

CHIMERA INVESTMENT CORP
Form 10-Q
July 01, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED: MARCH 31, 2014

OR

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

FOR THE TRANSITION PERIOD FROM _____ TO _____

COMMISSION FILE NUMBER: 1-33796

CHIMERA INVESTMENT CORPORATION
(Exact name of Registrant as specified in its Charter)

MARYLAND
(State or other jurisdiction of incorporation or
organization)

26-0630461
(IRS Employer Identification No.)

1211 AVENUE OF THE AMERICAS, SUITE 2902
NEW YORK, NEW YORK
(Address of principal executive offices)

10036
(Zip Code)

(646) 454-3759
(Registrant's telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all documents and reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days:

Yes No

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to

submit and post such files).

Yes No

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

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

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the last practicable date:

| Class | Outstanding at June 30, 2014 |
|-------------------------------|------------------------------|
| Common Stock, \$.01 par value | 1,027,509,949 |

CHIMERA INVESTMENT CORPORATION
FORM 10-Q
TABLE OF CONTENTS

Part I. FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements:

Consolidated Statements of Financial Condition as of March 31, 2014 (Unaudited) and December 31, 2013 (Derived from the audited consolidated financial statements as of December 31, 2013) 1

Consolidated Statements of Operations and Comprehensive Income (Loss) (Unaudited) for the quarters ended March 31, 2014 and 2013 2

Consolidated Statements of Changes In Stockholders' Equity (Deficit) (Unaudited) for the quarters ended March 31, 2014 and 2013 3

Consolidated Statements of Cash Flows (Unaudited) for the quarters ended March 31, 2014 and 2013 4

Notes to Consolidated Financial Statements (Unaudited) 5

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations 36

Item 3. Quantitative and Qualitative Disclosures about Market Risk 58

Item 4. Controls and Procedures 62

Part II. OTHER INFORMATION 63

Item 1. Legal Proceedings 63

Item 1A. Risk Factors 63

Item 6. Exhibits 64

SIGNATURES S-1

CHIMERA INVESTMENT CORPORATION
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
(dollars in thousands, except share and per share data)

| | March 31, 2014 (Unaudited) | December 31, 2013 (1) |
|--|-------------------------------|--------------------------|
| Assets: | | |
| Cash and cash equivalents | \$ 40,602 | \$ 77,629 |
| Non-Agency RMBS, at fair value | | |
| Senior | 187,095 | 89,687 |
| Senior interest-only | 258,803 | 229,065 |
| Subordinated | 474,786 | 457,569 |
| Subordinated interest-only | 16,018 | 16,571 |
| Agency RMBS, at fair value | | |
| Pass-through | 1,868,413 | 1,954,796 |
| Interest-only | 42,936 | 42,782 |
| Receivable for investments sold | 88,536 | 253,541 |
| Accrued interest receivable | 15,325 | 15,821 |
| Other assets | 11,910 | 8,297 |
| Derivatives, at fair value, net | 3,620 | 8,095 |
| Subtotal | 3,008,044 | 3,153,853 |
| Assets of Consolidated VIEs: | | |
| Non-Agency RMBS transferred to consolidated variable interest entities ("VIEs"), at fair value | | |
| | 2,935,051 | 2,981,571 |
| Securitized loans held for investment, net of allowance for loan losses of \$9 million, respectively | | |
| | 748,138 | 783,484 |
| Accrued interest receivable | 15,797 | 17,173 |
| Subtotal | 3,698,986 | 3,782,228 |
| Total assets | \$ 6,707,030 | \$ 6,936,081 |
| Liabilities: | | |
| Repurchase agreements, Agency RMBS (\$1.7 billion pledged as collateral, respectively) | | |
| | \$ 1,561,920 | \$ 1,658,561 |
| Payable for investments purchased | 176,152 | - |
| Accrued interest payable | 1,867 | 1,397 |
| Dividends payable | 92,454 | 297,904 |
| Accounts payable and other liabilities | 1,625 | 1,861 |
| Investment management fees and expenses payable to affiliate | 5,364 | 5,658 |
| Derivatives, at fair value | 26,802 | 30,199 |
| Subtotal | 1,866,184 | 1,995,580 |
| Non-Recourse Liabilities of Consolidated VIEs | | |
| Securitized debt, collateralized by Non-Agency RMBS (\$2.9 billion and \$3.0 | 828,663 | 933,732 |

billion pledged as collateral, respectively)

| | | |
|---|--------------|--------------|
| Securitized debt, collateralized by loans held for investment (\$735 million and \$763 million pledged as collateral, respectively) | 637,190 | 669,981 |
| Accrued interest payable | 4,843 | 5,278 |
| Subtotal | 1,470,696 | 1,608,991 |
| Total liabilities | \$ 3,336,880 | \$ 3,604,571 |

Commitments and Contingencies (See Note 16)

Stockholders' Equity:

| | | |
|--|--------------|--------------|
| Preferred Stock: par value \$0.01 per share; 100,000,000 shares authorized, 0 shares issued and outstanding, respectively | \$ - | \$ - |
| Common stock: par value \$0.01 per share; 1,500,000,000 shares authorized, 1,027,588,342 and 1,027,626,237 shares issued and outstanding, respectively | 10,273 | 10,272 |
| Additional paid-in-capital | 3,605,306 | 3,605,241 |
| Accumulated other comprehensive income (loss) | 1,021,463 | 990,803 |
| Retained earnings (accumulated deficit) | (1,266,892) | (1,274,806) |
| Total stockholders' equity | \$ 3,370,150 | \$ 3,331,510 |
| Total liabilities and stockholders' equity | \$ 6,707,030 | \$ 6,936,081 |

(1) Derived from the audited consolidated financial statements.

See accompanying notes to consolidated financial statements.

CHIMERA INVESTMENT CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)
(dollars in thousands, except share and per share data)
(unaudited)

| | For the Quarter Ended | |
|---|-----------------------|----------------|
| | March 31, 2014 | March 31, 2013 |
| Net Interest Income: | | |
| Interest income | \$35,456 | \$29,067 |
| Interest expense | (1,726) | (1,833) |
| Interest income, Assets of consolidated VIEs | 85,211 | 96,728 |
| Interest expense, Non-recourse liabilities of consolidated VIEs | (20,699) | (26,996) |
| Net interest income (expense) | 98,242 | 96,966 |
| Other-than-temporary impairments: | | |
| Total other-than-temporary impairment losses | (400) | - |
| Portion of loss recognized in other comprehensive income (loss) | (1,134) | (6,163) |
| Net other-than-temporary credit impairment losses | (1,534) | (6,163) |
| Other gains (losses): | | |
| Net unrealized gains (losses) on derivatives | (2,198) | 5,402 |
| Net realized gains (losses) on derivatives | (5,748) | (5,530) |
| Net gains (losses) on derivatives | (7,946) | (128) |
| Net unrealized gains (losses) on interest-only RMBS | 15,010 | (1,013) |
| Net realized gains (losses) on sales of investments | 8,377 | 6 |
| Loss on Extinguishment of Debt | (2,184) | - |
| Total other gains (losses) | 13,257 | (1,135) |
| Net investment income (loss) | 109,965 | 89,668 |
| Other expenses: | | |
| Management fees | 6,221 | 6,449 |
| Expense recoveries from Manager | (681) | (1,855) |
| Net management fees | 5,540 | 4,594 |
| Provision for loan losses, net | 319 | 424 |
| General and administrative expenses | 3,736 | 4,847 |
| Total other expenses | 9,595 | 9,865 |
| Income (loss) before income taxes | 100,370 | 79,803 |
| Income taxes | 2 | 2 |
| Net income (loss) | \$100,368 | \$79,801 |
| Net income (loss) per share available to common shareholders: | | |
| Basic | \$0.10 | \$0.08 |
| Diluted | \$0.10 | \$0.08 |
| Weighted average number of common shares outstanding: | | |
| Basic | 1,027,262,613 | 1,027,009,515 |
| Diluted | 1,027,588,763 | 1,027,595,515 |
| Dividends declared per share of common stock | \$0.09 | \$0.09 |

| | | |
|--|------------|------------|
| Comprehensive income (loss): | | |
| Net income (loss) | \$ 100,368 | \$ 79,801 |
| Other comprehensive income (loss): | | |
| Unrealized gains (losses) on available-for-sale securities, net | 37,503 | 117,594 |
| Reclassification adjustment for net losses included in net income (loss) for other-than-temporary credit impairment losses | 1,534 | 6,163 |
| Reclassification adjustment for net realized losses (gains) included in net income (loss) | (8,377 |) (6 |
| Other comprehensive income (loss) | 30,660 | 123,751 |
| Comprehensive income (loss) | \$ 131,028 | \$ 203,552 |

See accompanying notes to consolidated financial statements.

CHIMERA INVESTMENT CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (DEFICIT)
(dollars in thousands, except per share data)

| | Common Stock Par Value | Additional Paid- in Capital | Accumulated Other Comprehensive Income (Loss) | Retained Earnings (Accumulated Deficit) | Total |
|--|------------------------------|-----------------------------------|---|--|--------------|
| Balance, December 31, 2012 | \$ 10,268 | \$ 3,604,554 | \$ 989,936 | \$ (1,062,279) | \$ 3,542,479 |
| Net income (loss) | - | - | - | 79,801 | 79,801 |
| Unrealized gains (losses) on available-for-sale securities, net | - | - | 117,594 | - | 117,594 |
| Reclassification adjustment for net losses included in net income (loss) for other-than-temporary credit impairment losses | - | - | 6,163 | - | 6,163 |
| Reclassification adjustment for net realized losses (gains) included in net income (loss) | - | - | (6) | - | (6) |
| Proceeds from restricted stock grants | 2 | 73 | - | - | 75 |
| Common dividends declared, \$0.09 per share | - | - | - | (92,433) | (92,433) |
| Balance, March 31, 2013 | \$ 10,270 | \$ 3,604,627 | \$ 1,113,687 | \$ (1,074,911) | \$ 3,653,673 |
| Balance, December 31, 2013 | \$ 10,272 | \$ 3,605,241 | \$ 990,803 | \$ (1,274,806) | \$ 3,331,510 |
| Net income (loss) | - | - | - | 100,368 | 100,368 |
| Unrealized gains (losses) on available-for-sale securities, net | - | - | 37,503 | - | 37,503 |
| Reclassification adjustment for net losses included in net income (loss) for other-than-temporary credit impairment losses | - | - | 1,534 | - | 1,534 |
| Reclassification adjustment for net realized losses (gains) included in net income (loss) | - | - | (8,377) | - | (8,377) |
| Proceeds from restricted stock grants | 1 | 65 | - | - | 66 |
| Common dividends declared, \$0.09 per share | - | - | - | (92,454) | (92,454) |
| Balance, March 31, 2014 | \$ 10,273 | \$ 3,605,306 | \$ 1,021,463 | \$ (1,266,892) | \$ 3,370,150 |

See accompanying notes to consolidated financial statements.

CHIMERA INVESTMENT CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(dollars in thousands)
(unaudited)

| | March 31, 2014 | March 31, 2013 |
|---|-------------------|-------------------|
| Cash Flows From Operating Activities: | | |
| Net income (loss) | \$100,368 | \$79,801 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | | |
| (Accretion) amortization of investment discounts/premiums, net | (19,791) | (19,052) |
| Amortization of deferred financing costs | 490 | 2,114 |
| Accretion (amortization) of securitized debt discounts/premiums, net | 2,423 | 1,813 |
| Net unrealized losses (gains) on derivatives | 2,198 | (5,402) |
| Net realized losses (gains) on option contracts settled | 308 | - |
| Net unrealized losses (gains) on interest-only RMBS | (15,010) | 1,013 |
| Net realized losses (gains) on sales of investments | (8,377) | (6) |
| Net other-than-temporary credit impairment losses | 1,534 | 6,163 |
| Loss on extinguishment of debt | 2,184 | |
| Provision for loan losses, net | 319 | 424 |
| Equity-based compensation expense | 66 | 75 |
| Changes in operating assets: | | |
| Decrease (increase) in accrued interest receivable, net | 4,674 | 2,857 |
| Decrease (increase) in other assets | (6,862) | 109 |
| Changes in operating liabilities: | | |
| Increase (decrease) in accounts payable and other liabilities | (236) | 1,199 |
| Increase (decrease) in investment management fees and expenses payable to affiliate | (294) | (4,228) |
| Increase (decrease) in accrued interest payable, net | 35 | (477) |
| Net cash provided by (used in) operating activities | \$64,029 | \$66,403 |
| Cash Flows From Investing Activities: | | |
| Agency RMBS portfolio: | | |
| Purchases | \$(17,613) | \$(1,694) |
| Sales | 397,572 | 182 |
| Principal payments | 60,367 | 158,360 |
| Non-Agency RMBS portfolio: | | |
| Purchases | (136,525) | (5,730) |
| Sales | 16,234 | - |
| Principal payments | 6,868 | 829 |
| Non-Agency RMBS transferred to consolidated VIEs: | | |
| Principal payments | 74,826 | 105,550 |
| Securitized loans held for investment: | | |
| Principal payments | 34,002 | 211,439 |
| Net cash provided by (used in) investing activities | \$435,731 | \$468,936 |
| Cash Flows From Financing Activities: | | |
| Proceeds from repurchase agreements | \$1,894,296 | \$1,686,498 |
| Payments on repurchase agreements | (1,990,937) | (1,794,148) |
| Payments on securitized debt borrowings, collateralized by loans held for investment | (32,993) | (209,430) |

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| | | |
|--|--------------|--------------|
| Payments on securitized debt borrowings, collateralized by Non-Agency RMBS | (53,177) | (97,455) |
| Repurchase of securitized debt borrowings, collateralized by Non-Agency RMBS | (56,072) | - |
| Common dividends paid | (297,904) | (92,431) |
| Net cash provided by (used in) financing activities | \$(536,787) | \$(506,966) |
| Net increase (decrease) in cash and cash equivalents | \$(37,027) | \$28,373 |
| Cash and cash equivalents at beginning of period | 77,629 | 621,153 |
| Cash and cash equivalents at end of period | \$40,602 | \$649,526 |

Supplemental disclosure of cash flow information:

| | | |
|--|-----------|-----------|
| Interest received | \$102,748 | \$109,600 |
| Interest paid | \$19,477 | \$25,380 |
| Management fees and expenses paid to affiliate | \$6,515 | \$10,677 |

Non-cash investing activities:

| | | |
|---|-----------|-----------|
| Receivable for investments sold | \$88,536 | \$- |
| Payable for investments purchased | \$176,152 | \$- |
| Net change in unrealized gain (loss) on available-for sale securities | \$30,660 | \$123,751 |

Non-cash financing activities:

| | | |
|---|----------|----------|
| Common dividends declared, not yet paid | \$92,454 | \$92,433 |
|---|----------|----------|

See accompanying notes to consolidated financial statements.

CHIMERA INVESTMENT CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Organization

Chimera Investment Corporation (the “Company”) was organized in Maryland on June 1, 2007. The Company commenced operations on November 21, 2007 when it completed its initial public offering. The Company elected to be taxed as a real estate investment trust (“REIT”) under the Internal Revenue Code of 1986, as amended, and regulations promulgated thereunder (the “Code”). The Company formed the following wholly-owned qualified REIT subsidiaries: Chimera Securities Holdings, LLC in July 2008; Chimera Asset Holding LLC and Chimera Holding LLC in June 2009; and Chimera Special Holding LLC in January 2010 which is a wholly-owned subsidiary of Chimera Asset Holding LLC. In July 2010, the Company formed CIM Trading Company LLC, a wholly-owned taxable REIT subsidiary (“TRS”). In October 2013, the Company formed Chimera Funding TRS LLC, which is a wholly-owned TRS.

Annaly Capital Management, Inc. (“Annaly”) owns approximately 4.38% of the Company’s common shares. The Company is managed by Fixed Income Discount Advisory Company (“FIDAC”), an investment advisor registered with the Securities and Exchange Commission (“SEC”). FIDAC is a wholly-owned subsidiary of Annaly.

2. Summary of the Significant Accounting Policies

(a) Basis of Presentation and Consolidation

The accompanying consolidated financial statements and related notes of the Company have been prepared in accordance with accounting principles generally accepted in the United States (“GAAP”). In the opinion of management, all adjustments considered necessary for a fair presentation of the Company’s financial position, results of operations and cash flows have been included. These statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Annual Report on Form 10-K for the year ended December 31, 2013. Certain prior year amounts have been reclassified to conform to the current year’s presentation.

The consolidated financial statements include, on a consolidated basis, the Company’s accounts, the accounts of its wholly-owned subsidiaries, and variable interest entities (“VIEs”) in which the Company is the primary beneficiary. All significant intercompany balances and transactions have been eliminated in consolidation.

The Company uses securitization trusts considered to be VIEs in its securitization and re-securitization transactions. VIEs are defined as entities in which equity investors (i) do not have the characteristics of a controlling financial interest, and/or (ii) do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. The entity that consolidates a VIE is known as its primary beneficiary, and is generally the entity with (i) the power to direct the activities that most significantly impact the VIEs’ economic performance, and (ii) the right to receive benefits from the VIE or the obligation to absorb losses of the VIE that could be significant to the VIE. For VIEs that do not have substantial on going activities, the power to direct the activities that most significantly impact the VIEs’ economic performance may be determined by an entity’s involvement with the design and structure of the VIE.

The trusts are structured as pass through entities that receive principal and interest on the underlying collateral and distribute those payments to the certificate holders. The assets held by the securitization entities are restricted in that they can only be used to fulfill the obligations of the securitization entity. The Company’s risks associated with its

involvement with these VIEs are limited to its risks and rights as a certificate holder of the bonds it has retained. There have been no recent changes to the nature of risks associated with the Company's involvement with VIEs.

Determining the primary beneficiary of a VIE requires significant judgment. The Company determined that for the securitizations it consolidates, its ownership of substantially all subordinate interests provided the Company with the obligation to absorb losses and/or the right to receive benefits from the VIE that could be significant to the VIE. In addition, the Company is considered to have the power to direct the activities of the VIEs that most significantly impact the VIEs' economic performance ("power") or the Company was determined to have power in connection with its involvement with the purpose and design of the VIE.

The Company's interest in the assets held by these securitization vehicles, which are consolidated on the Company's Statements of Financial Condition, is restricted by the structural provisions of these entities, and a recovery of the Company's investment in the vehicles will be limited by each entity's distribution provisions. The liabilities of the securitization vehicles, which are also consolidated on the Company's Statements of Financial Condition, are non-recourse to the Company, and can generally only be satisfied from each securitization vehicle's respective asset pool.

The securitization entities are comprised of senior classes of residential mortgage backed securities ("RMBS") and jumbo, prime, residential mortgage loans. See Notes 3, 4 and 8 for further discussion of the characteristics of the securities and loans in the Company's portfolio.

(b) Statements of Financial Condition Presentation

The Company's Consolidated Statements of Financial Condition separately present: (i) the Company's direct assets and liabilities, and (ii) the assets and liabilities of consolidated securitization vehicles. Assets of each consolidated VIE can only be used to satisfy the obligations of that VIE, and the liabilities of consolidated VIEs are non-recourse to the Company. The Company is not obligated to provide, nor has it provided, any financial support to these consolidated securitization vehicles.

The Company has aggregated all the assets and liabilities of the consolidated securitization vehicles due to the determination that these entities are substantively similar and therefore a further disaggregated presentation would not be more meaningful. The notes to the consolidated financial statements describe the Company's direct assets and liabilities and the assets and liabilities of consolidated securitization vehicles. See Note 8 for additional information related to the Company's investments in consolidated securitization vehicles.

(c) Cash and Cash Equivalents

Cash and cash equivalents include cash on hand and cash deposited overnight in money market funds, which are not bank deposits and are not insured or guaranteed by the Federal Deposit Insurance Corporation. There were no restrictions on cash and cash equivalents at March 31, 2014 and December 31, 2013.

(d) Agency and Non-Agency Residential Mortgage-Backed Securities

The Company invests in RMBS representing interests in obligations backed by pools of mortgage loans. The Company delineates between Agency RMBS and Non-Agency RMBS as follows: Agency RMBS are mortgage pass-through certificates, collateralized mortgage obligations ("CMOs"), and other RMBS representing interests in or obligations backed by pools of mortgage loans issued or guaranteed by agencies of the U.S. Government, such as Ginnie Mae, or federally chartered corporations such as Freddie Mac or Fannie Mae where principal and interest repayments are guaranteed by the respective agency of the U.S. Government or federally chartered corporation. Non-Agency RMBS are not issued or guaranteed by a U.S. Government Agency or other institution and are subject to credit risk. Repayment of principal and interest on Non-Agency RMBS is subject to the performance of the mortgage loans or RMBS collateralizing the obligation.

The Company classifies its RMBS as available-for-sale, records investments at estimated fair value as described in Note 5 of these consolidated financial statements, and includes unrealized gains and losses considered to be temporary on all RMBS, excluding interest-only ("IO") strips, in Other comprehensive income (loss) in the Consolidated Statements of Operations and Comprehensive Income (Loss). IO strips are recorded at estimated fair value and all unrealized gains and losses are included in earnings in the Consolidated Statements of Operations and Comprehensive Income (Loss). From time to time, as part of the overall management of its portfolio, the Company may sell any of its

RMBS investments and recognize a realized gain or loss as a component of earnings in the Consolidated Statements of Operations and Comprehensive Income (Loss) utilizing the average cost method.

The Company's accounting policy for interest income and impairment related to its RMBS is as follows:

6

Interest Income Recognition

The recognition of interest income on RMBS securities varies depending on the characteristics of the security as follows:

Agency RMBS and Non-Agency RMBS of High Credit Quality

The Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) 310-20, Nonrefundable Fees and Other Costs (“ASC 310-20”) is applied to the recognition of interest income for the following securities:

Agency RMBS

Non-Agency RMBS that meet all of the following conditions at the acquisition date (referred to hereafter as “Non-Agency RMBS of High Credit Quality”):

1. Rated AA or higher by a nationally recognized credit rating agency. The Company uses the lowest rating available.
2. The Company expects to collect all of the security’s contractual cash flows.
3. The security cannot be contractually prepaid such that the Company would not recover substantially all of its recorded investment.

Under ASC 310-20, interest income, including premiums and discounts associated with the acquisition of these securities, is recognized over the life of such securities using the interest method based on the contractual cash flows of the security. In applying the interest method, the Company considers estimates of future principal prepayments in the calculation of the constant effective yield. Differences that arise between previously anticipated prepayments and actual prepayments received, as well as changes in future prepayment assumptions, result in a recalculation of the effective yield on the security on a quarterly basis. This recalculation results in the recognition of an adjustment to the carrying amount of the security based on the revised prepayment assumptions and a corresponding increase or decrease in reported interest income.

Non-Agency RMBS Not of High Credit Quality

Non-Agency RMBS that are purchased at a discount and that are not of high credit quality at the time of purchase are accounted for under ASC 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality (“ASC 310-30”) or ASC 325-40, Beneficial Interests in Securitized Financial Assets (“ASC 325-40”) (referred to hereafter as “Non-Agency RMBS Not of High Credit Quality”).

Non-Agency RMBS are accounted for under ASC 310-30 if the following conditions are met as of the acquisition date:

1. There is evidence of deterioration in credit quality of the security from its inception.
2. It is probable that the Company will be unable to collect all contractual cash flows of the security.

Non-Agency RMBS that are not within the scope of ASC 310-30 are accounted for under ASC 325-40 if at the acquisition date:

1. The security is not of high credit quality (defined as rated below AA or is unrated), or
2. The security can contractually be prepaid or otherwise settled in such a way that the Company would not recover substantially all of its recorded investment.

Interest income on Non-Agency RMBS Not of High Credit Quality is recognized using the interest method based on management's estimates of cash flows expected to be collected. The effective interest rate on these securities is based on management's estimate for each security of the projected cash flows, which are estimated based on observation of current market information and include assumptions related to fluctuations in prepayment speeds and the timing and amount of credit losses. Quarterly, the Company reviews and, if appropriate, makes adjustments to its cash flow projections based on inputs and analyses received from external sources, internal models, and the Company's judgments about prepayment rates, the timing and amount of credit losses, and other factors. Changes in the amount and/or timing of cash flows from those originally projected, or from those estimated at the last evaluation date, are considered to be either positive changes or adverse changes. For securities accounted for under ASC 325-40, any positive or adverse change in cash flows that does not result in the recognition of an other-than-temporary impairment ("OTTI") results in a prospective increase or decrease in the effective interest rate used to recognize interest income. For securities accounted for under ASC 310-30, only significant positive changes are reflected prospectively in the effective interest rate used to recognize interest income. Adverse changes in cash flows expected to be collected are generally treated consistently for RMBS accounted for under ASC 325-40 and ASC 310-30, and generally result in recognition of an OTTI with no change in the effective interest rate used to recognize interest income.

Impairment

Considerations Applicable to all RMBS

When the fair value of an available-for-sale RMBS is less than its amortized cost the security is considered impaired. On at least a quarterly basis the Company evaluates its securities for OTTI. If the Company intends to sell an impaired security, or it is more-likely-than-not that the Company will be required to sell an impaired security before its anticipated recovery, then the Company must recognize an OTTI through a charge to earnings equal to the entire difference between the investment's amortized cost and its fair value at the measurement date. If the Company does not intend to sell an impaired security and it is not more-likely-than-not that it would be required to sell an impaired security before recovery, the Company must further evaluate the security for impairment due to credit losses. The credit component of OTTI is recognized in earnings and the remaining or non-credit component is recorded as a component of Other comprehensive income (loss) ("OCI"). Following the recognition of an OTTI through earnings, a new amortized cost basis is established for the security and subsequent recoveries in fair value may not be adjusted through earnings.

When evaluating whether the Company intends to sell an impaired security or will more-likely-than-not be required to sell an impaired security before recovery, the Company makes judgments that consider among other things, its liquidity, leverage, contractual obligations, and targeted investment strategy to determine its intent and ability to hold the investments that are deemed impaired. The determination as to whether an OTTI exists is subjective as such determinations are based on factual information available at the time of assessment as well as the Company's estimates of future conditions. As a result, the determination of OTTI and its timing and amount is based on estimates that may change materially over time.

The Company's estimate of the amount and timing of cash flows for its RMBS is based on its review of the underlying securities or mortgage loans securing the RMBS. The Company considers historical information available and expected future performance of the underlying securities or mortgage loans, including timing of expected future cash flows, prepayment rates, default rates, loss severities, delinquency rates, percentage of non-performing loans, extent of credit support available, Fair Isaac Corporation ("FICO") scores at loan origination, year of origination, loan-to-value ratios, geographic concentrations, as well as reports by credit rating agencies, such as Moody's Investors Service, Inc., Standard & Poor's Rating Services or Fitch Ratings, Inc., general market assessments and dialogue with market participants. As a result, substantial judgment is used in the Company's analysis to determine the expected cash flows for its RMBS.

Considerations Applicable to Non-Agency RMBS of High Credit Quality

The impairment assessment for Non-Agency RMBS of High Credit Quality involves comparing the present value of the remaining cash flows expected to be collected to the amortized cost of the security at the assessment date. The discount rate used to calculate the present value of the expected future cash flows is based on the security's effective interest rate as calculated under ASC 310-20 (i.e., the discount rate implicit in the security as of the last measurement date). If the present value of the remaining cash flows expected to be collected is less than the amortized cost basis, an OTTI is recognized in earnings for the difference. This amount is considered to be the credit loss component; the remaining difference between amortized cost and the fair value of the security is considered to be the portion of loss recognized in other comprehensive income (loss).

Following the recognition of an OTTI through earnings for the credit loss component, a new amortized cost basis is established for the security and subsequent recoveries in fair value may not be adjusted through earnings.

Considerations Applicable to Non-Agency RMBS Not of High Credit Quality

Non-Agency RMBS within the scope of ASC 325-40 or ASC 310-30 are considered other-than-temporarily impaired when the following two conditions exist: (1) the fair value is less than the amortized cost basis, and (2) there has been an adverse change in cash flows expected to be collected from the last measurement date (i.e., adverse changes in either the amount or timing of cash flows from those previously expected).

The OTTI is separated into a credit loss component that is recognized in earnings and the portion of loss recognized in other comprehensive income (loss). The credit component is comprised of the impact of the fair value decline due to changes in assumptions related to default (collection) risk and prepayments. The portion of loss recognized in other comprehensive income (loss) comprises the change in fair value of the security due to all other factors, including changes in benchmark interest rates and market liquidity. In determining the OTTI related to credit losses for securities, the Company compares the present value of the remaining cash flows adjusted for prepayments expected to be collected at the current financial reporting date to the present value of the remaining cash flows expected to be collected at the original purchase date (or the last date those estimates were revised for accounting purposes). The discount rate used to calculate the present value of expected future cash flows is the effective interest rate used for income recognition purposes as determined under ASC 325-40 or ASC 310-30.

Following the recognition of an OTTI through earnings for the credit component, a new amortized cost basis is established for the security and subsequent recoveries in fair value may not be adjusted through earnings. However, to the extent that there are subsequent increases in cash flows expected to be collected, the OTTI previously recorded through earnings may be accreted into interest income following the guidance in ASC 325-40 or ASC 310-30.

The determination of whether an OTTI exists and, if so, the extent of the credit component is subject to significant judgment and management's estimates of both historical information available at the time of assessment, the current market environment, as well as the Company's estimates of the future performance and projected amount and timing of cash flows expected to be collected on the security. As a result, the timing and amount of OTTI constitutes an accounting estimate that may change materially over time.

(e) Interest-Only RMBS

The Company invests in IO Agency and Non-Agency RMBS strips ("IO RMBS strips"). IO RMBS strips represent the Company's right to receive a specified proportion of the contractual interest flows of the collateral. The Company has accounted for IO RMBS strips at fair value with changes in fair value recognized in the Company's Consolidated Statements of Operations and Comprehensive Income (Loss). The Company has elected the fair value option to account for IO RMBS strips to simplify the reporting of changes in fair value. The IO RMBS strips are included in RMBS, at fair value, on the accompanying Consolidated Statements of Financial Condition. Interest income on IO RMBS strips is accrued based on the outstanding notional balance and the security's contractual terms, and amortization of any premium or discount is calculated in accordance with ASC 325-40. Changes in fair value are presented in Net unrealized gains (losses) on interest-only RMBS on the Consolidated Statement of Operations and Comprehensive Income (Loss). Included in Non-Agency RMBS transferred to VIEs, at fair value on the Consolidated Statements of Financial Condition are IO RMBS strips carried at fair value with changes in fair value reflected in earnings of \$12 million as of March 31, 2014 and December 31, 2013. Total Interest income reported on IO securities was \$10 million and \$4 million for the three months ended March 31, 2014 and 2013, respectively.

(f) Securitized Loans Held for Investment and Related Allowance for Loan Losses

The Company's securitized residential mortgage loans are comprised of fixed-rate and variable-rate loans. Mortgage loans are designated as held for investment, and are carried at their principal balance outstanding, plus any premiums, less discounts and allowances for loan losses. Interest income on loans held for investment is recognized over the expected life of the loans using the interest method. Nonrefundable fees and costs related to acquiring the Company's securitized residential mortgage loans are recognized as expenses over the life of the associated debt using the interest method of amortization. Income recognition is suspended for loans when, based on information from the servicer, a full recovery of interest or principal becomes doubtful. The Company estimates the fair value of securitized loans for disclosure purposes only as described in Note 5 of these consolidated financial statements.

(g) Allowance for Loan Losses – Securitized Loans Held for Investment

The securitized loan portfolio is comprised primarily of non-conforming, single family, owner occupied, jumbo, prime loans that are not guaranteed as to repayment of principal or interest. Securitized loans are serviced and modified by a third-party servicer. The Company generally has the ability to approve certain loan modifications and determine the course of action to be taken as it relates to certain loans in technical default, including whether or not to proceed with foreclosure.

The Company's general reserve is based on historical loss rates for pools of loans with similar credit characteristics, adjusted for current trends and market conditions, including current trends in delinquencies and severities.

The Company has established a specific reserve that reflects consideration of loans more than 60 days delinquent, loans in foreclosure and borrowers that have declared bankruptcy. The loan loss provision related to these loans is measured as the difference between the unpaid principal balance and the estimated fair value of the property securing the mortgage, less estimated costs to sell. The specific reserve also reflects consideration of concessions granted to borrowers by the servicer in the form of modifications (i.e., reductions). Loan loss provisions related to these modifications are based on the contractual principal and interest payments, post-modification, discounted at the loan's original effective interest rate. Loans with specific reserves are individually evaluated for impairment. Loan modifications made by the servicer are evaluated to determine if they constitute troubled debt restructurings ("TDRs"). A restructuring of a loan constitutes a TDR if the servicer, for economic or legal reasons related to the borrower's financial difficulties, grants a concession to the borrower that it would not otherwise consider. Impairment of modified loans considered to be TDRs is measured based on the present value of expected cash flows discounted at the loan's effective interest rate at inception. If the present value of expected cash flows is less than the recorded investment in the loan, an allowance for loan losses is recognized with a corresponding charge to the provision for loan losses. Impairment of all other loans individually evaluated is measured as the difference between the unpaid principal balance and the estimated fair value of the collateral, less estimated costs to sell. The Company charges off the corresponding loan allowance and related principal balance when the servicer reports a realized loss. A complete discussion of securitized loans held for investment is included in Note 4 to these consolidated financial statements.

(h) Repurchase Agreements

The Company finances the acquisition of a significant portion of its Agency mortgage-backed securities with repurchase agreements. The Company has evaluated each agreement and has determined that each of the repurchase agreements be accounted for as secured borrowings. None of the Company's repurchase agreements are accounted for as components of linked transactions. As a result, the Company separately accounts for the financial assets posted as collateral and related repurchase agreements in the accompanying consolidated financial statements.

(i) Securitized Debt, Non-Agency RMBS Transferred to Consolidated VIEs, and Securitized Debt, Loans Held for Investment

The Company has issued securitized debt to finance a portion of its residential mortgage loan and RMBS portfolios. Certain transactions involving residential mortgage loans are accounted for as secured borrowings, and are recorded as Securitized loans held for investment and the corresponding debt as Securitized debt, collateralized by loans held for investment in the Consolidated Statements of Financial Condition. These securitizations are collateralized by residential adjustable or fixed rate mortgage loans that have been placed in a trust and pay interest and principal to the debt holders of that securitization. Re-securitization transactions classified as Securitized debt, collateralized by Non-Agency RMBS reflect the transfer to a trust of fixed or adjustable rate RMBS which are classified as Non-Agency RMBS transferred to consolidated VIEs that pay interest and principal to the debt holders of that re-securitization. Re-securitization transactions completed by the Company that did not qualify as sales are accounted for as secured borrowings. The associated securitized debt is carried at amortized cost. The Company estimates the fair value of its securitized debt for disclosure purposes as described in Note 5 to these consolidated financial statements.

(j) Fair Value Disclosure

A complete discussion of the methodology utilized by the Company to estimate the fair value of its financial instruments is included in Note 5 to these consolidated financial statements.

(k) Derivative Financial Instruments

The Company's investment policies permit it to enter into derivative contracts, including interest rate swaps, interest rate caps, options, and futures as a means of managing its interest rate risk as well as to enhance investment returns. The Company's derivatives are recorded as either assets or liabilities in the Consolidated Statements of Financial Condition and measured at fair value. These derivative financial instrument contracts are not designated as hedges for GAAP; therefore, all changes in fair value are recognized in earnings. The Company estimates the fair value of its derivative instruments as described in Note 5 of these consolidated financial statements. Net payments on derivative instruments are included in the Consolidated Statements of Cash Flows as a component of net income (loss). Unrealized gains (losses) on derivatives are removed from net income (loss) to arrive at cash flows from operating activities.

The Company elects to net by counterparty the fair value of its derivative contracts when appropriate. These contracts contain legally enforceable provisions that allow for netting or setting off of all individual swaps receivables and payables with each counterparty and, therefore, the fair value of those swap contracts are reported net by counterparty. The credit support annex provisions of the Company's interest rate swap contracts allow the parties to mitigate their credit risk by requiring the party which is in a net payable position to post collateral. As the Company elects to net by counterparty the fair value of interest rate swap contracts, it also nets by counterparty any cash collateral exchanged as part of the interest rate swap contracts.

(l) Sales, Securitizations, and Re-Securitizations

The Company periodically enters into transactions in which it sells financial assets, such as RMBS, and mortgage loans. Gains and losses on sales of assets are calculated using the average cost method whereby the Company records a gain or loss on the difference between the average amortized cost of the asset and the proceeds from the sale. In addition, the Company from time to time securitizes or re-securitizes assets and sells tranches in the newly securitized assets. These transactions may be recorded as either sales and the assets contributed to the securitization are removed from the Consolidated Statements of Financial Condition and a gain or loss is recognized, or as secured borrowings whereby the assets contributed to the securitization are not derecognized but rather the debt issued by the securitization entity are recorded to reflect the term financing of the assets. In these securitizations and re-securitizations, the Company may retain senior or subordinated interests in the securitized and/or re-securitized assets.

(m) Income Taxes

The Company has elected to be taxed as a REIT and intends to comply with the provision of the Code, with respect thereto. Accordingly, the Company will not be subject to federal, state or local income tax to the extent that qualifying distributions are made to stockholders and as long as certain asset, income, distribution and stock ownership tests are met. If the Company failed to qualify as a REIT and did not qualify for certain statutory relief provisions, the Company would be subject to federal, state and local income taxes and may be precluded from qualifying as a REIT for the subsequent four taxable years following the year in which the REIT qualification was lost. The Company, CIM Trading and CIM Funding TRS made joint elections to treat CIM Trading and CIM Funding TRS as TRS's. As such, CIM Trading and CIM Funding TRS are taxable as domestic C corporations and subject to federal, state, and local income taxes based upon their respective taxable income.

A tax position is recognized only when, based on management's judgment regarding the application of income tax laws, it is more likely than not that the tax position will be sustained upon examination. The Company does not have any unrecognized tax benefits that would affect its financial position or require disclosure. No accruals for penalties and interest were necessary as of March 31, 2014 or 2013.

(n) Net Income per Share

The Company calculates basic net income per share by dividing net income for the period by the basic weighted-average shares of its common stock outstanding for that period. Diluted net income per share takes into account the effect of dilutive instruments such as unvested restricted stock.

(o) Stock-Based Compensation

The Company accounts for stock-based compensation awards granted to the employees of FIDAC and FIDAC's affiliates at the fair value of the stock-based compensation provided. The Company measures the fair value of the equity instrument using the stock prices and other measurement assumptions as of the earlier of either the date at

which a performance commitment by the recipient is reached or the date at which the recipient's performance is complete. Stock compensation expense related to the grants of stock is recognized over the vesting period of such grants based on the fair value of the stock on each quarterly vesting date, at which the recipient's performance is complete.

Compensation expense for equity based awards granted to the Company's independent directors is recognized pro-rata over the vesting period of such awards, based upon the fair value of such awards at the grant date.

(p) Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although the Company's estimates contemplate current conditions and how it expects them to change in the future, it is reasonably possible that actual conditions could be materially different than anticipated in those estimates, which could have a material adverse impact on the Company's results of operations and its financial condition. Management has made significant estimates in accounting for income recognition and OTTI on Agency and Non-Agency RMBS and IO RMBS (Note 3), valuation of Agency and Non-Agency RMBS (Notes 3 and 5), and derivative instruments (Notes 5 and 9). Actual results could differ materially from those estimates.

(q) Recent Accounting Pronouncements

Broad Transactions

Receivables—Troubled Debt Restructurings by Creditors (Subtopic 310-40)

In January 2014, the FASB issued ASU No. 2014-04, Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans Upon Foreclosure. This update clarifies when the Company is considered to have obtained physical possession, from an in-substance possession or foreclosure, of a residential real estate property collateralizing a mortgage loan. Current guidance indicates that the Company should reclassify a collateralized mortgage loan such that the loan should be derecognized and the collateral asset recognized when it determines that there has been an in-substance repossession or foreclosure by the Company. This update defines the term in substance repossession or foreclosure to reduce diversity in interpretation of when such an event occurs. The guidance in this update is effective for the Company beginning January 1, 2015. The Company is evaluating the impact of this update.

Transfers and Servicing (Subtopic 860)

In June 2014, the FASB issued ASU No. 2014-11, Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures. This update makes limited amendments to the guidance in ASC 860 on accounting for certain repurchase agreements. The ASU requires entities to account for repurchase-to-maturity transactions as secured borrowings, rather than as sales with forward repurchase agreements. The ASU defines a repurchase-to-maturity transaction as a repo that (1) settles at the maturity of the transferred financial asset and (2) does not require the transferor to reacquire the transferred financial asset. In addition, the ASU eliminates accounting guidance on linked repurchase financing transactions. The ASU also expands disclosure requirements related to certain transfers of financial assets that are accounted for as sales and certain transfers accounted for as secured borrowings. The guidance in this update will be effective for the Company beginning January 1, 2015. As of March 31, 2014, the Company does not have any repurchase-to-maturity transactions or any linked repurchase financing transactions, therefore, the Company expects that this standard will impact disclosures only and will not have a significant impact on the consolidated financial statements of the Company.

3. Residential Mortgage-Backed Securities

The Company classifies its Non-Agency RMBS as senior, senior IO, subordinated, subordinated IO, and Non-Agency RMBS transferred to consolidated VIEs. The Company also invests in Agency RMBS. Senior interests in

Non-Agency RMBS are considered to be entitled to the first principal repayments in their pro-rata ownership interests at the reporting date. The total fair value of the Non-Agency RMBS that are held by consolidated re-securitization trusts was \$2.9 billion and \$3.0 billion at March 31, 2014 and December 31, 2013, respectively. See Note 8 of these consolidated financial statements for further discussion of consolidated VIEs.

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The following tables present the principal or notional value, total premium, total discount, amortized cost, fair value, gross unrealized gains, gross unrealized losses, and net unrealized gain (loss) related to the Company's available-for-sale RMBS portfolio as of March 31, 2014 and December 31, 2013, by asset class.

| March 31, 2014 | | | | | | | | |
|--|-----------------------------------|------------------|-------------------|-------------------|-------------|------------------------------|-------------------------------|----------------------------------|
| (dollars in thousands) | | | | | | | | |
| | Principal or Notional Value | Total Premium | Total Discount | Amortized Cost | Fair Value | Gross Unrealized Gains | Gross Unrealized Losses | Net Unrealized Gain/(Loss) |
| Non-Agency RMBS | | | | | | | | |
| Senior | \$265,883 | \$- | \$(85,764) | \$180,119 | \$187,095 | \$6,976 | \$- | \$6,976 |
| Senior interest-only | 6,571,076 | 299,486 | - | 299,486 | 258,803 | 16,380 | (57,063) | (40,683) |
| Subordinated | 815,296 | - | (475,929) | 339,367 | 474,786 | 136,072 | (653) | 135,419 |
| Subordinated interest-only | 269,946 | 13,899 | - | 13,899 | 16,018 | 2,517 | (398) | 2,119 |
| RMBS transferred to consolidated variable interest entities ("VIEs") | | | | | | | | |
| | 3,805,867 | 7,830 | (1,700,029) | 2,034,782 | 2,935,051 | 900,269 | - | 900,269 |
| Agency RMBS | | | | | | | | |
| Pass-through | 1,793,785 | 91,882 | - | 1,885,667 | 1,868,413 | 21,269 | (38,523) | (17,254) |
| Interest-only | 226,023 | 42,426 | - | 42,426 | 42,936 | 1,358 | (848) | 510 |
| Total | \$13,747,876 | \$455,523 | \$(2,261,722) | \$4,795,746 | \$5,783,102 | \$1,084,841 | \$(97,485) | \$987,356 |

| December 31, 2013 | | | | | | | | |
|---|-----------------------------------|------------------|-------------------|-------------------|------------|------------------------------|-------------------------------|----------------------------------|
| (dollars in thousands) | | | | | | | | |
| | Principal or Notional Value | Total Premium | Total Discount | Amortized Cost | Fair Value | Gross Unrealized Gains | Gross Unrealized Losses | Net Unrealized Gain/(Loss) |
| Non-Agency RMBS | | | | | | | | |
| Senior | \$128,217 | \$- | \$(39,395) | \$88,822 | \$89,687 | \$974 | \$(109) | \$865 |
| Senior interest-only | 5,742,781 | 283,271 | - | 283,271 | 229,065 | 11,802 | (66,008) | (54,206) |
| Subordinated | 830,632 | - | (490,400) | 340,232 | 457,569 | 119,233 | (1,896) | 117,337 |
| Subordinated interest-only | 274,462 | 14,666 | - | 14,666 | 16,571 | 2,483 | (578) | 1,905 |
| RMBS transferred to consolidated variable interest entities | | | | | | | | |
| | 3,912,376 | 7,490 | (1,763,401) | 2,075,628 | 2,981,571 | 905,943 | - | 905,943 |

| ("VIEs") | | | | | | | | |
|---------------|--------------|-----------|---------------|-------------|-------------|-------------|-------------|-----------|
| Agency | | | | | | | | |
| RMBS | | | | | | | | |
| Pass-through | 1,898,131 | 90,843 | (5,004) | 1,983,970 | 1,954,796 | 23,320 | (51,494) | (29,174) |
| Interest-only | 247,344 | 43,766 | - | 43,766 | 42,782 | 332 | (1,316) | (984) |
| Total | \$13,033,943 | \$440,036 | \$(2,298,200) | \$4,830,355 | \$5,772,041 | \$1,063,087 | \$(121,401) | \$941,686 |

The table below presents changes in Accretable Yield, or the excess of the security's cash flows expected to be collected over the Company's investment, solely as it pertains to the Company's Non-Agency RMBS portfolio accounted for according to the provisions of ASC 310-30.

| | For the Quarter Ended | |
|--|-----------------------|----------------|
| | March 31, 2014 | March 31, 2013 |
| (dollars in thousands) | | |
| Balance at beginning of period | \$ 1,794,577 | \$ 2,107,387 |
| Purchases | 24,289 | - |
| Accretion | (77,285) | (85,935) |
| Reclassification (to) from non-accretable difference | (13,980) | (6,632) |
| Sales | (1,126) | (31) |
| Balance at end of period | \$ 1,726,475 | \$ 2,014,789 |

The table below presents the outstanding principal balance and related amortized cost at March 31, 2014 and December 31, 2013 as it pertains to the Company's Non-Agency RMBS portfolio accounted for according to the provisions of ASC 310-30.

| | For the Quarter Ended | For the Year Ended |
|--------------------------------|-----------------------|--------------------|
| | March 31, 2014 | December 31, 2013 |
| (dollars in thousands) | | |
| Outstanding principal balance: | | |
| Beginning of period | \$ 3,949,664 | \$ 4,508,475 |
| End of period | \$ 3,936,908 | \$ 3,949,664 |
| Amortized cost: | | |
| Beginning of period | \$ 2,027,738 | \$ 2,268,751 |
| End of period | \$ 2,043,076 | \$ 2,027,738 |

The following tables present the gross unrealized losses and estimated fair value of the Company's RMBS by length of time that such securities have been in a continuous unrealized loss position at March 31, 2014 and December 31, 2013. All securities in an unrealized loss position have been evaluated by the Company for OTTI as discussed in Note 2(d).

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March 31, 2014
(dollars in thousands)

| | Unrealized Loss Position for Less than 12 Months | | | Unrealized Loss Position for 12 Months or More | | | Total | | |
|---------------------------------------|---|----------------------|----------------------------|---|----------------------|----------------------------|-------------------------|----------------------|----------------------------|
| | Estimated Fair Value | Unrealized Losses | Number of Securities | Estimated Fair Value | Unrealized Losses | Number of Securities | Estimated Fair Value | Unrealized Losses | Number of Securities |
| Non-Agency RMBS | | | | | | | | | |
| Senior | \$ - | \$ - | - | \$ - | \$ - | - | \$ - | \$ - | - |
| Senior interest-only | 128,963 | (29,579) | 54 | 44,391 | (27,484) | 28 | 173,354 | (57,063) | 82 |
| Subordinated | - | - | - | 11,486 | (653) | 2 | 11,486 | (653) | 2 |
| Subordinated interest-only | 1,448 | (398) | 3 | - | - | - | 1,448 | (398) | 3 |
| RMBS transferred to consolidated VIEs | - | - | - | - | - | - | - | - | - |
| Agency RMBS | | | | | | | | | |
| Pass-through | 913,213 | (38,523) | 22 | - | - | - | 913,213 | (38,523) | 22 |
| Interest-only | 12,002 | (601) | 2 | 367 | (247) | 1 | 12,369 | (848) | 3 |
| Total | \$ 1,055,626 | \$ (69,101) | 81 | \$ 56,244 | \$ (28,384) | 31 | \$ 1,111,870 | \$ (97,485) | 112 |

December 31, 2013
(dollars in thousands)

| | Unrealized Loss Position for Less than 12 Months | | | Unrealized Loss Position for 12 Months or More | | | Total | | |
|----------------------------|---|----------------------|----------------------------|---|----------------------|----------------------------|-------------------------|----------------------|----------------------------|
| | Estimated Fair Value | Unrealized Losses | Number of Securities | Estimated Fair Value | Unrealized Losses | Number of Securities | Estimated Fair Value | Unrealized Losses | Number of Securities |
| Non-Agency RMBS | | | | | | | | | |
| Senior | \$ 28,163 | \$ (109) | 3 | \$ - | \$ - | - | \$ 28,163 | \$ (109) | 3 |
| Senior interest-only | 119,913 | (35,252) | 54 | 45,167 | (30,756) | 28 | 165,080 | (66,008) | 82 |
| Subordinated | - | - | - | 17,661 | (1,896) | 2 | 17,661 | (1,896) | 2 |
| Subordinated interest-only | 1,062 | (578) | 2 | - | - | - | 1,062 | (578) | 2 |
| RMBS transferred to | - | - | - | - | - | - | - | - | - |

| consolidated\ | | | | | | | | | |
|---------------|--------------|-------------|----|-----------|-------------|----|--------------|--------------|-----|
| VIEs | | | | | | | | | |
| Agency RMBS | | | | | | | | | |
| Pass-through | 1,126,881 | (51,494) | 30 | - | - | - | 1,126,881 | (51,494) | 30 |
| Interest-only | 22,246 | (1,018) | 4 | 491 | (298) | 3 | 22,737 | (1,316) | 7 |
| Total | \$ 1,298,265 | \$ (88,451) | 93 | \$ 63,319 | \$ (32,950) | 33 | \$ 1,361,584 | \$ (121,401) | 126 |

At March 31, 2014, the Company did not intend to sell any of its RMBS that were in an unrealized loss position, and it was not more likely than not that the Company would be required to sell these RMBS before recovery of their amortized cost basis, which may be at their maturity. With respect to RMBS held by consolidated VIEs, the ability of any entity to cause the sale by the VIE prior to the maturity of these RMBS is either expressly prohibited, not probable, or is limited to specified events of default, none of which have occurred as of March 31, 2014.

Gross unrealized losses on the Company's Agency RMBS were \$39 million and \$53 million at March 31, 2014 and December 31, 2013, respectively. Given the credit quality inherent in Agency RMBS, the Company does not consider any of the current impairments on its Agency RMBS to be credit related. In evaluating whether it is more likely than not that it will be required to sell any impaired security before its anticipated recovery, which may be at their maturity, the Company considers the significance of each investment, the amount of impairment, the projected future performance of such impaired securities, as well as the Company's current and anticipated leverage capacity and liquidity position. Based on these analyses, the Company determined that at March 31, 2014 and December 31, 2013, unrealized losses on its Agency RMBS were temporary.

Gross unrealized losses on the Company's Non-Agency RMBS (excluding IO Agency and Non-Agency RMBS strips which are accounted for under the fair value option with changes in fair value recorded in earnings) were \$1 million and \$2 million at March 31, 2014 and December 31, 2013, respectively. Based upon the most recent evaluation, the Company does not consider these unrealized losses to be indicative of OTTI and does not believe that these unrealized losses are credit related, but rather are due to other factors. The Company has reviewed its Non-Agency RMBS that are in an unrealized loss position to identify those securities with losses that are other-than-temporary based on an assessment of changes in cash flows expected to be collected for such RMBS, which considers recent bond performance and expected future performance of the underlying collateral.

A summary of the OTTI included in earnings for the three months ended March 31, 2014 and 2013 is presented below.

| | March 31, 2014 | March 31, 2013 |
|---|-------------------|-------------------|
| (dollars in thousands) | | |
| Total other-than-temporary impairment losses | \$ (400) | \$ - |
| Portion of loss recognized in other comprehensive income (loss) | (1,134) | (6,163) |
| Net other-than-temporary credit impairment losses | \$ (1,534) | \$ (6,163) |

The following table presents a roll forward of the credit loss component of OTTI on the Company's Non-Agency RMBS for which a portion of loss was previously recognized in OCI. The table delineates between those securities that are recognizing OTTI for the first time as opposed to those that have previously recognized OTTI.

| | For the Quarter Ended | |
|---|------------------------|-------------------|
| | March 31, 2014 | March 31, 2013 |
| | (dollars in thousands) | |
| Cumulative credit loss beginning balance | \$ 524,432 | \$ 510,089 |
| Additions: | | |
| Other-than-temporary impairments not previously recognized | 1,534 | 712 |
| Reductions for securities sold during the period | (1,670) | (359) |
| Increases related to other-than-temporary impairments on securities with previously recognized other-than-temporary impairments | - | 5,451 |
| Reductions for increases in cash flows expected to be collected that are recognized over the remaining life of the security | (2,813) | (1,947) |
| Cumulative credit loss ending balance | \$ 521,483 | \$ 513,946 |

Cash flows generated to determine net other-than-temporary credit impairment losses recognized in earnings are estimated using significant unobservable inputs. The significant inputs used to measure the component of OTTI recognized in earnings for the Company's Non-Agency RMBS are summarized as follows:

| | For the Quarter Ended | |
|----------------------|-----------------------|-------------------|
| | March 31, 2014 | March 31, 2013 |
| Loss Severity | | |
| Weighted Average | 72% | 45% |
| Range | 43% - 80% | 41% - 69% |
| 60+ days delinquent | | |
| Weighted Average | 36% | 16% |
| Range | 17% - 47% | 0% - 34% |
| Credit Enhancement | | |
| (1) Weighted Average | 8% | 10% |
| Range | 0% - 14% | 0% - 48% |

| 3 Month CPR | | |
|------------------|-----------|----------|
| Weighted Average | 11% | 18% |
| Range | 10% - 11% | 0% - 25% |
| 12 Month CPR | | |
| Weighted Average | 12% | 20% |
| Range | 11% - 19% | 9% - 35% |

(1) Calculated as the combined credit enhancement to the Re-REMIC and underlying from each of their respective capital structures.

The following tables present a summary of unrealized gains and losses at March 31, 2014 and December 31, 2013. IO RMBS included in the tables below represent the right to receive a specified proportion of the contractual interest cash flows of the underlying principal balance of specific securities. At March 31, 2014, IO RMBS had a net unrealized loss of \$34 million and had an amortized cost of \$364 million. At December 31, 2013, IO RMBS had a net unrealized loss of \$49 million and had an amortized cost of \$349 million. The fair value of IOs at March 31, 2014 and December 31, 2013 was \$330 million, and \$300 million, respectively. All changes in fair value of IOs are reflected in Net income (loss).

March 31, 2014
(dollars in thousands)

| | Gross Unrealized Gain Included in Accumulated Other Comprehensive Income | Gross Unrealized Gain Included in Accumulated Deficit | Total Gross Unrealized Gain | Gross Unrealized Loss Included in Accumulated Other Comprehensive Income | Gross Unrealized Loss Included in Accumulated Deficit | Total Gross Unrealized Loss |
|--|---|--|-----------------------------------|---|--|-----------------------------------|
| Non-Agency RMBS | | | | | | |
| Senior | \$ 6,976 | \$ - | \$ 6,976 | \$ - | \$ - | \$ - |
| Senior interest-only | - | 16,380 | 16,380 | 1 | (57,064) | (57,063) |
| Subordinated | 136,072 | - | 136,072 | (653) | - | (653) |
| Subordinated interest-only | - | 2,517 | 2,517 | - | (398) | (398) |
| RMBS transferred to consolidated VIEs | 896,321 | 3,948 | 900,269 | - | - | - |
| Agency RMBS | | | | | | |
| Pass-through | 21,269 | - | 21,269 | (38,523) | - | (38,523) |
| Interest-only | - | 1,358 | 1,358 | - | (848) | (848) |
| Total | \$ 1,060,638 | \$ 24,203 | \$ 1,084,841 | \$ (39,175) | \$ (58,310) | \$ (97,485) |

December 31, 2013
(dollars in thousands)

| | Gross Unrealized Gain Included in Accumulated Other Comprehensive Income | Gross Unrealized Gain Included in Accumulated Deficit | Total Gross Unrealized Gain | Gross Unrealized Loss Included in Accumulated Other Comprehensive Income | Gross Unrealized Loss Included in Accumulated Deficit | Total Gross Unrealized Loss |
|--|---|--|-----------------------------------|---|--|-----------------------------------|
| Non-Agency RMBS | | | | | | |
| Senior | \$ 974 | \$ - | \$ 974 | \$ (109) | \$ - | \$ (109) |
| Senior interest-only | - | 11,802 | 11,802 | - | (66,008) | (66,008) |
| Subordinated | 119,233 | - | 119,233 | (1,896) | - | (1,896) |
| Subordinated interest-only | - | 2,483 | 2,483 | - | (578) | (578) |
| RMBS transferred to consolidated | 901,773 | 4,170 | 905,943 | - | - | - |

| VIEs | | | | | | | |
|---------------|--------------|-----------|--------------|--------------|--------------|--------------|--|
| Agency RMBS | | | | | | | |
| Pass-through | 22,320 | - | 22,320 | (51,494) | - | (51,494) | |
| Interest-only | 2 | 330 | 332 | - | (1,316) | (1,316) | |
| Total | \$ 1,044,302 | \$ 18,785 | \$ 1,063,087 | \$ (53,499) | \$ (67,902) | \$ (121,401) | |

Changes in prepayments, actual cash flows, and cash flows expected to be collected, among other items, are affected by the collateral characteristics of each asset class. The portfolio is most heavily weighted to contain Non-Agency RMBS with credit risk. The Company chooses assets for the portfolio after carefully evaluating each investment's risk profile.

The following tables provide a summary of the Company's RMBS portfolio at March 31, 2014 and December 31, 2013.

| | March 31, 2014 | | | | | |
|---|--|---------------------------------------|-----------------------------|-------------------------|--|--|
| | Principal or Notional Value at Period-End (dollars in thousands) | Weighted Average Amortized Cost Basis | Weighted Average Fair Value | Weighted Average Coupon | Weighted Average Yield at Period-End (1) | |
| Non-Agency Mortgage-Backed Securities | | | | | | |
| Senior | \$ 265,883 | \$ 67.74 | \$ 70.37 | 1.3 % | 5.6 % | |
| Senior, interest only | \$ 6,571,076 | \$ 4.56 | \$ 3.94 | 1.3 % | 13.6 % | |
| Subordinated | \$ 815,296 | \$ 41.62 | \$ 58.23 | 3.0 % | 12.5 % | |
| Subordinated, interest only | \$ 269,946 | \$ 5.15 | \$ 5.93 | 1.7 % | 8.8 % | |
| RMBS transferred to consolidated variable interest entities | \$ 3,805,867 | \$ 54.60 | \$ 78.75 | 4.6 % | 16.2 % | |
| Agency Mortgage-Backed Securities | | | | | | |
| Pass-through | \$ 1,793,785 | \$ 105.12 | \$ 106.55 | 3.6 % | 3.2 % | |
| Interest-only | \$ 226,023 | \$ 18.77 | \$ 19.00 | 3.3 % | 6.7 % | |

(1) Bond Equivalent Yield at period end.

| | December 31, 2013 | | | | |
|--|---|---------------------------------------|-----------------------------|-------------------------|--|
| | Principal or Notional Value at Period-End (dollars in | Weighted Average Amortized Cost Basis | Weighted Average Fair Value | Weighted Average Coupon | Weighted Average Yield at Period-End (1) |

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thousands)

| | | | | | | |
|--|--------------|-----------|-----------|-------|--------|--|
| Non-Agency Mortgage-Backed Securities | | | | | | |
| Senior | \$ 128,217 | \$ 69.27 | \$ 69.95 | 1.4 % | 5.9 % | |
| Senior, interest only | \$ 5,742,781 | \$ 4.93 | \$ 3.99 | 1.4 % | 17.2 % | |
| Subordinated | \$ 830,632 | \$ 40.96 | \$ 55.09 | 2.9 % | 13.5 % | |
| Subordinated, interest only | \$ 274,462 | \$ 5.34 | \$ 6.04 | 1.7 % | 9.0 % | |
| RMBS transferred to consolidated variable interest entities | | | | | | |
| | \$ 3,912,376 | \$ 54.17 | \$ 77.82 | 4.7 % | 15.8 % | |
| Agency Mortgage-Backed Securities | | | | | | |
| Pass-through | \$ 1,898,131 | \$ 104.52 | \$ 105.24 | 3.6 % | 3.3 % | |
| Interest-only | \$ 247,344 | \$ 17.69 | \$ 17.30 | 3.2 % | 5.3 % | |

(1) Bond Equivalent
Yield at period end.

The following table presents the weighted average credit rating, based on the lowest rating available, of the Company's Non-Agency RMBS portfolio at March 31, 2014 and December 31, 2013.

| | March 31, 2014 | December 31, 2013 | |
|----------------------|----------------|----------------------|---|
| AAA | 0.85 | %0.00 | % |
| AA | 0.47 | %0.71 | % |
| A | 0.00 | %0.01 | % |
| BBB | 0.38 | %0.00 | % |
| BB | 1.69 | %1.38 | % |
| B | 3.61 | %4.26 | % |
| Below B or not rated | 93.00 | %93.64 | % |
| Total | 100.00 | %100.00 | % |

Actual maturities of RMBS are generally shorter than the stated contractual maturities. Actual maturities of the Company's RMBS are affected by the contractual lives of the underlying mortgages, periodic payments of principal and prepayments of principal. The following tables provide a summary of the fair value and amortized cost of the Company's RMBS at March 31, 2014 and December 31, 2013 according to their estimated weighted-average life classifications. The weighted-average lives of the RMBS in the tables below are based on lifetime expected prepayment rates using an industry prepayment model for the Agency RMBS portfolio and the Company's prepayment assumptions for the Non-Agency RMBS. The prepayment model considers current yield, forward yield, steepness of the interest rate curve, current mortgage rates, mortgage rates of the outstanding loan, loan age, margin, and volatility.

March 31, 2014
(dollars in thousands)

| | Weighted Average Life | | | | Total |
|---------------------------------------|-----------------------|--|---|------------------------|-------------|
| | Less than one year | Greater than one year and less than five years | Greater than five years and less than ten years | Greater than ten years | |
| Fair value | | | | | |
| Non-Agency RMBS | | | | | |
| Senior | \$4,676 | \$19,453 | \$102,086 | \$60,880 | \$187,095 |
| Senior interest-only | 728 | 97,688 | 119,845 | 40,542 | 258,803 |
| Subordinated | 3,206 | 33,281 | 299,568 | 138,731 | 474,786 |
| Subordinated interest-only | - | - | 9,531 | 6,487 | 16,018 |
| RMBS transferred to consolidated VIEs | - | 307,248 | 1,838,344 | 789,459 | 2,935,051 |
| Agency RMBS | | | | | |
| Pass-through | - | - | 1,868,413 | - | 1,868,413 |
| Interest-only | - | 569 | 16,044 | 26,323 | 42,936 |
| Total fair value | \$8,610 | \$458,239 | \$4,253,831 | \$1,062,422 | \$5,783,102 |
| Amortized cost | | | | | |
| Non-Agency RMBS | | | | | |
| Senior | \$4,510 | \$18,171 | \$98,498 | \$58,940 | \$180,119 |
| Senior interest-only | 1,221 | 114,807 | 136,528 | 46,930 | 299,486 |
| Subordinated | 2,695 | 25,916 | 220,152 | 90,604 | 339,367 |
| Subordinated interest-only | - | - | 9,358 | 4,541 | 13,899 |
| RMBS transferred to consolidated VIEs | - | 233,613 | 1,246,598 | 554,571 | 2,034,782 |
| Agency RMBS | | | | | |
| Pass-through | - | - | 1,885,667 | - | 1,885,667 |
| Interest-only | - | 763 | 16,338 | 25,325 | 42,426 |
| Total amortized cost | \$8,426 | \$393,270 | \$3,613,139 | \$780,911 | \$4,795,746 |

December 31, 2013
(dollars in thousands)

| | Weighted Average Life | | | | Total |
|----------------------|-----------------------|--|---|------------------------|----------|
| | Less than one year | Greater than one year and less than five years | Greater than five years and less than ten years | Greater than ten years | |
| Fair value | | | | | |
| Non-Agency RMBS | | | | | |
| Senior | \$- | \$29,283 | \$60,404 | \$- | \$89,687 |
| Senior interest-only | 376 | 103,688 | 96,968 | 28,033 | 229,065 |

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| | | | | | |
|---------------------------------------|---------|-----------|-------------|-----------|-------------|
| Subordinated | 3,359 | 63,177 | 321,333 | 69,700 | 457,569 |
| Subordinated interest-only | - | - | 14,862 | 1,709 | 16,571 |
| RMBS transferred to consolidated VIEs | 5,724 | 276,752 | 1,986,879 | 712,216 | 2,981,571 |
| Agency RMBS | | | | | |
| Pass-through | - | 20,375 | 1,808,346 | 126,075 | 1,954,796 |
| Interest-only | 54 | 636 | 42,092 | - | 42,782 |
| Total fair value | \$9,513 | \$493,911 | \$4,330,884 | \$937,733 | \$5,772,041 |
| Amortized cost | | | | | |
| Non-Agency RMBS | | | | | |
| Senior | \$- | \$28,900 | \$59,922 | \$- | \$88,822 |
| Senior interest-only | 1,017 | 131,159 | 117,008 | 34,087 | 283,271 |
| Subordinated | 2,877 | 50,483 | 243,350 | 43,522 | 340,232 |
| Subordinated interest-only | - | - | 13,344 | 1,322 | 14,666 |
| RMBS transferred to consolidated VIEs | 4,744 | 211,925 | 1,356,981 | 501,978 | 2,075,628 |
| Agency RMBS | | | | | |
| Pass-through | - | 18,608 | 1,837,611 | 127,751 | 1,983,970 |
| Interest-only | 122 | 825 | 42,819 | - | 43,766 |
| Total amortized cost | \$8,760 | \$441,900 | \$3,671,035 | \$708,660 | \$4,830,355 |

The Non-Agency RMBS portfolio is subject to credit risk. The Company seeks to mitigate credit risk through its asset selection process. The Non-Agency RMBS portfolio is primarily collateralized by what the Company classifies as Alt-A first lien mortgages. The Company categorizes collateral as Alt-A regardless of whether the loans were originally described as “prime” if the behavior of the collateral when the Company purchased the security more typically resembles Alt-A. The Company defines Alt-A collateral characteristics to be evidenced by the 60+ day delinquency bucket of the pool being greater than 5% and the current weighted average FICO scores between 585 and 700. At March 31, 2014 and December 31, 2013, 97% of the Non-Agency RMBS collateral was Alt-A, respectively.

The Non-Agency RMBS in the Portfolio have the following collateral characteristics at March 31, 2014 and December 31, 2013.

| | March 31, 2014 | | | December 31, 2013 | | |
|--|----------------|-------|---|-------------------|-------|---|
| Weighted average maturity (years) | | 23.8 | | | 24.1 | |
| Weighted average amortized loan to value (1) | | 69.1 | % | | 69.4 | % |
| Weighted average FICO (2) | | 709 | | | 710 | |
| Weighted average loan balance (in thousands) | \$ | 367.0 | | \$ | 385.0 | |
| Weighted average percentage owner occupied | | 83.8 | % | | 84.0 | % |
| Weighted average percentage single family residence | | 65.3 | % | | 65.4 | % |
| Weighted average current credit enhancement | | 1.6 | % | | 1.6 | % |
| Weighted average geographic concentration of top five states | | | | | | |
| | CA | 33.4 | % | CA | 33.4 | % |
| | FL | 8.8 | % | FL | 9.1 | % |
| | NY | 7.8 | % | NY | 7.1 | % |
| | NJ | 3.0 | % | NJ | 3.0 | % |
| | MD | 2.5 | % | MD | 2.7 | % |

(1) Value represents appraised value of the collateral at the time of loan origination.

(2) FICO as determined at the time of loan origination.

The table below presents the origination year of the underlying loans related to the Company's portfolio of Non-Agency RMBS at March 31, 2014 and December 31, 2013.

| Origination Year | March 31, 2014 | | | December 31, 2013 | | |
|------------------|----------------|---|--|-------------------|---|--|
| 1999 | 0.6 | % | | 0.0 | % | |
| 2000 | 0.5 | % | | 0.6 | % | |
| 2001 | 1.1 | % | | 1.2 | % | |
| 2002 | 0.7 | % | | 1.0 | % | |
| 2003 | 1.0 | % | | 1.4 | % | |
| 2004 | 3.6 | % | | 3.6 | % | |
| 2005 | 20.1 | % | | 17.8 | % | |
| 2006 | 32.0 | % | | 32.2 | % | |
| 2007 | 37.6 | % | | 40.1 | % | |
| 2008 | 1.9 | % | | 2.1 | % | |
| 2013 | 0.9 | % | | 0.0 | % | |
| Total | 100.0 | % | | 100.0 | % | |

Gross realized gains and losses are recorded in “Net realized gains (losses) on sales of investments” on the Company’s Consolidated Statements of Operations and Comprehensive Income. The proceeds and gross realized gains and gross realized losses from sales of investments for the three months ended March 31, 2014 and 2013 are as follows:

| | For the Quarter Ended | |
|-----------------------|------------------------|----------------|
| | March 31, 2014 | March 31, 2013 |
| | (dollars in thousands) | |
| Proceeds from sales | \$ 100,256 | \$ 182 |
| Gross realized gains | 8,469 | 9 |
| Gross realized losses | (92) | (3) |
| Net realized gain | \$ 8,377 | \$ 6 |

4. Securitized Loans Held for Investment

The Company is considered to be the primary beneficiary of VIEs formed for the purpose of securitizing whole mortgage loans. Refer to Note 8 for additional details regarding the Company’s involvement with VIEs. The securitized loans held for investment are carried at their principal balance outstanding, plus unamortized premiums, less unaccreted discounts and an allowance for loan losses. The following table provides a summary of the changes in the carrying value of securitized loans held for investment at March 31, 2014 and December 31, 2013:

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| | For the Quarter Ended March 31, 2014 | For the Year Ended December 31, 2013 |
|--|---|---|
| | (dollars in thousands) | |
| Balance, beginning of period | \$ 783,484 | \$ 1,300,131 |
| Purchases | - | - |
| Principal paydowns | (34,002) | (507,683) |
| Net periodic amortization (accretion) | (1,025) | (10,763) |
| Change to loan loss provision | (319) | 1,799 |
| Balance, end of period | \$ 748,138 | \$ 783,484 |

The following table represents the Company's securitized residential mortgage loans classified as held for investment at March 31, 2014 and December 31, 2013:

| | March 31, 2014 | December 31, 2013 |
|--|------------------------|----------------------|
| | (dollars in thousands) | |
| Securitized loans, at amortized cost | \$ 757,155 | \$ 792,547 |
| Less: allowance for loan losses | 9,017 | 9,063 |
| Securitized loans held for investment | \$ 748,138 | \$ 783,484 |

The securitized loan portfolio is collateralized by prime, jumbo, first lien residential mortgages of which 40% were originated during 2012, 38% were originated during 2011, 7% during 2010, and the remaining 15% of the loans were originated prior to 2010. A summary of key characteristics of these loans follows.

| | March 31, 2014 | | | December 31, 2013 | | |
|--|----------------|-------|---|-------------------|-------|---|
| Number of loans | 1,011 | | | 1,053 | | |
| Weighted average maturity (years) | 27.1 | | | 27.3 | | |
| Weighted average loan to value (1) | 71.7 | % | | 71.7 | % | |
| Weighted average FICO (2) | 766 | | | 766 | | |
| Weighted average loan balance (in thousands) | \$ | 733.6 | | \$ | 737.0 | |
| Weighted average percentage owner occupied | 94.9 | % | | 94.7 | % | |
| Weighted average percentage single family residence | 70.2 | % | | 70.0 | % | |
| Weighted average geographic concentration of top five states | CA | 34.6 | % | CA | 34.7 | % |

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| | | | | | |
|----|-----|---|----|-----|---|
| VA | 5.7 | % | VA | 5.6 | % |
| NY | 5.3 | % | NY | 5.5 | % |
| NJ | 5.2 | % | NJ | 5.1 | % |
| TX | 4.7 | % | TX | 4.9 | % |

(1) Value represents appraised value of the collateral at the time of loan origination.

(2) FICO as determined at the time of loan origination.

The following table summarizes the changes in the allowance for loan losses for the securitized mortgage loan portfolio at March 31, 2014 and December 31, 2013:

| | March 31, 2013 | December 31, 2013 |
|------------------------------|-------------------|----------------------|
| (dollars in thousands) | | |
| Balance, beginning of period | \$ 9,063 | \$ 11,624 |
| Provision for loan losses | 319 | (1,799) |
| Charge-offs | (365) | (762) |
| Balance, end of period | \$ 9,017 | \$ 9,063 |

The Company has established an allowance for loan losses related to securitized loans that is composed of a general and specific reserve. The balance in the allowance for loan losses related to the general reserve at March 31, 2014 and December 31, 2013 was \$4 million, respectively. The balance in the allowance for loan losses related to the specific reserve at March 31, 2014 and December 31, 2013 was \$5 million, respectively.

The total unpaid principal balance of impaired loans for which the Company established a specific reserve was \$25 million and \$26 million at March 31, 2014 and December 31, 2013, respectively. The Company's recorded investment in impaired loans for which there is a related allowance for credit losses at March 31, 2014 and December 31, 2013 was \$18 million and \$19 million, respectively. The total unpaid principal balance of non-impaired loans for which the Company established a general reserve was \$716 million and \$750 million at March 31, 2014 and December 31, 2013, respectively. The Company's recorded investment in loans that are not impaired for which there is a related general reserve for credit losses at March 31, 2014 and December 31, 2013 was \$730 million and \$765 million, respectively. Interest income on impaired loans is not significant.

The following table summarizes the outstanding principal balance of loans 30 days delinquent and greater as reported by the servicer at March 31, 2014 and December 31, 2013.

| (dollars in thousands) | 30 Days | 60 Days | 90+ Days | Bankruptcy | Foreclosure | REO | Total |
|------------------------|------------|------------|------------|------------|-------------|----------|-----------|
| | Delinquent | Delinquent | Delinquent | | | | |
| March 31, 2014 | \$ 3,166 | \$ 1,530 | \$ 2,228 | \$ 473 | \$ 4,222 | \$ 1,995 | \$ 13,614 |
| December 31, 2013 | \$ 999 | \$ 570 | \$ 2,087 | \$ 473 | \$ 7,530 | \$ 1,179 | \$ 12,838 |

With the exception of its ability to approve certain loan modifications, the Company is not involved with the servicing or modification of loans held for investment. The trustee and servicer of the respective securitization are responsible for servicing and modifying these loans. The Company is required to make certain assumptions in accounting for loans held for investment due to the limitation of information available to the Company. The following table presents the loans that were modified by the servicer during the quarters ended March 31, 2014 and 2013.

| Quarter Ended | Number of Loans Modified During Period | Unpaid Principal Balance of Modified Loans (Pre-modification) | Unpaid Principal Balance of Modified Loans (Post-modification) | Amortized Cost of Modified Loans | Amortized Cost of Modified Loans For Which There is an Allowance for Loan Losses | Amortized |
|----------------|--|---|--|----------------------------------|--|--|
| | | | | | | Cost of Modified Loans For Which There is No Allowance for Loan Losses |
| March 31, 2014 | 1 | \$ 671 | \$ 760 | \$ 710 | \$ 710 | \$ 0 |
| March 31, 2013 | 3 | \$ 2,349 | \$ 2,358 | \$ 2,248 | \$ 2,248 | \$ 0 |

Loans are modified by the servicer as a method of loss mitigation. Based on the information available, during the quarter ended March 31, 2014, the Company determined that all loans modified by the servicer were considered TDRs, as defined under GAAP. A TDR is generally any modification of a loan to a borrower that is experiencing financial difficulties, where a lender agrees to terms that are more favorable to the borrower than are otherwise available in the current market. All loan modifications during the quarters ended March 31, 2014 and 2013 included a reduction of the stated interest rates. Loans modified by the servicer have been individually assessed for impairment and measurement of impairment is based on the excess of the recorded investment in the loan over the present value of the expected cash flows, post modification, discounted at the loan's effective interest rate at inception. In the absence of additional loan modifications by the servicer in future periods that are considered to be TDRs, the \$5 million specific reserve related to TDRs as of March 31, 2014 will be recognized in net income in future periods by way of a decrease in the provision for loan losses. If there are further modifications, the reduction of the cashflow is reflected in the provision for loan losses.

As of March 31, 2014, there were no loans that were modified in the past twelve months and delinquent on scheduled payments.

5. Fair Value Measurements

The Company follows fair value guidance in accordance with GAAP to account for its financial instruments. The Company categorizes its financial instruments, based on the priority of the inputs to the valuation technique, into a three-level fair value hierarchy. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). If the inputs used to measure the financial instruments fall within different levels of the hierarchy, the categorization is based on the lowest level input that is significant to the fair value measurement of the instrument. Financial assets and liabilities recorded at fair value on the Consolidated Statements of Financial Condition or disclosed in the related notes are categorized based on the inputs to the valuation techniques as follows:

Level 1 – inputs to the valuation methodology are quoted prices (unadjusted) for identical assets and liabilities in active markets.

Level 2 – inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level 3 – inputs to the valuation methodology are unobservable and significant to fair value.

Fair value measurements categorized within Level 3 are sensitive to changes in the assumptions or methodology used to determine fair value and such changes could result in a significant increase or decrease in the fair value. For the Company's investments in Non-Agency RMBS categorized within Level 3 of the fair value hierarchy, the significant unobservable inputs include the discount rates, assumptions relating to prepayments, default rates and loss severities. Significant increases (decreases) in any of the discount rates, default rates or loss severities in isolation would result in a significantly lower (higher) fair value measurement. The impact of changes in prepayment speeds would have differing impacts on fair value, depending on the seniority of the investment. Generally, a change in the default assumption is accompanied by directionally similar changes in the assumptions used for the loss severity and the prepayment speed.

Any changes to the valuation methodology are reviewed by management to ensure the changes are appropriate. As markets and products evolve and the pricing for certain products becomes more transparent, the Company will continue to refine its valuation methodologies. The methodology utilized by the Company for the periods presented is unchanged. The methods used to produce a fair value calculation may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Company believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies, or assumptions, to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date. The Company uses inputs that are current as of the measurement date, which may include periods of market dislocation, during which price transparency may be reduced.

During times of market dislocation, as has been experienced for some time and continues to exist, the observability of prices and inputs can be difficult for certain Non-Agency RMBS. If third party pricing services are unable to provide a price for an asset, or if the price provided by them is deemed unreliable by the Company, then the asset will be valued at its fair value as determined by the Company without validation to third-party pricing. In addition, validating third party pricing for the Company's investments may be more subjective as fewer participants may be willing to provide this service to the Company. Illiquid investments typically experience greater price volatility as an active market does not exist. Observability of prices and inputs can vary significantly from period to period and may cause instruments to change classifications within the three level hierarchy.

A description of the methodologies utilized by the Company to estimate the fair value of its financial instruments by instrument class follows:

Short-term Instruments

The carrying value of cash and cash equivalents, accrued interest receivable, receivable for securities, dividends payable, payable for securities and accrued interest payable are considered to be a reasonable estimate of fair value due to the short term nature of these financial instruments.

Agency and Non-Agency RMBS

Generally, the Company determines the fair value of its investment securities utilizing an internal pricing model that incorporates such factors as coupon, prepayment speeds, weighted average life, collateral composition, borrower characteristics, expected interest rates, life caps, periodic caps, reset dates, collateral seasoning, expected losses, expected default severity, credit enhancement, and other pertinent factors. Management reviews the fair values generated by the model to determine whether prices are reflective of the current market. Management indirectly corroborates its estimates of the fair value using pricing models by comparing its results to independent prices provided by third party pricing services. Certain very liquid asset classes, such as Agency fixed-rate pass-throughs may be priced using independent sources such as quoted prices for To-Be-Announced ("TBA") securities.

The Agency RMBS market is considered to be an active market such that participants transact with sufficient frequency and volume to provide transparent pricing information on an ongoing basis. The liquidity of the Agency RMBS market and the similarity of the Company's securities to those actively traded enable the Company to observe quoted prices in the market and utilize those prices as a basis for formulating fair value measurements. Consequently, the Company has classified Agency RMBS as having Level 2 inputs in the fair value hierarchy.

The Company's fair value estimation process for Non-Agency RMBS utilizes inputs other than quoted prices that are observed in the market. The Company's estimate of prepayment, default and severity curves all involve management judgment and assumptions that are deemed to be significant to the fair value measurement process, which renders the resulting Non-Agency RMBS fair value estimates Level 3 inputs in the fair value hierarchy.

Derivatives

Interest Rate Swaps

The Company utilizes dealer quotes to determine the fair values of its interest rate swaps. The Company compares the dealer quotations received to its own estimate of fair value to evaluate for reasonableness. The dealer quotes incorporate common market pricing methods, including a spread measurement to the Treasury yield curve or interest rate swap curve as well as underlying characteristics of the particular contract. Interest rate swaps are modeled by the Company by incorporating such factors as the term to maturity, Treasury curve, overnight index swap rates, and the payment rates on the fixed portion of the interest rate swaps. The Company has classified the characteristics used to determine the fair value of interest rate swaps as Level 2 inputs in the fair value hierarchy.

Mortgage Options

Mortgage options are valued using an option pricing model which considers the strike price of the option, the price of the underlying security, settle date, a discount rate and the implied volatility. The implied volatility is determined from the daily price of the underlying security as well as prices on similar financial instruments. The Company has classified the characteristics used to determine the fair value of mortgage options as Level 3 inputs in the fair value hierarchy.

Treasury Futures

The fair value of Treasury futures is determined by quoted market prices for similar financial instruments in an active market. The Company has classified the characteristics used to determine the fair value of Treasury futures as Level 1 inputs in the fair value hierarchy.

The Company's financial assets and liabilities carried at fair value on a recurring basis, including the level in the fair value hierarchy, at March 31, 2014 and December 31, 2013 is presented below.

| March 31, 2014 | | | |
|---------------------------------------|-----------------|-----------------------------------|---------------------|
| (dollars in thousands) | Level 1 | Level 2 (dollars in thousands) | Level 3 |
| Assets: | | | |
| Non-Agency RMBS | | | |
| Senior | \$ - | \$ - | \$ 187,095 |
| Senior interest-only | - | - | 258,803 |
| Subordinated | - | - | 474,786 |
| Subordinated interest-only | - | - | 16,018 |
| RMBS transferred to consolidated VIEs | - | - | 2,935,051 |
| Agency RMBS | | | |
| Pass-through | - | 1,868,413 | - |
| Interest-only | - | 42,936 | - |
| Liabilities: | | | |
| Derivatives, net | 3,620 | (26,134) | (668) |
| Total | \$ 3,620 | \$ 1,885,215 | \$ 3,871,085 |
| December 31, 2013 | | | |
| (dollars in thousands) | | | |
| | Level 1 | Level 2 (dollars in thousands) | Level 3 |
| Assets: | | | |
| Non-Agency RMBS | | | |
| Senior | \$ - | \$ - | \$ 89,687 |
| Senior interest-only | - | - | 229,065 |
| Subordinated | - | - | 457,569 |
| Subordinated interest-only | - | - | 16,571 |
| RMBS transferred to consolidated VIEs | - | - | 2,981,571 |
| Agency RMBS | | | |
| Pass-through | - | 1,954,796 | - |
| Interest-only | - | 42,782 | - |
| Liabilities: | | | |
| Derivatives, net | 8,095 | (30,199) | - |
| Total | \$ 8,095 | \$ 1,967,379 | \$ 3,774,463 |

The table below provides a summary of the changes in the fair value of securities classified as Level 3 at March 31, 2014 and December 31, 2013.

Fair Value Reconciliation, Level 3

For the Quarter Ended
March 31, 2014
(dollars in thousands)

| | Non-Agency RMBS | Derivatives | Total |
|---|--------------------|-------------|--------------|
| Beginning balance Level 3 assets | \$ 3,774,463 | \$ - | \$ 3,774,463 |
| Transfers in to Level 3 assets | - | - | - |
| Transfers out of Level 3 assets | - | - | - |
| Purchases | 136,525 | - | 136,525 |
| Principal payments | (81,694) | - | (81,694) |
| Sales and Settlements | (16,234) | (2,324) | (18,558) |
| Accretion of purchase discounts | 25,213 | - | 25,213 |
| Gains (losses) included in net income | | | |
| Other than temporary credit impairment losses | (1,534) | - | (1,534) |
| Realized gains (losses) on sales and settlements | 8,462 | 910 | 9,372 |
| Net unrealized gains (losses) included in income | 13,515 | - | 13,515 |
| Gains (losses) included in other comprehensive income | | | |
| Total unrealized gains (losses) for the period | 13,037 | 746 | 13,783 |
| Ending balance Level 3 assets | \$ 3,871,753 | \$ (668) | \$ 3,871,085 |

Fair Value Reconciliation, Level 3

For the Year Ended
December 31, 2013
(dollars in thousands)

| | Non-Agency RMBS | Derivatives | Total |
|----------------------------------|--------------------|-------------|--------------|
| Beginning balance Level 3 assets | \$ 3,961,208 | - | \$ 3,961,208 |
| Transfers in to Level 3 assets | - | - | - |
| Transfers out of Level 3 assets | - | - | - |

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| | | | |
|---|--------------|-----------|--------------|
| Purchases | 317,299 | - | 317,299 |
| Principal payments | (475,092) | - | (475,092) |
| Sales and Settlements | (181,215) | (10,221) | (191,436) |
| Accretion of purchase discounts | 106,290 | - | 106,290 |
| Gains (losses) included in net income | | | |
| Other than temporary credit impairment losses | (45,167) | - | (45,167) |
| Realized gains (losses) on sales and settlements | 36,645 | 10,221 | 46,866 |
| Realized losses on principal write-downs of Non-Agency RMBS | (18,316) | - | (18,316) |
| Net unrealized gains (losses) included in income | (43,252) | - | (43,252) |
| Gains (losses) included in other comprehensive income | | | |
| Total unrealized gains (losses) for the period | 116,063 | - | 116,063 |
| Ending balance Level 3 assets | \$ 3,774,463 | \$ - | \$ 3,774,463 |

There were no transfers to or from Level 3 for the quarter ended March 31, 2014 and for year ended December 31, 2013.

Sensitivity of Significant Inputs

The significant unobservable inputs used in the fair value measurement of the Company's Non-Agency RMBS are the weighted average discount rates, constant prepayment speed ("CPR"), cumulative default rate, and the loss severity.

Prepayment speeds, as reflected by the CPR, vary according to interest rates, the type of investment, conditions in financial markets, and other factors, none of which can be predicted with any certainty. In general, when interest rates rise, it is relatively less attractive for borrowers to refinance their mortgage loans, and as a result, prepayment speeds tend to decrease. When interest rates fall, prepayment speeds tend to increase. For RMBS investments purchased at a premium, as prepayment speeds increase, the amount of income the Company earns decreases as the purchase premium on the bonds amortizes faster than expected. Conversely, decreases in prepayment speeds result in increased income and can extend the period over which the Company amortizes the purchase premium. For RMBS investments purchased at a discount, as prepayment speeds increase, the amount of income the Company earns increases from the acceleration of the accretion of the discount into interest income. Conversely, decreases in prepayment speeds result in decreased income as the accretion of the purchase discount into interest income occurs over a longer period.

Cumulative default rates represent an annualized rate of default on a group of mortgages. The constant default rate ("CDR") represents the percentage of outstanding principal balances in the pool that are in default, which typically equates to the home being past 60-day and 90-day notices and in the foreclosure process. When default rates increase, expected cash flows on the underlying collateral decreases. When default rates decrease, expected cash flows on the underlying collateral increases.

Loss severity rates reflect the amount of loss expected from a foreclosure and liquidation of the underlying collateral in the mortgage loan pool. When a mortgage loan is foreclosed the collateral is sold and the resulting proceeds are used to settle the outstanding obligation. In many circumstances, the proceeds from the sale do not fully repay the outstanding obligation. In these cases a loss is incurred by the lender. Loss severity is used to predict how costly future losses are likely to be. An increase in loss severity results in a decrease in expected future cashflows. A decrease in loss severity results in an increase in expected future cashflows.

The discount rate refers to the interest rate used in discounted cash flow analysis to determine the present value of future cash flows. The discount rate takes into account not just the time value of money, but also the risk or uncertainty of future cash flows. An increased uncertainty of future cash flows results in a higher discount rate. The discount rate used to calculate the present value of the expected future cash flows is based on the discount rate implicit in the security as of the last measurement date. As discount rates move up, the discounted cash flows are reduced.

A summary of the significant inputs used to estimate the fair value of Non-Agency RMBS as of March 31, 2014 and December 31, 2013 follows:

| | March 31, 2014 Significant Inputs | | | | December 31, 2013 Significant Inputs | | | |
|---------------------------------------|---|--------------|----------|------------------|---|--------------|----------|------------------|
| | Weighted Average Discount Rate | CPR Range | CDR | Loss Severity | Weighted Average Discount Rate | CPR Range | CDR | Loss Severity |
| Non-Agency RMBS | | | | | | | | |
| Senior | 5.5% | 1% - 6% | 0% - 31% | 50% - 85% | 6.4% | 1% - 6% | 0% - 33% | 50% - 85% |
| Senior interest-only | 17.0% | 1% - 25% | 0% - 32% | 50% - 85% | 14.1% | 1% - 28% | 0% - 33% | 50% - 85% |
| Subordinated | 5.1% | 1% - 20% | 0% - 35% | 50% - 85% | 6.1% | 1% - 22% | 0% - 38% | 50% - 85% |
| Subordinated interest-only | 10.6% | 3% - 10% | 0% - 18% | 50% - 69% | 12.7% | 2% - 13% | 0% - 18% | 50% - 73% |
| RMBS transferred to consolidated VIEs | 4.9% | 1% - 19% | 0% - 30% | 50% - 85% | 5.3% | 1% - 20% | 0% - 33% | 50% - 85% |

All of the significant inputs listed have some degree of market observability, based on the Company's knowledge of the market, information available to market participants, and use of common market data sources. Collateral default and loss severity projections are in the form of "curves" that are updated quarterly to reflect the Company's collateral cash flow projections. Methods used to develop these projections conform to industry conventions. The Company uses assumptions it considers its best estimate of future cash flows for each respective security.

The discount rates applied to the expected cash flows to determine fair value are derived from a range of observable prices on securities backed by similar collateral. As the market becomes more or less liquid, the availability of these observable inputs will change.

The prepayment speed specifies the percentage of the collateral balance that is expected to prepay at each point in the future. The prepayment speed is based on factors such as collateral FICO score, loan-to-value ratio, debt-to-income ratio, and vintage on a loan level basis and is scaled up or down to reflect recent collateral-specific prepayment experience as obtained from remittance reports and market data services.

Default vectors are determined from the current “pipeline” of loans that are more than 30 days delinquent, in foreclosure, bankruptcy, or are real estate owned (“REO”). These delinquent loans determine the first 30 months of the default curve. Beyond month 30, the default curve transitions to a value that is reflective of a portion of the current delinquency pipeline.

The curve generated to reflect the Company’s expected loss severity is based on collateral-specific experience with consideration given to other mitigating collateral characteristics. Characteristics such as seasoning are taken into consideration because severities tend to initially increase on newly originated securities, before beginning to decline as the collateral ages and eventually stabilizes. Collateral characteristics such as loan size, loan-to-value, and geographic location of collateral also effect loss severity.

Securitized Loans Held for Investment

The Company carries securitized loans held for investment at principal value, plus unamortized premiums, less unaccreted discounts and an allowance for loan losses. The Company estimates the fair value of its securitized loans held for investment by considering the loan characteristics, including the credit characteristics of the borrower, purpose of the loan, use of the collateral securing the loan, and management’s expectations of general economic conditions in the sector and greater economy.

Repurchase Agreements

Repurchase agreements are collateralized financing transactions utilized by the Company to acquire investment securities. Due to the short term nature of these financial instruments, the Company estimates the fair value of these repurchase agreements using the contractual obligation plus accrued interest payable at maturity.

Securitized Debt, Non-Agency RMBS Transferred to Consolidated VIEs and Securitized Debt, Loans Held for Investment

The Company records securitized debt for certificates or notes financed without recourse to the Company in securitization or re-securitization transactions treated as secured borrowings. The Company carries securitized debt at the principal balance outstanding plus unamortized premiums, less unaccreted discounts recorded in connection with the financing of the loans or RMBS with third parties. The premiums or discounts associated with the financing of the notes or certificates are amortized over the contractual life of the instrument using the interest method. The Company estimates the fair value of securitized debt by estimating the future cash flows associated with the underlying assets collateralizing the secured debt outstanding. The Company models the fair value of each underlying asset by considering, among other items, the structure of the underlying security, coupon, servicer, actual and expected defaults, actual and expected default severities, reset indices, and prepayment speeds in conjunction with market research for similar collateral performance and management's expectations of general economic conditions in the sector and other economic factors.

The following table presents the carrying value and fair value, as described above, of the Company's financial instruments not carried at fair value on a recurring basis at March 31, 2014 and December 31, 2013.

March 31, 2014
(dollars in thousands)

| | Level in Fair Value Hierarchy | Carrying Amount | Fair Value |
|---|-------------------------------------|--------------------|--------------|
| Securitized loans held for investment | 3 | 748,138 | 734,909 |
| Repurchase agreements | 2 | (1,561,920) | (1,564,128) |
| Securitized debt, collateralized by Non-Agency RMBS | 3 | (828,663) | (843,133) |
| Securitized debt, collateralized by loans held for investment | 3 | (637,190) | (619,940) |

December 31, 2013
(dollars in thousands)

| | Level in Fair Value Hierarchy | Carrying Amount | Fair Value |
|---------------------------------------|-------------------------------------|--------------------|--------------|
| Securitized loans held for investment | 3 | 783,484 | 762,550 |
| Repurchase agreements | 2 | (1,658,561) | (1,660,941) |

| | | | |
|---|---|------------|------------|
| Securitized debt, collateralized by Non-Agency RMBS | 3 | (933,732) | (940,712) |
| Securitized debt, collateralized by loans held for investment | 3 | (669,981) | (647,628) |

6. Repurchase Agreements

The Company had outstanding \$1.6 billion and \$1.7 billion of repurchase agreements with weighted average borrowing rates of 0.41% and 0.44% and weighted average remaining maturities of 40 days and 58 days as of March 31, 2014 and December 31, 2013, respectively. At March 31, 2014 and December 31, 2013, Agency RMBS pledged as collateral under these repurchase agreements had an estimated fair value of \$1.7 billion, respectively. The average daily balances of the Company's repurchase agreements for the quarters ended March 31, 2014 and December 31, 2013 were \$1.6 billion and \$1.5 billion, respectively. The interest rates of these repurchase agreements are generally indexed to the one-month or the three-month LIBOR rate and re-price accordingly.

At March 31, 2014 and December 31, 2013, the repurchase agreements collateralized by Agency RMBS had the following remaining maturities.

| | March 31, 2014 | December 31, 2013 |
|-----------------------------------|------------------------|----------------------|
| | (dollars in thousands) | |
| Overnight | \$ - | \$ - |
| 1-29 days | 748,081 | 644,332 |
| 30 to 59 days | 647,017 | 606,945 |
| 60 to 89 days | 166,822 | - |
| 90 to 119 days | - | 129,049 |
| Greater than or equal to 120 days | - | 278,235 |
| Total | \$ 1,561,920 | \$ 1,658,561 |

At March 31, 2014 and December 31, 2013, the Company did not have an amount at risk under its repurchase agreements greater than 10% of its equity with any counterparty.

7. Securitized Debt

All of the Company's securitized debt is collateralized by residential mortgage loans or Non-Agency RMBS. For financial reporting purposes, the Company's securitized debt is accounted for as secured borrowings. Thus, the residential mortgage loans or RMBS held as collateral are recorded in the assets of the Company as securitized loans held for investment or Non-Agency RMBS transferred to consolidated VIEs and the securitized debt is recorded as a non-recourse liability in the accompanying Consolidated Statements of Financial Condition.

At March 31, 2014 the Company's securitized debt collateralized by residential mortgage loans had a principal balance of \$637 million. The debt matures between the years 2023 and 2042. At December 31, 2013 the debt carried a weighted average cost of financing equal to 3.29%. At December 31, 2013 the Company's securitized debt collateralized by residential mortgage loans had a principal balance of \$670 million. The debt matures between the years 2023 and 2042. At December 31, 2013 the debt carried a weighted average cost of financing equal to 3.31%.

At March 31, 2014 the Company's securitized debt collateralized by Non-Agency RMBS had a principal balance of \$859 million. The debt matures between the years 2035 and 2047. At December 31, 2013 the debt carried a weighted average cost of financing equal to 4.33%. At December 31, 2013 the Company's securitized debt collateralized by Non-Agency RMBS had a principal balance of \$966.4 million. The debt matures between the years 2035 and 2047. At December 31, 2013 the debt carried a weighted average cost of financing equal to 4.26%.

During the quarter ended March 31, 2014, the Company acquired securitized debt collateralized by Non-Agency RMBS with an outstanding principal balance of \$54 million for \$56 million in cash. This transaction resulted in a loss on the extinguishment of debt of \$2 million reflected in earnings.

The carrying value of securitized debt is based on its amortized cost, net of premiums or discounts related to sales of senior certificates to third parties. The following table presents the estimated principal repayment schedule of the securitized debt at March 31, 2014 and December 31, 2013, based on expected cash flows of the residential mortgage loans or RMBS, as adjusted for projected losses on the underlying collateral of the debt. All of the securitized debt recorded in the Company's Consolidated Statements of Financial Condition is non-recourse to the Company.

| | March 31, 2014 | December 31, 2013 |
|--------------------|------------------------|----------------------|
| | (dollars in thousands) | |
| Within One Year | \$ 314,419 | \$ 370,250 |
| One to Three Years | 432,463 | 497,943 |

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| | | |
|-------------------------------------|--------------|--------------|
| Three to Five Years | 243,241 | 264,456 |
| Greater Than or Equal to Five Years | 398,216 | 396,916 |
| Total | \$ 1,388,339 | \$ 1,529,565 |

Maturities of the Company's securitized debt are dependent upon cash flows received from the underlying loans. The estimate of their repayment is based on scheduled principal payments on the underlying loans. This estimate will differ from actual amounts to the extent prepayments and/or loan losses are experienced. See Notes 3 and 4 for a more detailed discussion of the securities and loans collateralizing the securitized debt.

8. Consolidated Securitization Vehicles and Other Variable Interest Entities

Since its inception, the Company has created VIEs for the purpose of securitizing whole mortgage loans or re-securitizing RMBS and obtaining permanent, non-recourse term financing. The Company evaluated its interest in each VIE to determine if it is the primary beneficiary.

As of March 31, 2014, the Company's Consolidated Statements of Financial Condition includes consolidated VIEs with \$3.7 billion of assets and \$1.5 billion of liabilities. As of December 31, 2013, the Company's Consolidated Statements of Financial Condition includes consolidated VIEs with \$3.8 billion of assets and \$1.6 billion of liabilities.

During the quarter ended March 31, 2014, the Company sold all of its interests in a consolidated VIE to an unrelated third party. In April, 2014, the purchaser of the interests in this VIE liquidated the VIE and took possession of the underlying securities of the original VIE for the purposes of creating a new re-securitization entity. The Company agreed to acquire certain interests in the new re-securitization entity collateralized by all of the underlying securities of the original VIE. These interests acquired by the Company were evaluated for consolidation under GAAP. The Company determined that the acquired interests in the new re-securitization entity represented variable interests in only specified assets of the new re-securitization entity as these specified assets are essentially the only source of payment for the related variable interests of the new re-securitization entity. The Company concluded that it was the primary beneficiary of the specified assets and interests of the new re-securitization entity and consolidated the assets and liabilities related to their interests. As of March 31, 2014, the balance sheet includes all of the underlying assets of the original consolidated VIE as the Company had agreed to repurchase these interests; therefore, no gain or loss is recognized on the transaction. All intercompany balances are eliminated in consolidation.

In April, 2014, the Company ultimately elected not to repurchase certain interests in the new re-securitization entity and as a result will recognize a gain on this portion of the transaction during the second quarter of 2014.

VIEs for Which the Company is the Primary Beneficiary

The retained beneficial interests in VIEs for which the Company is the primary beneficiary are typically the subordinated tranches of these re-securitizations and in some cases the Company may hold interests in additional tranches. The result of consolidation at March 31, 2014 is the inclusion of \$2.9 billion of Non-Agency RMBS at fair value representing the underlying securities of the trusts, the inclusion of \$748 million of securitized loans held for investment, the recognition of \$829 million of securitized debt associated with Non-Agency RMBS transferred to consolidated VIEs and \$637 million of securitized debt associated with loans held for investment. In addition, at March 31, 2014 the Company recognized \$16 million and \$5 million of accrued interest receivable and accrued interest payable, respectively, of the securitizations.

The table below reflects the assets and liabilities recorded in the Consolidated Statements of Financial Condition related to the consolidated VIEs as of March 31, 2014 and December 31, 2013.

| | March 31, 2014 | December 31, 2013 |
|--|------------------------|----------------------|
| | (dollars in thousands) | |
| Assets | | |
| Non-Agency RMBS transferred to consolidated VIEs | \$ 2,935,051 | \$ 2,981,571 |
| Securitized loans held for investment | 748,138 | 783,484 |
| Accrued interest receivable | 15,797 | 17,173 |
| Liabilities | | |

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| | | |
|---|------------|------------|
| Securitized debt, collateralized by Non-Agency RMBS | \$ 828,663 | \$ 933,732 |
| Securitized debt, collateralized by loans held for investment | 637,190 | 669,981 |
| Accrued interest payable | 4,843 | 5,278 |

Income and expense and OTTI amounts related to consolidated VIEs recorded in the Consolidated Statements of Operations and Comprehensive Income (Loss) is presented in the table below.

| | For the Quarter Ended | |
|---|------------------------|-------------------|
| | March 31, 2014 | March 31, 2013 |
| | (dollars in thousands) | |
| Interest income, Assets of consolidated VIEs | \$ 85,211 | \$ 96,728 |
| Interest expense, Non-recourse liabilities of VIEs | (20,699) | (26,996) |
| Net interest income | \$ 64,512 | \$ 69,732 |
| Total other-than-temporary impairment losses | - | \$ - |
| Portion of loss recognized in other comprehensive income (loss) | - | (135) |
| Net other-than-temporary credit impairment losses | \$ - | \$ (135) |

VIEs for Which the Company is Not the Primary Beneficiary

The Company is not required to consolidate VIEs in which it has concluded it does not have a controlling financial interest, and thus is not the primary beneficiary. In such cases, the Company does not have both the power to direct the entities' most significant activities and the obligation to absorb losses or right to receive benefits that could potentially be significant to the VIEs. The Company's investments in these unconsolidated VIEs are carried in Non-Agency RMBS on the Consolidated Statements of Financial Condition and include senior and subordinated bonds issued by the VIEs. The Company's investments in unconsolidated VIEs at March 31, 2014, ranged from less than \$1 million to \$45 million, with an aggregate amount of \$937 million. The Company's investments in unconsolidated VIEs at December 31, 2013, ranged from less than \$1 million to \$42 million, with an aggregate amount of \$793 million. The Company's maximum exposure to loss from these unconsolidated VIEs was \$833 million at March 31, 2014 and \$727 million at December 31, 2013. The maximum exposure to loss was determined as the amortized cost of the unconsolidated VIE, which represents the purchase price of the investment less any unamortized premiums or discounts as of the reporting date.

9. Derivative Instruments

In connection with the Company's interest rate risk management strategy, the Company economically hedges a portion of its interest rate risk by entering into derivative financial instrument contracts in the form of interest rate swaps. The Company's swaps are used to lock in a fixed rate related to a portion of its current and anticipated payments on its repurchase agreements. The Company typically agrees to pay a fixed rate of interest ("pay rate") in exchange for the right to receive a floating rate of interest ("receive rate") over a specified period of time. In addition to interest rate swaps, the Company has purchased mortgage options and Treasury futures. Mortgage options give the Company the right, but not the obligation, to buy or sell mortgage backed securities at a future date for a fixed price. Treasury futures are derivatives which track the prices of specific Treasury securities and are traded on an active exchange. It is generally the Company's policy to close out any Treasury futures positions prior to taking delivery of the underlying security. The Company has invested in mortgage options and Treasury futures to lock in prices on the purchase or sale of Agency RMBS, to hedge changes in interest rates on its existing portfolio, or to enhance investment returns.

The use of derivatives creates exposure to credit risk relating to potential losses that could be recognized if the counterparties to these instruments fail to perform their obligations under the contracts. In the event of a default by the counterparty, the Company could have difficulty obtaining its RMBS or cash pledged as collateral for these derivative instruments. The Company periodically monitors the credit of its counterparties to determine if it is exposed to counterparty credit risk. See Note 14 for further discussion of counterparty credit risk.

The table below summarizes the location and fair value of the derivatives reported in the Consolidated Statements of Financial Condition after counterparty netting and posting of cash collateral as of March 31, 2014 and December 31, 2013.

| March 31, 2014 | | | | | |
|------------------------|-----------------------------|--|---|--|---|
| Derivative Instruments | Notional Amount Outstanding | Derivative Assets | | Derivative Liabilities | |
| | | Location on Consolidated Statements of Financial Condition | Net Estimated Fair Value/Carrying Value | Location on Consolidated Statements of Financial Condition | Net Estimated Fair Value/Carrying Value |
| (dollars in thousands) | | | | | |

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| | | | | | |
|---------------------|--------------|---------------------------------|----------|----------------------------|--------------|
| Interest Rate Swaps | \$ 1,365,000 | Derivatives, at fair value, net | \$ - | Derivatives, at fair value | \$ (26,134) |
| Mortgage Options | 450,000 | Derivatives, at fair value, net | - | Derivatives, at fair value | (668) |
| Treasury Futures | 550,000 | Derivatives, at fair value, net | 3,620 | Derivatives, at fair value | - |
| Total | \$ 2,365,000 | | \$ 3,620 | | \$ (26,802) |

December 31, 2013

| Derivative Instruments | Notional Amount Outstanding | Derivative Assets | | Derivative Liabilities | |
|------------------------|-----------------------------|--|---|--|---|
| | | Location on Consolidated Statements of Financial Condition | Net Estimated Fair Value/Carrying Value | Location on Consolidated Statements of Financial Condition | Net Estimated Fair Value/Carrying Value |
| (dollars in thousands) | | | | | |
| Interest Rate Swaps | \$ 1,355,000 | Derivatives, at fair value, net | \$ - | Derivatives, at fair value | \$ (30,199) |
| Treasury Futures | 550,000 | Derivatives, at fair value, net | 8,095 | Derivatives, at fair value | - |
| Total | \$ 1,905,000 | | \$ 8,095 | | \$ (30,199) |

The effect of the Company's derivatives on the Consolidated Statements of Operations and Comprehensive Income (Loss) is presented below.

| For the Quarter Ended March 31, 2014 | | |
|---|--|---|
| Derivative Instruments | Location on Consolidated Statements of Operations and Comprehensive Income (Loss) | Net gains (losses) on derivatives |
| (dollars in thousands) | | |
| Interest Rate Swaps | Net unrealized gains (losses) on derivatives | \$ 4,065 |
| Interest Rate Swaps | Net realized gains (losses) on derivatives | (5,650) |
| Mortgage Options | Net unrealized gains (losses) on derivatives | 746 |
| Mortgage Options | Net realized gains (losses) on derivatives | 603 |
| Treasury Futures | Net unrealized gains (losses) on derivatives | (7,009) |
| Treasury Futures | Net realized gains (losses) on derivatives | (701) |
| Total | | \$ (7,946) |

| For the Quarter Ended March 31, 2013 | | |
|---|--|---|
| Derivative Instruments | Location on Consolidated Statements of Operations and Comprehensive Income (Loss) | Net gains (losses) on derivatives |
| (dollars in thousands) | | |
| Interest Rate Swaps | Net unrealized gains (losses) on derivatives | \$ 5,402 |
| Interest Rate Swaps | Net realized gains (losses) on derivatives | (5,530) |
| Mortgage Options | Net unrealized gains (losses) on derivatives | - |
| Mortgage Options | Net realized gains (losses) on derivatives | - |
| Treasury Futures | Net unrealized gains (losses) on derivatives | - |
| Treasury Futures | Net realized gains (losses) on derivatives | - |
| Total | | \$ (128) |

The weighted average pay rate on the Company's interest rate swaps at March 31, 2014 was 1.80% and the weighted average receive rate was 0.15%. The weighted average pay rate on the Company's interest rate swaps at December 31,

2013 was 1.81% and the weighted average receive rate was 0.17%.

Certain of the Company's interest rate swap and mortgage option contracts are subject to International Swaps and Derivatives Association Master Agreements ("ISDA") which contain provisions that grant counterparties certain rights with respect to the applicable ISDA upon the occurrence of (i) negative performance that results in a decline in net assets in excess of specified thresholds or dollar amounts over set periods of time, (ii) the Company's failure to maintain its REIT status, (iii) the Company's failure to comply with limits on the amount of leverage, and (iv) the Company's stock being delisted from the New York Stock Exchange (NYSE). Upon the occurrence of items (i) through (iv), the counterparty to the applicable ISDA has a right to terminate the ISDA in accordance with its provisions. Certain of the Company's interest rate swaps are cleared through a registered commodities exchange. Each of the Company's ISDAs and clearing exchange agreements contains provisions under which the Company is required to fully collateralize its obligations under the interest rate swap agreements if at any point the fair value of the swap represents a liability greater than the minimum transfer amount contained within the agreements. The Company is also required to post initial collateral upon execution of certain of its swap transactions. If the Company breaches any of these provisions, it will be required to settle its obligations under the agreements at their termination values, which approximates fair value. Cleared swaps are fair valued using internal pricing models and compared to the exchange market values. The aggregate fair value of all derivative instruments with credit-risk-related contingent features that are in a net liability position at March 31, 2014 is approximately \$27 million including accrued interest, which represents the maximum amount the Company would be required to pay upon termination, which is fully collateralized.

10. Common Stock

During the quarter ended March 31, 2014 the Company declared dividends to common shareholders totaling \$92 million, or \$0.09 per share. During the quarter ended March 31, 2013 the Company declared dividends to common shareholders totaling \$92 million, or \$0.09 per share.

Earnings per share for the quarters ended March 31, 2014 and 2013, respectively, are computed as follows:

| | For the Quarter Ended | |
|--|------------------------|----------------|
| | March 31, 2014 | March 31, 2013 |
| | (dollars in thousands) | |
| Numerator: | | |
| Net income | \$ 100,368 | \$ 79,801 |
| Effect of dilutive securities: | - | - |
| Dilutive net income available to stockholders | \$ 100,368 | \$ 79,801 |
| Denominator: | | |
| Weighted average basic shares | 1,027,262,613 | 1,027,009,515 |
| Effect of dilutive securities | 326,150 | 586,000 |
| Weighted average diluted shares | 1,027,588,763 | 1,027,595,515 |
| Net income per average share attributable to common stockholders | | |
| - Basic | \$ 0.10 | \$ 0.08 |
| Net income per average share attributable to common stockholders | | |
| - Diluted | \$ 0.10 | \$ 0.08 |

11. Accumulated Other Comprehensive Income

The following table presents the changes in the components of Accumulated Other Comprehensive Income (“AOCI”) for the quarters ended March 31, 2014 and 2013:

| | March 31, 2014 (dollars in thousands) | |
|---------------------------------|--|-------------------------------------|
| | Unrealized gains (losses) on available- for-sale securities, net | Total Accumulated OCI Balance |
| Balance as of December 31, 2013 | \$ 990,803 | \$ 990,803 |
| OCI before reclassifications | 37,503 | 37,503 |
| Amounts reclassified from AOCI | (6,843) | (6,843) |
| Net current period OCI | 30,660 | 30,660 |
| Balance as of March 31, 2014 | \$ 1,021,463 | \$ 1,021,463 |

| | March 31, 2013 (dollars in thousands) | |
|---------------------------------|--|-------------------------------------|
| | Unrealized gains (losses) on available- for-sale securities, net | Total Accumulated OCI Balance |
| Balance as of December 31, 2012 | \$ 989,936 | \$ 989,936 |

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| | | |
|--------------------------------|--------------|--------------|
| OCI before reclassifications | 117,594 | 117,594 |
| Amounts reclassified from AOCI | 6,157 | 6,157 |
| Net current period OCI | 123,751 | 123,751 |
| Balance as of March 31, 2013 | \$ 1,113,687 | \$ 1,113,687 |

The following table presents the details of the reclassifications from AOCI for the quarters ended March 31, 2014 and 2013:

| Details about Accumulated OCI Components | March 31, 2014 | March 31, 2013 | Affected Line on the Consolidated Statements Of Operations And Comprehensive Income (Loss) |
|--|---|---|--|
| | Amounts Reclassified from Accumulated OCI | Amounts Reclassified from Accumulated OCI | |
| Unrealized gains and losses on available-for-sale securities | | | |
| | \$ 8,377 | \$ 6 | Net realized gains (losses) on sales of investments |
| | (1,534) | (6,163) | Net other-than-temporary credit impairment losses |
| | \$ 6,843 | \$ (6,157) | Income (loss) before income taxes |
| | - | - | Income taxes |
| | \$ 6,843 | \$ (6,157) | Net of tax |

12. Long Term Incentive Plan

On January 2, 2008, the Company granted restricted stock awards in the amount of 1,301,000 shares to employees of FIDAC and its affiliates and the Company's independent directors. The awards to the independent directors vested on the date of grant and the awards to FIDAC's employees vest quarterly over a period of 10 years. During the quarters ended March 31, 2014 and 2013, 21 thousand and 27 thousand shares of restricted stock issued by the Company to FIDAC's employees vested, respectively. As of March 31, 2014 there were 326 thousand remaining non-vested shares representing \$996 thousand of total unrecognized compensation costs granted under the long term incentive plan, based on the closing price of the shares at quarter end. That cost is expected to be recognized over a period of approximately 3.8 years.

13. Income Taxes

For the quarter ended March 31, 2014, the Company was qualified to be taxed as a REIT under Code Sections 856 through 860. As a REIT, the Company is not subject to federal income tax to the extent that it makes qualifying distributions of taxable income to its stockholders. To maintain qualification as a REIT, the Company must distribute at least 90% of its annual REIT taxable income to its shareholders and meet certain other requirements such as assets it may hold, income it may generate and its shareholder composition. It is generally the Company's policy to distribute to its shareholders all of the Company's taxable income.

The state and local tax jurisdictions for which the Company is subject to tax-filing obligations recognize the Company's status as a REIT, and therefore, the Company generally does not pay income tax in such jurisdictions. The Company may, however, be subject to certain minimum state and local tax filing fees and its TRS's are subject to federal, state, and local taxes.

For the quarters ended March 31, 2014 and 2013, the Company recorded income tax expense of \$2 thousand, respectively.

In general, common stock cash dividends declared by the Company will be considered ordinary income to stockholders for income tax purposes. From time to time, a portion of the Company's dividends may be characterized as capital gains or return of capital.

The Company's effective tax rate differs from its combined federal, state and city corporate statutory tax rate primarily due to the deduction of dividend distributions required to be paid under Code Section 857(a).

The Company's 2012, 2011 and 2010 federal, state and local tax returns remain open for examination.

14. Credit Risk and Interest Rate Risk

The Company's primary components of market risk are credit risk and interest rate risk. The Company is subject to interest rate risk in connection with its investments in Agency and Non-Agency RMBS, residential mortgage loans, and borrowings under repurchase agreements. When the Company assumes interest rate risk, it attempts to minimize interest rate risk through asset selection, hedging and matching the income earned on mortgage assets with the cost of related liabilities. The Company attempts to minimize credit risk through due diligence and asset selection by purchasing loans underwritten to agreed-upon specifications of selected originators. The Company has established a whole loan target market including prime borrowers with FICO scores generally greater than 650, Alt-A documentation, geographic diversification, owner-occupied property, and moderate loan-to-value ratios. These factors are considered to be important indicators of credit risk.

By using derivative instruments and repurchase agreements, the Company is exposed to counterparty credit risk if counterparties to the contracts do not perform as expected. If a counterparty fails to perform on a derivative hedging instrument, the Company's counterparty credit risk is equal to the amount reported as a derivative asset on its balance sheet to the extent that amount exceeds collateral obtained from the counterparty or, if in a net liability position, the extent to which collateral posted exceeds the liability to the counterparty. The amounts reported as a derivative asset/(liability) are derivative contracts in a gain/(loss) position, and to the extent subject to master netting arrangements, net of derivatives in a loss/(gain) position with the same counterparty and collateral received/(pledged). If the counterparty fails to perform on a repurchase agreement, the Company is exposed to a loss to the extent that the fair value of collateral pledged exceeds the liability to the counterparty. The Company attempts to minimize counterparty credit risk by evaluating and monitoring the counterparty's credit, executing master netting arrangements and obtaining collateral, and executing contracts and agreements with multiple counterparties to reduce exposure to a single counterparty, where appropriate.

Our repurchase agreements and derivative transactions are governed by underlying agreements that provide for a right of setoff under master netting arrangements, including in the event of default or in the event of bankruptcy of either party to the transactions. We present our assets and liabilities subject to such arrangements on a net basis in our consolidated statements of financial condition. The following table presents information about our liabilities that are subject to such arrangements and can potentially be offset on our consolidated statements of financial condition as of March 31, 2014 and December 31, 2013. The Company has no financial instruments subject to master netting arrangements, or similar arrangements, in an asset position on a gross basis.

March 31, 2014
(dollars in thousands)

| | | | | Gross Amounts Not Offset with Financial Assets (Liabilities) in the Consolidated Statements of Financial Position | | |
|-----------------------|--|---|---|---|------------------------------------|------------|
| | Gross Amounts of Recognized Assets (Liabilities) | Gross Amounts Offset in the Consolidated Statements of Financial Position | Net Amounts Offset in the Consolidated Statements of Financial Position | Financial Instruments | Cash Collateral (Received) Pledged | Net Amount |
| Repurchase agreements | \$ (1,561,920) | \$ - | \$ (1,561,920) | \$ 1,695,587 | \$ - | \$ 133,667 |
| Interest Rate Swaps | (26,134) | \$ - | (26,134) | 33,184 | 50 | 7,100 |
| Mortgage Options | (668) | - | (668) | - | - | (668) |
| Treasury Futures | 3,620 | - | 3,620 | - | 3,810 | 7,430 |
| Total Liabilities | \$ (1,585,102) | \$ - | \$ (1,585,102) | \$ 1,728,771 | \$ 3,860 | \$ 147,529 |

December 31, 2013
(dollars in thousands)

Gross Amounts Not Offset with Financial Assets (Liabilities) in the

Consolidated Statements
of
Financial Position

| | Gross Amounts of Recognized Assets (Liabilities) | Gross Amounts Offset in the Consolidated Statements of Financial Position | Net Amounts Offset in the Consolidated Statements of Financial Position | Financial Instruments | Cash Collateral (Received) Pledged | Net Amount |
|-----------------------|---|---|---|--------------------------|---|---------------|
| Repurchase agreements | \$ (1,658,561) | \$ - | \$ (1,658,561) | \$ 1,737,381 | \$ - | \$ 78,820 |
| Interest Rate Swaps | (30,199) | - | (30,199) | 39,470 | - | 9,271 |
| Mortgage Options | - | - | - | - | - | - |
| Treasury Futures | 10,629 | (2,534) | 8,095 | - | - | 8,095 |
| Total Liabilities | \$ (1,678,131) | \$ (2,534) | \$ (1,680,665) | \$ 1,776,851 | \$ - | \$ 96,186 |

15. Management Agreement and Related Party Transactions

The Company entered into a management agreement with FIDAC, which provided for an initial term through December 31, 2010 with an automatic one-year extension option and subject to certain termination rights. In 2011 and through November 28, 2012, the Company paid FIDAC a quarterly management fee equal to 1.50% per annum of the gross Stockholders' Equity (as defined in the management agreement) of the Company. Effective November 28, 2012, the management fee was reduced to 0.75% per annum of gross Stockholders' Equity, which reduction will remain in effect until the Company is current on all of its filings required under applicable securities laws.

Management fees accrued and paid to FIDAC for the quarters ended March 31, 2014 and 2013 were \$6 million, respectively.

Under the management agreement, the Company is obligated to reimburse FIDAC for its costs incurred under the management agreement. In addition, the management agreement permits FIDAC to require the Company to pay for its pro rata portion of rent, telephone, utilities, office furniture, equipment, machinery and other office, internal and overhead expenses that FIDAC incurred in connection with the Company's operations. These expenses are allocated between FIDAC and the Company based on the ratio of the Company's proportion of gross assets compared to the gross assets managed by FIDAC as calculated at each quarter end. FIDAC and the Company will modify this allocation methodology, subject to the approval of the Company's board of directors if the allocation becomes inequitable (i.e., if the Company becomes very highly leveraged compared to FIDAC's other funds and accounts). During the quarters ended March 31, 2014 and 2013, the Company reimbursed FIDAC approximately \$111 thousand and \$99 thousand for such expenses, respectively.

Because of the Restatement Filing (as defined below), the Company and FIDAC amended the management agreement on March 8, 2013. In the amendment, the reduction in the management fee was memorialized. In addition, FIDAC agreed to pay all past and future expenses that the Company and/or the Audit Committee of the Company incur to: (1) evaluate the Company's accounting policy related to the application of GAAP to its Non-Agency RMBS portfolio (the "Evaluation"); (2) restate the Company's financial statements for the period covering 2008 through 2011 as a result of the Evaluation (the "Restatement Filing"); and (3) investigate and evaluate any shareholder derivative demands arising from the Evaluation and/or the Restatement Filing (the "Investigation"); provided, however, that FIDAC's obligation to pay expenses applies only to expenses not paid by the Company's insurers under its insurance policies. Expenses shall include, without limitation, fees and costs incurred with respect to auditors, outside counsel, and consultants engaged by the Company and/or the Audit Committee of the Company for the Evaluation, Restatement Filing and the Investigation. The amount paid by FIDAC related to these expenses for the quarters ended March 31, 2014 and 2013 is \$681 thousand and \$2 million, respectively, and is presented in the Consolidated Statements of Operations and Comprehensive Income (Loss) as Expense recoveries from Manager.

The amendment also provides that the independent directors or the holders of a majority of the outstanding shares of common stock (other than those held by Annaly or its affiliates) may elect to terminate the management agreement upon 30 days notice at any time in their sole discretion without the payment of a termination fee. The amendment also provides that the Company may terminate the management agreement effective immediately if (i) FIDAC engages in any act of fraud, misappropriation of funds, or embezzlement against the Company, (ii) there is an event of any gross negligence on the part of FIDAC in the performance of its duties under the management agreement, (iii) there is a commencement of any proceeding relating to FIDAC's bankruptcy or insolvency, (iv) there is a dissolution of FIDAC, or (v) FIDAC is convicted of (including a plea of nolo contendere) a felony.

On March 1, 2011, the Company entered into an administrative services agreement with RCap Securities Inc., ("RCap"). RCap is a SEC-registered broker-dealer and a wholly-owned subsidiary of Annaly that clears the Company's securities trades in return for normal and customary fees that RCap charges for such services. RCap may also provide brokerage services to the Company from time to time. During the quarters ended March 31, 2014 and 2013, fees paid to RCap were \$35 thousand and \$34 thousand, respectively.

16. Commitments and Contingencies

From time to time, the Company may become involved in various claims and legal actions arising in the ordinary course of business. In connection with certain re-securitization transactions engaged in by the Company, the Company has the obligation under certain circumstances to repurchase assets from the VIE upon breach of certain representations and warranties. Management is not aware of any contingencies that require accrual or disclosure as of March 31, 2014 and December 31, 2013.

17. Subsequent Events

The Board of Directors has also determined that there will be a quarterly dividend of \$0.09 per share for the second, third and fourth quarters of 2014. Subsequent to March 31, 2014, the Company increased its Agency portfolio by approximately \$6 billion, financed primarily by repurchase agreements. From time to time, the Company may add to its Agency and Non-Agency portfolio and may increase leverage to increase net interest income.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion of the Company's ("we" or "our") financial condition and results of operations should be read in conjunction with the consolidated financial statements and notes to those statements included in Item 1 of this quarterly report on Form 10-Q.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

We make forward-looking statements in this report that are subject to risks and uncertainties. These forward-looking statements include information about possible or assumed future results of our business, financial condition, liquidity, results of operations, plans and objectives. When we use the words "believe," "expect," "anticipate," "estimate," "plan," "continue," "intend," "should," "may," "would," "will" or similar expressions, we intend to identify forward-looking statements. Statements regarding the following subjects, among others, are forward-looking by their nature:

our business and investment strategy;

our ability to maintain existing financing arrangements and our ability to obtain future financing arrangements;

our ability to timely file our periodic reports with the Securities and Exchange Commission, or SEC;

our expectations regarding materiality or significance;

the effectiveness of our disclosure controls and procedures;

material weaknesses in our internal controls over financial reporting;

additional information that may arise from the preparation of our financial statements;

inadequacy of or weakness in our internal controls over financial reporting of which we are not currently aware or which have not been detected;

general volatility of the securities markets in which we invest;

the impact of and changes to various government programs;

our expected investments;

changes in the value of our investments;

interest rate mismatches between our investments and our borrowings used to finance such purchases;

changes in interest rates and mortgage prepayment rates;

effects of interest rate caps on our adjustable-rate investments;

rates of default, delinquencies or decreased recovery rates on our investments;

prepayments of the mortgage and other loans underlying our mortgage-backed securities, or RMBS, or other asset-backed securities, or ABS;

the degree to which our hedging strategies may or may not protect us from interest rate volatility;

the potential delisting of our common stock from the New York Stock Exchange, or NYSE;

impact of and changes in governmental regulations, tax law and rates, accounting guidance, and similar matters;

availability of investment opportunities in real estate-related and other securities;

availability of qualified personnel;

estimates relating to our ability to make distributions to our stockholders in the future;

our understanding of our competition;

market trends in our industry, interest rates, the debt securities markets or the general economy;

our ability to maintain our classification as a real estate investment trust, or REIT, for federal income tax purposes; and

our ability to maintain our exemption from registration under the Investment Company Act of 1940, as amended, or 1940 Act.

The forward-looking statements are based on our beliefs, assumptions and expectations of our future performance, taking into account all information currently available to us. You should not place undue reliance on these forward-looking statements. These beliefs, assumptions and expectations can change as a result of many possible events or factors, not all of which are known to us. Some of these factors are described under the caption ‘Risk Factors’ in our 2013 Form 10-K. If a change occurs, our business, financial condition, liquidity and results of operations may vary materially from those expressed in our forward-looking statements. Any forward-looking statement speaks only as of the date on which it is made. New risks and uncertainties arise from time to time, and it is impossible for us to predict those events or how they may affect us. Except as required by law, we are not obligated to, and do not intend to, update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Executive Summary

We are a Maryland corporation that commenced operations on November 21, 2007. We acquire, either directly or indirectly through our subsidiaries, residential mortgage-backed securities, or RMBS, residential mortgage loans, commercial mortgage loans, real estate related securities and various other asset classes. We are externally managed by Fixed Income Discount Advisory Company, which we refer to as FIDAC or our Manager. FIDAC is a fixed-income investment management company that is registered as an investment adviser with the SEC. FIDAC is a wholly owned subsidiary of Annaly Capital Management, Inc., or Annaly. FIDAC has a broad range of experience in managing investments in Agency RMBS, which are mortgage pass-through certificates, collateralized mortgage obligations, or CMOs, and other RMBS representing interests in or obligations backed by pools of mortgage loans issued or guaranteed by Fannie Mae, Freddie Mac, and Ginnie Mae, Non-Agency RMBS, collateralized debt obligations, or CDOs, and other real estate related investments.

Our objective is to provide attractive risk-adjusted returns to our investors over the long-term, primarily through dividends and secondarily through capital appreciation. We intend to achieve this objective by investing in a diversified investment portfolio of RMBS, residential mortgage loans, real estate-related securities and various other asset classes, subject to maintaining our REIT status and exemption from registration under the 1940 Act. The RMBS, ABS, CMBS, and CDOs we purchase may include investment-grade and non-investment grade classes, including the BB-rated, B-rated and non-rated classes.

We rely on our Manager's expertise in identifying assets within our target asset classes. Our Manager makes investment decisions based on various factors, including expected cash yield, relative value, risk-adjusted returns, current and projected credit fundamentals, current and projected macroeconomic considerations, current and projected supply and demand, credit and market risk concentration limits, liquidity, cost of financing and financing availability, as well as maintaining our REIT qualification and our exemption from registration under the 1940 Act.

Over time, we will modify our investment allocation strategy as market conditions change to seek to maximize the returns from our investment portfolio. We believe this strategy, combined with our Manager's experience, will enable us to pay dividends and achieve capital appreciation through various changing interest rate and credit cycles and provide attractive long-term returns to investors.

Our targeted asset classes and the principal investments we have made and in which we may in the future invest are:

| Asset Class | Principal Investments |
|----------------------------|--|
| RMBS | <p>Non-Agency RMBS, including investment-grade and non-investment grade classes, including the BB-rated, B-rated and non-rated classes</p> <p>Agency RMBS</p> <p>Interest-only ("IO") RMBS</p> |
| Residential Mortgage Loans | <p>Prime mortgage loans, which are mortgage loans that conform to the underwriting guidelines of Fannie Mae and Freddie Mac, which we refer to as Agency Guidelines; and jumbo prime mortgage loans, which are mortgage loans that conform to the Agency Guidelines except as to loan size</p> |

Alt-A mortgage loans, which are mortgage loans that may have been originated using documentation standards that are less stringent than the documentation standards applied by certain other first lien mortgage loan purchase programs, such as the Agency Guidelines, but have one or more compensating factors such as a borrower with a strong credit or mortgage history or significant assets

FHA/VA insured loans, which are mortgage loans that comply with the underwriting guidelines of the Federal Housing Administration (FHA) or Department of Veteran Affairs (VA) and which are guaranteed by the FHA or VA, respectively

Mortgage servicing rights associated with residential mortgage loans, which reflect the value of the future stream of expected cash flows from the contractual rights to service a given pool of residential mortgage loans

| | |
|-------------------------------|--|
| Commercial Mortgage Loans | First or second lien loans secured by multifamily properties, which are residential rental properties consisting of five or more dwelling units; and mixed residential or other commercial properties; retail properties; office properties; or industrial properties, which may or may not conform to the Agency Guidelines |
| Other Asset-Backed Securities | <p>CMBS</p> <p>Debt and equity tranches of CDOs</p> <p>Consumer and non-consumer ABS, including investment-grade and non-investment grade classes, including the BB-rated, B-rated and non-rated classes</p> |
| Hedging Instruments | <p>Swaps</p> <p>Swaptions</p> <p>Futures</p> <p>Index options</p> <p>Mortgage options</p> |

Since we commenced operations in November 2007, we have focused our investment activities on acquiring Non-Agency and Agency RMBS and on purchasing residential mortgage loans that have been originated by select originators, including the retail lending operations of leading commercial banks. Our investment portfolio at March 31, 2014 was weighted toward Non-Agency RMBS. At March 31, 2014, based on the amortized cost balance of our interest earning assets, approximately 51% of our investment portfolio was Non-Agency RMBS, 35% of our investment portfolio was Agency RMBS, and 14% of our investment portfolio was securitized residential mortgage loans. At December 31, 2013, based on the amortized cost balance of our interest earning assets, approximately 50% of our investment portfolio was Non-Agency RMBS, 36% of our investment portfolio was Agency RMBS, and 14% of our investment portfolio was securitized residential mortgage loans. We expect that over the near term, our investment portfolio will continue to be weighted toward Non-Agency RMBS, subject to maintaining our REIT qualification and our 1940 Act exemption.

We have engaged in transactions with residential mortgage lending operations of leading commercial banks and other originators in which we identified and re-underwrote residential mortgage loans owned by such entities, and purchased and securitized such residential mortgage loans. In the past we have also acquired formerly AAA-rated Non-Agency RMBS and immediately re-securitized those securities. We sold the resulting AAA-rated super senior RMBS and retained the rated or unrated mezzanine RMBS.

Our investment strategy is intended to take advantage of opportunities in the current interest rate and credit environment. We expect to adjust our strategy to changing market conditions by shifting our asset allocations across these various asset classes as interest rate and credit cycles change over time. We believe that our strategy, combined with FIDAC's experience, will enable us to pay dividends and achieve capital appreciation throughout changing market cycles. We expect to take a long-term view of assets and liabilities, and our reported earnings and estimates of the fair value of our investments at the end of a financial reporting period will not significantly impact our objective of providing attractive risk-adjusted returns to our stockholders over the long-term.

We use leverage to seek to increase our potential returns and to finance the acquisition of our assets. Our income is generated primarily by the difference, or net spread, between the income we earn on our assets and the cost of our borrowings. We expect to finance our investments using a variety of financing sources including, when available, repurchase agreements, warehouse facilities and securitizations. We may manage our debt and interest rate risk by utilizing interest rate hedges, such as interest rate swaps, caps, options and futures to reduce the effect of interest rate fluctuations related to our financing sources.

We have elected and believe we are organized and have operated in a manner that qualifies us to be taxed as a REIT under the Code. A REIT generally will not be subject to federal income tax on taxable income that is distributed to stockholders. Furthermore, substantially all of our assets consist of qualified REIT real estate assets (of the type described in Code Section 856(c)(5)). We calculate that at least 75% of our assets were qualified REIT assets, as defined in the Code, for the three months ended March 31, 2014 and the years ended December 31, 2013 and 2012. We also calculate that our revenues qualified for the 75% REIT income test and for the 95% REIT income test for the three months ended March 31, 2014 and years ended December 31, 2013 and 2012. We also met all REIT requirements regarding the ownership of our common stock and the distribution of our REIT taxable income. Therefore, for the three months ended March 31, 2014 and years ended December 31, 2013 and 2012, we believe that we qualified as a REIT under the Code.

We operate our business to be exempt from registration under the 1940 Act, and therefore we are required to invest a substantial majority of our assets in loans secured by mortgages on real estate and real estate-related assets. Subject to maintaining our REIT qualification and our 1940 Act exemption, we do not have any limitations on the amounts we may invest in any of our targeted asset classes.

Looking forward, we cannot predict the percentage of our assets that will be invested in each asset class or whether we will invest in other classes of investments. We may change our investment strategy and policies without a vote of our stockholders.

Net Income Summary

The table below presents our net income on a GAAP basis for the quarters ended March 31, 2014 and 2013.

| | Net Income (Loss) (dollars in thousands) (unaudited) | |
|---|--|----------------|
| | For the Quarter Ended March 31, 2014 | March 31, 2013 |
| Net Interest Income: | | |
| Interest income | \$ 35,456 | \$ 29,067 |
| Interest expense | (1,726) | (1,833) |
| Interest income, Assets of consolidated VIEs | 85,211 | 96,728 |
| Interest expense, Non-recourse liabilities of consolidated VIEs | (20,699) | (26,996) |
| Net interest income (expense) | 98,242 | 96,966 |
| Other-than-temporary impairments: | | |
| Total other-than-temporary impairment losses | (400) | - |
| Portion of loss recognized in other comprehensive income (loss) | (1,134) | (6,163) |
| Net other-than-temporary credit impairment losses | (1,534) | (6,163) |
| Other gains (losses): | | |
| Net unrealized gains (losses) on derivatives | (2,198) | 5,402 |
| Net realized gains (losses) on derivatives | (5,748) | (5,530) |
| Net gains (losses) on derivatives | (7,946) | (128) |
| Net unrealized gains (losses) on interest-only RMBS | 15,010 | (1,013) |
| Net realized gains (losses) on sales of investments | 8,377 | 6 |
| Loss on extinguishment of Debt | (2,184) | - |
| Total other gains (losses) | 13,257 | (1,135) |
| Net investment income (loss) | 109,965 | 89,668 |
| Other expenses: | | |
| Management fees | 6,221 | 6,449 |
| Expense recoveries from Manager | (681) | (1,855) |
| Net management fees | 5,540 | 4,594 |
| Provision for loan losses, net | 319 | 424 |
| General and administrative expenses | 3,736 | 4,847 |
| Total other expenses | 9,595 | 9,865 |
| Income (loss) before income taxes | 100,370 | 79,803 |
| Income taxes | 2 | 2 |
| Net income (loss) | \$ 100,368 | \$ 79,801 |

For the quarter ended March 31, 2014, our net income was \$100 million, or \$0.10 per average basic common share, as compared to \$80 million, or \$0.08 per average basic common share, for the quarter ended March 31, 2013. The increase in earnings for the quarter ended March 31, 2014 over the same period of 2013 is primarily attributable to an increase in unrealized gains on interest-only RMBS of \$16 million, lower net other-than-temporary credit impairment (OTTI) losses of \$5 million, as well as realized gains on sales of investments of \$8 million offset in part by greater unrealized losses on derivatives of \$8 million.

We discuss the changes in our net income in greater detail in the discussion on our results of operations below.

Trends

We expect the results of our operations to be affected by various factors, many of which are beyond our control. Our results of operations will primarily depend on, among other things, the level of our net interest income, the market value of our assets, and the supply of and demand for such assets. Economic trends, both macro as well as those directly affecting the residential housing market, and the supply and demand of RMBS may affect our operations and financial results. We also evaluate market information regarding current residential mortgage loan underwriting criteria and loan defaults to manage our portfolio of assets, leverage, and debt. Our net interest income, which reflects the amortization of purchase premiums and accretion of discounts, varies primarily as a result of changes in interest rates, borrowing costs, credit impairment losses, and prepayment speeds, which is a measurement of how quickly borrowers pay down the unpaid principal balance on their mortgage loans. Further description of these factors is provided below.

Prepayment Speeds. Prepayment speeds, as reflected by the Constant Prepayment Rate, or CPR, vary according to interest rates, the type of investment, conditions in financial markets, and other factors, none of which can be predicted with any certainty. In general, when interest rates rise, it is relatively less attractive for borrowers to refinance their mortgage loans, and as a result, prepayment speeds tend to decrease. When interest rates fall, prepayment speeds tend to increase. For mortgage loan and RMBS investments purchased at a premium, as prepayment speeds increase, the amount of income we earn decreases as the purchase premium on the bonds amortizes faster than expected. Conversely, decreases in prepayment speeds result in increased income and can extend the period over which we amortize the purchase premium. For mortgage loan and RMBS investments purchased at a discount, as prepayment speeds increase, the amount of income we earn increases from the acceleration of the accretion of the discount into interest income. Conversely, decreases in prepayment speeds result in decreased income as the accretion of the purchase discount into interest income occurs over a longer period. Recently, the correlation between interest rates and prepayment has not followed normal trends for certain asset classes. Due to economic hardship, some borrowers have been unable to refinance their loans as underwriting standards are more stringent and credit conditions remain restrictive.

Rising Interest Rate Environment. As indicated above, as interest rates rise, prepayment speeds generally decrease. Rising interest rates, however, increase our financing costs which may result in a net negative impact on our net interest income. In addition, if we acquire Agency and Non-Agency RMBS collateralized by monthly reset adjustable-rate mortgages, or ARMs, and three- and five-year hybrid ARMs, such interest rate increases could result in decreases in our net investment income, as the increase in our adjustable rate assets may increase slower than our adjustable rate financing. We expect that our fixed-rate assets would decline in value in a rising interest rate environment and that our net interest spreads on fixed rate assets could decline in a rising interest rate environment to the extent such assets are financed with floating rate debt.

Credit Risk. One of our strategic focuses is on acquiring distressed Non-Agency RMBS that have been downgraded because of defaults in the mortgages collateralizing such RMBS. When we acquire such RMBS we attempt to purchase it at a price such that its loss-adjusted return profile is in line with our targeted yields. We retain the risk of potential credit losses on all of the residential mortgage loans we hold in our portfolio as well as all of the Non-Agency RMBS. We attempt to mitigate credit risk in the asset selection process. Prior to the purchase of investments, we conduct a credit-risk based analysis of the collateral securing our investment that includes examining borrower characteristics, geographic concentrations, current and projected delinquencies, current and projected severities, and actual and expected prepayment speeds among other characteristics to estimate expected losses. We also acquire assets which we believe to be of high credit quality.

Size of Investment Portfolio. The size of our investment portfolio, as measured by the aggregate unpaid principal balance of our mortgage loans and aggregate principal balance of our mortgage related securities and the other assets we own, is also a key revenue driver. Generally, as the size of our investment portfolio grows, the amount of interest income we receive increases. The larger investment portfolio, however, may result in increased expenses if we incur additional interest expense to finance the purchase of our assets.

Financial Condition

Estimated Economic Book Value

This Management Discussion and Analysis section contains analysis and discussion of financial information that utilizes or presents ratios based on GAAP book value. The table and discussion below present our estimated economic book value. We calculate and disclose this non-GAAP measurement because we believe it represents an estimate of the fair value of the assets we own or are able to dispose of, pledge, or otherwise monetize. The estimated economic book value should not be viewed in isolation and is not a substitute for book value computed in accordance with GAAP.

GAAP requires us to consolidate certain securitizations and re-securitization transactions where we have determined that we are the primary beneficiary. In these transactions, we transferred assets to the trusts, which issued tranches of senior and subordinate notes or certificates. We sold the senior tranches and therefore have no continuing involvement in these trusts other than being a holder of notes or certificates issued by the trusts, with the same rights as other holders of the notes or certificates, except as it relates to certain VIEs collateralized by loans held for investment. As it relates solely to certain VIEs collateralized by loans held for investment, we have the ability to approve loan modifications and determine the course of action to be taken as it relates to loans in technical default, including whether or not to proceed with foreclosure. The notes and certificates we own that were issued by the trusts are largely subordinated interests in those trusts. The trusts have no recourse to our assets other than pursuant to a breach by us of the transaction documents related to the transfer of the assets by us to the trusts, but are presented as if we own 100% of the trust.

For re-securitized RMBS transactions and loan securitizations, we present the pre-securitized assets transferred into the consolidated trusts in our Consolidated Statements of Financial Condition as Non-Agency RMBS transferred to consolidated variable interest entities or Securitized loans held for investment. Post securitization RMBS assets sold are presented as liabilities in our Consolidated Statements of Financial Condition as Securitized debt, collateralized by Non-Agency RMBS and Securitized debt, collateralized by loans held for investment. We have presented the underlying securities we transferred to the trusts for the calculation of GAAP book value at fair value and recorded the corresponding liability for the notes or certificates sold to third parties at amortized cost. Fair value adjustments that are not credit related are recorded in Other comprehensive income (loss). Credit related impairments are deemed other-than-temporary and are recorded in earnings.

Because we are unable to dispose of, monetize or pledge the RMBS or loans we transferred into the trusts, we also present our estimated economic book value. We believe this measure represents the estimated value of the securities issued by these trusts that we own. In contrast to GAAP book value, our estimated economic book value considers only the assets we own or are able to dispose of, pledge, or otherwise monetize. To determine our estimated economic book value, we consider only the fair value of the notes or certificates issued by the securitization and re-securitization trusts that we actually own. Accordingly, our estimated economic book value does not include assets or liabilities for which we have no direct ownership, specifically the notes or certificates of the securitization and re-securitization trusts that were sold to third parties.

At March 31, 2014, the difference between GAAP book value and estimated economic book value was determined to be \$269 million, or \$0.26 per share. At December 31, 2013, the difference between GAAP book value and estimated economic book value was determined to be \$438 million, or \$0.42 per share. This difference is primarily driven by the value of the RMBS assets we have retained in these re-securitization transactions as compared to the value of consolidated loans and securities net of RMBS assets sold, but treated as a secured financing and recorded at amortized cost on the statement of financial condition. In these re-securitization transactions, we retained the subordinated, typically non-rated, first loss notes or certificates issued by the securitization trusts. These securities are complex, typically locked out as to principal repayment, relatively illiquid, and do not necessarily appreciate or depreciate in tandem with the broader Non-Agency RMBS market or with the loans on securities owned by the trusts. The tables below present the adjustments to GAAP book value that we believe are necessary to adequately reflect our calculation of estimated economic book value as of March 31, 2014 and December 31, 2013.

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March 31, 2014
(dollars in thousands, except per share data)

| | GAAP Book Value | Adjustments | Estimated Economic Book Value |
|---|---------------------|------------------------|-------------------------------|
| Assets: | | | |
| Non-Agency RMBS, at fair value | | | |
| Senior | \$ 187,095 | \$ 587,289 | \$ 774,384 |
| Senior interest-only | 258,803 | 66,619 | 325,422 |
| Subordinated | 474,786 | 1,293,767 | 1,768,553 |
| Subordinated interest-only | 16,018 | 263 | 16,281 |
| RMBS transferred to consolidated VIEs | 2,935,051 | (2,935,051) | - |
| Agency RMBS, at fair value | | | |
| Pass-through | 1,868,413 | | 1,868,413 |
| Interest-only | 42,936 | | 42,936 |
| Securitized loans held for investment, net of allowance for loan losses | 748,138 | (748,138) | - |
| Other assets | 175,790 | - | 175,790 |
| Total assets | \$ 6,707,030 | \$ (1,735,251) | \$ 4,971,779 |
| Liabilities: | | | |
| Repurchase agreements, Agency RMBS | 1,561,920 | - | 1,561,920 |
| Securitized debt, collateralized by Non-Agency RMBS | 828,663 | (828,663) | - |
| Securitized debt, collateralized by loans held for investment | 637,190 | (637,190) | - |
| Other liabilities | 309,107 | - | 309,107 |
| Total liabilities | 3,336,880 | (1,465,853) | 1,871,027 |
| Total stockholders' equity | 3,370,150 | (269,398) | 3,100,452 |
| Total liabilities and stockholders' equity | \$ 6,707,030 | \$ (1,735,251) | \$ 4,971,779 |
| Book Value Per Share | \$ 3.28 | \$ (0.26) | \$ 3.02 |

December 31, 2013
(dollars in thousands, except per share data)

| | GAAP Book Value | Adjustments | Estimated Economic Book Value |
|---------------------------------------|-----------------|--------------|-------------------------------|
| Assets: | | | |
| Non-Agency RMBS, at fair value | | | |
| Senior | \$ 89,687 | \$ 12,365 | \$ 102,052 |
| Senior interest-only | 229,065 | 116,951 | 346,016 |
| Subordinated | 457,569 | 1,593,924 | 2,051,493 |
| Subordinated interest-only | 16,571 | 280 | 16,851 |
| RMBS transferred to consolidated VIEs | 2,981,571 | (2,981,571) | - |
| Agency RMBS, at fair value | | | |
| Pass-through | 1,954,796 | - | 1,954,796 |

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| | | | |
|---|--------------|-----------------|--------------|
| Interest-only | 42,782 | - | 42,782 |
| Securitized loans held for investment, net of allowance for loan losses | 783,484 | (783,484) | - |
| Other assets | 380,556 | - | 380,556 |
| Total assets | \$ 6,936,081 | \$ (2,041,535) | \$ 4,894,546 |
| Liabilities: | | | |
| Repurchase agreements, Agency RMBS | 1,658,561 | - | 1,658,561 |
| Securitized debt, collateralized by Non-Agency RMBS | 933,732 | (933,732) | - |
| Securitized debt, collateralized by loans held for investment | 669,981 | (669,981) | - |
| Other liabilities | 342,297 | - | 342,297 |
| Total liabilities | 3,604,571 | (1,603,713) | 2,000,858 |
| Total stockholders' equity | | | |
| Total stockholders' equity | 3,331,510 | (437,822) | 2,893,688 |
| Total liabilities and stockholders' equity | \$ 6,936,081 | \$ (2,041,535) | \$ 4,894,546 |
| Book Value Per Share | | | |
| Book Value Per Share | \$ 3.24 | \$ (0.42) | \$ 2.82 |

Our estimate of economic book value has important limitations. Our estimate of fair value is as of a point in time and subject to significant judgment, primarily the estimate of the fair value of the securities issued by the trusts which we own and can freely sell or pledge. Should we sell the assets in our portfolio, we may realize materially different proceeds from the sale than we have estimated as of the reporting date.

The calculation of estimated economic book value described above is used by management to understand the fair value of the assets we own and the liabilities for which we are legally obligated, and is presented for informational use only. The estimated economic book value should not be viewed in isolation and is not a substitute for book value computed in accordance with GAAP.

Portfolio Review

During the quarter ended March 31, 2014, on an aggregate basis, we purchased \$326 million, sold \$244 million, and received \$176 million in principal payments related to our Agency RMBS, Non-Agency RMBS, and loans held for investment. In addition, we used \$142 million of proceeds from our assets to repay principal on our securitized debt.

The following table summarizes certain characteristics of our portfolio at March 31, 2014 and December 31, 2013.

| | March 31, 2014 | December 31, 2013 |
|--|----------------|-------------------|
| Interest earning assets at period-end (1) | \$ 6,531,240 | \$ 6,555,525 |
| Interest bearing liabilities at period-end | \$ 3,027,773 | \$ 3,262,274 |
| Leverage at period-end | 0.9:0:1 | 1.0:1 |
| Leverage at period-end (recourse) | 0.5:1 | 0.5:1 |
| Portfolio Composition, at amortized cost | | |
| Non-Agency RMBS | 51.6 | % 49.8 |
| Senior | 3.2 | % 1.5 |
| Senior, interest only | 5.4 | % 5.1 |
| Subordinated | 6.1 | % 6.0 |
| Subordinated, interest only | 0.2 | % 0.3 |
| RMBS transferred to consolidated VIEs | 36.6 | % 36.9 |
| Agency RMBS | 34.7 | % 36.1 |
| Pass-through | 34.0 | % 35.3 |
| Interest-only | 0.8 | % 0.8 |
| Securitized loans | 13.6 | % 14.1 |
| Fixed-rate percentage of portfolio | 74.9 | % 76.3 |
| Adjustable-rate percentage of portfolio | 25.1 | % 23.7 |

(1) Excludes interest income on cash and cash equivalents.

The following table presents details of each asset class in our portfolio at March 31, 2014 and December 31, 2013. The principal or notional value represents the interest income earning balance of each class. The weighted average figures are weighted by each investment's respective principal/notional value in the asset class.

March 31, 2014

| | Principal or Notional Value at Period-End (dollars in thousands) | Weighted Average Amortized Cost Basis | Weighted Average Fair Value | Weighted Average Coupon | Weighted Average Yield | | | Weighted Average Delinquency | | | Principal Writedowns During Period (dollars in thousands) |
|---------------------------------------|--|---------------------------------------|-----------------------------|-------------------------|------------------------|---------|----------|------------------------------|-----------------|-------------|---|
| | | | | | at Period-End (1) | 3 Month | 12 Month | at Pipeline 60+ | at Pipeline (2) | at Pipeline | |
| Non-Agency Mortgage-Backed Securities | | | | | | | | | | | |
| Senior | \$265,883 | \$67.74 | \$70.37 | 1.3% | 5.6% | 8.5% | 12.9% | 34.8% | 69.7% | 12.6% | \$824 |
| Senior, interest only | \$6,571,076 | \$4.56 | \$3.94 | 1.3% | 13.6% | 12.7% | 15.3% | 22.5% | 51.1% | 0.0% | \$- |
| Subordinated | \$815,296 | \$41.62 | \$58.23 | 3.0% | 12.5% | 15.0% | 18.7% | 17.8% | 50.1% | 12.3% | \$6,758 |
| Subordinated, interest only | \$269,946 | \$5.15 | \$5.93 | 1.7% | 8.8% | 12.5% | 17.4% | 15.3% | 45.0% | 0.0% | \$- |

| RMBS transferred to consolidated variable interest entities | \$3,805,867 | \$54.60 | \$78.75 | 4.6% | 16.2% | 10.4% | 14.0% | 25.7% | 57.3% | 1.5% | \$(53,637) |
|---|-------------|----------|----------|------|-------|-------|-------|-------|-------|-------|------------|
| Agency Mortgage-Backed Securities | | | | | | | | | | | |
| Pass-through | \$1,793,785 | \$105.12 | \$106.55 | 3.6% | 3.2% | 7.9% | 12.2% | NA | NA | 0.0% | \$- |
| Interest-only | \$226,023 | \$18.77 | \$19.00 | 3.3% | 6.7% | 8.7% | 8.7% | NA | NA | 0.0% | \$- |
| Securitized | | | | | | | | | | | |
| loans | \$741,708 | \$102.08 | \$99.08 | 4.7% | 3.7% | 15.4% | 28.4% | 1.4% | 22.0% | 16.8% | \$365 |

(1) Bond Equivalent Yield at period end. Weighted Average Yield is calculated using each investment's respective amortized cost.

(2) Calculated based on reported losses to date, utilizing widest data set available (i.e., life-time losses, 12-month loss, etc.)

December 31, 2013

| | Principal or Notional Value at Period-End (dollars in thousands) | Weighted Average Amortized Cost Basis | Weighted Average Fair Value | Weighted Average Coupon | Weighted Average Yield at Period-End (1) | Weighted Average 3 Month CPR at Period-End | Weighted Average 12 Month CPR at Period-End | Weighted Average Delinquency at Pipeline 60+ | Weighted Average Loss Severity (2) | Weighted Average Credit Enhancements | Principal Writedowns During Period (dollars in thousands) |
|---------------------------------------|--|---------------------------------------|-----------------------------|-------------------------|--|--|---|--|------------------------------------|--------------------------------------|---|
| Non-Agency Mortgage-Backed Securities | | | | | | | | | | | |
| Senior | \$128,217 | \$69.27 | \$69.95 | 1.4% | 5.9% | 12.1% | 15.1% | 38.0% | 63.3% | 8.3% | \$297 |
| Senior, interest only | \$5,742,781 | \$4.93 | \$3.99 | 1.4% | 17.2% | 15.2% | 16.8% | 19.9% | 51.1% | 0.0% | \$- |
| Subordinated | \$830,632 | \$40.96 | \$55.09 | 2.9% | 13.5% | 17.0% | 19.6% | 16.2% | 49.6% | 12.6% | \$6,563 |
| Subordinated, interest only | \$274,462 | \$5.34 | \$6.04 | 1.7% | 9.0% | 17.0% | 18.1% | 15.4% | 45.0% | 0.0% | \$- |

| RMBS transferred to consolidated variable interest entities | \$3,912,376 | \$54.17 | \$77.82 | 4.7% | 15.8% | 11.7% | 14.7% | 25.8% | 57.9% | 1.6% | \$34,386 |
|---|-------------|----------|----------|------|-------|-------|-------|-------|-------|-------|----------|
| Agency Mortgage-Backed Securities | | | | | | | | | | | |
| Pass-through | \$1,898,131 | \$104.52 | \$105.24 | 3.6% | 3.3% | 7.7% | 18.2% | NA | NA | 0.0% | \$- |
| Interest-only | \$247,344 | \$17.69 | \$17.30 | 3.2% | 5.3% | 9.8% | 17.5% | NA | NA | 0.0% | \$- |
| Securitized | | | | | | | | | | | |
| loans | \$776,074 | \$102.12 | \$98.26 | 4.7% | 3.5% | 18.3% | 36.4% | 1.5% | 22.3% | 16.4% | \$(6) |

(1) Bond Equivalent Yield at period end. Weighted Average Yield is calculated using each investment's respective amortized cost.

(2) Calculated based on reported losses to date, utilizing widest data set available (i.e., life-time losses, 12-month loss, etc.)

Based on the projected cash flows for our Non-Agency RMBS that are not of high credit quality, a portion of the original purchase discount is designated as Accretable Discount, which reflects the purchase discount expected to be accreted into interest income, and a portion is designated as Non-Accretable Difference, which represents the contractual principal on the security that is not expected to be collected. The amount designated as Non-Accretable Difference may be adjusted over time, based on the actual performance of the security, its underlying collateral, actual and projected cash flow from such collateral, economic conditions and other factors. If the performance of a security is more favorable than previously estimated, a portion of the amount designated as Non-Accretable Difference may be accreted into interest income over time. Conversely, if the performance of a security is less favorable than previously estimated, the amounts designated as Non-Accretable Difference may increase, resulting in an OTTI loss.

The following table presents changes to Accretable Discount and Non-Accretable Difference as it pertains to our entire Non-Agency RMBS portfolio for assets with purchase discounts during the previous five quarters.

| | For the Quarter Ended | | | | |
|-------------------------------|------------------------|----------------------|-----------------------|------------------|-------------------|
| | March 31, 2014 | December 31, 2013 | September 30, 2013 | June 30, 2013 | March 31, 2013 |
| | (dollars in thousands) | | | | |
| | Accretable Discount | | | | |
| Balance, beginning of period | \$ 996,694 | \$ 1,012,513 | \$ 1,026,921 | \$ 1,088,157 | \$ 1,115,268 |
| Accretion of discount | (40,304) | (40,812) | (40,001) | (40,042) | (39,326) |
| Purchases | 18,815 | - | - | - | 935 |
| Sales | (3,843) | - | (6,655) | (46,125) | (17) |
| Transfers from credit reserve | 31,666 | 28,962 | 35,054 | 30,744 | 18,419 |
| Transfers to credit reserve | (12,826) | (3,969) | (2,806) | (5,813) | (7,122) |
| Balance, end of period | \$ 990,202 | \$ 996,694 | \$ 1,012,513 | \$ 1,026,921 | \$ 1,088,157 |

| | For the Quarter Ended | | | | |
|---|---------------------------|----------------------|-----------------------|------------------|-------------------|
| | March 31, 2014 | December 31, 2013 | September 30, 2013 | June 30, 2013 | March 31, 2013 |
| | (dollars in thousands) | | | | |
| | Non-Accretable Difference | | | | |
| Balance, beginning of period | \$ 1,217,793 | \$ 1,261,945 | \$ 1,370,792 | \$ 1,464,558 | \$ 1,540,780 |
| Principal Writedowns | (47,079) | (41,708) | (93,054) | (68,835) | (72,055) |
| Purchases | 18,815 | - | - | - | 935 |
| Sales | (1,093) | - | - | - | 32 |
| Net other-than-temporary credit impairment losses | 1,534 | 22,549 | 16,455 | - | 6,163 |
| Transfers from credit reserve | (31,666) | (28,962) | (35,054) | (30,744) | (18,419) |
| Transfers to credit reserve | 12,826 | 3,969 | 2,806 | 5,813 | 7,122 |
| Balance, end of period | \$ 1,171,130 | \$ 1,217,793 | \$ 1,261,945 | \$ 1,370,792 | \$ 1,464,558 |

Critical Accounting Policies and Estimates

We prepare our financial statements in accordance with accounting principles generally accepted in the United States, or GAAP, which requires the use of estimates and assumptions. Management has discussed and reviewed the development, selection, and disclosure of critical accounting estimates with the Company's Audit Committee. Management believes that the most critical accounting policies and estimates, since these estimates require significant judgment, are interest income and other-than-temporary impairment, or OTTI, on Non-Agency RMBS, the determination of the appropriate accounting model for Non-Agency RMBS, the impact of default and prepayment

assumptions on RMBS, and fair value measurements. Financial results could be materially different if other methodologies were used or if management modified its assumptions.

For a discussion of the Company's critical accounting policies and estimates, see "Critical Accounting Policies and Estimates" in Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" included in the Company's Annual Report on Form 10-K for the year ended December 31, 2013.

Recent Accounting Pronouncements

Refer to Note 2(q) in the Notes to Consolidated Financial Statements for a discussion of accounting guidance recently adopted by the Company.

Results of operations for the quarters ended March 31, 2014 and 2013

Our primary source of income is interest income earned on our assets. Our economic net interest income equals interest income excluding interest earned on cash and cash equivalents less interest expense and realized losses on our interest rate hedges. For the purpose of computing economic net interest income and ratios relating to cost of funds measures throughout this section, interest expense includes net payments on interest rate hedges, including interest rate swaps and Treasury futures, which is presented as a part of Realized gains (losses) on derivatives in our Consolidated Statements of Operations and Comprehensive Income. Interest rate hedges are used to manage the increase in interest paid on repurchase agreements in a rising rate environment. Presenting the net contractual interest payments on interest rate hedges with the interest paid on interest-bearing liabilities reflects our total contractual interest payments. We believe this presentation is useful to investors because this presentation depicts the economic value of our investment strategy, by showing actual interest expense and net interest income. Where indicated, interest expense, including interest payments on interest rate hedges, is referred to as economic interest expense. Where indicated, net interest income reflecting interest payments on interest rate hedges, is referred to as economic net interest income.

The following table reconciles the GAAP and non-GAAP measurements reflected in the Management's Discussion and Analysis of Financial Condition and Results of Operations.

| | GAAP Interest Income | GAAP Interest Expense | Add: Net Realized Losses on Interest Rate Hedges | Economic Interest Expense | GAAP Net Interest Income | Less: Net Realized Losses on Interest Rate Hedges | Economic Net Interest Income (1) |
|---|----------------------------|-----------------------------|--|---------------------------------|-----------------------------------|--|--|
| For the Quarter Ended March 31, 2014 | \$ 120,667 | \$ 22,425 | \$ 6,351 | \$ 28,776 | \$ 98,242 | | |