or \$(0.62) per share, on our interest rate hedging portfolio. In our hedging portfolio, the relative proportion (based on 10-year equivalents<sup>1</sup>) of TBA short positions decreased year over year relative to interest rate swaps.

<sup>1</sup>"10-year equivalents" for a group of positions represent the amount of 10-year U.S. Treasury securities that would experience a similar change in market value under a standard parallel move in interest rates.



After giving effect to quarterly dividends in the aggregate amount of \$1.57 per share, and including the approximately \$0.44 per share dilutive effect of our common share offerings during the year, our book value per share decreased to \$14.45 as of December 31, 2017, from \$15.52 as of December 31, 2016, and as a result we had an economic return of 3.2% for the year. Excluding the dilutive effect of our common share offerings, we had an economic return of 6.1% for the year. Economic return is computed by adding back dividends declared to ending book value per share, and comparing that amount to book value per share as of the beginning of the year.

Our net Agency premium as a percentage of the fair value of our specified pool holdings is one metric that we use to measure the overall prepayment risk of our specified pool portfolio. Net Agency premium represents the total premium (excess of market value over outstanding principal balance) on our specified pool holdings less the total premium on related net short TBA positions. The lower our net Agency premium, the less we believe that our specified pool portfolio is exposed to market-wide increases in Agency RMBS prepayments. As of December 31, 2017, our net Agency premium as a percentage of fair value of our specified pool holdings was approximately 3.5%, as compared to 3.6% as of December 31, 2016. Excluding TBA positions used to hedge our specified pool holdings, our Agency premium as a percentage of fair value was approximately 4.8% and 5.4% as of December 31, 2017 and 2016, respectively. Our Agency premium percentage and net Agency premium percentage may fluctuate from period to period based on a variety of factors, including market factors such as interest rates and mortgage rates, and, in the case of our net Agency premium percentage, based on the degree to which we hedge prepayment risk with short TBAs. We believe that our focus on purchasing pools with specific prepayment characteristics provides a measure of protection against prepayments.

We believe that our adaptive and active style of portfolio management is well suited to the current MBS market environment, which continues to be shaped by heightened prepayment risk, shifting central bank and government policies, regulatory changes, and developing technologies.

#### Financing

Over the course of the year our cost of repo financing increased as LIBOR increased. Our average borrowing cost for the year ended December 31, 2017 was 1.21%, as compared to 0.71% for the year ended December 31, 2016.

While large banks still dominate the repo market, non-bank firms, not subject to the same regulations as banks, are becoming more active in providing repo financing. Most of our outstanding repo financing is still provided by banks and bank affiliates; however, in limited amounts, we have also entered into repo agreements with non-bank dealers. In general, we continue to see strong appetite and competitive terms from both types of lenders.

Our debt-to-equity ratio was to 8.3:1 as of December 31, 2017 as compared to 8.5:1 as of December 31, 2016.

Adjusted for unsettled security purchases and sales, our debt-to-equity ratio was 8.2:1 as of December 31, 2017 and 8.3:1 as of December 31, 2016. Our leverage ratio may fluctuate period over period based on portfolio management decisions, market conditions, and the timing of security purchase and sale transactions.

#### Critical Accounting Policies

Our consolidated financial statements have been prepared in conformity with generally accepted accounting principles in the United States of America, or "U.S. GAAP." Entities in which we have a controlling financial interest, through ownership of the majority of the entities' voting equity interests, or through other contractual right that give us control, are consolidated by us. All inter-company balances and transactions have been eliminated.

Certain of our critical accounting policies require management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. We believe that all of the decisions and assessments upon which our consolidated financial statements are based were reasonable at the time made based upon information available to us at that time. We rely on our Manager and Ellington Management Group, L.L.C. and its affiliates', or "Ellington's," experience and analysis of historical and current market data in order to arrive at what we believe to be reasonable estimates. See Note 2 of the notes to our consolidated financial statements included in this Annual Report on Form 10-K for a complete discussion of our significant accounting policies. We have identified our most critical accounting policies to be the following:

**Valuation:** For financial instruments that are traded in an "active market," the best measure of fair value is the quoted market price. However, many of our financial instruments are not traded in an active market. Therefore, management generally uses third-party valuations when available. If third-party valuations are not available, management uses

other valuation techniques, such as the discounted cash flow methodology. Summary descriptions, for the various categories of financial instruments, of the valuation methodologies management uses in determining fair value of our financial instruments are detailed

in Note 2 of the notes to our consolidated financial statements. Management utilizes such methodologies to assign a good faith fair value (the estimated price that, in an orderly transaction at the valuation date, would be received to sell an asset, or paid to transfer a liability, as the case may be) to each such financial instrument.

See the notes to our consolidated financial statements for more information on valuation techniques used by management in the valuation of our assets and liabilities.

**Accounting for Securities:** Investments in mortgage-backed securities are recorded on trade date. We have chosen to make a fair value election pursuant to ASC 825-10, Financial Instruments, for our mortgage-backed securities portfolio. Electing the fair value option allows us to record changes in fair value in our Consolidated Statement of Operations, which, in our view, more appropriately reflects the results of our operations for a particular reporting period as all securities activities will be recorded in a similar manner. As such, the mortgage-backed securities are recorded at fair value on our Consolidated Balance Sheet and the period change in fair value is recorded in current period earnings on our Consolidated Statement of Operations as a component of Change in net unrealized gains (losses) on securities.

Realized gains or losses on sales of mortgage-backed securities are included in Net realized gains (losses) on securities on the Consolidated Statement of Operations, and are recorded at the time of disposition. The cost of positions sold is calculated based on identified cost. Principal write-offs are generally treated as realized losses.

**Interest Income:** Coupon interest income on investment securities is accrued based on the outstanding principal balance and the current coupon rate on each security. We amortize purchase premiums and accrete purchase discounts on our fixed income investments using the effective interest method.

Our accretion of discounts and amortization of premiums on securities for U.S. federal and other tax purposes is likely to differ from the accounting treatment under U.S. GAAP of these items as described above.

See the Note 2 of the notes to our consolidated financial statements for more information on the assumptions and methods that we use to amortize purchase premiums and accrete purchase discounts.

**Income Taxes:** We made an election to be taxed as a REIT for U.S. federal income tax purposes. As a REIT, we generally are not subject to corporate-level federal and state income tax on net income we distribute to our shareholders. To qualify as a REIT, we must meet a number of organizational and operational requirements, including a requirement to distribute at least 90% of our taxable income to our shareholders. Even if we qualify as a REIT, we may be subject to certain federal, state, local and foreign taxes on our income and property and to federal income and excise taxes on our undistributed taxable income. 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 four taxable years following the year in which the Company fails to qualify as a REIT.

We follow the authoritative guidance on accounting for and disclosure of uncertainty on tax positions, which requires management to determine whether a tax position is more likely than not to be sustained upon examination by the applicable taxing authority, including resolution of any related appeals or litigation processes, based on the technical merits of the position. For uncertain tax positions, the tax benefit to be recognized is measured as the largest amount of benefit that is greater than 50% likely of being realized upon ultimate settlement. The Company did not have any unrecognized tax benefits resulting from tax positions related to the current period or to 2016, 2015, and 2014 (its open tax years). In the normal course of business, we may be subject to examination by federal, state, local, and foreign jurisdictions, where applicable, for the current period, 2016, 2015, and 2014 (our open tax years). We may take positions with respect to certain tax issues which depend on legal interpretation of facts or applicable tax regulations. Should the relevant tax regulators successfully challenge any such positions; we might be found to have a tax liability that has not been recorded in the accompanying consolidated financial statements. Also, management's conclusions regarding the authoritative guidance may be subject to review and adjustment at a later date based on changing tax laws, regulations, and interpretations thereof. There were no amounts accrued for penalties or interest as of or during the periods presented in the consolidated financial statements included in this Annual Report on Form 10-K.

#### Recent Accounting Pronouncements

Refer to the notes to our consolidated financial statements for a description of relevant recent accounting pronouncements.



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Financial Condition  
Investment portfolio

The following tables summarize our mortgage-backed securities portfolio of as of December 31, 2017 and 2016:

(In thousands)	December 31, 2017				December 31, 2016				Average Cost	Average Cost
	Current Principal	Fair Value	Average Price <sup>(1)</sup>	Cost	Average Cost <sup>(1)</sup>	Current Principal	Fair Value	Average Price <sup>(1)</sup>		
Agency RMBS <sup>(2)</sup>										
15-year fixed-rate mortgages	\$ 170,998	\$ 176,774	\$ 103.38	\$ 178,551	\$ 104.42	\$ 141,829	\$ 148,363	\$ 104.61	\$ 148,873	\$ 104.61
20-year fixed-rate mortgages	8,712	9,230	105.95	9,394	107.83	10,488	11,185	106.65	11,275	107.83
30-year fixed-rate mortgages	1,303,584	1,369,589	105.06	1,380,265	105.88	888,976	940,457	105.79	948,157	106.65
ARMs	28,087	29,558	105.24	29,949	106.63	31,656	33,138	104.68	33,226	104.63
Reverse mortgages	64,608	70,617	109.30	70,901	109.74	57,411	62,058	108.09	63,114	109.74
Total Agency RMBS	1,575,989	1,655,768	105.06	1,669,060	105.91	1,130,360	1,195,201	105.74	1,204,645	105.91
Non-Agency RMBS	21,995	18,025	81.95	15,278	69.46	27,794	19,446	69.96	18,268	65.77
Total RMBS <sup>(2)</sup>	1,597,984	1,673,793	104.74	1,684,338	105.40	1,158,154	1,214,647	104.88	1,222,913	105.40
Agency IOs	n/a	12,205	n/a	13,197	n/a	n/a	12,347	n/a	11,841	n/a
Total mortgage-backed securities		1,685,998		1,697,535			1,226,994		1,234,754	
U.S. Treasury securities sold short	(82,492)	(81,289)	98.54	(81,836)	99.20	(78,589)	(74,194)	94.41	(75,465)	96.00
Reverse repurchase agreements	81,461	81,461	100.00	81,461	100.00	75,012	75,012	100.00	75,012	100.00
Total		\$ 1,686,170		\$ 1,697,160			\$ 1,227,812		\$ 1,234,301	

(1) Represents the dollar amount (not shown in thousands) per \$100 of current principal of the price or cost for the security.

(2) Excludes Agency IOs.

The vast majority of our capital is allocated to our Agency RMBS strategy, which includes investments in Agency pools and Agency CMOs. Within this strategy, we generally target Agency RMBS pools that, taking into account their particular composition and based on our prepayment projections: (1) should generate attractive yields relative to other Agency RMBS and U.S. Treasury securities, (2) should have less prepayment sensitivity to government policy shocks and/or (3) should create opportunities for trading gains once the market recognizes their value, which for newer pools may come only after several months when actual prepayment experience can be observed. As of both December 31, 2017 and 2016, investments in non-Agency RMBS constituted a relatively small portion of our total investments.

Our most prevalent method of financing RMBS is through short-term repurchase agreements, which generally have maturities of 180 days or less. The weighted average lives of the RMBS that we own are generally much longer. Consequently, the weighted average term of our repurchase agreement financings will almost always be substantially shorter than the expected average maturity of our RMBS. This mismatch in maturities, together with the uncertainty of RMBS prepayments, and other potential changes in timing and/or amount of cash flows on our RMBS assets, creates the risk that changes in interest rates will cause our financing costs with respect to our RMBS to increase relative to the income on our RMBS over the term of our investments.



## Financial Derivatives

The following table summarizes our portfolio of financial derivative holdings as of December 31, 2017 and 2016:

(In thousands)	December 31, 2017	December 31, 2016
Financial derivatives—assets, at fair value:		
TBA securities purchase contracts	\$ 26	\$ 96
TBA securities sale contracts	376	949
Fixed payer interest rate swaps	7,475	4,198
Fixed receiver interest rate swaps	563	693
Swaptions	181	—
Futures	171	72
Total financial derivatives—assets, at fair value	8,792	6,008
Financial derivatives—liabilities, at fair value:		
TBA securities purchase contracts	(266 )	—
TBA securities sale contracts	(469 )	(554 )
Fixed payer interest rate swaps	(1,128 )	(1,421 )
Total financial derivatives—liabilities, at fair value	(1,863 )	(1,975 )
Total	\$ 6,929	\$ 4,033

Pursuant to our hedging program, we engage in a variety of interest rate hedging activities that are designed to reduce the interest rate risk with respect to the liabilities incurred to acquire or hold RMBS. These interest rate hedges generally seek to reduce the interest rate sensitivity of our liabilities or, in other words, reduce the volatility of our financing cost over time attributable to interest rate changes. Our interest rate hedging transactions may include:

- Interest rate swaps (a contract exchanging a variable rate for a fixed rate, or vice versa);
- Interest rate swaptions (options to enter into interest rate swaps at a future date);
- TBA forward contracts on Agency pass-through certificates;
- Short sales of U.S. Treasury securities;
- Eurodollar and U.S. Treasury futures; and
- Other derivatives.

We generally enter into these transactions to offset the potential adverse effects of rising interest rates on short-term repurchase agreements. Our repurchase agreements generally have maturities of up to 180 days and carry interest rates that are determined by reference to LIBOR or correlated benchmark rates for those same periods. As each then-existing fixed-rate repo borrowing matures, it will generally be replaced with a new fixed-rate repo borrowing based on market interest rates established at that future date.

In the case of interest rate swaps, most of our agreements are structured such that we receive payments based on a variable interest rate and make payments based on a fixed interest rate. The variable interest rate on which payments are received is generally calculated based on various reset mechanisms for LIBOR. To the extent that our future repo borrowing costs continue to be highly correlated with LIBOR, our swap agreements help to reduce the variability of our overall repo borrowing costs, thus reducing risk to the extent we hold fixed-rate assets that are financed with repo borrowings.

In the case of TBAs, most of our positions are short TBA positions with a negative duration, meaning that as interest rates rise, the value of the short position increases, so these positions serve as a hedge against increases in interest rates. In the event that interest rates rise, the increase in value of the short TBA position serves to offset corollary increases in our current and/or future borrowing costs under our repurchase agreements. While we primarily use TBAs to hedge interest rate risk, from time to time we also hold net long positions in certain TBA securities as a means of acquiring exposure to Agency RMBS. Our ability to engage in TBA transactions may be limited by our intention to remain qualified as a REIT.

As of December 31, 2017, as part of our interest rate hedging program, we also held short positions in U.S. Treasury securities, with a total principal amount of \$82.5 million and a fair value of \$81.3 million. As of December 31, 2016, we also held short positions in U.S. Treasury securities, with a total principal amount of \$78.6 million and a fair value of \$74.2 million.





The composition and relative mix of our hedging instruments may vary from period to period given the amount of our liabilities outstanding or anticipated to be entered into, the overall market environment and our view as to which instruments best enable us to execute our hedging goals.

#### Leverage

The following table summarizes our outstanding liabilities under repurchase agreements as of December 31, 2017 and 2016. We had no other borrowings outstanding.

Remaining Days to Maturity	December 31, 2017			December 31, 2016		
	Borrowings Outstanding	Interest Rate	Weighted Average Remaining Days to Maturity	Borrowings Outstanding	Interest Rate	Weighted Average Remaining Days to Maturity
	(In thousands)					
30 days or less	\$410,628	1.41%	15	\$545,817	0.80%	19
31-60 days	906,602	1.46	46	304,398	0.91	45
61-90 days	273,665	1.60	74	299,081	0.98	74
91-120 days	6,311	1.61	120	1,050	0.88	109
121-150 days	—	—	—	12,428	0.97	135
151-180 days	—	—	—	35,199	1.05	164
Total	\$1,597,206	1.47%	43	\$1,197,973	0.88%	45

We finance our assets with what we believe to be a prudent amount of leverage, which will vary from time to time based upon the particular characteristics of our portfolio, availability of financing, and market conditions. Because our strategy is flexible, dynamic, and opportunistic, our overall leverage will vary over time. As of December 31, 2017 and 2016, our total debt-to-equity ratio was 8.3:1 and 8.5:1, respectively. Collateral transferred with respect to our outstanding repo borrowings as of December 31, 2017 and 2016 had an aggregate fair value of \$1.7 billion and \$1.2 billion, respectively. Adjusted for unsettled security purchases and sales, our debt-to-equity ratio was 8.2:1 and 8.3:1 as of December 31, 2017 and 2016, respectively. Our leverage ratio may fluctuate period over period based on portfolio management decisions, market conditions, and the timing of security purchase and sale transactions.

#### Shareholders' Equity

As of December 31, 2017, our shareholders' equity increased to \$192.7 million from \$141.7 million as of December 31, 2016. This increase principally consisted of net proceeds from the issuance of common shares of approximately \$59.1 million, after underwriters' discount and third party agent commissions, and net income of \$10.8 million, partially offset by dividends declared of \$18.9 million. Our common share issuances during the year included our May 2017 follow-on common share offering, the underwriters' subsequent partial exercise of their option to purchase additional common shares, and issuances under our ATM program. As of December 31, 2017, our book value per share was \$14.45 as compared to \$15.52 as of December 31, 2016.

## Results of Operations for the Years Ended December 31, 2017, 2016, and 2015

The following table summarizes our results of operations for the years ended December 31, 2017, 2016, and 2015:

(In thousands except for per share amounts)	Year Ended December 31,		
	2017	2016	2015
Interest Income (Expense)			
Interest income	\$49,190	\$33,498	\$40,751
Interest expense	\$(19,047)	\$(9,274)	\$(6,236)
Net interest income	\$30,143	\$24,224	\$34,515
Expenses			
Management fees to affiliate	2,678	2,129	2,304
Other operating expenses	3,024	2,880	2,841
Total expenses	5,702	5,009	5,145
Other Income (Loss)			
Net realized and change in net unrealized gains (losses) on securities	(7,175)	(1,676)	(9,327)
Net realized and change in net unrealized gains (losses) on financial derivatives	(6,478)	(5,633)	(20,013)
Total Other Income (Loss)	(13,653)	(7,309)	(29,340)
Net Income	\$10,788	\$11,906	\$30
Net Income Per Common Share	\$0.93	\$1.31	\$—

## Core Earnings

Core Earnings consists of net income (loss), excluding realized and change in net unrealized gains and (losses) on securities and financial derivatives, and, if applicable, items of income or loss that are of a non-recurring nature. Core Earnings includes net realized and change in net unrealized gains (losses) associated with payments and accruals of periodic payments on interest rate swaps. Our interest income is subject to fluctuations based on adjustments to premium amortization as a result of changes in prepayments of our Agency RMBS (accompanied by a corresponding offsetting adjustment to realized and unrealized gains and losses). We refer to this adjustment as a "Catch-up Premium Amortization Adjustment." Adjusted Core Earnings represents Core Earnings excluding the effect of the Catch-up Premium Amortization Adjustment on interest income. Core Earnings and Adjusted Core Earnings are supplemental non-GAAP financial measures. We believe that Core Earnings and Adjusted Core Earnings provide information useful to investors because they are metrics that we use to assess our performance and to evaluate the effective net yield provided by the portfolio. Moreover, one of our objectives is to generate income from the net interest margin on the portfolio, and Core Earnings and Adjusted Core Earnings are used to help measure the extent to which this objective is being achieved. However, because Core Earnings and Adjusted Core Earnings are incomplete measures of our financial results and differ from net income (loss) computed in accordance with U.S. GAAP, they should be considered as supplementary to, and not as substitutes for, net income (loss) computed in accordance with U.S. GAAP.

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The table below reconciles Core Earnings and Adjusted Core Earnings for the years ended December 31, 2017, 2016, and 2015 to the line, Net Income, on our Consolidated Statement of Operations, which we believe is the most directly comparable U.S. GAAP measure:

(In thousands except for share amounts)	Year Ended December 31,		
	2017	2016	2015
Net Income	\$10,788	\$11,906	\$30
Less:			
Net realized gains (losses) on securities	(2,674 )	8,420	9,577
Net realized losses on financial derivatives, excluding periodic payments <sup>(1)</sup>	(6,592 )	(7,782 )	(16,405 )
Change in net unrealized gains (losses) on securities	(4,501 )	(10,096 )	(18,904 )
Change in net unrealized gains (losses) on financial derivatives, excluding accrued periodic payments <sup>(2)</sup>	2,439	5,724	3,769
Subtotal	(11,328 )	(3,734 )	(21,963 )
Core Earnings	\$22,116	\$15,640	\$21,993
Less: Catch-up Premium Amortization Adjustment	1,243	(2,051 )	(1,076 )
Adjusted Core Earnings	20,873	17,691	23,069
Weighted Average Shares Outstanding	11,601,979	9,121,344	9,143,508
Core Earnings Per Share	\$1.91	\$1.71	\$2.41
Adjusted Core Earnings Per Share	\$1.80	\$1.94	\$2.52

For the year ended December 31, 2017, represents Net realized gains (losses) on financial derivatives of \$(9,083) less Net realized gains (losses) on periodic settlements of interest rate swaps of \$(2,491). For the year ended December 31, 2016, represents Net realized gains (losses) on financial derivatives of \$(12,120) less Net realized gains (losses) on periodic settlements of interest rate swaps of \$(4,338). For the year ended December 31, 2015, represents Net realized gains (losses) on financial derivatives of \$(23,432) less Net realized gains (losses) on periodic settlements of interest rate swaps of \$(7,027).

For the year ended December 31, 2017, represents Change in net unrealized gains (losses) on financial derivatives of \$2,605 less Change in net unrealized gains (losses) on accrued periodic settlements of interest rate swaps of \$166. For the year ended December 31, 2016, represents Change in net unrealized gains (losses) on financial derivatives of \$6,487 less Change in net unrealized gains (losses) on accrued periodic settlements of interest rate swaps of \$763. For the year ended December 31, 2015, represents Change in net unrealized gains (losses) on financial derivatives of \$3,419 less Change in net unrealized gains (losses) on accrued periodic settlements of interest rate swaps of \$(350).

Results of Operations for the Years Ended December 31, 2017 and 2016

Net Income

The decrease in net income for the year ended December 31, 2017 as compared to the year ended December 31, 2016 was principally due to an increase in Total Other Loss, partially offset by an increase in net interest income. The decrease in net income per share was also affected by an increase in common shares outstanding during the year ended December 31, 2017. Average outstanding shares for the year ended December 31, 2017 include the impact of shares issued through our follow-on equity offering as well as our ATM program.

Interest Income

Our portfolio as of each of December 31, 2017 and 2016 consisted primarily of Agency RMBS, and to a lesser extent, non-Agency RMBS. Before interest expense, we earned approximately \$48.3 million and \$33.2 million in interest income on these securities for the years ended December 31, 2017 and 2016, respectively. The year-over-year increase in interest income resulted from higher average holdings and higher weighted average yields on our Agency RMBS. Our average holdings increased following the leveraged deployment, in Agency RMBS, of capital raised through our equity offering and ATM program. Some of the variability in our interest income and portfolio yields is due to the Catch-up Premium Amortization Adjustment. For the year ended December 31, 2017, we had a positive Catch-up Premium Amortization Adjustment of approximately \$1.2 million, which increased our interest income. Excluding the Catch-up Premium Amortization Adjustment, the weighted average yield of our overall portfolio was 3.02% for the year ended December 31, 2017. By comparison, for the year ended December 31, 2016 the Catch-up Premium

Amortization Adjustment decreased interest income by approximately \$(2.1) million. Excluding this Catch-up Premium Amortization Adjustment, the weighted average yield on our overall portfolio for the year ended December 31, 2016 would have been 2.88%.

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The following table details our interest income, average holdings of yield-bearing assets, and weighted average yield based on amortized cost for the years ended December 31, 2017 and 2016:

(In thousands)	Non-Agency <sup>(1)</sup>			Agency <sup>(1)</sup>			Total <sup>(1)</sup>		
	Interest Income	Average Holdings	Yield	Interest Income	Average Holdings	Yield	Interest Income	Average Holdings	Yield
Year ended December 31, 2017	\$1,373	\$16,219	8.46%	\$46,893	\$1,543,144	3.04%	\$48,266	\$1,559,363	3.10%
Year ended December 31, 2016	\$2,188	\$22,792	9.60%	\$31,001	\$1,201,860	2.58%	\$33,189	\$1,224,652	2.71%

(1) Amounts exclude interest income on cash and cash equivalents (including when posted as margin) and long U.S. Treasury securities.

Interest Expense

For the years ended December 31, 2017 and 2016, the majority of interest expense that we incurred was related to our repo borrowings, which we use to finance our assets. We also incur interest expense in connection with our short positions in U.S. Treasury securities. Our total interest expense for the year ended December 31, 2017 was \$19.0 million, of which \$17.5 million represented interest expense on our repo and approximately \$1.5 million represented interest expense related primarily to our short positions in U.S. Treasury securities. Our total interest expense for the year ended December 31, 2016 was \$9.3 million, of which \$8.1 million represented interest expense on our repo borrowings and approximately \$1.2 million represented interest expense related primarily to our short positions in U.S. Treasury securities. The year-over-year increase in our total interest expense resulted mainly from higher rates on our repo borrowings stemming from the increase in short-term interest rates, as well as an increase in average borrowings as a result of our larger asset base following our capital raise during the year. Our average outstanding repo borrowings for the year ended December 31, 2017 was \$1.45 billion, resulting in an average cost of funds of 1.21%. Our average outstanding repo borrowings for the year ended December 31, 2016 was \$1.15 billion, resulting in an average cost of funds of 0.71%.

The following table shows information related to our average cost of funds<sup>(1)</sup> for the years ended December 31, 2017 and 2016.

	Repurchase Agreements		Interest Rate Swaps <sup>(2)</sup>	Short U.S. Treasury Securities <sup>(2)</sup>		Total <sup>(2)</sup>			
	Average Borrowed Funds	Interest Expense		Interest expense	Average Cost of Funds	Interest and net periodic expense paid or payable	Average Cost of Funds		
For the year ended December 31, 2017	\$1,447,158	\$17,499	1.21 %	\$2,390	0.16 %	\$1,454	0.10 %	\$21,343	1.47 %
For the year ended December 31, 2016	\$1,145,850	\$8,148	0.71 %	\$3,575	0.31 %	\$1,025	0.09 %	\$12,748	1.11 %

(In thousands)

For the year ended December 31, 2017	\$1,447,158	\$17,499	1.21 %	\$2,390	0.16 %	\$1,454	0.10 %	\$21,343	1.47 %
For the year ended December 31, 2016	\$1,145,850	\$8,148	0.71 %	\$3,575	0.31 %	\$1,025	0.09 %	\$12,748	1.11 %

(1) This metric does not take into account other instruments that we use to hedge interest rate risk, such as TBAs, swaptions, and futures.

As an alternative cost of funds measure, we add to our repo borrowing cost the net periodic amounts paid or (2) payable by us on our interest rate swaps and the interest expense we incur on our short positions in U.S. Treasury securities, and express the total as a percentage of our average outstanding repurchase agreement borrowings. For the years ended December 31, 2017 and 2016, average one-month LIBOR was 1.11% and 0.50%, respectively. For the years ended December 31, 2017 and 2016, average six-month LIBOR was 1.48% and 1.06%, respectively. For the year ended December 31, 2017, the weighted average yield of our portfolio of Agency and non-Agency RMBS was 3.10%, while our total average cost of funds, including interest rate swaps and short U.S. Treasury securities, was 1.47%, resulting in a net interest margin of 1.63%. In comparison, for the year ended December 31, 2016, the weighted average yield of our Agency and non-Agency RMBS was 2.71%, while our average cost of funds, including

interest rate swaps and short U.S. Treasury securities, was 1.11%, resulting in a net interest margin of 1.60%. For the years ended December 31, 2017 and 2016, excluding the impact of the Catch-up Premium Amortization Adjustment, the weighted average yield of our portfolio was 3.02% and 2.88%, respectively and our adjusted net interest margin was 1.55% and 1.77%, respectively.

Management Fees

For the years ended December 31, 2017 and 2016, our management fee expense was approximately \$2.7 million and \$2.1

million, respectively. The year-over-year increase was due to our higher capital base in 2017, which resulted from our follow-on equity offering as well as our ATM program. Management fees are calculated based on our shareholders' equity at the end of each quarter.

#### Other Operating Expenses

Other operating expenses, as presented above, include professional fees, compensation expense, insurance expense, and various other expenses incurred in connection with the operation of our business. Other operating expenses for the years ended December 31, 2017 and 2016 were approximately \$3.0 million and \$2.9 million, respectively. The slight increase in other operating expenses was a result of an increase in professional fees and compensation expense for the year ended December 31, 2017 as compared to the year ended December 31, 2016 partially offset by a decrease to administration fees and insurance expense for the year ended December 31, 2017 as compared to the year ended December 31, 2016. Our expense ratio, which represents our annualized management fees and other operating expenses as a percentage of our average shareholders' equity, decreased to 3.3% for the year ended December 31, 2017, as compared to 3.5% for the year ended December 31, 2016. The decrease in our expense ratio was due to an increase in our average shareholders' equity for the year ended December 31, 2017 as compared to the year ended December 31, 2016, as a result of our follow-on equity offering and sales of shares under our ATM program.

#### Other Income (Loss)

Other income (loss) consists of net realized and net change in unrealized gain (losses) on securities and financial derivatives. For the year ended December 31, 2017, other loss was \$(13.7) million, consisting of net realized and change in net unrealized losses of \$(7.2) million on our securities, primarily our Agency RMBS, and \$(6.5) million on our financial derivatives. Although Agency RMBS spreads generally tightened during the year ended December 31, 2017, asset prices were mixed, with shorter-duration RMBS (such as higher-coupon pools and 15-year pools) generally underperforming longer-duration RMBS. Given the characteristics of our portfolio, especially its concentration in higher-coupon pools, this led to net unrealized losses on our portfolio for the year. The net realized and unrealized losses on our financial derivatives primarily included (\$7.2) million of net realized and unrealized losses on our net TBA short positions, which was only partially offset by \$0.8 million of net realized and unrealized gains on our other financial derivatives, primarily interest rate swaps. Low volatility and a muted prepayment environment negatively affected our net short TBA hedges. For the year ended December 31, 2017, as measured by sales and excluding paydowns, we turned over approximately 98% of our Agency RMBS portfolio and, as a result of these sales, we generated net realized losses of \$(3.6) million on our Agency RMBS portfolio.

Other income (loss) for the year ended December 31, 2016 was \$(7.3) million and consisted of net realized and change in net unrealized losses of \$(5.6) million on our financial derivatives and \$(1.7) million on our securities, primarily our Agency RMBS. Interest rates declined over the first half of 2016, but increased significantly towards the end of the year. Generally, our assets produced net gains as interest rates declined in the first half of the year, and net losses when interest rates fell in the latter half of the year. Conversely, our interest rate hedges produced losses in the first half of the year, but gains in the latter half of the year.

#### Results of Operations for the Years Ended December 31, 2016 and 2015

##### Net Income

The increase in net income for the year ended December 31, 2016 as compared to the year ended December 31, 2015 was principally due to a decrease in net realized and unrealized losses on securities and financial derivatives for the year ended December 31, 2016. Each year included periods of high volatility in interest rates which led to significant swings in net realized and unrealized gains and losses on our securities and financial derivatives. Our year-over-year net interest income declined as a result of a decline in the size of our average portfolio holdings, as well as an increase in our cost of repo. Reduced net interest income resulted in a commensurate decline in our Core Earnings.

##### Interest Income

Our portfolio as of both December 31, 2016 and 2015 consisted primarily of Agency RMBS, and to a lesser extent, non-Agency RMBS. Before interest expense, we earned approximately \$33.2 million and \$40.7 million in interest income on these securities for the years ended December 31, 2016 and 2015, respectively. The year-over-year decrease in interest income resulted from lower average holdings and lower average yields on both our Agency and non-Agency RMBS. Some of the variability in our interest income and portfolio yields is due to the Catch-up Premium Amortization Adjustment. For the year ended December 31, 2016, we had a negative Catch-up Premium

Amortization Adjustment of approximately \$(2.1) million, which decreased our interest income. Excluding the Catch-up Premium Amortization Adjustment, the weighted average yield of our overall portfolio was 2.88% for the year ended December 31, 2016. By comparison, for the year ended December 31, 2015



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the Catch-up Premium Amortization Adjustment decreased interest income by approximately \$(1.1) million. Excluding this Catch-up Premium Amortization Adjustment, the weighted average yield on our overall portfolio for the year ended December 31, 2015 would have been 3.16%.

The following table details our interest income, average holdings of interest-earning assets, and weighted average yield based on amortized cost for the years ended December 31, 2016 and 2015:

(In thousands)	Non-Agency <sup>(1)</sup>			Agency <sup>(1)</sup>			Total <sup>(1)</sup>		
	Interest Income	Average Holdings	Yield	Interest Income	Average Holdings	Yield	Interest Income	Average Holdings	Yield
Year ended December 31, 2016	\$2,188	\$22,792	9.60 %	\$31,001	\$1,201,860	2.58 %	\$33,189	\$1,224,652	2.71 %
Year ended December 31, 2015	\$3,158	\$28,808	10.96 %	\$37,546	\$1,293,950	2.90 %	\$40,704	\$1,322,758	3.08 %

Amounts exclude interest income on cash and cash equivalents (including when posted as margin) and long U.S. Treasury securities.

#### Interest Expense

For the years ended December 31, 2016 and 2015, the majority of interest expense that we incurred was related to our repo borrowings, which we use to finance our assets. We also incur interest expense in connection with our short positions in U.S. Treasury securities. Our total interest expense for the year ended December 31, 2016 was \$9.3 million, of which \$8.1 million represented interest expense on our repo borrowings and approximately \$1.2 million represented interest expense related primarily to our short positions in U.S. Treasury securities. Our total interest expense for the year ended December 31, 2015 was \$6.2 million, of which \$5.2 million represented interest expense on our repo borrowings and approximately \$1.0 million represented interest expense related primarily to our short positions in U.S. Treasury securities. The year-over-year increase in our total interest expense resulted mainly from higher rates on our repo borrowings. In December 2015, for the first time in several years, the Federal Reserve increased the target range for the federal funds rate, to a range of 0.25%-to-0.50%, up 25 basis points from the prior range of 0.0%-to-0.25%; this increase has caused repo borrowing rates to increase. Our average outstanding repo borrowings for the year ended December 31, 2016 was \$1.15 billion, resulting in an average cost of funds of 0.71%. Our average outstanding repo borrowings for the year ended December 31, 2015 was \$1.24 billion, resulting in an average cost of funds of 0.42%.

The following table shows information related to our average cost of funds<sup>(1)</sup> for the years ended December 31, 2016 and 2015.

	Repurchase Agreements		Interest Rate Swaps <sup>(2)</sup>	Short U.S. Treasury Securities <sup>(2)</sup>		Total <sup>(2)</sup>	Average Cost of Funds		
	Average Borrowed Funds	Interest Expense		Average Cost of Funds	Interest expense			Average Cost of Funds	
			Net periodic expense paid or payable			Interest and net periodic expense paid or payable			
(In thousands)									
For the year ended December 31, 2016	\$1,145,850	\$8,148	0.71 %	\$3,575	0.31 %	\$1,025	0.09 %	\$12,748	1.11 %
For the year ended December 31, 2015	\$1,239,580	\$5,208	0.42 %	\$7,377	0.60 %	\$1,000	0.08 %	\$13,585	1.10 %

(In thousands)

For the year ended December 31, 2016

For the year ended December 31, 2015

(1) This metric does not take into account other instruments that we use to hedge interest rate risk, such as TBAs, swaptions, and futures.

As an alternative cost of funds measure, we add to our repo borrowing cost the net periodic amounts paid or (2) payable by us on our interest rate swaps and the interest expense we incur on our short positions in U.S. Treasury securities, and express the total as a percentage of our average outstanding repurchase agreement borrowings.

For the years ended December 31, 2016 and 2015, average one-month LIBOR was 0.50% and 0.20%, respectively.

For the years ended December 31, 2016 and 2015, average six-month LIBOR was 1.06% and 0.49%, respectively. For

the year ended December 31, 2016, the weighted average yield of our portfolio of Agency and non-Agency RMBS was 2.71%, while our total average cost of funds, including interest rate swaps and short U.S. Treasury securities, was 1.11%, resulting in a net interest margin of 1.60%. In comparison, for the year ended December 31, 2015, the weighted average yield of our Agency and non-Agency RMBS was 3.08%, while our average cost of funds, including interest rate swaps and short U.S. Treasury securities, was 1.10%, resulting in a net interest margin of 1.98%. For the years ended December 31, 2016 and 2015, excluding

the impact of the Catch-up Premium Amortization Adjustment, the weighted average yield of our portfolio was 2.88% and 3.16%, respectively and our adjusted net interest margin was 1.77% and 2.06%, respectively.

#### Management Fees

For the years ended December 31, 2016 and 2015, our management fee expense was approximately \$2.1 million and \$2.3 million, respectively. The decrease in management fees year over year was due to our smaller capital base.

#### Other Operating Expenses

Other operating expenses, as presented above, include professional fees, compensation expense, insurance expense, and various other expenses incurred in connection with the operation of our business. Other operating expenses for the years ended December 31, 2016 and 2015 were approximately \$2.9 million and \$2.8 million, respectively. Our expense ratio, which represents our management fees and other operating expenses as a percentage of our average shareholders' equity, was 3.5% for the year ended December 31, 2016, as compared to 3.3% for the year ended December 31, 2015. The increase in our expense ratio was primarily due to a decrease in our average shareholders' equity for the year ended December 31, 2016 as compared to the year ended December 31, 2015.

#### Other Income (Loss)

Other income (loss) consists of net realized and net change in unrealized gain (losses) on securities and financial derivatives. For the year ended December 31, 2016, other loss was \$(7.3) million, and consisted of net realized and change in net unrealized losses of \$(5.6) million on our financial derivatives and approximately \$(1.7) million on our securities, primarily our Agency RMBS. The year ended December 31, 2016 included periods of significant interest rate volatility. Interest rates declined over the first half of the year, but increased significantly towards the end of the year. Generally, our assets produced net gains as interest rates declined in the first half of the year, and net losses when interest rates fell in the latter half of the year. Conversely our interest rate hedges produced losses in the first half of the year, but gains in the latter half of the year. For the year ended December 31, 2016, as measured by sales and excluding paydowns, we turned over approximately 118% of our Agency RMBS portfolio and, as a result, we generated net realized gains of \$8.1 million on our Agency RMBS portfolio. Even though long-term interest rates ended the year only moderately higher than where they began, volatility throughout the year led to "delta-hedging" losses, as we actively adjusted our portfolio following significant interest rate movements. To the extent that our hedging portfolio is more heavily concentrated in interest rate swaps, futures, and/or U.S. Treasury securities, as opposed to swaptions and/or short positions in TBAs, our delta-hedging losses can be significant in volatile markets, and can lead to volatility in our results.

Other income (loss) for the year ended December 31, 2015 was \$(29.3) million and consisted of net realized and change in net unrealized losses of \$(20.0) million on our financial derivatives and net realized and change in net unrealized losses of approximately \$(9.3) million on our securities, primarily our Agency RMBS. The year ended December 31, 2015 was marked by significant interest rate volatility, and our hedging portfolio was generally more heavily concentrated in interest rate swaps during 2015 as compared to 2016, which led to greater delta-hedging losses in 2015 as compared to 2016.

#### Liquidity and Capital Resources

Liquidity refers to our ability to meet our cash needs, including repaying our borrowings, funding and maintaining RMBS and other assets, paying dividends, and other general business needs. Our short-term (one year or less) and long-term liquidity requirements include acquisition costs for assets we acquire, payment of our management fee, compliance with margin requirements under our repurchase agreements, TBA and other financial derivative contracts, repayment of repurchase agreement borrowings to the extent we are unable or unwilling to extend our repurchase agreements, the payment of dividends, and payment of our general operating expenses. Our capital resources primarily include cash on hand, cash flow from our investments (including monthly principal and interest payments received on our RMBS and proceeds from the sale of RMBS), borrowings under repurchase agreements, and proceeds from equity offerings. We expect that these sources of funds will be sufficient to meet our short-term and long-term liquidity needs.

We borrow funds in the form of repurchase agreements. The terms of our repo borrowings are predominantly governed by Master Repurchase Agreements, or "MRAs," which generally conform to the terms in the standard master repurchase agreement as published by the Securities Industry and Financial Markets Association as to repayment and margin requirements. In addition, each lender may require that we include supplemental terms and

conditions to the standard master repurchase agreement. Typical supplemental terms and conditions include the addition of or changes to provisions relating to margin calls, net asset value requirements, cross default provisions, certain key person events, changes in corporate structure, and requirements that all controversies related to the repurchase agreement be litigated in a particular jurisdiction. These provisions may differ for each of our lenders.

As of December 31, 2017 and 2016, we had \$1.6 billion and \$1.2 billion, respectively, outstanding under our repurchase agreements. As of December 31, 2017, our outstanding repurchase agreements were with fifteen counterparties.

Amount at risk represents the excess, if any, for each counterparty of the fair value of collateral held by such counterparty over the amounts outstanding under repurchase agreements. The following table reflects counterparties for which the amounts at risk relating to our repurchase agreements was greater than 5% of shareholders' equity as of December 31, 2017 and 2016.

December 31, 2017:

Counterparty	Amount at Risk <sup>(1)</sup> (In thousands)	Weighted Average Remaining Days to Maturity	Percentage of Shareholders' Equity	
RBC Capital Markets LLC	\$ 17,795	45	9.2	%
J.P. Morgan Securities Inc.	16,225	47	8.4	%
Deutsche Bank Securities	14,027	45	7.3	%
Wells Fargo Bank, N.A.	13,689	27	7.1	%

(1) Amounts at risk exclude, in aggregate, \$1.5 million of net accrued interest, defined as accrued interest on securities held as collateral less interest payable on cash borrowed.

December 31, 2016:

Counterparty	Amount at Risk <sup>(1)</sup> (In thousands)	Weighted Average Remaining Days to Maturity	Percentage of Shareholders' Equity	
J.P. Morgan Securities Inc.	\$ 15,077	58	10.6	%
Deutsche Bank Securities	11,778	36	8.3	%
Wells Fargo Bank, N.A.	11,533	38	8.1	%
RBC Capital Markets LLC	11,506	34	8.1	%

(1) Amounts at risk exclude, in aggregate, \$1.6 million of net accrued interest, defined as accrued interest on securities held as collateral less interest payable on cash borrowed.

The amounts borrowed under our repurchase agreements are generally subject to the application of "haircuts." A haircut is the percentage discount that a repo lender applies to the market value of an asset serving as collateral for a repo borrowing, for the purpose of determining whether such repo borrowing is adequately collateralized. As of December 31, 2017 and 2016, the weighted average contractual haircut applicable to the assets that serve as collateral for our outstanding repo borrowings was 4.9% and 4.8%, respectively.

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The following table details total outstanding borrowings, average outstanding borrowings, and the maximum outstanding borrowings at any month end for each quarter under repurchase agreements for the past twelve quarters.

Quarter Ended	Borrowings Outstanding at Quarter End	Average Borrowings Outstanding	Maximum Borrowings Outstanding at Any Month End
(In thousands)			
December 31, 2017	\$ 1,597,206	\$ 1,614,096	\$ 1,643,683
September 30, 2017	1,642,313	1,633,746	1,650,729
June 30, 2017 <sup>(1)</sup>	1,628,450	1,339,806	1,628,450
March 31, 2017	1,178,285	1,194,321	1,199,860
December 31, 2016	1,197,973	1,170,091	1,197,973
September 30, 2016	1,158,962	1,138,439	1,158,962
June 30, 2016	1,205,987	1,132,184	1,205,987
March 31, 2016	1,133,841	1,142,501	1,175,531
December 31, 2015	1,222,719	1,228,964	1,286,274
September 30, 2015	1,225,905	1,242,650	1,248,604
June 30, 2015	1,264,479	1,247,617	1,269,551
March 31, 2015	1,211,110	1,239,167	1,255,568
December 31, 2014	1,323,080	1,275,874	1,323,080

For the quarter ended June 30, 2017 the significant increase between average borrowings outstanding and total borrowings as of June 30, 2017 was the result of our deployment of the proceeds from our follow-on offering of common shares during the quarter. Based on our higher equity base, we increased our repo borrowings so as to maintain our desired debt-to-equity ratio.

We held cash and cash equivalents of approximately \$56.1 million and \$33.5 million as of December 31, 2017 and 2016, respectively.

We may declare dividends based on, among other things, our earnings, our financial condition, the REIT qualification requirements of the Internal Revenue Code of 1986, as amended, our working capital needs and new opportunities.

The declaration of dividends to our shareholders and the amount of such dividends are at the discretion of our Board of Trustees. The following table sets forth the dividend distributions authorized by the Board of Trustees for the periods indicated below:

Year Ended December 31, 2017

	Dividend Per Share	Dividend Amount (In thousands)	Declaration Date	Record Date	Payment Date
First Quarter	\$ 0.40	\$ 3,652	March 6, 2017	March 31, 2017	April 25, 2017
Second Quarter	0.40	4,947	June 13, 2017	June 30, 2017	July 25, 2017
Third Quarter	0.40	5,334	September 12, 2017	September 29, 2017	October 25, 2017
Fourth Quarter	0.37	4,936	December 12, 2017	December 29, 2017	January 25, 2018

Year Ended December 31, 2016

	Dividend Per Share	Dividend Amount (In thousands)	Declaration Date	Record Date	Payment Date

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First Quarter	\$ 0.45	\$ 4,103	March 8, 2016	March 31, 2016	April 25, 2016
Second Quarter	0.40	3,647	June 14, 2016	June 30, 2016	July 27, 2016
Third Quarter	0.40	3,651	September 13, 2016	September 30, 2016	October 25, 2016
Fourth Quarter	0.40	3,652	December 13, 2016	December 30, 2016	January 25, 2017

For the year ended December 31, 2017, our operating activities provided net cash of \$60.2 million and our investing activities used net cash of \$477.9 million. Our repo activity used to finance our purchase of securities (including repayments, in conjunction with the sales of securities, of amounts borrowed under our repurchase agreements) provided net cash of \$399.2

million. Thus our operating and investing activities, when combined with our net repo financing activities, used net cash of \$18.4 million. We received net proceeds from the issuance of common shares of \$59.1 million, after underwriters' discounts and third party agent commissions. We used \$17.6 million to pay dividends and \$0.5 million to pay offering costs. As a result of these activities, there was an increase in our cash holdings of \$22.6 million from \$33.5 million as of December 31, 2016 to \$56.1 million as of December 31, 2017.

For the year ended December 31, 2016, our operating activities provided net cash of \$19.9 million and our investing activities provided net cash of \$13.9 million. Our repo activity used to finance our purchase of securities (including repayments, in conjunction with the sales of securities, of amounts borrowed under our repurchase agreements) used net cash of \$24.7 million. Thus our operating and investing activities, when combined with our net repo financing activities, provided net cash of \$9.0 million. We used \$15.5 million to pay dividends and \$0.2 million for the repurchase of common shares. As a result of these activities, there was a decrease in our cash holdings of \$6.7 million from \$40.2 million as of December 31, 2015 to \$33.5 million as of December 31, 2016.

For the year ended December 31, 2015, our operating activities provided net cash of \$24.8 million and our investing activities provided net cash of \$90.1 million. Our repo activity used to finance our purchase of securities (including repayments, in conjunction with the sales of securities, of amounts borrowed under our repurchase agreements) used net cash of \$100.4 million. Thus our operating and investing activities, when combined with our net repo financing activities, provided net cash of \$14.5 million for the year ended December 31, 2015. We used \$19.2 million to pay dividends and \$0.4 million for the repurchase of common shares. As a result of these activities, there was a decrease in our cash holdings of \$5.1 million from \$45.2 million as of December 31, 2014 to \$40.2 million as of December 31, 2015.

On August 13, 2013, our Board of Trustees approved the adoption of a \$10 million share repurchase program. The program, which is open-ended in duration, allows us to make repurchases from time to time on the open market or in negotiated transactions. Repurchases are at our discretion, subject to applicable law, share availability, price and our financial performance, among other considerations. During the year ended December 31, 2017, we did not purchase any of our common shares.

On February 6, 2018, our Board of Trustees approved the adoption of a share repurchase program under which we are authorized to repurchase up to 1.2 million common shares. The program, which is open-ended in duration, allows us to make repurchases from time to time on the open market or in negotiated transactions, including through Rule 10b5-1 plans. Repurchases are at our discretion, subject to applicable law, share availability, price and our financial performance, among other considerations. This program supersedes the program that was previously adopted on August 13, 2013. In 2018, through March 9, 2018, we have repurchased 216,881 shares for an aggregate cost of \$2.4 million under the current repurchase program adopted on February 6, 2018.

In addition to completing an equity offering during the three month period ended June 30, 2017, we also entered into equity distribution agreements for an ATM program whereby we are able to sell shares from time to time in the open market or in negotiated transactions. Under the program, which is open-ended in duration, we can sell shares with a value of up to \$100 million. As of December 31, 2017, we sold 964,968 shares at an average price of \$14.49 under the offering program, for net proceeds of \$14.0 million after third party agent commissions and fees of \$0.2 million.

Based on our current portfolio, amount of free cash on hand, debt-to-equity ratio and current and anticipated availability of credit, we believe that our capital resources will be sufficient to enable us to meet anticipated short-term and long-term liquidity requirements.

We are not required by our investment guidelines to maintain any specific debt-to-equity ratio, and we believe that the appropriate leverage for the particular assets we hold depends on the credit quality and risk of those assets, as well as the general availability and terms of stable and reliable financing for those assets.

#### Contractual Obligations and Commitments

We are a party to a management agreement with our Manager. Pursuant to that agreement, our Manager is entitled to receive a management fee based on shareholders' equity, reimbursement of certain expenses and, in certain circumstances, a termination fee. Such fees and expenses do not have fixed and determinable payments. For a description of the management agreement provisions, see Note 9 to our consolidated financial statements.





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The following table summarizes our contractual obligations at December 31, 2017:

(In thousands)	Less than One Year	1-3 Years	3-5 Years	More than Five Years	Total
Repurchase agreements	1,597,206	—	—	—	1,597,206
Interest expense on repurchase agreements, based on rates at December 31, 2017 <sup>(1)</sup>	5,763	—	—	—	5,763
Payable for securities purchased	3,830	—	—	—	3,830
Total	1,606,799	—	—	—	1,606,799

<sup>(1)</sup> Includes accrued interest expense on repurchase agreements at December 31, 2017 of \$2.9 million which is included in Interest payable on the Consolidated Balance Sheet.

We enter into repurchase agreements with third-party broker-dealers whereby we sell securities to such broker-dealers at agreed-upon purchase prices at the initiation of the repurchase agreements and agree to repurchase such securities at predetermined repurchase prices and termination dates, thus providing the broker-dealers with an implied interest rate on the funds initially transferred to us by the broker-dealers. We may enter into reverse repurchase agreements with third-party broker-dealers whereby we purchase securities under agreements to resell at an agreed-upon price and date. In general, we most often will enter into reverse repurchase agreement transactions in order to effectively borrow securities that we can then deliver to counterparties to whom we have made short sales of the same securities. The implied interest rates on the repurchase agreements and reverse repurchase agreements we enter into are based upon competitive market rates at the time of initiation. Repurchase agreements and reverse repurchase agreements that are conducted with the same counterparty may be reported on a net basis if they meet the requirements of ASC 210-20, Balance Sheet, Offsetting. As of both December 31, 2017 and 2016, there were no repurchase agreements and reverse repurchase agreements reported on a net basis on the Consolidated Balance Sheet.

As of December 31, 2017 we had \$1.6 billion of outstanding borrowings with fifteen counterparties.

#### Off-Balance Sheet Arrangements

As of December 31, 2017, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. Further, we have not guaranteed any obligations of unconsolidated entities nor do we have any commitment or intent to provide funding to any such entities. As such, we are not materially exposed to any market, credit, liquidity, or financing risk that could arise if we had engaged in such relationships.

#### Inflation

Virtually all of our assets and liabilities are interest rate-sensitive in nature. As a result, interest rates and other factors influence our performance far more so than does inflation. Changes in interest rates do not necessarily correlate with inflation rates or changes in inflation rates. Our activities and balance sheet are measured with reference to historical cost and/or fair market value without considering inflation.

#### Item 7A. Quantitative and Qualitative Disclosures About Market Risk

The primary components of our market risk are related to interest rate risk, prepayment risk, and credit risk. We seek to actively manage these and other risks and to acquire and hold assets that we believe justify bearing those risks, and to maintain capital levels consistent with those risks.

#### Interest Rate Risk

Interest rates are highly sensitive to many factors, including governmental monetary and tax policies, domestic and international economic and political considerations, and other factors beyond our control. We are subject to interest rate risk in connection with most of our assets and liabilities. For some securities in our portfolio, the coupon interest rates on, and therefore also the values of, such securities are highly sensitive to interest rate movements, such as inverse floating rate RMBS, which benefit from falling interest rates. Our repurchase agreements generally have maturities of up to 180 days and carry interest rates that are determined by reference to LIBOR or similar short-term benchmark rates for those same periods. Whenever one of our fixed-rate repo borrowings matures, it will generally be replaced with a new fixed-rate repo borrowing based on market interest rates prevailing at such time. Subject to

qualifying and maintaining our qualification as a REIT and our

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exclusion from registration under the Investment Company Act, we opportunistically hedge our interest rate risk by entering into interest rate swaps, TBAs, U.S. Treasury securities, Eurodollar and U.S. Treasury futures, and other instruments. In general, such hedging instruments are used to offset the large majority of the interest rate risk we estimate to arise from our repurchase agreement indebtedness generally associated with our Agency RMBS positions. Hedging instruments may also be used to offset a portion of the interest rate risk arising from our repurchase agreement liabilities associated with non-Agency RMBS positions, if any.

In addition to measuring and mitigating the risk related to changes in interest rates with respect to the generally shorter-term liabilities we incur to acquire and hold generally longer-lived RMBS, we also monitor the effect of changes in interest rates on the discounted present value of our portfolio of assets and liabilities. The following sensitivity analysis table shows the estimated impact on the fair value of our portfolio segregated by certain identified categories as of December 31, 2017, assuming a static portfolio and immediate and parallel shifts in interest rates from current levels as indicated below.

(In thousands)	Estimated Change for a Decrease in Interest Rates by				Estimated Change for an Increase in Interest Rates by			
	50 Basis Points		100 Basis Points		50 Basis Points		100 Basis Points	
	Market Value	% of Total Equity	Market Value	% of Total Equity	Market Value	% of Total Equity	Market Value	% of Total Equity
Agency RMBS, excluding TBAs	\$22,460	11.66 %	\$34,409	17.85 %	\$(32,970)	(17.11)%	\$(76,449)	(39.67)%
TBAs	(8,621 )	(4.47 )%	(12,688 )	(6.58 )%	13,174	6.84 %	30,900	16.03 %
Non-Agency RMBS	381	0.20 %	744	0.39 %	(397 )	(0.21 )%	(812 )	(0.42 )%
U.S. Treasury Securities, Interest Rate Swaps, and Futures	(16,374 )	(8.50 )%	(33,152 )	(17.20)%	15,969	8.29 %	31,535	16.36 %
Repurchase and Reverse Repurchase Agreements	(952 )	(0.50 )%	(1,905 )	(0.99 )%	952	0.49 %	1,904	0.99 %
Total	\$(3,106 )	(1.61 )%	\$(12,592)	(6.53 )%	\$(3,272 )	(1.70 )%	\$(12,922)	(6.71 )%

Our analysis of interest rate risk is derived from Ellington's proprietary models as well as third-party information and analytics. Many assumptions have been made in connection with the calculations set forth in the table above and, as such, there can be no assurance that assumed events will occur or that other events will not occur that would affect the outcomes. For example, for each hypothetical immediate shift in interest rates, assumptions have been made as to the response of mortgage prepayment rates, the shape of the yield curve, and market volatilities of interest rates; each of the foregoing factors can significantly and adversely affect the fair value of our interest rate sensitive instruments.

The above analysis utilizes assumptions and estimates based on management's judgment and experience, and relies on financial models, which are inherently imperfect; in fact, different models can produce different results for the same securities. While the table above reflects the estimated impacts of immediate parallel interest rate increases and decreases on specific categories of instruments in our portfolio, we intend to actively trade many of the instruments in our portfolio and intend to diversify our portfolio to reflect a portfolio comprised primarily of Agency RMBS, and, to a lesser extent, non-Agency RMBS and mortgage-related assets. Therefore, our current or future portfolios may have risks that differ significantly from those of our December 31, 2017 portfolio estimated above. Moreover, the impact of changing interest rates on fair value can change significantly when interest rates change by a greater amount than the hypothetical shifts assumed above. Furthermore, our portfolio is subject to many risks other than interest rate risks, and these additional risks may or may not be correlated with changes in interest rates. For all of the foregoing reasons and others, the table above is for illustrative purposes only and actual changes in interest rates would likely cause changes in the actual fair value of our portfolio that would differ from those presented above, and such differences might be significant and adverse. See "Business—Special Note Regarding Forward-Looking Statements."

#### Prepayment Risk

Prepayment risk is the risk of change, whether an increase or a decrease, in the rate at which principal is returned in respect to mortgage loans underlying RMBS, including both through voluntary prepayments and through liquidations

due to defaults and foreclosures. This rate of prepayment is affected by a variety of factors, including the prevailing level of interest rates as well as economic, demographic, tax, social, legal, and other factors. Changes in prepayment rates will have varying effects on the different types of securities in our portfolio, and we attempt to take these effects into account in making asset

management decisions. Additionally, increases in prepayment rates may cause us to experience losses on our investment in interest-only securities, or "IOs," and inverse interest only securities, or "IIOs," as these securities are extremely sensitive to prepayment rates. Finally, prepayment rates, besides being subject to interest rates and borrower behavior, are also substantially affected by government policy and regulation.

#### Credit Risk

We are subject to credit risk in connection with our assets, especially our non-Agency RMBS. Credit losses on real estate loans underlying our non-Agency RMBS can occur for many reasons, including, but not limited to, poor origination practices, fraud, faulty appraisals, documentation errors, poor underwriting, legal errors, poor servicing practices, weak economic conditions, decline in the value of homes, special hazards, earthquakes and other natural events, over-leveraging of the borrower on the property, reduction in market rents and occupancies and poor property management services in the case of rented homes, changes in legal protections for lenders, reduction in personal income, job loss, and personal events such as divorce or health problems. Property values are subject to volatility and may be affected adversely by a number of factors, including, but not limited to, national, regional, and local economic conditions (which may be adversely affected by industry slowdowns and other factors), local real estate conditions (such as an oversupply of housing), changes or continued weakness in specific industry segments, construction quality, age and design, demographic factors, and retroactive changes to building or similar codes. For mortgage-related instruments, the two primary components of credit risk are default risk and severity risk.

#### Default Risk

Default risk is the risk that borrowers will fail to make principal and interest payments on their mortgage loans. Subject to qualifying and maintaining our qualification as a REIT and our exclusion from registration under the Investment Company Act, we may selectively attempt to mitigate our default risk by, among other things, opportunistically entering into credit default swaps and total return swaps. These instruments can reference various RMBS indices, corporate bond indices, or corporate entities, such as publicly traded REITs. We also rely on third-party mortgage servicers to mitigate our default risk, but such third-party mortgage servicers may have little or no economic incentive to mitigate loan default rates.

#### Severity Risk

Severity risk is the risk of loss upon a borrower default on a mortgage loan underlying our RMBS. Severity risk includes the risk of loss of value of the property underlying the mortgage loan as well as the risk of loss associated with taking over the property, including foreclosure costs. We rely on third-party mortgage servicers to mitigate our severity risk, but such third-party mortgage servicers may have little or no economic incentive to mitigate loan loss severities. Such mitigation efforts may include loan modification programs and prompt foreclosure and property liquidation following a default.

Item 8. Financial Statements and Supplementary Data

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Report of Independent Registered Public Accounting Firm

To the Board of Trustees and Shareholders of Ellington Residential Mortgage REIT:

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Ellington Residential Mortgage REIT and its subsidiaries as of December 31, 2017 and 2016, and the related consolidated statements of operations, shareholders' equity and cash flows for each of the three years in the period ended December 31, 2017, including the related notes (collectively referred to as the "consolidated financial statements"). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2017 and 2016, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2017 in conformity with accounting principles generally accepted in the United States of America.

Basis for Opinion

These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's consolidated financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits of these consolidated financial statements in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting.

Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ PricewaterhouseCoopers LLP

New York, New York

March 14, 2018

We have served as the Company's auditor since 2012.



ELLINGTON RESIDENTIAL MORTGAGE REIT  
CONSOLIDATED BALANCE SHEET

	December 31, December	
	2017	31, 2016
(In thousands except for share amounts)		
<b>ASSETS</b>		
Cash and cash equivalents	\$ 56,117	\$ 33,504
Mortgage-backed securities, at fair value	1,685,998	1,226,994
Due from brokers	26,754	49,518
Financial derivatives—assets, at fair value	8,792	6,008
Reverse repurchase agreements	81,461	75,012
Receivable for securities sold	21,606	33,199
Interest receivable	5,784	4,633
Other assets	575	266
Total Assets	\$ 1,887,087	\$ 1,429,134
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>LIABILITIES</b>		
Repurchase agreements	\$ 1,597,206	\$ 1,197,973
Payable for securities purchased	3,830	5,516
Due to brokers	489	1,055
Financial derivatives—liabilities, at fair value	1,863	1,975
U.S. Treasury securities sold short, at fair value	81,289	74,194
Dividend payable	4,936	3,652
Accrued expenses	728	647
Management fee payable to affiliate	725	533
Interest payable	3,318	1,912
Total Liabilities	1,694,384	1,287,457
<b>SHAREHOLDERS' EQUITY</b>		
Preferred shares, par value \$0.01 per share, 100,000,000 shares authorized; (0 shares issued and outstanding, respectively)	—	—
Common shares, par value \$0.01 per share, 500,000,000 shares authorized; (13,340,217 and 9,130,897 shares issued and outstanding, respectively)	134	92
Additional paid-in-capital	240,062	180,996
Accumulated deficit	(47,493	) (39,411 )
Total Shareholders' Equity	192,703	141,677
Total Liabilities and Shareholders' Equity	\$ 1,887,087	\$ 1,429,134

See Notes to Consolidated Financial Statements

ELLINGTON RESIDENTIAL MORTGAGE REIT  
CONSOLIDATED STATEMENT OF OPERATIONS

	Year Ended December 31,		
	2017	2016	2015
(In thousands except for per share amounts)			
<b>INTEREST INCOME (EXPENSE)</b>			
Interest income	\$49,190	\$33,498	\$40,751
Interest expense	(19,047 )	(9,274 )	(6,236 )
Total net interest income	30,143	24,224	34,515
<b>EXPENSES</b>			
Management fees to affiliate	2,678	2,129	2,304
Professional fees	737	668	574
Compensation expense	775	599	621
Insurance expense <sup>(1)</sup>	304	361	408
Other operating expenses <sup>(1)</sup>	1,208	1,252	1,238
Total expenses	5,702	5,009	5,145
<b>OTHER INCOME (LOSS)</b>			
Net realized gains (losses) on securities	(2,674 )	8,420	9,577
Net realized gains (losses) on financial derivatives	(9,083 )	(12,120 )	(23,432 )
Change in net unrealized gains (losses) on securities	(4,501 )	(10,096 )	(18,904 )
Change in net unrealized gains (losses) on financial derivatives	2,605	6,487	3,419
Total other income (loss)	(13,653 )	(7,309 )	(29,340 )
<b>NET INCOME</b>	<b>\$10,788</b>	<b>\$11,906</b>	<b>\$30</b>
<b>NET INCOME PER COMMON SHARE:</b>			
Basic and Diluted	\$0.93	\$1.31	\$—
<b>CASH DIVIDENDS PER COMMON SHARE:</b>			
Dividends declared	\$1.57	\$1.65	\$2.00

(1) Conformed to current period presentation.

See Notes to Consolidated Financial Statements

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ELLINGTON RESIDENTIAL MORTGAGE REIT  
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY

	Common Shares	Common Shares, par value	Preferred Shares, par value	Preferred Shares, par value	Additional Paid-in-Capital	Accumulated (Deficit) Earnings	Total
(In thousands except for share amounts)							
BALANCE, December 31, 2014	9,149,274	91	—	—	181,282	(18,008 )	163,365
Share based compensation					120		120
Issuance of restricted shares	15,390	1	—	—	—		1
Repurchase of common shares	(29,561 )	—	—	—	(375 )		(375 )
Dividends declared						(18,286 )	(18,286 )
Net income						30	30
BALANCE, December 31, 2015	9,135,103	92	—	—	181,027	(36,264 )	144,855
Share based compensation					165		165
Issuance of restricted shares	13,714	—	—	—	—		—
Repurchase of common shares	(17,920 )	—	—	—	(196 )		(196 )
Dividends declared						(15,053 )	(15,053 )
Net income						11,906	11,906
BALANCE, December 31, 2016	9,130,897	92	—	—	180,996	(39,411 )	141,677
Shares issued <sup>(1)</sup>	4,194,968	42	—	—	59,061		59,103
Offering costs					(191 )		(191 )
Issuance of restricted shares	14,389	—	—	—	—		—
Forfeiture of common shares to satisfy tax withholding obligations	(37 )	—			—		—
Share based compensation					196		196
Dividends declared						(18,870 )	(18,870 )
Net income						10,788	10,788
BALANCE, December 31, 2017	13,340,217	\$ 134	—	\$	—\$ 240,062	\$(47,493 )	\$192,703

(1) For the year ended December 31, 2017 proceeds from the issuance of shares is net of an underwriters' discount of \$1.9 million and third-party agent commissions and fees of \$0.2 million.

See Notes to Consolidated Financial Statements

ELLINGTON RESIDENTIAL MORTGAGE REIT  
CONSOLIDATED STATEMENT OF CASH FLOWS

	Year Ended December 31,		
	2017	2016	2015
(In thousands)			
Cash flows provided by (used in) operating activities:			
Net income	\$ 10,788	\$ 11,906	\$ 30
Reconciliation of net income (loss) to net cash provided by (used in) operating activities:			
Net realized (gains) losses on securities	2,674	(8,420 )	(9,577 )
Change in net unrealized (gains) losses on securities	4,501	10,096	18,904
Net realized (gains) losses on financial derivatives	9,083	12,120	23,432
Change in net unrealized (gains) losses on financial derivatives	(2,605 )	(6,487 )	(3,419 )
Amortization of premiums and accretion of discounts (net)	12,888	15,785	9,415
Share based compensation	196	165	120
(Increase) decrease in assets:			
Due from brokers	22,764	(16,221 )	(14,766 )
Interest receivable	(1,151 )	(308 )	468
Other assets	(5 )	23	28
Increase (decrease) in liabilities:			
Due to brokers	(566 )	616	(144 )
Accrued expenses	81	114	(357 )
Interest payable	1,406	551	674
Management fees payable to affiliate	192	(12 )	(6 )
Net cash provided by (used in) operating activities	60,246	19,928	24,802
Cash flows provided by (used in) investing activities:			
Purchases of securities	(2,518,069)	(2,082,622)	(2,020,500)
Proceeds from sale of securities	1,888,229	1,965,304	1,996,591
Principal repayments of mortgage-backed securities	161,490	144,232	136,726
Proceeds from investments sold short	738,776	772,022	799,493
Repurchase of investments sold short	(732,492)	(776,483 )	(734,495)
Proceeds from disposition of financial derivatives	14,515	16,319	14,241
Purchase of financial derivatives	(23,888 )	(28,528 )	(37,341 )
Payments made on reverse repurchase agreements	(17,530,390)	(16,623,353)	(14,584,118)
Proceeds from reverse repurchase agreements	17,523,948	16,626,972	14,519,473
Net cash provided by (used in) investing activities	(477,887)	13,863	90,070

See Notes to Consolidated Financial Statements

ELLINGTON RESIDENTIAL MORTGAGE REIT  
CONSOLIDATED STATEMENT OF CASH FLOWS (CONTINUED)

	Year Ended December 31,		
	2017	2016	2015
Cash flows provided by (used in) financing activities:			
Net proceeds from the issuance of common shares	59,103	—	—
Offering costs paid	(496 )	—	—
Repurchase of common shares	—	(196 )	(375 )
Dividends paid	(17,586 )	(15,511 )	(19,207 )
Borrowings under repurchase agreements	3,388,961	1,957,256	2,660,924
Repayments of repurchase agreements	(2,989,728)	(1,982,002)	(2,761,285)
Cash provided by (used in) financing activities	440,254	(40,453 )	(119,943 )
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	22,613	(6,662 )	(5,071 )
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	33,504	40,166	45,237
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$56,117	\$ 33,504	\$ 40,166
Supplemental disclosure of cash flow information:			
Interest paid	\$17,641	\$ 8,723	\$ 5,562
Dividends payable	\$4,936	\$ 3,652	\$ 4,111

See Notes to Consolidated Financial Statements

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ELLINGTON RESIDENTIAL MORTGAGE REIT  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2017

1. Organization and Investment Objective

Ellington Residential Mortgage REIT, or "EARN," was formed as a Maryland real estate investment trust, or "REIT," on August 2, 2012, and commenced operations on September 25, 2012. EARN conducts its business through its wholly owned subsidiaries, EARN OP GP LLC, or the "General Partner," and Ellington Residential Mortgage LP, or the "Operating Partnership," which were formed as a Delaware limited liability company and a Delaware limited partnership, respectively, on July 31, 2012 and commenced operations on September 25, 2012. The Operating Partnership conducts its business of acquiring, investing in, and managing residential mortgage- and real estate-related assets through its wholly owned subsidiaries. EARN, the General Partner, the Operating Partnership, and their consolidated subsidiaries are hereafter defined as the "Company."

Ellington Residential Mortgage Management LLC, or the "Manager," serves as the Manager of the Company pursuant to the terms of the Fourth Amended and Restated Management Agreement, or the "Management Agreement." The Manager is an affiliate of Ellington Management Group, L.L.C., or "EMG," an investment management firm that is an SEC-registered investment adviser with a 23-year history of investing in a broad spectrum of mortgage-backed securities and related derivatives, with an emphasis on the residential mortgage-backed securities, or "RMBS," market. In accordance with the terms of the Management Agreement and the Services Agreement (as described in Note 9), the Manager is responsible for administering the Company's business activities and day-to-day operations, and performs certain services, subject to oversight by the Board of Trustees. See Note 9 for further information on the Management Agreement.

The Company acquires and manages RMBS, for which the principal and interest payments are guaranteed by a U.S. government agency or a U.S. government-sponsored entity, or "Agency RMBS," and RMBS that do not carry such guarantees, or "non-Agency RMBS," such as RMBS backed by prime jumbo, Alternative A-paper, manufactured housing, and subprime residential mortgage loans. Agency RMBS include both Agency pools and Agency collateralized mortgage obligations, or "CMOs," and non-Agency RMBS primarily consist of non-Agency CMOs, both investment grade and non-investment grade. The Company may also acquire and manage mortgage servicing rights, credit risk transfer securities, residential mortgage loans, and other mortgage- and real estate-related assets. The Company may also invest in other instruments including, but not limited to, forward-settling To-Be-Announced Agency pass-through certificates, or "TBAs," interest rate swaps and swaptions, U.S. Treasury securities, Eurodollar and U.S. Treasury futures, other financial derivatives, and cash equivalents. The Company's targeted investments may range from unrated first loss securities to AAA senior securities.

The Company has elected to be taxed as a REIT under the Internal Revenue Code of 1986, as amended, or "the Code," and intends to conduct its operations to be qualified and taxed as a REIT. As a REIT, the Company is required to distribute annually at least 90% of its taxable income. As long as the Company continues to qualify as a REIT, it will not be subject to U.S. federal corporate taxes on its taxable income to the extent that it distributes all of its annual taxable income to its shareholders. It is the intention of the Company to distribute at least 100% of its taxable income, after application of available tax attributes, within the time limits prescribed by the Code, which may extend into the subsequent taxable year.

2. Significant Accounting Policies

(A) Basis of Presentation: The Company's consolidated financial statements have been prepared in conformity with generally accepted accounting principles in the United States of America, or "U.S. GAAP." Entities in which the Company has a controlling financial interest, through ownership of the majority of the entities' voting equity interests, or through other contractual rights that give the Company control, are consolidated by the Company. All inter-company balances and transactions have been eliminated. The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates and those differences could be material.

(B) Valuation: The Company applies ASC 820-10, Fair Value Measurement ("ASC 820-10"), to its holdings of financial instruments. ASC 820-10 establishes a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy is based upon the observability of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

Level 1—inputs to the valuation methodology are observable and reflect quoted prices (unadjusted) for identical assets or liabilities in active markets. Currently, the types of financial instruments the Company generally includes in this category are exchange-traded derivatives;

Level 2—inputs to the valuation methodology other than quoted prices included in Level 1 are observable for the asset or liability, either directly or indirectly. Currently, the types of financial instruments that the Company generally includes in this category are Agency RMBS, U.S. Treasury securities, certain non-Agency RMBS, and actively traded derivatives such as TBAs, interest rate swaps, and swaptions, and;

Level 3—inputs to the valuation methodology are unobservable and significant to the fair value measurement. Currently, this category includes certain RMBS, such as certain non-Agency RMBS and certain Agency IOs, where there is less price transparency.

For certain financial instruments, the various inputs that management uses to measure fair value for such financial instrument may fall into different levels of the fair value hierarchy. In such cases, the determination of which category within the fair value hierarchy is appropriate for such financial instrument is based on the lowest level of input that is significant to the fair value measurement. ASC 820 prioritizes the various inputs that management uses to measure fair value with the highest priority to inputs that are observable and reflect quoted prices (unadjusted) for identical assets or liabilities in active markets (Level 1) and the lowest priority to inputs that are unobservable and significant to the fair value measurement (Level 3). The assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the financial instrument. The Company may use valuation techniques consistent with the market and income approaches to measure the fair value of its assets and liabilities. The market approach uses third-party valuations and information obtained from market transactions involving identical or similar assets or liabilities. The income approach uses projections of the future economic benefits of an instrument to determine its fair value, such as in the discounted cash flow methodology. The inputs or methodology used for valuing financial instruments are not necessarily an indication of the risk associated with investing in these financial instruments. The leveling of each financial instrument is reassessed at the end of each period. Transfers between levels of the fair value hierarchy are assumed to occur at the end of the reporting period.

#### Summary Valuation Techniques

For financial instruments that are traded in an "active market," the best measure of fair value is the quoted market price. However, many of the Company's financial instruments are not traded in an active market. Therefore, management generally uses third-party valuations when available. If third-party valuations are not available, management uses other valuation techniques, such as the discounted cash flow methodology. The following are summary descriptions, for the various categories of financial instruments, of the valuation methodologies management uses in determining fair value of the Company's financial instruments in such categories. Management utilizes such methodologies to assign a good faith fair value (the estimated price that, in an orderly transaction at the valuation date, would be received to sell an asset, or paid to transfer a liability, as the case may be) to each such financial instrument. Valuations for fixed-rate RMBS pass-throughs issued by a U.S government agency or government-sponsored enterprise, or "GSE," are typically based on observable pay-up data (pay-ups are price premiums for specified categories of fixed-rate pools relative to their TBA counterparts) or models that use observable market data, such as interest rates and historical prepayment speeds, and are validated against third-party valuations. With respect to the Company's other RMBS investments and TBAs, management seeks to obtain at least one third-party valuation, and often obtains multiple valuations when available. Management has been able to obtain third-party valuations on the vast majority of these instruments and expects to continue to solicit third-party valuations in the future. Management generally values each financial instrument at the average of third-party valuations received and not rejected as described below. Third-party valuations are not binding, and while management generally does not adjust the valuations it receives, management may challenge or reject a valuation when, based on its validation criteria, management determines that such valuation is unreasonable or erroneous. Furthermore, based on its validation criteria, management may determine that the average of the third-party valuations received for a given instrument does not result in what management believes to be the fair value of such instrument, and in such circumstances management may override this average with its own good faith valuation. The validation criteria may take into account output from management's own models, recent trading activity in the same or similar instruments, and valuations received from third parties. The use of proprietary models requires the use of a significant amount of judgment and the application of various assumptions including, but not limited to, assumptions concerning future prepayment rates and default rates.



Given their relatively high level of price transparency, Agency RMBS pass-throughs and TBAs are typically designated as Level 2 assets. Non-Agency RMBS and Agency interest only and inverse interest only RMBS are generally classified as either Level 2 or Level 3 based on the analysis of available market data and/or third-party valuations. Furthermore, the methodology used by the third-party valuation providers is reviewed at least annually by management, so as to ascertain whether such providers are utilizing observable market data to determine the valuations that they provide.

Interest rate swaps and swaptions are typically valued based on internal models that use observable market data, including applicable interest rates in effect as of the measurement date; the model-generated valuations are then typically compared to counterparty valuations for reasonableness. These financial derivatives are generally designated as Level 2 instruments.

In valuing its derivatives, the Company also considers the creditworthiness of both the Company and its counterparties, along with collateral provisions contained in each derivative agreement.

The Company's repurchase and reverse repurchase agreements are carried at cost, which approximates fair value. Repurchase agreements and reverse repurchase agreements are classified as Level 2 assets and liabilities based on the adequacy of the collateral and their short term nature.

The Company's valuation process, including the application of validation criteria, is overseen by the Manager's Valuation Committee ("Valuation Committee"). The Valuation Committee includes senior level executives from various departments within the Manager, and each quarter the Valuation Committee reviews and approves the valuations of the Company's investments. The valuation process also includes a monthly review by the Company's third party administrator. The goal of this review is to replicate various aspects of the Company's valuation process based on the Company's documented procedures.

Because of the inherent uncertainty of valuation, the estimated fair value of the Company's financial instruments may differ significantly from the values that would have been used had a ready market for the financial instruments existed, and the differences could be material to the consolidated financial statements.

(C) Accounting for Securities: Purchases and sales of investments are recorded on trade date and realized and unrealized gains and losses are calculated based on identified cost.

The Company has chosen to make a fair value election pursuant to ASC 825-10, Financial Instruments, for its securities portfolio. Electing the fair value option allows the Company to record changes in fair value in the Consolidated Statement of Operations, which, in management's view, more appropriately reflects the results of operations for a particular reporting period as all securities activities will be recorded in a similar manner. As such, securities are recorded at fair value on the Consolidated Balance Sheet and the period change in fair value is recorded in current period earnings on the Consolidated Statement of Operations as a component of Change in net unrealized gains (losses) on securities.

(D) Interest Income: Coupon interest income on investment securities is accrued based on the outstanding principal balance or notional amount and the current coupon rate on each security. The Company amortizes purchase premiums and accretes purchase discounts on its fixed-income securities. For RMBS that are deemed to be of high credit quality at the time of purchase, premiums and discounts are generally amortized/accreted into interest income over the life of such securities using the effective interest method. An effective yield retroactive to the time of purchase is periodically recomputed based on actual prepayments and changes in projected prepayment activity, and a catch-up adjustment, or "Catch-up Premium Amortization Adjustment," is made to amortization to reflect the cumulative impact of the change in effective yield. For RMBS that are deemed not to be of high credit quality at the time of purchase, interest income is recognized based on the effective interest method. For purposes of determining the effective interest rate, management estimates the future expected cash flows of its investment holdings based on assumptions including, but not limited to, assumptions for future prepayment rates, default rates, and loss severities (each of which may in turn incorporate various macro-economic assumptions, such as future housing prices). These assumptions are re-evaluated not less than quarterly. Principal write-offs are generally treated as realized losses. Changes in projected cash flows, as applied to the current amortized cost of the security, may result in a prospective change in the yield/interest income recognized on such securities.

The Company's accretion of discounts and amortization of premiums on securities for U.S. federal and other tax purposes is likely to differ from the accounting treatment under U.S. GAAP of these items as described above.

(E) Cash and Cash Equivalents: Cash and cash equivalents include cash and short term investments with original maturities of three months or less at the date of acquisition. Cash and cash equivalents typically include amounts held in an interest bearing overnight account and amounts held in money market funds, and these balances generally exceed insured limits. The Company holds its cash at institutions that it believes to be highly creditworthy.

(F) Due from brokers/Due to brokers: Due from brokers and Due to brokers accounts on the Consolidated Balance Sheet include collateral transferred to or received from counterparties, including clearinghouses, along with receivables and payables for open and/or closed derivative positions.

(G) Financial Derivatives: The Company enters into various types of financial derivatives subject to its investment guidelines, which include restrictions associated with maintaining its qualification as a REIT. The Company's financial derivatives are predominantly subject to bilateral collateral arrangements or clearing in accordance with the Dodd-Frank Wall

Street Reform and Consumer Protection Act of 2010. The Company may be required to deliver or may receive cash or securities as collateral upon entering into derivative transactions. In addition, changes in the relative value of financial derivative transactions may require the Company or the counterparty to post or receive additional collateral. In the case of cleared financial derivatives, the clearinghouse becomes the Company's counterparty and a futures commission merchant acts as intermediary between the Company and the clearinghouse with respect to all facets of the related transaction, including the posting and receipt of required collateral. Collateral received by the Company is reflected on the Consolidated Balance Sheet as "Due to Brokers." Conversely, collateral posted by the Company is reflected as "Due from Brokers" on the Consolidated Balance Sheet. The types of financial derivatives that have been utilized by the Company to date are interest rate swaps, TBAs, swaptions, and futures.

**Swaps:** The Company enters into interest rate swaps. Interest rate swaps are contractual agreements whereby one party pays a floating interest rate on a notional principal amount and receives a fixed-rate payment on the same notional principal, or vice versa, for a fixed period of time. The Company enters into interest rate swap contracts primarily to mitigate interest rate risk. The Company is subject to interest rate risk exposure in the normal course of pursuing its investment objectives.

Swaps change in value with movements in interest rates or total return of the reference securities. During the term of swap contracts, changes in value are recognized as unrealized gains or losses on the Consolidated Statement of Operations. When a contract is terminated, the Company realizes a gain or loss equal to the difference between the proceeds from (or cost of) the closing transaction and the Company's basis in the contract, if any. Periodic payments or receipts required by swap agreements are recorded as unrealized gains or losses when accrued and realized gains or losses when received or paid. Upfront payments paid and/or received by the Company to open swap contracts are recorded as an asset and/or liability on the Consolidated Balance Sheet and are recorded as a realized gain or loss on the termination date.

**TBA Securities:** The Company transacts in the forward settling TBA market. A TBA position is a forward contract for the purchase ("long position") or sale ("short position") of Agency RMBS at a predetermined price, face amount, issuer, coupon, and maturity on an agreed-upon future delivery date. For each TBA contract and delivery month, a uniform settlement date for all market participants is determined by the Securities Industry and Financial Markets Association. The specific Agency RMBS to be delivered into the contract at the settlement date are not known at the time of the transaction. The Company typically does not take delivery of TBAs, but rather enters into offsetting transactions and settles the associated receivable and payable balances with its counterparties. The Company primarily uses TBAs to mitigate interest rate risk, but from time to time it also holds net long positions in certain TBA securities as a means of acquiring exposure to Agency RMBS.

TBAs are accounted for by the Company as financial derivatives. The difference between the contract price and the fair value of the TBA position as of the reporting date is included in Change in net unrealized gains (losses) on financial derivatives in the Consolidated Statement of Operations. Upon settlement of the TBA contract, the realized gain (loss) on the TBA contract is equal to the net cash amount received (paid).

**Options:** The Company enters into swaption contracts. It may purchase or write put, call, straddle, or other similar options contracts. The Company enters into options contracts primarily to help mitigate interest rate risk. When the Company purchases an options contract, the option asset is initially recorded at an amount equal to the premium paid, if any, and is subsequently marked-to-market. Premiums paid for purchasing options contracts that expire unexercised are recognized on the expiration date as realized losses. If an options contract is exercised, the premium paid is subtracted from the proceeds of the sale or added to the cost of the purchase to determine whether the Company has realized a gain or loss on the related investment transaction. When the Company writes an options contract, the option liability is initially recorded at an amount equal to the premium received, if any, and is subsequently marked-to-market. Premiums received for writing options contracts that expire unexercised are recognized on the expiration date as realized gains. If an options contract is exercised, the premium received is subtracted from the cost of the purchase or added to the proceeds of the sale to determine whether the Company has realized a gain or loss on the related investment transaction. When the Company enters into a closing transaction, the Company will realize a gain or loss depending upon whether the amount from the closing transaction is greater or less than the premiums paid or received. In general, the Company's options contracts contain forward-settling premiums. In this case, no money is

exchanged upfront; instead, the agreed-upon premium is paid by the buyer upon expiration of the options contract, regardless of whether or not the options contract is exercised. Unrealized gains or (losses) resulting from the options contract being marked-to-market are included in Change in net unrealized gains (losses) on financial derivatives in the Consolidated Statement of Operations. Realized gains or (losses) are included in Realized gains (losses) on financial derivatives in the Consolidated Statement of Operations.

**Futures Contracts:** The Company enters into Eurodollar futures contracts and U.S. Treasury futures contracts. A futures contract is an exchange-traded agreement to buy or sell an asset for a set price on a future date. Initial margin deposits are made upon entering into futures contracts and can be either in the form of cash or securities. During the period the futures contract is open, changes in the value of the contract are recognized as unrealized gains or losses by marking-to-market to reflect the

current market value of the contract. Unrealized gains or (losses) are included in Change in net unrealized gains (losses) on financial derivatives in the Consolidated Statement of Operations. Variation margin payments are made or received periodically, depending upon whether unrealized losses or gains are incurred. When the contract is closed, the Company records a realized gain or loss equal to the difference between the proceeds of the closing transaction and the Company's basis in the contract. Realized gains or (losses) are included in Realized gains (losses) on financial derivatives in the Consolidated Statement of Operations.

Financial derivative assets are included in Financial derivatives—assets, at fair value on the Consolidated Balance Sheet while financial derivative liabilities are included in Financial derivatives—liabilities, at fair value on the Consolidated Balance Sheet.

(H) Repurchase Agreements: The Company enters into repurchase agreements with third-party broker-dealers, whereby it sells securities under agreements to repurchase at an agreed upon price and date. The Company accounts for repurchase agreements as collateralized borrowings, with the initial sale price representing the amount borrowed, and with the future repurchase price consisting of the amount borrowed plus interest, at the implied interest rate of the repurchase agreement, on the amount borrowed over the term of the repurchase agreement. The interest rate on a repurchase agreement is based on competitive market rates (or competitive market spreads, in the case of agreements with floating interest rates) at the time such agreement is entered into. When the Company enters into a repurchase agreement, the lender establishes and maintains an account containing cash and/or securities having a value not less than the repurchase price, including accrued interest, of the repurchase agreement. Repurchase agreements are carried at their contractual amounts, which approximate fair value due to their short-term nature.

(I) Reverse Repurchase Agreements: The Company enters into reverse repurchase agreement transactions with third-party broker-dealers, whereby it purchases securities under agreements to resell at an agreed upon price and date. The interest rate on a reverse repurchase agreement is based on competitive market rates (or competitive market spreads, in the case of agreements with floating interest rates) at the time such agreement is entered into. Reverse repurchase agreements are carried at their contractual amounts, which approximate fair value due to their short-term nature.

Repurchase and reverse repurchase agreements that are conducted with the same counterparty can be reported on a net basis if they meet the requirements of ASC 210-20, Balance Sheet Offsetting. There are currently no repurchase and reverse repurchase agreements reported on a net basis in the Company's consolidated financial statements.

(J) Securities Sold Short: The Company may purchase or engage in short sales of U.S. Treasury securities to mitigate the potential impact of changes in interest rates on the performance of its portfolio. When the Company sells securities short, it typically satisfies its security delivery settlement obligation by obtaining the security sold short from the same or a different counterparty. The Company generally is required to deliver cash or securities as collateral to the counterparty for the Company's obligation to return the borrowed security.

The Company has chosen to make a fair value election pursuant to ASC 825-10, Financial Instruments, for its securities sold short. Electing the fair value option allows the Company to record changes in fair value in the Consolidated Statement of Operations, which, in management's view, more appropriately reflects the results of operations for a particular reporting period as all securities activities will be recorded in a similar manner. As such, securities sold short are recorded at fair value on the Consolidated Balance Sheet and the period change in fair value is recorded in current period earnings on the Consolidated Statement of Operations as a component of Change in net unrealized gains (losses) on securities. A realized gain or loss will be recognized upon the termination of a short sale if the market price is less or greater than the proceeds originally received. Such realized gain or loss is recorded on the Company's Consolidated Statement of Operations in Net realized gains (losses) on securities.

(K) Offering Costs/Deferred Offering Costs/Underwriters' Discounts: Offering costs, underwriters' discounts and commissions and fees, are charged against shareholders' equity within Additional paid-in-capital. Offering costs typically include legal, accounting, and other fees associated with the cost of raising equity capital.

(L) Share Based Compensation: The Company applies the provisions of ASC 718, Compensation—Stock Compensation ("ASC 718"), with regard to its equity incentive plans. ASC 718 covers a wide range of share-based compensation arrangements including share options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. ASC 718 requires that compensation cost relating to share-based payment transactions

be recognized in the financial statements. The cost is measured based on the fair value, at the grant date, of the equity or liability instruments issued and is amortized over the vesting period. Restricted shares issued to the Company's independent directors and partially dedicated personnel are participating securities and receive dividends prior to vesting. Fair value for such awards is based on the closing stock price on the New York Stock Exchange at the grant date. The vesting period for restricted share

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awards is typically one to two years. Shares issued to the Company's independent directors and partially dedicated personnel are subject to tax withholding upon vesting. The Company's independent directors and partially dedicated personnel are permitted to forfeit a portion of their vested shares to pay such withholding tax. Forfeited shares decrease the total number of shares issued and outstanding and are immediately retired upon settlement.

(M) Dividends: Dividends payable are recorded on the declaration date.

(N) Expenses: Expenses are recognized as incurred on the Consolidated Statement of Operations.

(O) Earnings Per Share: In accordance with the provisions of ASC 260, Earnings per Share, the Company calculates basic income (loss) per share by dividing net income (loss) for the period by the weighted average of the Company's common shares outstanding for that period. Diluted income (loss) per share takes into account the effect of dilutive instruments, such as share options and warrants, and uses 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.

(P) Share Repurchases: Common shares that are repurchased by the Company subsequent to issuance decrease the total number of shares issued and outstanding and are immediately retired upon settlement. The cost of such share repurchases is charged against Additional paid-in-capital on the Company's Consolidated Balance Sheet.

(Q) Income Taxes: The Company has elected to be taxed as a REIT under Sections 856 to 860 of the Code. As a REIT, the Company is generally not subject to corporate-level federal and state income tax on net income it distributes to its shareholders. To qualify as a REIT, the Company must meet a number of organizational and operational requirements, including the distribution of at least 90% of its annual taxable income to shareholders. Even if the Company qualifies as a REIT, it may be subject to certain federal, state, local and foreign taxes on its income and property and to federal income and excise taxes on its undistributed taxable income. 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 four taxable years following the year in which the Company fails to qualify as a REIT.

The Company follows the authoritative guidance on accounting for and disclosure of uncertainty on tax positions, which requires management to determine whether a tax position of the Company is more likely than not to be sustained upon examination by the applicable taxing authority, including resolution of any related appeals or litigation processes, based on the technical merits of the position. For uncertain tax positions, the tax benefit to be recognized is measured as the largest amount of benefit that is greater than 50% likely of being realized upon ultimate settlement. The Company did not have any unrecognized tax benefits resulting from tax positions related to the current period or to 2016, 2015, or 2014 (its open tax years). In the normal course of business, the Company may be subject to examination by federal, state, local, and foreign jurisdictions, where applicable, for the current period, 2016, 2015, and 2014 (its open tax years). The Company may take positions with respect to certain tax issues which depend on legal interpretation of facts or applicable tax regulations. Should the relevant tax regulators successfully challenge any of such positions, the Company might be found to have a tax liability that has not been recorded in the accompanying consolidated financial statements. Also, management's conclusions regarding the authoritative guidance may be subject to review and adjustment at a later date based on changing tax laws, regulations, and interpretations thereof. There were no amounts accrued for penalties or interest as of or during the periods presented in these consolidated financial statements.

(R) Recent Accounting Pronouncements: In February 2015, the FASB issued ASU 2015-02, Amendments to the Consolidation Analysis ("ASU 2015-02"). This amends ASC 810, Consolidation (ASC "810"), to improve targeted areas of consolidation guidance by simplifying the requirements of consolidation and placing more emphasis on risk of loss when determining a controlling financial interest. ASU 2015-02 is effective for annual periods beginning after December 15, 2016 and interim periods beginning after December 15, 2017 with early adoption permitted. The adoption of ASU 2015-02 is not expected to have a material impact on the Company's consolidated financial statements.

### 3. Mortgage-Backed Securities

The following tables present details of the Company's mortgage-backed securities portfolio at December 31, 2017 and 2016, respectively. The Company's Agency RMBS include mortgage pass-through certificates and CMOs representing interests in or obligations backed by pools of residential mortgage loans issued or guaranteed by a U.S.



government agency or GSE. The non-Agency RMBS portfolio is not issued or guaranteed by the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, or any agency of the U.S. Government and is therefore subject to greater credit risk.

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By RMBS Type  
December 31, 2017:  
(\$ in thousands)

	Current Principal	Unamortized Premium (Discount)	Amortized Cost	Gross Unrealized			Weighted Average		
				Gains	Losses	Fair Value	Coupon	Yield	Life (Years) <sup>(1)</sup>
Agency RMBS:									
15-year fixed-rate mortgages	\$170,998	\$ 7,553	\$178,551	\$28	\$(1,805 )	\$176,774	3.38%	2.31%	4.75
20-year fixed-rate mortgages	8,712	682	9,394	—	(164 )	9,230	4.00%	2.55%	6.02
30-year fixed-rate mortgages	1,303,584	76,681	1,380,265	1,929	(12,605 )	1,369,589	3.96%	3.06%	8.18
Adjustable rate mortgages	28,087	1,862	29,949	30	(421 )	29,558	3.87%	2.58%	4.70
Reverse mortgages	64,608	6,293	70,901	259	(543 )	70,617	4.53%	2.79%	6.09
Interest only securities	n/a	n/a	13,197	382	(1,374 )	12,205	4.36%	5.64%	3.28
Total Agency RMBS	1,575,989	93,071	1,682,257	2,628	(16,912 )	1,667,973	3.95%	2.98%	7.38
Non-Agency RMBS	21,995	(6,717 )	15,278	2,846	(99 )	18,025	3.58%	8.39%	7.94
Total RMBS	\$1,597,984	\$ 86,354	\$1,697,535	\$5,474	\$(17,011)	\$1,685,998	3.94%	3.03%	7.39

Average lives of RMBS are generally shorter than stated contractual maturities. Average lives are affected by the (1)contractual maturities of the underlying mortgages, scheduled periodic payments of principal, and unscheduled prepayments of principal.

December 31, 2016:  
(\$ in thousands)

	Current Principal	Unamortized Premium (Discount)	Amortized Cost	Gross Unrealized			Weighted Average		
				Gains	Losses	Fair Value	Coupon	Yield	Life (Years) <sup>(1)</sup>
Agency RMBS:									
15-year fixed-rate mortgages	\$141,829	\$ 7,044	\$148,873	\$405	\$(915 )	\$148,363	3.41%	2.19%	4.75
20-year fixed-rate mortgages	10,488	787	11,275	25	(115 )	11,185	4.00%	2.51%	6.33
30-year fixed-rate mortgages	888,976	59,181	948,157	3,158	(10,858 )	940,457	3.99%	2.81%	8.34
Adjustable rate mortgages	31,656	1,570	33,226	121	(209 )	33,138	3.84%	2.37%	4.63
Reverse mortgages	57,411	5,703	63,114	100	(1,156 )	62,058	4.51%	2.61%	6.07
Interest only securities	n/a	n/a	11,841	1,465	(959 )	12,347	3.97%	2.75%	3.11
Total Agency RMBS	1,130,360	74,285	1,216,486	5,274	(14,212 )	1,207,548	3.94%	2.71%	7.24
Non-Agency RMBS	27,794	(9,526 )	18,268	1,550	(372 )	19,446	2.93%	7.82%	7.01
Total RMBS	\$1,158,154	\$ 64,759	\$1,234,754	\$6,824	\$(14,584)	\$1,226,994	3.92%	2.78%	7.24

Average lives of RMBS are generally shorter than stated contractual maturities. Average lives are affected by the (1)contractual maturities of the underlying mortgages, scheduled periodic payments of principal, and unscheduled prepayments of principal.



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By Estimated Weighted Average Life  
As of December 31, 2017:

(\$ in thousands)	Agency RMBS			Agency Interest Only Securities			Non-Agency RMBS		
	Fair Value	Amortized Cost	Weighted Average Coupon	Fair Value	Amortized Cost	Weighted Average Coupon	Fair Value	Amortized Cost	Weighted Average Coupon
Estimated Weighted Average Life <sup>(1)</sup>									
Less than three years	\$7,931	\$7,935	3.70 %	\$3,357	\$4,253	4.15 %	\$—	\$—	— %
Greater than three years and less than seven years	419,295	423,248	3.93 %	8,848	8,944	4.51 %	9,625	9,062	5.00 %
Greater than seven years and less than eleven years	1,221,160	1,230,479	3.92 %	—	—	— %	5,892	3,697	2.14 %
Greater than eleven years	7,382	7,398	3.68 %	—	—	— %	2,508	2,519	2.18 %
Total	\$1,655,768	\$1,669,060	3.92 %	\$12,205	\$13,197	4.36 %	\$18,025	\$15,278	3.58 %

(1) Average lives of RMBS are generally shorter than stated contractual maturities.

As of December 31, 2016:

(\$ in thousands)	Agency RMBS			Agency Interest Only Securities			Non-Agency RMBS		
	Fair Value	Amortized Cost	Weighted Average Coupon	Fair Value	Amortized Cost	Weighted Average Coupon	Fair Value	Amortized Cost	Weighted Average Coupon
Estimated Weighted Average Life <sup>(1)</sup>									
Less than three years	\$15,009	\$14,956	4.43 %	\$3,748	\$4,289	3.56 %	\$—	\$—	— %
Greater than three years and less than seven years	286,517	286,984	3.87 %	8,599	7,552	4.39 %	11,316	11,314	3.90 %
Greater than seven years and less than eleven years	890,277	899,220	3.96 %	—	—	— %	8,130	6,954	1.95 %
Greater than eleven years	3,398	3,485	4.00 %	—	—	— %	—	—	— %
Total	\$1,195,201	\$1,204,645	3.94 %	\$12,347	\$11,841	3.97 %	\$19,446	\$18,268	2.93 %

(1) Average lives of RMBS are generally shorter than stated contractual maturities.

The following table reflects the components of interest income on the Company's RMBS for the years ended December 31, 2017, 2016, and 2015:

(\$ in thousands)	Year Ended December 31, 2017			Year Ended December 31, 2016			Year Ended December 31, 2015		
	Coupon Interest	Net Amortization	Interest Income	Coupon Interest	Net Amortization	Interest Income	Coupon Interest	Net Amortization	Interest Income
Agency RMBS	\$60,256	\$(13,363)	\$46,893	\$47,850	\$(16,849)	\$31,001	\$49,028	\$(11,482)	\$37,546
Non-Agency RMBS	803	570	1,373	1,091	1,097	2,188	1,153	2,005	3,158
Total	\$61,059	\$(12,793)	\$48,266	\$48,941	\$(15,752)	\$33,189	\$50,181	\$(9,477)	\$40,704

For the years ended December 31, 2017, 2016, and 2015 the Catch-up Premium Amortization Adjustment was \$1.2 million, \$(2.1) million, and \$(1.1) million, respectively.



## 4. Valuation

The following tables present the Company's financial instruments measured at fair value on:

December 31, 2017:

(In thousands)

Description	Level 1	Level 2	Level 3	Total
Assets:				
Mortgage-backed securities, at fair value:				
Agency RMBS:				
15-year fixed-rate mortgages	\$—	\$176,774	\$—	\$176,774
20-year fixed-rate mortgages	—	9,230	—	9,230
30-year fixed-rate mortgages	—	1,369,589	—	1,369,589
Adjustable rate mortgages	—	29,558	—	29,558
Reverse mortgages	—	70,617	—	70,617
Interest only securities	—	9,951	2,254	12,205
Non-Agency RMBS	—	9,193	8,832	18,025
Mortgage-backed securities, at fair value	—	1,674,912	11,086	1,685,998
Financial derivatives—assets, at fair value:				
TBA's	—	402	—	402
Interest rate swaps	—	8,038	—	8,038
Swaptions	—	181	—	181
Futures	171	—	—	171
Total financial derivatives—assets, at fair value	171	8,621	—	8,792
Total mortgage-backed securities and financial derivatives—assets, at fair value	\$171	\$1,683,533	\$11,086	\$1,694,790
Liabilities:				
U.S. Treasury securities sold short, at fair value	\$—	\$(81,289)	\$—	\$(81,289)
Financial derivatives—liabilities, at fair value:				
TBA's	—	(735)	—	(735)
Interest rate swaps	—	(1,128)	—	(1,128)
Total financial derivatives—liabilities, at fair value	—	(1,863)	—	(1,863)
Total U.S. Treasury securities sold short and financial derivatives—liabilities, at fair value	\$—	\$(83,152)	\$—	\$(83,152)

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December 31, 2016:

(In thousands)

Description	Level 1	Level 2	Level 3	Total
<b>Assets:</b>				
Mortgage-backed securities, at fair value:				
Agency RMBS:				
15-year fixed-rate mortgages	\$ —	\$ 148,363	\$—	\$ 148,363
20-year fixed-rate mortgages	—	11,185	—	11,185
30-year fixed-rate mortgages	—	940,457	—	940,457
Adjustable rate mortgages	—	33,138	—	33,138
Reverse mortgages	—	62,058	—	62,058
Interest only securities	—	—	12,347	12,347
Non-Agency RMBS	—	12,948	6,498	19,446
Mortgage-backed securities, at fair value	—	1,208,149	18,845	1,226,994
Financial derivatives—assets, at fair value:				
TBAs	—	1,045	—	1,045
Interest rate swaps	—	4,891	—	4,891
Futures	72	—	—	72
Total financial derivatives—assets, at fair value	72	5,936	—	6,008
Total mortgage-backed securities and financial derivatives—assets, at fair value	\$ 72	\$ 1,214,085	\$ 18,845	\$ 1,233,002
<b>Liabilities:</b>				
U.S. Treasury securities sold short, at fair value	\$ —	\$ (74,194 )	\$—	\$ (74,194 )
Financial derivatives—liabilities, at fair value:				
TBAs	—	(554 )	—	(554 )
Interest rate swaps	—	(1,421 )	—	(1,421 )
Total financial derivatives—liabilities, at fair value	—	(1,975 )	—	(1,975 )
Total U.S. Treasury securities sold short and financial derivatives—liabilities, at fair value	\$ —	\$ (76,169 )	\$—	\$ (76,169 )

The following tables present additional information about the Company's investments which are measured at fair value for which the Company has utilized Level 3 inputs to determine fair value:

Year ended December 31, 2017:

(In thousands)	Non-Agency RMBS	Agency RMBS
Beginning balance as of December 31, 2016	\$ 6,498	\$ 12,347
Purchases	2,707	207
Proceeds from sales	(2,866 )	—
Principal repayments	(1,017 )	—
(Amortization)/accretion, net	342	(3,119 )
Net realized gains (losses)	184	(219 )
Change in net unrealized gains (losses)	1,043	(1,435 )
<b>Transfers:</b>		
Transfers into level 3	1,941	—
Transfers out of level 3	—	(5,527 )
Ending balance as of December 31, 2017	\$ 8,832	\$ 2,254

All amounts of net realized and changes in net unrealized gains (losses) in the table above are reflected in the accompanying Consolidated Statement of Operations. The table above incorporates changes in net unrealized gains (losses) for both Level 3 financial instruments held by the Company at December 31, 2017, as well as Level 3

financial instruments

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disposed of by the Company during the year ended December 31, 2017. For Level 3 financial instruments held by the Company as of December 31, 2017, change in net unrealized gains (losses) of \$1.3 million and \$(0.3) million, for the year ended December 31, 2017 relate to non-Agency RMBS and Agency RMBS, respectively.

As of June 30, 2017, the Company modified its procedures to determine the level within the hierarchy for certain financial instruments. Under the revised procedure, the Company examines financial instruments individually rather than in cohorts of like instruments as it had previously. At December 31, 2017, the Company transferred \$5.5 million of RMBS from Level 3 to Level 2 and \$1.9 million of RMBS from Level 2 to Level 3. Transfers between these hierarchy levels were based on the availability of sufficient observable inputs to meet Level 2 versus Level 3 criteria. The level designation of each financial instrument is reassessed at the end of each period.

Year ended December 31, 2016:

(In thousands)	Non-Agency RMBS	Agency RMBS
Beginning balance as of December 31, 2015	\$ 4,020	\$7,758
Purchases	2,608	7,188
Proceeds from sales	(1,270 )	—
Principal repayments	(1,256 )	—
(Amortization)/accretion, net	344	(3,535 )
Net realized gains (losses)	1,079	(303 )
Change in net unrealized gains (losses)	(571 )	1,239
Transfers:		
Transfers into level 3	3,120	—
Transfers out of level 3	(1,576 )	—
Ending balance as of December 31, 2016	\$ 6,498	\$12,347

All amounts of net realized and changes in net unrealized gains (losses) in the table above are reflected in the accompanying Consolidated Statement of Operations. The table above incorporates changes in net unrealized gains (losses) for both Level 3 financial instruments held by the Company as of December 31, 2016, as well as Level 3 financial instruments disposed of by the Company during the year ended December 31, 2016. For Level 3 financial instruments held by the Company as of December 31, 2016, change in net unrealized gains (losses) of \$0.8 million and \$1.1 million, for the year ended December 31, 2016 relate to non-Agency RMBS and Agency RMBS, respectively.

At December 31, 2016, the Company transferred \$1.6 million of RMBS from Level 3 to Level 2. These assets were transferred from Level 3 to Level 2 based on an increased volume of observed trading of these and/or similar assets. This increase in observed trading activity led to greater price transparency for these assets, thereby making a Level 2 designation appropriate in the Company's view.

At December 31, 2016, the Company transferred \$3.1 million of RMBS from Level 2 to Level 3. Since December 31, 2015, these securities exhibited indications of a reduced level of price transparency. Examples of such indications include wider spreads and/or higher delinquencies relative to similar securities and a reduction in observable transactions or executable quotes involving these and similar securities.

Year ended December 31, 2015:

(In thousands)	Non-Agency RMBS	Agency RMBS
Beginning balance as of December 31, 2014	\$ 10,082	\$ 11,244
Purchases	—	4,360
Proceeds from sales	(2,861 )	(4,538 )
Principal repayments	(1,765 )	—
(Amortization)/accretion, net	1,371	(2,714 )
Net realized gains (losses)	791	602
Change in net unrealized gains (losses)	(496 )	(1,196 )
Transfers:		
Transfers into level 3	1,681	—
Transfers out of level 3	(4,783 )	—
Ending balance as of December 31, 2015	\$ 4,020	\$ 7,758

All amounts of net realized and changes in net unrealized gains (losses) in the table above are reflected in the accompanying Consolidated Statement of Operations. The table above incorporates changes in net unrealized gains (losses) for both Level 3 financial instruments held by the Company as of December 31, 2015, as well as Level 3 financial instruments disposed of by the Company during the year ended December 31, 2015. For Level 3 financial instruments held by the Company as of December 31, 2015, change in net unrealized gains (losses) of \$(0.3) million and \$(0.3) million, for the year ended December 31, 2015 relate to non-Agency RMBS and Agency RMBS, respectively.

At December 31, 2015, the Company transferred \$4.8 million of non-Agency RMBS from Level 3 to Level 2. These assets were transferred from Level 3 to Level 2 based on an increased volume of observed trading of these and/or similar assets. This increase in observed trading activity has led to greater price transparency for these assets, thereby making a Level 2 designation appropriate in the Company's view.

At December 31, 2015, the Company transferred \$1.7 million of non-Agency RMBS from Level 2 to Level 3.

Following December 31, 2014, these securities exhibited indications of a reduced level of price transparency.

Examples of such indications include wider spreads and/or higher delinquencies relative to similar securities and a reduction in observable transactions or executable quotes involving these and similar securities.

There were no transfers of financial instruments between Levels 1 and 2 of the fair value hierarchy during the years ended December 31, 2017, 2016, or 2015.

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The following tables identify the significant unobservable inputs that affect the valuation of the Company's Level 3 assets and liabilities as of December 31, 2017 and 2016:

December 31, 2017:

Description	Fair Value (In thousands)	Valuation Technique	Significant Unobservable Input	Range		Weighted Average <sup>(1)</sup>	
				Min	Max		
Non-Agency RMBS	\$ 2,258	Market quotes	Non-Binding Third-Party Valuation	\$57.84	\$87.45		\$ 78.02
Non-Agency RMBS	6,574	Discounted Cash Flows	Yield	4.6	% 5.1	% 4.8	%
			Projected Collateral Prepayments	19.2	% 44.9	% 26.5	%
			Projected Collateral Losses	0.9	% 20.1	% 9.2	%
			Projected Collateral Recoveries	8.8	% 31.5	% 22.5	%
			Projected Collateral Scheduled Amortization	33.1	% 47.5	% 41.8	%
Agency RMBS–Interest Only Securities	2,254	Option Adjusted Spread ("OAS")	LIBOR OAS <sup>(2)</sup>	627	1,408	781	100.0 %
			Projected Collateral Prepayments	43.8	% 88.1	% 71.2	%
			Projected Collateral Scheduled Amortization	11.9	% 56.2	% 28.8	%
							100.0 %

(1) Averages are weighted based on the fair value of the related instrument.

(2) Shown in basis points.

December 31, 2016:

Description	Fair Value (In thousands)	Valuation Technique	Significant Unobservable Input	Range		Weighted Average <sup>(1)</sup>	
				Min	Max		
Non-Agency RMBS	\$ 652	Discounted Cash Flows	Yield	30.6	% 30.6	% 30.6	%
			Projected Collateral Prepayments	49.0	% 49.0	% 49.0	%
			Projected Collateral Losses	1.0	% 1.0	% 1.0	%
			Projected Collateral Recoveries	3.3	% 3.3	% 3.3	%
			Projected Collateral Scheduled Amortization	46.7	% 46.7	% 46.7	%
						100.0 %	
Non-Agency RMBS	5,846	Market quotes	Non-Binding Third-Party Valuation	\$46.40	\$63.29	\$ 56.49	

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Agency RMBS–Interest Only Securities	8,784	Market quotes	Non-Binding Third-Party Valuation	\$3.94	\$21.56	\$13.96		
Agency RMBS–Interest Only Securities	3,563	Option Adjusted Spread ("OAS")	LIBOR OAS <sup>(2)</sup>	103	1,147	468		
			Projected Collateral Prepayments	51.1	% 85.4	% 70.9	%	
			Projected Collateral Scheduled Amortization	14.6	% 48.9	% 29.1	%	
						100.0	%	

(1) Averages are weighted based on the fair value of the related instrument.

(2) Shown in basis points.

Third-party non-binding valuations are validated by comparing such valuations to internally generated prices based on the Company's models and to recent trading activity in the same or similar instruments. For those instruments valued using discounted cash flows, collateral prepayments, losses, recoveries, and scheduled amortization are projected over the remaining life of the collateral and expressed as a percentage of the collateral's current principal balance. For those assets valued using the LIBOR Option Adjusted Spread, or "OAS," valuation methodology, cash flows are projected using the Company's models over multiple interest rate scenarios, and these projected cash flows are then discounted using the LIBOR rates implied by each interest rate scenario. The LIBOR OAS of an asset is then computed as the unique constant yield spread that, when added to all LIBOR rates in each interest rate scenario generated by the model, will equate (a) the expected present value of the projected asset cash flows over all model scenarios to (b) the actual current market price of the asset. LIBOR OAS is therefore model-dependent. Generally speaking, LIBOR OAS measures the additional yield spread over LIBOR that an asset provides at its current market price after taking into account any interest rate options embedded in the asset.

Material changes in any of the inputs above in isolation could result in a significant change to reported fair value measurements. Fair value measurements are impacted by the interrelationships of these inputs. For example, a higher expectation of collateral prepayments will generally result in a lower expectation of collateral losses. Conversely, higher losses will generally result in lower prepayments.

The following table summarizes the estimated fair value of all other financial instruments not included in the disclosures above as of December 31, 2017 and 2016:

(In thousands)	December 31, 2017		December 31, 2016	
	Fair Value	Carrying Value	Fair Value	Carrying Value
Other financial instruments				
Assets:				
Cash and cash equivalents	\$56,117	\$ 56,117	\$33,504	\$ 33,504
Due from brokers	26,754	26,754	49,518	49,518
Reverse repurchase agreements	81,461	81,461	75,012	75,012
Liabilities:				
Repurchase agreements	1,597,206	1,597,206	1,197,973	1,197,973
Due to brokers	489	489	1,055	1,055

Cash and cash equivalents includes cash held in an interest bearing overnight account for which fair value equals the carrying value and cash held in money market accounts which are liquid in nature and for which fair value equals the carrying value; such assets are considered Level 1 assets. Due from brokers and Due to brokers include collateral transferred to or received from counterparties, along with receivables and payables for open and/or closed derivative positions. These receivables and payables are short term in nature and any collateral transferred consists primarily of cash; fair value of these items approximates carrying value and such items are considered Level 1 assets and liabilities. The Company's repurchase and reverse repurchase agreements are carried at cost, which approximates fair value due to their short term nature. Repurchase agreements and reverse repurchase agreements are classified as Level 2 assets and liabilities based on the adequacy of the collateral and their short term nature.

##### 5. Financial Derivatives

The Company is exposed to certain risks arising from both its business operations and economic conditions. Specifically, the Company's primary source of financing is repurchase agreements and the Company enters into financial derivative and other instruments to manage exposure to variable cash flows on portions of its borrowings under those repurchase agreements. Since the interest rates on repurchase agreements typically change with market interest rates such as LIBOR, the Company is exposed to constantly changing interest rates, which accordingly affects cash flows associated with the Company's borrowings. To mitigate the effect of changes in these interest rates and their related cash flows, the Company may enter into a variety of derivative contracts, including interest rate swaps, swaptions, and TBAs. Additionally, from time to time, the Company may use short positions in U.S. Treasury securities to mitigate its interest rate risk.



The following table details the fair value of the Company's holdings of financial derivatives as of December 31, 2017 and 2016:

	December 31, 2017	December 31, 2016
	(In thousands)	
Financial derivatives—assets, at fair value:		
TBA securities purchase contracts	\$26	\$ 96
TBA securities sale contracts	376	949
Fixed payer interest rate swaps	7,475	4,198
Fixed receiver interest rate swaps	563	693
Swaptions	181	—
Futures	171	72
Total financial derivatives—assets, at fair value	8,792	6,008
Financial derivatives—liabilities, at fair value:		
TBA securities purchase contracts	(266 )	—
TBA securities sale contracts	(469 )	(554 )
Fixed payer interest rate swaps	(1,128 )	(1,421 )
Total financial derivatives—liabilities, at fair value	(1,863 )	(1,975 )
Total	\$6,929	\$ 4,033

Interest Rate Swaps

The following tables provide information about the Company's fixed payer interest rate swaps as of December 31, 2017 and 2016:

December 31, 2017:

Maturity	Notional Amount	Fair Value	Weighted Average		Remaining Years to Maturity
			Pay Rate	Receive Rate	
	(In thousands)				
2018	\$65,990	\$187	0.97%	1.38%	0.43
2019	19,540	165	1.41	1.60	1.51
2020	131,900	1,514	1.60	1.41	2.39
2021	131,400	1,194	1.88	1.40	3.41
2022	79,044	736	1.97	1.39	4.48
2023	54,200	873	1.93	1.37	5.47
2024	8,900	142	1.99	1.34	6.26
2025	15,322	196	2.04	1.37	7.13
2026	40,885	2,230	1.63	1.36	8.71
2027	48,010	235	2.30	1.40	9.38
2043	12,380	(1,125 )	2.99	1.41	25.38
Total	\$607,571	\$6,347	1.77%	1.40%	4.54

December 31, 2016:

Maturity	Notional Amount	Fair Value	Weighted Average		Remaining Years to Maturity
			Pay Rate	Receive Rate	
	(In thousands)				
2017	\$74,750	\$(258 )	1.21 %	0.92 %	0.59
2018	65,990	193	0.97	0.89	1.43
2019	4,200	57	0.96	0.88	2.60
2020	79,500	554	1.48	0.89	3.32
2021	19,300	99	1.83	0.93	4.92
2022	13,044	172	1.75	0.89	5.68
2023	54,200	514	1.93	0.89	6.47
2024	8,900	87	1.99	0.85	7.26
2025	15,322	123	2.04	0.89	8.13
2026	46,435	2,306	1.72	0.91	9.74
2043	12,380	(1,070 )	2.99	0.89	26.38
Total	\$394,021	\$2,777	1.53 %	0.90 %	4.82

The following tables provide information about the Company's fixed receiver interest rate swaps as of December 31, 2017 and 2016.

December 31, 2017:

Maturity	Notional Amount	Fair Value	Weighted Average		Remaining Years to Maturity
			Pay Rate	Receive Rate	
	(In thousands)				
2025	\$9,700	\$ 563	1.36 %	3.00 %	7.54
Total	\$9,700	\$ 563	1.36 %	3.00 %	7.54

December 31, 2016:

Maturity	Notional Amount	Fair Value	Weighted Average		Remaining Years to Maturity
			Pay Rate	Receive Rate	
	(In thousands)				
2025	\$9,700	\$ 693	0.88 %	3.00 %	8.54
Total	\$9,700	\$ 693	0.88 %	3.00 %	8.54

## Interest Rate Swaptions

The following table provides information about the Company's swaptions as of December 31, 2017. The Company did not hold any interest rate swaptions as of December 31, 2016.

December 31, 2017:

Option Type	Fair Value	Months to Expiration	Underlying Swap		
			Notional Amount	Term (Years)	Fixed Rate
	(\$ in thousands)				
Fixed Payer	\$ 181	7.0	\$10,000	10	2.40%



Futures

The following tables provide information about the Company's short positions in futures as of December 31, 2017 and 2016.

December 31, 2017:

Description	Notional Amount	Fair Value	Remaining Months to Expiration
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(\$ in thousands)

U.S. Treasury Futures	\$(25,800)	\$ 171	2.63
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December 31, 2016:

Description	Notional Amount	Fair Value	Remaining Months to Expiration
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(\$ in thousands)

U.S. Treasury Futures	\$(26,700)	\$ 71	2.70
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Eurodollar Futures	(9,000 )	1	5.59
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TBAs

The Company transacts in the forward settling TBA market. Pursuant to these TBA transactions, the Company agrees to purchase or sell, for future delivery, Agency RMBS with certain principal and interest terms and certain types of underlying collateral, but the particular Agency RMBS to be delivered is not identified until shortly before the TBA settlement date. TBAs are liquid and have quoted market prices and represent the most actively traded class of MBS. The Company primarily uses TBAs to mitigate interest rate risk, typically in the form of short positions. However, from time to time, the Company also invests in TBAs as a means of acquiring additional exposure to Agency RMBS, or for speculative purposes, including holding long positions. Overall, the Company typically holds a net short position.

The Company does not generally take delivery of TBAs; rather, it settles the associated receivable and payable with its trading counterparties on a net basis. Transactions with the same counterparty for the same TBA that result in a reduction of the position are treated as extinguished.

As of December 31, 2017 and 2016, the Company had outstanding contracts to purchase ("long positions") and sell ("short positions") TBA securities as follows:

TBA Securities	December 31, 2017				December 31, 2016			
	Notional Amount <sup>(1)</sup>	Cost Basis <sup>(2)</sup>	Market Value <sup>(3)</sup>	Net Carrying Value <sup>(4)</sup>	Notional Amount <sup>(1)</sup>	Cost Basis <sup>(2)</sup>	Market Value <sup>(3)</sup>	Net Carrying Value <sup>(4)</sup>
(In thousands)								
Purchase contracts:								
Assets	\$37,355	\$38,065	\$38,091	\$ 26	\$49,138	\$49,774	\$49,870	\$ 96
Liabilities	75,789	79,570	79,304	(266 )	—	—	—	—
	113,144	117,635	117,395	(240 )	49,138	49,774	49,870	96
Sale contracts:								
Assets	(358,279 )	(372,219 )	(371,843 )	376	(281,655 )	(298,807 )	(297,858 )	949
Liabilities	(328,576 )	(341,134 )	(341,603 )	(469 )	(183,381 )	(189,694 )	(190,248 )	(554 )
	(686,855 )	(713,353 )	(713,446 )	(93 )	(465,036 )	(488,501 )	(488,106 )	395
Total TBA securities, net	\$(573,711)	\$(595,718)	\$(596,051)	\$(333 )	\$(415,898)	\$(438,727)	\$(438,236)	\$ 491

(1) Notional amount represents the principal balance of the underlying Agency RMBS.

(2) Cost basis represents the forward price to be paid (received) for the underlying Agency RMBS.

(3) Market value represents the current market value of the underlying Agency RMBS (on a forward delivery basis) as of period end.

Net carrying value represents the difference between the market value of the TBA contract as of period end and the (4) cost basis and is reported in Financial derivatives-assets at fair value and Financial derivatives-liabilities at fair value on the Consolidated Balance Sheet.

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The table below details the average notional values of the Company's financial derivatives, using absolute value of month end notional values, for the years ended December 31, 2017 and 2016:

Derivative Type	Year	Year
	Ended December 31, 2017	Ended December 31, 2016
	(In thousands)	
Interest rate swaps	\$549,907	\$451,847
TBAs	796,813	488,075
Futures	30,092	22,085
Swaptions	4,615	—

Gains and losses on the Company's financial derivatives for the years ended December 31, 2017, 2016, and 2015 are summarized in the tables below:

Derivative Type	Year Ended December 31, 2017			Change in Net Unrealized Gains (Losses) on Accrued Periodic Settlements of Interest Rate Swaps	Change in Net Unrealized Gains (Losses) on Accrued Periodic Settlements of Interest Rate Swaps	Change in Net Unrealized Gains (Losses) on Financial Derivatives
	Net Realized Gains (Losses) on Periodic Settlements of Interest Rate Swaps	Net Realized Gains (Losses) Other Than Periodic Settlements of Interest Rate Swaps	Net Realized Gains (Losses) on Financial Derivatives			
	(In thousands)					
Interest rate swaps	\$ (2,491)	\$ 229	\$ (2,262)	\$ 166	\$ 3,232	\$ 3,398
Swaptions		—	—		(68)	(68)
TBAs		(6,423)	(6,423)		(824)	(824)
Futures		(398)	(398)		99	99
Total	\$ (2,491)	\$ (6,592)	\$ (9,083)	\$ 166	\$ 2,439	\$ 2,605

Derivative Type	Year Ended December 31, 2016			Change in Net Unrealized Gains (Losses) on Accrued Periodic Settlements of Interest Rate Swaps	Change in Net Unrealized Gains (Losses) on Accrued Periodic Settlements of Interest Rate Swaps	Change in Net Unrealized Gains (Losses) on Financial Derivatives
	Net Realized Gains (Losses) on Periodic Settlements of Interest Rate Swaps	Net Realized Gains (Losses) Other Than Periodic Settlements of Interest Rate Swaps	Net Realized Gains (Losses) on Financial Derivatives			
	(In thousands)					
Interest rate swaps	\$ (4,338)	\$ (10,418)	\$ (14,756)	\$ 763	\$ 5,231	\$ 5,994
TBAs		1,424	1,424		439	439
Futures		1,212	1,212		54	54
Total	\$ (4,338)	\$ (7,782)	\$ (12,120)	\$ 763	\$ 5,724	\$ 6,487

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Derivative Type	Net Realized Gains (Losses) on Periodic Settlements of Interest Rate Swaps	Net Realized Gains (Losses) Other Than Periodic Settlements of Interest Rate Swaps	Net Realized Gains (Losses) on Financial Derivatives	Change in Net Unrealized Gains (Losses) on Accrued Periodic Settlements of Interest Rate Swaps	Change in Net Unrealized Gains (Losses) Other Than on Accrued Periodic Settlements of Interest Rate Swaps	Change in Net Unrealized Gains (Losses) on Financial Derivatives
(In thousands)						
Interest rate swaps	\$(7,027)	\$ (8,850 )	\$ (15,877 )	\$ (350 )	\$ 2,578	\$ 2,228
Swaptions		(500 )	(500 )		(78 )	(78 )
TBAs		(7,041 )	(7,041 )		1,251	1,251
Futures		\$ (14 )	\$ (14 )		\$ 18	\$ 18
Total	\$(7,027)	\$ (16,405 )	\$ (23,432 )	\$ (350 )	\$ 3,769	\$ 3,419

From time to time, the Company uses short positions in U.S. Treasury positions as a component of its interest rate hedging portfolio. As of December 31, 2017, the Company held short positions in U.S. Treasury securities, with a principal amount of \$82.5 million and a fair value of \$81.3 million. As of December 31, 2016, the Company held short positions in U.S. Treasury securities, with a principal amount of \$78.6 million and a fair value of \$74.2 million. Such securities are included on the Company's Consolidated Balance Sheet under the caption U.S. Treasury securities sold short, at fair value.

#### 6. Borrowings under Repurchase Agreements

The Company enters into repurchase agreements. A repurchase agreement involves the sale of an asset to a counterparty together with a simultaneous agreement to repurchase the transferred asset or similar asset from such counterparty at a future date. The Company accounts for its repurchase agreements as collateralized borrowings, with the transferred assets effectively serving as collateral for the related borrowing. The Company's repurchase agreements typically range in term from 30 to 180 days. The principal economic terms of each repurchase agreement—such as loan amount, interest rate, and maturity date—are typically negotiated on a transaction-by-transaction basis. Other terms and conditions, such as relating to events of default, are typically governed under the Company's master repurchase agreements. Absent an event of default, the Company maintains beneficial ownership of the transferred securities during the term of the repurchase agreement and receives the related principal and interest payments. Interest rates on these borrowings are generally fixed based on prevailing rates corresponding to the terms of the borrowings, and interest is paid at the termination of the repurchase agreement at which time the Company may enter into a new repurchase agreement at prevailing market rates with the same counterparty, repay that counterparty and possibly negotiate financing terms with a different counterparty, or choose to no longer finance the related asset. In response to a decline in the fair value of the transferred securities, whether as a result of changes in market conditions, security paydowns, or other factors, repurchase agreement counterparties will typically make a margin call, whereby the Company will be required to post additional securities and/or cash as collateral with the counterparty in order to re-establish the agreed-upon collateralization requirements. In the event of increases in fair value of the transferred securities, the Company generally can require the counterparty to post collateral with it in the form of cash or securities. The Company is generally permitted to sell or re-pledge any securities posted by the counterparty as collateral; however, upon termination of the repurchase agreement, or other circumstance in which the counterparty is no longer required to post such margin, the Company must return to the counterparty the same security that had been posted. The contractual amount (loan amount) of the Company's repurchase agreements approximates fair value, based on the short-term nature of the debt and the adequacy of the collateral.

At any given time, the Company seeks to have its outstanding borrowings under repurchase agreements with several different counterparties in order to reduce the exposure to any single counterparty. As of December 31, 2017 and 2016, the Company had outstanding borrowings under repurchase agreements with fifteen and thirteen counterparties, respectively.

The following table details the Company's outstanding borrowings under repurchase agreements as of December 31, 2017 and 2016:

Remaining Days to Maturity	December 31, 2017			December 31, 2016		
	Borrowings Outstanding	Interest Rate	Weighted Average Remaining Days to Maturity	Borrowings Outstanding	Interest Rate	Weighted Average Remaining Days to Maturity
	(In thousands)					
30 days or less	\$410,628	1.41 %	15	\$545,817	0.80 %	19
31-60 days	906,602	1.46	46	304,398	0.91	45
61-90 days	273,665	1.60	74	299,081	0.98	74
91-120 days	6,311	1.61	120	1,050	0.88	109
121-150 days	—	—	—	12,428	0.97	135

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151-180 days	—	—	—	35,199	1.05	164
Total	\$1,597,206	1.47%	43	\$1,197,973	0.88%	45

Repurchase agreements involving underlying investments that the Company sold prior to period end, for settlement following period end, are shown using their original maturity dates even though such repurchase agreements may be expected to be terminated early upon settlement of the sale of the underlying investment.

As of December 31, 2017 and 2016, the fair value of RMBS transferred as collateral under outstanding borrowings under repurchase agreements was \$1.7 billion and \$1.2 billion, respectively. Collateral transferred under outstanding borrowings as of December 31, 2017 includes RMBS in the amount of \$21.5 million that were sold prior to period end but for which such sale

had not yet settled. Collateral transferred under outstanding borrowings as of December 31, 2016 includes RMBS in the amount of \$33.5 million that were sold prior to year end but for which such sale had not yet settled. In addition the Company posted net cash collateral of \$18.7 million and additional securities with a fair value of \$2.5 million as of December 31, 2017 as a result of margin calls from various counterparties. The Company posted net cash collateral of \$42.2 million and additional securities with a fair value of \$0.5 million as of December 31, 2016 as a result of margin calls from various counterparties.

Amount at risk represents the excess, if any, for each counterparty of the fair value of collateral held by such counterparty over the amounts outstanding under repurchase agreements. The following table reflects counterparties for which the amounts at risk relating to our repurchase agreements was greater than 10% of shareholders' equity as of December 31, 2016. There was no counterparty for which the amount at risk was greater than 10% of shareholders' equity as of December 31, 2017.

December 31, 2016:

Counterparty	Amount at Risk <sup>(1)</sup> (In thousands)	Weighted Average Remaining Days to Maturity	Percentage of Shareholders' Equity
J.P. Morgan Securities Inc.	\$ 15,077	58	10.6 %

(1) Amounts at risk exclude, in aggregate, \$0.6 million of net accrued interest, defined as accrued interest on securities held as collateral less interest payable on cash borrowed.

#### 7. Offsetting of Assets and Liabilities

The Company records financial instruments at fair value as described in Note 2. All financial instruments are recorded on a gross basis on the Consolidated Balance Sheet. In connection with its financial derivatives, repurchase agreements, and related trading agreements, the Company and its counterparties are required to pledge collateral. Cash or other collateral is exchanged as required with each of the Company's counterparties in connection with open derivative positions and repurchase agreements.

The following tables present information about certain assets and liabilities representing financial instruments as of December 31, 2017 and 2016. The Company has not previously entered into master netting agreements with any of its counterparties. Certain of the Company's repurchase and reverse repurchase agreements and financial derivative transactions are governed by underlying agreements that generally provide a right of offset in the event of default or in the event of a bankruptcy of either party to the transaction.

December 31, 2017:

Description	Amount of Assets (Liabilities) Presented in the Consolidated Balance Sheet <sup>(1)</sup>	Financial Instruments for Offset	Financial Instruments Transferred or Pledged as Collateral <sup>(2)(3)</sup>	Cash Collateral (Received) Pledged <sup>(2)(3)</sup>	Net Amount
(In thousands)					
Assets:					
Financial derivatives—assets	\$ 8,792	\$ (1,046 )	\$ —	\$ —	—\$ 7,746
Reverse repurchase agreements	81,461	(81,461 )	—	—	—
Liabilities:					
Financial derivatives—liabilities	(1,863 )	1,046	—	697	(120 )
Repurchase agreements	(1,597,206 )	81,461	1,497,038	18,707	—

(1) In the Company's Consolidated Balance Sheet, all balances associated with the repurchase agreements and financial derivatives are presented on a gross basis.

For the purpose of this presentation, for each row the total amount of financial instruments transferred or pledged and cash collateral (received) or pledged may not exceed the applicable gross amount of assets or (liabilities) as presented here. Therefore, the Company has reduced the amount of financial instruments transferred or pledged as collateral related to the Company's repurchase agreements and cash collateral pledged on the Company's financial derivative assets and liabilities. Total financial instruments transferred or pledged as collateral on the Company's repurchase agreements as of December 31, 2017 were \$1.66 billion. As of December 31, 2017 total cash collateral on financial derivative assets and liabilities excludes \$5.4 million and \$1.4 million respectively of net excess cash collateral.

When collateral is pledged to or pledged by a counterparty, it is often pledged or posted with respect to all positions with such counterparty, and in such cases such collateral cannot be specifically identified as relating to a specific asset or liability. As a result, in preparing the above table, the Company has made assumptions in allocating pledged or posted collateral among the various rows.



December 31, 2016:

Description	Amount of Assets (Liabilities) Presented in the Consolidated Balance Sheet <sup>(1)</sup>	Financial Instruments for Offset	Financial Instruments Transferred or Pledged as Collateral <sup>(2)(3)</sup>	Cash Collateral (Received) Pledged <sup>(2)(3)</sup>	Net Amount
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(In thousands)

Assets:

Financial derivatives—assets	\$ 6,008	\$ (1,346 )	\$ —	\$ (50 )	\$ 4,612
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Reverse repurchase agreements	75,012	(75,012 )	—	—	—
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Liabilities:

Financial derivatives—liabilities	(1,975 )	1,346	—	555	(74 )
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Repurchase agreements	(1,197,973 )	75,012	1,080,786	42,175	—
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(1) In the Company's Consolidated Balance Sheet, all balances associated with the repurchase agreements and financial derivatives are presented on a gross basis.

For the purpose of this presentation, for each row the total amount of financial instruments transferred or pledged and cash collateral (received) or pledged may not exceed the applicable gross amount of assets or (liabilities) as presented here. Therefore the Company has reduced the amount of financial instruments transferred or pledged as collateral related to the Company's repurchase agreements and cash collateral pledged on the Company's financial derivative assets and liabilities. Total financial instruments transferred or pledged as collateral on the Company's repurchase agreements as of December 31, 2016 were \$1.22 billion. As of December 31, 2016 total cash collateral on financial derivative assets and liabilities excludes \$4.6 million and \$0.1 million, respectively of net excess cash collateral.

(2) When collateral is pledged to or pledged by a counterparty, it is often pledged or posted with respect to all positions with such counterparty, and in such cases such collateral cannot be specifically identified as relating to a specific asset or liability. As a result, in preparing the above table, the Company has made assumptions in allocating pledged or posted collateral among the various rows.

## 8. Earnings Per Share

Basic earnings per share, or "EPS," is calculated by dividing net income (loss) for the period by the weighted average of the Company's common shares outstanding for the period. Diluted EPS takes into account the effect of outstanding dilutive instruments, such as share options and warrants, if any, and uses 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. As of December 31, 2017, 2016, and 2015, the Company did not have any dilutive instruments outstanding.

The following table presents a reconciliation of the earnings/(losses) and shares used in calculating basic EPS for the years ended December 31, 2017, 2016, and 2015:

(In thousands except for share amounts)	Year Ended December 31, 2017	Year Ended December 31, 2016	Year Ended December 31, 2015
Numerator:			
Net income	\$ 10,788	\$ 11,906	\$ 30
Denominator:			
Basic and diluted weighted average shares outstanding	11,601,979	9,121,344	9,143,508
Basic and Diluted Earnings Per Share	\$ 0.93	\$ 1.31	\$ —

## 9. Related Party Transactions

#### Management Agreement

The Company is party to the Management Agreement, which has a current term that expires on September 24, 2018, and has been, and will continue to be, renewed automatically each year thereafter for an additional one-year period, subject to certain termination rights. The Company is externally managed and advised by the Manager. Pursuant to the terms of the Management Agreement, the Manager provides the Company with its management team, including its officers, and appropriate support personnel. The Company does not have any employees. The Manager is responsible for the day-to-day operations of the Company.

The Manager receives an annual management fee in an amount equal to 1.50% per annum of shareholders' equity (as defined in the Management Agreement) as of the end of each fiscal quarter (before deductions for any management fee with respect to such fiscal period). The management fee is payable quarterly in arrears. For the years ended December 31, 2017, 2016, and 2015, the total management fee incurred was \$2.7 million, \$2.1 million, and \$2.3 million, respectively.

#### Services Agreement

The Manager and EMG are parties to a services agreement, pursuant to which EMG is required to provide to the Manager sufficient personnel, services, and resources to enable the Manager to carry out its obligations and responsibilities under the Management Agreement. The Company is a named third-party beneficiary to the services agreement and, as a result, has, as a non-exclusive remedy, a direct right of action against EMG in the event of any breach by the Manager of any of its duties, obligations, or agreements under the Management Agreement that arise out of or result from any breach by EMG of its obligations under the services agreement. The services agreement will terminate upon the termination of the Management Agreement. Pursuant to the services agreement, the Manager makes certain payments to EMG in connection with the services provided. The Manager and EMG have overlapping ownership and are under common control.

#### Expense Reimbursement

Under the terms of the Management Agreement, the Company is required to reimburse the Manager for operating expenses related to the Company that are incurred by the Manager, including expenses relating to legal, accounting, due diligence, other services, and all other costs and expenses. The Company's reimbursement obligation is not subject to any dollar limitation. Expenses will be reimbursed in cash within 60 days following delivery of the expense statement by the Manager; provided, however, that such reimbursement may be offset by the Manager against amounts due to the Company from the Manager. The Company will not reimburse the Manager for the salaries and other compensation of the Manager's personnel except that the Company will be responsible for expenses incurred by the Manager in employing certain dedicated or partially dedicated personnel as further described below.

The Company reimburses the Manager for the allocable share of the compensation, including, without limitation, wages, salaries, and employee benefits paid or reimbursed, as approved by the Compensation Committee of the Board of Trustees, to certain dedicated or partially dedicated personnel who spend all or a portion of their time managing the Company's affairs, based upon the percentage of time devoted by such personnel to the Company's affairs. In their capacities as officers or personnel of the Manager or its affiliates, such personnel will devote such portion of their time to the Company's affairs as is necessary to enable the Company to operate its business.

For the years ended December 31, 2017, 2016, and 2015, the Company reimbursed the Manager \$2.1 million, \$1.8 million, and \$1.5 million, respectively, for previously incurred operating and compensation expenses.

#### Termination Fee

The Management Agreement requires the Company to pay a termination fee to the Manager in the event of (1) the Company's termination or non-renewal of the Management Agreement without cause or (2) the Manager's termination of the Management Agreement upon a default by the Company in the performance of any material term of the Management Agreement. Such termination fee will be equal to 5% of Shareholders' Equity, as defined in the Management Agreement as of the month-end preceding the date of the notice of termination or non-renewal of the Management Agreement.

#### Registration Rights Agreement

The Company is a party to a registration rights agreement with an affiliate of EMG and with the Blackstone Tactical Opportunities Funds (the "Blackstone Funds") pursuant to which the Company has granted its initial investors and each of their permitted transferees and other holders of the Company's "registrable common shares" (as such term is defined in the registration rights agreement) who become parties to the registration rights agreement with certain demand and/or piggy-back registration and shelf takedown rights.

#### 10. Capital

The Company has authorized 500,000,000 common shares, \$0.01 par value per share, and 100,000,000 preferred shares, \$0.01 par value per share. The Board of Trustees may authorize the issuance of additional shares of either class. As of December 31, 2017 and 2016, there were 13,340,217 and 9,130,897 common shares outstanding, respectively. No preferred shares have been issued.

During the years ended December 31, 2017, 2016, and 2015, the Board of Directors authorized dividends totaling \$1.57 per share, \$1.65 per share, and \$2.00 per share, respectively. Total dividends declared during the years ended December 31, 2017, 2016, and 2015 were \$18.9 million, \$15.1 million, and \$18.3 million, respectively.

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On May 15, 2017, the Company completed a follow-on offering of 3,000,000 of its common shares. The offering generated net proceeds, after underwriters' discounts and offering costs, in the amount of \$41.8 million. On June 7, 2017 the Company issued an additional 230,000 common shares in connection with the partial exercise of the underwriters' option to

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purchase up to 15% of the common shares that the Company issued in the initial offering. The exercise of the underwriters' option resulted in net proceeds to the Company of an additional \$3.2 million, after underwriters' discount and offering costs.

On June 26, 2017, the Company entered into equity distribution agreements with third party sales agents under which the Company is authorized to offer and sell common shares from time to time with a maximum aggregate gross offering price of up to \$100.0 million. During the year ended December 31, 2017, the Company issued 964,968 common shares under the agreements, generating net proceeds of \$14.0 million, after third party agent commissions and fees of \$0.2 million.

On September 12, 2017, the Company's Board of Trustees authorized the issuance of 9,976 restricted common shares to its independent trustees pursuant to trustee share award agreements. Such restricted common shares are subject to forfeiture restrictions that will lapse on September 11, 2018.

On December 12, 2017, the Company's Board of Trustees authorized the issuance of 4,413 restricted common shares to certain of its partially dedicated employees pursuant to employee share award agreements. Such restricted common shares are subject to forfeiture restrictions that will lapse on December 12, 2018 with respect to 2,630 common shares and December 12, 2019 with respect to 1,783 common shares.

Detailed below is a roll forward of the Company's common shares outstanding for the years ended December 31, 2017, 2016, and 2015:

	Year Ended December 31,		
	2017	2016	2015
Common Shares Outstanding (12/31/2016, 12/31/2015, and 12/31/2014, respectively)	9,130,897	9,135,103	9,149,274
Share Activity:			
Shares issued	4,194,968	—	—
Restricted shares issued	14,389	13,714	15,390
Shares repurchased	—	(17,920 )	(29,561 )
Forfeiture of common shares to satisfy tax withholding obligations	(37 )	—	—
Common Shares Outstanding (12/31/2017, 12/31/2016, and 12/31/2015, respectively)	13,340,217	9,130,897	9,135,103
Unvested restricted shares outstanding (12/31/2017, 12/31/2016, and 12/31/2015, respectively)	15,945	16,395	15,390

The below table provides details on the Company's restricted shares granted pursuant to share award agreements which are unvested at December 31, 2017:

Grant Recipient	Number of Restricted Shares Granted	Grant Date	Vesting Date <sup>(1)</sup>
Independent trustees:	9,976	September 12, 2017	September 11, 2018
Partially dedicated employees:	2,630	December 12, 2017	December 12, 2018
	1,783	December 12, 2017	December 12, 2019
	1,556	December 13, 2016	December 13, 2018

(1)Date at which such restricted shares will vest and become non-forfeitable.

As of December 31, 2017, there were 340,461 shares available for future issuance under the Company's 2013 Equity Incentive Plan.

On August 13, 2013, the Company's Board of Trustees approved the adoption of a \$10 million share repurchase program. The program, which is open-ended in duration, allows the Company to make repurchases from time to time on the open market or in negotiated transactions, including through Rule 10b5-1 plans. Repurchases are at the Company's discretion, subject to applicable law, share availability, price and the Company's financial performance, among other considerations. During the year ended December 31, 2017, the Company did not purchase any of its

common shares. From inception of the share repurchase program through December 31, 2017, the Company purchased 47,481 of its common shares at an aggregate cost of \$0.6 million, and an average price per share of \$12.03.

### Distribution Policy

The timing and frequency of distributions will be determined by the Board of Trustees based upon a variety of factors deemed relevant by the Company's trustees, including restrictions under applicable law, capital requirements of the Company, and the REIT requirements of the Code. Distributions to shareholders generally will be taxable as ordinary income, although a portion of such distributions may be designated as long-term capital gain or qualified dividend income, or may constitute a return of capital. The Company will furnish annually to each shareholder a statement setting forth distributions paid or deemed paid during the preceding year and their U.S. federal income tax treatment. It is the intention of the Company to distribute at least 100% of its taxable income, after application of available tax attributes, within the time limits prescribed by the Internal Revenue Code, which may extend into the subsequent taxable year.

### 11. Commitments and Contingencies

From time to time, the Company may become involved in various claims and legal actions arising in the ordinary course of business. The Company provides current directors and officers with a limited indemnification against liabilities arising in connection with the performance of their duties to the Company.

In the normal course of business the Company may also enter into contracts that contain a variety of representations, warranties, and general indemnifications. The Company's maximum exposure under these arrangements, including future claims that may be made against the Company that have not yet occurred, is unknown. The Company has not incurred any costs to defend lawsuits or settle claims related to these indemnification agreements. The Company has no liabilities recorded for these agreements as of December 31, 2017 and 2016 and management is not aware of any significant contingencies at December 31, 2017.

### 12. Condensed Quarterly Financial Data (Unaudited)

Detailed below is unaudited quarterly information for the years ended December 31, 2017 and 2016.

(In thousands except for per share amounts)	Three Month Period Ended March 31, 2017	Three Month Period Ended June 30, 2017	Three Month Period Ended September 30, 2017	Three Month Period Ended December 31, 2017
<b>INTEREST INCOME (EXPENSE)</b>				
Interest income	\$12,329	\$10,883	\$12,867	\$13,111
Interest expense	(3,179 )	(4,020 )	(5,719 )	(6,129 )
Total net interest income	9,150	6,863	7,148	6,982
<b>EXPENSES</b>				
Management fees to affiliate	527	685	741	725
Professional fees	175	178	157	227
Compensation expense	159	216	222	178
Insurance expense <sup>(1)</sup>	82	74	74	74
Other operating expenses <sup>(1)</sup>	329	284	287	308
Total expenses	1,272	1,437	1,481	1,512
<b>OTHER INCOME (LOSS)</b>				
Net realized gains (losses) on securities and financial derivatives	(1,337 )	(9,487 )	(2,632 )	1,699
Change in net unrealized gains (losses) on securities and financial derivatives	(4,489 )	5,664	3,305	(6,376 )
Total other income (loss)	(5,826 )	(3,823 )	673	(4,677 )
<b>NET INCOME (LOSS)</b>	<b>\$2,052</b>	<b>\$1,603</b>	<b>\$6,340</b>	<b>\$793</b>
<b>NET INCOME (LOSS) PER COMMON SHARE:</b>				
Basic and Diluted <sup>(2)</sup>	\$0.22	\$0.15	\$0.48	\$0.06
<b>CASH DIVIDENDS PER COMMON SHARE:</b>				
Dividends declared	\$0.40	\$0.40	\$0.40	\$0.37

(1) Conformed to current period presentation.

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For the year ended December 31, 2017 the sum of EPS for the four quarters of the year does not equal EPS as (2) calculated for the entire year (see Note 8) as a result of changes in shares during the year due to issuances of common shares, as EPS is calculated using average shares outstanding during the period.



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(In thousands except for per share amounts)	Three Month Period Ended March 31, 2016	Three Month Period Ended June 30, 2016	Three Month Period Ended September 30, 2016	Three Month Period Ended December 31, 2016
<b>INTEREST INCOME (EXPENSE)</b>				
Interest income	\$9,651	\$7,538	\$ 7,096	\$ 9,213
Interest expense	(2,051 )	(2,260 )	(2,279 )	(2,684 )
Total net interest income	7,600	5,278	4,817	6,529
<b>EXPENSES</b>				
Management fees to affiliate	528	528	539	534
Professional fees	218	161	171	118
Compensation expense	151	169	142	137
Insurance expense <sup>(1)</sup>	97	88	88	88
Other operating expenses <sup>(1)</sup>	357	326	314	255
Total expenses	1,351	1,272	1,254	1,132
<b>OTHER INCOME (LOSS)</b>				
Net realized gains (losses) on securities and financial derivatives	(986 )	(11,507)	(28 )	8,821
Change in net unrealized gains (losses) on securities and financial derivatives	(5,502 )	11,008	3,091	(12,206 )
Total other income (loss)	(6,488 )	(499 )	3,063	(3,385 )
<b>NET INCOME (LOSS)</b>	<b>\$(239 )</b>	<b>\$3,507</b>	<b>\$ 6,626</b>	<b>\$ 2,012</b>
<b>NET INCOME (LOSS) PER COMMON SHARE:</b>				
Basic and Diluted <sup>(2)</sup>	\$(0.03 )	\$0.38	\$ 0.73	\$ 0.22
<b>CASH DIVIDENDS PER COMMON SHARE:</b>				
Dividends declared	\$0.45	\$0.40	\$ 0.40	\$ 0.40

(1) Conformed to current period presentation.

For the year ended December 31, 2016 the sum of EPS for the four quarters of the year does not equal EPS as (2) calculated for the entire year (see Note 8) as a result of changes in shares during the year due to restricted share issuances and common share repurchases, as EPS is calculated using average shares outstanding during the period.

### 13. Subsequent Events

On February 6, 2018, the Company's Board of Trustees approved the adoption of a share repurchase program under which the Company is authorized to repurchase up to 1.2 million of its common shares. The program, which is open-ended in duration, allows the Company to make repurchases from time to time on the open market or in negotiated transactions, including through Rule 10b5-1 plans. Repurchases are at the Company's discretion, subject to applicable law, share availability, price and our financial performance, among other considerations. This program superseded the program that was previously adopted on August 13, 2013. From the adoption of the program through March 9, 2018, the Company has repurchased 216,881 shares for an aggregate cost of \$2.4 million.

On March 7, 2018 the Company's Board of Trustees approved a dividend for the first quarter of 2018 in the amount of \$0.37 per share payable on April 25, 2018 to shareholders of record as of March 29, 2018.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosures  
None.

Item 9A. Controls and Procedures

Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC, and that such information is accumulated and communicated to our management as appropriate to allow timely decisions regarding required disclosures. An evaluation was performed under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act) as of December 31, 2017. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of December 31, 2017.

Internal Control Over Financial Reporting

There have been no changes in our internal control over financial reporting that occurred during the three month period ended December 31, 2017 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Management's Annual Report on Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in 13a-15(f) and 15d-15(f) of the Exchange Act). Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. GAAP. Our internal control over financial reporting includes policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. GAAP, and that receipts and expenditures are being made only in accordance with authorizations of our management and directors; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of assets that could have a material effect on our financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we evaluated the effectiveness of our internal control over financial reporting using the criteria set forth in the 2013 Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on our assessment and those criteria, our management concluded that our internal control over financial reporting was effective as of December 31, 2017.

This Annual Report on Form 10-K does not include an attestation report of our independent registered public accounting firm regarding internal control over financial reporting. Because we are an "emerging growth company" under the federal securities laws, management's report was not subject to attestation by our independent registered public accounting firm pursuant to an exemption under Section 404(b) of the Sarbanes-Oxley Act of 2002.

Item 9B. Other Information

Additional Material U.S. Federal Income Tax Considerations

The information set forth in Exhibit 99.1 hereto and incorporated by reference herein is a summary of certain additional material U.S. federal income tax considerations with respect to the ownership of our securities. The information filed herewith as Exhibit 99.1 supplements and should be read together with "Material U.S. Federal Income Tax Considerations" in the base prospectus dated December 28, 2017, which is included in and forms a part of our registration statement on Form S-3 (No. 333-220923).

Amended and Restated Management Agreement

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On March 13, 2018, the Company, for itself and on behalf of each of the Company's current and future subsidiaries, and Ellington Residential Mortgage Management LLC (the "Manager") entered into the Fifth Amended and Restated Management

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Agreement (the "Amended Management Agreement"). The Amended Management Agreement was amended to allow a majority of the independent members of the Board of Trustees to waive potential fee reductions in specified circumstances. The Amended Management Agreement amends, restates, and supersedes in all respects that certain Fourth Amended and Restated Management Agreement between the Company and the Manager, dated as of November 3, 2015.

A copy of the Amended Management Agreement is filed as Exhibit 10.1 hereto and incorporated herein by reference.

### PART III

#### Item 10. Directors, Executive Officers and Corporate Governance

The information required by Item 10 is incorporated by reference to information to be included in our definitive Proxy Statement for our 2018 annual shareholders' meeting.

Our Board of Trustees has established a Code of Business Conduct and Ethics that applies to our officers and trustees and to our Manager's and certain of its affiliates' officers, directors, and employees when such individuals are acting for us or on our behalf which is available on our website at [www.earnreit.com](http://www.earnreit.com). Any waiver of our Code of Business Conduct and Ethics of our executive officers or trustees may be made only by our Board of Trustees or one of its committees.

We intend to satisfy the disclosure requirement under Item 5.05 of Form 8-K relating to amendments to or waivers from any provision of our Code of Business Conduct and Ethics applicable to our principal executive officer, principal financial officer, principal accounting officer or controller or persons performing similar functions and that relates to any element of the code of ethics definition enumerated in Item 406(b) of Regulation S-K by posting such information on our website at [www.earnreit.com](http://www.earnreit.com) under the, "For Our Shareholders-Corporate Governance" section of the website.

#### Item 11. Executive Compensation

The information required by Item 11 is incorporated by reference to information to be included in our definitive Proxy Statement for our 2018 annual shareholders' meeting.

#### Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters

The information required by Item 12 is incorporated by reference to information to be included in our definitive Proxy Statement for our 2018 annual shareholders' meeting.

#### Item 13. Certain Relationships and Related Transactions, and Director Independence

The information required by Item 13 is incorporated by reference to information to be included in our definitive Proxy Statement for our 2018 annual shareholders' meeting.

#### Item 14. Principal Accounting Fees and Services

The information required by Item 14 is incorporated by reference to information to be included in our definitive Proxy Statement for our 2018 annual shareholders' meeting.

PART IV

Item 15. Exhibits and Financial Statement Schedules

(a) Documents filed as part of this report:

1. Financial Statements.

See Index to consolidated financial statements, included in Part II, Item 8 of this Annual Report on Form 10-K.

2. Schedules to Financial Statements:

All financial statement schedules not included have been omitted because they are either inapplicable or the information required is provided in our Financial Statements and Notes thereto, included in Part II, Item 8, of this Annual Report on Form 10-K.

Exhibit Description

- 3.1 Articles of Amendment and Restatement of Ellington Residential Mortgage REIT filed on May 3, 2013 (incorporated by reference to the Company's quarterly report on Form 10-Q for the quarter ended March 31, 2013).
- 3.2 Amended and Restated Bylaws of Ellington Residential Mortgage REIT (incorporated by reference to the Company's quarterly report on Form 10-Q for the quarter ended March 31, 2013).
- 4.1 Specimen Common Share Certificate of Ellington Residential Mortgage REIT (incorporated by reference to the registration statement on Form S-11 (No. 333-187662), filed on April 23, 2013).
- 10.1 Fifth Amended and Restated Management Agreement between Ellington Residential Mortgage REIT and Ellington Residential Mortgage Management LLC, dated as of March 13, 2018
- 10.2 Fourth Amended and Restated Management Agreement between Ellington Residential Mortgage REIT and Ellington Residential Mortgage Management LLC (incorporated by reference to the Quarterly Report on Form 10-Q, filed on November 5, 2015).
- 10.3+ 2013 Equity Incentive Plan (incorporated by reference to the registration statement on Form S-11 (No. 333-187662), filed on April 23, 2013).
- 10.4+ Form of Share Award Agreement (for trustees) (incorporated by reference to the Company's Current Report on Form 8-K, filed on September 25, 2013).
- 10.5+ Form of Share Award Agreement (for trustees) (incorporated by reference to the Company's quarterly report on Form 10-Q for the quarter ended September 30, 2014).
- 10.6+ Form of Share Award Agreement (for Ellington employees) (incorporated by reference to the Company's Current Report on Form 8-K filed on December 18, 2015).
- 10.7+ Form of Share Award Agreement (for Ellington employees) (incorporated by reference to the Company's Annual Report on Form 10-K for the year ended December 31, 2016).
- 10.8 Form of Indemnification Agreement (incorporated by reference to the registration statement on Form S-11 (No. 333-187662), filed on April 29, 2013).
- 10.9 Registration Rights Agreement, dated as of September 24, 2012, by and among Ellington Residential Mortgage REIT, EMG Holdings, L.P. and Blackstone Tactical Opportunities EARN Holdings, L.L.C.(incorporated by reference to the registration statement on Form S-11 (No. 333-187662), filed on April 23, 2013).

- 10.10 Shareholders Agreement by and among Ellington Residential Mortgage REIT, EMG Holdings, L.P., and Blackstone Tactical Opportunities EARN Holdings, L.L.C. dated May 6, 2013 (incorporated by reference to the Company's quarterly report on Form 10-Q for the quarter ended March 31, 2013).
- 10.11 Amended and Restated Agreement of Limited Partnership of Ellington Residential Mortgage LP (incorporated by reference to the registration statement on Form S-11 (No. 333-187662), filed on April 23, 2013).
- 10.12 Underwriting Agreement, dated May 10, 2017, among Ellington Residential Mortgage REIT, and Morgan Stanley & LLC as representative of the several underwriters listed on Schedule A attached thereto (incorporated by reference to the Current Report on Form 8-K filed on May 12, 2017)
- 10.13 Form of Equity Distribution Agreement, dated June 26, 2017, by and among Ellington Residential Mortgage REIT, Ellington Residential Mortgage Management LLC, and the applicable Agent (incorporated by reference to the Current Report on Form 8-K filed on June 26, 2017)

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Exhibit Description

Continued

- 12.1 Statement re: Computation of Ratio of Earnings to Fixed Charges and of Earnings to Combined Fixed Charges and Preferred Stock Dividends
- 21.1 List of Subsidiaries
- 23.1 Consent of the Independent Registered Public Accounting Firm
- 24.1 Power of Attorney (included on signature page)
- 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes – Oxley Act of 2002
- 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes – Oxley Act of 2002
- 32.1\* Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes – Oxley Act of 2002
- 32.2\* Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes – Oxley Act of 2002
- 99.1 Additional Material U.S. Federal Income Tax Considerations

101 The following financial information from Ellington Residential Mortgage REIT's Annual Report on Form 10-K for the year ended December 31, 2016, formatted in XBRL (Extensible Business Reporting Language):  
(i) Consolidated Balance Sheet, (ii) Consolidated Statement of Operations, (iii) Consolidated Statement of Shareholders' Equity, (iv) Consolidated Statement of Cash Flows and (v) Notes to Consolidated Financial Statements.

\*Furnished herewith. These certifications are not deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended.

+Compensatory plan or arrangement.

Item 16. Form 10-K Summary

None.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ELLINGTON RESIDENTIAL  
MORTGAGE REIT

Date: March 14, 2018 By: /s/ LAURENCE PENN  
Laurence Penn  
Chief Executive Officer  
(Principal Executive Officer)

POWER OF ATTORNEY

We, the undersigned officers and trustees of Ellington Residential Mortgage REIT, hereby severally constitute Laurence Penn, Daniel Margolis, Jason Frank and Lisa Mumford, and each of them singly, our true and lawful attorneys with full power to them, and each of them singly, to sign for us and in our names in the capacities indicated below, any and all amendments to this Annual Report on Form 10-K, and generally to do all such things in our names and in our capacities as officers and trustees to enable Ellington Residential Mortgage REIT to comply with the provisions of the Securities Exchange Act of 1934, as amended, and all requirements of the SEC, hereby ratifying and confirming our signatures as they may be signed by our said attorneys, or any of them, to said Annual Report on Form 10-K and any and all amendments thereto.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and dates indicated.

Signature	Title	Date
/s/ LAURENCE PENN LAURENCE PENN	Chief Executive Officer, President and Trustee (Principal Executive Officer)	March 14, 2018
/s/ LISA MUMFORD LISA MUMFORD	Chief Financial Officer (Principal Financial and Accounting Officer)	March 14, 2018
/s/ MICHAEL W. VRANOS MICHAEL W. VRANOS	Trustee	March 14, 2018
/s/ THOMAS F. ROBARDS THOMAS F. ROBARDS	Chairman of the Board	March 14, 2018
/s/ RONALD I. SIMON PH.D RONALD I. SIMON PH.D	Trustee	March 14, 2018
/s/ ROBERT B. ALLARDICE, III ROBERT B. ALLARDICE, III	Trustee	March 14, 2018
/s/ MENES O. CHEE MENES O. CHEE	Trustee	March 14, 2018



/s/ DAVID MILLER

Trustee

March 14,  
2018

DAVID MILLER

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EXHIBIT INDEX

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+Compensatory plan or arrangement.

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