MFA FINANCIAL, INC.
Form 10-K
March 06, 2013
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2012

OR

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

For the transition period from to

Commission File Number: 1-13991

MFA FINANCIAL, INC.

(Exact name of registrant as specified in its charter)

Maryland	**13-3974868**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
350 Park Avenue, 20th Floor, New York, New York	**10022**
(Address of principal executive offices)	(Zip Code)

(212) 207-6400

(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 Stock, par value $0.01 per share	New York Stock Exchange
8.50% Series A Cumulative Redeemable Preferred Stock, par value $0.01 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 x No o

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 o No x

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K 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. o

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

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o	Smaller reporting company o

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

On June 29, 2012, the aggregate market value of the registrant s common stock held by non-affiliates of the registrant was $2.801 billion based on the closing sales price of our common stock on such date as reported on the New York Stock Exchange.

On February 22, 2013, the registrant had a total of 358,867,860 shares of Common Stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s proxy statement to be filed with the Securities and Exchange Commission in connection with the Annual Meeting of Stockholders scheduled to be held on or about May 22, 2013, are incorporated by reference into Part III of this Annual Report on Form 10-K.

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CAUTIONARY STATEMENT This Annual Report on Form 10-K includes forward-looking statements within the Private Securities Litigation Reform Act of 1995. These forward-looking statements include information about possible or assumed future results with respect to the Company s business, financial condition, liquidity, results of operations, plans and objectives. You can identify forward-looking statements by such words as will, believe, expect, anticipate, estimate, plan, continue, intend, should, could, would, may or similar expressions. We caution that any such forward-looking statements made by us are not guarantees of future performance and that actual results may differ materially from these forward-looking statements. We discuss certain factors that affect our business and that may cause our actual results to differ materially from these forward-looking statements under Item 1A. Risk Factors of this Annual Report on Form 10-K. You are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date on which they are made. We undertake no obligation to update or revise any forward-looking statements.

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In this Annual Report on Form 10-K, references to we, us, our or the Company refer to MFA Financial, Inc. and its subsidiaries unless specifically stated otherwise or the context otherwise indicates. The following defines certain of the commonly used terms in this Annual Report on Form 10-K: MBS refers to mortgage-backed securities secured by pools of residential mortgage loans; Agency MBS refers to MBS that are issued or guaranteed by a federally chartered corporation, such as Fannie Mae or Freddie Mac, or an agency of the U.S. Government, such as Ginnie Mae; Non-Agency MBS are residential MBS that are not guaranteed by any agency of the U.S. Government or any federally chartered corporation; Hybrids refer to hybrid mortgage loans that have interest rates that are fixed for a specified period of time and, thereafter, generally adjust annually to an increment over a specified interest rate index; ARMs refer to Hybrids and adjustable-rate mortgage loans which typically have interest rates that adjust annually to an increment over a specified interest rate index; ARM-MBS refers to residential MBS that are secured by ARMs; and Linked Transactions refer to Non-Agency MBS purchases which were financed with the same counterparty and are therefore considered linked for financial statement reporting purposes and are reported at fair value on a combined basis.

PART I

Item 1. Business.

GENERAL

We are primarily engaged in the business of investing, on a leveraged basis, in residential Agency MBS and Non-Agency MBS. Our principal business objective is to generate net income for distribution to our stockholders resulting from the difference between the interest and other income we earn on our investments and the interest expense we pay on the borrowings that we use to finance our leveraged investments and our operating costs.

We were incorporated in Maryland on July 24, 1997, and began operations on April 10, 1998. We have elected to be taxed as a real estate investment trust (or REIT) for U.S. federal income tax purposes. In order to maintain our qualification as a REIT, we must, among other things, distribute at least 90% of our annual REIT taxable income to our stockholders.

INVESTMENT STRATEGY

Our operating policies require that at least 50% of our investment portfolio consist of Agency and Non-Agency MBS. The remainder of our assets may consist of direct or indirect investments in: (i) other types of MBS and residential mortgage loans; (ii) other mortgage and real estate-related debt and equity; and (iii) other yield instruments (corporate or government), subject at all times to compliance with various asset and income tests to maintain our qualification as a REIT as well as our exemption from the Investment Company Act of 1940, as amended (or the Investment Company Act).

The mortgages collateralizing our MBS portfolio are predominantly Hybrids, ARMs and 15-year fixed-rate mortgages. The Hybrids collateralizing our MBS typically have initial fixed-rate periods generally ranging from three to ten years. After entering their adjustable rate period, interest rates for most of our ARM-MBS reset based on London Interbank Offered Rate (or LIBOR) and the one-year constant maturity treasury (or CMT) rate. The mortgages collateralizing our ARM-MBS typically have interim and lifetime caps on interest rate adjustments.

The coupons earned on ARM-MBS adjust over time as interest rates change, typically after an initial fixed-rate period. Because the interest rates on ARM-MBS adjust, the market values of these assets are generally less sensitive to changes in interest rates than are fixed-rate MBS. Furthermore, 15-year fixed-rate mortgages amortize according to a 15-year amortization schedule and have a 15-year final maturity. Due to their accelerated amortization and shorter final maturity, these assets are generally less sensitive to changes in long-term interest rates as compared to mortgages with a longer final maturity, such as 30-year mortgages. In order to mitigate our interest rate risks, our strategy is to maintain a majority of our portfolio in ARM-MBS and 15-year fixed rate MBS.

While the majority of our portfolio holdings remain in Agency MBS, as part of our investment strategy a significant portion of our portfolio is invested in Non-Agency MBS. By blending Non-Agency MBS with Agency MBS, we seek to generate attractive returns with less sensitivity to changes in the yield curve, interest rate cycles and prepayments.

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Non-Agency MBS Portfolio

Our Non-Agency MBS have been acquired primarily at discounts to face/par value. A portion of the purchase discount on substantially all of our Non-Agency MBS is designated as a non-accretable purchase discount (or Credit Reserve), which effectively mitigates our risk of loss on the mortgages collateralizing such MBS and is not expected to be accreted into interest income. The portion of the purchase discount that is not designated as credit reserve is accreted into interest income over the life of the security. Because the expected yields on our Non-Agency MBS are significantly greater than the expected yields on non-credit sensitive assets, we believe that changes in Non-Agency MBS prices are generally not highly correlated to changes in market interest rates and are more significantly impacted by general economic conditions and housing specific performance. Yields on Non-Agency MBS, unlike Agency MBS, will exhibit sensitivity to changes in credit performance. The extent to which our yield on Non-Agency MBS is impacted by the accretion of purchase discounts will vary over time by security, based upon the amount of purchase discount, the actual credit performance, and conditional prepayment rate (or CPR) experienced on each MBS.

FINANCING STRATEGY

Our financing strategy is designed to increase the size of our MBS portfolio by borrowing against a substantial portion of the market value of the MBS in our portfolio. We primarily use repurchase agreements to finance the acquisition of our Agency MBS and repurchase agreements and securitized debt to finance the acquisition of our Non-Agency MBS. We enter into interest rate derivatives to hedge the interest rate risk associated with a portion of our repurchase agreement borrowings and securitized debt. During 2012 we also issued 8% Senior Notes due 2042 (or Senior Notes) as part of our financing strategy.

Repurchase agreements, although legally structured as a sale and repurchase obligation, are financing contracts (i.e., borrowings) under which we pledge our MBS as collateral to secure loans with repurchase agreement counterparties (i.e., lenders). The amount borrowed under a repurchase agreement is limited to a specified percentage of the fair value of the MBS pledged as collateral. The portion of the pledged collateral held by the lender in excess of the amount borrowed under the repurchase agreement is the margin requirement for that borrowing. Repurchase agreements involve the transfer of the pledged collateral to a lender at an agreed upon price in exchange for such lender s simultaneous agreement to return the same security back to the borrower at a future date (i.e., the maturity of the borrowing) at a higher price. The difference between the original transfer price and return price is the cost, or interest expense, of borrowing under a repurchase agreement. Our cost of borrowings under repurchase agreements is generally LIBOR based. Under our repurchase agreements, we retain beneficial ownership of the pledged collateral and continue to receive principal and interest payments, while the lender maintains custody of such collateral. At the maturity of a repurchase financing, unless the repurchase financing is renewed with the same counterparty, we are required to repay the loan including any accrued interest and concurrently reacquire custody of the pledged collateral or, with the consent of the lender, we may renew the repurchase financing at the then prevailing market interest rate and terms. Margin calls pursuant to which a lender may require that we pledge additional securities and/or cash as collateral to secure our borrowings under repurchase financing with such lender, are routinely experienced by us, when the fair value of our existing pledged collateral declines as a result of principal amortization and prepayments or due to changes in market interest rates, spreads or other market conditions. We also may make margin calls on counterparties when collateral values increase. To date, we have satisfied all of our margin calls and have never sold assets in response to any margin calls.

In order to reduce our exposure to counterparty-related risk, we generally seek to enter into repurchase agreements and other financing arrangements, including but not limited to, resecuritizations, collateralized financing arrangements and other structured financings and derivatives, with a diversified group of financial institutions. At December 31, 2012, we had outstanding balances under repurchase agreements with 26 separate lenders.

We have engaged in and may engage in future resecuritization transactions. The objective of such a transaction may include obtaining permanent non-recourse financing, obtaining liquidity or financing the underlying securitized financial assets on improved terms. For financial statement reporting purposes, we will generally account for such transactions as a financing of the underlying MBS. (See Note 15 to the consolidated financial statements included under Item 8 of this Annual Report on Form 10-K.)

In addition to repurchase agreements, securitized debt and Senior Notes, we may also use other sources of funding in the future to finance our MBS portfolio, including, but not limited to, other types of collateralized borrowings, loan agreements, lines of credit, commercial paper or the issuance of debt securities.

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COMPETITION

We operate in the mortgage-REIT industry. We believe that our principal competitors in the business of acquiring and holding MBS of the types in which we invest are financial institutions, such as banks, savings and loan institutions, life insurance companies, institutional investors, including mutual funds and pension funds, hedge funds, other mortgage-REITs as well as the U.S. Federal Reserve as part of its monetary policy activities. Some of these entities may not be subject to the same regulatory constraints (i.e., REIT compliance or maintaining an exemption under the Investment Company Act) as us. In addition, many of these entities have greater financial resources and access to capital than us. The existence of these entities, as well as the possibility of additional entities forming in the future, may increase the competition for the acquisition of MBS, resulting in higher prices and lower yields on such assets.

EMPLOYEES

At December 31, 2012, we had 37 employees, all of whom were full-time. We believe that our relationship with our employees is good. None of our employees is unionized or represented under a collective bargaining agreement.

AVAILABLE INFORMATION

We maintain a Web site at www.mfafinancial.com. We make available, free of charge, on our Web site our (a) Annual Report on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K (including any amendments thereto), proxy statements and other information (or, collectively, the Company Documents) filed with, or furnished to, the Securities and Exchange Commission (or SEC), as soon as reasonably practicable after such documents are so filed or furnished, (b) Corporate Governance Guidelines, (c) Code of Business Conduct and Ethics and (d) written charters of the Audit Committee, Compensation Committee and Nominating and Corporate Governance Committee of our Board of Directors (or our Board). Our Company Documents filed with, or furnished to, the SEC are also available at the SEC s Web site at www.sec.gov. We also provide copies of the foregoing materials, free of charge, to stockholders who request them. Requests should be directed to the attention of our General Counsel at MFA Financial, Inc., 350 Park Avenue, 20th Floor, New York, New York 10022.

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Item 1A. Risk Factors.

This section highlights specific risks that could affect our Company and its businesses. Readers should carefully consider each of the following risks and all of the other information set forth in this Annual Report on Form 10-K. Based on the information currently known to us, we believe the following information identifies the most significant risk factors affecting our Company. However, the risks and uncertainties our Company faces are not limited to those described below. Additional risks and uncertainties not presently known to us or that we currently believe to be immaterial may also adversely affect our business.

If any of the following risks and uncertainties develops into actual events or if the circumstances described in the risks and uncertainties occur or continue to occur, these events or circumstances could have a material adverse effect on our business, financial condition, results of operations, cash flows or liquidity. These events could also have a negative effect on the trading price of our securities.

General.

Our business and operations are affected by a number of factors, many of which are beyond our control, and primarily depend on, among other things, the level of our net interest income, the market value of our assets, the supply and demand for MBS, the availability of adequate financing and the credit performance of our Non-Agency MBS. Our net interest income varies primarily as a result of changes in interest rates, the slope of the yield curve (i.e., the differential between long-term and short-term interest rates), borrowing costs (i.e., interest expense) and prepayment speeds on our MBS, the behavior of which involves various risks and uncertainties. Interest rates and prepayment speeds, as measured by the CPR, vary according to the type of investment, conditions in the financial markets, competition and other factors, none of which can be predicted with any certainty. Our operating results also depend upon our ability to effectively manage the risks associated with our business operations, including interest rate, prepayment, financing and credit risks, while maintaining our qualification as a REIT.

Risks Associated With Adverse Developments in the Mortgage Finance and Credit Markets

Volatile market conditions for mortgages and mortgage-related assets as well as the broader financial markets may materially adversely affect the value of the assets in which we invest.

Our results of operations are materially affected by conditions in the markets for mortgages and mortgage-related assets, including MBS, as well as the broader financial markets and the economy generally. Beginning in 2007, significant adverse changes in financial market conditions resulted in a deleveraging of the entire global financial system and the forced sale of large quantities of mortgage-related and other financial assets. More recently, concerns over economic recession, geopolitical issues, the ability of certain European sovereigns to honor their debt obligations and the exposure of certain European financial institutions to such debt, continuing relatively high levels of unemployment, the availability and cost of financing, the mortgage market, uncertainty related to political events such as the fiscal cliff and debt ceiling debates and an uncertain real estate market have contributed to volatility and relatively low expectations for the economy and markets. In particular, the residential mortgage market in the United States has experienced a variety of difficulties and changed economic conditions, including defaults, credit losses, liquidity concerns and, until recently, declining real estate valuations in many geographic markets. Certain commercial banks, investment banks and insurance companies have announced extensive losses from exposure to the residential mortgage market and, in some cases, have filed for bankruptcy. These factors, which persisted in 2012 and are likely to continue to a varying degree in 2013, have impacted investor perception of the risk associated with residential MBS, real estate-related securities and various other asset classes in which we may invest. As a result, values for residential MBS, real estate-related securities and various other asset classes in which we may invest have experienced volatility. Any decline in the value of our investments, or perceived market uncertainty about their value, would likely make it difficult for us to obtain financing on favorable terms or at all, or maintain our compliance with terms of any financing arrangements already in place. Continuing volatility and deterioration in the broader residential mortgage and MBS markets may materially adversely affect the performance and market value of our investments.

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 and Freddie Mac and the U.S. Government, may materially adversely affect our business.

The payments of principal and interest we receive on our Agency MBS, which depend directly upon payments on the mortgages underlying such securities, are guaranteed by Fannie Mae, Freddie Mac and Ginnie Mae. Fannie Mae and Freddie Mac are U.S. Government-sponsored entities (or GSEs), but their guarantees are not backed by the full faith and credit of the United States. Ginnie Mae is part of a U.S. Government agency and its guarantees are backed by the full faith and credit of the United States.

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In response to general market instability and, more specifically, the financial conditions of Fannie Mae and Freddie Mac, in July 2008 Congress enacted the Housing and Economic Recovery Act of 2008 established a new regulator for Fannie Mae and Freddie Mac, the U.S. Federal Housing Finance Agency (or the FHFA). In September 2008, the U.S. Department of the Treasury (or U.S. Treasury), the FHFA, and the U.S. Federal Reserve announced a comprehensive action plan to help stabilize the financial markets, support the availability of mortgage finance and protect taxpayers. Under this plan, among other things, the FHFA was appointed as conservator of both Fannie Mae and Freddie Mac, allowing the FHFA to control the actions of the two GSEs without forcing them to liquidate (which would have been the case under receivership). The primary focus of the plan was to increase the availability of mortgage financing by allowing these GSEs to continue to grow their guarantee business without limit, while limiting the size of their retained mortgage and Agency MBS portfolios and requiring that these portfolios be reduced over time.

In an effort to further stabilize the U.S. mortgage market, the U.S. Treasury pursued three additional initiatives beginning in 2008. First, it entered into preferred stock purchase agreements, which have been subsequently amended, with each of the GSEs to ensure that they maintain a positive net worth. Second, it established a new secured short-term credit facility, which was available to Fannie Mae and Freddie Mac (as well as Federal Home Loan Banks) when other funding sources were unavailable. Third, it established an Agency MBS purchase program under which the U.S. Treasury purchased Agency MBS in the open market. The U.S. Federal Reserve also established a program of purchasing Agency MBS.

Those efforts resulted in significant U.S. Government financial support and increased control of the GSEs. In October 2012, the FHFA reported that, from the time of execution of the preferred stock purchase agreements, funding provided to Fannie Mae and Freddie Mac under the preferred stock purchase agreements totaled approximately $187.5 billion. The U.S. Treasury committed to support the positive net worth of Fannie Mae and Freddie Mac, through preferred stock purchases as necessary, through 2012. Nonetheless, FHFA has made projections for those purchases through 2015, predicting that cumulative U.S. Treasury draws (including dividends) at the end of 2015 could range from $191 billion to $209 billion. Those preferred stock purchase agreements, as amended, also require the reduction of Fannie Mae s and Freddie Mac s mortgage and Agency MBS portfolios (they were limited to $900 billion as of December 31, 2009, and to $810 billion as of December 31, 2010, and must be reduced each year until their respective mortgage assets reach $250 billion). In August 2012, the Treasury Department amended its stock purchase agreements to provide that the GSEs portfolios will be wound down at an annual rate of 15 percent (an increase of five percent over the previously agreed annual rate of ten percent), requiring the GSEs to reach the $250 billion target four years earlier than previously planned.

Although the U.S. Government has committed to support the positive net worth of Fannie Mae and Freddie Mac, there can be no assurance that these actions will be adequate for their needs, and there is no guarantee of continuing capital support (although some amount of such support is projected to be necessary). These uncertainties lead to questions about the availability of, and trading market for, Agency MBS. Despite the steps taken by the U.S. Government, Fannie Mae and Freddie Mac could default on their guarantee obligations which would materially and adversely affect the value of our Agency MBS. Accordingly, if these government actions are inadequate and the GSEs return to suffering losses or cease to exist (as discussed below), our business, operations and financial condition could be materially and adversely affected.

In addition, the problems faced by Fannie Mae and Freddie Mac resulting in their being placed into federal conservatorship and receiving significant U.S. Government support have sparked serious debate among federal policy makers regarding the continued role of the U.S. Government in providing liquidity for mortgage loans. In 2011, the Obama administration proposed a plan to wind down the GSEs, and certain members of Congress have proposed various plans, including merging the GSEs into a government-owned corporation. Thus, the future roles of Fannie Mae and Freddie Mac are likely to be reduced and (perhaps significantly) the nature of their guarantee obligations could be considerably limited relative to historical measurements. Alternatively, Fannie Mae and Freddie Mac could be dissolved or privatized, and the U.S. Government could determine to stop providing liquidity

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support of any kind to the mortgage market. Any changes to the nature of their guarantee obligations could redefine what constitutes an Agency MBS and could have broad adverse implications for the market and our business, operations and financial condition. If Fannie Mae or Freddie Mac were eliminated, or their structures were to change radically (i.e., limitation or removal of the guarantee obligation), we may be unable to acquire additional Agency MBS and our existing Agency MBS could be materially and adversely impacted.

We could be negatively affected in a number of ways depending on the manner in which related events unfold for Fannie Mae and Freddie Mac. We rely on our Agency MBS as collateral for our financings under our repurchase agreements. 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 MBS on acceptable terms or at all, or to maintain our compliance with the terms of any financing transactions. Further, the current support provided by the U.S. Treasury to Fannie Mae and Freddie Mac, and any additional support it may provide in the future, could have the effect of lowering the interest rates we expect to receive from Agency MBS, thereby tightening the spread between the interest we earn on our Agency MBS and the cost of financing those assets. A reduction in the supply of Agency MBS could also negatively affect the pricing of Agency MBS by reducing the spread between the interest we earn on our portfolio of Agency MBS and our cost of financing that portfolio.

As indicated above, as legislation enacted over the past few years has changed the relationship between Fannie Mae and Freddie Mac and the U.S. Government, future legislation could further change that relationship by, among other things, nationalizing, privatizing, or eliminating such entities entirely. Any law affecting these GSEs may create market uncertainty and have the effect of reducing the actual or perceived credit quality of securities issued or guaranteed by Fannie Mae or Freddie Mac. As a result, such laws could increase the risk of loss on our investments in Agency MBS guaranteed by Fannie Mae and/or Freddie Mac. It also is possible that such laws could adversely impact the market for such securities and spreads at which they trade. All of the foregoing could materially and adversely affect our business, operations and financial condition.

Mortgage loan modification and refinancing programs and future legislative action may materially adversely affect the value of, and the returns on, our MBS.

The U.S. Government, through the Federal Reserve, the Treasury Department, the Federal Housing Administration (or the FHA) and other agencies has implemented a number of federal programs designed to assist homeowners, including the Home Affordable Modification Program (or HAMP), which provides homeowners with assistance in avoiding residential mortgage loan foreclosures, the Hope for Homeowners Program (or H4H Program), which allows certain distressed borrowers to refinance their mortgages into FHA-insured loans in order to avoid residential mortgage loan foreclosures, and the Home Affordable Refinance Program, which allows borrowers who are current on their mortgage payments to refinance and reduce their monthly mortgage payments without new mortgage insurance, up to an unlimited loan-to-value ratio for fixed-rate mortgages. HAMP, the H4H Program and other loss mitigation programs may involve, among other things, the modification of mortgage loans to reduce the principal amount of the loans (through forbearance and/or forgiveness) and/or the rate of interest payable on the loans, or to extend the payment terms of the loans. Especially with Non-Agency MBS, a significant number of loan modifications with respect to a given security, including, but not limited to, those related to principal forgiveness and coupon reduction, could negatively impact the realized yields and cash flows on such security. These loan modification programs, future legislative or regulatory actions, including possible amendments to the bankruptcy laws, which result in the modification of outstanding residential mortgage loans, as well as changes in the requirements necessary to qualify for refinancing mortgage loans with Fannie Mae, Freddie Mac or Ginnie Mae, may materially adversely affect the value of, and the returns on, our MBS.

Actions by the U.S. Government designed to stabilize or reform the financial markets may not achieve their intended effect or otherwise benefit our business, and could materially adversely affect our business.

In July 2010, the U.S. Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act (or the Dodd-Frank Act), in part to impose significant investment restrictions and capital requirements on banking entities and other organizations that are significant to U.S. financial markets. For instance, the Dodd-Frank Act imposes significant restrictions on the proprietary trading activities of certain banking entities and subjects other systemically significant organizations regulated by the U.S. Federal Reserve to increased capital requirements and quantitative limits for engaging in such activities. The Dodd-Frank Act also seeks to reform the asset-backed securitization market (including the MBS market) by requiring the retention of a portion of the credit risk inherent in the pool of securitized assets and by imposing additional registration and disclosure requirements. The Dodd-Frank Act also imposes significant regulatory restrictions on the origination of residential mortgage loans. While the full impact of the Dodd-Frank Act cannot be assessed until implementing regulations are finalized and implemented, the Dodd-Frank Act s extensive requirements may have a significant effect on the financial markets, and may affect the

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availability or terms of financing from our lender counterparties and the availability or terms of MBS, both of which could have a material adverse effect on our business.

In addition, U.S. Government, Federal Reserve, U.S. Treasury and other governmental and regulatory bodies have taken or are considering taking other actions to address the financial crisis. We cannot predict whether or when such actions may occur or what affect, if any, such actions could have on our business, results of operations and financial condition.

Risks Related to our Business, Assets and Use of Leverage

Prepayment rates on the mortgage loans underlying our MBS may materially adversely affect our profitability or result in liquidity shortfalls that could require us to sell assets in unfavorable market conditions.

The MBS that we acquire are secured by pools of mortgages on residential properties. In general, the mortgages collateralizing our MBS may be prepaid at any time without penalty. Prepayments on our MBS result when homeowners/mortgagees satisfy (i.e., pay off) the mortgage upon selling or refinancing their mortgaged property. When we acquire a particular MBS, we anticipate that the underlying mortgage loans will prepay at a projected rate which, together with expected coupon income, provides us with an expected yield on such MBS. If we purchase assets at a premium to par value, and borrowers prepay their mortgage loans faster than expected, the corresponding prepayments on the MBS may reduce the expected yield on such securities because we will have to amortize the related premium on an accelerated basis. Conversely, if we purchase assets at a discount to par value, when borrowers prepay their mortgage loans slower than expected, the decrease in corresponding prepayments on the MBS may reduce the expected yield on such securities because we will not be able to accrete the related discount as quickly as originally anticipated. Prepayment rates on loans are influenced by changes in mortgage and market interest rates and a variety of economic, geographic, governmental and other factors (including, without limitation, the various quantitative easing and Operation Twist actions undertaken by the U.S. Federal Reserve over the past few years with respect to its purchases and sales of U.S. Government and agency securities, as well as the refinancing programs described above) all of which are beyond our control. Consequently, such prepayment rates cannot be predicted with certainty and no strategy can completely insulate us from prepayment or other such risks. In periods of declining interest rates, prepayment rates on mortgage loans generally increase. If general interest rates decline at the same time, the proceeds of such prepayments received during such periods are likely to be reinvested by us in assets yielding less than the yields on the assets that were prepaid (to the extent such assets are available for us to reinvest in). In addition, the market value of our MBS may, because of the risk of prepayment, benefit less than other fixed-income securities from declining interest rates.

With respect to Agency MBS, we often purchase securities that have a higher coupon rate than the prevailing market interest rates. In exchange for a higher coupon rate, we typically pay a premium over par value to acquire these securities. In accordance with U.S. generally accepted accounting principles (or GAAP), we amortize the premiums on our MBS over the life of the related MBS. If the mortgage loans securing these securities prepay at a more rapid rate than anticipated, we will have to amortize our premiums on an accelerated basis which may adversely affect our profitability. Defaults on Agency MBS typically have the same effect as prepayments because of the underlying Agency guarantee. As of December 31, 2012, we had net purchase premiums of $227.3 million, or 3.3% of current par value, on our Agency MBS and net purchase discounts of $1.751 billion, or 26.9% of current par value, on our Non-Agency MBS.

Prepayments, which are the primary feature of MBS that distinguish them from other types of bonds, are difficult to predict and can vary significantly over time. As the holder of MBS, on a monthly basis, we receive a payment equal to a portion of our investment principal in a particular MBS as the underlying mortgages are prepaid. With respect to our Agency MBS, we typically receive notice of monthly principal prepayments on the fifth business day of each month (such day is commonly referred to as factor day) and receive the related scheduled payment on a specified later date, which for (a) our Agency ARM-MBS and fixed-rate Agency MBS guaranteed by Fannie Mae is the 25th day of that month (or next business day thereafter), (b) our Agency ARM-MBS guaranteed by Freddie Mac is the 15th day of the following month (or next business day thereafter), (c) our fixed-rate Agency MBS guaranteed by Freddie Mac is the 15th day of the month (or next business day thereafter), and (d) our Agency ARM-MBS guaranteed by Ginnie Mae is the 20th day of that month (or next business day thereafter). With respect to our Non-Agency MBS, we typically receive notice of monthly principal prepayments and the related scheduled payment on the 25th day of each month (or next business day thereafter). In general, on the date each month that principal prepayments are announced (i.e., factor day for Agency MBS), the value of our MBS pledged as collateral under our repurchase agreements is reduced by the amount of the prepaid principal and, as a result, our lenders will typically initiate a margin call requiring the pledge of additional collateral or cash, in an amount equal to such

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prepaid principal, in order to re-establish the required ratio of borrowing to collateral value under such repurchase agreements. Accordingly, with respect to our Agency MBS, the announcement on factor day of principal prepayments is in advance of our receipt of the related scheduled payment, thereby creating a short-term receivable for us in the amount of any such principal prepayments; however, under our repurchase agreements, we may receive a margin call relating to the related reduction in value of our Agency MBS and, prior to receipt of this short-term receivable, be required to post additional collateral or cash in the amount of the principal prepayment on or about factor day, which would reduce our liquidity during the period in which the short-term receivable is outstanding. As a result, in order to meet any such margin calls, we could be forced to sell assets in order to maintain liquidity. Forced sales under adverse market conditions may result in lower sales prices than ordinary market sales made in the normal course of business. If our MBS were liquidated at prices below our amortized cost (i.e., the cost basis) of such assets, we would incur losses, which could materially adversely affect our earnings. In addition, in order to continue to earn a return on this prepaid principal, we must reinvest it in additional MBS or other assets; however, if interest rates decline, we may earn a lower return on our new investments as compared to the MBS that prepay.

Prepayments may have a materially negative impact on our financial results, the effects of which depend on, among other things, the timing and amount of the prepayment delay on our Agency MBS, the amount of unamortized premium on our prepaid MBS, the rate at which prepayments are made on our Non-Agency MBS, the reinvestment lag and the availability of suitable reinvestment opportunities.

Our business strategy involves the use of leverage, and we may not achieve what we believe to be optimal levels of leverage or we may become overleveraged, which may materially adversely affect liquidity, results of operations or financial condition.

Our business strategy involves the use of borrowing or leverage. Pursuant to our leverage strategy, we borrow against a substantial portion of the market value of our MBS and use the borrowed funds to finance the acquisition of additional investment assets. We are not required to maintain any particular debt-to-equity ratio. Future increases in the amount by which the collateral value is required to contractually exceed the repurchase transaction loan amount, decreases in the market value of our MBS, increases in interest rate volatility and changes in the availability of acceptable financing could cause us to be unable to achieve the amount of leverage we believe to be optimal. The return on our assets and cash available for distribution to our stockholders may be reduced to the extent that changes in market conditions prevent us from achieving the desired amount of leverage on our investments or cause the cost of our financing to increase relative to the income earned on our leveraged assets. In addition, the payment of interest expense on our borrowings reduces cash flow available for distributions to our stockholders. If the interest income on our MBS purchased with borrowed funds fails to cover the interest expense of the related borrowings, we will experience net interest losses and may experience net losses from operations. Such losses could be significant as a result of our leveraged structure. The use of leverage to finance our MBS and other assets involves a number of other risks, including, among other things, the following:

- ***Adverse developments involving major financial institutions or involving one of our lenders could result in a rapid reduction in our ability to borrow and materially adversely affect our business, profitability and liquidity.*** As of December 31, 2012, we had amounts outstanding under repurchase agreements with 26 separate lenders. A material adverse development involving one or more major financial institutions or the financial markets in general could result in our lenders reducing our access to funds available under our repurchase agreements or terminating such repurchase agreements altogether. Dramatic declines in the housing market, with decreasing home prices and increasing foreclosures and unemployment, have resulted in significant asset write-downs by financial institutions, which have caused many financial institutions to seek additional capital, to merge with other institutions and, in some cases, to fail. Certain institutions from which we seek to obtain financing have owned or financed residential mortgage loans, real estate-related securities and real estate loans which have declined in value and caused losses as a result of the downturn in the markets. Because all of our repurchase agreements are uncommitted and renewable at the discretion of our lenders, these conditions could cause our lenders to determine to reduce or terminate our access to future borrowings at virtually any time, which could materially adversely affect our business and profitability. Furthermore, if a number of our lenders became unwilling or unable to continue to provide us with financing, we could be forced to sell assets, including MBS in an unrealized loss position, in order to maintain liquidity. Forced sales under adverse market conditions may result in lower sales prices than ordinary market sales made in the normal course of business. If our MBS were liquidated at prices below our amortized cost (i.e., the cost basis) of such assets, we would incur losses, which could adversely affect our earnings.

• ***Our profitability may be materially adversely affected by a reduction in our leverage.*** As long as we earn a positive spread between interest and other income we earn on our leveraged assets and our borrowing

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costs, we believe that we can generally increase our profitability by using greater amounts of leverage. We cannot, however, assure you that repurchase financing will remain an efficient source of long-term financing for our assets. The amount of leverage that we use may be limited because our lenders might not make funding available to us at acceptable rates or they may require that we provide additional collateral to secure our borrowings. If our financing strategy is not viable, we will have to find alternative forms of financing for our assets which may not be available to us on acceptable terms or at acceptable rates. In addition, in response to certain interest rate and investment environments or to changes in market liquidity, we could adopt a strategy of reducing our leverage by selling assets or not reinvesting principal payments as MBS amortize and/or prepay, thereby decreasing the outstanding amount of our related borrowings. Such an action could reduce interest income, interest expense and net income, the extent of which would be dependent on the level of reduction in assets and liabilities as well as the sale prices for which the assets were sold.

- ***If we are unable to renew our borrowings at acceptable interest rates, it may force us to sell assets under adverse market conditions, which may materially adversely affect our liquidity and profitability.*** Since we rely primarily on borrowings under repurchase agreements to finance our MBS, our ability to achieve our investment objectives depends on our ability to borrow funds in sufficient amounts and on acceptable terms, and on our ability to renew or replace maturing borrowings on a continuous basis. Our repurchase agreement credit lines are renewable at the discretion of our lenders and, as such, do not contain guaranteed roll-over terms. Our ability to enter into repurchase transactions in the future will depend on the market value of our MBS pledged to secure the specific borrowings, the availability of acceptable financing and market liquidity and other conditions existing in the lending market at that time. If we are not able to renew or replace maturing borrowings, we could be forced to sell assets, including MBS in an unrealized loss position, in order to maintain liquidity. Forced sales under adverse market conditions could result in lower sales prices than ordinary market sales made in the normal course of business. If our MBS were liquidated at prices below our amortized cost (i.e., the cost basis) of such assets, we would incur losses, which could materially adversely affect our earnings.

- ***A decline in the market value of our assets may result in margin calls that may force us to sell assets under adverse market conditions, which may materially adversely affect our liquidity and profitability.*** In general, the market value of our MBS is impacted by changes in interest rates, prevailing market yields and other market conditions. A decline in the market value of our MBS may limit our ability to borrow against such assets or result in lenders initiating margin calls, which require a pledge of additional collateral or cash to re-establish the required ratio of borrowing to collateral value, under our repurchase agreements. Posting additional collateral or cash to support our credit will reduce our liquidity and limit our ability to leverage our assets, which could materially adversely affect our business. As a result, we could be forced to sell a portion of our assets, including MBS in an unrealized loss position, in order to maintain liquidity.

- ***If a counterparty to our repurchase transactions defaults on its obligation to resell the underlying security back to us at the end of the transaction term or if we default on our obligations under the repurchase agreement, we could incur losses.*** When we engage in repurchase transactions, we generally transfer securities to lenders (i.e., repurchase agreement counterparties) and receive cash from such lenders. Because the cash we receive from the lender when we initially transfer the securities to the lender is less than the value of those securities (this difference is referred to as the haircut), if the lender defaults on its obligation to transfer the same securities back to us, we would incur a loss on the transaction equal to the amount of the haircut (assuming there was no change in the value of the securities). See Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations of this Annual Report on Form 10-K, for further discussion regarding risks related to exposure to financial institution counterparties in light of recent market conditions. Our exposure to defaults by counterparties may be more pronounced during periods of significant volatility in the market conditions for mortgages and mortgage-related assets as well as the broader financial markets. At December 31, 2012, we had greater than 5% stockholders equity at risk to the following repurchase agreement counterparties: Credit Suisse (approximately 19.5%), Wells Fargo (approximately 9.7%), UBS (approximately 8.1%) and Deutsche Bank (approximately 6.8%).

In addition, generally, if we default on one of our obligations under a repurchase transaction with a particular lender, that lender can elect to terminate the transaction and cease entering into additional repurchase transactions with us. In addition, some of our repurchase agreements contain cross-default provisions, so that if a default occurs under any one agreement, the lenders under our other repurchase agreements could also declare a default. Any losses we incur on our repurchase transactions could materially adversely affect our earnings and thus our cash available for distribution to our stockholders.

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- ***Our use of repurchase agreements to borrow money may give our lenders greater rights in the event of bankruptcy.*** Borrowings made under repurchase agreements may qualify for special treatment under the U.S. Bankruptcy Code. If a lender under one of our repurchase agreements defaults on its obligations, it may be difficult for us to recover our assets pledged as collateral to such lender. 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 lender s insolvency may be further limited by those statutes. These claims would be subject to significant delay and, if and when received, may be substantially less than the damages we actually incur. In addition, in the event of our insolvency or bankruptcy, certain repurchase agreements may qualify for special treatment under the Bankruptcy Code, the effect of which, among other things, would be to allow the creditor under the agreement to avoid the automatic stay provisions of the Bankruptcy Code and take possession of, and liquidate, our collateral under our repurchase agreements without delay. Our risks associated with the insolvency or bankruptcy of a lender maybe more pronounced during periods of significant volatility in the market conditions for mortgages and mortgage-related assets as well as the broader financial markets.

We have experienced declines in the market value of our assets resulting in us recording impairments, which have had an adverse effect on our results of operations and financial condition.

A decline in the market value of our MBS or other assets may require us to recognize an other-than-temporary impairment (or OTTI) against such assets under GAAP. When the fair value of our MBS is less than its amortized cost, the security is considered impaired. We assess our impaired securities on at least a quarterly basis and designate such impairments as either temporary or other-than-temporary. If we intend to sell an impaired security, or it is more likely than not that we will be required to sell the impaired security before its anticipated recovery, then we must recognize an OTTI through charges to earnings equal to the entire difference between the MBS amortized cost and its fair value at the balance sheet date. If we do not expect to sell an other-than-temporarily impaired security, only the portion of the OTTI related to credit losses is recognized through charges to earnings with the remainder recognized through other accumulated comprehensive income/(loss) on our consolidated balance sheet. Impairments are recognized through other comprehensive income/(loss) and do not impact earnings. Following the recognition of an OTTI through earnings, a new cost basis is established for the MBS and may not be adjusted for subsequent recoveries in fair value through earnings. However, OTTIs recognized through charges to earnings may be accreted back to the amortized cost basis of the security on a prospective basis through interest income. The determination as to whether an OTTI exists and, if so, the amount of credit impairment recognized in earnings is subjective, as such determinations are based on factual information available at the time of assessment as well as the Company s estimates of the future performance and cash flow projections. As a result, the timing and amount of OTTIs constitute material estimates that are susceptible to significant change. During 2012 as well as in prior years, we experienced declines in the fair value of our MBS and other assets, which were determined to be other-than-temporary. As a result, we recognized other-than-temporary impairments against such assets under GAAP.

Any downgrade, or perceived potential of a downgrade, of U.S. sovereign credit ratings by the various credit rating agencies may materially adversely affect our business.

During the summer of 2011, Standard & Poor s Corporation (or S&P), one of the major credit rating agencies, downgraded the U.S. sovereign credit rating in response to the protracted debate over the U.S. debt ceiling limit and S&P s perception of the U.S. Government s ability to address its long-term budget deficit. In addition, the credit rating of the GSEs was also downgraded by S&P in response to the downgrade in the U.S. sovereign credit rating, as the value of the Agency MBS issued by such GSEs and their ability to meet their obligations under such Agency MBS is impacted by the support provided to them by the U.S. Government and market perceptions of the strength of such support and the likelihood of its continuity. To the extent that the credit rating of any or all of the GSEs were to be downgraded by other credit rating agencies or further downgraded by S&P, the value of our Agency MBS could be negatively impacted. In addition, we could be negatively affected in a number of ways in the event of a default by the U.S. Government or a downgrade of the U.S. sovereign credit rating by other credit rating agencies or a further downgrade by S&P. Such negative impacts could include changes in the financing terms of our repurchase agreements collateralized by Agency MBS, which could include higher financing costs and/or a reduction in the amount of financing provided based on the market value of collateral posted under these agreements. These outcomes could in turn materially adversely affect our operations and financial condition in a

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number of ways, including a reduction in the net interest spread between our assets and associated repurchase agreement borrowings or by decreasing our ability to obtain repurchase agreement financing on acceptable terms, or at all.

Because assets we acquire may experience periods of illiquidity, we may lose profits, incur losses or be prevented from earning capital gains if we cannot sell mortgage-related assets at an opportune time.

We bear the risk of being unable to dispose of our investments at advantageous times or in a timely manner because mortgage-related assets may experience periods of illiquidity. A lack of liquidity may result from the absence of a willing buyer or an established market for these assets, as well as legal or contractual restrictions on resale or the unavailability of financing for these assets. As a result, our ability to vary our portfolio in response to changes in economic and other conditions may be relatively limited, which may cause us to incur losses or prevent us from realizing capital gains.

A lack of liquidity in our investments may materially adversely affect our business.

The assets that comprise our investment portfolio and that we acquire are not traded on an exchange. A portion of these securities may be subject to legal and other restrictions on resale and are otherwise generally less liquid than exchange-traded securities. Any illiquidity of our investments may make it difficult for us to sell such investments if the need or desire 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 investments. Further, we may face other restrictions on our ability to liquidate an investment in a business entity to the extent that we have or could be attributed with material, non-public information regarding such business entity. As a result, our ability to vary our portfolio in response to changes in economic and other conditions may be relatively limited, which could adversely affect our results of operations and financial condition.

Our investments in Non-Agency MBS or other investment assets of lower credit quality involve credit risk, which could materially adversely affect our results of operations.

The holder of a mortgage or MBS assumes a risk that the borrowers may default on their obligations to make full and timely payments of principal and interest. Pursuant to our investment policy, we have the ability to acquire Non-Agency MBS and other investment assets of lower credit quality. In general, Non-Agency MBS carry greater investment risk than Agency MBS because they are not guaranteed as to principal and/or interest by the U.S. Government, any federal agency or any federally chartered corporation. Unexpectedly high rates of default (e.g., in excess of the default rates forecasted) and/or higher than expected loss severities on the mortgages collateralizing our Non-Agency MBS may adversely affect the value of such assets. Accordingly, Non-Agency MBS and other investment assets of less-than-high credit quality could cause us to incur losses of income from, and/or losses in market value relating to, these assets if there are defaults of principal and/or interest on these assets.

We may have significant credit risk, especially on Non-Agency MBS, in certain geographic areas and may be disproportionately affected by economic or housing downturns, natural disasters, terrorist events, adverse climate changes or other adverse events specific to those markets.

A significant number of the mortgages collateralizing our MBS may be concentrated in certain geographic areas. For example, with respect to our Non-Agency MBS portfolio, we have significantly higher exposure in California, Florida, New York, Virginia and New Jersey. (See Market Value Risk included under Part II, Item 7A. Quantitative and Qualitative Disclosures About Market Risk of this Annual Report on Form 10-K) Certain markets within these states (particularly California and Florida) experienced significant decreases in residential home value during the recent housing crisis and continue to experience challenging economic and real estate conditions. Any event that adversely affects the economy or real estate market in these states could have a disproportionately adverse effect on our Non-Agency MBS portfolio. In general, any material decline in the economy or significant difficulties in the real estate markets would be likely to cause a decline in the value of residential properties securing the mortgages in the relevant geographic area. This, in turn, would increase the risk of delinquency, default and foreclosure on real estate collateralizing our Non-Agency MBS in this area. This may then materially adversely affect our credit loss experience on our Non-Agency MBS in such area if unexpectedly high rates of default (e.g., in excess of the default rates forecasted) and/or higher than expected loss severities on the mortgages collateralizing such securities were to occur.

The occurrence of a natural disaster (such as an earthquake, tornado, hurricane or a flood) or a significant adverse climate change may cause a sudden decrease in the value of real estate and would likely reduce the value of the properties securing the mortgages collateralizing our Non-Agency MBS. Since certain natural disasters may not typically be covered by the standard hazard insurance policies maintained by borrowers, the borrowers may have to

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pay for repairs due to the disasters. Borrowers may not repair their property or may stop paying their mortgages under those circumstances. This would likely cause defaults and credit loss severities to increase on the pool of mortgages securing our Non-Agency MBS which, unlike Agency MBS, are not guaranteed as to principal and/or interest by the U.S. Government, any federal agency or federally chartered corporation.

We have some investments in Non-Agency MBS collateralized by Alt A loans and may also have investments collateralized by subprime mortgage loans, which, due to lower underwriting standards, are subject to increased risk of losses.

We have certain investments in Non-Agency MBS backed by collateral pools containing mortgage loans that have been originated using underwriting standards that are less strict than those used in underwriting prime mortgage loans . These lower standards permit mortgage loans made to borrowers having impaired credit histories, mortgage loans where the amount of the loan at origination is 80% or more of the value of the mortgage property, mortgage loans made to borrowers with low credit scores, mortgage loans made to borrowers who have other debt that represents a large portion of their income and mortgage loans made to borrowers whose income is not required to be disclosed or verified. Due to economic conditions, including increased interest rates and lower home prices, as well as aggressive lending practices, Alt A and subprime mortgage loans have in recent periods experienced increased rates of delinquency, foreclosure, bankruptcy and loss, and they are likely to continue to experience delinquency, foreclosure, bankruptcy and loss rates that are higher, and that may be substantially higher, than those experienced by mortgage loans underwritten in a more traditional manner. Thus, because of higher delinquency rates and losses associated with Alt A and subprime mortgage loans, the performance of Non-Agency MBS backed by these types of loans that we may acquire could be correspondingly adversely affected, which could materially adversely impact our results of operations, financial condition and business.

We may generate taxable income that differs from our GAAP income on Non-Agency MBS purchased at a discount to par value, which may result in significant timing variances in the recognition of income and losses.

We have acquired and intend to continue to acquire Non-Agency MBS at prices that reflect significant market discounts on their unpaid principal balances. For financial statement reporting purposes, we generally establish a portion of this discount as a Credit Reserve. This Credit Reserve is generally not accreted into income for financial statement reporting purposes. For tax purposes, however, we are not permitted to anticipate, or establish a reserve for, credit losses prior to their occurrence. As a result, discount on securities acquired in the primary or secondary market is included in the determination of taxable income and is not impacted by losses until such losses are incurred. Such differences in accounting for tax and GAAP can lead to significant timing variances in the recognition of income and losses. Taxable income on Non-Agency MBS purchased at a discount to their par value may be higher than GAAP earnings in early periods (before losses are actually incurred) and lower than GAAP earnings in periods during and subsequent to when realized credit losses are incurred. Dividends will be declared and paid at the discretion of our Board and will depend on REIT taxable earnings, our financial results and overall financial condition, maintenance of our REIT qualification and such other factors as our Board may deem relevant from time to time.

An increase in our borrowing costs relative to the interest we receive on our MBS may materially adversely affect our profitability.

Our earnings are primarily generated from the difference between the interest income we earn on our investment portfolio, less net amortization of purchase premiums and discounts, and the interest expense we pay on our borrowings. We rely primarily on borrowings under repurchase agreements to finance the acquisition of MBS which have longer-term contractual maturities. Even though the majority of our MBS have interest rates that adjust over time based on short-term changes in corresponding interest rate indexes, the interest we pay on our borrowings may increase at a faster pace than the interest we earn on our MBS. In general, if the interest expense on our borrowings increases relative to the interest income we earn on our MBS, our profitability may be materially adversely affected, including due to the following reasons:

- ***Changes in interest rates, cyclical or otherwise, may materially adversely affect our profitability.*** Interest rates are highly sensitive to many factors, including fiscal and monetary policies and domestic and international economic and political conditions, as well as other factors beyond our control. In general, we finance the acquisition of our MBS through borrowings in the form of repurchase transactions, which exposes us to interest rate risk on the financed assets. The cost of our borrowings is based on prevailing market interest rates. Because the terms of our repurchase transactions typically range from one to six months at inception, the interest rates on our borrowings generally adjust more frequently (as new repurchase transactions are entered into upon the maturity of existing repurchase transactions) than the interest rates on our MBS. During a period of rising interest rates, our borrowing costs generally will increase at a faster pace than our interest earnings on the leveraged portion of our MBS portfolio, which could result in a decline in our net interest spread and net interest margin. The severity of any such decline would depend on our asset/liability composition, including the impact of hedging transactions, at the time as well as the magnitude and period over which interest rates increase. Further, an increase in short-term interest rates could also have a negative impact on the market value of our MBS portfolio. If any of these events happen, we could experience a decrease in net income or incur a net loss during these periods, which may negatively impact our distributions to stockholders.

- ***Interest rate caps on the mortgages collateralizing our MBS may materially adversely affect our profitability if short-term interest rates increase.*** The coupons earned on ARM-MBS adjust over time as interest rates change (typically after an initial fixed-rate period for Hybrids). The financial markets primarily determine the interest rates that we pay on the repurchase transactions used to finance the acquisition of our MBS; however, the level of adjustment to the interest rates earned on our ARM-MBS is typically limited by contract (or in certain cases by state or federal law). The interim and lifetime interest rate caps on the mortgages collateralizing our MBS limit the amount by which the interest rates on such assets can adjust. Interim interest rate caps limit the amount interest rates on a particular ARM can adjust during the next adjustment period. Lifetime interest rate caps limit the amount interest rates can adjust upward from inception through maturity of a particular ARM. Our repurchase transactions are not subject to similar restrictions. Accordingly, in a sustained period of rising interest rates or a period in which interest rates rise rapidly, we could experience a decrease in net income or a net loss because the interest rates paid by us on our borrowings (excluding the impact of hedging transactions) could increase without limitation (as new repurchase transactions are entered into upon the maturity of existing repurchase transactions) while increases in the interest rates earned on the mortgages collateralizing our MBS could be limited due to interim or lifetime interest rate caps.

- ***Adjustments of interest rates on our borrowings may not be matched to interest rate indexes on our MBS.*** In general, the interest rates on our repurchase transactions are based on LIBOR, while the interest rates on our ARM-MBS may be indexed to LIBOR or CMT rate. Accordingly, any increase in LIBOR relative to one-year CMT rates will generally result in an increase in our borrowing costs that is not matched by a corresponding increase in the interest earned on our ARM-MBS tied to these other index rates. Any such interest rate index mismatch could adversely affect our profitability, which may negatively impact our distributions to stockholders.

- ***A flat or inverted yield curve may adversely affect ARM-MBS prepayment rates and supply***. Our net interest income varies primarily as a result of changes in interest rates as well as changes in interest rates across the yield curve. When the differential between short-term and long-term benchmark interest rates narrows, the yield curve is said to be flattening. We believe that when the yield curve is relatively flat, borrowers have an incentive to refinance into Hybrids with longer initial fixed-rate periods and fixed rate mortgages, causing our MBS to experience faster prepayments. In addition, a flatter yield curve generally leads to fixed-rate mortgage rates that are closer to the interest rates available on ARMs, potentially decreasing the supply of ARM-MBS. At times, short-term interest rates may increase and exceed long-term interest rates, causing an inverted yield curve. When the yield curve is inverted, fixed-rate mortgage rates may approach or be lower than mortgage rates on ARMs, further increasing ARM-MBS prepayments and further negatively impacting ARM-MBS supply. Increases in prepayments on our MBS portfolio cause our premium amortization to accelerate, lowering the yield on such assets. If this happens, we could experience a decrease in net income or incur a net loss during these periods, which may negatively impact our distributions to stockholders.

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We are dependent on our executive officers and key personnel for our success, the loss of any of which may materially adversely affect our business.

Our success is dependent upon the efforts, experience, diligence, skill and network of business contacts of our executive officers and key personnel. The departure of any of our executive officers and/or key personnel could have a material adverse effect on our operations and performance.

We are dependent on information systems and systems failures could significantly disrupt our business.

Our business is highly dependent on our communications and information systems. Any failure or interruption of our systems could cause delays or other problems in our securities trading activities, which could have a material adverse effect on our operation and performance.

We operate in a highly competitive market for investment opportunities and competition may limit our ability to acquire desirable investments, which could materially adversely affect our results of operations.

We operate in a highly competitive market for investment opportunities. Our profitability depends, in large part, on our ability to acquire MBS or other investments at favorable prices. In acquiring our investments, we compete with a variety of institutional investors, including other REITs, public and private funds, commercial and investment banks, commercial finance and insurance companies and other financial institutions. Many of our competitors are substantially larger and have considerably greater financial, technical, marketing and other resources than we do. Some competitors may have a lower cost of funds and access to funding sources that are not available to us. Many of our competitors are not subject to the operating constraints associated with REIT compliance or maintenance of an exemption from the Investment Company Act. 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 investments and establish additional business relationships than us. Furthermore, government or regulatory action and competition for investment securities of the types and classes which we acquire 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. Also, as a result of this competition, desirable investments may be limited in the future and we may not be able to take advantage of attractive investment opportunities from time to time, as we can provide no assurance that we will be able to identify and make investments that are consistent with our investment objectives.

The ongoing debt crisis in Europe could have a material adverse effect on our business.

During the past several years, certain of our repurchase agreement counterparties in the United States and Europe have experienced financial difficulty and have been either rescued by government assistance or otherwise benefitted from accommodative monetary policy of Central Banks. Several European governments have coordinated plans to attempt to shore up their financial sectors through loans, credit guarantees, capital infusions, promises of continued liquidity funding and interest rate cuts. Additionally, other governments of the world s largest economic countries also implemented interest rate cuts. There is no assurance that these and other plans and programs will be successful in halting the global credit crisis or in preventing other banks from failing. If unsuccessful, this could materially adversely affect our financing and operations as well as those of the entire mortgage sector in general.

As the European credit crisis continues, with the problems in other countries such as Greece, Italy, Spain and Portugal, there is a growing risk to the financial condition and stability of major European banks. Some of these banks have U.S. banking subsidiaries, which have provided financing to us, particularly repurchase agreement financing for the acquisition of various investments, including MBS investments. Recently, the U.S. government placed many of the U.S. banking subsidiaries of these major European banks on credit watch. If the European credit crisis continues to impact these major European banks, there is the possibility that it will also impact the operations of their U.S. banking subsidiaries. This could adversely affect our financing and operations as well as those of the entire mortgage sector in general.

Government use of eminent domain to seize underwater mortgages could materially adversely affect the value of, and the returns on, our MBS.

The mortgages securing our Non-Agency MBS are located in many geographic regions across the United States, with significantly higher exposure in California, Florida, New York, Virginia and New Jersey. Several county and municipal governments have discussed using eminent domain to seize from mortgage holders the mortgages of borrowers who are underwater, but not in default. If these discussions lead to definitive action by such governments and such actions withstand Constitutional and other legal challenges, resulting in mortgages securing our Non-Agency MBS being seized using eminent domain, the consideration received from the seizing authorities

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for such mortgages may be substantially less than the outstanding principal balance, which would result in a realized loss and a corresponding write-down of the principal balance of those mortgages. The result of these seizures would be that the amounts we receive on our Non-Agency MBS would be less than we would otherwise have received if the mortgage loans had not been seized, which may result in a decline in the market value and/or OTTI of these securities. If governments ultimately adopt such plans and mortgages securing our Non-Agency MBS are seized on a widespread scale, it could have a material adverse effect on the value of and/or returns on our Non-Agency MBS and our results of operations more generally.

Risks Related to Our Hedging and Investment Strategies

Our use of hedging strategies to mitigate our interest rate exposure may not be effective and may expose us to counterparty risks.

In accordance with our operating policies, we pursue various types of hedging strategies, including Swaps, interest rate cap agreements and other derivative transactions, to seek to mitigate or reduce our exposure to losses from adverse changes in interest rates. Our hedging activity will vary in scope based on the level and volatility of interest rates, the type of assets held and financing sources used and other changing market conditions. No hedging strategy, however, can completely insulate us from the interest rate risks to which we are exposed and there is no guarantee that the implementation of any hedging strategy would have the desired impact on our results of operations or financial condition. Certain of the U.S. federal income tax requirements that we must satisfy in order to qualify as a REIT may limit our ability to hedge against such risks. We will not enter into derivative transactions if we believe that they will jeopardize our qualification as a REIT.

Interest rate 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 liability;
- the credit quality of the party owing money on the hedge may be downgraded to such an extent that it impairs our ability to sell or assign our side of the hedging transaction; and
- the party owing money in the hedging transaction may default on its obligation to pay.

We primarily use interest rate swap agreements (or Swaps) to hedge against future increases in interest rates on our repurchase agreements. Should a Swap counterparty be unable to make required payments pursuant to such Swap, the hedged liability would cease to be hedged for the remaining term of the Swap. In addition, we may be at risk for any collateral held by a hedging counterparty to a Swap, should such counterparty become insolvent or file for bankruptcy. Our hedging transactions, which are intended to limit losses, may actually adversely affect our earnings, which could reduce our cash available for distribution to our stockholders.

Hedging instruments used by us involve risk since they often are not traded on regulated exchanges, guaranteed by an exchange or its clearing house, or regulated by any U.S. or foreign governmental authorities. Consequently, there are no requirements with respect to record keeping, financial responsibility or segregation of customer funds and positions. Furthermore, the enforceability of hedging instruments may depend on compliance with applicable statutory and commodity and other regulatory requirements and, depending on the identity of the counterparty, applicable international requirements. The business failure of a hedging counterparty with whom we enter into a hedging transaction will most likely result in its default. Default by a party with whom we enter into a hedging transaction may result in a loss and force us to cover our commitments, if any, at the then current market price. Although generally we will seek to reserve the right to terminate our hedging positions, it may not always be possible to dispose of or close out a hedging position without the consent of the hedging counterparty and we may not be able to enter into an offsetting contract in order to cover our risk. We cannot assure you that a liquid secondary market will exist for hedging instruments purchased or sold, and we may be required to maintain a position until exercise or expiration, which could result in losses.

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We may enter into hedging instruments that could expose us to contingent liabilities in the future, which could materially adversely affect our results of operations.

Subject to maintaining our qualification as a REIT, part of our financing strategy involves entering into hedging instruments that could require us to fund cash payments in certain circumstances (e.g., the early termination of a hedging instrument caused by an event of default or other voluntary or involuntary termination event or the decision by a hedging counterparty to request the posting of collateral that it is contractually owed under the terms of a hedging instrument). With respect to the termination of an existing Swap, the amount due would generally be equal to the unrealized loss of the open Swap position with the hedging counterparty and could also include other fees and charges. These economic losses will be reflected in our financial results of operations and our ability to fund these obligations will depend on the liquidity of our assets and access to capital at the time. Any losses we incur on our hedging instruments could materially adversely affect our earnings and thus our cash available for distribution to our stockholders.

We may fail to qualify for hedge accounting treatment, which could materially adversely affect our results of operations.

We record derivative and hedge transactions in accordance with GAAP, specifically according to the Financial Accounting Standards Board Accounting Standards Codification Topic on Derivatives. Under these standards, we may fail to qualify for hedge accounting treatment for a number of reasons, including if we use instruments that do not meet the definition of a derivative, we fail to satisfy hedge documentation and hedge effectiveness assessment requirements or our instruments are not highly effective. If we fail to qualify for hedge accounting treatment, our operating results for financial reporting purposes may be materially adversely affected because losses on the derivatives we enter into would be recorded in net income, rather than accumulated other comprehensive income, a component of stockholders equity.

We may change our investment strategy, operating policies and/or asset allocations without stockholder consent, which could materially adversely affect our results of operations.

We may change our investment strategy, operating policies and/or asset allocation with respect to investments, acquisitions, leverage, growth, operations, indebtedness, capitalization and distributions at any time without the consent of our stockholders. A change in our investment strategy may increase our exposure to interest rate risk, credit risk, default risk and/or real estate market fluctuations. Furthermore, a change in our asset allocation could result in our making investments in asset categories different from our historical investments. These changes could materially adversely affect our financial condition, results of operations, the market price of our common stock or our ability to pay dividends or make distributions.

We may enter into Resecuritization Transactions, the tax treatment of which could have a material adverse effect on our results of operations.

We have engaged in and intend to engage in future resecuritization transactions in which we transfer Non-Agency MBS to a special purpose entity that has formed or will form a securitization vehicle that will issue multiple classes of securities secured by and payable from cash flows on the underlying Non-Agency MBS. To date, we have structured two such transactions as a real estate mortgage investment conduit (or REMIC) securitization, which, to the extent we have transferred securities in a resecuritization, is viewed as the sale of securities for tax purposes. Although such transactions are treated as sales for tax purposes, they have historically not given rise to any taxable gain so that the prohibited transactions tax rules have not been implicated (*i.e.*, the tax only applies to net taxable gain from sales that are prohibited transactions); however, no assurance can be offered that the Internal Revenue Service (or IRS) will agree with such treatment. In addition, to these REMIC securitization transactions, we have also engaged in two resecuritization transactions that we believe should be treated as financing transactions for tax purposes. If a securitization transaction were to be considered to be a sale of property to customers in the ordinary course of a trade or business, and we recognized a gain on such transaction for tax purposes, then we could risk exposure to the 100% tax on net taxable income from prohibited transactions. Moreover, even if we retained MBS resulting from a resecuritization transaction and then subsequently sold such securities at a tax gain, the gain could, absent an available safe-harbor provision, be characterized as net income from a prohibited transaction. Under these circumstances, our results of operations could be materially adversely affected.

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Risks Related to Our Taxation as a REIT and the Taxation of Our Assets

Our qualification as a REIT

We have elected to qualify as a REIT and intend to comply with the provisions of the Internal Revenue Code of 1986, as amended (or the Code) related to REIT qualification. Accordingly, we will not be subjected to federal income tax to the extent we distribute 100% of our REIT taxable income (which is generally our taxable income, computed without regard to the dividends paid deduction, any net income from prohibited transactions, and any net income from foreclosure property) to stockholders within the timeframe permitted under the Code and provided that we comply with certain income, asset and ownership tests applicable to REITs. We believe that we currently meet all of the REIT requirements (other than certain underdistributions of REIT taxable income for certain prior years, which we are in the process of remedying through the declaration of deficiency dividends and payment of associated excise tax and interest), and continue to qualify as a REIT under the provisions of the Code. Many of the REIT requirements however are highly technical and complex. The determination that we are a REIT requires an analysis of various factual matters and circumstances, some of which may not be totally within our control and some of which involve interpretation. For example, if we are to qualify as a REIT, annually at least 75% of our gross income must come from, among other sources, interest on obligations secured by mortgages on real property or interests in real property, gain from the disposition of real property, including mortgages or interest in real property (other than sales or dispositions of real property, including mortgages on real property, or securities that are treated as mortgages on real property, to customers in the ordinary course of a trade or business (*i.e.*, prohibited transactions)), dividends, other distributions and gains from the disposition of shares in other REITs, commitment fees received for agreements to make real estate loans and certain temporary investment income. In addition, the composition of our assets must meet certain requirements at the close of each quarter. There can be no assurance that the IRS or a court would agree with any conclusions or positions we have taken in interpreting the REIT requirements.

Also, to maintain our qualification as a REIT, we must distribute at least 90% of our REIT taxable income (determined without regard to the dividends paid deduction and excluding any net capital gain) to our stockholders within the timeframe permitted under the Code. We generally must make these distributions in the taxable year to which they relate, or in the following taxable year if declared before we timely (including extensions) file our tax return for the year and if paid with or before the first regular dividend payment after such declaration. To the extent that we satisfy this distribution requirement, but distribute less than 100% of our taxable income, we will be subject to federal income tax on our undistributed taxable income. In addition, if we should fail to distribute during each calendar year at least the sum of (a) 85% of our REIT ordinary income for such year, (b) 95% of our REIT capital gain net income for such year, and (c) any undistributed taxable income from prior periods, we would be subject to a non-deductible 4% excise tax on the excess of such required distribution over the sum of (x) the amounts actually distributed, plus (y) the amounts of income we retained and on which we have paid corporate income tax.

The dividend distribution requirement limits the amount of cash we have available for other business purposes, including amounts to fund our growth. Also, it is possible that because of differences in timing between the recognition of taxable income and the actual receipt of cash, we may have to borrow funds on a short-term basis to meet the 90% dividend distribution requirement.

Even a technical or inadvertent mistake could jeopardize our REIT qualification unless we meet certain statutory relief provisions. Furthermore, Congress and the IRS might make changes to the tax laws and regulations, and the courts might issue new rulings, that make it more difficult or impossible for us to remain qualified as a REIT.

Furthermore, even if we qualify as a REIT for U.S. federal income tax purposes, we may be required to pay certain federal, state and local taxes on our income. Any of these taxes will reduce our operating cash flow.

The taxable mortgage pool rules may increase the taxes that we or our stockholders may incur and may limit the manner in which we effect future securitizations.

Securitizations by us or our subsidiaries could result in the creation of taxable mortgage pools for U.S. federal income tax purposes. The REMIC provisions of the Code generally provide that REMICs are the only form of pass-through entity permitted to issue debt obligations with two or more maturities if the payments on those obligations bear a relationship to the mortgage obligations held by such entity. If we engage in a non-REMIC securitization transaction, directly or indirectly through a qualified REIT subsidiary (or QRS), in which the assets held by the securitization vehicle consist largely of mortgage loans or MBS, in which the securitization vehicle issues to investors two or more classes of debt instruments that have different maturities, and in which the timing and amount of payments on the debt instruments is determined in large part by the amounts received on the mortgage loans or MBS held by the securitization vehicle, the securitization vehicle will be a taxable mortgage pool. As long as we or another REIT hold a 100% interest in the equity interests in a taxable mortgage pool, either directly, or through a QRS, it will not be subject to tax. A portion of the income that we realize with respect to the equity interest we hold in a taxable mortgage pool will, however, by considered to be excess inclusion income and, as a result, a portion of the dividends that we pay to our stockholders will be considered to consist of excess inclusion income. Such excess inclusion income is treated as unrelated business taxable income (or UBTI) for tax-exempt stockholders, is subject to withholding for foreign stockholders (without the benefit of any treaty reduction), and is not subject to reduction by net operating loss carryovers. Historically, we have not generated excess inclusion; however, despite our efforts, we may not be able to avoid creating or distributing excess inclusion income to our stockholders in the future. In addition, we could face limitations in selling equity interests to outside investors in securitization transactions that are taxable mortgage pools or selling any debt securities issued in connection with these securitizations that might be considered to be equity interests for tax purposes. These limitations may prevent us from using certain techniques to maximize our returns from securitization transactions.

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We have not established a minimum dividend payment level, and there is no guarantee that we will maintain current dividend payment levels or pay dividends in the future.

In order to maintain our qualification as a REIT, we must comply with a number of requirements under federal tax law, including that we distribute at least 90% of our REIT taxable income within the timeframe permitted under the Code, which is calculated generally before the dividends paid deduction and excluding net capital gain. Dividends will be declared and paid at the discretion of our Board and will depend on our REIT taxable earnings, our financial results and overall condition, maintenance of our REIT qualification and such other factors as our Board may deem relevant from time to time. We have not established a minimum dividend payment level for our common stock and our ability to pay dividends may be negatively impacted by adverse changes in our operating results. Therefore, our dividend payment level may fluctuate significantly, and, under some circumstances, we may not pay dividends at all.

Our reported GAAP financial results differ from the taxable income results that impact our dividend distribution requirements and, therefore, our GAAP results may not be an accurate indicator of future taxable income and dividend distributions.

Generally, the cumulative net income we report over the life of an asset will be the same for GAAP and tax purposes, although the timing of this income recognition over the life of the asset could be materially different. Differences exist in the accounting for GAAP net income and REIT taxable income which can lead to significant variances in the amount and timing of when income and losses are recognized under these two measures. Due to these differences, our reported GAAP financial results could materially differ from our determination of taxable income results, which impacts our dividend distribution requirements, and, therefore, our GAAP results may not be an accurate indicator of future taxable income and dividend distributions.

Over time, accounting principles, conventions, rules, and interpretations may change, which could affect our reported GAAP and taxable earnings, and stockholders equity.

Accounting rules for the various aspects of our business change from time to time. Changes in GAAP, or the accepted interpretation of these accounting principles, can affect our reported income, earnings, and stockholders equity. In addition, changes in tax accounting rules or the interpretations thereof could affect our taxable income and our dividend distribution requirements. These changes may materially adversely affect our results of operations.

Dividends payable by REITs do not qualify for the reduced tax rates

Legislation enacted in 2003 generally reduces the maximum tax rate for dividends payable to domestic stockholders that are individuals, trusts and estates from 38.6% to 15% (through 2012). For taxable years beginning after 2012, the rate will rise to 20% for taxpayers with incomes exceeding $400,000 ($450,000 for married tax payers). Dividends payable by REITs, however, are generally not eligible for the reduced rates. Although this legislation does not adversely affect the taxation of REITs or dividends paid by REITs, the more favorable rates applicable to regular corporate dividends could cause investors who are individuals, trusts and estates to perceive investments in REITs to be relatively less attractive than investments in stock of non-REIT corporations that pay dividends, which could adversely affect the value of the stock of REITs, including our common stock.

Risks Associated with our Regulatory Environment and Internal Control Over Financial Reporting

We have identified, and may identify in the future, a material weakness in our internal control over financial reporting, which may require us to incur substantial costs and divert management resources in connection with our efforts to remediate this material weakness.

We have determined that a material weakness existed at the Company as of December 31, 2012. Specifically, we have determined that control deficiencies existed in our process to calculate taxable income for our MBS that rose to the level of a material weakness. A detailed description of this material weakness is provided in Part II, Item 9A., Controls and Procedures of this Annual Report on Form 10-K. Due solely to this material weakness, management has concluded that we did not maintain an effective internal control over financial reporting as of December 31, 2012 (and, solely as a result of this material weakness, we have concluded that our disclosure controls and procedures were not effective as of December 31, 2012). We are in the process of developing and implementing new processes and procedures to remediate this material weakness. We cannot be certain that any remedial measures we take will ensure that we design, implement and maintain adequate controls over our financial processes and reporting in the future and, accordingly, additional material weaknesses may occur in the future. It is possible that additional control deficiencies may be identified in addition to, or that are unrelated to, the material weakness described above. These control deficiencies may represent one or more material weaknesses. Our inability to remedy any additional deficiencies or material weaknesses that may be identified in the future could, among other things, cause us to fail to file timely our periodic reports with the SEC (which may have a material adverse effect on our ability to access the capital markets); prevent us from providing reliable and accurate financial information and forecasts or from avoiding or detecting fraud; or require us to incur additional costs or divert management resources to, among other things, comply with Section 404 of the Sarbanes-Oxley Act of 2002.

Future legal changes could require us to significantly restructure our operations in order to maintain our investment company exemption, which would materially and adversely affect us.

Our objective has been to conduct our business so as not to become regulated as an investment company under the Investment Company Act. Section 3(c)(5)(C) of the Investment Company Act exempts from the definition of investment company entities that are primarily engaged in the business of purchasing or otherwise acquiring mortgages and other liens on and interests in real estate. Under current interpretations of the SEC staff, this exemption generally means that at least 55% of our assets must be comprised of qualifying real estate assets and at least 80% of our portfolio must be comprised of qualifying real estate assets and real estate-related assets under the Investment Company Act. We primarily rely on an existing interpretation of the SEC staff that generally provides that whole pool certificates that are issued or guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae (or Agency Whole Pool Certificates) are considered qualifying real estate assets under Section 3(c)(5)(C). We treat as real estate-related assets MBS that do not represent all of the certificates issued with respect to the entire pool of mortgages. Compliance with this exemption inherently limits the types of assets we may acquire from time to time.

On August 31, 2011, the SEC issued a concept release in which it announced that it is reviewing interpretive issues related to the Section 3(c)(5)(C) exemption, including requesting comments on whether it should reconsider whether Agency Whole Pool Certificates may be treated as interests in real estate (and presumably Qualifying Real Estate Assets) and whether companies, such as us, whose primary business consists of investing in Agency Whole

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Pool Certificates, are the type of entities that Congress intended to be covered by the exclusion provided by Section 3(c)(5)(C).

The potential timetable and outcome of the SEC s review are unclear. However, if the SEC determines that Agency Whole Pool Certificates are not interests in real estate (and therefore not Qualifying Real Estate Assets), adopts an otherwise adverse interpretation with respect to Agency Whole Pool Certificates, issues different guidance regarding any of the matters bearing upon the exemption under Section 3(c)(5)(C) or otherwise believes we do not satisfy an Investment Company Act exemption, we would be required to significantly restructure our operations in order to maintain our investment company exemption. Under these circumstances, our ability to use leverage and our access to more favorable methods of financing would be substantially reduced, and we would be unable to conduct our business as we currently conduct it. We may also be required to sell certain of our assets and/or limit the types of assets we acquire. Under the circumstances described above, it is likely that our net interest income would be significantly reduced, which would materially and adversely affect our business.

Risks Related to Our Corporate Structure

Our ownership limitations may restrict business combination opportunities.

To qualify as a REIT under the Code, no more than 50% of the value of our outstanding shares of capital stock may be owned, directly or under applicable attribution rules, by five or fewer individuals (as defined by the Code to include certain entities) during the last half of each taxable year. To preserve our REIT qualification, among other things, our charter generally prohibits direct or indirect ownership by any person of more than 9.8% of the number or value of the outstanding shares of our capital stock. Generally, shares owned by affiliated owners will be aggregated for purposes of the ownership limit. Any transfer of shares of our capital stock or other event that, if effective, would violate the ownership limit will be void as to that number of shares of capital stock in excess of the ownership limit and the intended transferee will acquire no rights in such shares. Shares issued or transferred that would cause any stockholder to own more than the ownership limit or cause us to become closely held under Section 856(h) of the Code will automatically be converted into an equal number of shares of excess stock. All excess stock will be automatically transferred, without action by the prohibited owner, to a trust for the exclusive benefit of one or more charitable beneficiaries that we select, and the prohibited owner will not acquire any rights in the shares of excess stock. The restrictions on ownership and transfer contained in our charter could have the effect of delaying, deferring or preventing a change in control or other transaction in which holders of shares of common stock might receive a premium for their shares of common stock over the then current market price or that such holders might believe to be otherwise in their best interests. The ownership limit provisions also may make our shares of common stock an unsuitable investment vehicle for any person seeking to obtain, either alone or with others as a group, ownership of more than 9.8% of the number or value of our outstanding shares of capital stock.

Provisions of Maryland law and other provisions of our organizational documents may limit the ability of a third party to acquire control of our company.

Certain provisions of the Maryland General Corporation Law (or MGCL) may have the effect of delaying, deferring or preventing a transaction or a change in control of our company that might involve a premium price for holders of our common stock or otherwise be in their best interests, including:

- business combination provisions that, subject to limitations, prohibit certain business combinations between us and an interested stockholder (defined generally as any person who beneficially owns 10% or more of the voting power of our outstanding voting stock or an affiliate or associate of ours who, at any time within the two-year period immediately prior to the date in question, was the beneficial owner of 10% or more of the voting power of our then outstanding stock) or an affiliate of an interested stockholder for five years after the most recent date on which the stockholder becomes an interested stockholder, and thereafter impose two supermajority stockholder voting requirements to approve these combinations (unless our common stockholders receive a minimum price, as defined under Maryland law, for their shares in the form of cash or other consideration in the same form as previously paid by the interested stockholder for its shares); and

- control share provisions that provide that holders of control shares of our company (defined as voting shares of stock which, when aggregated with all other shares controlled by the acquiring stockholder, entitle the stockholder to exercise one of three increasing ranges of voting power in electing directors) acquired in a control share acquisition (defined as the direct or indirect acquisition of ownership or control of control shares) have no voting rights except to the extent approved by our stockholders by the affirmative vote of at least two-thirds of all the votes entitled to be cast on the matter, excluding all interested shares.

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Our bylaws provide that we are not subject to the control share provisions of the MGCL. However, our Board may elect to make the control share statute applicable to us at any time, and may do so without stockholder approval.

Title 3, Subtitle 8 of the MGCL permits our Board, without stockholder approval and regardless of what is currently provided in our charter or bylaws, to elect on behalf of our company to be subject to statutory provisions that may have the effect of delaying, deferring or preventing a transaction or a change in control of our company that might involve a premium price for holders of our common stock or otherwise be in their best interest. Our Board may elect to opt in to any or all of the provisions of Title 3, Subtitle 8 of the MGCL without stockholder approval at any time. In addition, without our having elected to be subject to Subtitle 8, our charter and bylaws already (1) provide for a classified board, (2) require the affirmative vote of the holders of at least 80% of the votes entitled to be cast in the election of directors for the removal of any director from our Board, which removal will be allowed only for cause, (3) vest in our Board the exclusive power to fix the number of directorships and (4) require, unless called by our Chairman of the Board, Chief Executive Officer or President or our Board, the written request of stockholders entitled to cast not less than a majority of all votes entitled to be cast at such a meeting to call a special meeting. These provisions may delay or prevent a change of control of our company.

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

In the future, we may attempt to increase our capital resources by making offerings of debt or additional offerings of equity securities, including commercial paper, senior or subordinated notes and series or classes of preferred stock or common stock. Upon liquidation, holders of our debt securities and shares of preferred stock, if any, and lenders with respect to other borrowings will receive a distribution of our available assets prior to the holders of our common stock. Additional equity offerings may dilute the holdings of our existing stockholders or reduce the market price of our common stock, or both. Preferred stock could have a preference on liquidating distributions or a preference on dividend payments or both that could limit our ability to make a dividend distribution to the holders of our common stock. 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 stock bear the risk of our future offerings reducing the market price of our common stock and diluting their stock holdings in us.

Our Board may approve the issuance of capital stock with terms that may discourage a third party from acquiring us.

Our charter permits our Board to issue shares of preferred stock, issuable in one or more classes or series. We may issue a class of preferred stock to individual investors in order to comply with the various REIT requirements or to finance our operations. Our charter further permits our Board to classify or reclassify any unissued shares of preferred or common stock and establish the preferences and rights (including, among others, voting, dividend and conversion rights) of any such shares of stock, which rights may be superior to those of shares of our common stock. Thus, our Board could authorize the issuance of shares of preferred or common stock with terms and conditions that could have the effect of discouraging a takeover or other transaction in which holders of the outstanding shares of our common stock might receive a premium for their shares over the then current market price of our common stock.

Future issuances or sales of shares could cause our share price to decline.

Sales of substantial numbers of shares of our common stock in the public market, or the perception that such sales might occur, could adversely affect the market price of our common stock. In addition, the sale of these shares could impair our ability to raise capital through a sale of additional equity securities. Other issuances of our common stock could have an adverse effect on the market price of our common stock. In addition, future issuances of our common stock may be dilutive to existing stockholders.

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Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

Office Leases

We pay monthly rent pursuant to two operating leases. Our lease for our corporate headquarters in New York, New York extends through May 31, 2020. The lease provides for aggregate cash payments ranging over time from approximately $2.4 million to $2.5 million per year, paid on a monthly basis, exclusive of escalation charges. In addition, as part of this lease agreement, we have provided the landlord a $785,000 irrevocable standby letter of credit fully collateralized by cash. The letter of credit may be drawn upon by the landlord in the event that we default under certain terms of the lease. In addition, we have a lease through December 31, 2016, for our off-site back-up facility located in Rockville Centre, New York, which provides for, among other things, cash payments ranging over time from $28,000 to $30,000 per year, paid on a monthly basis.

Item 3. Legal Proceedings.

There are no material legal proceedings to which we are a party or any of our assets are subject.

To date, we have not been required to make any payments to the IRS as a penalty for failing to make disclosures required with respect to certain transactions that have been identified by the IRS as abusive or that have a significant tax avoidance purpose.

Item 4. Mine Safety Disclosures.

Not applicable.

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PART II

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

Market Information

Our common stock is listed on the New York Stock Exchange, under the symbol MFA. On February 22, 2013, the last sales price for our common stock on the New York Stock Exchange was $8.83 per share. The following table sets forth the high and low sales prices per share of our common stock during each calendar quarter for the years ended December 31, 2012 and 2011:

	2012		2011	
Quarter Ended	**High**	**Low**	**High**	**Low**
March 31	$ 7.60	$ 6.65	$ 8.64	$ 7.88
June 30	7.93	7.01	8.26	7.62
September 30	8.63	7.61	8.35	6.71
December 31	8.77	7.50	7.26	6.23

Holders

As of February 22, 2013, we had 679 registered holders of our common stock. Such information was obtained through our registrar and transfer agent, based on the results of a broker search.

Dividends

No dividends may be paid on our common stock unless full cumulative dividends have been paid on our preferred stock. We have paid full cumulative dividends on our preferred stock on a quarterly basis through December 31, 2012. We have historically declared cash dividends on our common stock on a quarterly basis. During 2012 and 2011, we declared total cash dividends to holders of our common stock of $314.6 million ($0.88 per share) and $358.1 million ($1.01 per share), respectively. In general, our common stock dividends have been characterized as ordinary income to our stockholders for income tax purposes. However, a portion of our common stock dividends may, from time to time, be characterized as capital gains or return of capital. For 2012 and 2011, our common stock dividends were characterized as ordinary income to stockholders. (For additional dividend information, see Notes 11(a), 11(b) and 17 to the consolidated financial statements, included under Item 8 of this Annual Report on Form 10-K.)

We elected to be taxed as a REIT for U.S. federal income tax purposes commencing with our taxable year ended December 31, 1998 and, as such, have distributed and anticipate distributing annually at least 90% of our REIT taxable income. Although we may borrow funds to make distributions, cash for such distributions has generally been, and is expected to continue to be, largely generated from our results of our operations.

We declared and paid the following dividends on our common stock during the years 2012 and 2011:

Year (1)	Declaration Date	Record Date	Payment Date	Dividend per Share
2012	March 23, 2012	April 4, 2012	April 30, 2012	$ 0.240
	June 27, 2012	July 13, 2012	July 31, 2012	0.230
	September 28, 2012	October 12, 2012	October 31, 2012	0.210
	December 12, 2012	December 28, 2012	January 31, 2013	0.200*(2)*
2011	March 31, 2011	April 11, 2011	April 29, 2011	$ 0.235
	June 30, 2011	July 14, 2011	July 29, 2011	0.250
	September 26, 2011	October 11, 2011	October 31, 2011	0.250
	December 14, 2011	December 30, 2011	January 31, 2012	0.270*(3)*

(1) Table excludes special cash dividend of $0.50 per share payable on April 10, 2013 to stockholders of record on March 18, 2013.

(2) At December 31, 2012, the Company had accrued dividends and dividend equivalent rights (or DERs) payable of $72.2 million related to the common stock dividend declared on December 12, 2012.

(3) Includes a special dividend of $0.02 per share.

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Dividends are declared and paid at the discretion of our Board and depend on our cash available for distribution, financial condition, ability to maintain our qualification as a REIT, and such other factors that our Board may deem relevant. We have not established a minimum payout level for our common stock. (See Part I, Item 1A., Risk Factors , and Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations , of this Annual Report on Form 10-K, for information regarding the sources of funds used for dividends and for a discussion of factors, if any, which may adversely affect our ability to pay dividends.)

Purchases of Equity Securities

As previously disclosed, in August 2005, our Board authorized a stock repurchase program (or Repurchase Program), to repurchase up to 4.0 million shares of its outstanding common stock under the Repurchase Program. The Board reaffirmed such authorization in May 2010. Such authorization does not have an expiration date and, at present, there is no intention to modify or otherwise rescind such authorization. Subject to applicable securities laws, repurchases of common stock under the Repurchase Program are made at times and in amounts as we deem appropriate, using available cash resources. Shares of common stock repurchased by us under the Repurchase Program are cancelled and, until reissued by us, are deemed to be authorized but unissued shares of our common stock. The Repurchase Program may be suspended or discontinued by us at any time and without prior notice.

We engaged in no share repurchase activity during the first three quarters of 2012. The following table presents information with respect to (i) shares of common stock repurchased by us under the Repurchase Program and (ii) restricted shares withheld (under the terms of grants under our Amended and Restated 2010 Equity Compensation Plan (or 2010 Plan)) to offset tax withholding obligations that occur upon the vesting and release of restricted stock awards and restricted stock units, in each case during the fourth quarter of 2012:

Month	**Total Number of Shares Purchased**	**Weighted Average Price Paid Per Share (1)**	**Total Number of Shares Repurchased as Part of Publicly Announced Repurchase Program or Employee Plan**	**Maximum Number of Shares that May Yet be Purchased Under the Repurchase Program or Employee Plan**
October 1-31, 2012:				
Repurchase Program *(2)*		$		4,000,000
Employee Transactions *(3)*	1,998	8.70	N/A	N/A
November 1-30, 2012:				
Repurchase Program *(2)*	1,154,991	7.81	1,154,991	2,845,009
Employee Transactions *(3)*			N/A	N/A
December 1-31, 2012:				
Repurchase Program *(2)*	85,300	8.11	85,300	2,759,709
Employee Transactions *(3)*	289,805	8.11	N/A	N/A
Total Repurchase Program *(2)*	1,240,291	$ 7.83	1,240,291	2,759,709
Total Employee Transactions *(3)*	291,803	$ 8.12	N/A	N/A

(1) Includes brokerage commissions.

(2) As of December 31, 2012, we had repurchased an aggregate of 1,240,291 shares under the Repurchase Program.

(3) Our 2010 Plan provides that the value of the shares delivered or withheld be based on the price of our common stock on the date the relevant transaction occurs.

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Discount Waiver, Direct Stock Purchase and Dividend Reinvestment Plan

In September 2003, we initiated a Discount Waiver, Direct Stock Purchase and Dividend Reinvestment Plan (or the DRSPP) to provide existing stockholders and new investors with a convenient and economical way to purchase shares of our common stock. Under the DRSPP, existing stockholders may elect to automatically reinvest all or a portion of their cash dividends in additional shares of our common stock and existing stockholders and new investors may make optional cash purchases of shares of our common stock in amounts ranging from $50 (or $1,000 for new investors) to $10,000 on a monthly basis and, with our prior approval, in excess of $10,000. At our discretion, we may issue shares of our common stock under the DRSPP at discounts of up to 5% from the prevailing market price at the time of purchase. Computershare Shareowner Services LLC is the administrator of the DRSPP (or the Plan Agent). Stockholders who own common stock that is registered in their own name and want to participate in the DRSPP must deliver a completed enrollment form to the Plan Agent. Stockholders who own common stock that is registered in a name other than their own (e.g., broker, bank or other nominee) and want to participate in the DRSPP must either request such nominee holder to participate on their behalf or request that such nominee holder re-register our common stock in the stockholder s name and deliver a completed enrollment form to the Plan Agent. During 2012, we issued 1,977,165 shares of common stock through the DRSPP generating net proceeds of $15,460,074.

Controlled Equity Offering Program

On August 20, 2004, we initiated a controlled equity offering program (or the CEO Program) through which we may, from time to time, publicly offer and sell shares of our common stock through Cantor Fitzgerald & Co. in privately negotiated and/or at-the-market transactions. During 2012, we did not issue any shares of common stock through our CEO Program.

Securities Authorized For Issuance Under Equity Compensation Plans

During 2010, we adopted the 2010 Plan, as approved by our stockholders. (For a description of the 2010 Plan, see Note 13(a) to the consolidated financial statements included under Item 8 of this Annual Report on Form 10-K.)

The following table presents certain information with respect to our equity compensation plans as of December 31, 2012:

Award (1)	**Number of securities to be issued upon exercise of outstanding options, warrants and rights**	**Weighted-average exercise price of outstanding options, warrants and rights**	**Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in the first column of this table)**
Stock Options	427,000	$ 10.14	
Restricted Stock Units (or RSUs)	727,648	*(2)*	
Total	1,154,648	$ *(2)*	9,505,879*(3)*

(1) All equity based compensation is granted pursuant to plans that have been approved by our stockholders.

(2) A weighted average exercise price is not applicable for our RSUs, as such equity awards result in the issuance of shares of our common stock provided that such awards vest and, as such, do not have an exercise price. At December 31, 2012, 43,875 RSUs were vested, 418,891 RSUs were subject to time based vesting and 264,882 RSUs had vesting subject to achieving a market condition.

(3) Number of securities remaining available for future issuance under equity compensation plans excludes stock options and RSUs presented in the table and 483,442 shares of restricted stock, which were issued and outstanding at December 31, 2012, which are not presented in the table.

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Item 6. Selected Financial Data.

Our selected financial data set forth below is derived from our audited financial statements and should be read in conjunction with our consolidated financial statements and the accompanying notes, included under Item 8 of this Annual Report on Form 10-K.

	At or/For the Year Ended December 31,				
(Dollars in Thousands, Except per Share Amounts)	**2012**	**2011**	**2010**	**2009**	**2008**
Operating Data:					
Interest and dividend income on mortgage-backed securities	$ 499,030	$ 496,611	$ 390,953	$ 504,464	$ 519,788
Interest income on cash and cash equivalent investments	127	136	385	1,097	7,729
Interest expense	(171,670)	(149,411)	(145,125)	(229,406)	(342,688)
Net impairment losses recognized in earnings *(1)*	(1,200)	(10,570)	(12,277)	(17,928)	(5,051)
Unrealized net gains and net interest income from Linked Transactions	12,610	3,015	53,762	8,829	
Gain/(loss) on sale of investment securities, net *(2)*	9,001	6,730	33,739	22,617	(24,530)
Loss on termination of Swaps *(3)*					(92,467)
Loss on termination of repurchase agreements *(4)*			(26,815)		
Other income, net	10	1,082	1,464	1,563	1,901
Operating and other expense	(41,069)	(31,179)	(26,324)	(23,047)	(18,885)
Net income	$ 306,839	$ 316,414	$ 269,762	$ 268,189	$ 45,797
Preferred stock dividends	8,160	8,160	8,160	8,160	8,160
Net income available to common stock and participating securities	$ 298,679	$ 308,254	$ 261,602	$ 260,029	$ 37,637
Earnings per share basic and diluted	$ 0.83	$ 0.90	$ 0.93	$ 1.06	$ 0.21
Dividends declared per share of common stock *(5)*	$ 0.88	$ 1.005	$ 0.890	$ 0.990	$ 0.810
Dividends declared per share of preferred stock	$ 2.125	$ 2.125	$ 2.125	$ 2.125	$ 2.125
Balance Sheet Data:					
Mortgage-backed securities	$ 12,607,625	$ 10,912,977	$ 8,058,710	$ 8,757,954	$ 10,122,583
Cash and cash equivalents	401,293	394,022	345,243	653,460	361,167
Linked Transactions	12,704	55,801	179,915	86,014	
Total assets	13,517,550	11,750,634	8,687,407	9,627,209	10,641,419
Repurchase agreements	8,752,472	7,813,159	5,992,269	7,195,827	9,038,836
Securitized debt	646,816	875,520	220,933		
Swaps (in a liability position)	63,034	114,220	139,142	152,463	237,291
Total liabilities	10,206,544	9,252,874	6,436,960	7,458,947	9,384,342
Preferred stock, liquidation preference	96,000	96,000	96,000	96,000	96,000
Total stockholders equity	3,311,006	2,497,760	2,250,447	2,168,262	1,257,077
Other Data:					
Average total assets	$ 12,942,171	$ 11,185,224	$ 8,242,541	$ 10,105,128	$ 9,973,789
Average total stockholders equity	$ 2,945,687	$ 2,701,204	$ 2,226,546	$ 1,777,311	$ 1,173,667
Return on average total assets *(6)*	2.31%	2.76%	3.17%	2.57%	0.38%
Return on average total stockholders equity *(7)*	10.14%	11.41%	11.75%	14.63%	3.21%
	22.76%	24.18%	26.91%	17.59%	11.77%

Total average stockholders equity to total average assets *(8)*										
Dividend payout ratio *(9)*		1.06%		1.12%		0.96%		0.93%		3.86%
Book value per share of common stock *(10)*	$	8.99	$	6.74	$	7.68	$	7.40	$	5.29

(1) Reflects OTTI through earnings related to Non-Agency MBS. In addition, the 2008 period includes impairments of $5.1 million, of which $4.9 million reflected a full write-off of two unrated investment securities and $183,000 was an impairment charge against one Non-Agency MBS.

(2) 2012: We sold certain Agency MBS for $168.9 million, realizing gross gains of $9.0 million. 2011: We sold certain Agency MBS for $150.6 million, realizing gross gains of $6.7 million. 2010: During the first quarter of 2010, we sold 52 of our longer term-to-reset Agency MBS for $931.9 million, realizing gross gains of $33.1 million. (See Note (4) below.) 2009: We sold 36 of our longer-term Agency MBS with an amortized cost of $628.3 million for $650.9 million, realizing gross gains of $22.6 million. 2008: In response to tightening of market credit conditions in the first quarter, we decreased our debt-to-equity multiple. In order to implement this strategy, we reduced our borrowings, by selling MBS with an amortized cost of $1.876 billion, realizing aggregate net losses of $24.5 million, comprised of gross losses of $25.1 million and gross gains of $571,000.

(3) In March 2008, we terminated 48 Swaps, with an aggregate notional amount of $1.637 billion, in connection with the repayment of the repurchase agreements hedged by such Swaps. These transactions resulted in us recognizing net losses of $91.5 million. (See Note (2), above). In addition, during 2008, we recognized losses of $986,000 in connection with two Swaps terminated in connection with the bankruptcies related to Lehman Brothers Holdings Inc. in September 2008.

(footnotes continued on next page)

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(4) In connection with sales of our Agency MBS in the first quarter of 2010, we terminated $657.3 million of repurchase agreement borrowings, incurring losses of $26.8 million.

(5) During 2012 and 2011, we declared our common stock dividend in the third month of each calendar quarter. For the periods presented prior to 2011, we declared dividends on our common stock in the month subsequent to the end of each calendar quarter, with the exception of the fourth quarter dividend, which is typically declared during the fourth calendar quarter for tax reasons. Table excludes special cash dividend of $0.50 per share payable on April 10, 2013 to stockholders of record on March 18, 2013.

(6) Reflects net income divided by average total assets.

(7) Reflects net income divided by average total stockholders equity.

(8) Reflects total average stockholders equity divided by total average assets.

(9) Reflects dividends declared per share of common stock divided by earnings per share.

(10) Reflects total stockholders equity less the preferred stock liquidation preference divided by total shares of common stock outstanding.

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

The following discussion should be read in conjunction with our financial statements and accompanying notes included in Item 8 of this Annual Report on Form 10-K.

GENERAL

We are a REIT primarily engaged in the business of investing, on a leveraged basis, in residential Agency MBS and Non-Agency MBS. Our principal business objective is to generate net income for distribution to our stockholders resulting from the difference between the interest and other income we earn on our investments and the interest expense we pay on the borrowings that we use to finance our leveraged investments and our operating costs.

At December 31, 2012, we had total assets of approximately $13.518 billion, of which $12.608 billion, or 93.3%, represented our MBS portfolio. At such date, our MBS portfolio was comprised of $7.225 billion of Agency MBS and $5.382 billion of Non-Agency MBS. Our remaining investment-related assets were primarily comprised of cash and cash equivalents, restricted cash, collateral obtained in connection with reverse repurchase agreements, Linked Transactions and MBS-related receivables.

The results of our business operations are affected by a number of factors, many of which are beyond our control, and primarily depend on, among other things, the level of our net interest income, the market value of our assets, the supply and demand for MBS in the marketplace, the terms and availability of adequate financing, general economic and real estate conditions (both on a national and local level), the impact of government actions in the real estate and mortgage sector, and the credit performance of our Non-Agency MBS. Our net interest income varies primarily as a result of changes in interest rates, the slope of the yield curve (i.e., the differential between long-term and short-term interest rates), borrowing costs (i.e., our interest expense) and prepayment speeds on our MBS, the behavior of which involves various risks and uncertainties. Interest rates and CPRs (which measure the amount of unscheduled principal prepayment on a bond as a percentage of the bond balance), vary according to the type of investment, conditions in the financial markets, competition and other factors, none of which can be predicted with any certainty.

With respect to our business operations, increases in interest rates, in general, may over time cause: (i) the interest expense associated with our borrowings to increase; (ii) the value of our MBS portfolio and, correspondingly, our stockholders equity to decline; (iii) coupons on our ARM-MBS to reset, on a delayed basis, to higher interest rates; (iv) prepayments on our MBS to decline, thereby slowing the amortization of our MBS purchase premiums and the accretion of our purchase discounts; and (v) the value of our derivative hedging instruments and, correspondingly, our stockholders equity to increase. Conversely, decreases in interest rates, in general, may over time cause: (i) the interest expense associated with our borrowings to decrease; (ii) the value of our MBS portfolio and, correspondingly, our stockholders equity to increase; (iii) coupons on our ARM-MBS to reset, on a delayed basis, to lower interest rates; (iv) prepayments on our MBS to increase, thereby accelerating the amortization of our MBS purchase premiums and the accretion of our purchase discounts; and (v) the value of our derivative hedging instruments and, correspondingly, our stockholders equity to decrease. In addition, our borrowing costs and credit lines are further affected by the type of collateral we pledge and general conditions in the credit market.

We are exposed to credit risk in our Non-Agency MBS portfolio, generally meaning that we are subject to credit losses in our Non-Agency MBS portfolio that correspond to the risk of delinquency, default and foreclosure on the real estate collateralizing our Non-Agency MBS. In particular, we have significantly higher exposure in our Non-Agency MBS portfolio in California, Florida, New York, Virginia and New Jersey. However, the remaining credit support built into Non-Agency MBS transaction structures is designed to mitigate the extent of expected credit losses. In addition, we believe the discounted purchase prices paid on certain of our Non-Agency MBS effectively mitigates our risk of loss in the event, as we expect on most, that we receive less than 100% of the par value of these securities. Our Non-Agency MBS investment process involves analysis focused primarily on quantifying and pricing credit risk. Interest income on Non-Agency MBS purchased at a significant discount is recorded at an effective yield, based on management s estimate of expected cash flows from each security, which estimate is based on our observation of current information and events and include assumptions related to fluctuations in interest rates, prepayment speeds and the timing and amount of credit losses.

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The table below presents the composition of our MBS portfolios with respect to repricing characteristics as of December 31, 2012:

	December 31, 2012			
Underlying Mortgages (In Thousands)	**Agency MBS Fair Value (1)**	**Non-Agency MBS Fair Value (2)**	**Total MBS (1)**	**Percent of Total**
Hybrids in contractual fixed-rate period	$ 3,709,080	$ 1,390,126	$ 5,099,206	40.5%
Hybrids in adjustable period	1,062,760	2,265,490	3,328,250	26.4
15-year fixed rate	2,329,634	17,043	2,346,677	18.6
Greater than 15-year fixed rate		1,609,428	1,609,428	12.8
Floaters	119,563	100,078	219,641	1.7
Total	$ 7,221,037	$ 5,382,165	$ 12,603,202	100.0%

(1) Does not include principal receivable in the amount of $4.4 million.

(2) Does not reflect $47.8 million of Non-Agency MBS underlying our Linked Transactions.

As of December 31, 2012, approximately $9.055 billion, or 71.8%, of our MBS portfolio was in its contractual fixed-rate period or were fixed-rate MBS and approximately $3.548 billion, or 28.2%, was in its contractual adjustable-rate period, or were floating rate MBS. Our ARM-MBS in their contractual adjustable-rate period primarily include MBS collateralized by Hybrids for which the initial fixed-rate period has elapsed, such that the interest rate will typically adjust on an annual or semiannual basis. At December 31, 2012, we had $219.6 million of MBS with interest rates that reset monthly.

Premiums arise when we acquire MBS at a price in excess of the principal balance of the mortgages securing such MBS (i.e., par value). Conversely, discounts arise when we acquire MBS at a price below the principal balance of the mortgages securing such MBS. Premiums paid on our MBS are amortized against interest income and accretable purchase discounts on our MBS are accreted to interest income. Purchase premiums on our MBS, which are primarily carried on our Agency MBS, are amortized against interest income over the life of each security using the effective yield method, adjusted for actual prepayment activity. An increase in the prepayment rate, as measured by the CPR, will typically accelerate the amortization of purchase premiums, thereby reducing the yield/interest income earned on such assets. Generally, if prepayments on our Non-Agency MBS are less than anticipated, we expect that the income recognized on such assets would be reduced and impairments could result.

Conditional prepayment rate (or CPR) levels are impacted by, among other things, conditions in the housing market, new regulations, government and private sector initiatives, interest rates, availability of credit to home borrowers, underwriting standards and the economy in general. In particular, CPR reflects the conditional repayment rate (or CRR), which measures voluntary prepayments of mortgages collateralizing a particular MBS, and the conditional default rate (or CDR), which measures involuntary prepayments resulting from defaults. CPRs on Agency MBS and Non-Agency MBS may differ significantly. For the year ended December 31, 2012, our Agency MBS portfolio experienced a weighted average CPR of 19.8%, and our Non-Agency MBS portfolio (including Non-Agency MBS underlying our Linked Transactions) experienced a CPR of 15.0%. Over the last consecutive eight quarters, ending with December 31, 2012, the monthly fair value weighted average CPR on our MBS portfolio ranged from a high of 23.6% experienced during the quarter ended March 31, 2011 to a low of 15.2% experienced during the quarter ended June 30, 2011, with an average CPR over such quarters of 17.7%.

When we purchase Non-Agency MBS at significant discounts to par value, we make certain assumptions with respect to each security. These assumptions include, but are not limited to, future interest rates, voluntary prepayment rates, default rates, mortgage modifications and loss severities. As part of our Non-Agency MBS surveillance process, we track and compare each security s actual performance over time to the performance expected at the time of purchase or, if we have modified our original purchase assumptions, to our revised performance expectations. To the extent that actual performance of our Non-Agency MBS deviates materially from our expected performance parameters, we may revise our performance expectations, such that the amount of purchase discount designated as credit discount may be increased or decreased over time. Nevertheless, credit losses greater than those anticipated or in excess of the recorded purchase discount could occur, which could materially adversely impact our operating results.

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Loans underlying Agency ARM-MBS generally reset based on the same benchmark index, while Non-Agency MBS may be collateralized by mortgage loans that reset based on various benchmark indices and may contain fixed-rate mortgages. The ARMs collateralizing our Agency MBS are primarily comprised of Hybrids; which have interest rates that are typically fixed for three to ten years at origination and, thereafter, generally adjust annually to an increment over a specified interest rate index; and, to a lesser extent, ARMs, which have interest rates that generally adjust annually (although some may adjust more frequently) to an increment over a specified interest rate index.

Because the expected yields on our Non-Agency MBS are significantly greater than the expected yields on non-credit sensitive assets, we believe that changes in Non-Agency MBS prices are generally not highly correlated to changes in market interest rates and are more significantly impacted by general economic conditions and housing specific performance. Yields on Non-Agency MBS, unlike Agency MBS, will exhibit sensitivity to changes in credit performance. The extent to which the yield on our Non-Agency MBS is impacted by the accretion of purchase discounts will vary over time, by security, based upon the amount of purchase discount, the actual credit performance and CPRs experienced on each MBS.

The amount by which our Agency ARM-MBS can reset is limited by the interim and lifetime caps on the underlying mortgages. The following table presents information about the interim and lifetime caps on our Agency ARM-MBS portfolio at December 31, 2012:

Lifetime Interest Rate Caps on Agency ARMs ***(1)***

Maximum Lifetime Interest Rate	% of Total
6.0% to 8.0%	16.6%
>8.0% to 10.0%	52.5
>10.0% to 12.0%	28.3
>12.0%	2.6
	100.0%

Interim Interest Rate Caps on Agency ARMs ***(2)***

Maximum Interim Change in Rate	% of Total
≤1.0%	1.3%
>1.0% and ≤3.0%	21.0
>3.0% and ≤5.0%	75.0
>5.0%	0.1
No interim caps	2.6
	100.0%

(1) Lifetime interest rate caps limit the amount interest rates can adjust upward from inception through maturity of a particular ARM.

(2) Interim interest rate caps limit the amount interest rates on a particular ARM can adjust during the next adjustment period.

It is our business strategy to hold our MBS as long-term investments. On at least a quarterly basis, we assess our ability and intent to continue to hold each security and, as part of this process, we monitor our securities for other-than-temporary impairment. A change in our ability and/or intent to continue to hold any of our securities that are in an unrealized loss position, or a deterioration in the underlying characteristics of these securities, could result in our recognizing future impairment charges or a loss upon the sale of any such security. At December 31, 2012, we had net unrealized gains of $200.9 million on our Agency MBS, comprised of gross unrealized gains of $202.4 million and gross unrealized losses of $1.5 million, and had net unrealized gains on our Non-Agency MBS of $623.9 million, comprised of gross unrealized gains of $630.2 million and gross unrealized losses of $6.3 million. At December 31, 2012, we did not intend to sell any of our MBS that were in an unrealized loss position, and we believe it is more likely than not that we will not be required to sell those MBS before recovery of their amortized cost basis, which may be at their maturity. (See following discussion on Recent Market Conditions and Our Strategy .)

We rely primarily on borrowings under repurchase agreements to finance our Agency MBS and Non-Agency MBS. Our MBS have longer-term contractual maturities than our borrowings under repurchase agreements. We have also engaged in resecuritization transactions with respect to our Non-Agency MBS, which provide access to non-recourse financing. Even though the majority of our MBS have interest rates that adjust over time based on short-term changes in corresponding interest rate indices (typically following an initial fixed-rate period for our Hybrids), the interest rates we pay on our borrowings and securitized debt will typically change at a faster pace than the interest rates we earn on our MBS. In order to reduce this interest rate risk exposure, we may enter into derivative hedging instruments, which are currently comprised of Swaps.

Our derivative hedging instruments are designated as cash-flow hedges against a portion of our current and forecasted LIBOR-based repurchase agreements and securitized debt. Our Swaps do not extend the maturities of our repurchase agreements and/or securitized debt; they do, however, lock in a fixed rate of interest over their term for the notional amount of the Swap corresponding to the hedged item. During 2012, we entered into one new Swap with a notional amount of $100.0 million and a fixed-pay rate of 0.48% and had Swaps with an aggregate notional amount of $958.3 million and a weighted average fixed-pay rate of 3.87% amortize and/or expire. At December 31, 2012, we had Swaps with an aggregate notional amount of $2.520 billion with a weighted average fixed-pay rate of 2.31% and a weighted average variable interest rate of 0.22%.

Recent Market Conditions and Our Strategy

During 2012, we continued to invest in both Agency and Non-Agency MBS, as reflected by the increase in the size of our MBS portfolio at December 31, 2012. During the year ended December 31, 2012, we acquired approximately (i) $2.246 billion of Agency MBS at a weighted average purchase price of 104.9% of par value and (ii) $1.351 billion of Non-Agency MBS at a weighted average purchase price of 76.1% of par value. At December 31, 2012, our combined MBS portfolio was approximately $12.608 billion compared to $10.913 billion at December 31, 2011.

Due to the interest rate environment in 2012, yields on acquired assets were lower than in prior periods. At the end of 2012, the average coupon on mortgages underlying our Agency MBS was lower compared to the end of 2011, due to acquisition of assets in the marketplace at generally lower coupons reflecting current market conditions and as a result of prepayments on higher yielding assets and resets on Hybrid and ARM-MBS within the portfolio. As a result, the coupon yield on our Agency MBS portfolio declined 47 basis points to 3.58% for 2012 from 4.05% for 2011. In addition, the net Agency MBS yield decreased to 2.83% for 2012, from 3.50% for 2011. Our Non-Agency MBS portfolio yielded 6.76% for 2012 compared to 7.55% for 2011. The decrease in the yield on our Non-Agency MBS portfolio is primarily due to the flattening (downward movement in the later years) of the forward yield curve, which causes us to lower the projected future coupons and therefore the expected yields on our Hybrid Non-Agency MBS and the addition of newly acquired assets at yields less than our overall portfolio yield.

Our MBS portfolio acquisitions during 2012 reflected attractive investment opportunities and the continued availability of financing. We were able to selectively find relative value in the Agency MBS market due, in part, to the positively-sloped U.S. Treasury and LIBOR yield curves and low funding costs. Additionally, Non-Agency MBS were available in the marketplace at discounts to par value.

We continue to believe that loss-adjusted returns on Non-Agency MBS represent attractive investment opportunities. The yields on our Non-Agency MBS that were purchased at a discount are generally positively impacted if prepayment rates on these securities exceed our prepayment assumptions. Given rising multifamily rents, limited housing construction, capital flows into own-to-rent foreclosure purchases and demographic-driven U.S. household formation, there have been increasing signs of home price appreciation. However, we believe that we are appropriately factoring in the uncertainty regarding housing fundamentals into our cash flow projection and credit reserve analysis. A combination of both home price appreciation and mortgage amortization has led to a decrease in the Loan-to-Value ratio (or LTV) for many of the mortgages underlying our Non-Agency portfolio. Due to this lower LTV, we have reduced estimated future losses within our Non-Agency portfolio. As a result, during 2012 we transferred $152.5 million to accretable discount from Credit Reserve. This increase in accretable discount prospectively increases the yield on Non-Agency MBS and will be realized in income over the life of the assets. We expect that the majority of our assets will remain in Agency MBS.

Our book value per common share grew to $8.99 as of December 31, 2012, compared to $6.74 at December 31, 2011. The 33.4% increase in book value per share in 2012 was the result of our total return strategy of investing in both Agency and discounted Non-Agency residential MBS. At December 31, 2012, $5.382 billion, or 42.7% of our MBS portfolio, was invested in Non-Agency MBS. In addition, we had $47.8 million of Non-Agency MBS that were reported as a component of our Linked Transactions. For the year ended December 31, 2012, we experienced an increase of $1.607 billion in the market value of our Non-Agency MBS primarily due to the addition of $1.351 billion of newly acquired assets which was partially offset by $740.3 million of principal repayments on the entire Non-Agency MBS portfolio and an increase in net unrealized gains of $784.6 million for the portfolio as a result of market price appreciation. In addition, certain of our Non-Agency MBS underlying Linked Transactions became delinked during 2012 resulting in Non-Agency MBS of $175.2 million, previously included as a component of Linked Transactions, being recognized as Non-Agency MBS on our consolidated balance sheet at December 31, 2012.

With $401.3 million of cash and cash equivalents and $473.7 million of unpledged Agency MBS at December 31, 2012, we believe that we are positioned to continue to take advantage of investment opportunities within the residential MBS marketplace. In 2013 we intend to continue to selectively acquire Agency MBS and Non-Agency MBS. We believe that our Non-Agency assets will be positively impacted going forward as the existing private label MBS universe continues to decline in size due to prepayments, defaults and limited issuance. In addition, while most Non-Agency MBS in our portfolio will not return their full face value due to loan defaults, we believe that they will deliver attractive loss adjusted yields due to our discounted average amortized cost of 73% of face value as of December 31, 2012.

To finance the growth of our portfolio, we continue to pursue diversified financing sources, including longer term forms of repurchase agreement financing and resecuritizations. During the fourth quarter of 2012, we added a $75.5 million two-year repurchase agreement. During the third quarter of 2012, we extended by 13 months through January 2016 the maturity of our multi-year collateralized financing arrangements that effectively provides financing for approximately $500 million of Non-Agency MBS. The financing obtained under these arrangements was increased by approximately $200 million in the first quarter of 2012. During the second quarter of 2012, we added a $350.0 million three-year repurchase agreement and a $90.0 million 18-month repurchase agreement to finance Non-Agency MBS assets, and we issued $100.0 million aggregate principal amount of Senior Notes in an underwritten public offering. The total net proceeds from the offering of Senior Notes were approximately $96.6 million, after deducting offering expenses and the underwriting discount. In addition, in the second quarter of 2012, we sold $433.3 million in principal amount of Non-Agency MBS as a part of a resecuritization. In connection with this transaction, $186.7 million of senior bonds rated AAA by DBRS, Inc. were issued to third-party investors via a trust. These bonds, with an average life of 1.9 years, were priced at a 2.75% yield. While funding obtained under our multi-year financing agreements is incrementally more expensive than short-term repurchase agreement financing by 100-150 basis points, we believe the certainty of the committed term justifies the additional cost. Consequently, we anticipate that the net interest spread for the portion of the portfolio financed using these multi-year financing arrangements will be lower in future periods. See Liquidity and Capital Resources below for more information regarding our financing sources and strategies.

The financial environment continues to be favorably impacted by accommodative U.S. monetary policy. Repurchase agreement funding for both Agency MBS and Non-Agency MBS continues to be available to us from multiple counterparties. Typically, repurchase agreement funding involving Non-Agency MBS is available from fewer counterparties, at terms requiring higher collateralization and higher interest rates, than for repurchase agreement funding involving Agency MBS. At December 31, 2012, our debt consisted of borrowings under repurchase agreements with 26 counterparties, securitized debt and Senior Notes outstanding, payable for unsettled MBS purchases, and obligation to return securities obtained as collateral, resulting in a debt-to-equity multiple of 3.0x. (See table on page 44 under Results of Operations that presents our quarterly leverage multiples since March 31, 2011.)

During the year ended December 31, 2012, the U.S. Federal Reserve announced that it intends to keep the target range for the Federal Funds rate at 0% to 0.25% and anticipates that exceptionally low levels are likely to be warranted at least through mid-2015. The U.S. Federal Reserve also announced that it will increase its holdings of Agency MBS by $40 billion per month until the labor market improves. It is also continuing its policy of reinvesting principal payments from existing Agency holdings, bringing total monthly purchases near $85 billion. These actions have put downward pressure on Agency MBS yields.

Recent Developments

Following a detailed review of tax calculations, we determined that our originally calculated taxable income for certain years did not fully include the impact of discount accretion and premium amortization for certain MBS within our portfolio. In addition, the Company utilizes a reconciliation process to compare its calculation of GAAP income to taxable income, and this reconciliation process did not identify the underreporting of taxable income. Consequently, our Board of Directors declared a special cash dividend of $0.50 per share of common stock payable on April 10, 2013, to stockholders of record on March 18, 2013. Approximately $130.3 million of this distribution will be allocated to the previously undistributed REIT taxable income for 2010 and 2011, with the remainder available to satisfy a portion of 2012 taxable income undistributed to date.

Although determination of our 2012 taxable REIT income will not be finalized until the timely filing of our 2012 tax return, which is expected to occur in the third quarter of 2013, we currently estimate that taxable income for 2012 exceeds distributions paid in respect of such year. Before filing our 2012 tax return, as noted above we may elect to apply, on an asset-by-asset basis, an alternative methodology for calculating taxable income for certain Non-Agency MBS acquired in 2012. While application of this alternative methodology may reduce the final determination of 2012 taxable income, we expect that taxable income will still exceed distributions paid and declared to date in respect of 2012. We expect that our Board of Directors will declare additional dividends in 2013 to address any undistributed taxable income.

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Information About Our Assets

The tables below present certain information about our asset allocation at December 31, 2012.

ASSET ALLOCATION

GAAP Basis

At December 31, 2012 (Dollars in Thousands)	Agency MBS	Non-Agency MBS	MBS Portfolio	Cash (1)	Other, net (2)	Total
Amortized Cost	$ 7,024,517	$ 4,758,300	$ 11,782,817	$ 406,309	$ (107,330)	$ 12,081,796
Market Value	$ 7,225,460	$ 5,382,165	$ 12,607,625	$ 406,309	$ (107,330)	$ 12,906,604
Less Payable for Unsettled Purchases	(33,479)		(33,479)			(33,479)
Less Repurchase Agreements	(6,353,489)	(2,398,983)	(8,752,472)			(8,752,472)
Less Securitized Debt		(646,816)	(646,816)			(646,816)
Less Senior Notes					(100,000)	(100,000)
Equity Allocated	$ 838,492	$ 2,336,366	$ 3,174,858	$ 406,309	$ (207,330)	$ 3,373,837
Less Swaps at Market Value					(62,831)	(62,831)
Net Equity Allocated	$ 838,492	$ 2,336,366	$ 3,174,858	$ 406,309	$ (270,161)	$ 3,311,006
Debt/Net Equity Ratio *(3)*	7.62x	1.30x				3.03x

Non-GAAP Adjustments

At December 31, 2012 (Dollars in Thousands)	Agency MBS	Non-Agency MBS (4)	MBS Portfolio	Cash (1)	Other, net (4)	Total
Amortized Cost	$	$ 43,817	$ 43,817	$	$ 85,459	$ 129,276
Market Value	$	$ 47,828	$ 47,828	$	$ 85,459	$ 133,287
Repurchase Agreements		375,540	375,540			375,540
Multi-year Collateralized Financing Arrangements		(508,827)	(508,827)			(508,827)
Equity Allocated	$	$ (85,459)	$ (85,459)	$	$ 85,459	$
Less Swaps at Market Value						
Net Equity Allocated	$	$ (85,459)	$ (85,459)	$	$ 85,459	$

Non-GAAP Basis

At December 31, 2012 (Dollars in Thousands)	Agency MBS	Non-Agency MBS (4)	MBS Portfolio	Cash (1)	Other, net (6)	Total
Amortized Cost	$ 7,024,517	$ 4,802,117	$ 11,826,634	$ 406,309	$ (21,871)	$ 12,211,072
Market Value	$ 7,225,460	$ 5,429,993	$ 12,655,453	$ 406,309	$ (21,871)	$ 13,039,891
Less Payable for Unsettled Purchases	(33,479)		(33,479)			(33,479)
Less Repurchase Agreements	(6,353,489)	(2,023,443)	(8,376,932)			(8,376,932)
Less Multi-year Collateralized Financing Arrangements		(508,827)	(508,827)			(508,827)
Less Securitized Debt		(646,816)	(646,816)			(646,816)
Less Senior Notes					(100,000)	(100,000)
Equity Allocated	$ 838,492	$ 2,250,907	$ 3,089,399	$ 406,309	$ (121,871)	$ 3,373,837
Less Swaps at Market Value					(62,831)	(62,831)
Net Equity Allocated	$ 838,492	$ 2,250,907	$ 3,089,399	$ 406,309	$ (184,702)	$ 3,311,006
Debt/Net Equity Ratio *(5)*	7.62x	1.41x				3.04x

(1) Includes cash, cash equivalents and restricted cash.

(2) Includes securities obtained and pledged as collateral, Linked Transactions, interest receivable, goodwill, prepaid and other assets, obligation to return securities obtained as collateral, interest payable, dividends payable, excise tax and interest payable, and accrued expenses and other liabilities.

(3) For the Agency and Non-Agency MBS portfolio, represents the sum of borrowings under repurchase agreements, payable for unsettled purchases and securitized debt as a multiple of net equity allocated. The numerator of our Total Debt/Net Equity ratio also includes the obligation to return securities obtained of $508.8 million and Senior Notes.

(4) Includes Non-Agency MBS and repurchase agreements underlying Linked Transactions. The purchase of a Non-Agency MBS and contemporaneous repurchase borrowing of this MBS with the same counterparty are accounted for under GAAP as a linked transaction. The two components of a linked transaction (MBS and associated borrowings under a repurchase agreement) are evaluated on a combined basis and are presented net as Linked Transactions on our consolidated balance sheet.

(5) For the Agency and Non-Agency MBS portfolio, represents the sum of borrowings under repurchase agreements, payable for unsettled purchases, multi-year collateralized financing arrangements of $508.8 million and securitized debt as a multiple of net equity allocated. The numerator of our Total Debt/Net Equity ratio also includes borrowings under repurchase agreements of $410.8 million for which U.S. Treasury securities are pledged as collateral and Senior Notes.

(6) Includes securities obtained and pledged as collateral, interest receivable, goodwill, prepaid and other assets, borrowings under repurchase agreements of $410.8 million for which U.S. Treasury securities are pledged as collateral, interest payable, dividends payable, excise tax and interest payable, and accrued expenses and other liabilities.

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Agency MBS

The following table presents certain information regarding the composition of our Agency MBS portfolio as of December 31, 2012:

(Dollars in Thousands)		Current Face	Weighted Average Purchase Price	Weighted Average Market Price		Fair Value (1)	Weighted Average Loan Age (Months) (2)	Weighted Average Coupon (2)	Weighted Average 3 Month CPR
15-Year Fixed Rate:									
Low Loan Balance *(3)*	$	1,674,980	104.4%	107.0%	$	1,792,740	14	3.32%	10.2%
HARP *(4)*		203,929	104.8	106.7		217,506	10	3.16	7.4
Other (Post June 2009) *(5)*		296,277	103.4	106.9		316,864	30	4.19	29.1
Other (Pre June 2009) *(6)*		2,347	104.9	107.5		2,524	43	4.50	20.9
Total 15-Year Fixed Rate	$	2,177,533	104.3%	107.0%	$	2,329,634	16	3.43%	13.0%
Hybrid:									
Other (Post June 2009) *(5)*	$	2,697,573	103.9%	105.5%	$	2,846,944	22	3.26%	21.9%
Other (Pre June 2009) *(6)*		1,722,463	101.4	106.9		1,841,275	70	4.10	23.0
Total Hybrid	$	4,420,036	102.9%	106.1%	$	4,688,219	41	3.59%	22.3%
CMO/Other	$	195,199	102.4%	104.1%	$	203,184	145	2.75%	10.7%
Total Portfolio	$	6,792,768	103.3%	106.3%	$	7,221,037	36	3.51%	19.2%

(1) Does not include principal payments receivable of $4.4 million at December 31, 2012.

(2) Weighted average is based on MBS current face at December 31, 2012.

(3) Low loan balance represents MBS collateralized by mortgages with original loan balance of less than or equal to $175,000.

(4) Home Affordable Refinance Program (or HARP) MBS are backed by refinanced loans with loan-to-value ratio (or LTV) greater than or equal to 80% at origination.

(5) MBS issued in June 2009 or later. Majority of underlying loans are ineligible to refinance through the HARP program.

(6) MBS issued before June 2009.

The following table presents certain information regarding our 15-year fixed-rate Agency MBS as of December 31, 2012:

Coupon (Dollars in Thousands)		Current Face	Weighted Average Purchase Price	Weighted Average Market Price		Fair Value (1)	Weighted Average Loan Age (Months) (2)	Weighted Average Loan Rate	Low Loan Balance and/or HARP (3)	Weighted Average 3 Month CPR
15-Year Fixed Rate:										
2.5 %	$	520,202	104.2%	104.9%	$	545,528	3	3.04%	99%	2.6%
3.0		546,780	105.9	106.6		582,904	6	3.49	100	4.2

3.5		21,756	103.5	106.8	23,243	26	4.16	100	25.7
4.0		907,891	103.3	108.3	982,796	26	4.40	81	18.8
4.5		180,904	105.2	107.9	195,163	29	4.87	31	24.5
Total 15-Year Fixed Rate	$	2,177,533	104.3%	107.0%	$ 2,329,634	16	3.88%	86%	13.0%

(1) Does not include principal payments receivable of $4.4 million at December 31, 2012.

(2) Weighted average is based on MBS current face at December 31, 2012.

(3) Low Loan Balance represents MBS collateralized by mortgages with original loan balance less than or equal to $175,000. HARP MBS are backed by refinanced loans with LTV greater than or equal to 80% at origination.

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The following table presents certain information regarding our Hybrid Agency MBS as of December 31, 2012:

(Dollars in Thousands)		Current Face	Weighted Average Purchase Price	Weighted Average Market Price		Fair Value (1)	Weighted Average Coupon (2)	Weighted Average Loan Age (Months) (2)	Weighted Average Months to Reset (3)	Interest Only (4)	Weighted Average 3 Month CPR
Hybrid Post June 2009:											
Agency 5/1	$	1,195,531	103.3%	105.4%	$	1,260,379	3.43%	29	30	24%	26.1%
Agency 7/1		1,463,829	104.4	105.6		1,546,339	3.14	17	67	21	18.7
Agency 10/1		38,213	104.4	105.3		40,226	2.95	6	113		12.4
Total Hybrids Post June 2009	$	2,697,573	103.9%	105.5%	$	2,846,944	3.26%	22	51	22%	21.9%
Hybrid Pre June 2009:											
Coupon < 4.5% *(5)*	$	870,664	101.6%	106.8%	$	929,622	2.80%	78	6	51%	12.6%
Coupon >= 4.5% *(6)*		851,799	101.2	107.0		911,653	5.42	62	25	78	32.8
Total Hybrids Pre June 2009	$	1,722,463	101.4%	106.9%	$	1,841,275	4.10%	70	15	64%	23.0%
Total Hybrids	$	4,420,036	102.9%	106.1%	$	4,688,219	3.59%	41	37	38%	22.3%

(1) Does not include principal payments receivable of $4.4 million at December 31, 2012.

(2) Weighted average is based on MBS current face at December 31, 2012.

(3) Weighted average months to reset is the number of months remaining before the coupon interest rate resets. At reset, the MBS coupon will adjust based upon the underlying benchmark interest rate index, margin and periodic or lifetime caps. The months to reset do not reflect scheduled amortization or prepayments.

(4) Interest only represents MBS backed by mortgages currently in their interest only period. Percentage is based on MBS current face at December 31, 2012.

(5) Agency 3/1, 5/1, 7/1 and 10/1 Hybrid ARM-MBS with coupon less than 4.5%.

(6) Agency 3/1, 5/1, 7/1 and 10/1 Hybrid ARM-MBS with coupon greater than or equal to 4.5%.

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Non-Agency MBS

The following table presents information with respect to our Non-Agency MBS: (i) excluding Linked Transactions and reported in accordance with GAAP; (ii) underlying our Linked Transactions and reflected consistent with GAAP reporting requirements; and (iii) on a combined basis (Non-GAAP) as of December 31, 2012 and December 31, 2011:

(In Thousands)	December 31, 2012	December 31, 2011
(i) Non-Agency MBS (GAAP - excluding Linked Transactions)		
Face/Par	$ 6,509,560	$ 5,414,353
Fair Value	5,382,165	3,775,446
Amortized Cost	4,758,300	3,936,211
Purchase Discount Designated as Credit Reserve and OTTI	(1,380,506)*(1)*	(1,228,766)*(2)*
Purchase Discount Designated as Accretable	(371,626)	(250,479)
Purchase Premiums	872	1,103
(ii) Non-Agency MBS Underlying Linked Transactions		
Face/Par	$ 52,277	$ 289,536
Fair Value	47,828	225,969
Amortized Cost	43,817	237,595
Purchase Discount Designated as Credit Reserve	(6,051)	(45,735)
Purchase Discount Designated as Accretable	(2,409)	(6,206)
(iii) Combined Non-Agency MBS and MBS Underlying Linked Transactions (Non-GAAP)		
Face/Par	$ 6,561,837	$ 5,703,889
Fair Value	5,429,993	4,001,415
Amortized Cost	4,802,117	4,173,806
Purchase Discount Designated as Credit Reserve and OTTI	(1,386,557)*(3)*	(1,274,501)*(4)*
Purchase Discount Designated as Accretable	(374,035)	(256,685)
Purchase Premiums	872	1,103

(1) Includes discount designated as Credit Reserve of $1.332 billion and OTTI of $48.7 million.

(2) Includes discount designated as Credit Reserve of $1.174 billion and OTTI of $54.5 million.

(3) Includes discount designated as Credit Reserve of $1.338 billion and OTTI of $48.7 million.

(4) Includes discount designated as Credit Reserve of $1.220 billion and OTTI of $54.5 million.

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Purchase Discounts on Non-Agency MBS and Securities Underlying Linked Transactions

The following table presents the changes in the components of purchase discount on Non-Agency MBS with respect to purchase discount designated as Credit Reserve and OTTI, and accretable purchase discount, including securities underlying Linked Transactions, for the years ended December 31, 2012 and 2011 on both a GAAP and Non-GAAP basis.

	For the Year Ended December 31,			
	2012		2011	
GAAP Basis	**Discount Designated as Credit Reserve and OTTI**	**Accretable Discount (1)**	**Discount Designated as Credit Reserve and OTTI**	**Accretable Discount (1)**
Balance at beginning of period	$ (1,228,766)	$ (250,479)	$ (746,678)	$ (228,966)
Accretion of discount		38,185		42,358
Realized credit losses	162,458		33,074	
Purchases	(427,741)	3,497	(402,093)	(23,440)
Reclass discount for OTTI	866	(866)	101	(101)
Net impairment losses recognized in earnings	(1,200)		(10,570)	
Unlinking of Linked Transactions	(38,662)	(9,424)	(127,102)	(15,828)
Transfers/release of credit reserve	152,539	(152,539)	24,502	(24,502)
Balance at end of period	$ (1,380,506)	$ (371,626)	$ (1,228,766)	$ (250,479)

	For the Year Ended December 31,			
	2012		2011	
Non-GAAP Adjustments (In Thousands)	**Discount Designated as Credit Reserve and OTTI**	**Accretable Discount (1)**	**Discount Designated as Credit Reserve and OTTI**	**Accretable Discount (1)**
Balance at beginning of period	$ (45,735)	$ (6,206)	$ (99,094)	$ (45,756)
Accretion of discount		958		2,928
Realized credit losses	1,442		1,042	
Purchases			(74,805)	1,395
Unlinking of Linked Transactions	38,662	2,419	127,102	35,247
Transfers/release of credit reserve	(420)	420	20	(20)
Balance at end of period	$ (6,051)	$ (2,409)	$ (45,735)	$ (6,206)

	For the Year Ended December 31,			
	2012		2011	
Non-GAAP Basis	**Discount Designated as Credit Reserve and OTTI**	**Accretable Discount (1)**	**Discount Designated as Credit Reserve and OTTI**	**Accretable Discount (1)**

Balance at beginning of period	$ (1,274,501)	$ (256,685)	$ (845,772)	$ (274,722)
Accretion of discount		39,143		45,286
Realized credit losses	163,900		34,116	
Purchases	(427,741)	3,497	(476,898)	(22,045)
Reclass discount for OTTI	866	(866)	101	(101)
Net impairment losses recognized in earnings	(1,200)		(10,570)	
Unlinking of Linked Transactions		(7,005)		19,419
Transfers/release of credit reserve	152,119	(152,119)	24,522	(24,522)
Balance at end of period	$ (1,386,557)	$ (374,035)	$ (1,274,501)	$ (256,685)

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

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The following table presents information with respect to the yield components of our Non-Agency MBS: (i) excluding Linked Transactions and reported in accordance with GAAP; (ii) underlying our Linked Transactions and (iii) combined with the securities underlying Linked Transactions (Non-GAAP) for the periods presented:

	For the Year Ended December 31,		
	2012	**2011**	**2010**
Non-Agency MBS (GAAP - excluding Linked Transactions)			
Coupon Yield *(1)*	5.91%	6.30%	7.37%
Effective Yield Adjustment *(2)*	0.85	1.25	2.42
Net Yield	6.76%	7.55%	9.79%
Non-Agency MBS Underlying Linked Transactions			
Coupon Yield *(1)*	5.04%	5.80%	5.33%
Effective Yield Adjustment *(2)*	1.16	0.75	1.96
Net Yield	6.20%	6.55%	7.29%
Combined Non-Agency MBS and MBS Underlying Linked Transactions (Non-GAAP)			
Coupon Yield *(1)*	5.90%	6.25%	6.85%
Effective Yield Adjustment *(2)*	0.85	1.19	2.31
Net Yield	6.75%	7.44%	9.16%

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(1) Reflects the annualized coupon interest income divided by the average amortized cost. The discounted purchase price on Non-Agency MBS causes the coupon yield to be higher than the pass-through coupon interest rate.

(2) The effective yield adjustment is the difference between the net yield, calculated utilizing management s estimates of future cash flows for Non-Agency MBS, less the current coupon yield.

The information in the above tables, on pages 35-37, includes certain underlying Non-Agency MBS and the associated repurchase agreement borrowings that are disclosed both separately and/or on a combined basis with our Non-Agency MBS portfolio. However, for GAAP financial reporting purposes, these items are required to be accounted for by us as Linked Transactions. Consequently, the presentation of this information in the above tables constitutes Non-GAAP financial measures within the meaning of Regulation G, as promulgated by the SEC.

In assessing the performance of the Non-Agency MBS portfolio, we do not view these transactions as linked, but rather view the performance of the linked Non-Agency MBS and the related repurchase agreement borrowings as we would any other Non-Agency MBS that is not part of a linked transaction. Accordingly, we consider that the Non-GAAP information disclosed in the above tables enhances the ability of investors to analyze the performance of our Non-Agency MBS in the same way that we assess such assets.

In addition, in connection with our financing strategy for Non-Agency MBS, we have entered into contemporaneous repurchase agreement and reverse repurchase agreement transactions with a single counterparty. The transactions effectively result in us pledging Non-Agency MBS as collateral to the counterparty in connection with the repurchase agreement financing and obtaining U.S. Treasury securities as collateral in connection with the reverse repurchase agreement. Both the repurchase agreement and the reverse repurchase agreement have a contractual maturity of January 2016 with no net exchange of cash at inception. As of December 31, 2012 approximately $409 million of the approximately

$509 million U.S. Treasury collateral obtained is pledged as collateral in a subsequent repurchase agreement transaction with a different counterparty for cash. This subsequent repurchase transaction has a term of 90 days at inception. The remaining approximately $100 million of U.S. Treasury collateral obtained was sold for cash, as permitted under the reverse repurchase agreement. For purposes of presentation of its repurchase agreement financing liabilities in the Non-GAAP Asset Allocation table on page 32, the obligation to return the $509 million of U.S. Treasury collateral, is separately presented as Multi-year collateralized financing arrangements and is included in the numerator of the Debt/Net Equity Ratio for the Non-Agency MBS portfolio. In addition, the asset balance for U.S. Treasury securities obtained as collateral and the repurchase agreement liability to the second counterparty to which we pledged those U.S Treasury securities as collateral are included in the Other, net column as we believe net presentation is consistent with the economic substance of the transactions. However, GAAP prohibits offsetting of this asset and liability for a number of reasons, including the fact that the counterparties to these transactions are different, and there is no legal right of offset. For GAAP presentation purposes, the repurchase agreement liability against which we have pledged U.S.

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Treasuries is disclosed as Repurchase Agreements and is included in the numerator of the Debt/Net Equity Ratio for the Non-Agency MBS portfolio. In addition, the asset balance for the U.S. Treasury securities obtained as collateral and the liability balance for the Obligation to return this collateral are included in the Other, net column. However, management considers that the Non-GAAP Asset Allocation table presented on page 32 more appropriately reflects the economic substance of the transactions. Consequently, this presentation constitutes a Non-GAAP financial measure within the meaning of Regulation G, as promulgated by the SEC. The Non-GAAP presentation of liabilities associated with the Company s collateralized financing arrangements does not impact the overall calculation of Debt/Net Equity for the Company as a whole.

Actual maturities of MBS are generally shorter than stated contractual maturities because actual maturities of MBS are affected by the contractual lives of the underlying mortgages, periodic payments of principal, and prepayments of principal. The following table presents certain information regarding the amortized costs, estimated fair values, weighted average yields and contractual maturities of our MBS at December 31, 2012 and does not reflect the effect of prepayments or scheduled principal amortization on our MBS:

	One to Five Years		**Five to Ten Years**		**Over Ten Years**		**Total MBS (1)**		
(Dollars in Thousands)	**Amortized Cost**	**Weighted Average Yield**	**Amortized Cost**	**Weighted Average Yield**	**Amortized Cost**	**Weighted Average Yield**	**Total Amortized Cost**	**Total Fair Value**	**Weighted Average Yield**
Agency MBS:									
Fannie Mae	$ 714	4.19%	$ 1,997	2.32%	$ 6,171,305	2.84%	$ 6,174,016	$ 6,351,621	2.83%
Freddie Mac					835,724	2.90	835,724	858,560	2.90
Ginnie Mae					14,777	1.93	14,777	15,279	1.93
Total Agency MBS	$ 714	4.19%	$ 1,997	2.32%	$ 7,021,806	2.83%	$ 7,024,517	$ 7,225,460	2.83%
Non-Agency MBS	$	%	$ 16,175	6.06%	$ 4,742,125	6.76%	$ 4,758,300	$ 5,382,165	6.76%
Total MBS	$ 714	4.19%	$ 18,172	5.27%	$ 11,763,931	4.37%	$ 11,782,817	$ 12,607,625	4.37%

(1) We did not have any MBS with contractual maturities of less than one year at December 31, 2012.

Exposure to Financial Counterparties

We finance the acquisition of a significant portion of our MBS with repurchase agreements. In connection with these financing arrangements, we pledge our securities as collateral to secure the borrowing. The amount of collateral pledged will typically exceed the amount of the financing with the extent of over-collateralization ranging from 1-7% of the amount borrowed (U.S. Treasury and Agency MBS collateral) to up to 63% (Non-Agency MBS collateral). Consequently, while repurchase agreement financing results in us recording a liability to the counterparty in our consolidated balance sheet, we are exposed to the counterparty, if during the term of the repurchase agreement financing, a lender should default on its obligation and we are not able to recover our pledged assets. The amount of this exposure is the difference between the amount loaned to us plus interest due to the counterparty and the fair value of the collateral pledged by us to the lender including accrued interest receivable on such collateral.

In addition, we use interest rate swaps to manage interest rate risk exposure in connection with our repurchase agreement financings. We will make cash payments or pledge securities as collateral as part of a margin arrangement in connection with interest rate swaps that are in an unrealized loss position. In the event that a counterparty were to default on its obligation, we would be exposed to a loss to a swap counterparty to the extent that the amount of cash or securities pledged exceeded the unrealized loss on the associated swaps and we were not able to recover the excess collateral.

During the past several years, certain of our repurchase agreement counterparties in the United States and Europe have experienced financial difficulty and have been either rescued by government assistance or otherwise benefitted from accommodative monetary policy of central banks.

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The table below summarizes our exposure to such counterparties at December 31, 2012, by country of domicile:

Country (Dollars in Thousands)	Number of Counterparties	Repurchase Agreement Financing	Swaps at Fair Value	Exposure (1)	Exposure as a Percentage of MFA Total Assets
European Countries: *(2)*					
Germany	1	$ 530,703	$ (14,098)	$ 227,288	1.68%
Switzerland	3	1,409,357		915,621	6.76
France	1	462,239		23,305	0.17
Holland	1	345,307	203	13,645	0.10
United Kingdom	2	991,199	(22,076)	58,184	0.43
Total	8	3,738,805	(35,971)	1,238,043	9.14%
Other Countries:					
United States	11	$ 4,225,500	$ (26,860)	$ 688,570	5.08%
Japan	4	758,093		52,636	0.39
Other	3	565,345		125,883	0.93
Total	18	5,548,938	(26,860)	867,089	6.40%
Total Counterparty Exposure	26	$ 9,287,743*(3) (4)*	$ (62,831)	$ 2,105,132	15.54%

(1) Represents for each counterparty the amount of cash and/or securities pledged as collateral less the aggregate of repurchase agreement financing, Swaps at fair value, and net interest receivable/payable on all such instruments.

(2) Includes European-based counterparties as well as U.S.-domiciled subsidiaries of the European parent entity.

(3) Includes $500.0 million of repurchase agreements entered into in connection with contemporaneous repurchase and reverse repurchase agreements with a single counterparty.

(4) Includes $35.3 million of repurchase agreements which are a component of our Linked Transactions.

At December 31, 2012, we did not use credit default swaps or other forms of credit protection to hedge the exposures summarized in the table above.

If the European credit crisis continues to impact our major European financial counterparties, there is the possibility that it will also impact the operations of their U.S. domiciled subsidiaries. This could adversely affect our financing and operations as well as those of the entire mortgage sector in general. Management monitors our exposure to our repurchase agreement and swap counterparties on a regular basis, using various methods, including review of recent rating agency actions or other developments and by monitoring the amount of cash and securities collateral pledged and the associated loan amount under repurchase agreements and/or the fair of swaps with our counterparties. We intend to make reverse margin calls on our counterparties to recover excess collateral as permitted by the agreements governing our financing arrangements, or take other necessary actions to reduce the amount of our exposure to a counterparty when such actions are considered necessary.

Tax Considerations

Variances between GAAP and Tax Income

Due to the potential timing differences in the recognition of GAAP net income compared to REIT taxable income on our investments, our net income and the unamortized amount of purchase discounts and premiums calculated in accordance with GAAP may differ significantly from such amounts calculated for purposes of determining our REIT taxable income. At December 31, 2012, net premiums on our Agency MBS portfolio (excluding net premiums on MBS purchased but not yet settled) were $225.9 million compared to an estimated $243.3 million for tax purposes. In accordance with GAAP, a portion of the purchase discounts on our Non-Agency MBS are allocated to a Credit Reserve and, as such, are not expected to be accreted into interest income. In addition, under GAAP, certain Non-Agency MBS underlying our Linked Transactions are not reported as MBS; however, for purposes of determining our REIT taxable income, all Non-Agency MBS, including those underlying Linked Transactions, are treated as being owned and the purchase discounts associated with these securities are accreted into taxable income over the life of the applicable security. Under GAAP, we had net purchase discounts on our Non-Agency MBS portfolio of $1.751 billion, which when combined with purchase discounts of $8.5 million related to securities underlying our Linked Transactions, resulted in total net purchase discounts on Non-Agency MBS of $1.760 billion at December 31, 2012. Our total Non-Agency MBS portfolio for tax differs from our portfolio reported for GAAP. These differences are primarily due to the fact that for tax purposes: (i) certain of the MBS contributed to the variable interest entities (or VIEs) used to facilitate resecuritization transactions were deemed to be sold; (ii) the tax portfolio includes certain securities issued by these VIEs; and (iii) Non-Agency MBS underlying linked transactions are included in our tax portfolio. In addition, for our Non-Agency MBS tax portfolio, potential timing differences arise with respect to the accretion of market discount into income and recognition of actual and estimated realized losses for tax purposes as compared to GAAP. These differences result in net purchase discounts for tax on our Non-Agency MBS at December 31, 2012 that are currently estimated at $1.360 billion. However, estimated premiums on our Agency MBS and discounts on our Non-Agency MBS for tax purposes are subject to revision on completion of our 2012 REIT tax return, which is not required to be filed, including extensions, until the third quarter of 2013.

The determination of taxable income attributable to Non-Agency MBS is dependent on a number of factors, including principal payments, defaults and loss severities. In projecting taxable income for Non-Agency MBS during the year, management considers estimates of the amount of discount expected to be accreted. Such estimates require significant judgment and actual results may differ from these estimates. In calculating taxable income on Non-Agency MBS realized losses are applied not in the aggregate but rather on an asset-by-asset basis. In addition, the application of losses for the calculation of taxable income depends on the method of discount accretion elected, again, on an asset-by-asset basis. Finally, even using the discount accretion method that results in lower income recognition in earlier periods, realized losses impact only the amount of market discount accretion recognized in the period in which the loss occurs and future periods. Therefore, while realized losses on Non-Agency MBS will result in a reduction of taxable income, this reduction occurs gradually and primarily in periods after such losses are incurred.

Resecuritizations

For tax purposes, depending on the transaction structure, a resecuritization transaction may be treated either as a sale or a financing of the underlying MBS. Income recognized from resecuritization transactions will differ for tax and GAAP. For tax purposes, we own and may in the future acquire interests in resecuritization trusts, in which several of the classes of securities are or will be issued with Original Issue Discount (or OID). As the holder of the retained interests in the trust, we generally will be required to include OID in our current gross interest income over the term of the applicable securities as the OID accrues. The rate at which the OID is recognized into taxable income is calculated using a constant rate of yield to maturity, with realized losses impacting the amount of OID recognized in REIT taxable income once they are actually incurred. For tax purposes, REIT taxable income may be recognized in excess of economic income (i.e., OID) or in advance of the corresponding cash flow from these assets, thereby effecting our dividend distribution requirement to stockholders.

Regulatory Developments

The U.S. Congress, Board of Governors of the Federal Reserve System, U.S. Treasury, Federal Deposit Insurance Corporation, SEC and other governmental and regulatory bodies have taken and continue to consider additional actions in response to the financial crisis. In particular the Dodd-Frank Act created a new regulator housed within the Federal Reserve System, an independent bureau known as the Consumer Financial Protection Bureau (or the CFPB), which has broad authority over a wide range of consumer financial products and services, including mortgage lending. Another section of the Dodd-Frank Act, the Mortgage Reform and Anti-Predatory Lending Act (or the Mortgage Reform Act), contains new underwriting and servicing standards for the mortgage industry, as well as restrictions on compensation for mortgage originators. In addition, the Mortgage Reform Act grants broad discretionary regulatory authority to the CFPB to prohibit or condition terms, acts or practices relating to residential mortgage loans that the CFPB finds abusive, unfair, deceptive or predatory, as well as to take other actions that the CFPB finds are necessary or proper to ensure responsible affordable mortgage credit remains available to consumers. The Dodd-Frank Act also affects the securitization of mortgages (and other assets) with requirements for risk retention by securitizers and requirements for regulating credit rating agencies.

The implementation of the Dodd-Frank Act requires numerous regulations, many of which (including those mentioned above regarding underwriting and risk retention requirements) have only recently been finalized and are not effective. Several significant Dodd-Frank Act rulemakings have yet to be finalized. Thus, we are unable to fully predict at this time how the Dodd-Frank Act, as well as other laws that may be adopted in the future, will impact our business, results of operations and financial condition, or the environment for repurchase financing and other forms of borrowing, the investing environment for Agency MBS, Non-Agency MBS and/or residential mortgage loans, the securitization industry, Swaps and other derivatives. However, at a minimum, we believe that the Dodd-Frank Act and the regulations to be promulgated thereunder are likely to increase the economic and compliance costs for participants in the mortgage and securitization industries, including us.

In addition to the regulatory actions being implemented under the Dodd-Frank Act, on August 31, 2011, the SEC issued a concept release under which it is reviewing interpretive issues related to Section 3(c)(5)(C) of the Investment Company Act. Section 3(c)(5)(C) excludes from the definition of investment company entities that are primarily engaged in, among other things, purchasing or otherwise acquiring mortgages and other liens on and interests in real estate. Many companies that engage in the business of acquiring mortgages and mortgage-related instruments, including us, seek to rely on an existing interpretation of the SEC staff with respect to Section 3(c)(5)(C) so as not to become an investment company for the purpose of regulation under the Investment Company Act. The SEC has requested comments on, among other things, whether it should reconsider its existing interpretation of Section 3(c)(5)(C) on which we rely. (For additional discussion of the SEC s concept release and its potential impact on us, please see Part I, Item 1A. Risk Factors in this Form 10-K.)

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Results of Operations

Year Ended December 31, 2012 Compared to the Year Ended December 31, 2011

Our results for 2012 were generally influenced by the impact of declining net interest rate spreads. These declining spreads were primarily attributable to lower net yields on both Agency and Non-Agency MBS. Yields on Agency MBS were impacted, particularly in the second half of the year, by the lower interest rate environment and marginally higher CPRs, while yields on Non-Agency MBS were primarily impacted by the addition of lower yielding assets and changes in expected future interest rates. In addition, our holdings of Non-Agency MBS increased by approximately $1.607 billion throughout 2012, primarily due to the addition of $1.351 billion of newly acquired assets which was partially offset by $740.3 million of principal repayments on the entire Non-Agency MBS portfolio and an increase in net unrealized gains of $784.6 million for the portfolio as a result of market price appreciation.

For 2012, we had net income available to our common stock and participating securities of $298.7 million, or $0.83 per basic and diluted common share, compared to net income available to common stock and participating securities of $308.3 million, or $0.90 per basic and diluted common share, for 2011. The decrease in net income available to our common stock and participating securities, and the decrease of this item on a per share basis, were generally influenced by the impact of declining net interest rate spreads. These declining spreads were primarily attributable to lower net yields on both Agency and Non-Agency MBS. For Agency MBS, the spread impact of declining net yields was partially offset by decreased funding costs, particularly in the second half of the year. For Non-Agency MBS, in addition to yield declines, spreads were also impacted to some extent by incrementally higher funding costs resulting from longer terms of financing. Yields on Agency MBS were impacted by the lower interest rate environment and higher CPRs, while yields on Non-Agency MBS were primarily impacted by the addition of lower yielding assets and changes in expected future interest rates.

Interest income on our Agency MBS for 2012 decreased $45.9 million, or 19.0% to $196.1 million from $242.0 million for 2011. This change primarily reflects a decrease in the net yield on our Agency MBS to 2.83% for 2012 from 3.50% for 2011 partially offset by an increase in the average amortized cost of our Agency MBS portfolio to $6.926 billion for 2012 from $6.921 billion for 2011. During 2012, our Agency MBS portfolio experienced a 19.8% CPR and we recognized $52.0 million of net premium amortization compared to a CPR of 19.0% and $38.2 million of net premium amortization for 2011. At the end of 2012, the average coupon on mortgages underlying our Agency MBS was lower compared to the end of 2011, due to acquisition of assets in the marketplace at generally lower coupons reflecting current market conditions and as a result of prepayments on higher yielding assets and resets on Hybrid and ARM-MBS within the portfolio. As a result, the coupon yield on our Agency MBS portfolio declined 47 basis points to 3.58% for 2012 from 4.05% for 2011. At December 31, 2012, we had net purchase premiums on our Agency MBS of $227.3 million, or 3.3% of current par value, compared to net purchase premiums of $177.7 million and 2.6% of par value at December 31, 2011.

Interest income on our Non-Agency MBS (which includes Non-Agency MBS transferred to consolidated VIEs) increased $48.4 million, or 19.0% for 2012 to $303.0 million compared to $254.6 million for 2011, principally due to the increase in the amortized cost of our Non-Agency MBS portfolio. For 2012, the average amortized cost of our Non-Agency MBS increased by $1.109 billion, or 32.9%, to $4.482 billion, from $3.374 billion for 2011. The growth in our Non-Agency MBS has primarily been funded with longer term forms of repurchase agreement financings. In addition, certain of our Non-Agency MBS underlying Linked Transactions became delinked during 2012, due to the repayment of the repurchase agreement financing. These delinkings resulted in Non-Agency MBS of $175.2 million, previously included as a component of Linked Transactions, being recognized as Non-Agency MBS on our consolidated balance sheet at December 31, 2012. Our Non-Agency MBS portfolio yielded 6.76% for 2012 compared to 7.55% for 2011. The decrease in the yield on our Non-Agency MBS is primarily due to the impact of lower yields on assets purchased during 2012 as well as the flattening (downward movement in the later years) of the forward yield curve, which causes us to lower the projected future coupons and therefore the expected yields on our Hybrid Non-Agency MBS. During 2012, we recognized net purchase discount accretion of $38.0 million on our Non-Agency MBS, compared to $42.2 million for 2011. At

December 31, 2012, we had net purchase discounts of $1.751 billion, including Credit Reserve and previously recognized OTTI of $1.381 billion, on our Non-Agency MBS, or 26.9% of par value. During 2012 we reallocated $152.5 million of purchase discount designated as Credit Reserve to accretable purchase discount.

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The following table presents the components of the coupon yield and net yields earned on our Agency MBS and Non-Agency MBS and weighted average CPR experienced for such MBS for the quarterly periods presented:

	Agency MBS (1)			Non-Agency MBS (1)			Total MBS (1)		
Quarter Ended	Coupon Yield (2)	Net Yield (3)	Weighted Average CPR	Coupon Yield (2)	Net Yield (3)	Weighted Average CPR	Coupon Yield (2)	Net Yield (3)	Weighted Average CPR
December 31, 2012	3.38%	2.59%	19.23%	5.85%	6.70%	15.53%	4.37%	4.23%	17.67%
September 30, 2012	3.49	2.66	21.62	5.90	6.65	15.42	4.45	4.25	19.08
June 30, 2012	3.68	2.95	20.39	5.89	6.77	14.87	4.57	4.47	18.20
March 31, 2012	3.78	3.15	17.90	6.02	6.95	14.05	4.62	4.57	16.48
December 31, 2011	3.79	3.14	19.35	6.07	7.02	13.07	4.60	4.51	17.19
September 30, 2011	3.98	3.37	19.29	6.15	7.25	14.66	4.75	4.75	17.97
June 30, 2011	4.14	3.68	16.57	6.41	7.84	14.63	4.87	5.01	16.03
March 31, 2011	4.32	3.84	20.95	6.83	8.58	14.80	5.00	5.12	19.39

(1) Yields presented throughout this Annual Report on Form 10-K are calculated using average amortized cost data. For GAAP reporting purposes, MBS purchases and sales are reported on the trade date. Average amortized cost data used to determine yields is calculated based on the settlement date of the associated purchase or sale as interest income is not earned on purchased bonds and continues to be earned on sold bonds until settlement date.

(2) Reflects the annualized coupon interest income divided by the average amortized cost. The discounted purchase price on Non-Agency MBS causes the coupon yield to be higher than the pass-through coupon interest rate. (Does not include MBS underlying our Linked Transactions. See Note 4 to the accompanying consolidated financial statements, included under Item 8 of this Annual Report on Form 10-K.)

(3) Reflects annualized interest income divided by average amortized cost.

The following table presents information about average balances of our MBS portfolio by category and associated income for the years ended December 31, 2012 and 2011.

(Dollars in Thousands)	Average Amortized Cost (1)	Interest Income	Weighted Average Coupon	Coupon Yield (2)	Net Asset Yield (3)
Year Ended December 31, 2012					
Agency MBS	$ 6,925,973	$ 196,058	3.76%	3.58%	2.83%
Non-Agency MBS, including transfers to a consolidated VIE	4,482,281	302,972	4.34	5.91	6.76
Total	$ 11,408,254	$ 499,030	4.04%	4.50%	4.37%
Year Ended December 31, 2011					
Agency MBS	$ 6,921,494	$ 241,994	4.22%	4.05%	3.50%
Non-Agency MBS, including transfers to a consolidated VIE	3,373,534	254,617	4.64	6.30	7.55
Total	$ 10,295,028	$ 496,611	4.39%	4.79%	4.82%

(1) Includes principal payments receivable.

(2) Reflects the annualized coupon interest income divided by the average amortized cost. The discounted purchase price on Non-Agency MBS causes the coupon yield to be higher than the pass-through coupon interest rate. (Does not include MBS underlying our Linked Transactions. See Note 4 to the accompanying consolidated financial statements, included under Item 8 of this Annual Report on Form 10-K.)

(3) Reflects annualized interest income divided by the average amortized cost.

Interest income from our cash investments, which are comprised of money market investments and are not a material source of income, as the yields on such funds remain at historically low levels, decreased to $127,000 for 2012 from $136,000 for 2011. Our average cash investments were $382.4 million and yielded 0.03% for 2012 compared to average cash investments of $459.4 million that yielded 0.03% for 2011. In general, we manage our cash investments relative to our investing, financing and operating requirements, investment opportunities and current and anticipated market conditions.

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At December 31, 2012, we had repurchase agreement borrowings of $8.752 billion and securitized debt of $646.8 million, of which $2.520 billion was hedged with Swaps. At December 31, 2012, our Swaps had a weighted average fixed-pay rate of 2.31% and extended 17 months on average with a maximum remaining term of approximately 48 months.

Our interest expense for 2012 increased by 22.3 million, or 14.9%, to $171.7 million, from $149.4 million for 2011. This increase primarily reflects the combined impact of an increase in our average borrowings and the higher effective interest rate paid particularly on borrowings to finance Non-Agency MBS, as well as on securitized debt and Senior Notes. The following table presents information regarding the components of our interest expense for the years ended 2012 and 2011:

(Dollars in Thousands)	Average Balance	Interest Expense	Average Cost of Funds (1)
Year Ended December 31, 2012			
Agency Repurchase Agreements	$ 6,241,623	$ 97,094	1.56%
Non-Agency Repurchase Agreements	2,090,031	51,673	2.47
Total Repurchase Agreements	8,331,654	148,767	1.79
Securitized Debt	852,656	17,106	2.01
Senior Notes *(2)*	72,404	5,797	8.01
Total	$ 9,256,714	$ 171,670	1.85%
Year Ended December 31, 2011			
Agency Repurchase Agreements	$ 6,168,092	$ 113,062	1.83%
Non-Agency Repurchase Agreements	1,416,663	24,677	1.74
Total Repurchase Agreements	7,584,755	137,739	1.82
Securitized Debt	784,120	11,672	1.49
Total	$ 8,368,875	$ 149,411	1.79%

(1) Reflects the annualized interest expense divided by the average balance and includes the cost of Swaps designated as hedges against repurchase agreements.

(2) We did not have any Senior Notes prior to April 11, 2012.

The following table presents information about our securitized debt at December 31, 2012:

Benchmark Interest Rate (Dollars in Thousands)	At December 31, 2012 Securitized Debt	At December 31, 2012 Interest Rate
30 Day LIBOR + 100 basis points	$ 237,258	1.21%
30 Day LIBOR + 125 basis points	265,539	1.46
Fixed Rate	144,019	2.85
Total	$ 646,816	1.68%

The effective interest rate paid on our borrowings increased to 1.85% for 2012 from 1.79% for 2011. This increase reflects additional higher cost longer-term financing associated with our Non-Agency MBS portfolio, the issuance of fixed-rate securitized debt in February 2012, the issuance of our Senior Notes in April 2012 partially offset by the maturity of Swaps with higher fixed-pay rates. Payments made and/or received on our Swaps are a component of our borrowing costs and accounted for interest expense of $73.3 million, or 79 basis points, for 2012, compared to interest expense of $95.7 million, or 114 basis points, for 2011. Certain of our Swaps have fixed interest rates that are significantly higher than current market interest rates. As these Swaps continue to amortize and/or expire, the Swap component of our borrowing costs is expected to continue to decrease. The weighted average fixed-pay rate on our Swaps decreased to 2.68% for 2012 from 3.13% for 2011. The weighted average variable interest rate received on our Swaps increased slightly to 0.27% for 2012 from 0.25% for 2011. During 2012, we entered into one new Swap with a notional amount of $100.0 million, a fixed-pay rate of 0.48% and an initial maturity of four years, and had Swaps with an aggregate notional amount of $958.3 million and a weighted average fixed-pay rate of 3.87% amortize and/or expire.

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We expect that our interest expense and funding costs for 2013 will be impacted by market interest rates, the amount of our borrowings and incremental hedging activity, our existing and future interest rates on our hedging instruments and the extent to which we execute additional financing transactions, such as resecuritizations. As a result of these variables, our future borrowing costs cannot be predicted with any certainty. (See Notes 4, 7 and 15 to the accompanying consolidated financial statements, included under Item 8 of this Annual Report on Form 10-K.)

The following table presents our leverage multiples, as measured by debt-to-equity, at the dates presented:

At the Period Ended	GAAP Leverage Multiple (1)	Non-GAAP Leverage Multiple (2)
December 31, 2012	3.0*(3)*	3.0
September 30, 2012	3.2*(3)*	3.2
June 30, 2012	3.6*(4)*	3.6
March 31, 2012	3.4*(3)*	3.5
December 31, 2011	3.6*(5)*	3.7
September 30, 2011	3.4*(6)*	3.5
June 30, 2011	3.2*(7)*	3.3
March 31, 2011	2.9	3.0

(1) Represents the sum of borrowings under repurchase agreements, securitized debt, payable for unsettled MBS purchases, obligation to return securities obtained as collateral, and Senior Notes, divided by stockholders equity.

(2) The Non-GAAP Leverage Multiple reflects the sum of our borrowings under repurchase agreements, securitized debt, payable for unsettled MBS purchases, obligation to return securities obtained as collateral, Senior Notes and borrowings that are reported on our consolidated balance sheet as a component of Linked Transactions of $35.3 million, $36.4 million, $51.2 million, $84.8 million, $170.9 million, $193.0 million, $225.4 million and $304.1 million at December 31, 2012, September 30, 2012, June 30, 2012, and March 31, 2012, December 31, 2011, September 30, 2011, June 30, 2011, March 31, 2011, respectively. We present a Non-GAAP leverage multiple since repurchase agreement borrowings that are a component of Linked Transactions may not be linked in the future and, if no longer linked, will be reported as repurchase agreement borrowings, which will increase our leverage multiple. (See Note 4 to the accompanying consolidated financial statements, included under Item 8 of this Annual Report on Form 10-K.)

(3) The decrease compared to the prior quarter primarily reflects an increase in the market value of our Non-Agency MBS.

(4) The increase compared to the prior quarter primarily reflects a higher use of financing structures and the issuance of Senior Notes during the quarter.

(5) The increase compared to the prior quarter primarily reflects a decline in the market value of our Non-Agency MBS and increased use of structured financing to acquire Non-Agency MBS.

(6) The increase compared to the prior quarter primarily reflects a decline in the market value of our Non-Agency MBS.

(7) The increase compared to the prior quarter primarily reflects the use of resecuritization to finance a portion of our Non-Agency MBS portfolio.

For 2012, our net interest income decreased by $19.8 million, or 5.7%, to $327.5 million from $347.3 million for 2011. This decrease primarily reflects the impact of additional lower yielding MBS and increases in our average borrowings and the higher effective interest rate paid on such borrowings. Our net interest spread and margin for 2012 were 2.38% and 2.78%, respectively, compared to a net interest spread and margin of 2.83% and 3.23%, respectively, for 2011.

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The following table presents information regarding our average balances, interest income and expense, yields on average interest-earning assets, average cost of funds and net interest income for the quarters presented:

Quarter Ended (Dollars in Thousands)	Average Amortized Cost of MBS (1)	Interest Income on MBS	Average Interest Earning Cash (2)	Total Interest Income	Yield on Average Interest-Earning Assets (3)	Average Balance of Financing Arrangements (4)	Interest Expense	Average Cost of Funds	Net Interest Income
December 31, 2012	$ 11,807,038	$ 124,925	$ 405,490	$ 124,968	4.09%	$ 9,654,253	$ 43,054	1.77%	$ 81,914
September 30, 2012	11,778,939	125,097	406,488	125,135	4.11	9,660,381	45,801	1.89	79,334
June 30, 2012	11,219,055	125,504	292,302	125,531	4.36	8,981,553	42,688	1.91	82,843
March 31, 2012	10,819,531	123,504	424,691	123,523	4.39	8,721,868	40,127	1.85	83,396
December 31, 2011	11,000,704	123,964	402,958	123,994	4.35	8,899,013	38,811	1.73	85,183
September 30, 2011	11,010,686	130,741	548,339	130,766	4.53	9,034,044	38,752	1.70	92,014
June 30, 2011	10,545,419	132,082	432,005	132,109	4.81	8,473,314	37,195	1.76	94,914
March 31, 2011	8,587,526	109,824	453,730	109,878	4.86	7,041,406	34,653	1.99	75,225

(1) Unrealized gains and losses are not reflected in the average amortized cost of MBS.

(2) Includes average interest-earning cash, cash equivalents and restricted cash.

(3) Reflects annualized interest income divided by average amortized cost of interest-earning assets.

(4) Includes repurchase agreements, securitized debt and Senior Notes.

The following table presents our net interest spread and net interest margin for the quarters presented:

	Total Interest-Earning Assets and Interest-Bearing Liabilities	
Quarter Ended	Net Interest Spread (1)	Net Interest Margin (2)
December 31, 2012	2.32%	2.69%
September 30, 2012	2.22	2.61
June 30, 2012	2.45	2.87
March 31, 2012	2.54	2.96
December 31, 2011	2.62	3.00
September 30, 2011	2.83	3.20
June 30, 2011	3.05	3.46
March 31, 2011	2.87	3.31

(1) Reflects the difference between the yield on average interest-earning assets and average cost of funds.

(2) Annualized net interest income divided by average interest-earning assets.

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The following table presents the components of the net interest spread earned on our Agency and Non-Agency MBS for the quarters presented:

	Agency MBS			Non-Agency MBS			Total MBS		
Quarter Ended	Net Yield (1)	Cost of Funding (2)	Net Interest Spread (3)	Net Yield (1)	Cost of Funding (2)	Net Interest Spread (3)	Net Yield (1)	Cost of Funding (2)	Net Interest Spread (3)
December 31, 2012	2.59%	1.36%	1.23%	6.70%	2.42%	4.28%	4.23%	1.71%	2.52%
September 30, 2012	2.66	1.53	1.13	6.65	2.41	4.24	4.25	1.82	2.43
June 30, 2012	2.95	1.63	1.32	6.77	2.32	4.45	4.47	1.85	2.62
March 31, 2012	3.15	1.71	1.44	6.95	2.17	4.78	4.57	1.85	2.72
December 31, 2011	3.14	1.71	1.43	7.02	1.78	5.24	4.51	1.73	2.78
September 30, 2011	3.37	1.74	1.63	7.25	1.61	5.64	4.75	1.70	3.05
June 30, 2011	3.68	1.82	1.86	7.84	1.57	6.27	5.01	1.76	3.25
March 31, 2011	3.84	2.10	1.74	8.58	1.62	6.96	5.12	1.99	3.13

(1) Annualized interest income on MBS divided by average amortized cost of MBS.

(2) Annualized interest expense divided by average balance of repurchase agreements and securitized debt.

(3) Reflects the difference between the net yield on average MBS and average cost of funds on MBS.

During 2012, we recognized OTTI charges through earnings of $1.2 million against our Non-Agency MBS compared to $10.6 million during the year ended 2011. These impairment charges reflected changes in our estimated cash flows for such securities based on an updated assessment of the estimated future performance of the underlying collateral, including the expected principal loss over the term of the security and changes in the expected timing of receipt of cash flows. At December 31, 2012, we had 33 Non-Agency MBS with a gross unrealized loss of $6.3 million and 53 Agency MBS with a gross unrealized loss of $1.5 million. Impairments on Agency MBS in an unrealized loss position at December 31, 2012 are considered temporary and not credit related. Unrealized losses on Non-Agency MBS for which no OTTI was recorded during the year are considered temporary based on an assessment of changes in the expected cash flows for such MBS, which considers recent bond performance and expected future performance of the underlying collateral. Significant judgment is used both in the Company s analysis of expected cash flows for its Non-Agency MBS and any determination of the credit component of OTTI. See Critical Accounting Policies and Estimates for more information regarding OTTI.

For 2012, we had other income, net of $21.6 million compared to $10.8 million for 2011. The 2012 income primarily reflects the net gains of $12.6 million on our Linked Transactions and $9.0 million of gains realized on the sale of certain Agency MBS. The gains on Linked Transactions for 2012 included interest income of $5.1 million on the underlying Non-Agency MBS, interest expense of $1.1 million on borrowings under repurchase agreements and an increase of $8.6 million in the fair value of the underlying securities. The gains on Linked Transactions for 2011 included interest income of $25.6 million on the underlying Non-Agency MBS, interest expense of $4.8 million on borrowings under repurchase agreements and a decrease of $17.8 million in the fair value of the underlying securities. Changes in the market value of the securities underlying our Linked Transactions, the amount of bond purchases recorded as Linked Transactions in the future and the amount of Linked Transactions that become unlinked in the future, none of which can be predicted with any certainty, will impact future gains/(losses) on our Linked Transactions. During 2012, certain of our Linked Transactions became unlinked, resulting in our recording Non-Agency MBS with a fair value of $175.2 million on our consolidated balance sheet.

During 2012, we realized $9.0 million of gains on the sale of certain Agency MBS for proceeds of $168.9 million. During the 2011, we realized $6.7 million of gains on the sale of certain Agency MBS for proceeds of $150.6 million.

During 2012, we had compensation and benefits and other general and administrative expense of $33.6 million, or 1.14% of average equity, compared to $30.2 million, or 1.12% of average equity, for 2011. The increase in our compensation and benefits expense to $22.1 million for 2012, compared to $19.0 million for 2011, primarily reflects vesting of equity-based compensation awards and an increase in the level of incentive compensation awards to our employees. Our other general and administrative expenses increased slightly to $11.5 million for 2012 compared to $11.3 million for 2011.

During 2012, we recorded an accrual of $7.5 million for potential federal excise tax on our current estimate of 2012 REIT taxable income and interest for prior years undistributed taxable income.

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Year Ended December 31, 2011 Compared to Year Ended December 31, 2010

Our results for 2011 were generally influenced by the impact of declining net interest spreads on interest bearing assets and liabilities, particularly in the second half of the year. These declining spreads were primarily attributable to lower net yields on both Agency and Non-Agency MBS. Yields on Agency MBS were impacted, particularly in the second half of the year, by the lower interest rate environment and marginally higher CPRs, while yields on Non-Agency MBS were primarily impacted by the addition of lower yielding assets and changes in expected future interest rates. In addition, the decline in market values of Non-Agency MBS had a significant impact on the fair value of our portfolio, particularly in the last three fiscal quarters of 2011.

For 2011, we had net income available to our common stock and participating securities of $308.3 million, or $0.90 per basic and diluted common share, compared to net income available to common stock and participating securities of $261.6 million, or $0.93 per basic and diluted common share, for 2010. The increase in net income available to our common stock and participating securities, and the decrease of this item on a per share basis, was due primarily to the increase in the size of our MBS portfolio and the number of shares outstanding during 2011.

Interest income on our Agency MBS for 2011 decreased to $242.0 million from $250.6 million, or 3.4%, for 2010. This change primarily reflects a decrease in the net yield on our Agency MBS to 3.50% for 2011 from 4.03% for 2010, which was partially offset by an increase in our average Agency MBS portfolio (excluding changes in market values) to $6.921 billion for 2011 from $6.214 billion for 2010. During 2011, our Agency MBS portfolio experienced a 19.0% CPR and we recognized $38.2 million of premium amortization compared to a CPR of 29.0% and $40.5 million of premium amortization for 2010. At the end of 2011, the average coupon on mortgages underlying our Agency MBS was lower compared to the end of 2010, due to acquisition of assets in the marketplace at generally lower coupons reflecting current market conditions and as a result of prepayments on higher yielding assets and resets on Hybrid and ARM-MBS within the portfolio. As a result, the coupon yield on our Agency MBS portfolio declined 64 basis points to 4.05% for 2011 from 4.69% for 2010. At December 31, 2011, we had net purchase premiums on our Agency MBS of $177.7 million, or 2.6% of current par value, compared to net purchase premiums of $104.9 million and 1.8% of par value at December 31, 2010.

Interest income on our Non-Agency MBS (which includes Non-Agency MBS transferred to consolidated VIEs) for 2011 was $254.6 million compared to $140.4 million for 2010, principally due to the increase in our Non-Agency MBS portfolio in 2011. Certain of our Non-Agency MBS are reported as a component of Linked Transactions, rather than as MBS. (See Note 4 to the accompanying consolidated financial statements, included under Item 8 of this Annual Report on Form 10-K.) Excluding changes in market values, our average investment in our Non-Agency MBS increased by $1.940 billion, or 135.3%, to $3.374 billion for 2011 from $1.434 billion for 2010. The growth in our Non-Agency MBS since 2010 has primarily been funded with securitized debt in connection with our resecuritization transactions and capital raised in a public offering of our common stock in March 2011. In addition, certain of our Non-Agency MBS underlying Linked Transactions became delinked during 2011, primarily in connection with our resecuritization transactions in February and June 2011. These delinkings resulted in Non-Agency MBS of $773.0 million, previously included as a component of Linked Transactions, being recognized as MBS on our consolidated balance sheet as of December 31, 2011. Our Non-Agency MBS portfolio yielded 7.55% for 2011 compared to 9.79% for 2010. The decrease in the yield on our Non-Agency MBS portfolio is primarily due to the flattening (downward movement in the later years) of the forward yield curve, which causes us to lower the projected future coupons and therefore the expected yields on our Hybrid Non-Agency MBS and the addition of newly acquired assets at yields less than our overall portfolio yield. During 2011, we recognized net purchase discount accretion of $42.2 million on our Non-Agency MBS, compared to $34.7 million for 2010. At December 31, 2011, we had net purchase discounts of $1.478 billion, including Credit Reserve and previously recognized OTTI of $1.229 billion, on our Non-Agency MBS, or 27.3% of par value.

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The following table presents the components of the coupon yield and net yields earned on our Agency MBS and Non-Agency MBS and weighted average CPR experienced for such MBS for the quarterly periods presented:

	Agency MBS (1)			Non-Agency MBS (1)			Total MBS (1)		
Quarter Ended	Coupon Yield (2)	Net Yield (3)	Weighted Average CPR	Coupon Yield (2)	Net Yield (3)	Weighted Average CPR	Coupon Yield (2)	Net Yield (3)	Weighted Average CPR
December 31, 2011	3.79%	3.14%	19.35%	6.07%	7.02%	13.07%	4.60%	4.51%	17.19%
September 30, 2011	3.98	3.37	19.29	6.15	7.25	14.66	4.75	4.75	17.97
June 30, 2011	4.14	3.68	16.57	6.41	7.84	14.63	4.87	5.01	16.03
March 31, 2011	4.32	3.84	20.95	6.83	8.58	14.80	5.00	5.12	19.39
December 31, 2010	4.42	3.87	24.88	7.28	9.00	14.43	5.09	5.07	22.46
September 30, 2010	4.48	3.93	23.81	7.42	9.92	15.49	5.05	5.10	22.08
June 30, 2010	4.66	3.61	42.75	7.46	10.18	14.62	5.16	4.80	37.19
March 31, 2010	5.12	4.64	25.61	7.34	10.46	14.40	5.43	5.45	24.00

(1) Yields presented throughout this Annual Report on Form 10-K are calculated using average amortized cost data. For GAAP reporting purposes, MBS purchases and sales are reported on the trade date. Average amortized cost data used to determine yields is calculated based on the settlement date of the associated purchase or sale as interest income is not earned on purchased bonds and continues to be earned on sold bonds until settlement date.

(2) Reflects the annualized coupon interest income divided by the average amortized cost. The discounted purchase price on Non-Agency MBS causes the coupon yield to be higher than the pass-through coupon interest rate. (Does not include MBS underlying our Linked Transactions. See Note 4 to the accompanying consolidated financial statements, included under Item 8 of this Annual Report on Form 10-K.)

(3) Reflects annualized interest income divided by average amortized cost.

The following table presents information about average balances of our MBS portfolio by category and associated income for the years ended December 31, 2011 and 2010.

MBS Category (Dollars in Thousands)	Average Amortized Cost (1)	Interest Income	Weighted Average Coupon	Coupon Yield (2)	Net Asset Yield (3)
Year Ended December 31, 2011					
Agency MBS	$ 6,921,494	$ 241,994	4.22%	4.05%	3.50%
Non-Agency MBS, including transfers to a consolidated VIE	3,373,534	254,617	4.64	6.30	7.55
Total	$ 10,295,028	$ 496,611	4.39%	4.79%	4.82%
Year Ended December 31, 2010					
Agency MBS	$ 6,214,257	$ 250,602	4.91%	4.69%	4.03%
Non-Agency MBS, including transfers to a consolidated VIE	1,434,125	140,351	4.79	7.36	9.79
Total	$ 7,648,382	$ 390,953	4.88%	5.19%	5.11%

(1) Includes principal payments receivable.

(2) Reflects the annualized coupon interest income divided by the average amortized cost. The discounted purchase price on Non-Agency MBS causes the coupon yield to be higher than the pass-through coupon interest rate. (Does not include MBS underlying our Linked Transactions. See Note 4 to the accompanying consolidated financial statements, included under Item 8 of this Annual Report on Form 10-K.)

(3) Reflects annualized income divided by the average amortized cost.

Interest income from our cash investments, which are comprised of money market investments, is not a material source of income, as the yields on such funds remain at historically low levels, decreased to $136,000 for 2011 from $385,000 for 2010. Our average cash investments were $459.4 million and yielded 0.03% for 2011 compared to average cash investments of $520.5 million that yielded 0.07% for 2010. In general, we manage our cash investments relative to our investing, financing and operating requirements, investment opportunities and current and anticipated market conditions.

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At December 31, 2011, we had repurchase agreement borrowings of $7.813 billion and securitized debt of $875.5 million, of which $3.378 billion was hedged with Swaps. The increase in our borrowings and securitized debt in 2011 as compared to 2010 is primarily due to our acquisition of additional MBS. In addition, for GAAP reporting purposes, we recorded an obligation to return securities obtained as collateral of $306.4 million in connection with our financing of Non-Agency MBS. At December 31, 2011, our Swaps had a weighted average fixed-pay rate of 2.80% and extended 22 months on average with a maximum remaining term of approximately 50 months. Our cost of funding on the hedged portion of our borrowings is in effect fixed over the term of the related Swap. As a result, the interest expense on our hedged repurchase agreement borrowings has not declined to the same extent that market interest rates have declined over time.

Our interest expense for 2011 increased by 3.0% to $149.4 million, from $145.1 million for 2010. This increase reflects the combined impact of an increase in our average borrowings, partially offset by lower interest rates on such borrowings. Our interest expense for 2011 was comprised of interest expense of $137.7 million on our borrowings under repurchase agreements, which includes the cost of our Swaps, and $11.7 million on our securitized debt. Our average repurchase agreement borrowings for 2011 were $7.585 billion, compared to $6.236 billion for 2010. As a result of the three resecuritization transactions, we had securitized debt of $875.5 million at December 31, 2011. Our securitized debt, which bears interest at variable rates, had an aggregate weighted average balance of $784.1 million for 2011, compared to $55.0 million for 2010.

The following table presents information about our securitized debt at December 31, 2011:

Benchmark Interest Rate (Dollars in Thousands)	At December 31, 2011 Securitized Debt	At December 31, 2011 Interest Rate
One-month LIBOR + 100 basis points	$ 356,724	1.30%
One-month LIBOR + 125 basis points	518,796	1.55
Total	$ 875,520	1.44%

The effective interest rate paid on our borrowings decreased to 1.79% for 2011 from 2.31% for 2010, reflecting a decline in market interest rates and the maturity of Swaps with higher fixed-pay rates. Payments made and/or received on our Swaps are a component of our borrowing costs and accounted for interest expense of $95.7 million, or 114 basis points, for 2011, compared to interest expense of $111.8 million, or 178 basis points, for 2010. Certain of our Swaps have fixed interest rates that are significantly higher than current market interest rates, and as such Swaps continue to amortize and/or expire. The Swap component of our borrowing costs has and is expected to continue to decrease. During 2011, we entered into 15 Swaps with an aggregate notional amount of $1.215 billion, a weighted average fixed-pay rate of 1.34% and initial maturities ranging from one to five years that hedge against increases in the LIBOR rate associated with our anticipated repurchase financings and our securitized debt. During 2011, we had Swaps with an aggregate notional amount of $642.6 million and a weighted average fixed-pay rate of 4.12% expire.

In June 2011, we purchased an interest rate swaption (or Swaption), which at expiration of the option period in January 2012 gave us the right, but not the obligation, to enter into a Swap for a four-year term under which we would pay a fixed rate of 1.90% and receive a variable rate equal to one-month LIBOR on a $100.0 million notional. At the option s expiration, we could have elected to cash settle the option if such option was in-the-money or allow the option to expire at no additional cost to us. We entered into this Swaption to provide us with the ability to protect against rates rising above the fixed rate specified in the Swaption agreement. At the conclusion of the option period in January 2012, we allowed the option to expire.

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The following table presents our leverage multiples, as measured by debt-to-equity, at the dates presented:

At the Period Ended	GAAP Leverage Multiple (1)	Non-GAAP Leverage Multiple (2)
December 31, 2011	3.6*(3)*	3.7
September 30, 2011	3.4*(4)*	3.5
June 30, 2011	3.2*(5)*	3.3
March 31, 2011	2.9	3.0
December 31, 2010	2.8	3.0
September 30, 2010	2.6	2.8
June 30, 2010	2.8	3.0
March 31, 2010	2.7	2.8

(1) Represents the sum of borrowings under repurchase agreements, securitized debt, payable for unsettled MBS purchases, and obligations to return securities obtained as collateral divided by stockholders   equity.

(2) The Non-GAAP Leverage Multiple reflects the sum of our borrowings under repurchase agreements, securitized debt, payable for unsettled MBS purchases, obligations to return securities obtained as collateral and borrowings that are reported on our balance sheet as a component of Linked Transactions of $170.9 million, $193.0 million, $225.4 million, $304.1 million, $567.3 million, $422.3 million, $342.0 million and $321.8 million at December 31, 2011, September 30, 2011, June 30, 2011, March 31, 2011, December 31, 2010, September 30, 2010, June 30, 2010 and March 31, 2010, respectively. We present a Non-GAAP leverage multiple since repurchase agreement borrowings that are a component of Linked Transactions may not be linked in the future and, if no longer linked, will be reported as repurchase agreement borrowings, which will increase our leverage multiple. (See Note 4 to the accompanying consolidated financial statements, included under Item 8 of this Annual Report on Form 10-K.)

(3) The increase in our leverage multiple from 3.4x at September 30, 2011 to 3.6x at December 31, 2011 primarily reflects a decline in the market value of our Non-Agency MBS and increased use of financing structures of Non-Agency MBS.

(4) The increase in our leverage multiple from 3.2x at June 30, 2011 to 3.4x at September 30, 2011 primarily reflects a decline in the market value of our Non-Agency MBS.

(5) The increase in our leverage multiple from 2.9x at March 31, 2011 to 3.2x at June 30, 2011 reflects the use of resecuritization to finance a portion of our Non-Agency MBS portfolio.

For 2011, our net interest income increased by $101.1 million, or 41.1%, to $347.3 million from $246.2 million for 2010. This increase primarily reflects the impact of additional higher yielding Non-Agency MBS partially offset by an increase in our average borrowings. Our net interest spread and margin for 2011 were 2.83% and 3.23%, respectively, compared to a net interest spread and margin of 2.47% and 3.02%, respectively, for 2010.

The following table presents information regarding our average balances, interest income and expense, yields on average interest-earning assets, average cost of funds and net interest income for the quarters presented:

Average

Quarter Ended	Average Amortized Cost of MBS (1)	Interest Income on MBS	Average Interest Earning Cash (2)	Total Interest Income	Yield on Average Interest-Earning Assets	Balance of Repurchase Agreements and Securitized Debt	Interest Expense	Average Cost of Funds	Net Interest Income
December 31, 2011	$ 11,000,704	$ 123,964	$ 402,958	$ 123,994	4.35%	$ 8,899,013	$ 38,811	1.73%	$ 85,183
September 30, 2011	11,010,686	130,741	548,339	130,766	4.53	9,034,044	38,752	1.70	92,014
June 30, 2011	10,545,419	132,082	432,005	132,109	4.81	8,473,314	37,195	1.76	94,914
March 31, 2011	8,587,526	109,824	453,730	109,878	4.86	7,041,406	34,653	1.99	75,225
December 31, 2010	7,689,167	97,498	482,683	97,597	4.78	6,324,079	35,469	2.23	62,128
September 30, 2010	7,637,483	97,296	440,146	97,417	4.82	6,205,856	35,464	2.26	61,953
June 30, 2010	7,375,637	88,515	646,644	88,627	4.42	6,129,448	35,741	2.34	52,886
March 31, 2010	7,893,552	107,644	513,867	107,697	5.13	6,507,890	38,451	2.40	69,246

(1) Unrealized gains and losses are not reflected in the average amortized cost of MBS.

(2) Includes average interest-earning cash, cash equivalents and restricted cash.

(3) Reflects annualized interest income divided by average amortized cost of interest-earning assets.

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The following table presents certain quarterly information regarding our net interest spreads and net interest margin for the quarterly periods presented:

	Total Interest-Earning Assets and Interest-Bearing Liabilities	
Quarter Ended	Net Interest Spread (1)	Net Interest Margin (2)
December 31, 2011	2.62%	3.00%
September 30, 2011	2.83	3.20
June 30, 2011	3.05	3.46
March 31, 2011	2.87	3.31
December 31, 2010	2.55	3.06
September 30, 2010	2.56	3.08
June 30, 2010	2.08	2.64
March 31, 2010	2.73	3.29

(1) Reflects the difference between the yield on average interest-earning assets and average cost of funds.

(2) Annualized net interest income divided by average interest-earning assets.

The following table presents the components of the net interest spread earned on our Agency and Non-Agency MBS for the quarters presented:

		Agency MBS			Non-Agency MBS			Total MBS	
Quarter Ended	Net Yield (1)	Cost of Funding (2)	Net Interest Spread (3)	Net Yield (1)	Cost of Funding (2)	Net Interest Spread (3)	Net Yield (1)	Cost of Funding (2)	Net Interest Spread (3)
December 31, 2011	3.14%	1.71%	1.43%	7.02%	1.78%	5.24%	4.51%	1.73%	2.78%
September 30, 2011	3.37	1.74	1.63	7.25	1.61	5.64	4.75	1.70	3.05
June 30, 2011	3.68	1.82	1.86	7.84	1.57	6.27	5.01	1.76	3.25
March 31, 2011	3.84	2.10	1.74	8.58	1.62	6.96	5.12	1.99	3.13
December 31, 2010	3.87	2.34	1.53	9.00	1.70	7.30	5.07	2.23	2.84
September 30, 2010	3.93	2.32	1.61	9.92	1.85	8.07	5.10	2.26	2.84
June 30, 2010	3.61	2.41	1.20	10.18	1.80	8.38	4.80	2.34	2.46
March 31, 2010	4.64	2.41	2.23	10.46	1.90	8.56	5.45	2.40	3.05

(1) Annualized interest income on MBS divided by average amortized cost of MBS.

(2) Annualized interest expense divided by average balance of repurchase agreements and securitized debt.

(3) Reflects the difference between the net yield on average MBS and average cost of funds on MBS.

During 2011, we recognized OTTI charges through earnings of $10.6 million against 35 of our Non-Agency MBS. These impairment charges, which were recognized on Non-Agency MBS, reflected changes in our estimated cash flows for such securities based on an updated assessment of the estimated future performance of the underlying collateral, including the expected principal loss over the term of the security and changes in the expected timing of receipt of cash flows. At December 31, 2011, we had 40 Agency MBS with a gross unrealized loss of $1.7 million and 242 Non-Agency MBS with a gross unrealized loss of $288.0 million. Impairments on Agency MBS in an unrealized loss position at December 31, 2011 are considered temporary and not credit related. Unrealized losses on Non-Agency MBS for which no OTTI was recorded during the year are considered temporary based on an assessment of changes in the expected cash flows for such MBS, which considers recent bond performance and expected future performance of the underlying collateral. Significant judgment is used both in the Company s analysis of expected cash flows for its Non-Agency MBS and any determination of the credit component of OTTI. During 2010, we recognized impairment losses of $12.3 million through earnings in connection with eight Non-Agency MBS. See Critical Accounting Policies and Estimates for more information regarding OTTI.

For 2011, we had other income, net of $10.8 million. This income primarily reflects the impact of $6.7 million of gains realized on the sale of certain Agency MBS and net gains of $3.0 million on our Linked Transactions. The

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gains on our Linked Transactions for 2011 were comprised of interest income of $25.6 million on the underlying Non-Agency MBS, interest expense of $4.8 million on the associated repurchase agreements and a reduction of $17.8 million in the fair value of the underlying securities. Changes in the market value of the securities underlying our Linked Transactions, the amount of bond purchases recorded as Linked Transactions in the future and the amount of Linked Transactions that become unlinked in the future, none of which can be predicted with any certainty, will impact future gains/(losses) on our Linked Transactions. During 2011, certain of our Linked Transactions became unlinked, resulting in our recording Non-Agency MBS with a fair value of $773.0 million, repurchase agreement borrowings of $46.7 million and associated accrued interest accounts on a gross basis on our consolidated balance sheet. In addition, during 2011, we recognized $915,000 of expense reflecting the premium paid for a Swaption used to hedge interest rate exposure on our repurchase agreement financings and recognized a gain of $430,000 on the sale of real estate. For 2010, we had other income, net of $62.2 million. This income primarily reflects the net impact of: (i) $33.7 million of gains realized on the sale of MBS during the first quarter of 2010, of which $33.1 million was realized on the sale of $931.9 million of our longer-term Agency MBS; (ii) losses of $26.8 million on the termination of repurchase financings in connection with our MBS sales; and (iii) net gains of $53.8 million on our Linked Transactions.

During 2011, we had compensation and benefits and other general and administrative expense of $30.2 million, or 1.12% of average equity compared to $24.7 million, or 1.11% of average equity, for 2010. The $2.9 million increase in our compensation expense to $19.0 million for 2011, compared to $16.1 million for 2010, primarily reflects an increase to our bonus pool accrual and additional salary expense for new hires, salary increases, and vesting of equity-based compensation awards. Our other general and administrative expenses increased by $2.7 million to $11.3 million for 2011 compared to $8.6 million for 2010. This increase was primarily comprised of increases in office rent and related occupancy costs, professional services, including auditing and legal fees and the cost of data and analytical systems, which primarily reflects expenses to expand our investment analytic capability, associated primarily with our investments in Non-Agency MBS, and data system upgrades.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our consolidated financial statements include our accounts and all majority owned and controlled subsidiaries. In addition, we consolidated the special purpose entities (or SPEs) created to facilitate the resecuritization transactions that we completed in February 2012, June 2011, February 2011, and October 2010. The preparation of consolidated financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts reported in the consolidated financial statements. In preparing these consolidated financial statements, management has made estimates and judgments of certain amounts included in the consolidated financial statements, giving due consideration to materiality. Application of these accounting policies involves the exercise of judgment and use of assumptions as to future uncertainties and, as a result, actual results could differ from these estimates.

For discussion of New and Proposed Accounting Standards and Interpretations see Note 2(q) to the consolidated financial statements, included under Item 8 of this Annual Report on Form 10-K.

Our accounting policies are described in Note 2 to the consolidated financial statements, included under Item 8 of this Annual Report on Form 10-K. Management believes the more significant of these to be as follows:

Classifications of Investment Securities and Assessment for Other-Than-Temporary Impairments

Our investments in securities are comprised of Agency MBS and Non-Agency MBS, as discussed and detailed in Notes 2(b) and 3 to the consolidated financial statements, included under Item 8 of this Annual Report on Form 10-K. With the exception of MBS accounted for as a component of our Linked Transactions, all of our MBS are designated as available-for-sale and carried on the balance sheet at their fair value with unrealized gains and losses excluded from earnings (except when an OTTI is recognized, as discussed below) and recorded in accumulated other comprehensive income/(loss), a component of stockholders equity. We do not intend to hold any of our investment securities for trading purposes; however, if available-for-sale securities were classified as trading securities, there could be substantially greater volatility in our earnings.

When the fair value of an available-for-sale security is less than its amortized cost at the balance sheet date, the security is considered impaired. We assess our impaired securities on at least a quarterly basis and designate such impairments as either temporary or other-than-temporary. If we intend to sell an impaired security or it is more

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likely than not that we will be required to sell the impaired security before its anticipated recovery, an other-than-temporary impairment is recognized through charges to earnings equal to the entire difference between the investment s amortized cost and its fair value at the balance sheet date. If we do not expect to sell an other-than-temporarily impaired security, only the portion of the OTTI related to credit losses is recognized through charges to earnings with the remainder recognized through other accumulated comprehensive income/(loss) on the consolidated balance sheet.

In making our assessments about other-than-temporary impairments, we review and consider certain information relating to our financial position and the impaired securities, including the nature of such securities, the contractual collateral requirements impacting us and our investment and leverage strategies, as well as subjective information, including our current and targeted liquidity position, the credit quality and expected cash flows of the underlying assets collateralizing such securities, and current and anticipated market conditions. In determining the OTTI related to credit losses for securities that were purchased at significant discounts to par and/or are otherwise assessed to be of less than high credit quality, the Company compares the present value of the remaining cash flows expected to be collected at the purchase date (or last date previously revised) against the present value of the cash flows expected to be collected at the current financial reporting date. The determination as to whether an OTTI exists and, if so, the amount of credit impairment recognized in earnings is subjective, as such determinations are based on factual information available at the time of assessment as well as management s estimates of the future performance and cash flow projections. As a result, the timing and amount of OTTIs constitute material estimates that are susceptible to significant change.

During 2012, we recognized credit-related OTTI losses of $1.2 million through earnings against our Non-Agency MBS reflecting changes in the estimated cash flows for such securities based on an updated assessment of the estimated future performance of the underlying collateral, including the expected principal loss over the term of the security and changes in the expected timing of receipt of cash flows. At December 31, 2012, we did not intend to sell any MBS that were in an unrealized loss position, and it is more likely than not that we will not be required to sell these MBS before recovery of their amortized cost basis, which may be at their maturity.

Gross unrealized losses on our Agency MBS were $1.5 million at December 31, 2012. Given the credit quality inherent in Agency MBS, we do not consider any of the current impairments on our Agency MBS to be credit related. In assessing whether it is more likely than not that we will be required to sell any impaired security before its anticipated recovery, which may be at their maturity, we consider the significance of each investment, the amount of impairment, the projected future performance of such impaired securities, as well as our current and anticipated leverage capacity and liquidity position. Based on these analyses, we determined that at December 31, 2012 any unrealized losses on our Agency MBS were temporary.

The payments of principal and interest we receive on our Agency MBS, which depend directly upon payments on the mortgages underlying such securities, are guaranteed by Fannie Mae, Freddie Mac and Ginnie Mae. Fannie Mae and Freddie Mac are GSEs, but their guarantees are not explicitly backed by the full faith and credit of the United States. Ginnie Mae is part of a U.S. Government agency and its guarantees are explicitly backed by the full faith and credit of the United States. We believe that the stronger backing for the guarantors of Agency MBS resulting from the conservatorship of Fannie Mae and Freddie Mac has further strengthened their credit worthiness; however, there can be no assurance that these actions will be adequate for their needs. Accordingly, if these government actions are inadequate and the GSEs continue to suffer losses or cease to exist, our view of the credit worthiness of our Agency MBS could materially change, which may affect our assessment of OTTI for Agency MBS in future periods. (See Part I, Item 1A., Risk Factors, 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 and Freddie Mac and the U.S. Government, may adversely affect our business.)

Our expectations with respect to our securities in an unrealize