

DYNEX CAPITAL INC
Form 10-K
March 08, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549
FORM 10-K

Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the fiscal year ended December 31, 2015

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

Commission File Number: 1-9819

DYNEX CAPITAL, INC.

(Exact name of registrant as specified in its charter)

Virginia 52-1549373
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

4991 Lake Brook Drive, Suite 100, Glen Allen, Virginia 23060-9245
(Address of principal executive offices) (Zip Code)

(804) 217-5800
(Registrant's telephone number, including area code)

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

Title of each class	Name of each exchange on which registered
Common Stock, \$.01 par value	New York Stock Exchange
8.50% Series A Cumulative Redeemable Preferred Stock, par value \$0.01 per share	New York Stock Exchange
7.625% Series B Cumulative Redeemable Preferred Stock, par value \$0.01 per share	New York Stock Exchange

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act.

Yes No

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

Yes No

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

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Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

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

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

Yes No

As of June 30, 2015, the aggregate market value of the voting stock held by non-affiliates of the registrant was approximately \$376,818,281 based on the closing sales price on the New York Stock Exchange of \$7.62.

On February 29, 2016, the registrant had 48,952,860 shares outstanding of common stock, \$0.01 par value, which is the registrant's only class of common stock.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Definitive Proxy Statement for the registrant's 2016 annual meeting of shareholders, expected to be filed pursuant to Regulation 14A within 120 days from December 31, 2015, are incorporated by reference into Part III.

DYNEX CAPITAL, INC.
FORM 10-K
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CAUTIONARY STATEMENT – This Annual Report on Form 10-K may contain “forward-looking” statements within the meaning of Section 27A of the Securities Act of 1933, as amended (or “1933 Act”), and Section 21E of the Securities Exchange Act of 1934, as amended (or “Exchange Act”). We caution that any such forward-looking statements made by us are not guarantees of future performance, and actual results may differ materially from those expressed or implied in such forward-looking statements. Some of the factors that could cause actual results to differ materially from estimates expressed or implied in our forward-looking statements are set forth in this Annual Report on Form 10-K for the year ended December 31, 2015. See Item 1A. “Risk Factors” as well as “Forward-Looking Statements” set forth in Item 7. “Management’s Discussion and Analysis of Financial Condition and Results of Operations” of this Annual Report on Form 10-K.

In this Annual Report on Form 10-K, we refer to Dynex Capital, Inc. and its subsidiaries as “the Company,” “we,” “us,” or “our,” unless we specifically state otherwise or the context indicates otherwise.

PART I.

ITEM 1. BUSINESS

COMPANY OVERVIEW

We are an internally managed mortgage real estate investment trust, or mortgage REIT, which invests in residential and commercial mortgage-backed securities on a leveraged basis. Our common stock is traded on the New York Stock Exchange (“NYSE”) under the symbol “DX”. We also have two series of preferred stock outstanding, our 8.50% Series A Cumulative Redeemable Preferred Stock (the “Series A Preferred Stock”) which is traded on the NYSE under the symbol “DXPRA”, and our 7.625% Series B Cumulative Redeemable Preferred Stock (the “Series B Preferred Stock”) which is traded on the NYSE under the symbol “DXPRB”. Our objective is to provide attractive risk-adjusted returns to our shareholders over the long term that are reflective of a leveraged, high quality fixed income portfolio with a focus on capital preservation. We seek to provide returns to our shareholders primarily through regular quarterly dividends, and also through capital appreciation.

We invest in Agency and non-Agency mortgage-backed securities (“MBS”) consisting of residential MBS (“RMBS”), commercial MBS (“CMBS”) and CMBS interest-only (“IO”) securities. Agency MBS have a guaranty of principal payment by an agency of the U.S. government or a U.S. government-sponsored entity (“GSE”) such as Fannie Mae and Freddie Mac. Non-Agency MBS have no such guaranty of payment. Due to the guaranty of principal payment by a GSE, Agency MBS are the highest credit quality MBS available for investment. We seek to invest in Agency MBS and higher quality MBS (typically rated ‘A’ or better by one or more of the nationally recognized statistical rating organizations) to limit our exposure to credit losses and to minimize fluctuations in fair value from widening in credit spreads. In addition, Agency MBS and higher-rated MBS are typically more liquid (i.e., they are more easily converted into cash either through sales or pledges as collateral for repurchase agreement borrowings) than lower-rated MBS.

Our primary source of income is net interest income, which is the excess of the interest income earned on our investments over the cost of financing these investments. We invest our capital pursuant to our Operating Policies as approved by our Board of Directors which include an Investment Policy and Investment Risk Policy as discussed further below. We use leverage to enhance the returns on our invested capital by pledging our investments as collateral for borrowings such as repurchase agreements as discussed further below.

RMBS. Our Agency RMBS investments include MBS collateralized by adjustable-rate mortgage loans (“ARMs”), which have interest rates that generally will adjust at least annually to an increment over a specified interest rate

index, and hybrid adjustable-rate mortgage loans ("hybrid ARMs"), which are loans that have a fixed rate of interest for a specified period (typically three to ten years) and then adjust their interest rate at least annually to an increment over a specified interest rate index. Agency ARMs also include hybrid Agency ARMs that are past their fixed-rate periods or within twelve months of their initial reset period. We may also invest in fixed-rate Agency RMBS from time to time.

We also invest in non-Agency RMBS, which do not carry a principal guarantee from the U.S. government or a GSE. Non-Agency RMBS are collateralized by non-conforming residential mortgage loans and are tranced into different credit classes of securities with payments to junior classes subordinate to senior classes. Some of the non-Agency RMBS that we invest in may be collateralized by loans which are delinquent, the repayment of which is expected to come from foreclosure and liquidation of

the underlying real estate. We generally invest in senior classes of non-Agency RMBS which may include unrated securities. We seek to invest in non-Agency RMBS that we judge to have sufficiently high collateralization to be likely to protect the principal balance of our investment from credit losses on the underlying loans.

CMBS. Our Agency and non-Agency CMBS are collateralized by first mortgage loans and are primarily fixed-rate securities backed by multifamily housing and other commercial real estate property types such as office building, retail, hospitality, and health care. Loans underlying CMBS generally are geographically diverse, are fixed-rate, mature in ten to twelve years and have amortization terms of up to 30 years. Typically these loans have some form of prepayment protection provisions (such as prepayment lock-out) or prepayment compensation provisions (such as yield maintenance or prepayment penalty). Yield maintenance and prepayment penalty requirements are intended to create an economic disincentive for the loans to prepay. Non-Agency CMBS also includes securities that are backed by pools of single-family rental homes which have variable-rates that reset monthly based on an index rate, such as LIBOR.

CMBS IO. CMBS IO are interest-only securities issued as part of a CMBS securitization and represent the right to receive interest payments (but not principal cash flows) based on the unpaid principal balance of the underlying pool of commercial mortgage loans. We invest in both Agency-issued and non-Agency issued CMBS IO. The loans collateralizing CMBS IO pools are very similar in composition to the pools of loans that generally collateralize CMBS as discussed above. Since CMBS IO securities have no principal associated with them, the interest payments received are based on the unpaid principal balance of the underlying pool of mortgage loans, which is often referred to as the notional amount. Because CMBS IO receive no principal payments, CMBS IO securities generally have some form of prepayment protection including absolute loan prepayment lock-outs, loan prepayment penalties, or yield maintenance requirements associated with the underlying loans similar to CMBS described above.

Operating Policies and Restrictions

Our Operating Policies, which are reviewed and approved by the Board, set forth investment and risk limitations as they relate to the Company's investment activities and set parameters for the Company's investment and capital allocation decisions. Our Operating Policies require that we manage our operations and investments to comply with various REIT limitations (as discussed further below in "Federal Income Tax Considerations") and to avoid qualifying as an investment company as such term is defined in the Investment Company Act of 1940 (the "1940 Act") or as a commodity pool operator under the Commodity Exchange Act.

As of December 31, 2015, our Operating Policies target an asset allocation of 60% to Agency MBS and 40% to non-Agency MBS. For securities rated BBB+ or lower at the time of purchase by any of the nationally recognized statistical ratings organizations, our Operating Policies limit our investment in these securities to \$250 million in market value and limit our shareholders' equity at risk to \$50 million. We also conduct our own independent evaluation of the credit risk on any non-Agency MBS, such that we do not rely solely on the security's credit rating. In addition, our purchases of non-rated MBS in recent years have been shorter duration securities which we believe to have minimal credit risk.

Our Operating Policies also limit the overall leverage of the Company to seven times our shareholders' equity capital and place limits on certain risks to which we are exposed, such as interest rate and convexity risk, our earnings at risk, and our shareholders' equity at risk from changes in fair value of our investment securities as a result of changes in interest rates, prepayment rates, investment prices and spreads, and others items. Our Operating Policies require us to perform a variety of stress tests to model the effect on the investment portfolio value and our liquidity of adverse market conditions.

Within the overall limits established by our Operating Policies, our investment and capital allocation decisions depend on prevailing market conditions and other factors and may change over time in response to opportunities available in different economic and capital market environments.

Investment Philosophy and Strategy

Our investment philosophy encompasses a macroeconomic, top-down approach that focuses on the expected risk-adjusted outcome of any investment. Key points of our investment philosophy include the following:

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- understanding macroeconomic conditions including the current state of the U.S. and global economies;
- understanding the regulatory environment, competition for assets, and the terms and availability of financing;
- sector analysis including understanding absolute returns, relative returns and risk-adjusted returns;
- security and financing analysis including sensitivity analysis on credit, interest rate volatility, and market value risk; and
- managing performance and portfolio risks, including interest rate, credit, prepayment, and liquidity risks.

Our investment philosophy will dictate our investment strategy. In executing our strategy, we seek to balance the risks of owning various types of mortgage assets with the earnings opportunity on the investments. We believe our investment strategy provides superior diversification of these risks across our investment portfolio and therefore provides ample opportunities to generate attractive risk-adjusted returns while protecting our shareholders' capital.

The performance of our investment portfolio will depend on many factors including but not limited to interest rates, trends of interest rates, the steepness of interest rate curves, prepayment rates on our investments, demand for our investments, general market liquidity, and economic conditions and their impact on the credit performance of our investments. In addition, our business model may be impacted by other factors such as the state of the overall credit markets, which could impact the availability and costs of financing. See "Factors that Affect Our Results of Operations and Financial Condition" below and "Risk Factors-Risks Related to Our Business" in Item 1A of Part I of this Annual Report on Form 10-K for further discussion.

Our Financing Strategy

We finance our investment activities primarily by pledging investment securities to lending counterparties under short-term recourse repurchase agreements. These repurchase agreements generally have original terms to maturity of 30 days to one year, though in some instances we may enter into longer-dated maturities depending on market conditions. We pay interest on our repurchase agreement borrowings at a rate usually based on a spread to LIBOR and fixed for the term of the borrowing. Borrowings under these repurchase agreements are renewable at the discretion of our lenders and do not contain guaranteed roll-over terms. One of our repurchase agreement lenders provides a committed repurchase agreement financing facility to us with an aggregate borrowing capacity of \$300.0 million that expires on August 6, 2016.

The amount borrowed under a repurchase agreement is limited by the lender to a percentage of the estimated market value of the pledged collateral, which is generally up to 95% of the estimated market value for Agency MBS, up to 90% for higher credit quality non-Agency MBS, and up to 85% for CMBS IO and for non-rated or lower credit quality non-Agency MBS. The difference between the market value of the pledged MBS collateral and the amount of the repurchase agreement is the amount of equity we have in the position (or "haircut") and is intended to provide the lender some protection against fluctuations of value in the collateral and/or the failure by us to repay the borrowing at maturity.

Repurchase agreement financing is provided principally by major financial institutions and broker-dealers acting as financial intermediaries for money market funds and securities lenders that provide funds for the repurchase agreement markets. Repurchase agreement financing exposes us to counterparty risk, principally related to the excess of our collateral pledged over the amount borrowed. To mitigate this risk, we enter into repurchase agreement financings with multiple lenders. In very limited circumstances, a money market fund or securities lender has directly provided funds to us without the involvement of a financial intermediary typically at a lower cost than we would incur borrowing from the financial intermediary. Borrowing directly from these sources also reduces our risk to the financial intermediaries.

The fair value of MBS fluctuates primarily as a result of principal payments and changes in market interest rates and spreads, prevailing market yields, actual or anticipated prepayment speeds, and other market conditions. If the fair value of the MBS pledged as collateral declines below the lender's required haircut, the lender has the right to initiate a margin call which requires us to pledge additional assets to collateralize the outstanding repurchase agreement borrowings. Lenders may also initiate margin calls during periods of market stress as a result of actual or expected volatility in asset prices. If we fail to meet any margin call, our lenders also have the right to terminate the repurchase agreement and sell any collateral pledged. Therefore, we attempt to maintain cash and other liquid securities in sufficient amounts to manage our exposure to margin calls by lenders.

During 2015, our captive insurance subsidiary, Mackinaw Insurance Company, LLC ("Mackinaw"), became a member of the Federal Home Loan Bank ("FHLB") of Indianapolis. As a member of the FHLB system, Mackinaw had access to a variety

of services and products offered by the FHLB of Indianapolis, including the ability to secured advances against collateral pledged under an advances, pledge and security agreement which includes collateral requirements similar to our repurchase agreement borrowings. In January 2016, the Federal Housing Finance Administration ("FHFA") released a final rule on FHLB membership which excludes captive insurance entities from FHLB membership on a going-forward basis and provides termination rules for current captive insurance members. Because Mackinaw's membership in the FHLB became effective after the FHFA issued its proposed rule in September 2014, Mackinaw will be required to terminate its membership within one year of the rule's effective date of February 19, 2016 and will not be permitted new advances or renewals of existing advances during the transition period. Because we maintain excess borrowing capacity at our repurchase agreement financing counterparties, we do not anticipate any difficulties in replacing the FHLB advances at or before their respective maturities. We along with other mortgage REITs are pursuing federal legislation to preserve the membership of captive insurers in the FHLB system by reversing the FHFA's final rule, or to explicitly admit mortgage REITs into the FHLB system.

Please refer to "Risk Factors-Risks Related to Our Business" in Item 1A of Part 1 of this Annual Report on Form 10-K for additional information regarding significant risks related to our repurchase agreement financing.

Our Hedging Strategy

We use a variety of derivative instruments to mitigate our exposure to market events outside of our control which could impact our earnings, cash flow or book value. Our hedging activities attempt primarily to reduce our exposure to adverse effects of changes in interest rates. For example, given the nature of our investing and financing activities, in a period of rising interest rates our earnings and cash flow may be negatively impacted by borrowing costs increasing faster than income from our assets, and our book value may decline as a result of declining market values of our MBS. We enter into derivative instruments in an attempt to partially or fully mitigate our exposure to these changes in interest rates. We typically utilize interest rate swap agreements and Eurodollar futures to hedge interest rate risk, but may also utilize interest rate cap or floor agreements, put and call options on securities or securities underlying futures contracts, forward rate agreements, or swaptions.

In conducting our hedging activities, we intend to comply with REIT and tax limitations on our hedging instruments which could limit our activities and the instruments that we may use. We also intend to enter into derivative contracts only with the counterparties that we believe have a strong credit rating to help mitigate the risk of counterparty default or insolvency.

Factors that Affect Our Results of Operations and Financial Condition

Our financial performance is driven by the performance of our investment portfolio and related funding and derivative hedging activity which are impacted by multiple factors, many of which are related to macroeconomic conditions and other factors beyond our control. These factors include, but are not limited to, the absolute level of interest rates, the relative steepness of interest rate curves, changes in market expectations of future interest rates, actual and estimated future prepayment rates on our investments, competition for investments, economic conditions and their impact on the credit performance of our investments, and market required yields as reflected by market credit spreads. All of these factors are influenced by market forces and generally are exacerbated during periods of market volatility as we experienced at the end of 2015 and the beginning of 2016.

In addition, the performance of our investment portfolio, the cost and availability of financing and the availability of investments at acceptable risk-adjusted returns could be influenced by actions and policy measures of the U.S. government including, but not limited to, the FHFA, the U. S. Department of the Treasury (the "Treasury"), and the Board of Governors of the Federal Reserve System (the "Federal Reserve") and could also be influenced by reactions in U.S. markets from activities of central banks around the world.

Our business model may also be impacted by other factors such as the availability and cost of financing and the state of the overall credit markets. Reductions in the availability of financing for our investments could significantly impact our business and force us to sell assets that we otherwise would not sell, potentially at losses depending on market conditions. Regulatory developments since the 2008 financial crisis have impacted large U.S. domiciled banks and their broker dealer subsidiaries by requiring such entities to hold more capital against their assets, including reverse repurchase agreements. In general, this has led to reduced lending capacity in the repurchase agreement market, though we have not yet experienced a reduction in the availability of repurchase agreement financing. Other factors that could also impact our business include changes in regulatory requirements, including requirements to qualify for registration under the 1940 Act, and REIT requirements.

We believe that regulatory impacts on financial institutions, many of which are our trading and financing counterparties, continue to pose a threat to the overall liquidity in the capital markets. In particular, higher capital requirements under U.S. banking regulations adopted in 2013 and 2014 and limitations on the proprietary trading activities of large U.S. financial institutions under the Dodd-Frank Wall Street Reform and Consumer Protection Act ("the "Dodd-Frank Act") could result in reduced liquidity in times of market stress. U.S. federal banking regulators continue to explore further increasing regulatory and capital requirements for large U.S. financial institutions. While the Federal Reserve continues to reinvest principal payments received on its Agency RMBS portfolio, it is unlikely that this activity will provide enough liquidity to the market in times of stress, which could result in volatile asset prices. Further, the impact on market liquidity of our investments and the financing markets could be negatively impacted if the Federal Reserve's Federal Open Market Committee (or "FOMC") suddenly changes market expectations of the targeted Federal Funds Rate or takes other actions which have the effect of tightening monetary policy.

As discussed above, investing in mortgage-related securities on a leveraged basis subjects us to a number of risks including interest rate risk, prepayment and reinvestment risk, credit risk, market value risk and liquidity risk. Please refer to Part I, Item 1A, "Risk Factors" as well as Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and Item 7A, "Quantitative and Qualitative Disclosures about Market Risk" of this Annual Report on Form 10-K for a detailed discussion of these factors and others that have the potential to impact our results of operations and financial condition.

INDUSTRY OVERVIEW

Mortgage REITs provide liquidity to the U.S. real estate markets through the purchase of RMBS and CMBS and through the origination or purchase of mortgage loans. The business models of mortgage REITs range from investing only in Agency MBS to investing substantially in non-investment grade MBS and originating and securitizing mortgage loans. Each mortgage REIT will assume risks in its investment strategy. Whereas we invest in shorter-duration and higher quality MBS in order to mitigate interest rate risk and credit risk, other mortgage REITs may be willing to accept more of these risks than we are and invest in mortgage assets that we do not.

As a continuing consequence of the 2008 financial crisis, the U.S. Congress is exploring ways to reform the housing finance system, and in particular the roles of Fannie Mae, Freddie Mac and Ginnie Mae in this system, and to move toward a housing finance system with larger participation by private entities. Based on political and regulatory proposals and discussions, we believe that an immediate or near-term resolution of Fannie Mae, Freddie Mac, or Ginnie Mae is very unlikely. However, under the terms of their federal conservatorship, Fannie Mae and Freddie Mac must continue to reduce their investment portfolios of mortgage assets but may continue issuing guarantees on pools of qualified loans. Over the longer term, however, we believe the GSE's role in the housing finance system will change and could evolve in such a way that will present opportunities for industry participants who understand and are willing to hold long-term credit and assume interest rate risk of the U.S. housing market. Ultimately, we believe the cost of credit to the U.S. housing market may increase which will improve yields on investments in RMBS and CMBS.

Uncertainty around regulation of financial institutions under the Dodd-Frank Act, minimum capital standards implemented under the Basel III Accord (and associated implementing regulations) and related regulatory reform initiatives, increased risk-weightings for certain types of mortgage loans held by depository institutions, increased regulatory requirements related to origination of certain types of residential mortgage loans, and other potential regulatory changes, may further impact capital formation in the U.S. mortgage market in ways that could favor mortgage REITs. There are potential negative consequences to increased regulation of financial institutions, however, including increasing borrowing costs or reduced availability of repurchase agreement financing and the need to post more capital to leverage our investments and/or enter into derivative instruments.

COMPETITION

The financial services industry in which we compete is a highly competitive market. In purchasing investments and obtaining financing, we compete with other mortgage REITs, broker dealers and investment banking firms, mutual funds, banks, hedge funds, mortgage bankers, insurance companies, governmental bodies, and other entities, many of which have greater financial resources and a lower cost of capital than we do. Increased competition in the market may reduce the available supply of investments and may drive prices of investments to unacceptable levels which would negatively impact our ability to earn an acceptable amount of income from these investments. Competition can also reduce the availability of borrowing capacity at our repurchase agreement

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counterparties as such capacity is not unlimited, and many of our repurchase agreement counterparties limit the amount of financing they offer to the mortgage REIT industry.

FEDERAL INCOME TAX CONSIDERATIONS

As a REIT, we are required to abide by certain requirements for qualification as a REIT under the Internal Revenue Code of 1986, as amended (the "Code"). To retain our REIT status, the REIT rules generally require that we invest primarily in real estate-related assets, that our activities be passive rather than active and that we distribute annually to our shareholders substantially all of our taxable income, after certain deductions, including deductions for our tax net operating loss ("NOL") carryforward. We could be subject to income tax if we failed to satisfy those requirements. We use the calendar year for both tax and financial reporting purposes.

We utilize our NOL carryforward to offset our taxable earnings after taking the REIT distribution requirements into account. As a result of our public offering of common stock in February 2012, we incurred an "ownership change" as such term is defined in Section 382 of the Code. Because of this ownership change, the amount of the NOL carryforward that we may use each year is limited to approximately \$13.5 million, and portions of this amount not utilized are accumulated and rolled forward to the following year. Our NOL carryforward begins to expire substantially in 2020. The following table provides a rollforward of our NOL carryforward for the periods indicated:

	NOL Available for Use	Total NOL
As of December 31, 2012:	\$11,249	\$116,187
NOL limitation release for the years ended:		
December 31, 2013	13,451	
December 31, 2014	13,451	
December 31, 2015	13,451	
NOL used for the years ended:		
December 31, 2013	—	—
December 31, 2014	(26,412	) (26,412
December 31, 2015 ⁽¹⁾	—	—
As of December 31, 2015	\$25,190	\$89,775

(1) Subject to completion of our 2015 federal income tax return.

There may be differences between taxable income and net income computed in accordance with U.S. generally accepted accounting principles ("GAAP"). These differences primarily arise from timing differences in the recognition of revenue and expense for tax and GAAP purposes.

Failure to satisfy certain Code requirements could cause us to lose our status as a REIT. If we failed to qualify as a REIT for any taxable year, we may be subject to federal income tax (including any applicable alternative minimum tax) at regular corporate rates and would not receive deductions for dividends paid to shareholders. We could, however, utilize our NOL carryforward to offset all or part of our taxable income to the extent the NOL is available to us based on the limitations described above. If we lost or otherwise surrendered our status as a REIT, we could not elect REIT status again for five years. Several of our investments in securitized mortgage loans have ownership restrictions limiting their ownership to REITs. Therefore, if we fail to maintain our REIT status, we would have to sell these investments or otherwise provide for REIT ownership of these investments. In addition, many of our repurchase agreement lenders and interest rate swap counterparties require us to maintain our REIT status. If we were to lose our REIT status, these lenders would have the right to terminate any repurchase agreement borrowings and interest rate swaps outstanding at that time.

Qualification as a REIT

Qualification as a REIT requires that we satisfy a variety of tests relating to our income, assets, distributions and ownership. The significant tests are summarized below.

Sources of Income. To continue qualifying as a REIT, we must satisfy two distinct tests with respect to the sources of our income: the "75% income test" and the "95% income test." The 75% income test requires that we derive at least 75% of our gross income (excluding gross income from prohibited transactions) from certain real estate-related sources. In order to satisfy the 95% income test, 95% of our gross income for the taxable year must consist of either income that qualifies under the 75% income test or certain other types of passive income.

If we fail to meet either the 75% income test or the 95% income test, or both, in a taxable year, we might nonetheless continue to qualify as a REIT, if our failure was due to reasonable cause and not willful neglect and the nature and amounts of our items of gross income were properly disclosed to the Internal Revenue Service. However, in such a case we would be required to pay a tax equal to 100% of any excess non-qualifying income.

Nature and Diversification of Assets. At the end of each calendar quarter, we must meet multiple asset tests. Under the "75% asset test", at least 75% of the value of our total assets must represent cash or cash items (including receivables), government securities or real estate assets. Under the "10% asset test," we may not own more than 10% of the outstanding voting power or value of securities of any single non-governmental issuer, provided such securities do not qualify under the 75% asset test or relate to taxable REIT subsidiaries. Under the "5% asset test," ownership of any stocks or securities that do not qualify under the 75% asset test must be limited, in respect of any single non-governmental issuer, to an amount not greater than 5% of the value of our total assets (excluding ownership of any taxable REIT subsidiaries).

If we inadvertently fail to satisfy one or more of the asset tests at the end of a calendar quarter, such failure would not cause us to lose our REIT status, provided that (i) we satisfied all of the asset tests at the close of the preceding calendar quarter and (ii) the discrepancy between the values of our assets and the standards imposed by the asset tests either did not exist immediately after the acquisition of any particular asset or was not wholly or partially caused by such an acquisition. If the condition described in clause (ii) of the preceding sentence was not satisfied, we still could avoid disqualification by eliminating any discrepancy within 30 days after the close of the calendar quarter in which it arose.

Ownership. In order to maintain our REIT status, we must not be deemed to be closely held and must have more than 100 shareholders. The closely held prohibition requires that not more than 50% of the value of our outstanding shares be owned by five or fewer persons at any time during the last half of our taxable year. The "more than 100 shareholders" rule requires that we have at least 100 shareholders for 335 days of a twelve-month taxable year. In the event that we failed to satisfy the ownership requirements we would be subject to fines and be required to take curative action to meet the ownership requirements in order to maintain our REIT status.

EMPLOYEES

As of December 31, 2015, we have 20 employees and one corporate office in Glen Allen, Virginia. None of our employees are covered by any collective bargaining agreements, and we are not aware of any union organizing activity relating to our employees.

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Executive Officers of the Company

Name (Age)	Current Title	Business Experience
Thomas B. Akin (63)	Executive Chairman and Director	Executive Chairman effective January 1, 2014; Chief Executive Officer between 2008 and 2013; Chairman of the Board since 2003; managing general partner of Talkot Capital, LLC.
Byron L. Boston (57)	Chief Executive Officer, President, Co-Chief Investment Officer, and Director	Chief Executive Officer and Co-Chief Investment Officer effective January 1, 2014; President and Director since 2012; Chief Investment Officer since 2008.
Stephen J. Benedetti (53)	Executive Vice President, Chief Financial Officer, and Chief Operating Officer	Executive Vice President and Chief Operating Officer since 2005; Executive Vice President and Chief Financial Officer from 2001 to 2005 and beginning again in 2008.
Smriti L. Popenoe (47)	Executive Vice President and Co-Chief Investment Officer	Executive Vice President and Co-Chief Investment Officer effective January 1, 2014; Chief Risk Officer of PHH Corporation between 2010 and 2013; Senior Vice President, Balance Sheet Management, of Wachovia Bank, from 2006 to 2009.

AVAILABLE INFORMATION

We are subject to the reporting requirements of the Exchange Act and its rules and regulations. The Exchange Act requires us to file reports, proxy statements, and other information with the SEC. Copies of these reports, proxy statements, and other information can be read and copied at:

SEC Public Reference Room
100 F Street, N.E.
Washington, D.C. 20549

Information on the operation of the Public Reference Room may be obtained by calling the SEC at 1-800-SEC-0330. The SEC maintains a website that contains reports, proxy statements, and other information regarding issuers that file electronically with the SEC. These materials may be obtained electronically by accessing the SEC's home page at www.sec.gov.

Our website can be found at www.dynexcapital.com. Our annual reports on Form 10-K, our quarterly reports on Form 10-Q, our current reports on Form 8-K, and amendments to those reports, filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act, are made available free of charge through our website as soon as reasonably practicable after such material is electronically filed with or furnished to the SEC.

We have adopted a Code of Business Conduct and Ethics ("Code of Conduct") that applies to all of our employees, officers and directors. Our Code of Conduct is also available free of charge on our website, along with our Audit Committee Charter, our Nominating and Corporate Governance Committee Charter, and our Compensation Committee Charter. We will post on our website amendments to the Code of Conduct or waivers from its provisions, if any, which are applicable to any of our directors or executive officers in accordance with SEC or NYSE requirements.

ITEM 1A. RISK FACTORS

The following is a summary of the risk factors that we believe are most relevant to our business. These are factors which, individually or in the aggregate, we think could cause our actual results to differ significantly from anticipated or historical results. In addition to understanding the key risks described below, investors should understand that it is not possible to predict or identify all risk factors, and consequently, the following is not a complete discussion of all potential risks or uncertainties.

RISKS RELATED TO OUR BUSINESS

We use leverage in order to enhance returns to our shareholders. Using leverage increases the risk of volatility in our results and in an adverse market environment could lead to decreases in net income and dividends, declines in book value, and material decreases in our liquidity.

The use of leverage in our business increases the risk of volatility in returns to our shareholders and increases the risk of a material decline in our book value and liquidity. As of December 31, 2015, our leverage ratio was 6.5x shareholders' equity, and that range has fluctuated between 5x shareholders' equity and 7x shareholders' equity since 2008. Leverage increases returns on our invested capital if we can earn a greater return on investments purchased with borrowings than our cost of such borrowing, but can decrease returns if the cost of such leverage increases and we have not adequately hedged against such increase. In addition, using leverage magnifies the potential losses of our equity capital (and book value per common share) resulting from market value declines in our investments, net of hedges, and vice versa. Finally, we have increased liquidity risk stemming from the potential for margin calls by our lenders for fluctuations in collateral values, or if the lender fails to renew or roll over the financing. If we are unable to access or maintain financing on materially similar terms to existing borrowings, our ability to generate net interest income and dividends to our shareholders could be negatively impacted.

Our ability to access leverage sufficient to generate acceptable returns to our shareholders is impacted by the following:

- market conditions and overall market volatility and liquidity;
- regulation of our lenders;
- the liquidity of our investments;
- the market value of our investments;
- the advance rates by our lenders on investment collateral pledged, and;
- the willingness of our lenders to finance the types of investments we choose.

We may be required to post large amounts of additional assets as collateral or margin to secure our leveraged positions in the event of a sudden, precipitous drop in the value of our financed assets. Declines in the values of our financed assets could also require us to reduce our leverage by selling assets or not replacing MBS as they amortize and/or prepay, thereby decreasing the outstanding amount of our related borrowings. Even a small decrease in the value of a leveraged asset may require us to post additional collateral. The requirement to post additional collateral may decrease the amount of cash available to us for distributions to our shareholders, and deleveraging to manage declines in the fair value of our assets or due to the lack of available financing could reduce our net interest income, which could also adversely affect our financial condition, results of operations and distributions to shareholders.

For more information about our operating policies regarding leverage and historic leverage levels, please see “Liquidity and Capital Resources” within Part II, Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operation.”

Repurchase agreements are generally uncommitted short-term financings and changes to terms of such financing may adversely affect our profitability and our liquidity.

Repurchase agreements are generally uncommitted financings from lenders with an average term of ninety days or less. Because we rely heavily on borrowings under repurchase agreements to finance our investments, our ability to achieve our investment and profitability objectives can depend on our ability to access repurchase agreement financing in sufficient amounts and on favorable terms, and to renew or replace maturing financings on a continuing basis. If the terms on which we borrow change in a meaningful way, our profitability may be negatively impacted, thereby reducing distributions to our shareholders.

Because repurchase agreements are short-term commitments of capital, changes in conditions in the repurchase markets may make it more difficult for us to secure continued financing. In periods of high volatility, some lenders may lose their ability or curtail their willingness to provide financing. Additionally, regulatory capital requirements imposed on our lenders by financial and banking regulators have changed significantly in recent years, and as a result, the cost of financing has increased and may continue to increase. In addition, many lenders may find it unprofitable to lend against certain collateral types due to higher regulatory costs and regulatory capital requirements, and thus restrict their lending against such collateral. Moreover, the amount

of financing we receive under our repurchase agreements will be directly related to the lenders' valuation of the assets that secure the outstanding borrowings. All of these circumstances could increase the cost of our borrowings or reduce our ability to access leverage and could also force us to sell assets at significant losses if the unfavorable market environment requires us to deleverage.

We invest in assets that are traded in over-the-counter (OTC) markets which are less liquid and have less price transparency than securities exchanges. Owning securities that are traded in OTC markets may increase our liquidity risk, particularly in a volatile market environment, because our assets may be more difficult to borrow against or sell in a prompt manner and on terms acceptable to us, and we may not realize the full value at which we previously recorded the investments and/or may incur additional losses upon sale.

Though Agency MBS are generally deemed to be very liquid securities, turbulent market conditions in the past have at times significantly and negatively impacted the liquidity of these assets, resulting in reductions in their market value. Non-Agency MBS are typically more difficult to value, less liquid, and experience greater price volatility than Agency MBS. In addition, market values for non-Agency MBS are typically more subjective than Agency MBS. As a result of these factors, the number of lenders willing to provide financing for non-Agency MBS or accept them as collateral has generally been limited compared to Agency MBS.

A sudden reduction in the liquidity of our investments could limit our ability to finance or could make it difficult to sell investments if the need arises. If we are required to liquidate all or a portion of our portfolio quickly, we may realize significantly less than the fair value at which we have previously recorded our investments which would result in lower than anticipated gains or higher losses.

In an extreme case of market duress, a market may not exist for certain of our assets at any price. If the MBS market were to experience a severe or extended period of illiquidity, repurchase agreement lenders may refuse to accept our assets as collateral for repurchase agreement financing. Furthermore, repurchase agreements grant the respective lender the right to reevaluate the market value of the assets that secure outstanding borrowings at any time. If a lender determines that the market value of the assets has declined below the lender's required advance rate, it has the right to initiate a margin call. A margin call would require us to transfer additional assets to such lender or to repay a portion of the outstanding borrowings. Any such margin call could have a material adverse effect on our results of operations, financial condition, business, liquidity and ability to make distributions to stockholders, and could cause the value of our common stock or preferred stock to decline. We may be forced to sell assets at significantly depressed prices to meet margin calls and to maintain adequate liquidity, which could cause us to incur losses. Moreover, to the extent that we are forced to sell assets because of changes in market conditions, other market participants may face similar pressures, which could exacerbate a difficult market environment and which could result in significantly greater losses on our sale of such assets.

Fluctuations in interest rates may have various negative effects on us and could lead to reduced net interest income and a lower book value.

Fluctuations in interest rates impact us in a number of ways. For example, in a period of rising rates, we may experience a decline in our profitability from borrowing rates increasing faster than rates on our assets reset or from our investments adjusting less frequently or relative to a different index (e.g., six month or one-year LIBOR) from our borrowings (repurchase agreements are typically based on one-month LIBOR). Most of our assets are also fixed rate for a period of their lives and are financed with floating rate repurchase agreements that mature faster. In a period of rising interest rates, our borrowings will reset more quickly to market interest rates than most of our assets, which may negatively affect returns on our portfolio and our net interest income.

The mortgage loans collateralizing ARMs typically have periodic (or interim) and lifetime interest rate caps. Periodic interest rate caps limit the amount interest rates can adjust on a loan during any given period. Lifetime interest rate

caps limit the amount interest rates can adjust from inception through maturity of a loan. Because of these caps, the amount of gross interest income earned by ARMs may become limited in a sustained period of rising interest rates or in any period in which interest rates rise rapidly. We may also experience price volatility as ARMs approach their interest rate caps. In addition, we could experience additional declines in net interest income as the repurchase agreements financing ARMs do not have periodic or lifetime interest rate caps.

Fluctuations in interest rates may also negatively affect the market value of our securities. Since our securities are fixed rate or adjust generally over longer-term periods, rising interest rates will reduce the market value of our MBS as a result of higher yield requirements by the market for these types of securities. In some instances, increases in short-term interest rates are rapid enough that short-term interest rates equal or exceed medium/long-term interest rates, resulting in a flat or inverted yield curve. Any fixed-rate or hybrid ARM investment will generally be more negatively affected by these increases than ARMs (which have interest-rates that adjust more frequently). Reductions in the market value of our securities could result in margin calls from our lenders, potentially forcing us to sell securities at a loss. Conversely, while declining interest rates are more favorable for us, we may experience increasing prepayments, resulting in reduced profitability due to reinvestment of our capital in lower yielding investments.

A sudden shift in U.S. monetary policy may increase our borrowing costs and negatively impact the value of our investments and book value.

The FOMC maintained its targeted federal funds rate at the historically low range of between 0% and 0.25% from 2008 to December 2015, when it raised its targeted federal funds rate to a range between 0.25% and 0.5%. The FOMC has also sought to provide additional policy monetary stimulus with large-scale purchases of Treasury securities and Agency RMBS (which the market has referred to as quantitative easing, or "QE"). While the FRBNY, on behalf of the FOMC, is not actively purchasing additional securities under the QE program, it continues to reinvest principal repayments received on the securities which it owns in order to maintain an accommodative monetary policy.

The potential market volatility from the Federal Reserve's future withdrawal of its accommodative monetary policy through its reinvestment of principal payments received or increases in the targeted federal funds rate may be extreme. Once the Federal Reserve announces a higher targeted range or if markets determine that the Federal Reserve is likely to announce a higher targeted range, our borrowing costs are likely to increase which will negatively impact our results of operations and could impact our financial condition and book value. Further, significant price volatility could occur following large asset sales (or anticipation thereof) by the FRBNY. In such a case, it is likely that prices on our investments would decline which would cause a decline in our book value and also could result in margin calls by our lenders on Agency MBS pledged as collateral for repurchase agreements. If declines in prices are substantial, we could be forced to sell assets at a loss or at an otherwise inopportune time in order to meet margin calls or repay lenders.

Our repurchase agreements and derivative instruments may contain financial and non-financial covenants. Our inability to meet these covenants could adversely affect our financial condition, results of operations and cash flows.

In connection with certain of our repurchase agreements and derivative instruments, we are required to maintain certain financial and non-financial covenants. The most restrictive financial covenants as of February 29, 2016 require that, on any date, we have (i) a minimum of \$30 million of liquidity; (ii) a minimum shareholders' equity of the sum of \$110 million and 90% of all net capital contributions after June 30, 2008; (iii) declines in shareholders' equity less than 25% in any quarter and 35% in any year; and (iv) a maximum debt-to-equity ratio of 7-to-1. In addition, virtually all of our repurchase agreements and derivative instruments require us to maintain our status as a REIT and to be exempted from the provisions of the 1940 Act. Compliance with these covenants depends on market factors and the strength of our business and operating results. Various risks, uncertainties and events beyond our control, including significant fluctuations in interest rates, could affect our ability to comply with these covenants. Failure to comply with these covenants could result in an event of default, termination of a repurchase agreement, acceleration of all amounts owing under a repurchase agreement, and generally would give the counterparty the right to exercise certain other remedies under the repurchase agreement, including the sale of the asset subject to repurchase at the time of default, unless we were able to negotiate a waiver in connection with any such default related to failure to comply with a covenant. Any such waiver could be conditioned on an amendment to the repurchase agreement and any related guaranty agreement on terms that may be unfavorable to us. If we are unable to negotiate a covenant waiver or replace or refinance our assets under a new repurchase facility on favorable terms or at all, our financial condition, results of

operations and cash flows could be adversely affected. Further, certain of our repurchase agreements and derivative instruments have cross-default, cross-acceleration or similar provisions, such that if we were to violate a covenant under one agreement, that violation could lead to defaults, accelerations, or other adverse events under other agreements, as well.

Prepayment rates on the mortgage loans underlying our investments may adversely affect our profitability and the market value of our investments. Changes in prepayment rates may also subject us to reinvestment risk.

We are subject to prepayment risk to the extent that we own investments at premiums to their par value. Our investment portfolio consists substantially of RMBS and CMBS owned at premiums, and CMBS IO securities which have no principal amounts outstanding and consist only of the right to receive interest payments on the underlying pools of CMBS loans included in the securitization trust. Prepayments on our investments can occur both on a voluntary and involuntary (i.e., a loan default and subsequent foreclosure and liquidation) basis. Voluntary prepayments tend to increase when interest rates are declining or, in the case of ARMs or hybrid ARMs, based on the shape of the yield curve. CMBS and CMBS IO are generally protected from voluntary prepayment either by an absolute prepayment lock-out on the loan or by yield maintenance or prepayment penalty provisions which compensate us for future lost interest income on the loan. RMBS provide no specific protection from voluntary prepayment. The actual level of prepayments on our investments will be impacted by economic and market conditions, the absolute and relative levels of interest rates, and the general availability of mortgage credit among other factors. We have no protection from involuntary prepayments which tend to increase in periods of economic stress and may occur for any of our investment types.

We amortize the premiums we pay on a security using the effective yield method, which is impacted by actual and projected borrower prepayments of principal on the loans. If we experience actual prepayments in excess of our projections or increase our expectations of future prepayment activity, we will amortize investment premiums at an accelerated rate which would reduce our interest income. The impact of accelerated amortization is particularly acute on CMBS IO securities since our investments in these securities consist entirely of premium.

Increases in actual prepayment rates or market expectations of prepayment rates could also negatively impact the market value of our investments. Faster prepayments generally negatively impact the market value of RMBS due to less predictability of payments on the underlying mortgage loans and will increase the required market yield on such security. Faster prepayments will also negatively impact the market value of CMBS IO, depending on the amount of prepayment protection for a given security. Increasing prepayments will typically reduce the value of our securities owned at premiums which will negatively impact our book value. We are also more likely to experience margin calls from our lenders as a result of the decline in value of our securities.

In certain circumstances, compensation for voluntary prepayment on CMBS IO securities may not be sufficient to compensate us for the loss of future excess interest as a result of the prepayment, thereby adversely affecting our results of operations. Also, the amount of prepayment penalties on loans underlying CMBS and CMBS IO decline over time, and as loans age, interest rates decline, or market values of the collateral supporting the loan increase, prepayment penalties may not serve as a sufficient economic disincentive to prevent the borrower from prepaying.

If we receive increased prepayments of our principal in a declining or low interest rate environment, we may earn a lower return on our new investments as compared to the MBS that prepay given the declining interest rate environment. If we reinvest our capital in lower yielding investments, we will likely have lower net interest income and reduced profitability unless the cost of financing these investments declines faster than the rate at which we may reinvest.

Global sovereign credit risk could have a material adverse effect on our business, financial condition and liquidity.

Sovereign credit in the United States and Europe is currently under pressure as a result of large budget deficits, fiscal imbalances and below trend growth or negative growth. In addition, China is experiencing slower economic growth and Japan is experiencing very low inflation and has recently reported recessionary economic data. While we do not borrow directly from any sovereign, global risk appetite is impacted by changes in actual or perceived credit risk of the United States, Europe and Asia. Adverse changes in sovereign credit ratings or credit outlook could have a material adverse impact on financial markets and economic conditions in the United States and worldwide, and on the availability of financing as well as the value of securities that we own. Any such adverse impact could have a material

adverse effect on our liquidity, financial condition, book value and results of operations.

Provisions requiring yield maintenance charges, prepayment penalties, defeasance, or lock-outs in CMBS IO securities may not be enforceable.

Provisions in loan documents for mortgages in CMBS IO securities in which we invest requiring yield maintenance charges, prepayment penalties, defeasance, or lock-out periods may not be enforceable in some states and under federal bankruptcy law. Provisions in the loan documents requiring yield maintenance charges and prepayment penalties may also be interpreted as

constituting the collection of interest for usury purposes. Accordingly, we cannot be assured that the obligation of a borrower to pay any yield maintenance charge or prepayment penalty under a loan document in a CMBS IO security will be enforceable. Also, we cannot be assured that foreclosure proceeds under a loan document in a CMBS IO security will be sufficient to pay an enforceable yield maintenance charge. If yield maintenance charges and prepayment penalties are not collected, or if a lock-out period is not enforced, we may incur losses to write-down the value of the CMBS IO security for the present value of the amounts not collected. This would also likely cause margin calls from any lender on the CMBS IO impacted. Because a margin call would require us to transfer additional assets to such lender or to repay a portion of the outstanding borrowings, it could have a material adverse effect on our liquidity.

We invest in securities guaranteed by Fannie Mae and Freddie Mac which are currently under conservatorship by the FHFA. As conservator, the FHFA has assumed all the powers of the shareholders, directors and officers of the GSEs with the goal of preserving and conserving their assets. Both Fannie Mae's and Freddie Mac's solvency is being supported by the Treasury through their committed purchases of Fannie Mae and Freddie Mac preferred stock. The ultimate impact on the operations of Fannie Mae and Freddie Mac from the conservatorships and the support they receive from the U.S. government is not determinable and could affect Fannie Mae and Freddie Mac in such a way that our business, operations and financial condition may be adversely affected.

In 2008, the FHFA placed Fannie Mae and Freddie Mac under federal conservatorship. As its conservator, the FHFA has broad regulatory powers over Fannie Mae and Freddie Mac and has entered into Preferred Stock Purchase Agreements, as amended, ("PSPAs") pursuant to which the Treasury ensures that Fannie Mae and Freddie Mac will separately maintain a positive net worth by committing to purchase preferred stock of Fannie Mae and Freddie Mac. The FHFA as the regulator of the GSEs has proposed several reforms including, among other things, building a common, single, securitization platform between the two entities and gradually contracting their presence in the mortgage marketplace. In addition, the U.S. Congress at various times has considered structural changes to the GSEs, including winding down the GSEs and replacing them with a privately capitalized system that is intended to preserve market liquidity and protect taxpayers from future GSE losses due to economic downturns.

The outcome of the conservatorship and the scope and nature of actions that may ultimately be taken by the U.S. Congress to reform the GSEs and the housing finance system, are not predictable at this point. Actions limiting the guarantee on future Agency MBS could impact the amount of Agency MBS available to be purchased which could lead to increased competition and reduced returns from these assets. It could also negatively impact our ability to comply with the provisions of the 1940 Act (see further discussion below regarding the 1940 Act).

Both Fannie Mae and Freddie Mac have returned to profitability as a result of the housing market recovery but their long-term financial viability is highly dependent on governmental support. If the Treasury withdraws its support, the value of Agency MBS could significantly decline, which would make it difficult for us to obtain repurchase agreement financing and could force us to sell assets at substantial losses. In addition, future policies that change the relationship between Fannie Mae and Freddie Mac and the U.S. government, including those that result in their winding down, nationalization, privatization, or elimination, may create market uncertainty and have the effect of reducing the actual or perceived credit quality of securities issued or guaranteed by Fannie Mae and Freddie Mac. As a result, such policies could increase the risk of loss on investments in Agency MBS. It also is possible that such policies could adversely impact the market for such securities and spreads at which they trade, and thereby adversely impact the profitability of our investments.

All of the foregoing could materially adversely affect the availability, pricing, liquidity, market value and financing of our assets and materially adversely affect our business, operations and financial condition.

Risks related to the market value of our investments could negatively impact our net income, shareholders' equity, book value per common share and liquidity.

Our investments fluctuate in value due to changes in credit spreads, spot and forward interest rates, actual and anticipated prepayments and other factors. Changes in the market values of our investments are reflected in other comprehensive income, shareholders' equity and book value per common share. Changes in credit spreads represent the market's valuation of the perceived riskiness of assets relative to risk-free rates, and widening credit spreads such as in 2015 reduces the market value of our investments as market participants require additional yield to hold riskier assets. Credit spreads could change based on macro-economic or systemic factors specific to a particular security such as prepayment performance or credit performance. Other factors that could

impact credit spreads include technical issues such as supply and demand for a particular type of security or FOMC monetary policy. In addition, most of our investments are fixed rate or reset in rate over a period of time, and as interest rates rise, the market value of these investments will decrease.

Our investment strategy includes investing in securities with credit risk. Many of these securities have some form of subordinate credit enhancement within the security structure. The performance of these securities is dependent in large part on the performance of the underlying mortgage loans relative to the amount of the subordinate credit enhancement within the security structure. These mortgage loans are subject to defaults, foreclosure timeline extension, fraud, price depreciation, and unfavorable modification of loan principal amount, interest rate, and premium, any of which could result in losses to us.

MBS are secured by mortgage loans (generally single family residential properties for RMBS and pools of commercial mortgage loans for CMBS). We own securities that generally have some form of credit subordination to our investment with respect to credit losses on the underlying mortgage loans. We bear a risk of loss of principal on our security to the extent losses experienced on the loans in these securities are in excess of such subordination.

CMBS and CMBS IO securities that we own have a wide range of subordination levels and are collateralized by pools of commercial mortgage loans secured by multifamily or commercial properties. Commercial mortgage loans generally have a higher principal balance and the ability of a borrower to repay a loan secured by an income-producing property typically is dependent upon the successful operation of the property rather than upon the existence of independent income or assets of the borrower. If the net operating income of a commercial property is reduced, the borrower's ability to repay the loan may be impaired. Net operating income of an income-producing property can be affected by, among other things, economic conditions, tenancy, location and condition, property management decisions, competition, regulations, environmental conditions, occupancy rates, interest rates and real estate tax rates and other operating expenses. Losses on underlying commercial mortgage loans will potentially impact the yield on the CMBS and CMBS IO securities we own and could also negatively impact their market value. Negative impacts on yields will reduce our net income and reductions in market values could lead to margin calls by our lenders which, if significant, could force us to sell assets possibly at losses to meet margin calls.

Similar to CMBS and CMBS IO, we own RMBS that generally have some form of credit subordination to our investment with respect to credit losses on the underlying mortgage loans. We bear a risk of loss of principal on our security to the extent losses are sufficient to eliminate such subordination. RMBS securities are generally collateralized by pools of single family mortgage loans which have less idiosyncratic risk than CMBS and CMBS IO. The ability of a borrower to repay a mortgage loan secured by a residential property is dependent upon the income or assets of the borrower. A number of factors may impair borrowers' abilities to repay their loans, including among other things, their employment situation, economic conditions, and the availability of refinancing. In the event of defaults on the residential mortgage loans that underlie our investments in RMBS and the exhaustion of any underlying or any additional credit support, we may not realize our anticipated return on our investments and we may incur a loss on these investments.

For further discussion, see "Quantitative and Qualitative Disclosures About Market Risk" within Part II, Item 7A.

We may change our investment strategy, operating policies, dividend policy, and/or asset allocations without shareholder consent and/or in a manner in which shareholders, analysts, and capital markets may not agree, which could adversely affect our financial condition, results of operations, the market price of our common stock, and our ability to pay dividends to our shareholders.

A change in our investment strategy or asset allocation may materially change our exposure to interest rate and/or credit risk, default risk and real estate market fluctuations. These changes could have a material impact on our ability to continue to pay a dividend at a level that we had previously paid before the change in strategy. Furthermore, if any

change in investment strategy, asset allocation, operating or dividend policy is perceived negatively by the markets or analysts covering our stock, our stock price may decline.

Competition may prevent us from acquiring new investments at favorable yields, and we may not be able to achieve our investment objectives which may potentially have a negative impact on our profitability.

Our net income will largely depend on our ability to acquire mortgage-related assets with acceptable risk-return profiles at favorable spreads over our borrowing costs. The availability of mortgage-related assets meeting our investment criteria depends upon, among other things, the level of activity in the real estate market and the quality of and demand for securities in the mortgage securitization and secondary markets. The size and level of activity in real estate lending markets depends on various factors, including interest rates, regional and national economic conditions, and real estate values. In acquiring investments, we may compete with other purchasers of these types of investments, including but not limited to other mortgage REITs, broker-dealers, hedge funds, banks, insurance companies, mutual funds, and other entities that purchase assets similar to ours, many of which have greater financial resources than we do. As a result of all of these factors, we may not be able to acquire sufficient assets at acceptable spreads to our borrowing costs, which would adversely affect our profitability.

In order to maintain our portfolio size and our earnings, we must reinvest the cash flows we receive from our existing investment portfolio, including monthly principal and interest payments and proceeds from sales. If the assets we acquire in the future earn lower yields than the assets we currently own, our reported earnings per share will likely decline over time as the older assets pay down or are sold. In addition, based on market conditions, our leverage, and our liquidity profile, we may decide to not reinvest the cash flows we receive from our investment portfolio. If we retain, rather than reinvest, these cash flows, the size of our investment portfolio and the amount of net interest income generated by our investment portfolio will likely decline.

Our use of hedging strategies to mitigate our interest rate exposure may not be effective and may adversely affect our income and book value.

We use interest rate swap agreements, Eurodollar futures, interest rate caps, and other derivative transactions (collectively, "hedging instruments") to help mitigate increased financing costs and volatility in book value from adverse changes in interest rates. Our hedging activity will vary in scope based on our portfolio construction and objectives, the actual and implied level and volatility of interest rates, our forecast of future interest rates, and financing sources used. No hedging strategy, however, can completely insulate us from the interest rate risks to which we are exposed, and there can be no assurance that the implementation of any hedging strategy will have the desired impact on our results of operations or financial condition. In addition, hedging instruments that we use may adversely affect our results of operations and book value (particularly if interest rates decline) as the fair value of hedging instruments fluctuate with changes in rates (and require us to post margin to counterparties) and also involve an expense that we will incur regardless of the effectiveness of the hedging activity.

Our hedging instruments can be traded on an exchange or administered through a clearing house, or are administered under bilateral agreements between us and a counterparty. Bilateral agreements expose us to increased counterparty risk, and we may be at risk of loss of any collateral held by a hedging counterparty if the counterparty becomes insolvent or files for bankruptcy.

Interest rate hedging may fail to protect or could adversely affect us because, among other things:

- The performance of instruments used to hedge may not completely correlate with the performance of the assets or liabilities being hedged;
- Interest rate hedging can be expensive, particularly during periods of volatile interest rates;
- Available hedging instruments may not correspond directly with the interest rate risk from which we seek protection;
- The duration of the hedge may not match the duration of the related asset or liability given management's expectation of future changes in interest rates or a result of the inaccuracies of models in forecasting cash flows on the asset being hedged;
- The value of derivatives used for hedging will be adjusted from time to time in accordance with GAAP to reflect changes in fair value, and downward adjustments, or "mark-to-market losses," would reduce our earnings, shareholders' equity, and book value;

- The amount of income that a REIT may earn from hedging transactions (other than through taxable REIT subsidiaries) to offset interest rate losses may be limited by U.S. federal income tax provisions governing REITs;
- The credit quality of the party owing money on the hedge may be downgraded to such an extent that it impairs our ability to sell or assign our side of the hedging transaction; and
- The party owing money in the hedging transaction may default on its obligation to pay.

Our hedging transactions, which are intended to limit losses, may actually adversely affect our earnings, which could reduce our ability to pay dividends to our shareholders.

Clearing facilities or exchanges may increase the margin requirements we are required to post when entering into derivative instruments, which may negatively impact our ability to hedge and our liquidity.

We are required to post margin when entering into a hedging instrument which is traded on an exchange or administered through a clearing house. The amount of margin is set for each derivative by the exchange or clearinghouse and in prior periods, exchanges have required additional margin in response to events having or expected to have adverse economic consequences. For example, in response to the U.S. approaching its debt ceiling without resolution and the federal government shutdown in October 2013, the Chicago Mercantile Exchange announced that it would increase margin requirements by 12% for all over-the-counter interest rate swap portfolios that its clearinghouse guaranteed. This increase was subsequently rolled back shortly thereafter upon the news that Congress passed legislation to temporarily suspend the national debt ceiling. In the event that future adverse economic developments or market uncertainty (including those due to governmental, regulatory, or legislative action or inaction) result in increased margin requirements for our hedging instruments, it could materially adversely affect our liquidity position, business, financial condition and results of operations.

We may be subject to the risks associated with inadequate or untimely services from third-party service providers, which may negatively impact our results of operations. We also rely on corporate trustees to act on behalf of us and other holders of securities in enforcing our rights.

Loans underlying non-Agency MBS we own are serviced by third-party service providers. These servicers provide for the primary and special servicing of these securities. In that capacity these service providers control all aspects of loan collection, loss mitigation, default management and ultimate resolution of a defaulted loan including as applicable the foreclosure and sale of the real estate owned. The servicer has a fiduciary obligation to act in the best interest of the securitization trust, but significant latitude exists with respect to certain of its servicing activities. We have no contractual rights with respect to these servicers, and our risk management operations may not be successful in limiting future delinquencies, defaults, and losses. If a third party servicer fails to perform its duties under the securitization documents, this may result in a material increase in delinquencies or losses on the MBS. As a result, the value of the MBS may be impacted, and we may incur losses on our investment.

In addition, should a servicer experience financial difficulties, it may not be able to perform its obligations. Due to application of provisions of bankruptcy law, servicers who have sought bankruptcy protection may not be required to make advance payments required under the terms of the MBS of amounts due from loan borrowers. Even if a servicer were able to advance amounts in respect of delinquent loans, its obligation to make the advances may be limited to the extent that it does not expect to recover the advances due to the deteriorating credit of the delinquent loans.

We also rely on corporate trustees to act on behalf of us and other holders of securities in enforcing our rights. Under the terms of most securities we hold we do not have the right to directly enforce remedies against the issuer of the security, but instead must rely on a trustee to act on behalf of us and other security holders. Should a trustee not be required to take action under the terms of the securities, or fail to take action, we could experience losses.

Credit ratings assigned to debt securities by the credit rating agencies may not accurately reflect the risks associated with those securities. Changes in credit ratings for securities we own or for similar securities might negatively impact the market value of these securities.

Rating agencies rate securities based upon their assessment of the safety of the receipt of principal and interest payments on the securities. Rating agencies do not consider the risks of fluctuations in fair value or other factors that may influence the value of securities and, therefore, the assigned credit rating may not fully reflect the true risks of an

investment in securities. Also, rating agencies may fail to make timely adjustments to credit ratings based on available data or changes in economic outlook or may otherwise fail to make changes in credit ratings in response to subsequent events, so our investments may be better or worse than the ratings indicate. We attempt to reduce the impact of the risk that a credit rating may not accurately reflect the risks associated with a particular debt security by not relying solely on credit ratings as the indicator of the quality of an investment. We make our acquisition decisions after factoring in other information that we have obtained about the loans underlying the security and the

credit subordination structure of the security. Despite these efforts, our assessment of the quality of an investment may also prove to be inaccurate and we may incur credit losses in excess of our initial expectations.

Credit rating agencies may change their methods of evaluating credit risk and determining ratings on securities backed by real estate loans and securities. These changes may occur quickly and often. The market's ability to understand and absorb these changes, and the impact to the securitization market in general, are difficult to predict. Such changes may have a negative impact on the value of securities that we own.

If a lender to us in a repurchase transaction defaults on its obligation to resell the underlying security back to us at the end of the transaction term, or if we default on our obligations under a repurchase agreement, we will incur losses.

Repurchase agreement transactions are legally structured as the sale of a security to a lender in return for cash from the lender. These transactions are accounted for as financing agreements because the lenders are obligated to resell the same securities back to us at the end of the transaction term. Because the cash we receive from the lender when we initially sell the securities to the lender is less than the value of those securities, if the lender defaults on its obligation to resell the same securities back to us, we would incur a loss on the transaction equal to the difference between the value of the securities sold and the amount borrowed from the lender. The lender may default on its obligation to resell if it experiences financial difficulty or if the lender has re-hypothecated the security to another party who fails to transfer the security back to the lender. Additionally, if we default on one of our obligations under a repurchase agreement, the lender can terminate the transaction, sell the underlying collateral and cease entering into any other repurchase transactions with us. Any losses we incur on our repurchase transactions could adversely affect our earnings and reduce our ability to pay dividends to our shareholders.

In the event of bankruptcy either by ourselves or one or more of our third party lenders, under the U.S. Bankruptcy Code, assets pledged as collateral under repurchase agreements may not be recoverable by us. We may incur losses equal to the excess of the collateral pledged over the amount of the associated repurchase agreement borrowing.

In the event that one of our lenders under a repurchase agreement files for bankruptcy, it may be difficult for us to recover our assets pledged as collateral to such lender. In addition, if we ever file for bankruptcy, lenders under our repurchase agreements may be able to avoid the automatic stay provisions of the U.S. Bankruptcy Code and take possession of and liquidate our collateral under our repurchase agreements without delay. In the event of a bankruptcy by one of our lenders, or us, we may incur losses in amounts equal to the excess of our collateral pledged over the amount of repurchase agreement borrowing due to the lender.

If we fail to properly conduct our operations we could become subject to regulation under the 1940 Act. Conducting our business in a manner so that we are exempt from registration under and compliance with the 1940 Act may reduce our flexibility and could limit our ability to pursue certain opportunities.

We seek to conduct our operations so as to avoid falling under the definition of an investment company pursuant to the 1940 Act. Specifically, we seek to conduct our operations under the exemption provided under Section 3(c)(5)(C) of the 1940 Act, a provision available to companies primarily engaged in the business of purchasing and otherwise acquiring mortgages and other liens on and interests in real estate. According to SEC no-action letters, companies relying on this exemption must ensure that at least 55% of their assets are mortgage loans and other qualifying assets, and at least 80% of their assets are real estate-related. The 1940 Act requires that we and each of our subsidiaries evaluate our qualification for exemption under the Act. Our subsidiaries will rely either on Section 3(c)(5)(C) or other sections that provide exemptions from registering under the 1940 Act, including Sections 3(a)(1)(C) and 3(c)(7). The SEC is currently reviewing the Section 3(c)(5)(C) exemption as further discussed below. We believe that we are operating our business in accordance with the exemption requirements of Section 3(c)(5)(C).

Under the 1940 Act, an investment company is required to register with the SEC and is subject to extensive restrictive and potentially adverse regulations relating to, among other things, operating methods, management, capital structure, dividends, and transactions with affiliates. If we were determined to be an investment company, our ability to use leverage and conduct business as we do today would be substantially impaired.

In August 2011, the SEC initiated a review of Section 3(c)(5)(C) of the 1940 Act and the regulations and regulatory interpretations promulgated thereunder. We rely on Section 3(c)(5)(C) as an exemption from registration and regulation under the 1940 Act and any regulatory changes as a result of this SEC review could require us to change our business and operations.

On August 31, 2011, the SEC issued a concept release relating to the exclusion from registration as an investment company provided to mortgage companies by Section 3(c)(5)(C) of the 1940 Act. This release raises concerns regarding the ability of mortgage REITs to continue to rely on the exclusion in the future. In particular, the release states the SEC is concerned that certain types of mortgage-related pools today appear to resemble in many respects investment companies such as closed-end funds and may not be the kinds of companies that were intended to be excluded from regulation under the 1940 Act by Section 3(c)(5)(C).

Although we believe that we are properly relying on Section 3(c)(5)(C) to exempt us from regulation under the 1940 Act (which belief in large part is based on no-action letters issued by the SEC with respect to operations of other mortgage REITs), the SEC review could eventually affect our ability to rely on that exemption or could eventually require us to change our business and operations in order for us to continue to rely on that exemption. If the SEC changes or narrows this exemption, we could be required to sell a substantial amount of our MBS under potentially adverse market conditions, which could have a material adverse effect on our financial condition and results of operations. We could also be forced to materially alter our business model and investment strategies which could materially and adversely affect our profitability.

The outcome of the review by the SEC at this time is not determinable, and the SEC may take no action as a result of its review of the Section 3(c)(5)(C) exemption from the 1940 Act. It is also possible that the SEC issues interpretative guidance for mortgage REITs as to how their operations must be structured in order to avoid being considered an investment company, and compliance with any such guidance could limit our operations and our profitability as indicated above. Finally, it is possible that the SEC requires mortgage REITs to be considered investment companies and to register under the 1940 Act which would severely limit our operations and profitability and likely have a material adverse effect on our financial condition and results of operations.

If we fail to abide by certain Commodity Futures Trading Commission (“CFTC”) rules and regulations, we may be subject enforcement action by the CFTC.

On December 7, 2012, the CFTC’s Division of Swap Dealer and Intermediary Oversight (the “Division”) issued no-action relief from commodity pool operator (“CPO”) registration to mortgage REITs that use CFTC-regulated products (“commodity interests”) and that satisfy certain enumerated criteria. Pursuant to the no-action letter, the Division will not recommend that the CFTC take enforcement action against a mortgage REIT if its operator fails to register as a CPO, provided that the mortgage REIT (i) submits a claim to take advantage of the relief and (ii) the mortgage REIT: (a) limits the initial margin and premiums required to establish its commodity interest positions to no greater than 5 percent of the fair market value of the mortgage REIT’s total assets; (b) limits the net income derived annually from its commodity interest positions, excluding the income from commodity interest positions that are “qualifying hedging transactions,” to less than 5 percent of its annual gross income; (c) does not market interests in the mortgage REIT to the public as interests in a commodity pool or otherwise in a vehicle for trading in the commodity futures, commodity options or swaps markets; and (d) either: (A) identified itself as a “mortgage REIT” in Item G of its last U.S. income tax return on Form 1120-REIT; or (B) if it has not yet filed its first U.S. income tax return on Form 1120-REIT, it discloses to its shareholders that it intends to identify itself as a “mortgage REIT” in its first U.S. income tax return on Form 1120-REIT.

We believe that we have complied with all of the requirements set forth above as of and for the year ended December 31, 2015. If we fail to satisfy the criteria set forth above, or if the criteria change, we may become subject to CFTC regulation or enforcement action, the consequences of which could have a material adverse effect on our financial condition or results of operations.

RISKS RELATED TO REGULATORY POLICY

The Federal Reserve and other U.S. regulators have adopted regulations to improve the financial strength of the U.S. and international banking systems. Such regulation has limited certain activities of banks and other financial institutions and also has increased liquidity and capitalization requirements, particularly those applied to the largest financial institutions. U.S. regulators have recently introduced capitalization standards for U.S. domiciled broker dealers of foreign banks. When fully implemented, these regulations and capitalization standards may impact the future availability of repurchase agreement financing which could impact our business model and adversely affect our financial conditions and results of operations.

Banking regulators and the Basel Committee on Banking Supervision (the “Basel Committee”) continue to take steps to require financial institutions, and particularly the largest bank holding companies and their subsidiary banks and affiliates, to strengthen their funding and leverage positions in an effort to address factors that contributed to financial distress from 2007 through 2009. Several recently adopted regulations and rules that are expected to be proposed may significantly impact the future availability of repurchase agreement financing, which could impact our business model.

U.S. banking regulators adopted final rules in 2014 to implement a supplemental leverage ratio (“SLR”) and a liquidity coverage ratio (“LCR”). The SLR applies to U.S. bank holding companies with \$700 billion or more in consolidated assets, or over \$10 trillion in assets under custody, and their bank subsidiaries. The SLR requires that a covered institution maintain a regulatory leverage buffer of 2% above the minimum leverage ratio that is otherwise required (3%), for a total of 5%, and covered bank subsidiaries must maintain a 6% leverage ratio to be considered well-capitalized. The LCR applies to all banking organizations with \$250 billion or more in total consolidated assets, or \$10 billion or more in foreign exposure on the organization’s balance sheet, and a less stringent LCR applies to a banking organization with \$50 billion or more in consolidated assets that does not meet the other tests. The LCR creates a minimum liquidity standard that requires a banking organization to hold high quality, liquid assets that would meet net cash outflows during a 30-day stress period. The SLR will be effective on January 1, 2018 and the LCR will be effective on January 1, 2017.

In addition, during 2014 the Basel Committee finalized a net stable funding ratio (“NSFR”) that requires banking organizations to maintain stable funding, as measured on a long-term funding horizon. The NSFR is designed to address funding and maturity mismatches. If adopted and implemented by banking regulators, including those in the U.S., the NSFR would most likely apply to internationally active banking organizations on a consolidated basis, and could also apply to other large domestic banking organizations. The NSFR requires a covered banking organization to obtain and rely more on funding sources that are stable and longer-term in nature as a regulatory tool to reduce a banking organization’s reliance on more unstable, short-term funding (including short-term wholesale funding), which the Basel Committee believes may become endangered as a funding source during periods of significant economic stress. If applied in combination, the NSFR and the LCR could significantly impact a banking organization’s short-term liquidity and longer-term liquidity requirements, funding sources and funding risks. The U.S. banking regulators are currently expected to propose rules to implement the NSFR during 2015.

The complete impact of the SLR and the LCR, when fully implemented, and the NSFR, if adopted by the U.S. banking regulators and when fully implemented, is not currently known. Application of these regulatory requirements and ratios would impact the leverage and funding profiles of large financial institutions and their affiliates, including many broker-dealers and other subsidiaries that are affiliated with large banking organizations and from which we obtain financing, and could lead to an increase in our cost of financing and reduce the amount of repurchase agreement financing made available to the financing markets.

In addition to the SLR, and LCR, and the NSFR if adopted, the Federal Reserve has adopted rules that will require foreign bank holding companies with combined U.S. assets of more than \$50 billion to establish an intermediate holding company (“IHC”) that is headquartered in the U.S. over the company’s U.S. subsidiaries. Any such IHC will be subject to regulatory capital and leverage requirements, including the SLR and LCR, and the NSFR if adopted, subject to meeting relevant asset thresholds, as well as regulatory capital planning and stress testing requirements. This increased regulatory oversight could further limit the repurchase agreement financing made available by these foreign IHCs and their subsidiaries and affiliates, which could further increase our cost of financing. If the SLR, LCR or NSFR, including the application of these ratios to IHCs, causes the availability of repurchase agreement financing to decline, we may have fewer financing options in the future which could lead to lower profitability and could adversely affect our financial condition.

During 2015, U.S. federal banking regulators adopted final rules to impose a capital surcharge on U.S. banks that are global systemically important banks. This capital surcharge will be phased in from 2016 to 2019 and requires these institutions to hold from 1.0% to 4.5% additional common equity Tier 1 capital, depending on the institution's systemic importance calculated as provided in the final rules, over the minimum risk-based capital requirements. Also during 2015, U.S. federal banking regulators issued proposed rules to impose loss absorbency requirements, or a measure of combined eligible Tier 1 capital and eligible long-term debt, on U.S. banks that are global systemically important banks. These proposed rules also require these institutions to maintain an outstanding amount of eligible long-term debt based on either risk-weighted assets or average total consolidated assets. These final rules and these proposed rules aim to increase covered institutions' capital and leverage ratios and to increase the capital available to support or resolve these institutions in periods of severe market stress or in the event of resolution. Application of the capital surcharge and loss absorbency requirements may change the leverage and funding profiles of the largest U.S. banks and

their affiliates and counterparties, including entities from which we obtain financing, and could lead to a reduction in the amount of repurchase financing made available to the financing markets.

Recently adopted rules for money market funds could impact our access to funding for our non-Agency MBS which could negatively impact our business and results of operations.

During 2014 the SEC adopted amendments to the rules that govern money market mutual funds which made structural and operational reforms intended to address risks of investor runs in certain of these funds. The new rules require a floating net asset value ("NAV") for institutional prime money market funds, which means that the daily share prices of these funds will fluctuate along with changes in the market-based value of fund assets. The new rules also provide non-government money market funds with new tools to address liquidity runs on the funds including the ability to charge fees and to temporarily suspend redemptions (also known as a redemption gate) during periods of extreme market stress.

With a floating NAV, institutional prime money market funds are required to value their portfolio securities using market-based factors and sell and redeem shares based on a floating NAV instead of allowing the funds to maintain a constant share price of \$1.00. With liquidity fees and redemption gates, money market fund boards have the ability to impose fees and gates during periods of stress. The new rules will be effective in various stages over a two-year transition period, with the rules implementing the floating NAV, liquidity fee and redemption gate provisions effective in October 2016.

Money market funds provide substantial liquidity to the repurchase agreement markets. The impact of the changes to the regulatory structure of institutional prime money market funds is not yet known, but it is possible that the new SEC rules may lead to reduced availability of liquidity to the repurchase agreement markets which in turn could lead to an increase in our funding costs.

The effect of legislative and regulatory changes, including the Dodd-Frank Act and regulations implementing it, on our business, the mortgage industry and the markets in which we invest is uncertain, and may be adverse to our business, results of operations and financial condition.

The Dodd-Frank Act was signed into law in July 2010, and significantly changes the regulation of financial institutions and the financial services industry, including the mortgage industry. The Dodd-Frank Act tasks many agencies with issuing a variety of new regulations, including rules related to mortgage origination and servicing, securitization and derivatives. Because a number of regulations under the Dodd-Frank Act have yet to be proposed, adopted or fully implemented, it is not yet known how these additional regulations will ultimately affect the borrowing environment, the investing environment for MBS, or interest rate swaps and other derivatives. Consequently, it is not possible for us to predict how additional regulations will affect our business, and there can be no assurance that these regulations will not have an adverse impact on our business, results of operations or financial condition.

In addition, there is an ongoing debate over the degree and kind of regulation that should be applied to entities that participate in what is popularly referred to as "shadow banking." While there is no authoritative definition of what "shadow banking" is, it generally refers to financial intermediation involving entities and activities outside of the traditional depository banking system, such as mortgage REITs, repurchase agreement financing, securitizations, private equity funds and hedge funds. A general policy concern is that an aspect or component of shadow banking that is not subject to banking regulation - such as safety and soundness regulation and capital requirements - or other government oversight could be a source of financial instability or pose systemic risk to the broader banking and financial markets.

In August 2013, the Financial Stability Board, an international body of which the United States is a member, issued policy recommendations to strengthen oversight and regulation of shadow banking. The policy recommendations outlined initial steps to define the scope of the shadow banking system and proposed general governing principles for a monitoring and regulatory framework, including a "toolkit" of potential regulatory responses that national regulators could employ to reduce systemic risk. While at this stage it is difficult to predict the type and scope of any new regulations that may be adopted by member countries, including the United States, if such regulations were to extend the regulatory and supervisory requirements currently applicable to banks, such as capital and liquidity standards, to our business or that of our financing counterparties or mortgage originators, or were to otherwise classify all or a portion of our business (including financing strategy) as shadow banking, our regulatory and operating costs, particularly borrowing costs, could increase, which may have a material adverse effect on our business.

The Federal Reserve and other banking regulators continue to explore regulatory initiatives that could impact complex transactions, or complex series of transactions, that relate to shadow banking and related financing markets. Many of these initiatives that are subject to preliminary discussions would, like the SLR and the LCR, aim to combat the build-up of leverage at, and the offer of leveraged financing by, large financial institutions. Series of transactions that transform short-term maturities into longer-term assets are subject to particular focus during these discussions. At this stage, it is impossible to predict what regulations may be imposed, by which regulator, on which segment of shadow banking, and with what effect. However, any regulations that successfully restrict the shadow banking system or repurchase agreement financing markets may have a material negative affect on our financial condition, results of operations and investment and financing.

The Treasury and Congress continue to seek ways to support the U.S. housing market and the overall U.S. economy, including seeking ways to make it easier to refinance loans owned or guaranteed by Fannie Mae or Freddie Mac where the borrower may have negative equity. In addition, mortgage loan modification programs and future legislative action may adversely affect the value of and the return on Agency RMBS securities in which we invest. Since we own our Agency RMBS at premiums to their par balance, we could incur substantial losses on our Agency RMBS if there is an increase in mortgage loan refinancing.

The Treasury and the Department of Housing and Urban Development ("HUD") have implemented the Home Affordable Refinance Program (or "HARP"), which allows borrowers who are current on their mortgage payments to refinance loans originated on or before May 31, 2009, with current loan-to-value ratios exceeding 80%, in order to reduce their monthly mortgage payments. HARP specifically targets borrowers that are current on their mortgage payment but who have negative equity in their home and, as a result, have been unable to refinance into a lower cost mortgage (given the decline in current mortgage rates compared to pre-May 31, 2009). HUD also recently announced a reduction in mortgage insurance premiums effective January 26, 2015, which could further encourage some homeowners to refinance existing mortgages. If refinance activity increases for Agency RMBS as a result of these or other government programs or efforts, or if we increase forecasted prepayments on our Agency RMBS, our net interest income would be negatively impacted by the additional amortization of premium on our Agency RMBS. In addition, we may experience significant volatility in the market value of Agency RMBS as the market resets prepayment expectations on Agency RMBS. Such volatility could lead to margin calls from our repurchase agreement lenders and could force us to sell these securities under unfavorable conditions and possibly at a loss.

The Treasury and HUD have also created a number of different programs intended to assist borrowers that are struggling to make their mortgage payment that may involve, among other things, the modification of mortgage loans to reduce the principal amount of the loans (through forbearance and/or forgiveness) and/or the rate of interest payable on the loans, or to extend the payment terms of the loans. Loan modifications such as these could result in our ultimately receiving less than we are contractually due on certain of our investments. A significant number of loan modifications with respect to a given security could negatively impact the realized yields and cash flows on such security. These loan modification programs, future legislative or regulatory actions, including new mortgage loan modification programs and possible amendments to the bankruptcy laws, which result in the modification of outstanding residential mortgage loans, as well as changes in the requirements necessary to qualify for refinancing mortgage loans with Fannie Mae, Freddie Mac or Ginnie Mae, may adversely affect the value of, and the returns on, our securitized single-family mortgage loans and Agency RMBS.

RISKS RELATED TO OUR TAXATION AS A REIT AND OTHER TAX RELATED MATTERS

Qualifying as a REIT involves highly technical and complex provisions of the Code, and a technical or inadvertent violation could jeopardize our REIT qualification. Maintaining our REIT status may reduce our flexibility to manage our operations.

Qualification as a REIT involves the application of highly technical and complex Code provisions for which only limited judicial and administrative authorities exist. Even a technical or inadvertent violation could jeopardize our REIT qualification. Our qualification as a REIT will depend on our satisfaction of certain asset, income, organizational, distribution, stockholder ownership and other requirements on a continuing basis. Our operations and use of leverage also subjects us to interpretations of the Code, and technical or inadvertent violations of the relevant requirements under the Code could cause us to lose our REIT status or to pay significant penalties and interest. In addition, our ability to satisfy the requirements to qualify as a REIT depends in part on the actions of third parties over which we have no control or only limited influence, including in cases where we own an equity interest in an entity that is classified as a partnership for U.S. federal income tax purposes.

Maintaining our REIT status may limit flexibility in managing our operations. For instance:

If we make frequent asset sales from our REIT entities to persons deemed customers, we could be viewed as a “dealer,” and thus subject to 100% prohibited transaction taxes or other entity level taxes on income from such transactions.

Compliance with the REIT income and asset requirements may limit the type or extent of hedging that we can undertake.

Our ability to own non-real estate related assets and earn non-real estate related income is limited. Our ability to own equity interests in other entities is limited. If we fail to comply with these limits, we may be forced to liquidate attractive assets on short notice on unfavorable terms in order to maintain our REIT status.

Our ability to invest in taxable subsidiaries is limited under the REIT rules. Maintaining compliance with this limitation could require us to constrain the growth of future taxable REIT affiliates.

Notwithstanding our NOL carryforward, meeting minimum REIT dividend distribution requirements could reduce our liquidity. Earning non-cash REIT taxable income could necessitate our selling assets, incurring debt, or raising new equity in order to fund dividend distributions.

Stock ownership tests may limit our ability to raise significant amounts of equity capital from one source.

If we fail to maintain our REIT status, our ability to utilize repurchase agreements as a source of financing and to enter into interest rate swap agreements may be impacted.

Most of our repurchase agreements and the agreements governing our interest rate swaps require that we maintain our REIT status as a condition to engaging in a transaction with us. Even though repurchase agreements generally are not committed facilities with our lenders, if we failed to maintain our REIT status our ability to enter into new repurchase agreement transactions or renew existing, maturing repurchase agreements will likely be limited. Some of our repurchase agreements and swap agreements have cross-default provisions which provide for lenders to terminate these agreements if we default under any of our repurchase agreements or swap agreements. As such, we may be required to sell investments, potentially under adverse circumstances, that were previously financed with repurchase agreements and we may be forced to terminate our interest rate swap agreements.

If we do not qualify as a REIT or fail to remain qualified as a REIT, we may be subject to tax as a regular corporation and could face a tax liability, which would reduce the amount of cash available for distribution to our shareholders.

We intend to operate in a manner that will allow us to qualify as a REIT for federal income tax purposes. Our qualification as a REIT will depend on our satisfaction of certain asset, income, organizational, distribution, stockholder ownership and other requirements on a continuing basis. Our ability to satisfy the asset tests depends upon our analysis of the characterization and fair market values of our assets, some of which are not susceptible to a precise determination, and for which we will not obtain independent appraisals. Our compliance with the REIT income and quarterly asset requirements also depends upon our ability to successfully manage the composition of our income and assets on an ongoing basis.

If we were to fail to qualify as a REIT in any taxable year, we would be subject to federal income tax, after consideration of our NOL carryforward but not considering any dividends paid to our shareholders during the respective tax year. If we could not otherwise offset this taxable income with our NOL carryforward, the resulting corporate tax liability could be material to our results and would reduce the amount of cash available for distribution to our shareholders, which in turn could have an adverse impact on the value of our common stock. Unless we were entitled to relief under certain Code provisions, we also would be disqualified from taxation as a REIT until the fifth taxable year following the year for which we failed to qualify as a REIT.

Our future use of our tax NOL carryforward is limited under Section 382 of the Code, which could result in higher taxable income and greater distribution requirements in order to maintain our REIT status. Further, if we unknowingly

undergo another ownership change pursuant to Section 382, or miscalculate the limitations imposed by a known ownership change, and utilize an impermissible amount of the NOL, we may fail to meet the distribution requirements of a REIT and therefore we could lose our REIT status.

We can use our tax NOL carryforward to offset our taxable earnings after taking the REIT distribution requirements into account. Section 382 of the Code limits the amount of NOL that could be used to offset taxable earnings after an “ownership

change” occurs. A Section 382 ownership change generally occurs if one or more shareholders who own at least 5% of our stock, or certain groups of shareholders, increase their aggregate ownership by more than 50 percentage points over their lowest ownership percentage within a rolling three-year period.

Our public offering of common stock in February 2012 resulted in an ownership change under Section 382. Based on management's analysis and expert third-party advice, which necessarily includes certain assumptions regarding the characterization under Section 382 of our use of capital raised by us, we determined that the ownership change under Section 382 will limit our ability to use our NOL carryforward to offset our taxable income to an estimated maximum amount of \$13.5 million per year. Because NOLs generally may be carried forward for up to 20 years, this annual limitation may effectively limit the cumulative amount of pre-ownership change losses, including certain recognized built-in losses, that we may utilize. This would result in higher taxable income and greater distribution requirements in order to maintain REIT qualification than if such limitation were not in effect.

We may incur additional ownership changes under Section 382 in the future, in which case the use of our NOL could be further limited. Future issuances or sales of our stock (including transactions involving our stock that are out of our control) could result in an ownership change under Section 382. If further ownership changes occur, Section 382 would impose stricter annual limits on the amount of pre-ownership change NOLs and other losses we could use to reduce our taxable income.

If we unknowingly undergo another ownership change under Section 382, or miscalculate the limitations imposed by a known ownership change, the use of the NOL could be limited more than we have determined and we may utilize (or may have utilized) more of the NOL than we otherwise may have been allowed. In such an instance we may be required to pay taxes, penalties and interest on the excess amount of NOL used, or we may be required to declare a deficiency dividend to our shareholders for the excess amount. In addition, if any impermissible use of the NOL led to a failure to comply with the REIT distribution requirements, we could fail to qualify as a REIT.

The failure of investments subject to repurchase agreements to qualify as real estate assets could adversely affect our ability to qualify as a REIT.

Repurchase agreement financing arrangements are structured legally as a sale and repurchase whereby we sell certain of our investments to a counterparty and simultaneously enter into an agreement to repurchase these securities at a later date in exchange for a purchase price. Economically, these agreements are financings which are secured by the investments sold pursuant thereto. We believe that we would be treated for REIT asset and income test purposes as the owner of the securities that are the subject of any such sale and repurchase agreement, notwithstanding that such agreement may legally transfer record ownership of the securities to the counterparty during the term of the agreement. It is possible, however, that the IRS could assert that we did not own the securities during the term of the sale and repurchase agreement, in which case we could fail to qualify as a REIT.

Even if we remain qualified as a REIT, we may face other tax liabilities that reduce our cash flow and our profitability.

Even if we remain qualified for taxation as a REIT, we may be subject to certain federal, state and local taxes on our income and assets, including taxes on any undistributed income, tax on income from some activities conducted as a result of a foreclosure or considered prohibited transactions under the Code, and state or local income taxes. Any of these taxes would decrease cash available for distribution to our shareholders. In addition, in order to meet the REIT qualification requirements, or to avert the imposition of a 100% tax that applies to certain gains derived by a REIT from prohibited transactions, we may hold some of our assets through a taxable REIT subsidiary (“TRS”) or other subsidiary corporations that will be subject to corporate-level income tax at regular rates to the extent that such TRS does not have an NOL carryforward. Any of these taxes would decrease cash available for distribution to our shareholders.

Recognition of excess inclusion income by us could have adverse consequences to us or our shareholders.

Certain of our securities have historically generated excess inclusion income and may continue to do so in the future. Certain categories of shareholders, such as foreign shareholders eligible for treaty or other benefits, shareholders with NOLs, and certain tax-exempt shareholders that are subject to unrelated business income tax, could be subject to increased taxes on a portion of their dividend income from us that is attributable to excess inclusion income. In addition, to the extent that our stock is owned by tax-exempt “disqualified organizations,” such as certain government-related entities and charitable remainder trusts that are

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not subject to tax on unrelated business income, we may incur a corporate level tax on a portion of our income. In that case, we may reduce the amount of our distributions to any disqualified organization whose stock ownership gave rise to the tax.

Dividends payable by REITs do not qualify for the reduced tax rates available for some dividends.

The maximum tax rate applicable to income from “qualified dividends” payable to domestic shareholders that are individuals, trusts and estates may be either 15% or 20%, depending on whether the taxpayer's income exceeds the threshold for the newly enacted 39.6% income tax bracket. Dividends payable by REITs, however, generally are not eligible for the reduced rates. Although this legislation does not adversely affect the taxation of REITs or dividends payable by REITs, the more favorable rates applicable to regular corporate qualified dividends could cause investors who are individuals, trusts and estates to perceive investments in REITs to be relatively less attractive than investments in the stocks of non-REIT corporations that pay dividends, which could adversely affect the value of the stock of REITs, including our common stock.

We have not established a minimum dividend payment level and we cannot assure you of our ability to pay dividends in the future.

We intend to pay quarterly dividends to our common stockholders and to make distributions to our shareholders in amounts such that all or substantially all of our taxable income, subject to certain adjustments including utilization of our NOL, is distributed. However, we have not established a minimum dividend payment level and the amount of our dividend will fluctuate. Our ability to pay dividends may be adversely affected by the risk factors described herein. All distributions will be made at the discretion of our Board of Directors and will depend on our earnings, our financial condition, the requirements for REIT qualification and such other factors as our Board of Directors may deem relevant from time to time. We may not be able to make distributions or our Board of Directors may change our dividend policy in the future. In addition, some of our distributions may include a return of capital. To the extent that we decide to pay dividends in excess of our current and accumulated tax earnings and profits, such distributions would generally be considered a return of capital for federal income tax purposes. A return of capital reduces the basis of a stockholder's investment in our common stock to the extent of such basis and is treated as capital gain thereafter.

RISKS RELATED TO OUR CORPORATE STRUCTURE

The stock ownership limit imposed by the Code for REITs and our Articles of Incorporation may restrict our business combination opportunities. The stock ownership limitation may also result in reduced liquidity in our stock and may result in losses to an acquiring shareholder.

To qualify as a REIT under the Code, not more than 50% in value of our outstanding stock may be owned, directly or indirectly, by five or fewer individuals (as defined in the Code to include certain entities) at any time during the last half of each taxable year after our first year in which we qualify as a REIT. Our Articles of Incorporation, with certain exceptions, authorize our Board of Directors to take the actions that are necessary and desirable to qualify as a REIT. Pursuant to our Articles of Incorporation, no person may beneficially or constructively own more than 9.8% of our capital stock (including our common stock, Series A Preferred Stock, and Series B Preferred Stock). Our Board of Directors may grant an exemption from this 9.8% stock ownership limitation, in its sole discretion, subject to such conditions, representations and undertakings as it may determine are reasonably necessary.

The ownership limits imposed by the tax law are based upon direct or indirect ownership by “individuals,” but only during the last half of a tax year. The ownership limits contained in our Articles of Incorporation apply to the ownership at any time by any “person,” which includes entities, and are intended to assist us in complying with the tax law requirements and to minimize administrative burdens. However, these ownership limits might also delay or

prevent a transaction or a change in our control that might involve a premium price for our stock or otherwise be in the best interest of our shareholders.

Whether we would waive the ownership limitation for any other shareholder will be determined by our Board of Directors on a case by case basis. Our Articles of Incorporation's constructive ownership rules are complex and may cause the outstanding stock owned by a group of related individuals or entities to be deemed to be constructively owned by one individual or entity. As a result, the acquisition of less than these percentages of the outstanding stock by an individual or entity could cause that individual or entity to own constructively in excess of these percentages of the outstanding stock and thus be subject to the ownership limit.

The Board of Directors has the right to refuse to transfer any shares of our capital stock in a transaction that would result in ownership in excess of the ownership limit. In addition, we have the right to redeem shares of our capital stock held in excess of the ownership limit.

The stock ownership limit imposed by the Code for REITs and our Articles of Incorporation may impair the ability of holders to convert shares of our Series A Preferred Stock or Series B Preferred Stock into shares of our common stock upon a change of control.

The terms of our Series A Preferred Stock and Series B Preferred Stock provide that, upon occurrence of a change of control (as defined in the Articles of Incorporation), each holder of Series A Preferred Stock or Series B Preferred Stock will have the right (unless, prior to the Change of Control Conversion Date (as defined herein), we provide notice of our election to redeem the Series A Preferred Stock or Series B Preferred Stock, as applicable) to convert all or part of the Series A Preferred Stock and Series B Preferred Stock held by such holder on the Change of Control Conversion Date into a number of shares of our common stock per share of Series A Preferred Stock or Series B Preferred Stock, respectively, based on formulas set forth in our Articles of Incorporation. However, the stock ownership restrictions in our Articles of Incorporation also restrict ownership of shares of our Series A Preferred Stock and Series B Preferred Stock. As a result, no holder of Series A Preferred Stock or Series B Preferred Stock will be entitled to convert such stock into our common stock to the extent that receipt of our common stock would cause the holder to exceed the ownership limitations contained in our Articles of Incorporation, endanger the tax status of one or more real estate mortgage investment conduits ("REMICs") in which we have or plan to have an interest, or result in the imposition of a direct or indirect penalty tax on us. These provisions may limit the ability of a holder of Series A Preferred Stock or Series B Preferred Stock to convert shares of Series A Preferred Stock or Series B Preferred Stock into our common stock upon a change of control, which could adversely affect the market price of shares of our Series A Preferred Stock or of our Series B Preferred Stock.

ITEM 1B. UNRESOLVED STAFF COMMENTS

There are no unresolved comments from the SEC Staff.

ITEM 2. PROPERTIES

We lease one facility located at 4991 Lake Brook Drive, Suite 100, Glen Allen, Virginia 23060 which provides 9,350 square feet of office space for our executive officers and employees. The term of the lease expires in March 2020, but may be renewed at our option for four additional periods of one year each at a rental rate 2.5% greater than the rate in effect during the preceding 12-month period or for one additional five-year period at the fair market rental rate for the time period such determination is being made for office space of comparable condition and location.

ITEM 3. LEGAL PROCEEDINGS

The Company and its subsidiaries are parties to various legal proceedings. Although the ultimate outcome of these legal proceedings cannot be ascertained at this time, and the results of legal proceedings cannot be predicted with certainty, the Company believes, based on current knowledge, that the resolution of any of these proceedings will not have a material adverse effect on the Company's consolidated financial condition or liquidity. However, the resolution of any of the proceedings could have a material impact on consolidated results of operations or cash flows in a given future reporting period as the proceedings are resolved.

With respect to the case styled Basic Capital Management, Inc. et al. v. Dynex Commercial, Inc., et al., Cause No. DC-03-00675, 68th Judicial Dist. Ct., Dallas Co., Tex., on July 20, 2015, American Realty Trust, Inc. ("ART") and other related entities obtained a final judgment in the principal amount of \$46.5 million against Dynex Commercial, Inc. ("DCI"), a former affiliate of the Company also known as DCI Commercial, Inc. ART's portion of the judgment against DCI is \$24.9 million. As previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2013, the Company was a party to this lawsuit until the Fifth Court of Appeals in Dallas, Texas affirmed in May 2013 the trial court's decision with respect to a take nothing judgment against the Company. On July

31, 2014, in a case styled ART Midwest, Inc., et al. v. David M. Clapper, et al., Cause No. 3:99-CV-2355-N, U.S. Dist. Ct., N.D. Tex., David M. Clapper, Atlantic XIII, LLC, and Atlantic Midwest, LLC (the “Clapper Parties”) obtained a final judgment against ART in the principal amount of \$46.9 million. In an effort to collect their

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judgment against ART, on July 31, 2015, the Clapper Parties filed an Application for Writ of Garnishment against DCI and the Company in U.S. Dist. Ct., N.D. Tex. (“Garnishment Action”). In the Garnishment Action, the Clapper Parties seek to garnish ART’s judgment against DCI and allege that the Company is “the apparent successor to DCI.” In September 2015, the Company filed a motion to dismiss the Garnishment Action against it on the grounds that, among other things, the Clapper Parties have alleged no facts to support any allegations against the Company and have requested no relief against the Company. The Company’s motion to dismiss is pending. If the motion to dismiss is denied, the Company intends to vigorously defend itself in this action, including seeking to recover its attorneys’ fees and costs under Texas law.

ITEM 4. MINE SAFETY DISCLOSURES

None.

PART II.

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS, AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock is traded on the New York Stock Exchange under the trading symbol "DX". The common stock was held by approximately 19,968 holders of record as of February 29, 2016. On that date, the closing price of our common stock on the New York Stock Exchange was \$6.35 per share. The high and low common stock prices and cash dividends declared on our common stock, our Series A Preferred Stock, and our Series B Preferred Stock for each quarter during the last two years were as follows:

	High	Low	Dividends Declared		
			Common Stock	Series A Preferred Stock	Series B Preferred Stock
2015:					
First quarter	\$8.56	\$8.07	\$0.24	\$0.53125	\$0.4765625
Second quarter	\$8.29	\$7.62	\$0.24	\$0.53125	\$0.4765625
Third quarter	\$7.67	\$6.40	\$0.24	\$0.53125	\$0.4765625
Fourth quarter	\$6.96	\$6.10	\$0.24	\$0.53125	\$0.4765625
2014:					
First quarter	\$9.14	\$7.88	\$0.25	\$0.53125	\$0.4765625
Second quarter	\$8.98	\$8.33	\$0.25	\$0.53125	\$0.4765625
Third quarter	\$8.76	\$8.06	\$0.25	\$0.53125	\$0.4765625
Fourth quarter	\$8.67	\$7.75	\$0.25	\$0.53125	\$0.4765625

Any dividends declared by the Board of Directors have generally been for the purpose of maintaining our REIT status and maintaining compliance with dividend requirements of the Series A Preferred Stock and Series B Preferred Stock.

The following table summarizes dividends declared per share for the years ended December 31, 2015 and December 31, 2014, and their related tax characterization:

	Tax Characterization			Total Dividends Declared Per Share
	Ordinary	Capital Gain	Return of Capital	
Common dividends declared:				
Year ended December 31, 2015	\$0.8419484	\$—	\$0.1180516	\$0.9600
Year ended December 31, 2014	\$0.6860464	\$0.3139536	\$—	\$1.0000
Preferred Series A dividends declared:				
Year ended December 31, 2015	\$2.1250000	\$—	\$—	\$2.1250
Year ended December 31, 2014	\$2.1250000	\$—	\$—	\$2.1250
Preferred Series B dividends declared:				
Year ended December 31, 2015	\$1.9062500	\$—	\$—	\$1.9063
Year ended December 31, 2014	\$1.9062500	\$—	\$—	\$1.9063

The following graph is a five year comparison of cumulative total returns for the shares of our common stock, the Standard & Poor's 500 Stock Index ("S&P 500"), the Bloomberg Mortgage REIT Index, and the SNL U.S. Finance REIT Index. The table below assumes \$100 was invested at the close of trading on December 31, 2010 in each of our common stock, the S&P 500, the Bloomberg Mortgage REIT Index, and the SNL U.S. Finance REIT Index and assumes reinvestment of dividends.

Index	Cumulative Total Stockholder Returns as of December 31,					
	2010	2011	2012	2013	2014	2015
Dynex Capital, Inc. Common Stock	\$100.00	\$93.95	\$109.01	\$104.11	\$120.75	\$106.21
S&P 500	\$100.00	\$102.11	\$118.45	\$156.82	\$178.28	\$180.75
Bloomberg Mortgage REIT Index	\$100.00	\$98.16	\$116.22	\$113.57	\$135.64	\$122.36
SNL U.S. Finance REIT Index	\$100.00	\$97.97	\$117.65	\$113.63	\$130.13	\$119.33

The sources of this information are Bloomberg, SNL Financial, and Standard & Poor's, which management believes to be reliable sources. The historical information set forth above is not necessarily indicative of future performance. Accordingly, we do not make or endorse any predictions as to future share performance.

The Company has been authorized by its Board of Directors to repurchase up to \$50 million of its outstanding shares of common stock through December 31, 2016. Subject to applicable securities laws and the terms of the Series A Preferred Stock designation and the Series B Preferred Stock designation, both of which are contained in our Articles of Incorporation, future repurchases of common stock will be made at times and in amounts as the Company deems appropriate, provided that the repurchase price per share is less than the Company's estimate of the current net book value of a share of common stock. Repurchases may be suspended or discontinued at any time.

The following table summarizes repurchases of our common stock that occurred during the three months ended December 31, 2015:

	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs (in thousands)
October 1, 2015 - October 31, 2015	1,400,000	\$6.66	1,400,000	\$9,623
November 1, 2015 - November 30, 2015	—	—	—	\$9,623
December 1, 2015 - December 31, 2015	127,200	\$6.24	127,200	\$8,829
Total	1,527,200	\$6.63	1,527,200	

ITEM 6. SELECTED FINANCIAL DATA

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

	As of/For the Year Ended December 31,				
	2015	2014	2013	2012	2011
Balance Sheet Data:	(\$ in thousands except share data)				
Mortgage-backed securities	\$3,493,701	\$3,516,239	\$4,018,161	\$4,103,981	\$2,386,255
Total assets	3,670,048	3,688,311	4,217,137	4,280,229	2,582,193
Repurchase agreements	2,589,420	3,013,110	3,580,754	3,564,128	2,093,793
Total liabilities	3,178,023	3,081,009	3,631,261	3,663,519	2,210,844
Shareholders' equity	492,025	607,302	585,876	616,710	371,349
Common shares outstanding	49,047,335	54,739,111	54,310,484	54,268,915	40,382,530
Book value per common share	\$7.71	\$9.02	\$8.69	\$10.30	\$9.20
Income Statement Data:					
Interest income	\$100,244	\$105,644	\$127,132	\$113,548	\$83,377
Interest expense	22,605	25,915	39,028	35,147	24,082
Net interest income	77,639	79,729	88,104	78,401	59,295
Loss on derivative instruments, net ⁽¹⁾	(43,128)	(53,393)	(10,076)	(908)	(2,825)
(Loss) gain on sale of investments, net	(978)	16,223	3,354	8,461	2,096
General and administrative expenses	(17,668)	(16,007)	(13,058)	(12,736)	(9,956)
Net income to common shareholders	7,368	18,630	60,167	72,006	39,812
Comprehensive (loss) income to common shareholders	(26,716)	73,762	(26,160)	127,772	26,500
Net income per common share:					
Basic	\$0.14	\$0.34	\$1.10	\$1.35	\$1.03
Diluted	\$0.14	\$0.34	\$1.10	\$1.35	\$1.03
Dividends declared per share:					
Common	\$0.96	\$1.00	\$1.12	\$1.15	\$1.09
Series A Preferred	\$2.13	\$2.13	\$2.13	\$0.97	\$—
Series B Preferred	\$1.91	\$1.91	\$0.94	\$—	\$—

(1) Loss on derivative instruments, net increased significantly during the year ended December 31, 2013 and subsequent periods due to our discontinuation of cash flow hedge accounting for our interest rate derivative instruments effective June 30, 2013.

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	For the Year Ended December 31,					
	2015	2014	2013	2012	2011	
Other Data Including Non-GAAP Financial Measures:	(\$ in thousands except per share data)					
Effective borrowing costs ⁽¹⁾	\$24,836	\$27,345	\$42,783	\$35,801	\$24,680	
Adjusted net interest income ⁽¹⁾	75,408	78,299	84,349	77,747	58,697	
Core net operating income to common shareholders ⁽¹⁾	49,174	54,162	63,786	63,064	50,829	
Core net operating income per common share ⁽¹⁾	\$0.93	\$0.99	\$1.17	\$1.19	\$1.32	
Average interest earning assets	\$3,685,936	\$3,822,870	\$4,290,073	\$3,492,158	\$2,283,440	
Average balance of borrowings	3,269,711	3,347,701	3,797,845	3,069,348	2,002,981	
Weighted average effective yield ⁽²⁾	2.71	% 2.76	% 2.96	% 3.25	% 3.64	%
Cost of funds ⁽²⁾	0.68	% 0.76	% 1.01	% 1.12	% 1.19	%
Net interest spread	2.03	% 2.00	% 1.95	% 2.13	% 2.45	%
Effective borrowing rate ⁽¹⁾	0.75	% 0.81	% 1.10	% 1.14	% 1.22	%
Adjusted net interest spread ⁽³⁾	1.96	% 1.95	% 1.86	% 2.11	% 2.42	%

(1) Represents a non-GAAP financial measure. See reconciliations provided below.

(2) Recalculation of weighted average effective yields using interest income and cost of funds using interest expense may not be possible because certain income and expense items are based on a 360-day year for the calculation while others are based on actual number of days in the year.

(3) Adjusted net interest spread is a non-GAAP financial measure and is equal to the weighted average effective yield less the effective borrowing rate, both of which are included in the table above.

Non-GAAP Financial Measures

In addition to our operating results presented in accordance with GAAP, the information presented above and within Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" of this Annual Report on Form 10-K contains the following non-GAAP financial measures: core net operating income to common shareholders (including per common share), effective borrowing costs and rates, and adjusted net interest income and spread. Management uses core net operating income (including per common share) as an estimate of the net interest earnings from our investments after operating expenses. Within core net operating income, management uses effective borrowing cost and rate, adjusted net interest income, and adjusted net interest spread because management considers net periodic interest costs related to the Company's derivative instruments as an additional cost of using repurchase agreements to finance investments. Because these measures are used in the Company's internal analysis of financial and operating performance, management believes that they provide greater transparency to our investors of management's view of our economic performance. Management also believes that the presentation of these measures, when analyzed in conjunction with the Company's GAAP operating results, allows investors to more effectively evaluate and compare the performance of the Company to that of its peers even though peer companies may present non-GAAP measures on a different basis than the Company's. Because these non-GAAP financial measures exclude certain items used to compute GAAP net income to common shareholders and GAAP interest expense, these non-GAAP measures should be considered as a supplement to, and not as a substitute for, the Company's GAAP results as reported on its consolidated statements of comprehensive income. In addition, because not all companies use identical calculations, the Company's presentation of core net operating income, effective borrowing cost and rate, adjusted net interest income, and adjusted net interest spread may not be comparable to other similarly-titled measures of other companies.

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	For the Year Ended December 31,					
	2015	2014	2013	2012	2011	
Reconciliations of GAAP to Non-GAAP Financial Measures:	(\$ in thousands except share data)					
GAAP net income to common shareholders	\$7,368	\$18,630	\$60,167	\$72,006	\$39,812	
Amortization of de-designated cash flow hedges ⁽¹⁾	3,499	6,788	5,193	—	—	
Change in fair value on derivative instruments, net ⁽²⁾	37,398	45,175	1,128	254	2,227	
Loss (gain) on sale of investments, net	978	(16,223)	(3,354)	(8,461)	(2,096)	
Fair value adjustments, net	(69)	(208)	652	(735)	676	
Other reconciling items ⁽³⁾	—	—	—	—	10,210	
Core net operating income to common shareholders	\$49,174	\$54,162	\$63,786	\$63,064	\$50,829	
Average common shares outstanding	52,847,197	54,701,485	54,647,643	53,146,416	38,579,780	
Core net operating income per common share	\$0.93	\$0.99	\$1.17	\$1.19	\$1.32	
GAAP interest expense	\$22,605	\$25,915	\$39,028	\$35,147	\$24,082	
Amortization of de-designated cash flow hedges ⁽¹⁾	(3,499)	(6,788)	(5,193)	—	—	
Net periodic interest costs of derivative instruments ⁽⁴⁾	5,730	8,218	8,948	654	598	
Effective borrowing cost	\$24,836	\$27,345	\$42,783	\$35,801	\$24,680	
GAAP cost of funds ⁽⁵⁾	0.68	% 0.76	% 1.01	% 1.12	% 1.19	%
Effect of amortization of de-designated cash flow hedges ⁽¹⁾	(0.11))% (0.20))% (0.15))% —	% —	%
Effect of net periodic interest costs of derivative instruments ⁽⁴⁾	0.18	% 0.25	% 0.24	% 0.02	% 0.03	%
Effective borrowing rate ⁽⁵⁾	0.75	% 0.81	% 1.10	% 1.14	% 1.22	%
GAAP interest income	\$100,244	\$105,644	\$127,132	\$113,548	\$83,377	
Effective borrowing costs	24,836	27,345	42,783	35,801	24,680	
Adjusted net interest income	\$75,408	\$78,299	\$84,349	\$77,747	\$58,697	

Amount recorded as a portion of "interest expense" in accordance with GAAP related to the amortization of the (1) balance remaining in accumulated other comprehensive loss as of June 30, 2013 as a result of the Company's discontinuation of cash flow hedge accounting.

(2) Represents net realized and unrealized gains and losses on derivatives and excludes net periodic interest costs related to these instruments.

(3) Other reconciling items for the year ended December 31, 2011 includes litigation settlement and related costs of \$8.2 million and loss on non-recourse collateralized financing of \$2.0 million.

- (4) Amount equals the net periodic interest costs related to interest rate derivatives during the period which is recorded in "loss on derivative instruments, net" and not already included in "interest expense" in accordance with GAAP. Recalculation of cost of funds and effective borrowing rates using interest expense shown in the table may not be
- (5) possible because certain items use a 360-day year for the calculation while others use actual number of days in the year.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with our financial statements and the related notes included in Item 8, "Financial Statements and Supplementary Data" in this Annual Report on Form 10-K.

This discussion contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors including, but not limited to, those disclosed in Item 1A, "Risk Factors" elsewhere in this Annual Report on Form 10-K and in other documents filed with the SEC and otherwise publicly disclosed. Please refer to "Forward-Looking Statements" contained within this Item 7 for additional information. This discussion also contains non-GAAP financial measures. Please refer to Item 6 of this Annual Report on Form 10-K for reconciliations of these non-GAAP measures and additional information about why management believes these non-GAAP measures are useful for shareholders. For a complete description of our business including our operating policies, investment philosophy and strategy, financing and hedging strategies, and other important information, please refer to Item 1 of Part 1 of this Annual Report on Form 10-K.

EXECUTIVE OVERVIEW

The Company and the U.S. fixed income markets as a whole faced a challenging business environment throughout 2015, a trend the Company believes is likely to continue in 2016. Domestically, the U.S. economy exhibited signs of positive growth during 2015, but the pace of this growth slowed in the second half of the year. Federal Reserve policy makers stated throughout the year that the Federal Reserve was targeting an increase in the Federal Funds rate, which had been held near 0% since June 2006, with the pace and timing of the increase depending on the performance of the economy, the strength of the labor market, and Federal Reserve expectations with respect to inflation over the medium term. Given the uneven performance of the economy during the year, interest rates exhibited periods of significant volatility as markets were unsure as to the timing and magnitude of increases in the Federal Funds rate. At its last meeting of 2015 in mid-December, the Federal Open Market Committee ("FOMC") announced a 25 basis point increase in the Federal Funds rate to a new target range of 0.25%-0.50% from its previous range of 0-0.25%. Internationally, weakening global growth in emerging markets and deflation concerns in developed markets led global central banks to continue easing monetary conditions. Global markets were further buffeted by concerns over the slowing growth of the Chinese economy and declining oil prices.

These domestic and international factors caused significant interest rate volatility throughout the year, making it challenging for the Company to manage its interest rate risk as further discussed below. The graph below shows the 2-year to 10-year portions of the U.S. Treasury curve as of the end of each quarter since December 31, 2014 and illustrates recent volatility across all ends of the rate curve:

The second half of 2015 included a broad-based repricing of risk premiums across most asset classes, including the MBS that we own. We believe that many factors contributed to the credit spread widening of assets in the markets including fundamental concerns over credit performance for our non-Agency CMBS and CMBS IO, supply/demand technicals, and overall risk aversion in the market as a result of volatility induced by concerns over central bank actions. In addition, regulation negatively impacted the market-making function of Wall Street broker dealers, reducing the overall liquidity in certain of the fixed income markets and exacerbating price volatility in assets. The table below shows examples of credit spreads in basis points for certain investment types in our MBS portfolio as of the end of each quarter since December 31, 2014, reflecting the volatility and eventual credit spread widening throughout 2015:

Investment Type:	12/31/2014	3/31/2015	6/30/2015	9/30/2015	12/31/2015
Agency ARM 5/1 (Agency RMBS)	21	15	16	26	29
Agency DUS (Agency CMBS)	59	54	60	76	89
Freddie K AAA IO (Agency CMBS IO)	155	140	150	200	225
AAA CMBS IO (Non-Agency CMBS IO)	165	170	175	225	240

In that environment, the Company posted a total negative economic return of (3.9)% for 2015, consisting of \$0.96 in common dividends less a decrease in the book value per common share of \$(1.31). The Company anticipated volatility in interest rates as the FOMC moved toward tightening and given global economic uncertainty. Throughout 2015, we increased our portfolio allocation to Agency and AAA-rated investments, continuing the trend from the second half of 2014, which we believe reduced the negative impacts of credit spread widening on our total economic return for the year ended December 31, 2015. We used sale proceeds from assets with lower credit ratings we sold in the third and fourth quarters of 2014 to selectively reinvest during the first and second quarters of 2015 into higher credit quality CMBS, which experienced lower spread widening relative to riskier asset classes, and we shifted our portfolio away from Agency RMBS to limit prepayment risk. However, book value per common share was still negatively impacted by the volatility in interest rates and widening credit spreads during the year, which caused us to significantly reposition our hedging portfolio. During the year, we reduced the notional balance and weighted average pay-fixed rate of our effective interest rate swaps in order to reduce the impact of net periodic interest costs on our earnings for 2015. In

addition, we added forward-starting interest rate swaps to protect our earnings from anticipated increases in interest rates in 2016 as well as to reduce negative impact to our book value from a selloff in rates. Please refer to "Financial Condition" and "Results of Operations" for additional details on our hedging portfolio.

During the year, we repurchased 5.9 million, or over 10%, of our outstanding common shares at a weighted average price of \$6.97 with the majority of the repurchases occurring during the second quarter and early in the third quarter of 2015. We viewed these repurchases as a better use of our capital than investing in MBS given the investment environment and the common stock price which, similar to the common stock of other mortgage REITs, was trading at a sizable discount to our book value per common share during the year.

Management's Outlook for 2016

We believe that markets will continue to exhibit volatility in 2016, much like 2015, given the uncertain global economic outlook and market concerns about the efficacy of global central banks actions. In the U.S., economic growth slowed in the second half of 2015, and with the market volatility in asset prices previously discussed, market participants have lowered their expectations thus far in 2016 of future increases in the Federal Funds Target Rate. While our book value remains sensitive to movements in credit spreads, we believe the catalysts for further significant credit spread widening are beginning to fade for several reasons: (i) supply/demand considerations seem to be stabilizing in early 2016 versus 2015; (ii) U.S. yields/spreads offer an attractive risk/return profile given their absolute levels and U.S. dollar appreciation versus most other currencies in the world; and (iii) we expect demand for higher credit quality assets, such as the securities in our portfolio, to increase, favorably impacting their market values, as overall market volatility declines.

Due to the widening in credit spreads in 2015 which has continued into early 2016, new investments present better risk-reward opportunities than in 2015, and we believe there is an opportunity to add to our investment portfolio securities that can generate attractive long-term returns. During 2016, we expect to see continued market volatility and uncertainty which will lead us to be very cautious in deploying material amounts of new capital in new investments. Our investment portfolio is modestly lower at the beginning of 2016 than it was at the beginning of 2015, but our leverage is higher as we repurchased common stock during 2015 and as our shareholders' equity shrank due to market value declines in our assets. As such, we have less capital available to add meaningful investments in 2016 at the more attractive returns mentioned above.

Finally, with respect to interest-rate risk management, as of December 31, 2015 we had \$2.1 billion of forward starting pay-fixed interest rate swaps, the majority of which become effective within the first six months of 2016. These interest rate swaps fix our borrowing costs at a weighted average rate of approximately 1.37%, protecting our net interest income if short-term interest rates exceed this weighted average during 2016. We will continue carefully monitoring our hedge position during 2016, given the uncertainty of the future path of interest rates and potential interest rate volatility, and we could make significant changes to our hedge position at any time. The current uncertainty will likely drive up the costs of our hedging instruments, which could be reflected in our earnings and book value per common share.

CRITICAL ACCOUNTING POLICIES

The discussion and analysis of our financial condition and results of operations are based in large part upon our consolidated financial statements, which have been prepared in accordance with GAAP. The preparation of our consolidated financial statements requires management to make estimates, judgments and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and disclosure of contingent assets and liabilities. We base these estimates and judgments on historical experience and assumptions believed to be reasonable under current facts and circumstances. Actual results, however, may differ from the estimated amounts we have recorded.

Critical accounting policies are defined as those that require management's most difficult, subjective or complex judgments, and which may result in materially different results under different assumptions and conditions. The following discussion provides information on our accounting policies that require the most significant management estimates, judgments, or assumptions, or that management believes includes the most significant uncertainties, and are considered most critical to our results of operations or financial position.

Fair Value Measurements. Our Agency MBS, as well a majority of our non-Agency MBS, are substantially similar to securities that either are currently actively traded or have been recently traded in their respective market. Their fair values as recorded in the Company's consolidated balance sheets are derived from an average of multiple pricing services and dealer quotes. Pricing services and dealers will have access to observable market information through their trading desks. We typically receive a total of three to six prices from pricing services and brokers for each of our securities; prices obtained from brokers are not binding on either the broker or us. Management does not adjust the prices received, but, for securities on which we receive five or more prices, the high and low prices are excluded from the calculation of the average price. In addition, management reviews the prices received for each security by comparing those prices to actual purchase and sale transactions, our internally modeled prices that are calculated based on observable market rates and credit spreads, and the prices that our borrowing counterparties use in financing our securities. For any security for which significant variations in price exist (from other external prices received or from our internal price), management may exclude such prices from the calculation of the average price. The decision to exclude any price from use in the calculation of the fair values used in our consolidated financial statements is reviewed and approved by management independent of the pricing process. The average of the remaining prices received is used for the fair values included in our consolidated financial statements. If the price of a security is obtained from quoted prices for similar instruments or model-derived valuations whose inputs are observable, the security is classified as a level 2 security. The security is classified as a level 3 security if the inputs are unobservable, resulting in an estimate of fair value based primarily on management's judgment. As of December 31, 2015, less than 3% of our non-Agency MBS (and less than 1% of our total MBS) are level 3 securities. Please refer to Note 8 of the Notes to our Consolidated Financial Statements contained within Part II, Item 8 of this Annual Report on Form 10-K for additional information on fair value measurements.

Amortization of Investment Premiums. We amortize premiums and accrete discounts associated with the purchase of our MBS into interest income over the projected lives of our securities, including contractual payments and estimated prepayments, using the effective yield method. If prepayments increase (or are expected to increase), we will accelerate the rate of amortization (accretion) on the premiums (discounts). Conversely, if prepayments decrease (or are expected to decrease), we will decelerate the rate of amortization (accretion) on the premiums (discounts). Estimates and judgments related to future levels of prepayments are critical to the determination of how much premium or discount to amortize or accrete, and the determination of the rate of amortization or accretion and future levels of prepayment are difficult for management to predict. With respect to both RMBS and CMBS, mortgage prepayment expectations can change based on how changes in current and projected interest rates impact a borrower's likelihood of refinancing as well as other factors, including but not limited to real estate prices, borrowers' credit quality, changes in the stringency of loan underwriting practices, and lending industry capacity constraints. With respect to RMBS, modifications to existing government refinance programs, or the implementation of new programs can have a significant impact on the rate of prepayments. Further, GSE buyouts of loans in imminent risk of default, loans that have been modified, or loans that have defaulted will generally be reflected as prepayments on our securities and increase the uncertainty around management's estimates. We utilize various third party services to assist in estimating projected prepayments on our MBS. We review these estimates monthly and compare the results to any available market consensus prepayment speeds. We also consider historical prepayment rates and current market conditions to assess the reasonableness of the prepayment rates estimated by the third party service. Actual and anticipated prepayment experience is reviewed monthly and effective yields are adjusted for differences between the previously estimated future prepayments and the amounts actually received as well as changes in estimated future prepayments.

Other-than-Temporary Impairments. When the fair value of an available-for-sale security is less than its amortized cost as of the reporting date, the security is considered impaired. We assess our securities for impairment on at least a quarterly basis and determine if the impairments are either temporary or other-than-temporary. We assess our ability to hold any Agency MBS or non-Agency MBS with an unrealized loss until the recovery in its value. Our ability to hold any such MBS is based on our current investment strategy and significance of the related investment as well as our current leverage and anticipated liquidity. Although Fannie Mae and Freddie Mac are not explicitly backed by the full faith and credit of the United States, given their guarantee and commitments for support received from the

Treasury as well as the credit quality inherent in Agency MBS, we do not typically consider any of the unrealized losses on our Agency MBS to be credit-related. For our non-Agency MBS, we review the credit ratings of these MBS and the seasoning of the mortgage loans collateralizing these securities as well as the estimated future cash flows, which include any projected losses, in order to evaluate whether we believe any portion of the unrealized loss at the reporting date is related to credit losses.

The determination as to whether an other-than-temporary impairment ("OTTI") exists, as well as its amount, is subjective, as such determinations are based not only on factual information available at the time of assessment but also on management's estimates of future performance and cash flow projections. As a result, the timing and amount of any OTTI may constitute a

material estimate that is susceptible to significant change. Our expectations with respect to our securities in an unrealized loss position may change over time, given, among other things, the dynamic nature of markets and other variables. For example, although we believe that the conservatorship of Fannie Mae and Freddie Mac has further strengthened their creditworthiness, there can be no assurance that these actions will be adequate for their needs. Accordingly, if these government actions are inadequate and the GSEs continue to suffer losses or cease to exist, our view of the credit worthiness of our Agency MBS could materially change, which may affect our assessment of OTTI for Agency MBS in future periods. Future sales or changes in our expectations with respect to Agency or non-Agency securities in an unrealized loss position could result in us recognizing other-than-temporary impairment charges or realizing losses on sales of MBS in the future.

FINANCIAL CONDITION

During 2015, we shifted our MBS portfolio mix toward CMBS and CMBS IO, given the better risk-adjusted return profile of these investments and the more favorable prepayment profile versus RMBS. As of December 31, 2015, CMBS and CMBS IO constituted 52% of our investment portfolio compared to 36% as of December 31, 2014. The chart below presents the amortized cost of our MBS investments by collateral type as of the end of each quarter since December 31, 2014:

In addition to the sections below, please refer to Note 2 of the Notes to the Consolidated Financial Statements contained within Part II, Item 8 of this Annual Report on Form 10-K for additional information relating to our MBS. The following sections provide additional information on our investment portfolio as well as related financing.

RMBS

Activity related to our RMBS for the year ended December 31, 2015 is as follows:

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(\$ in thousands)	Agency RMBS	Non-Agency RMBS	Total
Balance as of December 31, 2014	\$2,186,700	\$22,448	\$2,209,148
Purchases	—	72,688	72,688
Principal payments	(386,454)	(29,190)	(415,644)
Sales	(177,430)	—	(177,430)
Net (amortization) accretion	(22,208)	45	(22,163)
Change in fair value	(2,086)	(781)	(2,867)
Balance as of December 31, 2015	\$1,598,522	\$65,210	\$1,663,732

Our investment in RMBS as of December 31, 2015 has decreased since December 31, 2014 as principal payments and sales have significantly outpaced purchases. Our RMBS are collateralized substantially by ARMs and hybrid ARMs which carry greater prepayment risk in the current low interest rate environment. We have sold certain lower yielding Agency ARMs during the past year that were at or near their interest rate reset periods and which were expected to reset at interest rates lower than their current coupon.

As of December 31, 2015, approximately 97% of our variable-rate Agency RMBS portfolio resets based on one-year LIBOR, which was approximately 1.18% as of December 31, 2015 compared to 0.63% as of December 31, 2014. The underlying mortgage loans for these RMBS are subject to periodic interest rate caps which limit the amount by which the security's interest yield may change during any given period and lifetime interest rate caps which limit the maximum interest rate on the loans. The following table presents certain interest rate information for the variable-rate portion of our Agency RMBS portfolio by weighted average months to reset ("MTR") as of the dates indicated:

December 31, 2015

(\$ in thousands)	Par Value	Reset Margin to LIBOR	WAC	WAVG Periodic Interest Cap	WAVG Life Interest Cap
0-12 MTR	\$309,826	1.79	% 2.75	% 2.40	% 10.00
13-36 MTR	380,455	1.79	% 3.47	% 5.00	% 9.01
37-60 MTR	91,769	3.11	% 2.97	% 5.00	% 8.35
61-84 MTR	541,720	1.76	% 3.09	% 5.00	% 8.48
85-120 MTR	197,473	1.62	% 2.56	% 5.00	% 7.78
ARMs and Hybrid ARMs	1,521,243	1.84	% 3.04	% 4.47	% 8.82
Fixed	15,490	n/a	2.50	% n/a	n/a
Total	\$1,536,733		3.03	%	

December 31, 2014

(\$ in thousands)	Par Value	Reset Margin to LIBOR	WAC	WAVG Periodic Interest Cap	WAVG Life Interest Cap
0-12 MTR	\$486,638	1.77	% 2.75	% 2.70	% 9.80
13-36 MTR	286,741	1.84	% 3.87	% 5.00	% 8.88
37-60 MTR	399,643	1.79	% 3.22	% 5.00	% 8.22
61-84 MTR	268,864	1.80	% 3.54	% 5.00	% 8.54
85-120 MTR	627,772	1.69	% 2.75	% 5.00	% 7.75
ARMs and Hybrid ARMs	2,069,658	1.77	% 3.10	% 4.46	% 8.58
Fixed	17,149	n/a	2.51	% n/a	n/a
Total	\$2,086,807		3.09	%	

As shown in the preceding tables, the weighted average coupon we earned for the majority of our variable-rate Agency RMBS was lower as of December 31, 2015 compared to December 31, 2014. These lower coupons combined with lower balances of Agency RMBS resulted in declining interest income from our Agency RMBS during the year ended December 31, 2015.

We have increased our non-Agency RMBS portfolio since December 31, 2014 with purchases of senior tranches of non-performing loan securitizations with maturities ranging between one and two years. Although these investments do not have a credit rating issued by any of the nationally recognized statistical ratings organization, they have substantial credit enhancement within the securitization structure and we believe that they offer an attractive return profile with relatively stable cash flows. These non-Agency RMBS were purchased at or near par and had a weighted average yield of 3.53% for the year ended December 31, 2015.

CMBS

Our Agency CMBS are collateralized primarily by fixed rate mortgage loans secured by multifamily properties. Our non-Agency CMBS are collateralized by fixed rate mortgage loans secured by income producing properties such as office, retail, and multifamily. Both Agency and non-Agency CMBS will generally have some form of prepayment protection provisions (such as prepayment lock-outs) or prepayment compensation provisions (such as yield maintenance or prepayment penalties) to prevent early voluntary prepayment of principal.

Activity related to our CMBS for the year ended December 31, 2015 is as follows:

(\$ in thousands)	Agency CMBS	Non-Agency CMBS	Total
Balance as of December 31, 2014	\$335,197	\$208,038	\$543,235
Purchases	767,277	12,999	780,276
Principal payments	(41,631)	(35,771)	(77,402)
Sales	(149,964)	(31,341)	(181,305)
Premium/discount (amortization)/accretion, net	(5,664)	360	(5,304)
Change in fair value	(19,284)	(102)	(19,386)
Balance as of December 31, 2015	\$885,931	\$154,183	\$1,040,114

The majority of our purchases during 2015 were new issue Agency CMBS which we believe offer more compelling risk-adjusted returns and a more stable cash flow profile amid the volatile interest rate environment, given Agency CMBS' limited prepayment and extension risks compared to RMBS. Most of our CMBS sales were during the second and third quarters of 2015 and consisted of investments that were financed at higher leverage rates than the average leverage on our portfolio.

The majority of our CMBS investments are collateralized by mortgages underwritten in more recent periods, which we believe are of higher credit quality than prior years, and in particular those originated prior to 2008. Agency CMBS are guaranteed by the GSEs with respect to return of principal, and our credit exposure is limited to any premium on those securities. Non-Agency CMBS are not guaranteed and therefore our entire investment is exposed to credit losses. The following table presents the par value, amortized cost, and weighted average months to estimated maturity of our CMBS investments as of the dates indicated by year of origination:

(\$ in thousands)	December 31, 2015			December 31, 2014		
	Par Value	Amortized Cost	Months to Estimated Maturity ⁽¹⁾	Par Value	Amortized Cost	Months to Estimated Maturity ⁽¹⁾
Year of Origination:						
2008 and prior	\$83,396	\$78,765	38	130,878	127,766	43
2009 to 2012	254,870	264,087	40	276,245	288,903	52
2013 to 2014	78,501	78,931	63	105,178	105,154	56
2015	616,202	616,304	120	—	—	—
	\$1,032,969	\$1,038,087	89	\$512,301	\$521,823	51

(1) Months to estimated maturity is an average weighted by the amortized cost of the investment.

The majority of the collateral underlying our non-Agency CMBS is comprised of single-family and multi-family properties.

The following charts present the collateral underlying our non-Agency CMBS by property type as of the dates indicated:

The collateral underlying our non-Agency CMBS investments is geographically dispersed in order to mitigate exposure to any particular region of the country. The U.S. state with the largest percentage of collateral underlying our non-Agency CMBS was Florida at 32% and 29% as of December 31, 2015 and December 31, 2014, respectively, with no other state exceeding 15% as of those dates. The following charts present the geographic diversification of the collateral underlying our non-Agency CMBS by the top 5 states as of the dates indicated:

CMBS IO

The majority of our CMBS IO investments are collateralized primarily by fixed rate mortgage loans. Agency CMBS IO are exclusively collateralized by multifamily properties, and non-Agency CMBS IO are secured by income producing properties such as office, retail, and hotel. Both types of CMBS IO have some form of prepayment protection (such as prepayment lock-outs) or prepayment compensation provisions (such as yield maintenance or prepayment penalties). Our CMBS IO investments are investment grade-rated with the majority rated 'AAA' by at least one of the nationally recognized statistical ratings organizations.

Activity related to our CMBS IO for the year ended December 31, 2015 is as follows:

(\$ in thousands) ⁽¹⁾	Agency CMBS IO	Non-Agency CMBS IO	Total
Balance as of December 31, 2014	\$438,737	\$325,119	\$763,856
Purchases	113,805	144,726	258,531
Sales	(43,398)	(48,766)	(92,164)
Premium amortization, net	(75,115)	(49,686)	(124,801)
Change in fair value	(7,901)	(7,666)	(15,567)
Balance as of December 31, 2015	\$426,128	\$363,727	\$789,855

(1) Amounts shown for CMBS IO represent premium only and exclude underlying notional balances.

Because investments in CMBS IO pay interest from the underlying commercial mortgage loan pools, our return on these investments is negatively impacted by involuntary prepayments as a result of liquidation or foreclosure on the underlying mortgage loans. In order to manage our exposure to credit performance, we generally invest in securities with higher credit ratings and in securities where we have evaluated the credit profile of the underlying loan pool and can monitor its credit performance. In addition, because underwriting standards vary over time, we consider the year of origination of the loans underlying CMBS IO in our selection of investments. The following table presents our CMBS IO investments as of December 31, 2015 by year of origination:

(\$ in thousands)	December 31, 2015		For the Year Ended December 31, 2015	December 31, 2014		For the Year Ended December 31, 2014
	Amortized Cost	Fair Value	WAL ⁽¹⁾	Amortized Cost	Fair Value	WAL ⁽¹⁾
Year of Origination:						
2010	\$12,843	\$13,472	24	\$23,335	\$24,615	29
2011	45,731	48,482	28	91,947	97,885	28
2012	131,085	133,086	31	188,093	193,165	37
2013	154,445	155,299	38	176,571	179,498	43
2014	223,542	221,933	44	265,898	268,694	49
2015	219,765	217,583	50	—	—	—
	\$787,411	\$789,855	41	\$745,844	\$763,857	41

(1) Weighted average life ("WAL") represents an estimate of the number of months of interest earnings remaining for the investments by year of origination.

Approximately half of the collateral underlying our non-Agency CMBS IO is comprised of retail and multifamily properties. The following charts present the property type of the collateral underlying our non-Agency CMBS IO as of the dates indicated:

The collateral underlying our non-Agency CMBS IO investments is geographically dispersed in order to mitigate exposure to any particular region of the country. The U.S. state with the largest percentage of collateral underlying our non-Agency CMBS IO was California at less than 13% as of December 31, 2015 and December 31, 2014. The following charts present the geographic

diversification of the collateral underlying our non-Agency CMBS IO by the top 5 states as of the dates indicated:

Derivative Assets and Liabilities

Our derivative assets and liabilities consist of interest rate swap agreements and Eurodollar futures, which we use to hedge our earnings and book value exposure to fluctuations in interest rates. Eurodollar futures represent forward starting 3-month LIBOR contracts and allow us to synthetically replicate swap curves and/or hedge specific points on the swap curve where we may have duration risk by shorting contracts at various points of the LIBOR curve. We use both pay-fixed and receive-fixed interest rate swaps to manage our overall hedge position.

The following graphs present our hedging portfolio as of the dates indicated:

During the year ended December 31, 2015, we added interest rate swaps with a combined notional of \$3.3 billion at a net weighted average pay-fixed rate of 1.64%, of which \$2.1 billion are forward-starting as of December 31, 2015. We terminated \$830.0 million in pay-fixed interest rate swaps with a weighted average pay-fixed rate of 2.19%. We also terminated \$10.3 billion in Eurodollar futures at a weighted average rate of 1.98%. These adjustments to our hedging portfolio were made in response to changes in our investment allocations, shifts in the yield curve, and our expectations with respect to the future path of interest rates and interest rate volatility.

Repurchase Agreements and FHLB Advances

During the year ended December 31, 2015, we financed the majority of our MBS with repurchase agreement borrowings and, to a lesser extent, FHLB advances. Our repurchase agreement borrowings declined approximately 14% during the year ended December 31, 2015 because the size of our investment portfolio did not significantly change and we replaced a portion of our repurchase agreement financing with FHLB advances as an alternative source of funding. We also reduced the combined weighted average original term to maturity for our repurchase agreements to 67 days as of December 31, 2015 from 144 days as of December 31, 2014 by rolling our longer term borrowings at their maturity dates into shorter term borrowings in order to minimize increases in our interest expense. The cost of longer maturity borrowings increased significantly during 2015 as a result of our lenders anticipating increases by the FOMC of the Federal Funds rate.

Due to the final rule issued by the FHFA in January 2016, we will not be permitted new FHLB advances or renewals of existing FHLB advances. As such, we are required to repay approximately 50% of our FHLB advances outstanding as of December 31, 2015 before the end of the first quarter of 2016 and the remainder prior to December 31, 2016. Please refer to Items 1 and 1A of Part 1 of this Annual Report on Form 10-K for additional information regarding the impact of this final ruling by the FHFA. As a member of the FHLB of Indianapolis ("FHLBI"), we are required to purchase stock in the FHLBI based primarily on the amount of our advances. As of December 31, 2015, we had purchased \$11.5 million of FHLBI common stock. We anticipate this stock will be repurchased by the FHLBI as we repay advances, though the FHLBI has up to five years to repurchase this stock.

As of December 31, 2015 and December 31, 2014, approximately 84% and 86%, respectively, of our repurchase agreement and FHLB borrowings were collateralized with Agency MBS which have historically had lower liquidity risk than non-Agency

MBS. The following table presents the amount pledged and leverage against the fair value of our non-Agency MBS investments by credit rating as of December 31, 2015 and December 31, 2014:

(\$ in thousands)	December 31, 2015			December 31, 2014		
	Fair Value	Amount Pledged	Related Borrowings	Fair Value	Amount Pledged	Related Borrowings
Non-Agency CMBS:						
AAA	\$60,192	\$53,589	\$48,400	\$73,553	\$8,133	\$7,279
AA	51,599	—	—	65,937	65,937	57,619
A	34,771	34,771	29,211	30,828	30,828	25,384
Below A/Not Rated	7,621	55,425	48,767	37,720	35,318	24,613
	\$154,183	\$143,785	\$126,378	\$208,038	\$140,216	\$114,895
Non-Agency CMBS IO:						
AAA	\$294,712	\$303,659	\$255,652	\$321,154	\$311,184	\$263,510
AA	53,974	—	—	1,057	1,057	1,005
Below A/Not Rated	15,041	55,692	47,119	2,908	2,908	2,467
	\$363,727	\$359,351	\$302,771	\$325,119	\$315,149	\$266,982
Non-Agency RMBS:						
Below A/Not Rated	\$65,210	\$64,286	\$52,127	\$22,448	\$21,787	\$17,594
	\$65,210	\$64,286	\$52,127	\$22,448	\$21,787	\$17,594

Please refer to Note 4 of the Notes to the Consolidated Financial Statements contained within Part II, Item 8 of this Annual Report on Form 10-K as well as "Interest Expense, Cost of Funds, and Effective Borrowings Costs" within "Results of Operations" and "Liquidity and Capital Resources" contained within this Item 7 for additional information relating to our borrowings.

RESULTS OF OPERATIONS

The discussions that follow include non-GAAP financial measures which management uses in its internal analysis of financial and operating performance. Please read the section "Non-GAAP Financial Measures" contained in Item 6 of Part II of this Annual Report on Form 10-K for additional important information about these measures and the reconciliations of these measures to GAAP measures.

For the year ended December 31, 2015, we recorded a comprehensive loss of \$(26.7) million, which consisted of net income to common shareholders of \$7.4 million and other comprehensive loss of \$(34.1) million. Net income to common shareholders consisted substantially of net interest income of \$77.6 million, loss on derivative instruments, net of \$(43.1) million, general and administrative expenses of \$(17.7) million, and preferred dividends of \$(9.2) million. The majority of the loss on derivative instruments was due to unfavorable changes in fair value, realized losses on terminated instruments, costs associated with forward starting hedges, and to a lesser extent, interest rate swap spread tightening. Other comprehensive loss consisted primarily of unrealized losses on our MBS portfolio of \$(37.6) million resulting from credit spread widening and increasing interest rates.

Core net operating income to common shareholders, a non-GAAP measure management uses as an estimate of the net interest earnings of the Company's portfolio after operating expenses, was \$49.2 million for the year ended December 31, 2015, which consisted substantially of adjusted net interest income, a non-GAAP measure, of \$75.4 million, general and administrative expenses of \$(17.7) million, and preferred dividends of \$(9.2) million.

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The following sections provide more information on these items and others on our consolidated statements of comprehensive income (loss).

Interest Income and Asset Yields

Interest income includes gross interest earned from the coupon rate on the securities, effects of premium amortization and discount accretion, and other interest income resulting from prepayment penalty income or other yield maintenance items on CMBS and CMBS IO securities. The following tables present information regarding interest income earned and effective yield on our MBS by collateral type for the periods indicated:

(\$ in thousands)	Year Ended December 31, 2015			2014				
	Interest Income	Average Balance ⁽¹⁾	Effective Yield ⁽²⁾	Interest Income	Average Balance ⁽¹⁾	Effective Yield ⁽²⁾		
RMBS:								
Agency	\$32,224	\$1,886,935	1.71	% \$44,432	\$2,450,100	1.81	%	
Non-Agency	2,342	64,243	3.64	% 941	13,586	6.93	%	
	34,566	1,951,178	1.77	% 45,373	2,463,686	1.84	%	
CMBS:								
Agency	23,411	751,949	3.08	% 11,883	324,338	3.62	%	
Non-Agency	11,173	194,265	5.74	% 17,285	317,763	5.44	%	
	34,584	946,214	3.62	% 29,168	642,101	4.52	%	
CMBS IO:								
Agency	16,231	417,975	3.88	% 18,695	429,664	4.35	%	
Non-Agency	13,555	340,946	3.98	% 9,645	236,624	4.08	%	
	29,786	758,921	3.92	% 28,340	666,288	4.25	%	
Total MBS portfolio:	\$98,936	\$3,656,313	2.70	% \$102,881	\$3,772,075	2.72	%	

	Year Ended December 31, 2013				
	Interest Income	Average Balance ⁽¹⁾	Effective Yield ⁽²⁾		
RMBS:					
Agency	\$56,376	\$2,835,130	1.99	%	
Non-Agency	659	12,641	5.22	%	
	57,035	2,847,771	2.00	%	
CMBS:					
Agency	11,726	323,174	3.59	%	
Non-Agency	23,383	415,212	5.63	%	
	35,109	738,386	4.74	%	
CMBS IO:					
Agency	25,760	520,689	4.95	%	
Non-Agency	5,725	118,759	4.82	%	
	31,485	639,448	4.92	%	

Total MBS portfolio:	\$ 123,629	\$4,225,605	2.92	%
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(1) Average balances are calculated as a simple average of the daily amortized cost and exclude unrealized gains and losses as well as securities pending settlement if applicable.

(2) Effective yields are weighted by average balance of the investments and based on annualized amounts.

Recalculation of effective yields may not be possible using data provided because certain components of interest income use a 360-day year for the calculation while others use actual number of days in the year.

The following tables present the estimated impact of changes in average balances and average yields on interest income for the periods indicated:

(\$ in thousands)	Year Ended December 31, 2015 vs. December 31, 2014			Year Ended December 31, 2014 vs. December 31, 2013		
	Due to Change in			Due to Change in		
	Increase (Decrease)	Average Balance	Effective Yield	Increase (Decrease)	Average Balance	Effective Yield
RMBS	\$(10,807)	\$(9,496)	\$(1,311)	\$(11,662)	\$(7,334)	\$(4,328)
CMBS	5,416	8,393	(2,977)	(5,942)	(5,463)	(479)
CMBS IO	1,446	3,774	(2,328)	(3,144)	1,098	(4,242)
Total	\$(3,945)	\$2,671	\$(6,616)	\$(20,748)	\$(11,699)	\$(9,049)

Our interest income from MBS for the year ended December 31, 2015 decreased compared to the year ended December 31, 2014 due to a decrease in the weighted average effective yield earned on our MBS portfolio to 2.70% for the year ended December 31, 2015 compared to 2.72% for the year ended December 31, 2014. The lower weighted average effective yield is primarily due to the lower average gross coupon we are earning on our MBS. This decrease was partially offset by the replacement of a portion of our RMBS with higher yielding CMBS and CMBS IO. Although our overall average balance of MBS was lower for the year ended December 31, 2015 compared to the year ended December 31, 2014, CMBS and CMBS IO increased 12% as a percentage of the total average balance for the year ended December 31, 2015 and earned a combined weighted average effective yield of 3.76% compared to the RMBS sold during 2015 which earned 1.32%.

Our interest income from MBS for the year ended December 31, 2014 decreased compared to the year ended December 31, 2013 due to a decrease in the average balance of our MBS portfolio and a decrease in the weighted average effective yield earned on our MBS portfolio. The balance of our investment portfolio declined throughout the year as the proceeds we received from sales of and principal repayments on our MBS were used to pay down our repurchase agreements borrowings rather than fully reinvesting into new assets. Our purchases of new assets declined during 2014 as there were fewer opportunities to add investments with acceptable risk and return profiles. Average yields on our MBS were lower as purchases across the portfolio were made at lower yields, in particular CMBS IO, and we experienced downward resets in interest rates on our variable-rate securities during 2014.

The following table presents information regarding premium amortization recognized on our RMBS and its corresponding impact on effective yield for the periods indicated:

	Year Ended December 31, 2015		2014		2013	
	Amount	Impact on Effective Yield	Amount	Impact on Effective Yield	Amount	Impact on Effective Yield
Scheduled amortization (1)	\$(20,331)	(1.08)%	\$(27,928)	(1.14)%	\$(35,218)	(1.24)%
Amortization adjustment (2)	(1,876)	(0.10)%	(619)	(0.03)%	2,030	0.07 %
	\$(22,207)	(1.18)%	\$(28,547)	(1.17)%	\$(33,188)	(1.17)%

Total effective yield
adjustment

(1) Represents premium amortization excluding any amortization adjustment resulting from the difference between prepayment speed estimated for the reporting period and actual prepayments received as well as from changes in projected prepayment speeds.

(2) Represents the adjustment to scheduled premium amortization resulting from the difference between prepayment speed estimated for the reporting period and actual prepayments received as well as from changes in projected prepayment speeds.

The rate at which we amortize the premiums we pay for our investments is impacted by actual and forecasted prepayments, which is measured by the constant prepayment rate ("CPR") for Agency RMBS. The following graph shows the actual CPRs and the projected 3 month CPR for our Agency RMBS for the periods indicated:

The following table presents the amount of interest income recognized from prepayment penalties and other yield maintenance provisions on our CMBS and CMBS IO, net of any adjustments to premium amortization, and its corresponding impact on effective yield for the periods indicated:

	Year Ended		2014		2013			
	December 31,							
	2015		2014		2013			
	Amount	Adjustment to Yield	Amount	Adjustment to Yield	Amount	Adjustment to Yield		
Agency CMBS	\$616	0.08	% \$282	0.09	% \$97	0.03	%	
Non-Agency CMBS	2,564	1.32	% 72	0.02	% (67	) (0.02)%	
Total CMBS ⁽¹⁾	3,180	0.34	% 354	0.06	% 30	—	%	
Agency CMBS IO	376	0.09	% 957	0.22	% 2,586	0.50	%	
Non-Agency CMBS IO	295	0.09	% 238	0.10	% 537	0.45	%	
Total CMBS IO ⁽¹⁾	671	0.09	% 1,195	0.18	% 3,123	0.49	%	
Total CMBS and CMBS IO ⁽¹⁾	\$3,851	0.23	% \$1,549	0.12	% \$3,153	0.23	%	

(1) Total adjustment to yield is a weighted average based on the average balance outstanding for each class of MBS.

During the three months ended September 30, 2015, we received prepayment penalty compensation of \$2.6 million on non-Agency CMBS due to the early payoff of one commercial mortgage loan issued in 1998.

Please refer to "Quantitative and Qualitative Information About Market Risk" contained within Item 7A for additional information on factors impacting prepayments on our MBS.

Interest Expense, Cost of Funds, and Effective Borrowing Cost

The following table summarizes the components of interest expense as well as average balances and cost of funds for the periods indicated:

(\$ in thousands)	Year Ended December 31,		
	2015	2014	2013
Interest expense on repurchase agreement borrowings	\$18,467	\$19,033	\$24,113
Interest expense on FHLB advances	541	—	—
Interest rate swap expense from cash flow hedging ⁽¹⁾	—	—	8,796
Amortization of de-designated cash flow hedges ⁽²⁾	3,499	6,788	5,193
Non-recourse collateralized financing and other interest expense	98	94	926
Total interest expense	\$22,605	\$25,915	\$39,028
Average balance of repurchase agreements	\$3,096,888	\$3,335,786	\$3,773,744
Average balance of FHLB advances	163,489	—	—
Average balance of non-recourse collateralized financing	9,334	11,915	24,101
Average balance of borrowings	\$3,269,711	\$3,347,701	\$3,797,845
Cost of funds ⁽³⁾	0.68	% 0.76	% 1.01

Amount was recorded within "interest expense" on the Company's consolidated statement of comprehensive income for the year ended December 31, 2013 and represents net periodic interest costs from interest rate swaps while they were designated as cash flow hedges for accounting purposes. We discontinued cash flow hedge accounting for all of our derivative instruments as of June 30, 2013. Net periodic interest costs from interest rate swaps are now recorded within "loss on derivative instruments, net" on the Company's consolidated statements of comprehensive income.

(1) Amount recorded in accordance with GAAP related to the amortization of the balance remaining in accumulated other comprehensive loss as of June 30, 2013 as a result of our discontinuation of cash flow hedge accounting.

(2) Cost of funds is calculated by dividing total interest expense by the total average balance of borrowings outstanding during the period with an assumption of 360 days in a year.

The following table presents the differences in interest expense for the comparative periods presented:

(\$ in thousands)	Years Ended	
	December 31, 2015 vs. December 31, 2014	December 31, 2014 vs. December 31, 2013
Decrease in average balance	\$(446)	\$(2,968)
Increase (decrease) in average rate	426	(2,944)
Decrease in interest rate swap expense from cash flow hedges	—	(8,796)
(Decrease) increase in amortization of de-designated cash flow hedges	(3,290)	1,595
Total change in interest expense	\$(3,310)	\$(13,113)

The majority of the decrease in our interest expense for the year ended December 31, 2015 compared to the prior year was due to lower amortization expense from our de-designated cash flow hedges. Interest expense also decreased because we carried a lower average balance of borrowings during 2015 compared to the prior year. Although our interest expense decreased, our average borrowing rate on our repurchase agreements increased 3 basis points to 0.59% for the year ended December 31, 2015 from 0.56% for the year ended December 31, 2014. This increase in borrowing rate increased interest expense by approximately \$0.4 million for the year ended December 31, 2015 as shown in the table above. In 2015, the volatile interest rate environment negatively impacted the availability and cost of repurchase agreement borrowings and the original term to maturity dates of our repurchase agreements shortened. In addition, during the second half of 2015, repurchase agreement borrowings that matured were rolled over into new

agreements in a higher interest rate environment than when initially borrowed as lenders began in the third quarter of 2015 to price in expectations for increases to the Federal Funds Rate.

In contrast, we experienced a less volatile interest rate environment during 2014 which favorably impacted the availability and cost of repurchase agreement financing as excess liquidity in the financing markets increased competition among our repurchase agreement counterparties and as funding markets lowered their expectations of an interest rate hike by the FOMC. We were also able to extend the maturities of our repurchase agreements during 2014 to take advantage of lower interest rates. Average balances of repurchase agreement borrowings were lower in 2014 compared to 2013 given our smaller investment portfolio and the overall shift in our portfolio mix to lower leveraged CMBS IO investments.

Because we use derivative instruments as economic hedges of our interest rate risk exposure, management considers net periodic interest costs from effective derivative instruments to be an additional cost of financing investments. As such, management utilizes a non-GAAP financial measure "effective borrowing cost" which includes the net periodic interest costs of our effective derivative instruments excluded from GAAP interest expense. Effective borrowing cost is included in the calculation of adjusted net interest income, a component of core net operating income discussed further below. The tables below present the reconciliation of GAAP interest expense and cost of funds to our effective borrowing cost and rate for the periods indicated:

(\$ in thousands)	Year Ended		December 31,		2015		2014		2013	
	Amount	Rate	Amount	Rate	Amount	Rate	Amount	Rate	Amount	Rate
GAAP interest expense/cost of funds	\$22,605	0.68	%	\$25,915	0.76	%	\$39,028	1.01	%	
Amortization of de-designated cash flow hedges (1)	(3,499)	(0.11	)%	(6,788)	(0.20	)%	(5,193)	(0.15)%	
Net periodic interest costs of derivative instruments	5,730	0.18	%	8,218	0.25	%	8,948	0.24	%	
Effective borrowing cost/rate	\$24,836	0.75	%	\$27,345	0.81	%	\$42,783	1.10	%	

Amount recorded as a portion of "interest expense" in accordance with GAAP and is related to the amortization of (1) the balance in accumulated other comprehensive loss as of June 30, 2013 related to the derivatives for which we discontinued cash flow hedge accounting.

Effective borrowing costs were \$2.5 million lower for the year ended December 31, 2015 versus the same period in 2014 due to lower net periodic interest costs from our interest rate swaps. During the year ended December 31, 2015, we terminated pay-fixed interest rate swaps with a notional of \$830.0 million with a weighted average pay-fixed rate of 2.19% and added current receive-fixed and current pay-fixed interest rate swaps with a combined notional of \$1.0 billion at a lower net weighted average pay-fixed rate of 1.22%.

Effective borrowing costs were \$15.4 million lower for the year ended December 31, 2014 versus the same period in 2013, of which \$9.5 million resulted from a decrease in the weighted average notional balance outstanding for our interest rate swaps of approximately \$793.8 million as well as a decrease of approximately 9 basis point in the weighted average net pay rate. The remainder of the decrease in our effective borrowing costs for the year ended December 31, 2014 versus the same period in 2013 resulted from the lower average balances outstanding for our repurchase agreement and non-recourse collateralized financings as well as our overall lower average borrowing rates for our repurchase agreements.

Net Interest Income and Net Interest Spread

The tables below present net interest income and related net interest spread for all of our interest-earning assets and interest-bearing liabilities pursuant to GAAP, and also present the non-GAAP measures "adjusted net interest income" and "adjusted net interest spread" for the periods indicated. "Adjusted net interest income" and "adjusted net interest spread" are calculated using the non-GAAP measure "effective borrowing cost/rate" reconciled in the table above, and

therefore include net periodic interest cost of derivative instruments whereas GAAP net interest income and GAAP net interest spread do not.

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	Year Ended		2014		2013			
	December 31,		Amount	Yield	Amount	Yield	Amount	Yield
(\$ in thousands)	2015	2014	2015	2014	2013	2013	2013	2013
GAAP interest income	\$100,244	2.71	% \$105,644	2.76	% \$127,132	2.96	%	
GAAP interest expense	22,605	0.68	% 25,915	0.76	% 39,028	1.01	%	
Net interest income/spread	77,639	2.03	% 79,729	2.00	% 88,104	1.95	%	
Amortization of de-designated cash flow hedges ⁽¹⁾	3,499	0.11	% 6,788	0.20	% 5,193	0.15	%	
Net periodic interest costs of derivative instruments	(5,730)	(0.18 )	)% (8,218)	(0.25 )	)% (8,948)	(0.24))%	
Adjusted net interest income/spread	\$75,408	1.96	% \$78,299	1.95	% \$84,349	1.86	%	
Average interest earning assets ⁽²⁾	\$3,685,936		\$3,822,870		\$4,290,073			
Average balance of borrowings ⁽³⁾	\$3,269,711		\$3,347,701		\$3,797,845			

Amount recorded as a portion of "interest expense" in accordance with GAAP related to the amortization of the (1) balance remaining in accumulated other comprehensive loss as of June 30, 2013 as a result of our discontinuation of cash flow hedge accounting.

(2) Average balances are calculated as a simple average of the daily amortized cost and exclude unrealized gains and losses as well as securities pending settlement if applicable.

(3) Average balances are calculated as a simple average of the daily borrowings outstanding for both repurchase agreement and non-recourse collateralized financing.

Our net interest income and adjusted net interest income decreased for the year ended December 31, 2015 compared to the same period in 2014 due to lower weighted average effective yield as discussed above under "Interest Income and Asset Yields". The impact of lower weighted average coupons was partially offset by lower interest expense and lower effective borrowing cost as further discussed above under "Interest Expense, Cost of Funds, and Effective Borrowing Costs" and below under "Loss on Derivative Instruments, Net". Conversely, our net interest spread increased 3 basis points for the year ended December 31, 2015 compared to the same period in 2014 because the decrease in our cost of funds more than offset the decrease in our weighted average effective yield. Similarly, adjusted net interest spread increased over the same periods because our effective borrowing rate decreased 1 basis point more than the decrease in our weighted average effective yield.

Our net interest income and adjusted net interest income decreased for the year ended December 31, 2014 compared to the same period in 2013 due to smaller average interest earning asset balances, lower coupons earned on our investments, and higher premium amortization resulting from the shift in our portfolio toward CMBS IO as discussed above under "Interest Income and Asset Yields". The impact of smaller average interest earning asset balances and lower coupons was partially offset by lower overall annualized cost of funds and lower effective borrowing costs as further discussed above under "Interest Expense, Cost of Funds, and Effective Borrowing Costs" and below under "Loss on Derivative Instruments, Net". Conversely, our net interest spread increased 5 basis points for the year ended December 31, 2014 compared to the same period in 2013 as a result of declining repurchase agreement costs which more than offset the decline in weighted average effective yields on our investments. Adjusted net interest spread increased 9 basis points for the year ended December 31, 2014 compared to the same period in 2013 as a result of lower net periodic interest costs.

Loss on Derivative Instruments, Net

The following table provides information on the components of our "loss on derivative instruments, net" for the periods indicated:

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(\$ in thousands) Type of Derivative Instrument	Year Ended December 31, 2015			2014		
	Net Periodic Interest Costs	Change in Fair Value ⁽¹⁾	Total	Net Periodic Interest Costs	Change in Fair Value ⁽¹⁾	Total
Receive-fixed interest rate swaps	\$5,036	\$1,486	\$6,522	\$1,436	\$3,476	\$4,912
Pay-fixed interest rate swaps	(10,766)	(17,921)	(28,687)	(9,654)	(21,100)	(30,754)
Eurodollar futures	—	(20,963)	(20,963)	—	(27,551)	(27,551)
Loss on derivative instruments, net	\$(5,730)	\$(37,398)	\$(43,128)	\$(8,218)	\$(45,175)	\$(53,393)

	Year Ended December 31, 2013		
	Net Periodic Interest Costs ⁽²⁾	Change in Fair Value ⁽¹⁾	Total
Receive-fixed interest rate swaps	\$—	\$—	\$—
Pay-fixed interest rate swaps	(8,948)	18,263	9,315
Eurodollar futures	—	(19,391)	(19,391)
Loss on derivative instruments, net	\$(8,948)	\$(1,128)	\$(10,076)

(1) Amount shown is inclusive of realized gains (losses) from terminated instruments.

(2) During the year ended December 31, 2013, we recorded an additional \$8.8 million within "interest expense" for net periodic interest costs from pay-fixed interest rate swaps while they were designated as cash flow hedges for accounting purposes. We discontinued cash flow hedge accounting for all of our derivative instruments as of June 30, 2013.

Loss on derivative instruments, net for the year ended December 31, 2015 was driven primarily by losses on forward starting interest rate swaps and Eurodollar futures which resulted in large part from the volatility in interest rates during the year and from periodic repositioning of our hedge position. In 2015, we realized \$22.5 million of losses, net of periodic interest, on our terminated derivatives. Our hedge repositioning was based on our evolving view of the interest rate environment during 2015 and the future path of interest rates and where we deemed hedges were most effective in relation to our capital allocation and interest rate risk.

Loss on derivative instruments, net for the year ended December 31, 2014 increased by \$43.3 million compared to the year ended December 31, 2013, principally as a result of the shifts in the yield curve during 2014. For example, the two-year swap rate increased by 0.41% during the year but the ten-year swap rate declined during the year by 0.83%. Our derivatives hedge different points on the yield curve, but, in general, declines in longer-term swap rates will result in a higher amount of losses on our derivative position.

(Loss) Gain on Sale of Investments, Net

Sales of our investments occur in the ordinary course of business as we manage our risk profile and as we allocate capital to preferred investment opportunities. The following tables provide information related to our (loss) gain on sale of investments, net for the periods indicated:

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(\$ in thousands)	Year Ended December 31, 2015		2014		2013	
	Amortized cost basis sold	(Loss) gain on sale of investments, net	Amortized cost basis sold	(Loss) gain on sale of investments, net	Amortized cost basis sold	(Loss) gain on sale of investments, net
Type of Investment						
Agency RMBS	\$177,430	\$(2,865)	\$143,112	\$(5,762)	\$4,496	\$(254)
Agency CMBS	149,964	(604)	—	—	36,311	689
Non-Agency CMBS	31,341	(566)	226,066	19,773	136,287	793
Agency CMBS IO	43,398	1,698	106,005	1,630	161,550	2,010
Non-Agency CMBS IO	48,766	1,359	12,513	582	10,263	456
Non-Agency RMBS	—	—	—	—	5,631	(340)
	\$450,899	\$(978)	\$487,696	\$16,223	\$354,538	\$3,354

As stated in "Executive Overview", we used sale proceeds from lower credit quality non-Agency CMBS sold in the third and fourth quarters of 2014 to selectively reinvest during the first and second quarters of 2015 into higher credit quality Agency CMBS in order to minimize our portfolio exposure to credit spread widening. We did not reinvest in Agency RMBS and increased our sales of Agency RMBS in order to reduce our exposure to prepayment risk. The majority of our Agency CMBS sales for the year ended December 31, 2015 were to manage our liquidity and leverage during the second quarter.

We sold Agency RMBS during the year ended December 31, 2014 for reasons similar to those that motivated Agency RMBS sales during the year ended December 31, 2015. In addition, we also sold certain Agency RMBS in the first half of 2014 that were at or near their interest rate reset periods and expected to reset at lower interest rates.

General and Administrative Expenses

The following table summarizes our general and administrative expenses during the periods indicated:

	Year Ended December 31,		
	2015	2014	2013
Compensation and benefits:			
Salary and benefits	\$4,498	\$4,453	\$4,077
Incentive compensation	1,890	2,548	740
Stock-based compensation	2,715	2,508	2,187
	9,103	9,509	7,004
Other:			
Accounting and auditing fees	\$271	\$304	\$356
Contract services and consulting	1,119	856	1,035
Legal fees and litigation expenses	2,898	1,384	712
Board fees, including stock-based compensation	598	432	484
Insurance	430	461	456
Occupancy and other office expenses	623	596	725
Software and systems expenses	1,678	1,544	1,254
Other employee and corporate expenses	948	921	1,032
	8,565	6,498	6,054

Total general and administrative expenses:	\$17,668	\$16,007	\$13,058
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Compensation and benefits for the year ended December 31, 2015 decreased \$0.4 million compared to the year ended December 31, 2014 due to lower incentive compensation expenses partially offset by an increase in stock-based compensation due to an increase in amortization of restricted stock vesting during 2015 versus 2014. Other general and administrative expenses for the year ended December 31, 2015 increased \$2.1 million compared to the year ended December 31, 2014 due primarily to increases in legal fees and litigation expenses and contract services and consulting.

Compensation and benefits for the year ended December 31, 2014 increased \$2.5 million compared to the year ended December 31, 2013 due to increased incentive compensation, an additional executive officer, and increased stock based compensation expense. Incentive compensation paid in cash is recognized as expense in the period earned whereas incentive compensation paid in restricted stock is recognized over its vesting period. Approximately \$1.4 million of incentive compensation for executive management for the year ended December 31, 2013 was paid in restricted stock with a vesting period of three years and \$0.1 million in cash. For the year ended December 31, 2014, \$1.6 million was paid in cash and \$1.6 million in restricted stock with a vesting period of three years. Other general and administrative expenses for the year ended December 31, 2014 increased \$0.4 million compared to the year ended December 31, 2013 primarily because of increased legal expenses.

LIQUIDITY AND CAPITAL RESOURCES

Our primary sources of liquidity include borrowings under repurchase arrangements, monthly principal and interest payments we receive on our investments, and cash generated from our operating results. Additional sources may also include proceeds from the sale of investments, equity offerings, issuances of collateralized financings, and payments received from counterparties from interest rate swap agreements. We use unencumbered cash, Agency MBS, and non-Agency MBS to support additional borrowings. We use our liquidity to fund our investment purchases and other operating costs, to pay down borrowings, to meet margin calls from our lenders, to make payments to counterparties as required under interest rate swap agreements, to repurchase shares of our common stock, and to pay dividends on our preferred and common stock.

We continually measure, manage, and forecast our liquidity on a daily basis and consider unrestricted cash and cash equivalents, unencumbered Agency MBS, and certain unencumbered non-Agency MBS as our available liquid assets. As of December 31, 2015, our available liquid assets were \$150.3 million compared to \$215.8 million as of December 31, 2014. Our liquid assets declined as we repurchased shares of our common stock, experienced losses on our derivatives and declines in fair values on our assets throughout the year, and to a lesser extent from shifts in our investment portfolio. As of December 31, 2015, our liquid assets consisted of unrestricted cash and cash equivalents of \$33.9 million and unencumbered Agency MBS of \$116.4 million. Generally, we seek to maintain enough liquidity to meet potential margin calls from lenders (as discussed further below), particularly in times of market stress or significant volatility.

Our liquid assets may fluctuate from period to period based on our investment activities and whether we have recently raised, but not yet deployed, equity capital. However, we seek to maintain sufficient liquidity based on the sensitivity analysis and debt-to-equity requirements discussed below, to support our operations and meet our anticipated liquidity needs.

We perform sensitivity analysis on our liquidity based on changes in the value of our investments due to changes in interest rates, credit spreads, lender haircuts and prepayment speeds. We also closely monitor our debt-to-invested equity ratio (which is the ratio of debt financing to invested equity for any investment) as part of our liquidity management process as well as our overall enterprise level debt-to-equity ratio. We also monitor the ratio of our available liquidity to outstanding repurchase agreement borrowings, which fluctuates due to changes in the fair value

of collateral we have pledged to our lenders. On an enterprise level basis, our current operating policies limit our total liabilities-to-shareholders' equity to seven (7) times our shareholders' equity. At the individual investment level, our targeted leverage ranges from three (3) to ten (10) times our invested equity capital depending on the investment type. The maximum targets represent fixed limits for leveraging our investment capital. We may change our leverage targets based on market conditions and our perceptions of the liquidity of our investments.

Our total liabilities increased to 6.5 times shareholders' equity as of December 31, 2015 from 5.1 times as of December 31, 2014 due to an increase in our borrowings resulting from FHLB advances used to partially finance investment purchases and declines in the fair value of our derivative instruments. In addition, our shareholder's equity was lower as a result of declines in the fair value of our MBS and lower additional paid-in capital as a result of share repurchases.

We have historically had ample sources of liquidity to fund our activities and operations. The ability to fund our operations in the future depends in large measure on the availability of credit through repurchase agreement financing and the liquidity of our investments. Credit markets have historically experienced brief periods of extreme volatility such as what occurred in 2008 and 2009. Such events are typically marked by concerns regarding counterparty credit, severe market illiquidity, and steep declines

in asset prices. At other times (such as the second half of 2015), credit markets have experienced lesser volatility, only modestly impacting liquidity and asset prices. In addition, in recent periods U.S. financial regulatory agencies (such as the Office of Financial Research in the U.S. Treasury and the Federal Reserve) have expressed some concern about the stability of repurchase agreement financing for mortgage REITs in a rising interest rate environment, and regulatory reform in the form of certain provisions of the Basel III capital framework (and supplemental bank capital rules) and the Dodd-Frank Wall Street Reform and Consumer Protection Act could impact the overall availability of credit by restricting the number of repurchase agreement lenders and the credit made available by such lenders. In times of severe market stress, repurchase agreement availability could be rapidly reduced and the terms on which we can borrow could be materially altered, particularly given the focus on these markets by the federal financial and banking regulators. Competition from other REITs, banks, hedge funds, and the federal government for capacity with our repurchase agreement lenders could also reduce our repurchase agreement availability. While we do not anticipate such events in the near term, a reduction in our borrowing capacity could force us to sell assets in order to repay our lenders or could otherwise restrict our ability to operate our business.

Depending on our liquidity levels, the condition of the credit markets, and other factors, we may from time to time consider the issuance of debt, equity, or other securities, or sell investments, the proceeds of which could provide additional liquidity for our operations. While we will attempt to avoid dilutive or otherwise costly issuances, depending on market conditions, in order to manage our liquidity we could be forced to issue equity or debt securities which are dilutive to our capital base or our profitability.

Repurchase Agreements

The following table presents information regarding the balances of our repurchase agreement borrowings for the periods indicated:

(\$ in thousands)	Balance Outstanding As of Quarter End	Average Balance Outstanding For the Quarter Ended	Maximum Balance Outstanding During the Quarter Ended
December 31, 2015	\$2,589,420	\$2,766,755	\$3,097,492
September 30, 2015	3,055,069	3,220,391	3,405,692
June 30, 2015	3,402,964	3,301,590	3,447,628
March 31, 2015	3,185,843	3,101,133	3,239,247
December 31, 2014	3,013,110	3,043,298	3,137,204
September 30, 2014	3,150,254	3,352,599	3,469,491
June 30, 2014	3,447,050	3,454,884	3,496,521
March 31, 2014	3,485,544	3,497,167	3,580,997

Our repurchase agreement borrowings are generally renewable at the discretion of our lenders without guaranteed roll-over terms. Given the short-term and uncommitted nature of most of our repurchase agreement financing, we attempt to maintain unused capacity under our existing repurchase agreement credit lines with multiple counterparties which helps protect us in the event of a counterparty's failure to renew existing repurchase agreements either with favorable terms or at all. As of December 31, 2015, we had repurchase agreement borrowings outstanding with 17 of our 32 available repurchase agreement counterparties at a weighted average borrowing rate of 0.75% compared to 0.55% as of December 31, 2014. Our repurchase agreement borrowings generally carry a rate of interest based on a spread to an index such as LIBOR.

For our repurchase agreement borrowings, we are required to post and maintain margin to the lender (i.e., collateral in excess of the repurchase agreement financing) in order to support the amount of the financing. This excess collateral is often referred to as a "haircut" (and which we also refer to as equity at risk). As the collateral pledged is generally MBS, the fair value of the collateral can fluctuate with changes in market conditions. If the fair value of the collateral falls below the haircut required by the lender, the lender has the right to demand additional margin, or collateral, to

increase the haircut back to the initial amount. These demands are typically referred to as "margin calls". Declines in the value of investments occur for any number of reasons including but not limited to changes in interest rates, changes in ratings on an investment, changes in actual or perceived liquidity of the investment, or changes in overall market risk perceptions. Additionally, values in Agency RMBS will also decline from the payment delay feature of those securities. Agency RMBS have a payment delay feature whereby Fannie Mae and Freddie Mac announce principal payments on Agency RMBS but do not remit the actual principal payments and interest for 20 days in the case of Fannie Mae and 40 days in the case of Freddie Mac. Because these securities are financed with repurchase agreements, the repurchase agreement lender generally makes a margin call for an amount equal to the product of their advance rate on the

repurchase agreement and the announced principal payments on the Agency RMBS. This causes a temporary use of our liquidity to meet the margin call until we receive the principal payments and interest 20 to 40 days later.

The following table presents the weighted average minimum haircut contractually required by our counterparties for MBS pledged as collateral for our repurchase agreement borrowings as of the dates indicated:

	December 31, 2015	September 30, 2015	June 30, 2015	March 31, 2015	December 31, 2014	
Agency RMBS and CMBS	5.0	% 5.0	% 5.1	% 5.3	% 5.3	%
Non-Agency RMBS and CMBS	14.5	% 14.1	% 13.5	% 16.0	% 16.1	%
CMBS IO	15.4	% 15.3	% 15.3	% 15.3	% 15.5	%

The counterparties with whom we have the greatest amounts of equity at risk may vary significantly during any given period due to the short-term and generally uncommitted nature of the repurchase agreement borrowings. Equity at risk is defined as the amount pledged as collateral to the counterparty in excess of the borrowed amount outstanding. The following tables present the five counterparties with whom we had the greatest amounts of equity at risk as of December 31, 2015 and as of December 31, 2014:

(\$ in thousands)	December 31, 2015	
	Amount Outstanding	Equity at Risk
Well Fargo Bank, N.A. and affiliates	\$297,916	\$56,193
JP Morgan Securities, LLC	298,823	46,197
South Street Financial Corporation	431,950	25,952
Royal Bank of Canada	187,993	23,091
BNP Paribas	102,211	15,038
Remaining counterparties	1,270,527	69,750
	\$2,589,420	\$236,221

(\$ in thousands)	December 31, 2014	
	Amount Outstanding	Equity at Risk
Well Fargo Bank, N.A. and affiliates	\$286,574	\$53,949
JP Morgan Securities, LLC	289,931	48,484
South Street Financial Corporation	608,000	36,483
Bank of America Securities LLC	181,593	15,711
Credit Suisse Securities LLC	103,078	13,258
Remaining counterparties	1,543,934	93,603
	\$3,013,110	\$261,488

The following table discloses our repurchase agreement amounts outstanding and the value of the related collateral pledged by geographic region of our counterparties as of December 31, 2015:

(\$ in thousands)	Amount Outstanding	Market Value of Collateral Pledged
North America	\$1,474,739	\$1,634,166
Asia	674,092	719,877
Europe	440,589	471,598
	\$2,589,420	\$2,825,641

Certain of our repurchase agreement counterparties require us to comply with various operating and financial covenants. The financial covenants include requirements that we maintain minimum shareholders' equity (usually a set minimum, or a percentage of the highest amount of shareholders' equity since the date of the agreement), maximum decline in shareholders' equity (expressed as a percentage decline in any given period), and limits on maximum leverage (as a multiple of shareholders' equity). Operating requirements include, among other things, requirements to maintain our status as a REIT and to maintain our listing on the NYSE. Violations of one or more of these covenants could result in the lender declaring an event of default which would result in the termination of the repurchase agreement and immediate acceleration of amounts due thereunder. In addition, some of the agreements contain cross default features, whereby default with one lender simultaneously causes default under agreements with other lenders. Violations could also restrict us from paying dividends or engaging in other transactions that are necessary for us to maintain our REIT status.

We monitor and evaluate on an ongoing basis the impact these customary financial covenants may have on our operating and financing flexibility. We have one repurchase agreement lender which requires that we maintain our enterprise level leverage as of quarter end at less than 7 times our shareholders' equity. Currently, we do not believe we are subject to any covenants that materially restrict our financing flexibility.

FHLB Advances

For information on FHLB advances obtained by our wholly-owned captive insurance subsidiary, Mackinaw, see "Financial Condition - Repurchase Agreements and FHLB Advances" in this Item 7. As a result of the final rule issued by the FHFA in January 2016, we will not be able to renew these FHLB advances as they mature in 2016. Because we maintain excess borrowing capacity at our financing counterparties, we do not anticipate any difficulties in replacing the FHLB advances at or before their respective maturities.

Derivative Instruments

Our derivative instruments require us to post initial margin at inception and variation margin based on subsequent changes in the fair value of the derivatives. The collateral posted as margin by us is typically in the form of cash or Agency MBS. Generally, as interest rates decline due to market changes, we will be required to post collateral with counterparties on our pay-fixed derivative instruments and receive collateral from our counterparties on our receive-fixed derivative instruments, and vice versa as interest rates increase. As of December 31, 2015, we had Agency MBS with a fair value of \$2.3 million and cash of \$51.2 million posted as credit support under these agreements.

Approximately \$370 million of the Company's interest rate swaps were entered into under bilateral agreements which contain cross-default provisions with other agreements between the parties. In addition, these bilateral agreements contain financial and operational covenants similar to those contained in our repurchase agreements, as described above.

Dividends

As a REIT, we are required to distribute to our shareholders amounts equal to at least 90% of our REIT taxable income for each taxable year after consideration of our tax NOL carryforwards. We generally fund our dividend distributions through our cash flows from operations. If we make dividend distributions in excess of our operating cash flows during the period, whether for purposes of meeting our REIT distribution requirements or other strategic reasons, those distributions are generally funded either through our existing cash balances or through the return of principal from our investments (either through repayment or sale).

We have approximately \$48.4 million of deferred tax hedge losses on terminated derivative instruments, which will be recognized over the original periods that were being hedged by the terminated derivatives. These losses have already been recognized in our GAAP earnings but will reduce taxable income over the next ten years as noted in the following table. Dividend distributions to our shareholders in excess of REIT taxable income, if any, as a result of the hedge loss deductions for the years noted below, will be considered a return of capital to the shareholder.

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(\$ in thousands)	Tax Hedge Loss Deduction
2016	25,014
2017	11,279
2018	3,830
2019 - 2026	8,316
	\$48,439

We also have available an estimated NOL carryforward of approximately \$89.8 million as of December 31, 2015, which can be used, subject to certain annual limitations, to offset taxable income and help us manage our REIT income distribution requirements.

Contractual Obligations

The following table summarizes our contractual obligations by payment due date as of December 31, 2015:

(\$ in thousands)	Payments due by period				
	Total	< 1 year	1-3 years	3-5 years	> 5 years
Contractual Obligations:					
Repurchase agreements ⁽¹⁾	\$2,590,605	\$2,590,605	\$—	\$—	\$—
FHLB advances ⁽¹⁾	521,341	521,341	—	—	—
Non-recourse collateralized financing ⁽²⁾	8,572	2,295	3,072	1,739	1,466
Operating lease obligations	908	204	426	278	—
Total	\$3,121,426	\$3,114,445	\$3,498	\$2,017	\$1,466

(1) Includes estimated interest payments calculated using interest rates in effect as of December 31, 2015.

(2) Amounts shown are for principal only and exclude interest obligations as those amounts are not significant.

Non-recourse collateralized financing represents securitization financing that is payable solely from loans and securities pledged as collateral. Payments due by period were estimated based on the principal repayments forecasted for the underlying loans and securities, substantially all of which is used to repay the associated financing outstanding.

Other Matters

As of December 31, 2015, we do not believe that any off-balance sheet arrangements exist that are reasonably likely to have a material effect on our current or future financial condition, results of operations, or liquidity. In addition, we do not have any material commitments for capital expenditures and have not obtained any commitments for funds to fulfill any capital obligations.

RECENT ACCOUNTING PRONOUNCEMENTS

There are no recently issued accounting pronouncements which have had or are expected to have a material impact on the Company's consolidated financial statements. Please refer to Note 1 of our "Notes to Consolidated Financial Statements" for information regarding recently issued accounting pronouncements.

FORWARD-LOOKING STATEMENTS

Certain written statements in this Annual Report on Form 10-K that are not historical facts constitute "forward-looking statements" within the meaning of Section 27A of the 1933 Act and Section 21E of the Exchange Act. Statements in this report addressing expectations, assumptions, beliefs, projections, future plans and strategies, future events, developments that we expect or anticipate will occur in the future, and future operating results are forward-looking statements. Forward-looking statements are based upon management's beliefs, assumptions, and expectations as of the date of this report regarding future events and operating performance, taking into account all information currently available to us, and are applicable only as of the date of this report. Forward-looking statements generally can be

Forward-looking statements in this Annual Report on Form 10-K may include, but are not limited to:

- Our business and investment strategy including our ability to generate acceptable risk-adjusted returns and our target investment allocations;
- Monetary policy and regulatory initiatives of the Federal Reserve (including the FOMC) and other financial regulators;
- Our financing strategy including our target leverage ratios and anticipated trends in financing costs, and our hedging strategy including changes to the derivative instruments to which we are a party, and changes to government regulation of hedging instruments and our use of these instruments;
- Our investment portfolio composition and target investments;
- Our investment portfolio performance, including the fair value, yields, and forecasted prepayment speeds of our investments;
- Our liquidity and ability to access financing, including with respect to maturity and replacement of FHLB advances, and the anticipated availability and cost of financing;
- Our stock repurchase activity and the impact of stock repurchases;
- Our use of and restrictions on using our tax NOL carryforward;
- The status of pending litigation;
- The competitive environment in the future, including competition for investments and the availability of financing;
- Estimates of future interest expenses, including related to the Company's repurchase agreements and derivative instruments;
- The status of regulatory rule-making or review processes and the status of reform efforts and other business developments in the repurchase agreement financing market;
- Market, industry and economic trends, how these trends and related economic data may impact the behavior of market participants and financial regulators; and
- Interest rates.

Forward-looking statements are inherently subject to risks, uncertainties and other factors that could cause our actual results to differ materially from historical results or from any results expressed or implied by such forward-looking statements. Not all of these risks and other factors are known to us. New risks and uncertainties arise over time, and it is not possible to predict those events or how they may affect us. The projections, assumptions, expectations or beliefs upon which the forward-looking statements are based can also change as a result of these risks or other factors. If such a risk or other factor materializes in future periods, our business, financial condition, liquidity and results of operations may vary materially from those expressed or implied in our forward-looking statements.

While it is not possible to identify all factors, some of the factors that may cause actual results to differ from historical results or from any results expressed or implied by forward-looking statements, or that may cause our projections, assumptions, expectations or beliefs to change, include the following:

- the risks and uncertainties referenced in this Annual Report on Form 10-K, particularly those set forth under and incorporated by reference into Part II, Item 1A, "Risk Factors";
- our ability to find suitable reinvestment opportunities;
- changes in economic conditions;
- changes in interest rates and interest rate spreads, including the repricing of interest-earning assets and interest-bearing liabilities;
- our investment portfolio performance particularly as it relates to cash flow, prepayment rates and credit performance;
- actual or anticipated changes in Federal Reserve monetary policy;
- adverse reactions in financial markets related to the budget deficit or national debt of the United States government;
- potential or actual default by the United States government on Treasury securities; and potential or actual downgrades to the sovereign credit rating of the United States;

the cost and availability of financing, including the future availability of financing due to changes to regulation of, and capital requirements imposed upon, financial institutions;

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- the cost and availability of new equity capital;
- changes in our use of leverage;
- changes to our investment strategy, operating policies, dividend policy or asset allocations;
- the quality of performance of third-party servicer providers of our loans and loans underlying our securities;
- the level of defaults by borrowers on loans we have securitized;
- changes in our industry;
- increased competition;
- changes in government regulations affecting our business;
- changes in the repurchase agreement financing markets and other credit markets;
- changes to the market for interest rate swaps and other derivative instruments, including changes to margin requirements on derivative instruments;
- government initiatives to support the U.S financial system and U.S. housing and real estate markets; or to reform the U.S. housing finance system including by imposing standards for originating residential mortgage loans;
- GSE reform or other government policies and actions;
- ownership shifts under Section 382 that further limit the use of our tax NOL carryforward; and
- exposure to current and future claims and litigation.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We seek to manage various risks inherent in our business strategy, which include interest rate, prepayment, reinvestment, market value, credit, and liquidity risks. These risks can and do cause fluctuations in our shareholders' equity, comprehensive income, and book value. We attempt to manage these risks and earn an acceptable return for our shareholders as discussed below.

Interest Rate Risk

Investing in interest-rate sensitive investments on a leveraged basis subjects our results to interest rate risk primarily from the mismatch between interest-rate reset dates (or maturity) of our assets and the maturity of our liabilities. Borrowing costs on our liabilities are generally based on prevailing market rates and reset more frequently than interest rates on our assets. During a period of rising interest rates (particularly short term rates in a flattening yield curve environment), our borrowing costs will increase faster than our asset yields, negatively impacting our net interest income. The amount of the impact will depend on the composition of portfolio and on the effectiveness of our hedge instruments at the time, as well as the magnitude and the duration of the increase in interest rates. In addition, our adjustable rate assets may have limits or caps on the amount that an interest rate may reset while our liabilities do not have rate reset caps. Changes in interest rates, particularly rapid changes, may also negatively impact the market value of our investments, thereby reducing our book value. In addition to the information set forth in the tables below, see "Market Value Risk" below for further discussion of the risks to the market value of our investments.

While having interest rate risk is a basic tenet of our investment strategy, we attempt to manage our exposure to changes in interest rates by investing in instruments that have short maturities/interest reset dates, entering into derivative instruments (such as interest rate swaps and Eurodollar futures) to hedge this risk and by managing our investment portfolio within interest rate risk tolerances set by our Board of Directors. Our current goal is to maintain net portfolio duration (a measure of interest rate risk) within a range of 0.5 to 1.5 years. Our portfolio duration may drift outside of this target range at various times based on the composition of our investment portfolio including derivative instruments, and in light of our expectations with respect to interest rates and FOMC monetary policy. In addition, duration is driven by model inputs, and in the case of Agency RMBS, the most important inputs include anticipated prepayment speeds. Estimates of prepayment speeds can vary significantly by investor for the same security and therefore estimates of security and portfolio duration can vary significantly.

Effect of Changes in Interest Rates on Adjusted Net Interest Income and Market Value. The table below shows the projected sensitivity of our adjusted net interest income and the market value of our investments and derivative instruments carried at fair value as they existed as of December 31, 2015 based on an instantaneous parallel shift in market interest rates as set forth in the table below. In light of the low interest rate environment at December 31, 2015, the only declining rate scenario that we present is a downward shift of 25 basis points. In order to include the impact of changes in interest rates on our effective derivative instruments, we are presenting the percentage change in adjusted net interest income (instead of net interest income) because net interest income does not include the net interest payments/receipts on these instruments.

The "percentage change in adjusted net interest income" includes the impact of changes in expected prepayment speeds on our investments and assumes that net proceeds received from pay downs on the investment portfolio are reinvested in MBS in amounts proportionate to the portfolio composition that existed as of December 31, 2015 and at yields consistent with those as of that date, adjusted for the parallel shift in the rates below. Changes in types of investments, the returns earned on these investments, future interest rates, credit spreads, the shape of the yield curve, the availability of financing, and/or the mix of our investments and financings including derivative instruments may cause actual results to differ significantly from the modeled results. There can be no assurance that assumed events used for the model below will occur, or that other events will not occur, that will affect the outcomes; therefore, the tables below and all related disclosures constitute forward-looking statements.

Parallel Shift in Interest Rates	Percentage change in market value ⁽¹⁾	Percentage change in adjusted net interest income
+100	(0.83)%	(10.93)%
+50	(0.37)%	(5.52)%
-25	0.13%	0.44%

Includes changes in market value of our investments and derivative instruments, but excludes changes in market (1) value of our financings because they are not carried at fair value on our balance sheet. The projections for market value do not assume any change in credit spreads.

Management also considers changes in the shape of the interest rate curves in assessing and managing portfolio interest rate risk. Often interest rates do not move in a parallel fashion from quarter to quarter. The table below shows the projected change in market value of our investment portfolio net of derivative hedge instruments for instantaneous changes in the shape of the U.S. Treasury curve (with similar changes to the interest rate swap curve and Eurodollar curves) as of December 31, 2015.

Basis point change in 2-year yield	Basis point change in 10-year yield	Percentage change in market value ⁽¹⁾
0	+25	(0.03)%
+10	+50	(0.11)%
+10	+75	(0.18)%
+25	+75	(0.22)%
+25	+0	(0.07)%
+50	+0	(0.15)%
-10	-50	0.01%

Includes changes in market value of our investments and derivative instruments, but excludes changes in market (1) value of our financings because they are not carried at fair value on our balance sheet. The projections for market value do not assume any change in credit spreads.

Our adjustable rate investments have interest rates which are predominantly based on one-year LIBOR and contain periodic (or interim) and lifetime interest rate caps which limit the amount by which the interest rate may reset on the investment. Please refer to "Financial Condition-RMBS" within Item 7 of this Annual Report on Form 10-K for details.

Market Value Risk

Our investments fluctuate in market value due to changes in credit spreads, spot and forward interest rates, actual and anticipated prepayments and other factors. Changes in the market values of our investments are reflected in other comprehensive income, shareholders' equity, and book value per common share. Changes in credit spreads represent the market's valuation of the perceived riskiness of assets relative to risk-free rates, and widening credit spreads such as in 2015 reduces the market value of our investments as market participants require additional yield to hold riskier assets. Credit spreads could change based on macroeconomic or systemic factors as well as the factors specific to a

particular security such as prepayment performance or credit performance. Other factors that could impact credit spreads include technical issues such as supply and demand for a particular

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type of security or FOMC monetary policy. Likewise, most of our investments are fixed rate or reset in rate over a period of time, and as interest rates rise, we would expect the market value of these investments to decrease. We use derivative instruments to hedge our exposure to rising interest rates, though often not on a one-to-one basis. We do not seek to hedge our exposure to credit spreads, prepayments or other factors other than through asset selection.

Fluctuations in credit spreads typically vary based on the type of investment. Though market conditions and technical factors such as FOMC monetary policy may impact Agency MBS credit spreads, Agency MBS credit spreads will generally have less volatility than non-Agency MBS credit spreads. This is due to the fact that market participants generally view Agency MBS, given their guarantee of principal by GSEs, as more liquid (i.e., more easily converted into cash) than non-Agency MBS.

The table below is an estimate of the projected change in our portfolio market value given the indicated change in market credit spreads as of December 31, 2015:

Basis Point Change in Market Credit Spreads	Percentage change in market value of investments
+50	(2.1)%
+25	(1.1)%
-25	1.1%
-50	2.1%

Prepayment and Reinvestment Risk

Prepayment risk is the risk of an early, unscheduled return of principal on an investment. We are subject to prepayment risk from premiums paid on investments which we acquire. Purchase premiums on our investments are amortized as a reduction in interest income using the effective yield method under GAAP, adjusted for the actual and anticipated prepayment activity of the investment. An increase in the actual or expected rate of prepayment will typically accelerate the amortization of purchase premiums, thereby reducing the yield/interest income earned on such assets. Principal prepayments on our investments are influenced by changes in market interest rates and a variety of economic, geographic, government policy and other factors beyond our control.

We have prepayment risk for all of our investments which we own at a premium to their par value. The majority of the loans underlying our RMBS are ARMs or hybrid ARMs and do not have any specific prepayment protection. Prepayments on these loans generally accelerate in a declining interest rate environment, as the loans age, and as the loans near their respective interest rate reset dates, particularly the initial reset date. Our prepayment models anticipate acceleration of prepayments in these events. To the extent the actual prepayments exceed our modeled prepayments, or if we change our future prepayment expectations, we will record adjustments to our premium amortization which may negatively impact our net interest income and could impact the fair value of our RMBS.

As an indication of our prepayment risk on our RMBS portfolio, the following table summarizes information for our Agency RMBS portfolio regarding the net premium and weighted average coupon by months until interest rate reset ("MTR") or

until maturity in the case of fixed-rate securities as of the end of the past four quarters:

(\$ in thousands)	December 31, 2015		September 30, 2015		June 30, 2015		March 31, 2015	
	Net Premium	WAC	Net Premium	WAC	Net Premium	WAC	Net Premium	WAC
0-12 MTR	\$18,098	2.75%	\$20,234	2.70%	\$20,752	2.69%	\$27,953	2.74%
13-36 MTR	23,401	3.47%	24,039	3.54%	22,874	3.63%	19,870	3.83%
37-60 MTR	4,202	2.97%	5,128	2.94%	10,126	3.07%	17,749	3.19%
> 60 MTR	31,924	2.95%	34,068	2.96%	36,501	2.97%	38,789	2.97%
Fixed rate	(8)	2.50%	(8)	2.50%	(9)	2.50%	(9)	2.50%
Total premium, net	\$77,617	3.03%	\$83,461	3.04%	\$90,244	3.05%	\$104,352	3.08%
Par balance	\$1,536,733		\$1,631,942		\$1,741,996		\$1,942,332	
Premium, net as a % of par value	5.1 %		5.1 %		5.2 %		5.4 %	

Loans underlying our CMBS and CMBS IO securities typically have some form of prepayment protection provisions (such as prepayment lock-outs) or prepayment compensation provisions (such as yield maintenance or prepayment penalties). Yield maintenance and prepayment penalty requirements are intended to create an economic disincentive for the loans to prepay; however, the amount of the prepayment penalty required to be paid may decline over time, and as loans age, interest rates decline, or market values of collateral supporting the loans increase, prepayment penalties may lessen as an economic disincentive to the borrower. Generally, our experience has been that prepayment lock-out and yield maintenance provisions result in stable prepayment performance from period to period. There are no prepayment protections, however, if the loan defaults and is partially or wholly repaid earlier as a result of loss mitigation actions taken by the underlying loan servicer. Historically, we have experienced low default rates on loans underlying CMBS and CMBS IO.

Because CMBS IO consist of rights to interest on the underlying commercial mortgage loan pools and do not have rights to principal payments on the underlying loans, prepayment risk on these securities would be particularly acute without these prepayment protection provisions. CMBS IO prepayment protection and compensation provisions vary by issuer of the security, (i.e. Freddie Mac, Fannie Mae, Ginnie Mae, or non-Agency). The majority of our Agency CMBS IO are issued by Freddie Mac and these securities generally have initial prepayment lock-outs followed by a defeasance period which on average extends to within six months of the stated maturities of the underlying loans. Non-Agency CMBS IO generally have prepayment protection in the form of prepayment lock-outs and defeasance provisions. The following table details the fair value of our CMBS IO portfolio by issuer as of the end of the periods indicated:

(\$ in thousands)	December 31, 2015	December 31, 2014
Fannie Mae	\$24,177	\$28,765
Freddie Mac	401,951	408,698
Ginnie Mae	—	1,274
Non-Agency CMBS IO	363,727	325,119
	\$789,855	\$763,856

We seek to manage our prepayment risk on our MBS by diversifying our investments, seeking investments which we believe will have superior prepayment performance, and investing in securities which have some sort of prepayment prohibition or yield maintenance (as is the case with CMBS and CMBS IO). With respect to RMBS, we will seek to invest in RMBS where we believe the underlying loans have favorable prepayment characteristics such as lower loan balances or favorable origination, borrower or geographic characteristics.

We are also subject to reinvestment risk as a result of the prepayment, repayment and sales of our investments. In order to maintain our investment portfolio size and our earnings, we need to reinvest capital received from these events into new interest-earning assets. Yields on assets in which we have reinvested in recent periods have generally been lower than yields on existing

assets due to lower overall interest rates and more competition for these as investment assets. As a result, our interest income has declined in recent periods and may continue to decline in the future, thereby reducing earnings per share. If we are unable to find suitable reinvestment opportunities, interest income on our investment portfolio and investment cash flows could be negatively impacted. In addition, based on market conditions, our leverage, and our liquidity profile, we may decide to not reinvest the cash flows we receive from our investment portfolio even when attractive reinvestment opportunities are available, or we may decide to reinvest in assets with lower yield but greater liquidity. If we retain rather than reinvest capital, or if we invest it in lower yielding assets for liquidity reasons, the size of our investment portfolio and the amount of net interest income generated by our investment portfolio will likely decline.

Credit Risk

Credit risk is the risk that we will not receive all contractual amounts due on investments that we own due to default by the borrower or due to a deficiency in proceeds from the liquidation of the collateral securing the obligation. We are also particularly exposed to credit risk on investments that we own at a premium. For investments owned at premiums, defaults on the underlying loan typically result in the complete loss of any remaining unamortized premium we paid.

We attempt to mitigate our credit risk by purchasing Agency MBS and higher quality non-Agency MBS. Agency MBS have credit risk to the extent that Fannie Mae or Freddie Mac fails to remit payments on the MBS for which they have issued a guaranty of payment. Given the improved financial performance and conservatorship of these entities and the continued support of the U.S. government, we believe this risk is low. For our non-Agency MBS, we seek to purchase investment grade securities (rated 'BBB' or better by a least one of the nationally recognized statistical ratings organizations) or securities that we believe are short-duration and which will have strong credit performance. We do not currently seek to purchase heavily discounted, credit sensitive MBS.

The majority of our non-Agency securities are CMBS and CMBS IO. The return we earn on these securities is dependent on the credit performance of the underlying commercial loans. In particular, since investments in CMBS IO pay interest from the underlying commercial mortgage loan pools, returns are more negatively impacted by liquidations of loans in the underlying loan pool.

In order to manage our exposure to credit performance, we generally invest in securities with higher credit ratings and in securities where we have evaluated the credit profile of the underlying loan pool and can monitor its credit performance. With respect to non-Agency RMBS, our purchases have been very short duration MBS backed by pools of re-performing or non-performing loans.

The following table presents information on our non-Agency MBS by credit rating as of December 31, 2015:

(\$ in thousands)	December 31, 2015			Total	Percentage	
	CMBS	CMBS IO	RMBS			%
AAA	\$60,192	\$294,712	\$—	\$354,904	60.9	%
AA	51,599	53,974	—	105,573	18.1	%
A	34,771	—	—	34,771	6.0	%
Below A or not rated	7,621	15,041	65,210	87,872	15.0	%
	\$154,183	\$363,727	\$65,210	\$583,120	100.0	%

Liquidity Risk

We have liquidity risk principally from the use of recourse repurchase agreements to finance our ownership of securities. In general, our repurchase agreements provide a source of uncommitted short-term financing that finances a

longer-term asset, thereby creating a mismatch between the maturity of the asset and of the associated financing. Our repurchase agreements are renewable at the discretion of our lenders and do not contain guaranteed roll-over terms. If we fail to repay the lender at maturity, the lender has the right to immediately sell the collateral and pursue us for any shortfall if the sales proceeds are inadequate to cover the

repurchase agreement financing. In addition, repurchase agreements are collateral based and declines in the market value of our investments subject us to liquidity risk.

For further information, including how we attempt to mitigate liquidity risk and monitor our liquidity position, please refer to “Liquidity and Capital Resources” in Part II, Item 7 of this Annual Report on Form 10-K.

ITEM 8. FINANCIAL STATEMENTS AND
SUPPLEMENTARY DATA

Our consolidated financial statements and the related notes, together with the Reports of the Independent Registered Public Accounting Firm thereon, are set forth on pages F-1 through F-27 of this Annual Report on Form 10-K.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND
FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

Our management evaluated, with the participation of our Principal Executive Officer and Principal Financial Officer, the effectiveness of our disclosure controls and procedures, as defined in Exchange Act Rule 13a-15(e), as of the end of the period covered by this report. Based on that evaluation, our Principal Executive Officer and Principal Financial Officer concluded that our disclosure controls and procedures were effective as of December 31, 2015 to ensure that information required to be disclosed in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC’s rules and forms, and that such information is accumulated and communicated to our management, including our Principal Executive Officer and Principal Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting during the three months ended December 31, 2015 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Management’s Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) of the Exchange Act. Because of inherent limitations, a system of internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate due to a change in conditions, or that the degree of compliance with policies or procedures may deteriorate.

Our management evaluated, with the participation of our principal executive officer and principal financial officer, the effectiveness of our internal control over financial reporting using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”) (2013) in “Internal Control-Integrated Framework.” Based on that evaluation, our principal executive officer and principal financial officer concluded that our internal control over financial reporting was effective as of the end of the period covered by this report.

The Company’s internal control over financial reporting as of December 31, 2015 has been audited by BDO USA, LLP, the independent registered public accounting firm that also audited the Company’s consolidated financial statements included in this Annual Report on Form 10-K. The attestation report of BDO USA, LLP on the

effectiveness of the Company's internal control over financial reporting appears on page F-4 herein.

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ITEM 9B. OTHER INFORMATION

None.

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PART III.

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information about our executive officers required by this item is included in Part I, Item I of this Annual Report on Form 10-K under the caption “Executive Officers of the Company”. The remaining information required by Item 10 will be included in our definitive proxy statement for use in connection with our 2016 Annual Meeting of Shareholders (“2016 Proxy Statement”) under the captions “Election of Directors,” “Committees of the Board,” “Code of Ethics” and “Section 16(a) Beneficial Ownership Reporting Compliance,” and is incorporated herein by reference.

ITEM 11. EXECUTIVE
COMPENSATION

The information required by Item 11 will be included in the 2016 Proxy Statement under the captions “Executive Compensation” and “Directors’ Compensation” and is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND
RELATED STOCKHOLDER MATTERS

The following table sets forth information as of December 31, 2015 with respect to our equity compensation plans under which shares of our common stock are authorized for issuance.

	Number of Securities to Be Issued upon Exercise of Outstanding Options, Warrants and Rights	Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans ⁽¹⁾
Equity Compensation Plans Approved by Shareholders:			
2009 Stock and Incentive Plan	—	—	994,096
Equity Compensation Plans Not Approved by Shareholders ⁽²⁾	—	—	—
Total	—	\$—	994,096

Reflects shares available to be granted under the 2009 Stock and Incentive Plan in the form of stock options, stock (1) appreciation rights, stock awards, dividend equivalent rights, performance share awards, stock units and incentive awards.

(2) The Company does not have any equity compensation plans that have not been approved by shareholders.

The remaining information required by Item 12 will be included in the 2016 Proxy Statement under the caption “Ownership of Stock” and is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE
The information required by Item 13 will be included in the 2016 Proxy Statement under the captions “Related Person Transactions” and “Director Independence,” and is incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by Item 14 will be included in the 2016 Proxy Statement under the caption “Audit Information,” and is incorporated herein by reference.

PART IV.

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a) Documents filed as part of this report:

Financial Statements and Schedules:

1. and 2. The information required by this section of Item 15 is set forth in the Consolidated Financial Statements and Reports of Independent Registered Public Accounting Firm beginning at page F-1 of this Annual Report on Form 10-K. The index to the Financial Statements is set forth at page F-2 of this Annual Report on Form 10-K.

Exhibit No.	Description
3.1	Restated Articles of Incorporation, effective June 2, 2014 (incorporated herein by reference to Exhibit 3.1 to Dynex's Registration Statement on Form S-8 filed September 17, 2014).
3.2	Amended and Restated Bylaws, amended as of December 12, 2013 (incorporated herein by reference to Exhibit 3.2 to Dynex's Annual Report on Form 10-K filed March 4, 2014).
10.5*	Severance Agreement between Dynex Capital, Inc. and Stephen J. Benedetti dated June 11, 2004 (incorporated herein by reference to Exhibit 10.5 to Dynex's Annual Report on Form 10-K for the year ended December 31, 2007).
10.5.1*	409A Amendment to Severance Agreement between Dynex Capital, Inc. and Stephen J. Benedetti, dated December 31, 2008 (incorporated herein by reference to Exhibit 10.1.1 to Dynex's Annual Report on Form 10-K for the year ended December 31, 2008).
10.9*	Dynex Capital, Inc. Performance Bonus Program, as approved August 5, 2010 (incorporated herein by reference to Exhibit 10.9 to Dynex's Quarterly Report on Form 10-Q for the quarter ended June 30, 2010).
10.11*	Dynex Capital, Inc. 2009 Stock and Incentive Plan, effective as of May 13, 2009 (incorporated herein by reference to Appendix A to Dynex's Proxy Statement filed April 3, 2009).
10.12*	Employment Agreement, dated as of July 31, 2009, between Dynex Capital, Inc. and Byron L. Boston (incorporated herein by reference to Exhibit 10.12 to Dynex's Quarterly Report on Form 10-Q for the quarter ended September 30, 2009).
10.14	Equity Distribution Agreement between Dynex Capital, Inc. and JMP Securities LLC, dated June 24, 2010 (incorporated herein by reference to Exhibit 10.14 to Dynex's Current Report on Form 8-K filed June 24, 2010).
10.14.1	Amendment No. 1 to Equity Distribution Agreement between Dynex Capital, Inc. and JMP Securities LLC, dated December 23, 2011 (incorporated herein by reference to Exhibit 10.14.1 to Dynex's Current Report on Form 10-K filed December 23, 2011).
10.16*	Form of Restricted Stock Agreement for Executive Officers under the Dynex Capital, Inc. 2009 Stock and Incentive Plan (incorporated herein by reference to Exhibit 10.16 to Dynex's Annual Report on Form 10-K for the year ended December 31, 2010).
10.17*	Base salaries for executive officers of Dynex Capital, Inc. (filed herewith).
10.18*	Non-employee directors' annual compensation for Dynex Capital, Inc. (filed herewith).
10.20*	Letter Agreement between Dynex Capital, Inc. and Byron L. Boston, dated September 7, 2011 (incorporated by reference to Exhibit 10.20 to Dynex's Current Report on Form 8-K filed September 9, 2011).
10.23	Master Repurchase and Securities Contract dated as of August 6, 2012 between Issued Holdings Capital Corporation, Dynex Capital, Inc. (as guarantor) and Wells Fargo Bank, National Association (incorporated herein by reference to Exhibit 10.23 to Dynex's Current Report on Form 8-K filed August 8, 2012).

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Exhibit No.	Description
10.23.1	Amendment No. 1 to Master Repurchase and Securities Contract dated as of October 1, 2013 between Issued Holdings Capital Corporation, Dynex Capital, Inc. (as guarantor) and Wells Fargo Bank, N.A. (incorporated herein by reference to Exhibit 10.23.1 to Dynex's Current Report on Form 8-K filed October 7, 2013).
10.23.2	Amendment No. 2 to Master Repurchase and Securities Contract dated as of February 5, 2015 between Issued Holdings Capital Corporation, Dynex Capital, Inc. (as guarantor) and Wells Fargo Bank, N.A. (incorporated herein by reference to Exhibit 10.23.2 to Dynex's Current Report on Form 8-K filed February 11, 2015).
10.24	Guarantee Agreement dated as of August 6, 2012 by Dynex Capital, Inc. in favor of Wells Fargo Bank, National Association (incorporated herein by reference to Exhibit 10.24 to Dynex's Current Report on Form 8-K filed August 8, 2012).
10.25*	Form of Restricted Stock Agreement for Non-Employee Directors under the Dynex Capital, Inc. 2009 Stock and Incentive Plan (incorporated herein by reference to Exhibit 10.25 to Dynex's Annual Report on Form 10-K for the year ended December 31, 2012).
10.27	Underwriting Agreement, dated April 11, 2013, by and among Dynex Capital, Inc., J.P. Morgan Securities LLC, and Keefe, Bruyette & Woods, Inc. (incorporated herein by reference to Exhibit 1.1 to Dynex's Current Report on Form 8-K filed April 16, 2013).
10.28*	Dynex Capital, Inc. Executive Incentive Plan (as adopted December 29, 2015) (incorporated herein by reference to Exhibit 10.28 to Dynex's Current Report on Form 8-K filed January 5, 2016).
21.1	List of consolidated entities of Dynex (filed herewith).
23.1	Consent of BDO USA, LLP (filed herewith).
31.1	Certification of principal executive officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
31.2	Certification of principal financial officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
32.1	Certification of principal executive officer and principal financial officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith).
101	The following materials from Dynex Capital, Inc.'s Annual Report on Form 10-K for the year ended December 31, 2015, formatted in XBRL (Extensible Business Reporting Language), filed herewith: (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Comprehensive Income, (iii) Consolidated Statements of Shareholder's Equity, (iv) Consolidated Statements of Cash Flows, and (v) Notes to Consolidated Financial Statements.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

DYNEX CAPITAL, INC.
(Registrant)

March 8, 2016

/s/ Stephen J. Benedetti
Stephen J. Benedetti, Executive Vice President, Chief
Financial Officer and Chief Operating Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ Thomas B. Akin Thomas B. Akin	Executive Chairman and Director	March 8, 2016
/s/ Byron L. Boston Byron L. Boston	Chief Executive Officer, President, Co-Chief Investment Officer, and Director (Principal Executive Officer)	March 8, 2016
/s/ Stephen J. Benedetti Stephen J. Benedetti	Executive Vice President, Chief Financial Officer and Chief Operating Officer (Principal Financial Officer)	March 8, 2016
/s/ Jeffrey L. Childress Jeffrey L. Childress	Vice President and Controller (Principal Accounting Officer)	March 8, 2016
/s/ Michael R. Hughes Michael R. Hughes	Director	March 8, 2016
/s/ Barry A. Igdaloff Barry A. Igdaloff	Director	March 8, 2016
/s/ Valerie A. Mosley Valerie A. Mosley	Director	March 8, 2016
/s/ Robert A. Salcetti Robert A. Salcetti	Director	March 8, 2016
/s/ James C. Wheat, III James C. Wheat, III	Director	March 8, 2016

DYNEX CAPITAL, INC.

CONSOLIDATED FINANCIAL STATEMENTS AND

REPORTS OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

For Inclusion in Form 10-K

Annual Report Filed with

Securities and Exchange Commission

December 31, 2015

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DYNEX CAPITAL, INC.
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Report of Independent Registered Public Accounting Firm

Board of Directors and Stockholders

Dynex Capital, Inc.
Glen Allen, Virginia

We have audited the accompanying consolidated balance sheets of Dynex Capital, Inc. (Dynex) as of December 31, 2015 and 2014 and the related consolidated statements of income and comprehensive income (loss), shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2015. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Dynex at December 31, 2015 and 2014, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2015, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Dynex's internal control over financial reporting as of December 31, 2015, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated March 8, 2016 expressed an unqualified opinion thereon.

BDO USA, LLP

Richmond, Virginia
March 8, 2016

Report of Independent Registered Public Accounting Firm

Board of Directors and Stockholders

Dynex Capital, Inc.

Glen Allen, Virginia

We have audited Dynex Capital, Inc.'s (Dynex) internal control over financial reporting as of December 31, 2015, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Dynex's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Item 9A, Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

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

In our opinion, Dynex maintained, in all material respects, effective internal control over financial reporting as of December 31, 2015, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Dynex as of December 31, 2015 and 2014, and the related consolidated statements of comprehensive income (loss), shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2015 and our report dated March 8, 2016 expressed an unqualified opinion thereon.

BDO USA, LLP

Richmond, Virginia

March 8, 2016

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DYNEX CAPITAL, INC.
CONSOLIDATED BALANCE SHEETS

(\$ in thousands except share data)

	December 31, 2015	December 31, 2014
ASSETS		
Mortgage-backed securities (including pledged of \$3,361,635 and \$3,265,979, respectively)	\$3,493,701	\$3,516,239
Mortgage loans held for investment, net	24,145	39,700
Investment in limited partnership	10,835	4,000
Investment in FHLB stock	11,475	—
Cash and cash equivalents	33,935	43,944
Restricted cash	51,190	42,263
Derivative assets	7,835	5,727
Principal receivable on investments	6,193	7,420
Accrued interest receivable	22,764	21,157
Other assets, net	7,975	7,861
Total assets	\$3,670,048	\$3,688,311
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities:		
Repurchase agreements	\$2,589,420	\$3,013,110
FHLB advances	520,000	—
Non-recourse collateralized financing	8,442	10,786
Derivative liabilities	41,205	35,898
Accrued interest payable	1,743	1,947
Accrued dividends payable	13,709	15,622
Other liabilities	3,504	3,646
Total liabilities	3,178,023	3,081,009
Shareholders' equity:		
Preferred stock, par value \$.01 per share, 8.5% Series A Cumulative Redeemable; 8,000,000 shares authorized; 2,300,000 shares issued and outstanding (\$57,500 aggregate liquidation preference)	55,407	55,407
Preferred stock, par value \$.01 per share, 7.625% Series B Cumulative Redeemable; 7,000,000 shares authorized; 2,250,000 shares issued and outstanding (\$56,250 aggregate liquidation preference)	54,251	54,251
Common stock, par value \$.01 per share, 200,000,000 shares authorized; 49,047,335 and 54,739,111 shares issued and outstanding, respectively	490	547
Additional paid-in capital	725,358	763,935
Accumulated other comprehensive (loss) income	(12,768	) 21,316
Accumulated deficit	(330,713	) (288,154
Total shareholders' equity	492,025	607,302
Total liabilities and shareholders' equity	\$3,670,048	\$3,688,311
See notes to the consolidated financial statements.		

DYNEX CAPITAL, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(amounts in thousands except per share data)

	Year Ended		
	December 31,		
	2015	2014	2013
Interest income:			
Mortgage-backed securities	\$98,936	\$102,881	\$123,629
Mortgage loans held for investment	1,308	2,763	3,503
	100,244	105,644	127,132
Interest expense:			
Repurchase agreements and FHLB advances	22,507	25,821	38,102
Non-recourse collateralized financing	98	94	926
	22,605	25,915	39,028
Net interest income	77,639	79,729	88,104
Loss on derivative instruments, net	(43,128)	) (53,393	) (10,076
(Loss) gain on sale of investments, net	(978)	) 16,223	3,354
Fair value adjustments, net	69	208	(652)
Equity in income of limited partnership	835	—	—
Other (expense) income, net	(225)	) 1,046	397
General and administrative expenses:			
Compensation and benefits	(9,103)	) (9,509	) (7,004)
Other general and administrative	(8,565)	) (6,498	) (6,054)
Net income	16,544	27,806	68,069
Preferred stock dividends	(9,176)	) (9,176	) (7,902)
Net income to common shareholders	\$7,368	\$18,630	\$60,167