

CHIMERA INVESTMENT CORP

Form 10-Q

November 03, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED: September 30, 2016

OR

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

FOR THE TRANSITION PERIOD FROM _____ TO _____

COMMISSION FILE NUMBER: 1-33796

CHIMERA INVESTMENT CORPORATION

(Exact name of Registrant as specified in its Charter)

MARYLAND

26-0630461

(State or other jurisdiction of incorporation or organization) (IRS Employer Identification No.)

520 Madison Avenue

32nd Floor

NEW YORK, NEW YORK

(Address of principal executive offices)

10022

(Zip Code)

(212) 626-2300

(Registrant's telephone number, including area code)

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

Yes No

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

Yes No

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

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

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

Yes No

APPLICABLE ONLY TO CORPORATE ISSUERS:

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

Class	Outstanding at October 31, 2016
Common Stock, \$.01 par value	187,729,838

CHIMERA INVESTMENT CORPORATION
FORM 10-Q
TABLE OF CONTENTS

Part I. FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements:

Consolidated Statements of Financial Condition as of September 30, 2016 (Unaudited) and December 31, 2015
(Derived from the audited consolidated financial statements as of December 31, 2015) 2

Consolidated Statements of Operations and Comprehensive Income (Unaudited) for the quarters and nine months
ended September 30, 2016 and 2015 3

Consolidated Statements of Changes In Stockholders' Equity (Unaudited) for the nine months ended September 30,
2016 and 2015 4

Consolidated Statements of Cash Flows (Unaudited) for the nine months ended September 30, 2016 and 2015 5

Notes to Consolidated Financial Statements (Unaudited) 7

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations 47

Item 3. Quantitative and Qualitative Disclosures about Market Risk 72

Item 4. Controls and Procedures 76

Part II. OTHER INFORMATION 77

Item 1. Legal Proceedings 77

Item 1A. Risk Factors 77

Item 6. Exhibits 78

SIGNATURES 79

PART I. FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements:

CHIMERA INVESTMENT CORPORATION
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

(dollars in thousands, except share and per share data)

(Unaudited)

	September 30, 2016	December 31, 2015
Assets:		
Cash and cash equivalents	\$ 156,608	\$ 114,062
Non-Agency RMBS, at fair value	3,437,235	3,675,841
Agency MBS, at fair value	4,362,550	6,514,824
Securitized loans held for investment, at fair value	8,909,037	4,768,416
Accrued interest receivable	84,328	66,247
Other assets	216,790	189,796
Derivatives, at fair value, net	2,153	15,460
Total assets ⁽¹⁾	\$ 17,168,701	\$ 15,344,646
Liabilities:		
Repurchase agreements, MBS (\$7.3 billion and \$8.8 billion pledged as collateral, respectively)	\$ 5,817,519	\$ 7,439,339
Securitized debt, collateralized by Non-Agency RMBS (\$1.9 billion and \$2.1 billion pledged as collateral, respectively)	380,715	529,415
Securitized debt at fair value, collateralized by loans held for investment (\$8.9 billion and \$4.8 billion pledged as collateral, respectively)	7,191,462	3,720,496
Payable for investments purchased	578,499	560,641
Accrued interest payable	49,743	37,432
Dividends payable	90,645	90,097
Accounts payable and other liabilities	15,309	11,404
Derivatives, at fair value	8,009	9,634
Total liabilities ⁽¹⁾	\$ 14,131,901	\$ 12,398,458

Commitments and Contingencies (See Note 15)

Stockholders' Equity:

Preferred Stock: par value \$0.01 per share; 100,000,000 shares authorized, 0 shares issued and outstanding, respectively	\$—	\$—
Common stock: par value \$0.01 per share; 300,000,000 shares authorized, 187,729,765 and 187,711,868 shares issued and outstanding, respectively	1,877	1,877
Additional paid-in-capital	3,367,943	3,366,568
Accumulated other comprehensive income	897,703	773,791
Accumulated deficit	(1,230,723)	(1,196,048)
Total stockholders' equity	\$ 3,036,800	\$ 2,946,188
Total liabilities and stockholders' equity	\$ 17,168,701	\$ 15,344,646

(1) The Company's consolidated statements of financial condition include assets of consolidated variable interest entities ("VIEs") that can only be used to settle obligations and liabilities of the VIE for which creditors do not have recourse to the primary beneficiary (Chimera Investment Corporation). As of September 30, 2016 and December 31, 2015, total assets of consolidated VIEs were \$10,996,318 and \$7,031,278, respectively, and total liabilities of consolidated VIEs were \$7,599,439 and \$4,262,017, respectively. See Note 8 for further discussion.

See accompanying notes to consolidated financial statements.

2

CHIMERA INVESTMENT CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME

(dollars in thousands, except share and per share data)

(Unaudited)

	For the Quarter Ended		For the Nine Months Ended	
	September 30,	September 30,	September 30,	September 30,
	2016	2015	2016	2015
Net Interest Income:				
Interest income ⁽¹⁾	\$250,953	\$ 211,876	\$673,246	\$ 670,825
Interest expense ⁽²⁾	94,911	67,910	241,120	194,410
Net interest income	156,042	143,966	432,126	476,415
Other-than-temporary impairments:				
Total other-than-temporary impairment losses	(993	)(3,129	)(8,555	)(6,389
Portion of loss recognized in other comprehensive income	(10,581	)(14,703	)(34,652	)(46,359
Net other-than-temporary credit impairment losses	(11,574	)(17,832	)(43,207	)(52,748
Other investment gains (losses):				
Net unrealized gains (losses) on derivatives	27,628	(71,540	)(51,382	)20,543
Realized gains (losses) on terminations of interest rate swaps	—	—	(60,616	)(99,703
Net realized gains (losses) on derivatives	(14,268	)(21,160	)(58,934	)(80,023
Net gains (losses) on derivatives	13,360	(92,700	)(170,932	)(159,183
Net unrealized gains (losses) on financial instruments at fair value	32,999	(40,955	)80,217	(88,640
Net realized gains (losses) on sales of investments	3,079	3,539	7,035	42,789
Gains (losses) on Extinguishment of Debt	(45	)(19,915	)(1,811	)(14,836
Total other gains (losses)	49,393	(150,031	)(85,491	)(219,870
Other income:				
Other income	—	—	95,000	—
Total other income	—	—	95,000	—
Other expenses:				
Management fees	—	4,088	—	24,610
Expense recoveries from Manager	—	(1,140	)—	(6,905
Net management fees	—	2,948	—	17,705
Compensation and benefits	6,911	3,955	19,087	4,482
General and administrative expenses	4,332	8,534	13,073	22,028
Servicing Fees of consolidated VIEs	9,788	6,499	23,139	19,276
Deal Expenses	—	2,426	13,022	5,337
Total other expenses	21,031	24,362	68,321	68,828
Income (loss) before income taxes	172,830	(48,259	)330,107	134,969
Income taxes	13	—	65	—
Net income (loss)	\$172,817	\$ (48,259	)\$330,042	\$ 134,969
Net income (loss) per share available to common shareholders:				
Basic	\$0.92	\$ (0.24	)\$1.76	\$ 0.67
Diluted	\$0.92	\$ (0.24	)\$1.76	\$ 0.66
Weighted average number of common shares outstanding:				
Basic	187,729,765	197,787,858	187,727,667	202,891,610
Diluted	187,919,792	197,875,408	187,917,692	202,979,160

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

Dividends declared per share of common stock	\$0.48	\$ 0.48	\$1.94	\$ 1.44
Comprehensive income (loss):				
Net income (loss)	\$172,817	\$ (48,259)	\$330,042	\$ 134,969
Other comprehensive income:				
Unrealized gains (losses) on available-for-sale securities, net	(18,364)	16,512	94,059	(121,142)
Reclassification adjustment for net losses included in net income for other-than-temporary credit impairment losses	11,574	17,832	43,207	52,748
Reclassification adjustment for net realized losses (gains) included in net income	(2,680)	(3,903)	(13,354)	(43,038)
Other comprehensive income (loss)	(9,470)	30,441	123,912	(111,432)
Comprehensive income (loss)	\$163,347	\$ (17,818)	\$453,954	\$ 23,537

(1) Includes interest income of consolidated VIEs of \$195,488 and \$142,053 for the quarters ended September 30, 2016 and 2015, respectively and interest income of consolidated VIEs of \$488,353 and \$439,571 for the nine months ended September 30, 2016 and 2015, respectively. See Note 8 to consolidated financial statements for further discussion.

(2) Includes interest expense of consolidated VIEs of \$70,715 and \$50,837 for the quarters ended September 30, 2016 and 2015, respectively and interest expense of consolidated VIEs of \$168,738 and \$148,017 for the nine months ended September 30, 2016 and 2015, respectively. See Note 8 to consolidated financial statements for further discussion.

See accompanying notes to consolidated financial statements.

CHIMERA INVESTMENT CORPORATION
 CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

(dollars in thousands, except per share data)

(Unaudited)

	Common Stock Par Value	Additional Paid-in Capital	Accumulated Other Comprehensive Income	Accumulated Deficit	Total
Balance, December 31, 2014	\$ 2,055	\$ 3,614,411	\$ 1,046,680	\$(1,055,456)	\$3,607,690
Net income (loss)	—	—	—	134,969	134,969
Cumulative effect of accounting change ⁽¹⁾	—	—	—	(12,137)	(12,137)
Other comprehensive income (loss)	—	—	(111,432)	—	(111,432)
Stock based compensation	2	944	—	—	946
Repurchase of common stock	(114)	(212,498)	—	—	(212,612)
Common dividends declared	—	—	—	(288,707)	(288,707)
Balance, September 30, 2015	\$ 1,943	\$ 3,402,857	\$ 935,248	\$(1,221,331)	\$3,118,717
Balance, December 31, 2015	\$ 1,877	\$ 3,366,568	\$ 773,791	\$(1,196,048)	\$2,946,188
Net income (loss)	—	—	—	330,042	330,042
Other comprehensive income (loss)	—	—	123,912	—	123,912
Stock based compensation	—	1,375	—	—	1,375
Common dividends declared	—	—	—	(364,717)	(364,717)
Balance, September 30, 2016	\$ 1,877	\$ 3,367,943	\$ 897,703	\$(1,230,723)	\$3,036,800

(1) Adoption of ASU No. 2014-13, Measuring the Financial Assets and the Financial Liabilities of a Consolidated Collateralized Financing Entity.

See accompanying notes to consolidated financial statements.

CHIMERA INVESTMENT CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS

(dollars in thousands)

(Unaudited)

	For the Nine Month Ended	
	September 30,	September 30,
	2016	2015
Cash Flows From Operating Activities:		
Net income	\$ 330,042	\$ 134,969
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
(Accretion) amortization of investment discounts/premiums, net	4,084	(3,425)
Accretion (amortization) of deferred financing costs and securitized debt discounts/premiums, net	(5,769	) 11,554
Amortization of swaption premium	5,130	—
Net unrealized losses (gains) on derivatives	51,382	(20,543)
Proceeds (payments) for derivative sales and settlements	—	(12,327)
Margin (paid) received on derivatives	(41,283	) 30,911
Net unrealized losses (gains) on financial instruments at fair value	(80,217	) 88,640
Net realized losses (gains) on sales of investments	(7,035	) (42,789)
Net other-than-temporary credit impairment losses	43,207	52,748
(Gain) loss on extinguishment of debt	1,811	14,836
Equity-based compensation expense	1,375	946
Changes in operating assets:		
Decrease (increase) in accrued interest receivable, net	(18,081	) 1,325
Decrease (increase) in other assets	(36,969	) (13,540)
Changes in operating liabilities:		
Increase (decrease) in accounts payable and other liabilities	3,905	9,047
Increase (decrease) in investment management fees and expenses payable to affiliate	—	(6,365)
Increase (decrease) in accrued interest payable, net	12,311	7,954
Net cash provided by (used in) operating activities	\$ 263,893	\$ 253,941
Cash Flows From Investing Activities:		
Agency MBS portfolio:		
Purchases	\$(810,630	) \$(3,452,119)
Sales	2,555,228	4,780,881
Principal payments	471,657	888,591
Non-Agency RMBS portfolio:		
Purchases	(160,805	) (792,408)
Sales	95,399	109,999
Principal payments	402,971	280,867
Securitized loans held for investment:		
Purchases	(4,745,083	) (281,811)
Principal payments	696,281	533,628
Acquisition of investments in consolidated VIEs	—	(109,872)
Net cash provided by (used in) investing activities	\$(1,494,982)	\$ 1,957,756
Cash Flows From Financing Activities:		
Proceeds from repurchase agreements	\$ 27,792,856	\$ 32,627,948
Payments on repurchase agreements	(29,414,676	) (33,932,508)
Proceeds from securitized debt borrowings, collateralized by loans held for investment	4,180,227	1,064,789
Payments on securitized debt borrowings, collateralized by loans held for investment	(773,875	) (1,456,021)

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

Payments on securitized debt borrowings, collateralized by Non-Agency RMBS	(146,729	)(138,009)
Payments on repurchase of common stock	—	(212,612)
Common dividends paid	(364,168	)(289,807)
Net cash provided by (used in) financing activities	\$1,273,635	\$ (2,336,220)
Net increase (decrease) in cash and cash equivalents	42,546	(124,523)
Cash and cash equivalents at beginning of period	114,062	164,620	
Cash and cash equivalents at end of period	\$156,608	\$40,097	
Supplemental disclosure of cash flow information:			
Interest received	\$659,249	\$668,725	
Interest paid	\$234,577	\$198,010	
Management fees and expenses paid	\$—	\$30,975	
Non-cash investing activities:			
Receivable for investments sold	\$—	\$57,680	
Payable for investments purchased	\$578,499	\$715,512	
Net change in unrealized gain (loss) on available-for sale securities	\$123,912	\$ (111,432)

Acquisition of investments in consolidated VIEs:

Securitized loans held for investment, at fair value	\$—	\$295,225
Securitized debt at fair value	\$—	\$185,353

Non-cash financing activities:

Common dividends declared, not yet paid	\$90,645	\$91,383
---	----------	----------

See accompanying notes to consolidated financial statements.

6

CHIMERA
INVESTMENT
CORPORATION
NOTES TO
CONSOLIDATED
FINANCIAL
STATEMENTS

(Unaudited)

1. Organization

Chimera Investment Corporation (the “Company”) was organized in Maryland on June 1, 2007. The Company commenced operations on November 21, 2007 when it completed its initial public offering. The Company elected to be taxed as a real estate investment trust (“REIT”) under the Internal Revenue Code of 1986, as amended, and regulations promulgated thereunder (the “Code”).

The Company conducts its operations through various subsidiaries including subsidiaries it treats as taxable REIT subsidiaries (“TRS”). In general, a TRS may hold assets and engage in activities that the Company cannot hold or engage in directly and generally may engage in any real estate or non-real estate related business. The Company currently has eight wholly owned direct subsidiaries: Chimera RMBS Whole Pool LLC, and Chimera RMBS LLC formed in June 2009; Chimera Special Holdings LLC, formed in January 2010; CIM Trading Company LLC (“CIM Trading”), a TRS formed in July 2010; Chimera Funding TRS LLC (“CIM Funding TRS”), a TRS formed in October 2013, Chimera CMBS Whole Pool LLC formed in March 2015; Chimera Insurance Company, LLC formed in July 2015 and Chimera RR Holdings LLC formed in April 2016.

Until August 5, 2015, the Company was externally managed by Fixed Income Discount Advisory Company (“FIDAC” or “Manager”), under the terms of a management agreement (“Management Agreement”). On August 5, 2015, the Company announced it had internalized its management and would continue to be led by its key professionals. In connection with the internalization, the Company and FIDAC terminated the Management Agreement.

2. Summary of the Significant Accounting Policies

(a) Basis of Presentation and Consolidation

The accompanying consolidated financial statements and related notes of the Company have been prepared in accordance with accounting principles generally accepted in the United States (“GAAP”). In the opinion of management, all adjustments considered necessary for a fair presentation of the Company's financial position, results of operations and cash flows have been included. Certain prior period amounts have been reclassified to conform to the current period's presentation.

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

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

the VIE that could be significant to the VIE. For VIEs that do not have substantial on-going activities, the power to direct the activities that most significantly impact the VIEs' economic performance may be determined by an entity's involvement with the design and structure of the VIE.

The trusts are structured as pass through entities that receive principal and interest on the underlying collateral and distribute those payments to the security holders. The assets held by the securitization entities are restricted in that they can only be used to fulfill the obligations of the securitization entity. The Company's risks associated with its involvement with these VIEs are limited to its risks and rights as a holder of the security it has retained. There have been no recent changes to the nature of risks associated with the Company's involvement with VIEs.

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

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

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

(b) Statements of Financial Condition Presentation

The Company's Consolidated Statements of Financial Condition include both the Company's direct assets and liabilities and the assets and liabilities of consolidated securitization vehicles. Assets of each consolidated VIE can only be used to satisfy the obligations of that VIE, and the liabilities of consolidated VIEs are non-recourse to the Company. The Company is not obligated to provide, nor does it intend to provide, any financial support to these consolidated securitization vehicles. The notes to the consolidated financial statements describe the Company's assets and liabilities including the assets and liabilities of consolidated securitization vehicles. See Note 8 for additional information related to the Company's investments in consolidated securitization vehicles.

(c) Cash and Cash Equivalents

Cash and cash equivalents include cash on hand and cash deposited overnight in money market funds, which are not bank deposits and are not insured or guaranteed by the Federal Deposit Insurance Corporation. There were no restrictions on cash and cash equivalents at September 30, 2016 and December 31, 2015.

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

The Company invests in mortgage backed securities ("MBS") representing interests in obligations backed by pools of mortgage loans. The Company delineates between Agency MBS and Non-Agency MBS as follows: (1) Agency MBS are mortgage pass-through certificates, collateralized mortgage obligations ("CMOs"), and other MBS representing interests in or obligations backed by pools of mortgage loans issued or guaranteed by agencies of the U.S. Government, such as Ginnie Mae, or federally chartered corporations such as Freddie Mac or Fannie Mae where principal and interest repayments are guaranteed by the respective agency of the U.S. Government or federally chartered corporation; and (2) Non-Agency MBS are not issued or guaranteed by a U.S. Government Agency or other institution and are subject to credit risk. Repayment of principal and interest on Non-Agency MBS is subject to the performance of the mortgage loans or MBS collateralizing the obligation.

The Company also invests in Interest Only Agency MBS strips and Interest Only Non-Agency RMBS strips ("IO MBS strips"). IO MBS strips represent the Company's right to receive a specified proportion of the contractual interest flows of the collateral. Interest income on IO MBS strips is accrued based on the outstanding notional balance and the security's contractual terms, and amortization of any premium is calculated in accordance with the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 325-40, Beneficial Interests in Securitized Financial Assets ("ASC 325-40"). The Company accounts for IO MBS strips at fair value with changes in fair value recognized in the Company's Consolidated Statements of Operations and Comprehensive Income.

The Company classifies the majority of its MBS as available-for-sale and records investments at estimated fair value as described in Note 5 of these consolidated financial statements. The Company includes unrealized gains and losses

considered to be temporary on all MBS in Other comprehensive income (“OCI”) in the Consolidated Statements of Operations and Comprehensive Income. For IO MBS strips and certain other MBS investments, the Company carries these investments at fair value with changes in fair value included in earnings in the Consolidated Statements of Operations and Comprehensive Income. From time to time, as part of the overall management of its portfolio, the Company may sell any of its investments and recognize a realized gain or loss as a component of earnings in the Consolidated Statements of Operations and Comprehensive Income utilizing the average cost method.

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

Interest Income Recognition

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

8

Agency MBS and Non-Agency RMBS of High Credit Quality

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

Agency MBS

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

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

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

Non-Agency RMBS Not of High Credit Quality

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

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

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

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

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

Interest income on Non-Agency RMBS Not of High Credit Quality is recognized using the interest method based on management’s estimates of cash flows expected to be collected. The effective interest rate on these securities is based on management’s estimate for each security of the projected cash flows, which are estimated based on observation of current market information and include assumptions related to fluctuations in prepayment speeds and the timing and amount of credit losses. On a quarterly basis, the Company reviews and, if appropriate, makes adjustments to its cash

flow projections based on inputs and analyses received from external sources, internal models, and the Company's judgments about prepayment rates, the timing and amount of credit losses, and other factors. Changes in the amount or timing of cash flows from those originally projected, or from those estimated at the last evaluation date, are considered to be either positive changes or adverse changes. For securities accounted for under ASC 325-40, any positive or adverse change in cash flows that does not result in the recognition of an other-than-temporary impairment ("OTTI") results in a prospective increase or decrease in the effective interest rate used to recognize interest income. For securities accounted for under ASC 310-30, only significant positive changes are reflected prospectively in the effective interest rate used to recognize interest income. Adverse changes in cash flows expected to be collected are generally treated consistently for Non-Agency RMBS accounted for under ASC 325-40 and ASC 310-30, and generally result in recognition of an OTTI with no change in the effective interest rate used to recognize interest income.

Impairment

Considerations Applicable to all MBS

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

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

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

Considerations Applicable to Non-Agency RMBS of High Credit Quality

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

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

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

The OTTI is separated into a credit loss component that is recognized in earnings and the portion of loss recognized in other comprehensive income. The credit component is comprised of the impact of the fair value decline due to

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

The determination of whether an OTTI exists and, if so, the extent of the credit component is subject to significant judgment and management's estimates of both historical information available at the time of assessment, the current market environment, as well as the Company's estimates of the future performance and projected amount and timing of cash flows expected to be

collected on the security. As a result, the timing and amount of OTTI constitutes an accounting estimate that may change materially over time.

Investments for which the Company has elected the fair value option are not evaluated for OTTI as all changes in fair value are reflected in earnings.

(e) Securitized Loans Held for Investment

Prime residential mortgage loans:

A portion of the securitized loan portfolio is comprised of non-conforming, single family, owner occupied, jumbo prime loans that are not guaranteed as to repayment of principal or interest. These securitized loans are serviced and may be modified, in the event of a default, by a third-party servicer. The Company generally has the ability to approve certain loan modifications and determine the course of action to be taken as it relates to certain loans in default, including whether or not to proceed with foreclosure. These mortgage loans are designated as held for investment. Interest income on loans held for investment is recognized over the expected life of the loans using the interest method with changes in yield reflected in earnings on a prospective basis. The securitized loan portfolio comprised of non-conforming, single family, owner occupied, jumbo, prime loans is carried at fair value with changes in fair value recorded in earnings.

The Company estimates the fair value of securitized loans as described in Note 5 of these consolidated financial statements.

Seasoned subprime residential mortgage loans:

A portion of the securitized loan portfolio is comprised of seasoned subprime residential mortgage loans that are not guaranteed as to repayment of principal or interest. These securitized loans are serviced and may be modified, in the event of default, by a third-party servicer. The Company generally has the ability to approve certain loan modifications and determine the course of action to be taken as it relates to certain loans in default, including whether or not to proceed with foreclosure. These mortgage loans are designated as held for investment. Interest income on loans held for investment is recognized over the expected life of the loans using the interest method with changes in yield reflected in earnings on a prospective basis. The securitized loan portfolio comprised primarily of seasoned subprime residential mortgage loans is carried at fair value with changes in fair value recorded in earnings.

The Company estimates the fair value of securitized loans as described in Note 5 of these consolidated financial statements.

All residential mortgage loans:

Interest is accrued on all securitized loans held for investment when due. Interest which is not received at the due date is written off when it becomes delinquent. Nonrefundable fees and costs related to acquiring the Company's securitized residential mortgage loans are recognized as expenses in the Statement of operations and comprehensive income. Income recognition is suspended for loans when, based on information from the servicer, a full recovery of interest or principal becomes doubtful.

Real estate owned ("REO") represents properties which the Company has received the legal title of the property to satisfy the outstanding loan. REO is re-categorized from loan to REO when the Company takes legal title of the property. REO assets are measured and reported at the estimated fair value less the estimated cost to sell at the end of each reporting period. At the time the asset is re-categorized, any difference between the previously recorded loan

balance and the carrying value of the REO at the time the Company takes legal title of the property, is recognized as a loss. All REO assets of the Company are held-for-sale and it is the Company's intention to sell the property in the shortest time possible to maximize their return and recovery on the previously recorded loan. The carrying value of REO assets at September 30, 2016 and December 31, 2015 was \$12 million and \$18 million, respectively, and were recorded in Other Assets on the Company's consolidated statements of financial condition.

(f) Repurchase Agreements

The Company finances the acquisition of a significant portion of its mortgage-backed securities with repurchase agreements. The Company has evaluated each agreement and has determined that each of the repurchase agreements be accounted for as secured borrowings.

(g) Securitized Debt, collateralized by Non-Agency RMBS and Securitized Debt, collateralized by loans held for investment

Certain re-securitization transactions classified as Securitized Debt, collateralized by Non-Agency RMBS, reflect the transfer to a trust of fixed or adjustable rate MBS which are classified as Non-Agency RMBS that pay interest and principal to the debt holders of that re-securitization. Re-securitization transactions completed by the Company that did not qualify as sales are accounted for as secured borrowings. The associated securitized debt is carried at amortized cost, net of any unamortized premiums or discounts.

Certain transactions involving residential mortgage loans are accounted for as secured borrowings, and are recorded as Securitized loans held for investment and the corresponding debt as Securitized debt, collateralized by loans held for investment in the Consolidated Statements of Financial Condition. These securitizations are collateralized by residential adjustable or fixed rate mortgage loans that have been placed in a trust and pay interest and principal to the debt holders of that securitization. The Securitized debt, collateralized by loans held for investment, is carried at fair value.

The Company recognizes interest expense on securitized debt over the expected life of the debt using the interest method with changes in yield reflected in earnings on a prospective basis.

The Company estimates the fair value of its securitized debt as described in Note 5 to these consolidated financial statements.

(h) Fair Value

Interest-Only MBS:

The Company accounts for the IO MBS strips at fair value with changes in fair value reported in earnings. The IO MBS strips are included in MBS, at fair value, on the accompanying Consolidated Statements of Financial Condition.

Included in Non-Agency RMBS, at fair value on the Consolidated Statements of Financial Condition are IO MBS strips carried at fair value with changes in fair value reflected in earnings of \$305 million and \$245 million as of September 30, 2016 and December 31, 2015. Included in Agency MBS, at fair value on the Consolidated Statements of Financial Condition are IO MBS strips carried at fair value with changes in fair value reflected in earnings of \$157 million and \$273 million as of September 30, 2016 and December 31, 2015. Interest income reported on all IO MBS securities was \$10 million and \$13 million for the quarters ended September 30, 2016 and 2015, respectively. Interest income reported on all IO MBS securities was \$32 million and \$38 million for the nine months ended September 30, 2016 and 2015, respectively.

Non-Agency RMBS:

The Company has elected the fair value option for certain interests in Non-Agency RMBS which we refer to as the overcollateralization classes. The cash flows for these holdings are generally subordinate to all other interests of the trusts and generally only pay out funds when certain ratios are met and excess cash holdings, as determined by the trustee, are available for distribution to the overcollateralization class. Many of the investments in this group have no current cash flows and may not ever pay cash flows, depending on the loss experience of the collateral group supporting the investment. Estimating future cash flows for this group of Non-Agency RMBS investments is highly subjective and uncertain; therefore, the Company has elected to carry these holdings at fair value with changes in fair value reflected in earnings.

Changes in fair value are presented in Net unrealized gains (losses) on financial instruments at fair value on the Consolidated Statement of Operations and Comprehensive Income. The fair value of the Non-Agency RMBS carried

at fair value with changes in fair value reflected in earnings is \$21 million and \$20 million as of September 30, 2016 and December 31, 2015, respectively.

Securitized Loans Held for Investment:

The Company's securitized loans held for investment are carried at fair value with changes in fair value reflected in earnings. The Company carries securitized loans held for investment at fair value as it may resecuritize these loans in the future. Additionally, the fair value option allows both the loans and related financing to be consistently reported at fair value and to achieve operational and valuation simplifications.

Changes in fair value of securitized loans held for investment are presented in Net unrealized gains (losses) on financial instruments at fair value on the Consolidated Statement of Operations and Comprehensive Income.

Securitized Debt, Collateralized by Loans Held for Investment:

12

The Company's securitized debt, collateralized by loans held for investment, is carried at fair value with changes in fair value reflected in earnings. The Company has elected the fair value option for these financings as it may call or restructure these debt financings in the future. Additionally, the fair value option allows both the loans and related financing to be consistently reported at fair value and to achieve operational and valuation simplifications.

Changes in fair value of securitized debt, collateralized by loans held for investment are presented in Net unrealized gains (losses) on financial instruments at fair value on the Consolidated Statement of Operations and Comprehensive Income.

(i) Derivative Financial Instruments

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

The Company elects to net the fair value of its derivative contracts by counterparty when appropriate. These contracts contain legally enforceable provisions that allow for netting or setting off of all individual derivative receivables and payables with each counterparty and therefore, the fair value of those derivative contracts are reported net by counterparty. The credit support annex provisions of the Company's derivative contracts allow the parties to mitigate their credit risk by requiring the party which is in a net payable position to post collateral. As the Company elects to net by counterparty the fair value of derivative contracts, it also nets by counterparty any cash collateral exchanged as part of the derivative. Refer to Note 9 Derivative Instruments for further details.

(j) Fair Value Disclosure

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

(k) Sales, Securitizations, and Re-Securitizations

The Company periodically enters into transactions in which it sells financial assets, such as MBS and mortgage loans. Gains and losses on sales of assets are calculated using the average cost method whereby the Company records a gain or loss on the difference between the average amortized cost of the asset and the proceeds from the sale. In addition, the Company from time to time securitizes or re-securitizes assets and sells tranches in the newly securitized assets. These transactions may be recorded as either sales, whereby the assets contributed to the securitization are removed from the Consolidated Statements of Financial Condition and a gain or loss is recognized, or as secured borrowings whereby the assets contributed to the securitization are not derecognized but rather the debt issued by the securitization entity are recorded to reflect the term financing of the assets. In these securitizations and re-securitizations, the Company may retain senior or subordinated interests in the securitized or re-securitized assets. In transfers that are considered secured borrowings, no gain or loss is recognized. Any difference in the proceeds received and the carrying value of the transferred asset is recorded as a premium or discount and amortized into earnings as an adjustment to yield.

(1) Income Taxes

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

A tax position is recognized only when, based on management's judgment regarding the application of income tax laws, it is more likely than not that the tax position will be sustained upon examination. The Company does not have any unrecognized tax positions that would affect its financial statements or require disclosure. No accruals for penalties and interest were necessary as of September 30, 2016 or 2015.

(m) Net Income per Share

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

(n) Stock-Based Compensation

The Company measures the fair value of the equity instrument granted to non-employees using the stock prices and other measurement assumptions as of the earlier of either the date at which a performance commitment by the recipient is reached or the date at which the recipient's performance is complete. Stock compensation expense related to the grants of stock is recognized over the vesting period of such grants based on the fair value of the stock on each vesting date at which the recipient's performance is complete.

Compensation expense for equity based awards granted to the Company's independent directors and stock based compensation awards granted to employees of the Company subject only to service condition is recognized on a straight-line basis over the vesting period of such awards, based upon the fair value of such awards at the grant date adjusted, as applicable, for estimated forfeitures. For awards subject to graded vesting, the total amount of expense is at least equal to the measured expense of each vested tranche. Awards subject to only a service condition are valued according to the market price for the Company's common stock at the date of grant. For awards based on the performance of the Company's stock price, the Company generally engages an independent appraisal company to determine the value of the shares at the date of grant, taking into account the underlying contingency risks associated with the performance criteria. The values of these grants are expensed ratably over their respective vesting periods (irrespective of achievement of the performance criteria) adjusted, as applicable, for forfeitures.

(o) Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although the Company's estimates contemplate current conditions and how it expects them to change in the future, it is reasonably possible that actual conditions could be materially different than anticipated in those estimates, which could have a material adverse impact on the Company's results of operations and its financial condition. Management has made significant estimates in accounting for income recognition and OTTI on Agency and Non-Agency RMBS and IO MBS (Note 3), valuation of Agency MBS and Non-Agency RMBS (Notes 3 and 5), residential mortgage loans (Note 4), securitized debt (Note 7) and derivative instruments (Notes 5 and 9). Actual results could differ materially from those estimates.

(p) Recent Accounting Pronouncements

Statement of Cash Flows - Classification of Certain Cash Receipts and Cash Payments – (Topic 230)

In August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows - Classification of Certain Cash Receipts and Cash Payments. This update provides guidance on eight specific cash flow issues. The guidance is

intended to reduce diversity in practice on those issues across all industries. The guidance in the ASU is effective for the Company as of January 1, 2018. Early adoption is allowed. The guidance is to be applied retrospectively, unless it is impracticable to do so for an issue, then the amendments related to that issue would be applied prospectively. The Company is currently evaluating what impact this update will have on the consolidated financial statements.

Financial Instruments - Credit Losses – (Topic 326)

In June 2016, the FASB issued ASU No. 2016-13, Measurement of Credit Losses on Financial Instruments. This update replaces the current model for recognizing credit losses from an incurred credit loss model to a current expected credit loss (CECL) model for instruments measured at amortized cost and requires entities to record allowances for available-for-sale (AFS) debt securities when the fair value of an AFS debt security is below the amortized cost of the asset rather than reduce the carrying amount, as we do under the current OTTI model. This update also simplifies the accounting model for purchased

credit-impaired debt securities and loans. The changes in the allowances created in accordance with this update will be recorded in earnings. The update also expands the disclosure requirements regarding the Company's assumptions, models, and methods for estimating the expected credit losses. In addition, the Company will disclose the amortized cost balance for each class of financial asset by credit quality indicator, disaggregated by the year of origination. The guidance in the ASU is effective for the Company as of January 1, 2020. Early adoption is allowed, beginning January 1, 2019. The standard requires entities to record a cumulative-effect adjustment to the statement of financial position as of the beginning of the first reporting period in which the guidance is effective. The Company is currently evaluating what impact this update will have on the consolidated financial statements.

Share Based Payments – (Topic 718)

In March 2016, the FASB issued ASU No. 2016-09, Improvements to Employee Share-Based Payment Accounting. Under this update companies will no longer record excess tax benefits and certain tax deficiencies associated with an award of equity instruments in additional paid-in capital. Instead, they will record all excess tax benefits and tax deficiencies as income tax expense or benefit in the income statement when the awards vest or are settled, and additional paid-in capital pools will be eliminated. The updated guidance will also allow the Company to repurchase more shares than it can today for tax withholding purposes without triggering liability accounting and to make a policy election to account for forfeitures as they occur. The guidance in the ASU is effective for the Company as of January 1, 2017. Early adoption is allowed. The guidance is to be applied using a modified retrospective transition method with a cumulative-effect adjustment recorded in retained earnings. The Company is currently evaluating what impact this update will have on the consolidated financial statements.

Contingent Put and Call Options in Debt Instruments – (Topic 815)

In March 2016, the FASB issued ASU No. 2016-06, Contingent Put and Call Options in Debt Instruments Accounting. This update clarifies that when a call or put option in a debt instrument can accelerate the repayment of principal on the debt instrument, a reporting entity does not need to assess whether the contingent event that triggers the ability to exercise the call or put option is related to interest rates or credit risk in determining whether the option should be accounted for separately as a derivative. The guidance in the ASU is effective for the Company as of January 1, 2017. Early adoption is permitted. The new guidance applies to existing debt instruments (or hybrid financial instruments that are determined to have a debt host) using a modified retrospective method as of the beginning of the period of adoption. The adoption of this guidance is not expected to have a material effect on the Company's financial statements as all of its debt instruments with contingent Put and Call options are eliminated on consolidation.

Effect of Derivative Contract Novations on Existing Hedge Accounting Relationships – (Topic 815)

In March 2016, the FASB issued ASU No. 2016-05, Effect of Derivative Contract Novations on Existing Hedge Accounting Relationships. The amendments in this update clarify that a change in the counterparty to a derivative instrument that has been designated as the hedging instrument under Topic 815 does not, in and of itself, require de-designation of that hedging relationship provided that all other hedge accounting criteria continue to be met. The guidance in the ASU is effective for the Company as of January 1, 2017. Early adoption is allowed. The new guidance may be applied prospectively or on a modified retrospective basis. The Company currently does not use hedge accounting for GAAP reporting purposes, therefore this guidance is not expected to have a material effect on the Company's financial statements.

Financial Instruments—Overall (Subtopic 825-10)

In January 2016, the FASB issued ASU No. 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities. This update changes how the Company will present changes in the fair value of financial liabilities measured under the fair value option that are attributable to our own credit. Under the updated guidance, the Company will record changes in instrument-specific credit risk for financial liabilities measured under the fair value option in other comprehensive income. The update also requires fair value measurement for equity investments that do not result in consolidation and are not accounted for under the equity method to be measured at fair value with any changes in fair value recognized in net income. The update also eliminates the requirement to disclose the methods and significant assumptions used to estimate the fair value of financial instruments measured at amortized cost. In addition, the Company will have to use the exit price notion when measuring the fair value of financial instruments measured at amortized cost for disclosure purposes. The guidance in the ASU is effective for the Company as of January 1, 2018. Early adoption for certain provisions of the update is allowed. Any adjustment as a result of the adoption of this standard will be recorded as a cumulative-effect adjustment to beginning retained earnings as of the first period in which the guidance is adopted. The Company is currently evaluating what impact this update will have on the consolidated financial statements.

Presentation of Financial Statements—Going Concern (Subtopic 205-40)

In August 2014, the FASB issued ASU No. 2014-15, Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern. This update provides guidance on determining when and how to disclose going-concern uncertainties in the financial statements. The new standard requires the Company to perform interim and annual assessments of its ability to continue as a going concern within one year of the date the financial statements are issued. The Company must provide certain disclosures if conditions or events raise substantial doubt about its ability to continue as a going concern. The ASU applies to all entities and is effective for the Company for the year ended December 31, 2016. Early adoption is permitted. The Company does not expect this update to have any impact as we do not expect to have the conditions or events which would raise substantial doubt about the Company's ability to continue as a going concern.

3. Mortgage-Backed Securities

The Company classifies its Non-Agency RMBS as senior, senior IO, subordinated, or subordinated IO. The Company also invests in residential and commercial Agency MBS. Senior interests in Non-Agency RMBS are considered to be entitled to the first principal repayments in their pro-rata ownership interests at the acquisition date.

September 30, 2016 (dollars in thousands)								
	Principal or Notional Value	Total Premium	Total Discount	Amortized Cost	Fair Value	Gross Unrealized Gains	Gross Unrealized Losses	Net Unrealized Gain/(Loss)
Non-Agency RMBS								
Senior	\$3,308,463	\$237	\$(1,457,711)	\$1,850,990	\$2,585,386	\$734,998	\$(602)	)\$734,396
Senior, interest-only	5,733,457	303,539	—	303,539	291,526	28,598	(40,611)	)\$ (12,013)
Subordinated	668,946	16,416	(218,239)	467,125	546,825	79,895	(195)	)\$79,700
Subordinated, interest-only	269,868	14,183	—	14,183	13,498	41	(726)	)\$ (685)
Agency MBS								
Residential	2,672,093	138,970	—	2,811,063	2,861,468	51,842	(1,437)	)\$50,405
Commercial	1,273,235	36,001	(2,717)	1,306,518	1,343,994	39,496	(2,020)	)\$37,476
Interest-only	3,474,731	163,542	—	163,542	157,088	2,274	(8,728)	)\$ (6,454)
Total	\$17,400,793	\$672,888	\$(1,678,667)	\$6,916,960	\$7,799,785	\$937,144	\$(54,319)	)\$882,825

December 31, 2015 (dollars in thousands)								
	Principal or Notional Value	Total Premium	Total Discount	Amortized Cost	Fair Value	Gross Unrealized Gains	Gross Unrealized Losses	Net Unrealized Gain/(Loss)
Non-Agency RMBS								
Senior	\$3,651,869	\$309	\$(1,553,317)	\$2,098,860	\$2,826,121	\$736,040	\$(8,779)	)\$727,261
Senior, interest-only	5,426,029	268,515	—	268,515	234,171	18,113	(52,457)	)(34,344)
Subordinated	762,466	23,635	(258,128)	527,975	604,295	83,896	(7,577)	)\$76,319
Subordinated, interest-only	284,931	15,226	—	15,226	11,254	62	(4,035)	)(3,973)
Agency MBS								
Residential	5,045,418	255,837	—	5,301,255	5,267,848	18,593	(52,001)	)(33,408)
Commercial	952,091	24,815	(3,170)	973,736	973,787	8,052	(8,001)	)\$51
Interest-only	6,722,472	280,073	—	280,073	273,189	2,756	(9,640)	)(6,884)

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

Total \$22,845,276 \$868,410 \$(1,814,615) \$9,465,640 \$10,190,665 \$867,512 \$(142,490) \$725,022

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

16

	For the Quarter Ended		For the Nine Months Ended	
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
Balance at beginning of period	\$1,714,592	\$1,698,323	\$1,742,744	\$1,534,497
Purchases	18,316	133,227	60,915	241,852
Yield income earned	(69,850)	(72,557)	(141,256)	(213,267)
Reclassification (to) from non-accretable difference	(29,490)	19,205	(2,031)	238,012
Sales and deconsolidation	(12,907)	(418)	(39,711)	(23,314)
Balance at end of period	\$1,620,661	\$1,777,780	\$1,620,661	\$1,777,780

The table below presents the outstanding principal balance and related amortized cost at September 30, 2016 and December 31, 2015 as it pertains to the Company's Non-Agency RMBS portfolio accounted for according to the provisions of ASC 310-30.

	For the Quarter Ended September 30, 2016	For the Year Ended December 31, 2015
Outstanding principal balance:		
Beginning of period	\$3,343,812	\$3,325,335
End of period	\$3,228,137	\$3,550,698
Amortized cost:		
Beginning of period	\$1,806,344	\$1,741,780
End of period	\$1,743,116	\$1,958,726

The following tables present the gross unrealized losses and estimated fair value of the Company's RMBS by length of time that such securities have been in a continuous unrealized loss position at September 30, 2016 and December 31, 2015. All securities in an unrealized loss position have been evaluated by the Company for OTTI as discussed in Note 2(d).

	September 30, 2016 (dollars in thousands)			December 31, 2015 (dollars in thousands)			Total		
	Unrealized Loss Position for Less than 12 Months	Unrealized Loss Position for 12 Months or More	Unrealized Loss Position for 12 Months or More	Unrealized Loss Position for Less than 12 Months	Unrealized Loss Position for 12 Months or More	Unrealized Loss Position for 12 Months or More	Unrealized Loss Position for Less than 12 Months	Unrealized Loss Position for 12 Months or More	Unrealized Loss Position for 12 Months or More
Non-Agency RMBS									
Senior	\$2,340	\$(111)	1	\$60,325	\$(491)	2	\$62,665	\$(602)	3
Senior, interest-only	36,729	(3,867)	33	90,295	(36,744)	85	127,024	(40,611)	118
Subordinated	—	—	—	1,726	(195)	1	1,726	(195)	1

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

Subordinated, interest-only Agency MBS	—	—	—	12,433	(726	)3	12,433	(726	)3
Residential	235,048	(1,146	)10	57,562	(291	)1	292,610	(1,437	)11
Commercial	140,402	(1,320	)32	55,068	(700	)43	195,470	(2,020	)75
Interest-only	68,822	(1,587	)19	36,645	(7,141	)11	105,467	(8,728	)30
Total	\$483,341	\$(8,031	)95	\$314,054	\$(46,288	)146	\$797,395	\$(54,319	)241

17

December 31, 2015
(dollars in thousands)

	Unrealized Loss Position for Less than 12 Months			Unrealized Loss Position for 12 Months or More			Total		
	Estimated Fair Value	Unrealized Losses	Number of Securities	Estimated Fair Value	Unrealized Losses	Number of Securities	Estimated Fair Value	Unrealized Losses	Number of Securities
Non-Agency RMBS									
Senior	\$294,520	\$(8,779)	)20	\$—	\$—	—	\$294,520	\$(8,779)	)20
Senior, interest-only	81,919	(18,715)	)83	64,058	(33,742)	)47	145,977	(52,457)	)130
Subordinated	138,257	(7,577)	)22	—	—	—	138,257	(7,577)	)22
Subordinated, interest-only	6,455	(1,039)	)1	3,635	(2,996)	)2	10,090	(4,035)	)3
Agency MBS									
Residential	4,468,717	(44,687)	)116	290,926	(7,314)	)4	4,759,643	(52,001)	)120
Commercial	393,058	(7,969)	)140	4,986	(32)	)4	398,044	(8,001)	)144
Interest-only	94,969	(3,457)	)24	39,707	(6,183)	)7	134,676	(9,640)	)31
Total	\$5,477,895	\$(92,223)	)406	\$403,312	\$(50,267)	)64	\$5,881,207	\$(142,490)	)470

At September 30, 2016, the Company did not intend to sell any of its RMBS that were in an unrealized loss position, and it was not more likely than not that the Company would be required to sell these RMBS before recovery of their amortized cost basis, which may be at their maturity. With respect to RMBS held by consolidated VIEs, the ability of any entity to cause the sale by the VIE prior to the maturity of these RMBS is either expressly prohibited, not probable, or is limited to specified events of default, none of which have occurred as of September 30, 2016.

Gross unrealized losses on the Company's Agency residential and commercial MBS were \$3 million and \$60 million as of September 30, 2016 and December 31, 2015, respectively. Given the inherent credit quality of Agency MBS, the Company does not consider any of the current impairments on its Agency MBS to be credit related. In evaluating whether it is more likely than not that it will be required to sell any impaired security before its anticipated recovery, which may be at their maturity, the Company considers the significance of each investment, the amount of impairment, the projected future performance of such impaired securities, as well as the Company's current and anticipated leverage capacity and liquidity position. Based on these analyses, the Company determined that at September 30, 2016 and December 31, 2015, unrealized losses on its Agency MBS were temporary.

Gross unrealized losses on the Company's Non-Agency RMBS (excluding Non-Agency IO MBS strips which are reported at fair value with changes in fair value recorded in earnings) were \$1 million and \$16 million at September 30, 2016 and December 31, 2015, respectively. Based upon the most recent evaluation, the Company does not consider these unrealized losses to be indicative of OTTI and does not believe that these unrealized losses are credit related, but rather are due to other factors. The Company has reviewed its Non-Agency RMBS that are in an unrealized loss position to identify those securities with losses that are other-than-temporary based on an assessment of changes in cash flows expected to be collected for such RMBS, which considers recent bond performance and expected future performance of the underlying collateral.

A summary of the OTTI included in earnings for the quarters and nine months ended September 30, 2016 and 2015 is presented below.

For the Quarter Ended

	For the Nine Months Ended			
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
	(dollars in thousands)			
Total other-than-temporary impairment losses	\$(993)	\$(3,129)	\$(8,555)	\$(6,389)
Portion of loss recognized in other comprehensive income (loss)	(10,581)	(14,703)	(34,652)	(46,359)
Net other-than-temporary credit impairment losses	\$(11,574)	\$(17,832)	\$(43,207)	\$(52,748)

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

	For the Quarter Ended		For the Nine Months Ended	
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
Cumulative credit loss beginning balance	\$546,187	\$ 528,548	\$529,112	\$ 507,548
Additions:				
Other-than-temporary impairments not previously recognized	6,184	7,863	17,137	34,133
Reductions for securities sold or deconsolidated during the period	(2,630)	(3,963)	(6,890)	(5,697)
Increases related to other-than-temporary impairments on securities with previously recognized other-than-temporary impairments	5,390	9,969	26,069	18,615
Reductions for increases in cash flows expected to be collected over the remaining life of the securities	(1,494)	—	(11,791)	(12,182)
Cumulative credit impairment loss ending balance	\$553,637	\$ 542,417	\$553,637	\$ 542,417

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

	For the Nine Months Ended	
	September 30, 2016	September 30, 2015
Loss Severity		
Weighted Average	59%	56%
Range	25% - 85%	17% - 92%
60+ days delinquent		
Weighted Average	21%	20%
Range	0% - 40%	2% - 41%
Credit Enhancement ⁽¹⁾		
Weighted Average	29%	8%
Range	0% - 100%	0% - 27%
3 Month CPR		
Weighted Average	5%	8%
Range	0% - 19%	3% - 27%
12 Month CPR		
Weighted Average	4%	8%
Range	0% - 21%	3% - 20%

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

The following tables present a summary of unrealized gains and losses at September 30, 2016 and December 31, 2015. IO MBS included in the tables below represent the right to receive a specified portion of the contractual interest cash flows of the underlying principal balance of specific securities. At September 30, 2016, IO MBS had a net unrealized loss of \$19 million and had an amortized cost of \$481 million. At December 31, 2015, IO MBS had a net unrealized loss of \$45 million and had an amortized cost of \$564 million. The fair value of IOs at September 30, 2016 and December 31, 2015 was \$462 million, and \$519 million, respectively. All changes in fair value of IOs are reflected in Net Income in the Consolidated Statements of Operations and Comprehensive Income.

	September 30, 2016 (dollars in thousands)					
	Gross Unrealized Gain Included in Accumulated Other Comprehensive Income	Gross Unrealized Gain Included in Accumulated Deficit	Total Gross Unrealized Gain	Gross Unrealized Loss Included in Accumulated Other Comprehensive Income	Gross Unrealized Loss Included in Accumulated Deficit	Total Gross Unrealized Loss
Non-Agency RMBS						
Senior	\$ 734,998	\$—	\$ 734,998	\$ (602)	\$ —	\$ (602)
Senior, interest-only	—	28,598	28,598	—	(40,611)	(40,611)
Subordinated	75,446	4,449	79,895	—	(195)	(195)
Subordinated, interest-only	—	41	41	—	(726)	(726)
Agency MBS						
Residential	51,842	—	51,842	(1,437)	—	(1,437)
Commercial	39,496	—	39,496	(2,020)	—	(2,020)
Interest-only	—	2,274	2,274	—	(8,728)	(8,728)
Total	\$ 901,782	\$35,362	\$ 937,144	\$ (4,059)	\$ (50,260)	\$ (54,319)

	December 31, 2015 (dollars in thousands)					
	Gross Unrealized Gain Included in Accumulated Other Comprehensive Income	Gross Unrealized Gain Included in Accumulated Deficit	Total Gross Unrealized Gain	Gross Unrealized Loss Included in Accumulated Other Comprehensive Income	Gross Unrealized Loss Included in Accumulated Deficit	Total Gross Unrealized Loss
Non-Agency RMBS						
Senior	\$ 736,040	\$—	\$ 736,040	\$ (8,779)	\$ —	\$ (8,779)
Senior, interest-only	—	18,113	18,113	—	(52,457)	(52,457)
Subordinated	81,588	2,309	83,896	(1,971)	(5,606)	(7,577)
Subordinated, interest-only	—	62	62	—	(4,035)	(4,035)
Agency MBS						
Residential	18,593	—	18,593	(52,001)	—	(52,001)
Commercial	8,052	—	8,052	(8,001)	—	(8,001)
Interest-only	—	2,756	2,756	—	(9,640)	(9,640)
Total	\$ 844,273	\$23,240	\$ 867,512	\$ (70,752)	\$ (71,738)	\$ (142,490)

Changes in prepayments, actual cash flows, and cash flows expected to be collected, among other items, are affected by the collateral characteristics of each asset class. The Company chooses assets for the portfolio after carefully evaluating each investment's risk profile.

The following tables provide a summary of the Company's RMBS portfolio at September 30, 2016 and December 31, 2015.

September 30, 2016

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

	Principal or Notional Value at Period-End (dollars in thousands)	Weighted Average Amortized Cost Basis	Weighted Average Fair Value	Weighted Average Coupon	Weighted Average Yield at Period-End (1)		
Non-Agency RMBS							
Senior	\$3,308,463	\$ 55.95	\$ 78.14	4.0	%	15.2	%
Senior, interest-only	5,733,457	5.29	5.08	2.0	%	11.1	%
Subordinated	668,946	69.83	81.74	3.4	%	10.2	%
Subordinated, interest-only	269,868	5.26	5.00	1.1	%	11.4	%
Agency MBS							
Residential pass-through	2,672,093	105.20	107.09	3.9	%	2.7	%
Commercial pass-through	1,273,235	102.61	105.56	3.6	%	2.9	%
Interest-only	3,474,731	4.71	4.52	0.9	%	3.7	%

(1) Bond Equivalent Yield at period end.

	December 31, 2015						
	Principal or Notional Value at Period-End (dollars in thousands)	Weighted Average Amortized Cost Basis	Weighted Average Fair Value	Weighted Average Coupon	Weighted Average Yield at Period-End (1)		
Non-Agency RMBS							
Senior	\$3,651,869	\$ 57.47	\$ 77.39	3.8 %	13.7 %		
Senior, interest-only	5,426,029	4.95	4.32	1.7 %	12.9 %		
Subordinated	762,466	69.25	79.26	3.2 %	8.8 %		
Subordinated, interest-only	284,931	5.34	3.95	1.2 %	10.9 %		
Agency MBS							
Residential pass-through	5,045,418	105.07	104.41	3.7 %	2.8 %		
Commercial pass-through	952,091	102.27	102.28	3.4 %	2.9 %		
Interest-only	6,722,472	4.17	4.06	0.8 %	3.4 %		

(1) Bond Equivalent Yield at period end.

The following table presents the weighted average credit rating, based on the lowest rating available, of the Company's Non-Agency RMBS portfolio at September 30, 2016 and December 31, 2015.

	September 30, 2016	December 31, 2015
AAA	0.4	%0.5
AA	0.3	%0.4
A	0.7	%0.8
BBB	0.3	%0.4
BB	3.1	%5.2
B	4.0	%3.0
Below B or not rated	91.2	%89.7
Total	100.0	%100.0

Actual maturities of MBS are generally shorter than the stated contractual maturities. Actual maturities of the Company's MBS are affected by the contractual lives of the underlying mortgages, periodic payments of principal and prepayments of principal. The following tables provide a summary of the fair value and amortized cost of the Company's MBS at September 30, 2016 and December 31, 2015 according to their estimated weighted-average life classifications. The weighted-average lives of the MBS in the tables below are based on lifetime expected prepayment rates using an industry prepayment model for the Agency MBS portfolio and the Company's prepayment assumptions for the Non-Agency RMBS. The prepayment model considers current yield, forward yield, steepness of the interest rate curve, current mortgage rates, mortgage rates of the outstanding loan, loan age, margin, and volatility.

September 30, 2016

(dollars in thousands)

Weighted Average Life

	Less than one year	Greater than one year and less than five years	Greater than five years and less than ten years	Greater than ten years	Total
Fair value					
Non-Agency RMBS					
Senior	\$22,267	\$477,875	\$1,393,164	\$692,080	\$2,585,386
Senior interest-only	606	42,519	136,316	112,085	291,526
Subordinated	1,473	76,840	215,695	252,817	546,825
Subordinated interest-only	—	—	13,498	—	13,498
Agency MBS					
Residential	—	2,451,083	410,385	—	2,861,468
Commercial	11,384	16,473	50,624	1,265,513	1,343,994
Interest-only	—	85,447	66,082	5,559	157,088
Total fair value	\$35,730	\$3,150,237	\$2,285,764	\$2,328,054	\$7,799,785
Amortized cost					
Non-Agency RMBS					
Senior	\$18,823	\$374,436	\$987,116	\$470,615	\$1,850,990
Senior interest-only	2,197	54,411	138,744	108,187	303,539
Subordinated	1,455	58,783	172,437	234,450	467,125
Subordinated interest-only	—	—	14,183	—	14,183
Agency MBS					
Residential	—	2,420,774	390,289	—	2,811,063
Commercial	11,198	16,567	50,270	1,228,483	1,306,518
Interest-only	—	86,304	71,898	5,340	163,542
Total amortized cost	\$33,673	\$3,011,275	\$1,824,937	\$2,047,075	\$6,916,960

December 31, 2015

(dollars in thousands)

Weighted Average Life

	Less than one year	Greater than one year and less than five years	Greater than five years and less than ten years	Greater than ten years	Total
Fair value					
Non-Agency RMBS					
Senior	\$—	\$374,462	\$1,629,564	\$822,095	\$2,826,121
Senior interest-only	1,458	41,862	123,538	67,313	234,171
Subordinated	2,229	108,728	212,003	281,335	604,295
Subordinated interest-only	—	—	11,254	—	11,254
Agency MBS					
Residential	—	150,357	5,117,491	—	5,267,848
Commercial	—	—	29,176	944,611	973,787

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

Interest-only	—	106,069	161,413	5,707	273,189
Total fair value	\$3,687	\$781,478	\$7,284,439	\$2,121,061	\$10,190,665
Amortized cost					
Non-Agency RMBS					
Senior	\$—	\$281,255	\$1,235,528	\$582,077	\$2,098,860
Senior interest-only	2,440	59,823	135,359	70,893	268,515
Subordinated	2,208	86,728	168,403	270,636	527,975
Subordinated interest-only	—	—	15,226	—	15,226
Agency MBS					
Residential	—	149,111	5,152,144	—	5,301,255
Commercial	—	—	29,156	944,580	973,736
Interest-only	—	106,708	167,646	5,719	280,073
Total amortized cost	\$4,648	\$683,625	\$6,903,462	\$1,873,905	\$9,465,640

The Non-Agency RMBS portfolio is subject to credit risk. The Company seeks to mitigate credit risk through its asset selection process. The Non-Agency RMBS portfolio is primarily collateralized by what the Company classifies as Alt-A first lien mortgages. An Alt-A mortgage is a type of U.S. mortgage that, for various reasons, is considered riskier than A-paper, or prime, and less risky than subprime, the riskiest category. Alt-A interest rates, which are determined by credit risk, therefore tend to be between those of prime and subprime home loans. Typically, Alt-A mortgages are characterized by borrowers with less than full documentation, lower credit scores and higher loan-to-value ratios. The Company defines Alt-A mortgage securities as Non-Agency RMBS where (i) the underlying collateral has weighted average FICO scores between 680 and 720 or (ii) the FICO scores are greater than 720 and RMBS have 30% or less of the underlying collateral composed of full documentation loans. At September 30, 2016 and December 31, 2015, 69% and 64% of the Non-Agency RMBS collateral was classified as Alt-A, respectively. At September 30, 2016 and December 31, 2015, 15% and 17% of the Non-Agency RMBS collateral was classified as prime, respectively. The remaining Non-Agency RMBS collateral is classified as subprime.

The Non-Agency RMBS in the Portfolio have the following collateral characteristics at September 30, 2016 and December 31, 2015.

	September 30, 2016		December 31, 2015			
Weighted average maturity (years)	21.3		22.0			
Weighted average amortized loan to value ⁽¹⁾	66.8	%	67.9	%		
Weighted average FICO ⁽²⁾	675		671			
Weighted average loan balance (in thousands)	\$ 327		\$ 330			
Weighted average percentage owner occupied	83.1	%	82.7	%		
Weighted average percentage single family residence	65.7	%	65.9	%		
Weighted average current credit enhancement	2.3	%	2.4	%		
Weighted average geographic concentration of top four states	CA	32.6	%	CA	30.4	%
	FL	8.0	%	FL	8.0	%
	NY	7.9	%	NY	8.0	%
	NJ	2.6	%	NJ	2.5	%

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

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

The table below presents the origination year of the underlying loans related to the Company's portfolio of Non-Agency RMBS at September 30, 2016 and December 31, 2015.

Origination Year	September 30, 2016	December 31, 2015	
1999	0.1	%0.1	%
2000	0.5	%0.6	%
2001	1.5	%1.6	%
2002	0.5	%0.5	%
2003	1.1	%2.2	%
2004	4.2	%3.7	%
2005	20.2	%21.7	%
2006	38.1	%32.9	%
2007	31.1	%34.2	%
2008	1.8	%1.9	%
2009	0.4	%—	%
2013	0.4	%0.5	%
2014	0.1	%0.1	%
Total	100.0	%100.0	%

Gross realized gains and losses are recorded in “Net realized gains (losses) on sales of investments” on the Company’s Consolidated Statements of Operations and Comprehensive Income. The proceeds and gross realized gains and gross realized losses from sales of investments for the quarters and nine months ended September 30, 2016 and 2015 are as follows:

23

	For the Quarter Ended		For the Nine Months Ended	
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
	(dollars in thousands)			
Proceeds from sales	\$58,036	\$ 196,192	\$2,697,239	\$3,433,527
Gross realized gains	3,622	4,612	16,798	46,007
Gross realized losses	(543)	(1,073)	(9,763)	(3,218)
Net realized gain (loss)	\$3,079	\$ 3,539	\$7,035	\$42,789

Included in the gross realized gains for the quarter and nine months ended September 30, 2016 in the table above are exchanges of securities with a fair value of \$30 million and \$47 million, where the Company exchanged its investment in a re-remic security for the underlying collateral supporting the group related to the exchanged asset. These exchanges were treated as non-cash sales and purchases and resulted in a realized gain of \$2 million and \$1 million reflected in earnings for the quarter and nine months ended September 30, 2016. For the quarter and nine months ended September 30, 2015, the fair value of these exchanges of securities was \$11 million and \$26 million, respectively and resulted in a realized gain of \$3 million and \$7 million, respectively.

4. Securitized Loans Held for Investment

The Securitized loans held for investment is comprised of two portfolios. The first portfolio is comprised of loans collateralized by non-conforming, single family, owner occupied, jumbo, prime residential mortgages. The second portfolio is comprised primarily of loans collateralized by seasoned subprime residential mortgages.

At September 30, 2016, all securitized loans held for investment are carried at fair value. See Note 5 for a discussion on how the Company determines the fair values of the securitized loans held for investment. As changes in the fair value of these securitized loans are reflected in earnings, the Company does not estimate or record a loan loss provision.

The following table provides a summary of the changes in the carrying value of securitized loans held for investment at fair value at September 30, 2016 and December 31, 2015:

	For the Nine Months Ended		For the Year Ended	
	September 30, 2016	December 31, 2015	September 30, 2016	December 31, 2015
	(dollars in thousands)			
Balance, beginning of period	\$4,768,416	\$5,306,501		
Purchases	4,745,083	577,036		
Principal paydowns	(696,281)	(707,996)		
Sales and settlements	6,001	(9,638)		
Net periodic accretion (amortization)	(27,828)	(19,100)		
Change in fair value	113,646	(90,581)		
Transfer due to deconsolidation	—	(287,806)		
Balance, end of period	\$8,909,037	\$4,768,416		

The primary cause of the change in fair value is due to changes in credit risk of the portfolio.

Jumbo prime residential mortgage loans

The securitized loan portfolio collateralized by jumbo prime residential mortgages was originated during the following years:

24

Origination Year	September 30, 2016	December 31, 2015	
2004	0.2	%0.1	%
2007	8.1	%8.5	%
2008	8.2	%7.4	%
2009	0.3	%0.3	%
2010	5.0	%5.1	%
2011	31.7	%33.1	%
2012	46.5	%45.5	%
Total	100.0	%100.0	%

A summary of key characteristics of the loan portfolio collateralized primarily of non-conforming, single family, owner occupied, jumbo, prime mortgages follows:

	September 30, 2016	December 31, 2015		
Number of loans	545	657		
Weighted average maturity (years)	24.8	25.5		
Weighted average loan to value ⁽¹⁾	70.4 %	70.7 %		
Weighted average FICO ⁽²⁾	764	765		
Weighted average loan balance (in thousands)	\$ 670	\$ 682		
Weighted average percentage owner occupied	95.5 %	94.3 %		
Weighted average percentage single family residence	71.0 %	70.1 %		
Weighted average geographic concentration of top five states	CA 31.4 %	CA 32.4 %		
	NJ 7.1 %	VA 6.4 %		
	MD 6.8 %	NJ 6.3 %		
	VA 6.7 %	MD 6.2 %		
	NY 4.8 %	TX 5.1 %		

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

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

The following table summarizes the outstanding principal balance of the jumbo prime loans which are 30 days delinquent and greater as reported by the servicer at September 30, 2016 and December 31, 2015.

	30 Days Delinquent	60 Days Delinquent	90+ Days Delinquent	Bankruptcy	Foreclosure	REO	Total
	(dollars in thousands)						
September 30, 2016	\$532	\$ 529	\$ 2,846	\$ —	\$ 2,318	\$—	\$6,225
December 31, 2015	\$3,079	\$ —	\$ 2,915	\$ —	\$ 2,875	\$2,312	\$11,181

The fair value of the jumbo prime residential mortgage loans 90 days or more past due is \$3 million as of September 30, 2016.

Seasoned subprime residential mortgage loans

The securitized loan portfolio collateralized by seasoned subprime residential mortgages originated during the following years:

Origination Year	September 30, 2016	December 31, 2015	
2002 and prior	9.5	% 11.2	%
2003	5.6	% 4.0	%
2004	12.5	% 11.1	%
2005	20.3	% 19.3	%
2006	22.9	% 17.4	%
2007	21.7	% 25.4	%
2008	6.4	% 9.5	%
2009	0.6	% 1.1	%
2010 and later	0.5	% 1.0	%
Total	100.0	% 100.0	%

A summary of key characteristics of the loan portfolio collateralized by seasoned subprime residential mortgages follows:

	September 30, 2016	December 31, 2015		
Number of loans	96,779	56,870		
Weighted average maturity (years)	19.6	21.5		
Weighted average loan to value ⁽¹⁾	87.7 %	80.7 %		
Weighted average FICO ⁽¹⁾	620	625		
Weighted average loan balance (in thousands)	\$ 90	\$ 76		
Weighted average percentage owner occupied	97.0 %	96.0 %		
Weighted average percentage single family residence	84.7 %	72.5 %		
Weighted average geographic concentration of top five states	CA 8.5 %	CA 8.8 %		
	OH 6.8 %	FL 7.2 %		
	FL 6.6 %	NC 7.1 %		
	VA 5.9 %	VA 6.3 %		
	NC 5.4 %	OH 6.1 %		

(1) As provided by the Trustee

The following table summarizes the outstanding principal balance of the loan portfolio consisting of seasoned subprime residential mortgage loans which are 30 days delinquent and greater as reported by the servicer at September 30, 2016 and December 31, 2015.

	30 Days Delinquent	60 Days Delinquent	90+ Days Delinquent	Bankruptcy	Foreclosure	REO	Total
	(dollars in thousands)						
September 30, 2016	\$ 329,973	\$ 98,414	\$ 127,327	\$ 209,785	\$ 201,247	\$ 38,611	\$ 1,005,357
December 31, 2015	\$ 189,816	\$ 66,429	\$ 125,897	\$ 117,308	\$ 218,493	\$ 36,124	\$ 754,067

The fair value of seasoned subprime residential mortgage loans 90 days or more past due is \$400 million as of September 30, 2016.

5. Fair Value Measurements

The Company applies fair value guidance in accordance with GAAP to account for its financial instruments. The Company categorizes its financial instruments, based on the priority of the inputs to the valuation technique, into a three-level fair value hierarchy. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). If the inputs used to

measure the financial instruments fall within different levels of the hierarchy, the categorization is based on the lowest level input that is significant to the fair value measurement of the instrument. Financial assets and liabilities recorded at fair value on the Consolidated Statements of Financial Condition or disclosed in the related notes are categorized based on the inputs to the valuation techniques as follows:

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

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

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

Fair value measurements categorized within Level 3 are sensitive to changes in the assumptions or methodology used to determine fair value and such changes could result in a significant increase or decrease in the fair value. Any changes to the valuation methodology are reviewed by management to ensure the changes are appropriate. As markets and products evolve and the pricing for certain products becomes more transparent, the Company will continue to refine its valuation methodologies. The methodology utilized by the Company for the periods presented is unchanged. The methods used to produce a fair value calculation may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Company believes its valuation methods are appropriate and consistent with other market participants. Using different methodologies, or assumptions, to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date. The Company uses inputs that are current as of the measurement date, which may include periods of market dislocation, during which price transparency may be reduced.

During times of market dislocation, the observability of prices and inputs can be difficult for certain investments. If third party pricing services are unable to provide a price for an asset, or if the price provided by them is deemed unreliable by the Company, then the asset will be valued at its fair value as determined by the Company without validation to third-party pricing. Illiquid investments typically experience greater price volatility as an active market does not exist. Observability of prices and inputs can vary significantly from period to period and may cause instruments to change classifications within the three level hierarchy.

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

Agency MBS and Non-Agency RMBS

The Company determines the fair value of all of its investment securities based on discounted cash flows utilizing an internal pricing model that incorporates factors such as coupon, prepayment speeds, loan size, collateral composition, borrower characteristics, expected interest rates, life caps, periodic caps, reset dates, collateral seasoning, delinquency, expected losses, expected default severity, credit enhancement, and other pertinent factors. To corroborate that the estimates of fair values generated by these internal models are reflective of current market prices, the Company compares the fair values generated by the model to non-binding independent prices provided by two independent third party pricing services. For certain highly liquid asset classes, such as Agency fixed-rate pass-through bonds, the Company's valuations are also compared to quoted prices for To-Be-Announced ("TBA") securities.

Each quarter the Company develops thresholds which are determined utilizing current bid/ask spreads, liquidity, price volatility and other factors as appropriate. If internally developed model prices differ from the independent prices provided by greater than a market derived predetermined threshold for the period, the Company highlights these differences for further review, both internally and with the third party pricing service. The Company obtains the inputs used by the third party pricing services and compares them to the Company's inputs. The Company updates its own inputs if the Company determines the third party pricing inputs more accurately reflect the current market environment. If the Company believes that its internally developed inputs more accurately reflect the current market environment, it will request that the third party pricing service review market factors that may not have been considered by the third party pricing service and provide updated prices. The Company reconciles and resolves all pricing differences in excess of the predetermined thresholds before a final price is established. At September 30,

2016, fourteen investment holdings with an internally developed fair value of \$172 million had a difference between the model generated prices and third party prices provided in excess of the derived predetermined threshold for the period. The internally developed prices were \$16 million lower than the third party prices provided of \$187 million. After review and discussion, the Company affirmed and valued the investments at the lower internally developed prices. No other differences were noted at September 30, 2016 in excess of the derived predetermined threshold for the period. At December 31, 2015, two investment holdings with an internally developed fair value of \$10 million had a difference between the model generated prices and third party prices provided in excess of the derived predetermined threshold for the period. The internally developed prices were \$1 million lower than the third party prices provided of \$11 million.

The Company's estimate of prepayment, default and severity curves all involve judgment and assumptions that are deemed to be significant to the fair value measurement process, which renders the resulting Non-Agency RMBS fair value estimates Level

3 inputs in the fair value hierarchy. As the fair values of Agency MBS are more observable, these investments are classified as level 2 in the fair value hierarchy.

Securitized Loans Held for Investment

Securitized loans consisting of seasoned subprime residential mortgage loans:

The Company estimates the fair value of its securitized loans held for investment consisting of seasoned subprime residential mortgage loans on a loan by loan basis using an internally developed model which compares the loan held by the Company with a loan currently offered in the market. The loan price is adjusted in the model by considering the loan factors which would impact the value of a loan. These loan factors include: loan coupon as compared to coupon currently available in the market, FICO, loan-to-value ratios, delinquency history, owner occupancy, and property type, among other factors. A baseline is developed for each significant loan factor and adjusts the price up or down depending on how that factor for each specific loan compares to the baseline rate. Generally, the most significant impact on loan value is the loan interest rate as compared to interest rates currently available in the market and delinquency history. These two factors are based on relevant observable inputs.

The Company also monitors market activity to identify trades which may be used to compare internally developed prices; however, as the portfolio of loans held at fair value is a seasoned subprime pool of mortgage loans, comparable loan pools are not common or directly comparable. There are limited transactions in the market place to develop a comprehensive direct range of values. However, if market data becomes available, the Company will compare this data to the internally developed prices to ensure reasonableness of the valuation.

The Company reviews the fair values generated by the model to determine whether prices are reflective of the current market by corroborating its estimates of fair value by comparing the results to non-binding independent prices provided by two independent third party pricing services for the loan portfolio. Each quarter the Company develops thresholds which are determined utilizing a senior securitization market for a similar pool of loans.

If the internally developed fair values of the loan pools differ from the independent prices provided by greater than a predetermined threshold for the period, the Company highlights these differences for further review, both internally and with the third party pricing service. The Company obtains certain inputs used by the third party pricing services and evaluates them for reasonableness. The Company updates its own model if the Company determines the third party pricing inputs more accurately reflect the current market environment or observed information from the third party vendors. If the Company believes that its internally developed inputs more accurately reflect the current market environment, it will request that the third party pricing service review market factors that may not have been considered by the third party pricing service. The Company reconciles and resolves all pricing differences in excess of the predetermined thresholds before a final price is established.

The Company's estimates of fair value of securitized loans held for investment involve management judgment and assumptions that are deemed to be significant to the fair value measurement process, which renders the resulting fair value estimates level 3 inputs in the fair value hierarchy.

Securitized loans collateralized by jumbo, prime residential mortgages:

The securitized loans collateralized by jumbo, prime residential mortgages are carried at fair value. The securitized loans are held as part of a consolidated Collateralized Financing Entity ("CFE"). A CFE is a variable interest entity that holds financial assets, issues beneficial interests in those assets and has no more than nominal equity and the beneficial interests have contractual recourse only to the related assets of the CFE. Accounting guidance for CFEs allow the Company to elect to measure the CFE's financial assets using the fair value of the CFE's financial liabilities as the fair values of the financial liabilities of the CFE are more observable. Therefore, the fair value of the securitized loans collateralized by jumbo, prime residential mortgages is based on the fair value of the securitized debt. See

discussion of the fair value of Securitized Debt, collateralized by Loans Held for Investment at fair value below.

As the more observable Securitized debt, collateralized by loans held for investment are considered level 3 in the fair value hierarchy, the Securitized loans collateralized by jumbo, prime residential mortgages are also level 3 in the fair value hierarchy.

Securitized Debt, collateralized by Non-Agency RMBS

The Company carries securitized debt, collateralized by Non-Agency RMBS at the principal balance outstanding plus unamortized premiums, less unaccreted discounts recorded in connection with the financing of the loans or RMBS with third parties. The Company estimates the fair value of securitized debt, collateralized by Non-Agency RMBS by estimating the

future cash flows associated with the underlying assets collateralizing the secured debt outstanding. The Company models the fair value of each underlying asset by considering, among other items, the structure of the underlying security, coupon, servicer, delinquency, actual and expected defaults, actual and expected default severities, reset indices, and prepayment speeds in conjunction with market research for similar collateral performance and management's expectations of general economic conditions in the sector and other economic factors. This process, including the review process, is consistent with the process used for Agency MBS and Non-Agency RMBS using internal models. For further discussion of the valuation process and benchmarking process, see Agency MBS and Non-Agency RMBS discussion herein.

The Company's estimates of fair value of securitized debt, collateralized by Non-Agency RMBS involve management's judgment and assumptions that are deemed to be significant to the fair value measurement process, which renders the resulting fair value estimates level 3 inputs in the fair value hierarchy.

Securitized Debt, collateralized by Loans Held for Investment

The Company determines the fair value of securitized debt, collateralized by loans held for investment based on discounted cash flows utilizing an internal pricing model that incorporates factors such as coupon, prepayment speeds, loan size, collateral composition, borrower characteristics, expected interest rates, life caps, periodic caps, reset dates, collateral seasoning, expected losses, expected default severity, credit enhancement, and other pertinent factors. This process, including the review process, is consistent with the process used for Agency MBS and Non-Agency RMBS using internal models. For further discussion of the valuation process and benchmarking process, see Agency MBS and Non-Agency RMBS discussion herein.

The Company's estimates of fair value of securitized debt, collateralized by loans held for investment involve management's judgment and assumptions that are deemed to be significant to the fair value measurement process, which renders the resulting fair value estimates level 3 inputs in the fair value hierarchy.

Derivatives

Interest Rate Swaps and Swaptions

The Company uses clearing exchange market prices to determine the fair value of its exchange cleared interest rate swaps. For bi-lateral swaps, the Company determines the fair value based on the net present value of expected future cash flows on the swap. The Company uses option pricing model to determine the fair value of its swaptions. For bi-lateral swaps and swaptions, the Company compares its own estimate of fair value with counterparty prices to evaluate for reasonableness. Both the clearing exchange and counter-party pricing quotes, incorporate common market pricing methods, including a spread measurement to the Treasury yield curve or interest rate swap curve as well as underlying characteristics of the particular contract. Interest rate swaps and swaptions are modeled by the Company by incorporating such factors as the term to maturity, swap curve, overnight index swap rates, and the payment rates on the fixed portion of the interest rate swaps. The Company has classified the characteristics used to determine the fair value of interest rate swaps as Level 2 inputs in the fair value hierarchy.

Treasury Futures

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

Mortgage Options

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

Repurchase Agreements

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

Short-term Financial Instruments

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

The Company's financial assets and liabilities carried at fair value on a recurring basis, including the level in the fair value hierarchy, at September 30, 2016 and December 31, 2015 is presented below.

	September 30, 2016 (dollars in thousands)			Counterparty and Cash Collateral, netting	Total
	Level 1	Level 2	Level 3		
Assets:					
Non-Agency RMBS, at fair value	\$—	—	\$3,437,235	\$ —	\$3,437,235
Agency RMBS, at fair value	—	4,362,550	—	—	4,362,550
Securitized loans held for investment, at fair value	—	—	8,909,037	—	8,909,037
Derivatives	—	2,255	—	(102)	2,153
Liabilities:					
Securitized debt at fair value, collateralized by loans held for investment	—	—	(7,191,462)	—	(7,191,462)
Derivatives	(2,852,561)	—	—	87,404	(8,009)
Total	(2,852,561)	2,245,154,810	—	87,302	\$9,511,504
December 31, 2015 (dollars in thousands)					
	Level 1	Level 2	Level 3	Counterparty and Cash Collateral, netting	Total
Assets:					
Non-Agency RMBS, at fair value	\$—	\$—	3,675,841	\$ —	\$3,675,841
Agency RMBS, at fair value	—	6,514,824	—	—	6,514,824
Securitized loans held for investment, at fair value	—	—	4,768,416	—	4,768,416
Derivatives	1,599	18,987	—	(5,126)	15,460
Liabilities:					
Securitized debt at fair value, collateralized by loans held for investment	—	—	(3,720,496)	—	(3,720,496)
Derivatives	(192)	(57,042)	—	47,600	(9,634)
Total	\$1,407	\$6,476,769	\$4,723,761	\$ 42,474	\$11,244,411

The table below provides a summary of the changes in the fair value of securities classified as Level 3 at September 30, 2016 and December 31, 2015.

Fair Value Reconciliation, Level 3

	For the Nine Months Ended, September 30, 2016 (dollars in thousands)				
	Non-Agency RMBS	Derivatives	Securitized Loans	Securitized Debt	Total
Beginning balance Level 3 assets	\$3,675,841	\$	-\$4,768,416	\$(3,720,496)	\$4,723,761
Transfers in to Level 3 assets	—	—	—	—	—
Transfers out of Level 3 assets	—	—	—	—	—
Purchases	222,756	—	4,745,083	(4,180,227)	787,612
Principal payments	(402,973)	)—	(696,281)	727,946	(371,308)
Sales and Settlements	(142,637)	)—	6,001	45,929	(90,707)
Accretion (amortization) of purchase discounts	88,886	—	(27,828)	4,180	65,238
Gains (losses) included in net income					
Other than temporary credit impairment losses	(43,207)	)—	—	—	(43,207)
Realized gains (losses) on sales and settlements	2,452	—	—	(1,766)	686
Net unrealized gains (losses) included in income	33,170	—	113,646	(67,028)	79,788
Gains (losses) included in other comprehensive income					
Total unrealized gains (losses) for the period	2,947	—	—	—	2,947
Ending balance Level 3 assets	\$3,437,235	\$	-\$8,909,037	\$(7,191,462)	\$5,154,810

Fair Value Reconciliation, Level 3

	For the Year Ended, December 31, 2015 (dollars in thousands)				
	Non-Agency RMBS	Derivatives	Securitized Loans ⁽¹⁾	Securitized Debt	Total
Beginning balance Level 3 assets	\$3,404,149	\$ (71)	\$5,306,501	\$(4,383,217)	\$4,327,362
Transfers in to Level 3 assets	—	—	—	—	—
Transfers out of Level 3 assets	—	—	—	—	—
Transfer due to consolidation/deconsolidation	(59,646)	)—	(287,806)	243,732	(103,720)
Purchases	1,045,534	—	577,036	(1,668,654)	(46,084)
Principal payments	(385,822)	)—	(707,996)	743,329	(350,489)
Sales and Settlements	(252,532)	)597)	(9,638)	1,395,292	1,132,526
Accretion (amortization) of purchase discounts	117,836	—	(19,100)	(6,344)	92,392
Gains (losses) included in net income					
Other than temporary credit impairment losses	(67,444)	)—	—	—	(67,444)
Realized gains (losses) on sales and settlements	28,724	443	—	(5,930)	23,236
Net unrealized gains (losses) included in income	(18,874)	)225	(90,581)	(38,704)	(147,934)
Gains (losses) included in other comprehensive income					
Total unrealized gains (losses) for the period	(136,084)	)—	—	—	(136,084)
Ending balance Level 3 assets	\$3,675,841	\$ —	\$4,768,416	\$(3,720,496)	\$4,723,761

(1) includes securitized loans held for investment of \$607 million for which the fair value option election was made beginning January 1, 2015.

There were no transfers to or from Level 3 for the nine months ended September 30, 2016 and the year ended December 31, 2015. The primary cause of the changes in fair value of the securitized loans and the securitized debt are due to changes in credit risk of the portfolio.

Sensitivity of Significant Inputs – Non-Agency RMBS and securitized debt, collateralized by loans held for investment

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

31

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

For securitized debt carried at fair value issued at a premium, as prepayment speeds increase, the amount of interest expense the Company recognizes decreases as the issued premium on the debt amortizes faster than expected. Conversely, decreases in prepayment speeds result in increased expense and can extend the period over which the Company amortizes the premium.

For debt issued at a discount, as prepayment speeds increase, the amount of interest the Company expenses increases from the acceleration of the accretion of the discount into interest expense. Conversely, decreases in prepayment speeds result in decreased expense as the accretion of the discount into interest expense occurs over a longer period.

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

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

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

A summary of the significant inputs used to estimate the fair value of Non-Agency RMBS held for investment at fair value as of September 30, 2016 and December 31, 2015 follows:

September 30, 2016 Significant Inputs				December 31, 2015 Significant Inputs			
Weighted Average Discount Rate	CPR Range	CDR	Loss Severity	Weighted Average Discount Rate	CPR Range	CDR	Loss Severity

Non-Agency
RMBS

Senior	5.3%	1%	0%	35%	-95%	5.5%	1%	0%	35%
		-35%	-20%				17%	22%	95%
Senior interest-only	11.9%	3%	0%	35%	-95%	13.1%	3%	0%	1%
		-35%	-23%				25%	23%	95%
Subordinated	6.2%	1%	0%	0%	-84%	6.6%	1%	0%	5%
		-22%	-20%				22%	20%	91%
Subordinated interest-only	12.3%	6%	0%	35%	-72%	17.4%	6%	0%	1%
		-15%	-11%				13%	10%	64%

A summary of the significant inputs used to estimate the fair value of securitized debt at fair value as of September 30, 2016 and December 31, 2015 follows:

	September 30, 2016 Significant Inputs			December 31, 2015 Significant Inputs		
	CPR Range	CDR Range	Loss Severity Range	CPR Range	CDR Range	Loss Severity Range
Securitized debt at fair value, collateralized by loans held for investment	4% - 30%	0% - 3%	35% - 60%	4% - 32%	0% - 6%	35% - 65%

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

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

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

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

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

Sensitivity of Significant Inputs – Securitized loans held for investment

The significant unobservable inputs used to estimate the fair value of the securitized loans held for investment collateralized by seasoned subprime residential mortgage loans, as of September 30, 2016 and December 31, 2015 include coupon, FICO score at origination, loan-to-value ratios (LTV), owner occupancy status, and property type. A summary of the significant inputs used to estimate the fair value of Securitized loans held for investment at fair value as of September 30, 2016 and December 31, 2015 follows:

	September 30, 2016	December 31, 2015
Factor:		
Coupon		
Base Rate	5.4%	4.8%
Actual	7.3%	6.8%
FICO		
Base Rate	631	620
Actual	620	625
Loan-to-value (LTV)		
Base Rate	87%	90%
Actual	88%	81%
Loan Characteristics:		
Occupancy		
Owner Occupied	97%	96%
Investor	2%	4%
Secondary	1%	—%
Property Type		
Single family	85%	77%
Manufactured housing	7%	11%
Multi-family/mixed use/other	8%	12%

The loan factors are generally not observable for the individual loans and the base rates developed by the Company's internal model are subjective and change as market conditions change. The impact of the loan coupon on the value of the loan is dependent on whether the loan is clean or reperforming. A clean loan, with no history of delinquent payments and a relatively high loan interest rate would result in a higher overall value than a reperforming loan which has a history of delinquency. Similarly, a higher FICO score and a lower LTV ratio results in increases in the fair market value of the loan and a lower FICO score and a higher LTV ratio results in a lower value.

Property types also affect the overall loan values. Property types include single family, manufactured housing and multi-family/mixed use and other types of properties. Single family homes represent properties which house only one family unit. Manufactured homes include mobile homes and modular homes. Loan value for properties that are investor or secondary homes have a reduced value as compared to the baseline loan value. Additionally, single family homes will result in an increase to the loan value where manufactured and multi-family/mixed use and other properties will result in a decrease to the loan value, as compared to the baseline.

The following table presents the carrying value and fair value, as described above, of the Company's financial instruments not carried at fair value on a recurring basis at September 30, 2016 and December 31, 2015.

	September 30, 2016 (dollars in thousands)	
	Level in Fair Value Hierarchy	Carrying Amount Fair Value
Repurchase agreements	2	5,817,519 5,831,019
Securitized debt, collateralized by Non-Agency RMBS	3	380,715 373,090

	December 31, 2015 (dollars in thousands)		
	Level in Fair Value Hierarchy	Carrying Amount	Fair Value
Repurchase agreements	2	7,439,339	7,466,409
Securitized debt, collateralized by Non-Agency RMBS	3	529,415	518,941

6. Repurchase Agreements

The interest rates of the Company's repurchase agreements are generally indexed to the one-month, three-month and twelve-month LIBOR rates and re-price accordingly. The repurchase agreements outstanding, weighted average borrowing rates, weighted average remaining maturities, average daily balances and the fair value of collateral pledged as of September 30, 2016 and December 31, 2015 is:

	September 30, 2016	December 31, 2015	
Repurchase agreements outstanding secured by:			
Agency MBS (in thousands)	\$3,378,579	\$5,324,729	
Non-agency MBS (in thousands)	2,438,940	2,114,610	
Total:	\$5,817,519	\$7,439,339	
Average daily balance of Repurchase agreements secured by:			
Agency MBS (in thousands)	\$4,479,616	\$5,776,980	
Non-agency MBS (in thousands)	2,263,806	1,627,909	
Total:	\$6,743,422	\$7,404,889	
Weighted average borrowing rate of Repurchase agreements secured by:			
Agency MBS	0.81	% 0.64	%
Non-agency MBS	2.76	% 2.44	%
Weighted average maturity of Repurchase agreements secured by:			
Agency MBS	49 Days	53 Days	
Non-agency MBS	104 Days	137 Days	
MBS pledged as collateral at fair value on Repurchase agreements:			
Agency MBS (in thousands)	\$3,612,975	\$5,655,410	
Non-agency MBS (in thousands)	3,682,220	3,117,875	
Total:	\$7,295,195	\$8,773,285	

At September 30, 2016 and December 31, 2015, the repurchase agreements collateralized by RMBS had the following remaining maturities.

	September 30, 2016	December 31, 2015
	(dollars in thousands)	
Overnight	\$—	\$—
1 to 29 days	2,856,171	3,312,902
30 to 59 days	432,336	2,501,513
60 to 89 days	920,977	246,970
90 to 119 days	842,876	430,026

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

Greater than or equal to 120 days	765,159	947,928
Total	\$5,817,519	\$7,439,339

35

At September 30, 2016 and December 31, 2015, the Company had an amount at risk with Credit Suisse First Boston of 16% and 10% of its equity related to the collateral posted on repurchase agreements. As of September 30, 2016 the weighted average maturity of the repurchase agreements with Credit Suisse First Boston was 15 days and the amount at risk was \$477 million. As of December 31, 2015 the weighted average maturity of the repurchase agreements with Credit Suisse First Boston was 25 days and the amount at risk was \$303 million. There were no other amounts at risk with any other counterparties greater than 10% of the Company's equity as of September 30, 2016 and December 31, 2015.

7. Securitized Debt

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

Securitized Debt Collateralized by Non-Agency RMBS

At September 30, 2016 and December 31, 2015 the Company's securitized debt collateralized by Non-Agency RMBS is carried at amortized cost and had a principal balance of \$398 million and \$545 million, respectively. At September 30, 2016 and December 31, 2015, the debt carried a weighted average cost of financing equal to 4.93% and 4.49%, respectively. The debt matures between the years 2035 and 2047. None of the Company's securitized debt collateralized by Non-Agency RMBS is callable.

During the quarter ended September 30, 2016, the Company acquired securitized debt collateralized by Non-Agency RMBS with an amortized cost balance of \$4 million for \$4 million. This transaction resulted in a net loss on the extinguishment of debt of \$45 thousand. This loss is reflected in earnings for the quarter and nine months ended September 30, 2016.

The following table presents the estimated principal repayment schedule of the securitized debt collateralized by Non-Agency RMBS at September 30, 2016 and December 31, 2015, based on expected cash flows of the residential mortgage loans or RMBS, as adjusted for projected losses on the underlying collateral of the debt. All of the securitized debt recorded in the Company's Consolidated Statements of Financial Condition is non-recourse to the Company.

	September 30, 2016	December 31, 2015
	(dollars in thousands)	
Within One Year	\$ 118,371	\$ 137,642
One to Three Years	98,894	178,191
Three to Five Years	30,361	60,872
Greater Than Five Years	32,158	52,280
Total	\$ 279,784	\$ 428,985

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

Securitized Debt Collateralized by Loans Held for Investment

At September 30, 2016 and December 31, 2015 the Company's securitized debt collateralized by loans held for investment had a principal balance of \$7.3 billion and \$3.8 billion, respectively. During the quarter and nine months ended September 30, 2016, the company recognized a loss of \$47 million and \$67 million, respectively, on the securitized debt carried at fair value in Net unrealized gains (losses) on financial instruments at fair value. During the quarter and nine months ended September 30, 2015, the company recognized a gain of \$3 million and a loss of \$27 million on the securitized debt carried at fair value in Net unrealized gains (losses) on financial instruments at fair value.

At September 30, 2016 and December 31, 2015 the total securitized debt collateralized by loans held for investment carried a weighted average cost of financing equal to 4.08% and 3.24% respectively. The debt matures between the years 2023 and 2065.

During the first quarter of 2016, the Company acquired securitized debt collateralized by loans with an amortized cost balance of \$44 million for \$46 million. This transaction resulted in a net loss on the extinguishment of debt of \$2 million. This loss is reflected in earnings for the nine months ended September 30, 2016.

The following table presents the estimated principal repayment schedule of the securitized debt collateralized by loans held for investment at September 30, 2016 and December 31, 2015, based on expected cash flows of the residential mortgage loans or RMBS, as adjusted for projected losses on the underlying collateral of the debt. All of the securitized debt recorded in the Company's Consolidated Statements of Financial Condition is non-recourse to the Company.

	September 30, 2016	December 31, 2015
	(dollars in thousands)	
Within One Year	\$1,174,427	\$591,171
One to Three Years	1,917,720	941,704
Three to Five Years	1,497,626	734,291
Greater Than Five Years	2,646,354	1,502,663
Total	\$7,236,127	\$3,769,829

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

Certain of the securitized debt collateralized by loans held for investment contain call provisions and are callable at par, at the option of the Company. The following table presents the par value of the callable debt by year at September 30, 2016.

September 30, 2016
(dollars in thousands)
Year Principal
2016 1,627,066
2017 181,117
2018 1,252,873
2019 —
2020 3,995,109
Total \$7,056,165

8. Consolidated Securitization Vehicles and Other Variable Interest Entities

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

As of September 30, 2016, the Company's Consolidated Statement of Financial Condition includes assets of consolidated VIEs with a carrying value of \$11.0 billion and liabilities with a carrying value of \$7.6 billion. As of December 31, 2015, the Company's Consolidated Statement of Financial Condition includes assets of consolidated VIEs with a carrying value of \$7.0 billion and liabilities with a carrying value of \$4.3 billion.

During the second quarter of 2016, the Company acquired approximately \$5.0 billion unpaid principal balance of seasoned residential subprime mortgage loans. We sold these loans to multiple real estate mortgage investment conduit trusts (the "Trusts"). The Company purchased certain subordinate notes and trust certificates of the Trusts. The Company evaluated the Trusts and determined that the total equity investment at risk is not sufficient to permit these trusts to finance its activities without additional subordinated financial support provided by another party. Therefore, the Company concluded that the Trusts were VIEs. The Company further determined that their interests in the Trusts gave the Company the power to direct the activity of these VIEs that most significantly impacted the Company's economic performance of the VIEs. As the Company concluded that it was the primary beneficiary of the Trusts, the Company consolidated the assets and liabilities of the Trusts. All intercompany balances and transactions are eliminated in consolidation.

The consolidation of these Trusts resulted in the addition of the following amounts, net of eliminations, at the time of acquisition.

	Consolidated Trusts (dollars in thousands)
Assets :	
Securitized loans held for investment, at fair value	\$ 4,789,782
Other Assets	39,318
Liabilities :	
Securitized debt at fair value ⁽¹⁾	\$ 4,097,712
(1) After the elimination of intercompany balances.	

As sponsor of the Trusts, the Company has retained an eligible horizontal retained interest consisting of the Class B and Class C notes in the Trusts in order to satisfy the U.S. risk retention rules (the “Required Credit Risk”). The U.S. risk retention rules impose limitations on the ability of the Company to dispose of or hedge the Required Credit Risk until the later of (i) the fifth anniversary of the closing date of the securitization transactions (the “Closing Date”) and (ii) the date on which the aggregate unpaid principal balance of the mortgage loans has been reduced to 25% of the aggregate unpaid principal balance of the mortgage loans as of the Closing Date, but in any event no longer than the seventh anniversary of the Closing Date. These investments have been eliminated in consolidation of the Trusts as of September 30, 2016.

VIEs for Which the Company is the Primary Beneficiary

The retained beneficial interests in VIEs for which the Company is the primary beneficiary are typically the subordinated tranches of these re-securitizations and in some cases the Company may hold interests in additional tranches. The table below reflects the assets and liabilities recorded in the Consolidated Statements of Financial Condition related to the consolidated VIEs as of September 30, 2016 and December 31, 2015.

	September 30, 2016	December 31, 2015
	(dollars in thousands)	
Assets:		
Non-Agency RMBS, at fair value	\$ 1,907,696	\$ 2,140,494
Securitized loans held for investment, at fair value	8,909,037	4,768,416
Accrued interest receivable	61,081	35,916
Other Assets	118,504	86,452
Liabilities:		
Securitized debt, collateralized by Non-Agency RMBS	\$ 380,715	\$ 529,415
Securitized debt at fair value, collateralized by loans held for investment	7,191,462	3,720,496
Accrued interest payable	27,262	12,106

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

	For the Quarter Ended	
	September 30,	September 30,
	2016	2015
	(dollars in thousands)	
Interest income, Assets of consolidated VIEs	\$195,488	\$ 142,053
Interest expense, Non-recourse liabilities of VIEs	70,715	50,837
Net interest income	\$124,773	\$ 91,216
Total other-than-temporary impairment losses	\$(21)	\$(301)
Portion of loss recognized in other comprehensive income (loss)	(4,599)	(15,838)
Net other-than-temporary credit impairment losses	\$(4,620)	\$(16,139)
	For the Nine Months	
	Ended	
	September 30,	September 30,
	2016	2015
	(dollars in thousands)	
Interest income, Assets of consolidated VIEs	\$488,353	\$ 439,571
Interest expense, Non-recourse liabilities of VIEs	168,738	148,017
Net interest income	\$319,615	\$ 291,554
Total other-than-temporary impairment losses	\$(866)	\$(1,738)
Portion of loss recognized in other comprehensive income (loss)	(31,925)	(43,217)
Net other-than-temporary credit impairment losses	\$(32,791)	\$(44,955)

VIEs for Which the Company is Not the Primary Beneficiary

The Company is not required to consolidate VIEs in which it has concluded it does not have a controlling financial interest, and thus is not the primary beneficiary. In such cases, the Company does not have both the power to direct the entities' most significant activities and the obligation to absorb losses or right to receive benefits that could potentially be significant to the VIEs. The Company's investments in these unconsolidated VIEs are carried in Non-Agency RMBS on the Consolidated Statements of Financial Condition and include senior and subordinated bonds issued by the VIEs. The fair value of the Company's investments in each unconsolidated VIEs at September 30, 2016, ranged from less than \$1 million to \$50 million, with an aggregate amount of \$1.5 billion. The fair value of the Company's investments in each unconsolidated VIEs at December 31, 2015, ranged from less than \$1 million to \$54 million, with an aggregate amount of \$1.5 billion. The Company's maximum exposure to loss from these unconsolidated VIEs was \$1.4 billion and \$1.5 billion at September 30, 2016 and December 31, 2015, respectively. The maximum exposure to loss was determined as the amortized cost of the unconsolidated VIE, which represents the purchase price of the investment adjusted by any unamortized premiums or discounts as of the reporting date.

9. Derivative Instruments

In connection with the Company's interest rate risk management strategy, the Company economically hedges a portion of its interest rate risk by entering into derivative financial instrument contracts in the form of interest rate swaps, swaptions, and Treasury futures. The Company's swaps are used to lock in a fixed rate related to a portion of its current and anticipated payments on its repurchase agreements. The Company typically agrees to pay a fixed rate of interest ("pay rate") in exchange for the right to receive a floating rate of interest ("receive rate") over a specified period of time. Treasury futures are derivatives which track the prices of specific Treasury securities and are traded on an active

exchange. It is generally the Company's policy to close out any Treasury futures positions prior to taking delivery of the underlying security. The Company uses Treasury futures to lock in prices on the purchase or sale of Agency MBS and to hedge changes in interest rates on its existing portfolio.

In addition to interest rate swaps, from time to time the Company purchases and sells mortgage options. Mortgage options give the Company the right, but not the obligation, to buy or sell mortgage backed securities at a future date for a fixed price. The Company uses mortgage options to lock in prices on the purchase or sale of Agency MBS and to enhance investment returns.

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

The table below summarizes the location and fair value of the derivatives reported in the Consolidated Statements of Financial Condition after counterparty netting and posting of cash collateral as of September 30, 2016 and December 31, 2015.

Derivative Instruments	Notional Amount Outstanding	September 30, 2016		Net Estimated Fair Value/Carrying Value	Derivative Liabilities		Net Estimated Fair Value/Carrying Value
		Location on Consolidated Statements of Financial Condition	Location on Consolidated Statements of Financial Condition		Location on Consolidated Statements of Financial Condition	Location on Consolidated Statements of Financial Condition	
(dollars in thousands)							
Interest Rate Swaps	\$ 1,380,900	Derivatives, at fair value, net	\$ —		Derivatives, at fair value, net	\$ —	
Swaptions	699,000	Derivatives, at fair value, net	2,153		Derivatives, at fair value, net	(8,009)	
Treasury Futures	619,700	Derivatives, at fair value, net	—		Derivatives, at fair value, net	—	
Total	\$ 2,699,600		\$ 2,153			\$ (8,009)	
(dollars in thousands)							
Derivative Instruments	Notional Amount Outstanding	December 31, 2015		Net Estimated Fair Value/Carrying Value	Derivative Liabilities		Net Estimated Fair Value/Carrying Value
		Location on Consolidated Statements of Financial Condition	Location on Consolidated Statements of Financial Condition		Location on Consolidated Statements of Financial Condition	Location on Consolidated Statements of Financial Condition	
(dollars in thousands)							
Interest Rate Swaps	\$ 4,555,400	Derivatives, at fair value, net	\$ 1,232		Derivatives, at fair value, net	\$ (6,369)	
Swaptions	779,000	Derivatives, at fair value, net	12,821		Derivatives, at fair value, net	(3,265)	
Treasury Futures	752,200	Derivatives, at fair value, net	1,407		Derivatives, at fair value, net	—	
Total	\$ 6,086,600		\$ 15,460			\$ (9,634)	

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

Derivative Instruments	Location on Consolidated Statements of Operations and Comprehensive Income	Net gains (losses) on derivatives	
		For the Quarter Ended September 30, 2016	For the Quarter Ended September 30, 2015
(dollars in thousands)			
Interest Rate Swaps	Net unrealized gains (losses) on derivatives	\$ 13,395	\$ (55,087)

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

Interest Rate Swaps	Net realized gains (losses) on derivatives	(4,595	)(11,355)
Treasury Futures	Net unrealized gains (losses) on derivatives	12,149	(6,886)
Treasury Futures	Net realized gains (losses) on derivatives	(7,823	)(9,309)
Swaptions	Net unrealized gains (losses) on derivatives	2,084	(9,567)
Swaptions	Net realized gains (losses) on derivatives	(1,850	)(496)
Total		\$13,360	\$ (92,700)

Derivative Instruments	Location on Consolidated Statements of Operations and Comprehensive Income	Net gains (losses) on derivatives For the Nine Months Ended	
		September 30, 2016	September 30, 2015
		(dollars in thousands)	
Interest Rate Swaps	Net unrealized gains (losses) on derivatives	\$(36,840)	\$ 25,143
Interest Rate Swaps	Net realized gains (losses) on derivatives ⁽¹⁾	(84,571)	(135,255)
Mortgage Options	Net unrealized gains (losses) on derivatives	—	225
Mortgage Options	Net realized gains (losses) on derivatives	—	443
Treasury Futures	Net unrealized gains (losses) on derivatives	(4,259)	1,909
Treasury Futures	Net realized gains (losses) on derivatives	(28,797)	(44,541)
Swaptions	Net unrealized gains (losses) on derivatives	(10,283)	(6,734)
Swaptions	Net realized gains (losses) on derivatives	(5,615)	(353)
Other Derivative Assets	Net unrealized gains (losses) on derivatives	—	—
Other Derivative Assets	Net realized gains (losses) on derivatives	(567)	(21)
Total		\$(170,932)	\$(159,183)

(1) Includes loss on termination of interest rate swap of \$61 million and \$100 million for the nine months ended September 30, 2016 and 2015, respectively.

There were no swaps terminations for the quarter ended September 30, 2016 and 2015. The Company paid \$61 million to terminate interest rate swaps with a notional value of \$3.3 billion during the nine months ended September 30, 2016. The terminated swaps had original maturities ranging from 2017 to 2034.

The Company paid \$100 million to terminate interest rate swaps with a notional value of \$1.2 billion during the nine month ended September 30, 2015. The terminated swaps had original maturities ranging from 2019 to 2044. These amounts represented the fair value of the terminated interest rate swaps, not counting any accrued interest at the time of settlement.

The weighted average pay rate on the Company's interest rate swaps at September 30, 2016 was 2.13% and the weighted average receive rate was 0.76%. The weighted average pay rate on the Company's interest rate swaps at December 31, 2015 was 1.51% and the weighted average receive rate was 0.36%. The weighted average maturity on the Company's interest rate swaps at September 30, 2016 and December 31, 2015 is 8 years and 4 years, respectively.

Certain of the Company's derivative contracts are subject to International Swaps and Derivatives Association Master Agreements or other similar agreements which may contain provisions that grant counterparties certain rights with respect to the applicable agreement upon the occurrence of certain events such as (i) a decline in stockholders' equity in excess of specified thresholds or dollar amounts over set periods of time, (ii) the Company's failure to maintain its REIT status, (iii) the Company's failure to comply with limits on the amount of leverage, and (iv) the Company's stock being delisted from the New York Stock Exchange (NYSE). Upon the occurrence of any one of items (i) through (iv), or another default under the agreement, the counterparty to the applicable agreement has a right to terminate the agreement in accordance with its provisions. Certain of the Company's interest rate swaps are cleared through a registered commodities exchange. Each of the Company's ISDAs and clearing exchange agreements contains provisions under which the Company is required to fully collateralize its obligations under the interest rate swap agreements if at any point the fair value of the swap represents a liability greater than the minimum transfer amount contained within the agreements. The Company is also required to post initial collateral upon execution of certain of its swap transactions. If the Company breaches any of these provisions, it will be required to settle its obligations under the agreements at their termination values, which approximates fair value. The Company uses clearing

exchange market prices to determine the fair value of its interest rate swaps. The aggregate fair value of all derivative instruments with credit-risk-related contingent features that are in a net liability position at September 30, 2016 is approximately \$98 million including accrued interest, which represents the maximum amount the Company would be required to pay upon termination, which is fully collateralized.

10. Common Stock

On August 5, 2015, our Board of Directors adopted a program that authorizes repurchases of our common stock up to \$250 million. During the first quarter of 2016, our Board of Directors authorized and increased the share repurchase program by \$100 million from \$250 million to \$350 million. Shares of our common stock may be purchased in the open market, including through block purchases, or through privately negotiated transactions, or pursuant to any trading plan that may be adopted in accordance with Rule 10b5-1 of the Securities Exchange Act of 1934, as amended. The timing, manner, price and amount of any repurchases will be determined at our discretion and the program may be suspended, terminated or modified at any time for any reason. Among other factors, we intend to only consider repurchasing shares of our common stock when the purchase price

is less than our estimate of our current net asset value per common share. Generally, when we repurchase our common stock at a discount to our net asset value, the net asset value of our remaining shares of common stock outstanding increases. In addition, we do not intend to repurchase any shares from directors, officers or other affiliates. The program does not obligate us to acquire any specific number of shares, and all repurchases will be made in accordance with Rule 10b-18, which sets certain restrictions on the method, timing, price and volume of stock repurchases.

Pursuant to our share repurchase program, during the third and fourth quarters of 2015, we repurchased approximately 18 million shares of our common stock at an average repurchase price of \$13.94 per share for a total of approximately \$250 million.

The Company did not repurchase any shares during the quarter and nine months ended of September 30, 2016, and has \$100 million in its share repurchase program that may yet be used to repurchase shares.

During the quarters ended September 30, 2016, and 2015 the Company declared dividends to common shareholders of \$0.48 per share to common shareholders totaling \$91 million, respectively. During the nine months ended September 30, 2016, the Company declared regular dividends to common shareholders totaling \$271 million, or \$1.44 per share, and a special dividend of \$94 million, or \$0.50 per share. For the nine months ended September 30, 2015, the Company declared dividends to common shareholders totaling \$289 million, or \$1.44 per share.

Earnings per share for the quarters and nine months ended September 30, 2016, and 2015, respectively, are computed as follows:

	For the Quarter Ended	
	September 30,	September 30,
	2016	2015
	(dollars in thousands)	
Numerator:		
Net income	\$ 172,817	\$ (48,259)
Effect of dilutive securities:	—	—
Dilutive net income available to stockholders	\$ 172,817	\$ (48,259)
Denominator:		
Weighted average basic shares	187,729,769	187,787,858
Effect of dilutive securities	190,027	87,550
Weighted average dilutive shares	187,919,796	187,875,408
Net income per average share attributable to common stockholders - Basic	\$ 0.92	\$ (0.24)
Net income per average share attributable to common stockholders - Diluted	\$ 0.92	\$ (0.24)

	For the Nine Months Ended September 30, 2016 2015 (dollars in thousands)	
Numerator:		
Net income	\$ 330,042	\$ 134,969
Effect of dilutive securities:	—	—
Dilutive net income available to stockholders	\$ 330,042	\$ 134,969
Denominator:		
Weighted average basic shares	187,727,600	202,891,610
Effect of dilutive securities	190,027	87,550
Weighted average dilutive shares	187,917,627	202,979,160
Net income per average share attributable to common stockholders - Basic	\$ 1.76	\$ 0.67
Net income per average share attributable to common stockholders - Diluted	\$ 1.76	\$ 0.66

11. Accumulated Other Comprehensive Income

The following table presents the changes in the components of Accumulated Other Comprehensive Income (“AOCI”) for the nine months ended September 30, 2016 and 2015:

	September 30, 2016 (dollars in thousands)	
	Unrealized gains (losses) Total on Accumulated available-for-sale securities, net	
Balance as of December 31, 2015	\$ 773,791	\$ 773,791
OCI before reclassifications	94,059	94,059
Amounts reclassified from AOCI	29,853	29,853
Net current period OCI	123,912	123,912
Balance as of September 30, 2016	\$ 897,703	\$ 897,703
	September 30, 2015 (dollars in thousands)	
	Unrealized gains (losses) on Total available-for-sale Accumulated securities, OCI Balance net	
Balance as of December 31, 2014	\$ 1,046,680	\$ 1,046,680
OCI before reclassifications	(121,142)	(121,142)
Amounts reclassified from AOCI	9,710	9,710

Net current period OCI	(111,432	)(111,432)
Balance as of September 30, 2015	\$935,248	\$935,248	

The following table presents the details of the reclassifications from AOCI for the nine months ended September 30, 2016 and 2015:

43

Details about Accumulated OCI Components	September 30,	September 30,	Affected Line on the Consolidated Statements Of Operations And Comprehensive Income
	2016	2015	
	Amounts	Amounts	
	Reclassified from Accumulated OCI	Reclassified from Accumulated OCI	
Unrealized gains and losses on available-for-sale securities	\$ 13,354	\$ 43,038	Net realized gains (losses) on sales of investments
	(43,207)	(52,748)	Net other-than-temporary credit impairment losses
	\$ (29,853)	\$ (9,710)	Income before income taxes
	—	—	Income taxes
	\$ (29,853)	\$ (9,710)	Net of tax

12. Equity Compensation, Employment Agreements and other Benefit Plans

In accordance with the terms of the Company's 2007 Equity Incentive Plan (as amended and restated on December 10, 2015) (the "Equity Plan"), directors, officers and employees of the Company are eligible to receive restricted stock grants. These awards generally have a restriction period lasting between two and ten years depending on the award, after which time the awards fully vest. During the vesting period, these shares may not be sold. There were approximately 7 million shares available for future grants under the 2007 Equity Incentive Plan as of September 30, 2016.

During the first quarter of 2016, the Compensation Committee of the Board of Directors of the Company approved a Stock Award Deferral Program (the "Deferral Program"). Under the Program, non-employee directors and certain executive officers can elect to defer payment of certain stock awards made pursuant to the Equity Plan. Deferred awards are treated as deferred stock units and paid at the earlier of separation from service or a date elected by the participant. Payments are generally made in a lump sum or, if elected by the participant, in five annual installments if paid upon separation from service. Deferred awards receive dividend equivalents during the deferral period in the form of additional deferred stock units. Amounts are paid at the end of the deferral period by delivery of shares from the Equity Plan (plus cash for any fractional deferred stock units), less any applicable tax withholdings. Deferral elections do not alter any vesting requirements applicable to the underlying stock award.

During the first quarter of 2016, the Company granted certain of its employees Restricted Stock Units ("RSU") awards. RSU awards are designed to reward certain employees of the Company for services provided over the previous year. The RSU awards vest equally over a three year period beginning one year from the grant date and will fully vest in 2019. The RSU awards are valued at the market price of the Company's common stock on the grant date and the employees must be employed by the Company on the vesting dates to receive the RSU awards. The Company granted 266,200 RSU awards during the first quarter of 2016 with a grant date fair value of \$3 million, which will be recognized as compensation expense on a straight-line basis over the three year vesting period.

During the first quarter of 2016, the Company granted certain of its employees 179,600 Performance Share Units ("PSU") awards. PSU awards are designed to align compensation with the Company's future performance. The PSU awards include a three year performance period ending on December 31, 2018. The final number of shares that will vest will be between 0% to 150% of the 179,600 granted based on the stock performance of the Company as compared to an index of comparable financial institutions and will cliff vest at the end of the performance period. The PSU awards are measured at fair value on the grant date which will be recognized as compensation expense ratably over the three year vesting period. Fair value is determined using a Monte Carlo valuation model developed to value

the specific features of the PSU awards, including market based conditions. Inputs into the model include the Company's historical volatility, the peer average historical volatility, and the correlation coefficient of the volatility. In addition, inputs also included the share price at the beginning of the measurement period and an estimated total shareholder return for both the Company and the peer group of comparable financial institutions. Based on the model results, the 179,600 PSU awards granted during the first quarter of 2016 had a grant date value of \$3 million that will cliff vest on December 31, 2018.

The Company recognized stock based compensation expenses of \$620 thousand and \$451 thousand for the quarters ended September 30, 2016 and 2015, respectively. For the nine months ended September 30, 2016 and 2015, the stock based compensation expenses were \$1 million, respectively. There were no forfeitures during the quarters and nine months ended September 30, 2016.

The Company also maintains a qualified 401(k) plan. The plan is a voluntary contributory plan that allows eligible employees to defer compensation for federal income tax purposes under Section 401(k) of the Internal Revenue Code of 1986, as amended. Employees may contribute, through payroll deductions, up to 25% of eligible compensation. The Company matches 100% of the first 6% of the eligible compensation deferred by employee contributions and 50% of the next 2% of such compensation. The 401(k) matching contributions are made in the form of cash, whereby participants may direct the Company match to an investment of their choice. The benefit of the Company's contributions vests immediately. Generally, a participating employee is entitled to distributions from the plans upon termination of employment, retirement, death or disability. Participants who qualify for distribution may receive a series of specified installment payments. The 401(k) expense related to the Company's qualified plan for the quarter ended September 30, 2016 and 2015 was \$78 thousand and \$34 thousand, respectively. The 401(k) expense related to the Company's qualified plan for the nine months ended September 30, 2016 and 2015 was \$292 thousand and \$34 thousand, respectively.

13. Income Taxes

For the quarter ended September 30, 2016 and the year ended December 31, 2015, the Company was qualified to be taxed as a REIT under Code Sections 856 through 860. As a REIT, the Company is not subject to federal income tax to the extent that it makes qualifying distributions of taxable income to its stockholders. To maintain qualification as a REIT, the Company must distribute at least 90% of its annual REIT taxable income to its shareholders and meet certain other requirements such as assets it may hold, income it may generate and its shareholder composition. It is generally the Company's policy to distribute to its shareholders all of the Company's taxable income.

The state and local tax jurisdictions to which the Company is subject to tax-filing obligations, recognize the Company's status as a REIT, and therefore, the Company generally does not pay income tax in such jurisdictions. The Company may, however, be subject to certain minimum state and local tax filing fees and its TRSs are subject to federal, state and local taxes. There were no significant income tax expenses for the quarters and nine months ended September 30, 2016 and 2015.

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

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

The Company's 2015, 2014 and 2013 federal, state and local tax returns remain open for examination.

14. Credit Risk and Interest Rate Risk

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

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

Our repurchase agreements and derivative transactions are governed by underlying agreements that provide for a right of setoff under master netting arrangements, including in the event of default or in the event of bankruptcy of either party to the

transactions. We present our assets and liabilities subject to such arrangements on a net basis in our consolidated statements of financial condition. The following table presents information about our liabilities that are subject to such arrangements and can potentially be offset on our consolidated statements of financial condition as of September 30, 2016 and December 31, 2015.

September 30, 2016
(dollars in thousands)

Gross Amounts of Recognized Assets (Liabilities)	Gross Amounts Offset in the Consolidated Statements of Financial Position	Net Amounts Offset in the Consolidated Statements of Financial Position	Gross Amounts Not Offset with Financial Assets (Liabilities) in the Consolidated Statements of Financial Position			Net Amount
			Cash Instruments	Collateral (Received)	Plugged ⁽¹⁾	
Repurchase Agreements	\$(5,817,519)	\$ —	\$(5,817,519)	\$7,295,378	\$ 11,454	\$ 1,489,313
Interest Rate Swaps - Gross Assets	102	(102)) —	—	—	—
Interest Rate Swaps - Gross Liabilities	(84,552)	)84,552	—	—	46,792	46,792
Treasury Futures - Gross Liabilities	(2,852)	)2,852	—	—	7,506	7,506
Swaptions - Gross Assets	2,153	—	2,153	—	—	2,153
Swaptions - Gross Liabilities	(8,009)	)—	(8,009)	)11,509	—	3,500
Other Derivative Assets	—	—	—	—	—	—
Total Liabilities	\$(5,910,677)	\$ 87,302	\$(5,823,375)	\$7,306,887	\$ 65,752	\$ 1,549,264

(1) Included in other assets

December 31, 2015
(dollars in thousands)

Gross Amounts of Recognized Assets (Liabilities)	Gross Amounts Offset in the Consolidated Statements of Financial Position	Net Amounts Offset in the Consolidated Statements of Financial Position	Gross Amounts Not Offset with Financial Assets (Liabilities) in the Consolidated Statements of Financial Position			Net Amount
			Cash Instruments	Collateral (Received)	Plugged ⁽¹⁾	
Repurchase Agreements	\$(7,439,339)	\$ —	\$(7,439,339)	\$8,773,285	\$ 37,296	\$ 1,371,242
Interest Rate Swaps - Gross Assets	6,166	(4,934)	) 1,232	—	—	1,232
Interest Rate Swaps - Gross Liabilities	(53,777)	)47,408	(6,369)	)8,589	51,424	53,644
Treasury Futures	1,599	(192)	) 1,407	—	6,420	7,827
Swaptions - Gross Assets	12,821	—	12,821	—	—	12,821
Swaptions - Gross Liabilities	(3,265)	)—	(3,265)	)—	—	(3,265)
Total Liabilities	\$(7,475,795)	\$ 42,282	\$(7,433,513)	\$8,781,874	\$ 95,140	\$ 1,443,501

(1) Included in other assets

15. Commitments and Contingencies

From time to time, the Company may become involved in various claims and legal actions arising in the ordinary course of business. In connection with certain re-securitization transactions engaged in by the Company, it has the obligation under certain circumstances to repurchase assets from the VIE upon breach of certain representations and warranties. Management is not aware of any contingencies that require accrual or disclosure as of September 30, 2016 and December 31, 2015.

The Audit Committee also pursued additional remedies against other parties regarding the facts and circumstances relating to our accounting for Non-Agency RMBS and the restatement of our financial statements, which were resolved in the first quarter of 2016 and we recovered \$95 million which was characterized as taxable income in 2016.

16. Subsequent Events

Subsequent to September 30, 2016, the Company exercised its call option to retire securitized debt, collateralized by loans held for investment with an unpaid principal amount of \$563 million at par.

Subsequent to September 30, 2016, the Company sold 5,800,000 shares of 8.00% Series A Cumulative Redeemable Preferred Stock, par value \$0.01 per share (the "Series A Preferred Stock"), at a public offering price of \$25.00 per share. The Series A Preferred Stock is redeemable at \$25.00 per share plus accrued and unpaid dividends (whether or not authorized or declared) exclusively at the Company's option commencing in October, 2021, subject to the Company's right, under limited circumstances, to redeem the Series A Preferred Stock prior to that date. The Series A Preferred Stock is entitled to receive a dividend at a rate of 8.0% per year on the \$25.00 liquidation preference before the common stock is paid any dividends and is senior to the common stock with respect to distributions upon liquidation, dissolution or winding up. This transaction was completed in October, 2016, pursuant to which the company received proceeds, net of offering costs, of \$140 million.

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

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

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

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

- our business and investment strategy;
- our ability to maintain existing financing arrangements and our ability to obtain future financing arrangements;
- general volatility of the securities markets in which we invest;
- the impact of and changes to various government programs;
- our expected investments;
- changes in the value of our investments;
- interest rate mismatches between our investments and our borrowings used to finance such purchases;
- changes in interest rates and mortgage prepayment rates;
- effects of interest rate caps on our adjustable-rate investments;

- rates of default, delinquencies or decreased recovery rates on our investments;
- prepayments of the mortgage and other loans underlying our mortgage-backed securities, or RMBS, or other asset-backed securities, or ABS;
- the degree to which our hedging strategies may or may not protect us from interest rate volatility;
- impact of and changes in governmental regulations, tax law and rates, accounting guidance, and similar matters;
- availability of investment opportunities in real estate-related and other securities;
- availability of qualified personnel;
- estimates relating to our ability to make distributions to our stockholders in the future;
- our understanding of our competition;

- market trends in our industry, interest rates, the debt securities markets or the general economy;
- our transition from an externally-managed real estate investment trust, or REIT, to an internally-managed REIT;
- our ability to maintain our classification as a REIT for federal income tax purposes;
- our ability to maintain our exemption from registration under the Investment Company Act of 1940, as amended, or 1940 Act;
- our expectations regarding materiality or significance; and
- the effectiveness of our disclosure controls and procedures.

The forward-looking statements are based on our beliefs, assumptions and expectations of our future performance, taking into account all information currently available to us. You should not place undue reliance on these forward-looking statements. These beliefs, assumptions and expectations can change as a result of many possible events or factors, not all of which are known to us. Some of these factors are described under the caption “Risk Factors” in our Form 10-K for fiscal year ended December 31, 2015. If a change occurs, our business, financial condition, liquidity and results of operations may vary materially from those expressed in our forward-looking statements. Any forward-looking statement speaks only as of the date on which it is made. New risks and uncertainties arise from time to time, and it is impossible for us to predict those events or how they may affect us. Except as required by law, we are not obligated to, and do not intend to, update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Executive Summary

We are an internally managed REIT engaged in the business of investing, on a leveraged basis, in a diversified portfolio of mortgage assets, including Agency RMBS, Non-Agency RMBS, Agency CMBS, residential mortgage loans, and real estate related securities. Our principal business objective is to deliver shareholder value through the generation of distributable income and through asset performance linked to residential mortgage credit fundamentals. We selectively invest in residential mortgage assets with a focus on credit analysis, projected prepayment rates, interest rate sensitivity and expected return.

We focus our investment activities primarily on acquiring Non-Agency and Agency residential and commercial mortgage-backed securities, or MBS, and on acquiring residential mortgage loans. At September 30, 2016, based on the amortized cost balance of our interest earning assets, approximately 27% of our investment portfolio was Agency MBS, 17% of our investment portfolio was Non-Agency RMBS, and 56% of our investment portfolio was securitized residential mortgage loans. At December 31, 2015, based on the amortized cost balance of our interest earning assets, approximately 46% of our investment portfolio was Agency MBS, 20% of our investment portfolio was Non-Agency RMBS, and 34% of our investment portfolio was securitized residential mortgage loans.

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

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

fluctuations related to our financing sources.

Under the new risk retention rules, we have committed to consolidate the loans for deals which we sponsor and retain a meaningful investment for a minimum of five years. Our credit investments are also structurally locked out from pre-payments resulting in a longer duration high yielding credit portfolio.

Market Conditions and our Strategy

The interest rate environment, US unemployment rates, residential home prices, and residential mortgage origination and refinance activity, are the major drivers of our financial results. We have operated over the past several years and continue to operate in a volatile interest rate environment. The broader markets have experienced fluctuations in 10-year Treasury yields that have exceeded 50 basis points (0.50%) in a short time frame. With the pending U.S. election and uncertainty around future action by the Federal Reserve, investors remain cautious in global fixed income, equity, commodity and currency markets.

During the third quarter, rising bond yields resulted in declines in bond-proxy sectors, such as utilities, staples, and real estate and spreads tightened across credit categories. Global markets recovered from the initial decline resulting from the U.K. referendum vote to leave the European Union and with expectations of additional monetary accommodation, the stable global economic data soothed investor concerns. While global liquidity remained ample, monetary policy rates remained relatively unchanged during the quarter and bond yields rose modestly.

In this interest rate environment, we continue to invest in more residential credit assets, which tends to be less interest rate sensitive than Agency MBS. At September 30, 2016, our residential mortgage credit portfolio, consisting non-Agency RMBS, consolidated RMBS securitizations and our securitized loan portfolio was approximately \$12.3 billion compared to \$8.4 billion at December 31, 2015. At September 30, 2016 our total our Agency RMBS portfolio was \$4.4 billion compared to \$6.5 billion at December 31, 2015.

In addition to our investments in Agency MBS, Non-Agency MBS and residential whole loans, we also invest in agency CMBS pass-through securities, which are debt obligations issued by Ginnie Mae, Fannie Mae and Freddie Mac. At September 30, 2016 the fair value of our investments in these securities totaled \$1.3 billion. We view our remaining \$3.1 billion of Agency RMBS and Agency IOs, which includes CMBS IOs, as highly liquid and a potential source of capital should other mortgage credit opportunities arise.

Our book value per common share was \$16.18 as of September 30, 2016. Book value per common share increased from \$15.78 as of June 30, 2016 due primarily to an overall increase in the market value of our investments.

Business Operations

As discussed in “Item 1 Business” section of our 2015 Form 10-K, in August 2015, we internalized the Company’s management (the “Internalization”). Specifically, we now have employees and no longer rely on a third-party manager to operate our business. In connection with the Internalization, we relocated to new office space in New York and hired additional staff necessary to complete the Internalization. Further, before year end, we built, tested, and completed the construction of a new data center, back up facility and independent software suite. We expect operating expenses to be lower on an internalized basis compared to the prior externally managed model and have eliminated certain inherent conflicts particular to externally managed companies.

Stock Buy Back

In August 2015, we announced a \$250 million stock buyback plan. Immediately following the announcement, we entered into a share repurchase agreement with Annaly Capital Management to acquire the 9 million shares then owned by Annaly Capital Management. We used the remaining amount available under the stock buyback plan to purchase shares in the open market during the third and fourth quarter of 2015. The stock buyback reduced shares outstanding by 18 million or 9% of shares outstanding prior to the buyback.

On February 18, 2016, our Board of Directors increased the existing share buyback program by \$100 million to \$350 million. We did not buy back any shares during the quarter or nine months ended September 30, 2016.

Net Income Summary

The table below presents our net income on a GAAP basis for the quarters and nine months ended September 30, 2016 and 2015.

Net Income

(dollars in thousands)

(unaudited)

	For the Quarter Ended		For the Nine Months Ended	
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
Net Interest Income:				
Interest income ⁽¹⁾	\$250,953	\$ 211,876	\$673,246	\$ 670,825
Interest expense ⁽²⁾	94,911	67,910	241,120	194,410
Net interest income	156,042	143,966	432,126	476,415
Other-than-temporary impairments:				
Total other-than-temporary impairment losses	(993	)(3,129	)(8,555	)(6,389
Portion of loss recognized in other comprehensive income	(10,581	)(14,703	)(34,652	)(46,359
Net other-than-temporary credit impairment losses	(11,574	)(17,832	)(43,207	)(52,748
Other investment gains (losses):				
Net unrealized gains (losses) on derivatives	27,628	(71,540	)(51,382	)20,543
Realized gains (losses) on terminations of interest rate swaps	—	—	(60,616	)(99,703
Net realized gains (losses) on derivatives	(14,268	)(21,160	)(58,934	)(80,023
Net gains (losses) on derivatives	13,360	(92,700	)(170,932	)(159,183
Net unrealized gains (losses) on financial instruments at fair value	32,999	(40,955	)80,217	(88,640
Net realized gains (losses) on sales of investments	3,079	3,539	7,035	42,789
Gains (losses) on Extinguishment of Debt	(45	)(19,915	)(1,811	)(14,836
Total other gains (losses)	49,393	(150,031	)(85,491	)(219,870
Other income:				
Other income	—	—	95,000	—
Total other income	—	—	95,000	—
Other expenses:				
Management fees	—	4,088	—	24,610
Expense recoveries from Manager	—	(1,140	)—	(6,905
Net management fees	—	2,948	—	17,705
Compensation and benefits	6,911	3,955	19,087	4,482
General and administrative expenses	4,332	8,534	13,073	22,028
Servicing Fees of consolidated VIEs	9,788	6,499	23,139	19,276
Deal Expenses	—	2,426	13,022	5,337
Total other expenses	21,031	24,362	68,321	68,828
Income (loss) before income taxes	172,830	(48,259	)330,107	134,969
Income taxes	13	—	65	—
Net income (loss)	\$172,817	\$ (48,259	)\$330,042	\$ 134,969
Net income (loss) per share available to common shareholders:				
Basic	\$0.92	\$ (0.24	)\$1.76	\$ 0.67
Diluted	\$0.92	\$ (0.24	)\$1.76	\$ 0.66

Weighted average number of common shares outstanding:

Basic	187,729,765	187,787,858	187,727,662	187,891,610
Diluted	187,919,792	187,875,408	187,917,692	187,979,160

(1) Includes interest income of consolidated VIEs of \$195,488 and \$142,053 for the quarters ended September 30, 2016 and 2015, respectively and interest income of consolidated VIEs of \$488,353 and \$439,571 for the nine months ended September 30, 2016 and 2015, respectively. See Note 8 to consolidated financial statements for further discussion.

(2) Includes interest expense of consolidated VIEs of \$70,715 and \$50,837 for the quarters ended September 30, 2016 and 2015, respectively and interest expense of consolidated VIEs of \$168,738 and \$148,017 for the nine months ended September 30, 2016 and 2015, respectively. See Note 8 to consolidated financial statements for further discussion.

Results of Operations for the Quarters and Nine Months Ended September 30, 2016 and 2015

Our net income increased by \$221 million to \$173 million, or \$0.92 per average basic common share, for the quarter ended September 30, 2016 as compared to a loss of \$48 million, or \$0.24 per average basic common share, for the quarter ended September 30, 2015. The increase in net income is primarily due to an increase in net unrealized gains on derivatives of \$99 million and an increase in net unrealized gains on financial instruments at fair value of \$74 million. In addition, our net interest income increased by \$12 million for the quarter ended September 30, 2016 compared to the same period of 2015.

Our net income increased by \$195 million to \$330 million, or \$1.76 per average basic common share, for the nine months ended September 30, 2016 as compared to \$135 million, or \$0.67 per average basic common share, for the nine months ended September 30, 2015. The increase in net income is primarily due to the increased net unrealized gains on financial instruments at fair value of \$169 million, which were partially offset by net unrealized losses on derivatives of \$72 million during the nine months ended September 30, 2016 as compared to the same period of 2015. We also had one-time receipt of additional remedies against other parties of \$95 million.

Our primary source of income is interest income earned on our assets. Our economic net interest income equals interest income excluding interest earned on cash and cash equivalents less interest expense and realized losses on our interest rate hedges.

Interest Income

Interest income increased by \$39 million, or 18%, to \$251 million for the quarter ended September 30, 2016 as compared to \$212 million for the same period of 2015. The increase is primarily due to the increase in interest income earned on subprime residential mortgage loans of \$58 million as compared to the same period of 2015. This increase was offset, in part, by lower Agency RMBS interest income of \$13 million as compared to the same period of 2015. These changes are primarily driven by increase in our seasoned subprime residential mortgage loan investment balances and decrease in our Agency RMBS investment balances.

Interest income increased marginally by \$2 million, to \$673 million for the nine months ended September 30, 2016 as compared to \$671 million for the same period of 2015. Our interest income earned on seasoned subprime residential mortgage loans increased by \$70 million which was largely offset by decrease in Agency RMBS interest income of \$58 million as compared to the same period of 2015. In addition, the interest income on Non-Agency RMBS transferred to consolidated VIEs decreased by \$14 million as this portfolio continues to run-off. The company sold Agency RMBS investments to finance acquisition of seasoned subprime residential mortgage loan investments during the nine months ended September 30, 2016, which resulted in lower interest earning Agency RMBS investment balances and higher seasoned subprime residential mortgage loan investment balances.

Interest Expense

Interest expense increased by \$27 million, or 40%, to \$95 million for the quarter ended September 30, 2016 as compared to \$68 million for the same period of 2015. The increase is primarily due to increased interest expense on securitized debt, collateralized by seasoned subprime residential mortgage loans of \$28 million as compared to the same period of 2015.

Interest expense increased by \$47 million, or 24%, to \$241 million for the nine months ended September 30, 2016 as compared to \$194 million for the same period of 2015. The increase is primarily due to increased interest expense on securitized debt, collateralized by seasoned subprime residential mortgage loans of \$41 million and increased interest expense on the non-Agency repurchase agreement of \$24 million. These increases were partially offset by decreased

interest expense on securitized debt, collateralized by non-Agency RMBS and jumbo prime residential mortgage loans of \$12 million and \$6 million, respectively, as compared to the same period of 2015. The increased expense on securitized debt, collateralized by seasoned subprime residential mortgage loans is driven by higher liability balance compared to prior period. The increase in non-Agency repurchase agreements interest expense is due to additional non-Agency RMBS pledged as collateral for repurchase financing, as we tend to use longer term repurchase agreements to finance non-agency holdings resulting in a higher interest expense.

Interest expense for GAAP reporting does not include the periodic costs of our derivative hedges, which are reported separately in our GAAP financial statements.

Economic Net Interest Income

Our “Economic net interest income” is a non-GAAP financial measure, that equals interest income, less interest expense and realized losses on our interest rate swaps. Realized losses on our interest rate swaps are the periodic net settlement payments made or received. For the purpose of computing economic net interest income and ratios relating to cost of funds measures

throughout this section, interest expense includes net payments on our interest rate swaps, which is presented as a part of Realized gains (losses) on derivatives in our Consolidated Statements of Operations and Comprehensive Income. Interest rate swaps are used to manage the increase in interest paid on repurchase agreements in a rising rate environment. Presenting the net contractual interest payments on interest rate swaps with the interest paid on interest-bearing liabilities reflects our total contractual interest payments. We believe this presentation is useful to investors because it depicts the economic value of our investment strategy by showing actual interest expense and net interest income. However, Economic net interest income should not be viewed in isolation and is not a substitute for net interest income computed in accordance with GAAP. Where indicated, interest expense, including interest payments on interest rate swaps, is referred to as economic interest expense. Where indicated, net interest income reflecting interest payments on interest rate swaps, is referred to as economic net interest income.

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

	GAAP Interest Income	GAAP Interest Expense	Net Realized Losses on Interest Rate Swaps	Other ⁽²⁾	Economic Interest Expense	GAAP Net Interest Income	Net Realized Losses on Interest Rate Swaps	Other ⁽¹⁾	Economic Net Interest Income
For the Quarter Ended September 30, 2016	\$250,953	\$94,911	\$4,595	\$—	\$99,506	\$156,042	\$(4,595)	\$(105)	\$151,342
For the Quarter Ended June 30, 2016	\$221,096	\$83,227	\$8,141	\$—	\$91,368	\$137,869	\$(8,141)	\$(367)	\$129,361
For the Quarter Ended March 31, 2016	\$201,194	\$62,981	\$11,220	\$—	\$74,201	\$138,213	\$(11,220)	\$(448)	\$126,545
For the Quarter Ended December 31, 2015	\$201,912	\$64,954	\$11,673	\$—	\$76,627	\$136,958	\$(11,673)	\$(13)	\$125,272
For the Quarter Ended September 30, 2015	\$211,876	\$67,910	\$11,355	\$(2,214)	\$77,051	\$143,966	\$(11,355)	\$2,103	\$134,714

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

(2) Other includes \$2 million of deferred financing expenses written off during the quarter ended September 30, 2015.

Net Interest Rate Spread

The following table shows our average earning assets held, interest earned on assets, yield on average interest earning assets, average debt balance, economic interest expense, economic average cost of funds, economic net interest income, and net interest rate spread for the periods presented.

	For the Quarter Ended September 30, 2016 (dollars in thousands)			September 30, 2015 (dollars in thousands)				
	Average Balance	Interest	Average Yield/Cost	Average Balance	Interest	Average Yield/Cost		
Assets:								
Interest-earning assets ⁽¹⁾ :								
Agency MBS	\$3,735,142	\$29,482	3.2 %	\$5,935,743	\$42,132	2.8 %		
Non-Agency RMBS	1,404,995	25,879	7.4 %	1,450,827	27,579	7.6 %		
Non-Agency RMBS transferred to consolidated VIEs	1,267,633	61,272	19.3 %	1,527,415	65,028	17.0 %		
Jumbo Prime securitized residential mortgage loans held for investment	383,916	3,025	3.2 %	510,708	3,972	3.1 %		
Seasoned subprime securitized residential mortgage loans held for investment	8,590,865	131,190	6.1 %	4,665,264	73,054	6.3 %		
Total	\$15,382,551	\$250,848	6.5 %	\$14,089,957	\$211,765	6.0 %		
Liabilities and stockholders' equity:								
Interest-bearing liabilities:								
Agency repurchase agreements ⁽²⁾	\$3,407,242	\$11,606	1.4 %	\$5,243,274	\$18,690	1.4 %		
Non-Agency repurchase agreements	2,462,140	17,185	2.8 %	1,772,806	9,739	2.2 %		
Securitized debt, collateralized by Non-Agency RMBS	402,657	5,182	5.1 %	598,562	9,946	6.6 %		
Securitized debt, collateralized by jumbo prime residential mortgage loans	287,845	2,288	3.2 %	402,407	3,227	3.2 %		
Securitized debt, collateralized by seasoned subprime residential mortgage loans	7,025,781	63,245	3.6 %	3,845,970	35,449	3.7 %		
Total	\$13,585,665	\$99,506	2.9 %	\$11,863,019	\$77,051	2.6 %		
Economic net interest income/net interest rate spread		\$151,342	3.6 %		\$134,714	3.4 %		
Net interest-earning assets/net interest margin	\$1,796,886		3.9 %	\$2,226,938		3.8 %		
Ratio of interest-earning assets to interest bearing liabilities	1.13			1.19				

(1) Interest-earning assets at amortized cost

(2) Interest includes cash paid on swaps

	For the Nine Months Ended					
	September 30, 2016 (dollars in thousands)			September 30, 2015 (dollars in thousands)		
	Average Balance	Interest	Average Yield/Cost	Average Balance	Interest	Average Yield/Cost
Assets:						
Interest-earning assets ⁽¹⁾ :						
Agency MBS	\$4,869,331	\$96,517	2.6 %	\$6,713,571	\$154,739	3.1 %
Non-Agency RMBS	1,433,403	87,454	8.1 %	1,224,947	75,530	8.2 %
Non-Agency RMBS transferred to consolidated VIEs	1,343,038	188,393	18.7 %	1,583,689	202,096	17.0 %
Jumbo Prime securitized residential mortgage loans held for investment	413,273	10,348	3.3 %	560,421	18,225	4.3 %
Seasoned subprime securitized residential mortgage loans held for investment	6,387,502	289,612	6.0 %	4,582,768	219,250	6.4 %
Total	\$14,446,547	\$672,324	6.2 %	\$14,665,396	\$669,840	6.1 %
Liabilities and stockholders' equity:						
Interest-bearing liabilities:						
Agency repurchase agreements ⁽²⁾	\$4,479,616	\$48,681	1.4 %	\$5,945,916	\$57,930	1.3 %
Non-Agency repurchase agreements	2,263,806	47,657	2.8 %	1,466,067	24,017	2.2 %
Securitized debt, collateralized by Non-Agency RMBS	456,709	15,101	4.4 %	645,086	27,111	5.6 %
Securitized debt, collateralized by jumbo prime residential mortgage loans	314,811	7,298	3.1 %	450,741	13,725	4.1 %
Securitized debt, collateralized by seasoned subprime residential mortgage loans	5,162,346	146,339	3.8 %	3,817,215	104,965	3.7 %
Total	\$12,677,288	\$265,076	2.8 %	\$12,325,025	\$227,748	2.5 %
Economic net interest income/net interest rate spread		\$407,248	3.4 %		\$442,092	3.6 %
Net interest-earning assets/net interest margin	\$1,769,259		3.8 %	\$2,340,371		4.0 %
Ratio of interest-earning assets to interest bearing liabilities	1.14			1.19		

(1) Interest-earning assets at amortized cost

(2) Interest includes cash paid on swaps

Economic Net Interest Income and the Average Earning Assets

Our economic net interest income increased by \$17 million to \$151 million for the quarter ended September 30, 2016 from \$135 million for the same period of 2015. Our economic net interest income declined by \$35 million to \$407 million for the nine months ended September 30, 2016 from \$442 million for the same period of 2015. Our net interest rate spread, which equals the yield on our average interest earning assets less the economic average cost of funds, increased by approximately 20 basis points and decreased by 20 basis points, respectively, for the quarter and nine months ended September 30, 2016 as compared to the same period of 2015. The net interest margin, which equals the economic net interest income as a percentage of the net average balance of our interest-earning assets less our

interest-bearing liabilities, increased by 10 basis points and decreased by 20 basis points for the quarter and nine months ended September 30, 2016 as compared to the same periods of 2015. Average net interest-earning assets decreased by \$430 million and \$571 million for the quarter and nine months ended September 30, 2016 from the same period of the prior year, primarily as a result of the decrease in our Agency MBS which was partially offset by an increase in our securitized debt and secured loan portfolio. Our net interest margin declined slightly due to an increase in our average cost of funds. The aggregate portfolio has experienced several changes from the same period for the prior year as we have decreased our average Agency RMBS and increased our seasoned subprime securitized loans held for investment as a percentage of the total portfolio.

Economic Interest Expense and the Cost of Funds

The borrowing rate at which we are able to finance our assets using repurchase agreements is typically correlated to LIBOR and the term of the financing. The table below shows our average borrowed funds, economic interest expense, average cost of funds

54

(inclusive of realized losses on interest rate swaps), average one-month LIBOR, average six-month LIBOR, average one-month LIBOR relative to average six-month LIBOR, and average cost of funds relative to average one- and six-month LIBOR.

	Average Debt Balance	Economic Interest Expense ⁽¹⁾	Average Cost of Funds	Average One-Month LIBOR	Average Six-Month LIBOR	Average One-Month LIBOR Relative to Average Six-Month LIBOR
(Ratios have been annualized, dollars in thousands)						
For The Quarter Ended September 30, 2016	\$ 13,585,665	\$ 99,506	2.93 %	0.51 %	1.15 %	(0.64) %
For The Quarter Ended June 30, 2016	\$ 12,986,780	\$ 91,368	2.81 %	0.40 %	0.90 %	(0.50) %
For The Quarter Ended March 31, 2016	\$ 11,678,852	\$ 74,201	2.54 %	0.43 %	0.88 %	(0.45) %
For The Quarter Ended December 31, 2015	\$ 11,913,613	\$ 76,627	2.57 %	0.25 %	0.63 %	(0.38) %
For The Quarter Ended September 30, 2015	\$ 11,859,833	\$ 77,051	2.60 %	0.20 %	0.51 %	(0.31) %

(1) Includes effect of realized losses on interest rate swaps.

Average interest-bearing liabilities increased by \$1.7 billion for the quarter ended September 30, 2016 as compared to the same period of 2015. Economic interest expense increased by \$22 million for the quarter ended September 30, 2016 as compared to the same period of 2015. The increase in average interest-bearing liabilities is primarily a result of the increase in our securitized debt collateralized by seasoned subprime mortgage loans. Our economic interest expense has increased due to increased expenses on securitized debt collateralized by seasoned subprime mortgage loans and non-agency repurchase agreements, which was partially offset by decreased expenses on securitized debt collateralized by non-agency RMBS and Agency repurchase agreements.

Average one-month and six month LIBOR were up 31 basis point and 64 basis points, respectively, during the quarter ended September 30, 2016 as compared to the same period of 2015, contributing to the increase in economic interest expense in addition to increased average debt balances. While we do acquire interest rate hedges to mitigate changes in interest rate risks, the hedges may not fully offset interest expense movements.

Net other-than-temporary credit impairment losses

OTTI losses are generated when fair values decline below our amortized cost basis, an unrealized loss, and the expected future cash flows decline from prior periods, an adverse change. When an unrealized loss and an adverse change in cash flows occur, we will recognize an OTTI loss in earnings. In addition, if we intend to sell a security, or believe we will be required to sell a security in an unrealized loss position, we will recognize an OTTI loss in earnings equal to the unrealized loss.

OTTI losses were \$12 million and \$18 million for the quarters ended September 30, 2016 and 2015 and \$43 million and \$53 million for the nine months ended September 30, 2016 and 2015, respectively. Of these amounts, \$5 million and \$16 million of the OTTI for the quarters ended September 30, 2016 and 2015 and \$33 million and \$45 million of the OTTI for the nine months ended September 30, 2016 and 2015, respectively, was related to securities included in our consolidated VIEs. As of September 30, 2016, we had 3 non-agency RMBS securities subject to OTTI in an unrealized loss position totaling \$1 million for which we did not recognize impairment. We intend to hold these securities until they recover their amortized cost. We continue to monitor our investment portfolio and will record an OTTI for all investments in an unrealized loss position for which we do not believe we will recover our amortized cost prior to maturity or sale.

Net gains (losses) on derivatives

The table below shows a summary of our net gain (loss) on derivative instruments, for the three and nine months ended September 30, 2016 and 2015, respectively.

55

	For the Quarter Ended September 30, 2016		Nine Months Ended September 30, 2015	
	2016	2015	2016	2015
	(dollars in thousands)			
Periodic interest cost of interest rate swaps, net	\$(4,595)	\$(11,355)	\$(23,955)	\$(35,551)
Realized gain (loss) on derivative instruments, net:				
Mortgage Options	—	—	—	443
Treasury Futures	(7,823)	(9,309)	(28,797)	(44,541)
Swaptions	(1,850)	(496)	(5,615)	(353)
Other Derivative Assets	—	—	(567)	(21)
Swaps - Terminations	—	—	(60,616)	(99,703)
Total realized gain (loss) on derivative instruments, net	(9,673)	(9,805)	(95,595)	(144,175)
Unrealized gain on derivative instruments, net:				
Interest Rate Swaps	13,395	(55,087)	(36,840)	25,143
Mortgage Options	—	—	—	225
Treasury Futures	12,149	(6,886)	(4,259)	1,909
Swaptions	2,084	(9,567)	(10,283)	(6,734)
Total unrealized gain (loss) on derivative instruments, net:	27,628	(71,540)	(51,382)	20,543
Total gain (loss) on derivative instruments, net	\$13,360	\$(92,700)	\$(170,932)	\$(159,183)

There were no swap terminations during the quarters ended September 30, 2016 and 2015. During the nine months ended September 30, 2016, we terminated interest rate swap agreements with a notional value of \$3.3 billion at a loss of \$61 million. The terminated swaps had original maturities ranging from 2017 to 2034. During the nine months ended September 30, 2015, we terminated interest rate swap agreements with a notional value of \$1.2 billion for \$100 million.

During the quarters ended September 30, 2016 and 2015, we did not change our Treasury future net positions. During the nine months ended September 30, 2016 and 2015, we decreased our Treasury Futures positions by \$133 million and \$390 million of notional value.

Changes in our derivative positions were a result of changes in the portfolio composition and changes in interest rates.

During the quarter ended September 30, 2016, we recognized total net gains on derivatives of \$13 million compared to net losses of \$93 million for the same period of 2015. For the nine months ended September 30, 2016, we recognized net losses on derivatives of \$171 million compared to net losses of \$159 million for the same period of 2015. The net gains and losses on our derivatives include both unrealized and realized gains and losses. Realized gains and losses include the net cash paid and received on our interest rate swaps during the period as well as sales and settlements of our Treasury Futures and mortgage options. The realized loss on our derivative instruments is primarily a result of the pay fixed leg of our swaps carried at a higher interest rate than the received floating leg of these same swaps, resulting in a net payment on the periodic settlement of the swaps during the year.

We also incurred realized losses of \$8 million and \$9 million for the quarters ended September 30, 2016 and 2015, respectively, and realized losses of \$29 million and \$45 million on our treasury futures for the nine months ended September 30, 2016 and 2015, respectively, as interest rates declined during those periods, the futures prices increased resulting in realized losses on our short futures positions.

Unrealized gains and losses include the change in market value, period over period, on our derivatives portfolio. Changes in market value are generally a result of changes in interest rates. The unrealized gains and losses of our derivatives portfolio are generally offset by net changes in our investment portfolio. We may or may not ultimately

realize these unrealized derivative gains and losses depending on trade activity, changes in interest rates and the values of the underlying securities.

Our interest rate swaps are primarily used to economically hedge the effects of changes in interest rates on our portfolio, specifically our floating rate debt. Therefore, we included the periodic interest costs of the interest rate swaps for the quarters ended September 30, 2016 and 2015 on these economic hedges in our presentation of economic net interest income and our net interest spreads. As we do not account for these as hedges for GAAP presentation, we present these gains and losses separately in the consolidated statements of operations and comprehensive income. The decrease in the net periodic interest cost of the interest rate swaps are primarily due to decline in our swap portfolio balance.

Treasury futures are not included in our economic interest expense and economic net interest income. We also do not include any gains or losses on our mortgage options in our economic interest expense and economic net interest income as the mortgage options were sold for income generation and not as an economic hedge for changes in interest rates in our portfolio. As we identify opportunities in the mortgage backed securities market, we may from time to time purchase or sell mortgage options, including both call and put options to take advantage of these opportunities. We had no mortgage options as of September 30, 2016 and 2015. For the nine months ended September 30, 2015 we had \$443 thousand of realized gains on our mortgage options.

Net Unrealized Gains (Losses) on Financial Instruments at Fair Value

We have elected the fair value option with changes in fair value reflected in earnings for our IO RMBS securities, certain Non-Agency RMBS securities which receive residual cash flows, securitized loans held for investment, and the related financing for the securitized loans consolidated as a VIE in our statement of financial condition. The table below shows the unpaid principal, fair value and impact of change in fair value on each of these financial instruments:

	As of September 30, 2016 (dollars in thousands)		As of September 30, 2015	
	Unpaid Principal/ Notional	Fair Value	Unpaid Principal/ Notional	Fair Value
Assets:				
IO RMBS securities	\$9,478,056	\$462,113	\$12,564,520	\$535,392
Non-Agency RMBS securities	N/A	\$20,671	N/A	23,908
Securitized loans held for investment, at fair value	9,030,908	8,909,037	5,353,694	5,281,652
Liabilities:				
Securitized debt at fair value, collateralized by loans held for investment	7,334,475	7,191,462	4,364,174	4,221,295
Total	\$25,843,439	\$16,583,283	\$22,282,388	\$10,062,247
	For the Quarter Ended		For the Nine Months Ended	
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
	(dollars in thousands)			
	Gain/(Loss)		Gain/(Loss)	
	on	Gain/(Loss)	on	Gain/(Loss)
	Change	on Change in	Change	on Change in
	in Fair	Fair Value	in Fair	Fair Value
	Value		Value	
Assets:				
IO RMBS securities	\$3,157	\$ (8,431)	\$26,049	\$ (5,445)
Non-Agency RMBS securities	\$8,257	\$ 2,546	\$7,551	\$ (749)
Securitized loans held for investment, at fair value	68,508	(37,575)	113,646	(55,664)
Liabilities:				
Securitized debt at fair value, collateralized by loans held for investment	(46,923)	2,505	(67,029)	(26,782)
Total	\$32,999	\$ (40,955)	\$80,217	\$ (88,640)

IO RMBS securities represent the right to receive the interest on a pool of mortgage backed securities, including both Agency and Non-Agency mortgage pools. The fair value of IO RMBS securities are heavily impacted by changes in expected prepayment rates. When IO securities prepay, the holder of the IO security will receive less interest on the investment due to the

57

reduced principal. During the second quarter of 2015, we acquired residual interests in several seasoned pools of mortgage loans. These holdings generally do not have a traditional unpaid principal amount and pay cash based on guidance in the trust documents when excess cash is available. Many of these holdings do not pay any interest and may never pay interest. We have elected to carry these residual interests at fair value with changes in fair value reflected in earnings. As of January 1, 2015, the Company adopted the guidance in ASU 2014-13, Measuring the Financial Assets and the Financial Liabilities of a Consolidated Collateralized Financing Entity, which allowed us to carry both the assets and liabilities of certain consolidated VIEs at fair value with changes in fair value reflected in earnings.

Gains and Losses on Sales of Assets and Loss on extinguishment of securitized debt

For the quarters ended September 30, 2016 and 2015, we had net realized gains of \$3 million and \$4 million on sales of investments, respectively. For the nine months ended September 30, 2016 and 2015, net realized gains on sales of investments were \$7 million and \$43 million, respectively. We do not forecast sales of investments as we generally expect to invest for long term gains. However, from time to time, we may sell assets to create liquidity necessary to pursue new opportunities, achieve targeted leverage ratios as well as for gains when prices indicate a sale is most beneficial to us, or is the most prudent course of action to maintain a targeted risk adjusted yield for our investors.

When we acquire our outstanding debt, we extinguish the outstanding debt and recognize a gain or loss based on the difference between the carrying value of the debt and the cost to acquire the debt which is reflected in the Consolidated Statement of Operations and Comprehensive Income as a loss on extinguishment of debt.

During the quarter ended September 30, 2016, the Company acquired securitized debt collateralized by Non-Agency RMBS with an amortized cost balance of \$4 million for \$4 million. This transaction resulted in a net loss on the extinguishment of debt of \$45 thousand. During the first quarter of 2016, the Company acquired securitized debt collateralized by seasoned subprime mortgage loans with an amortized cost balance of \$44 million for \$46 million. This transaction resulted in a net loss on the extinguishment of debt of \$2 million.

During the third quarter of 2015, the company called \$516 million of securitized debt collateralized by subprime residential mortgage loans at par for cash payments of \$508 million, resulting in a gain on extinguishment of debt of \$8 million. During the nine months ended September 30, 2015, the company called \$752 million of securitized debt collateralized by subprime residential mortgage loans on-agency RMBS at par for cash payments of \$739 million, resulting in a gain on extinguishment of debt of \$13 million. During the third quarter of 2015, the company also purchased \$107 million of securitized debt collateralized by subprime residential mortgage loans for a cash payment of \$135 million resulting in a loss on extinguishment of debt of \$28 million.

Compensation, General and Administrative Expenses, Deal Expenses and Management Fees

The table below shows our total compensation and benefit expense, general and administrative, or G&A, expenses, deal expenses and management fees as compared to average total assets and average equity for the periods presented.

Total Net Management Fee, Compensation and Other Expenses	Total Net Management Fee, Compensation and Other Expenses/Average Assets	Total Net Management Fee, Compensation and Other Expenses/Average Equity
--	---	---

(Ratios have been annualized, dollars in thousands)

For The Quarter Ended September 30, 2016	\$11,2430.26	%	1.50	%
For The Quarter Ended June 30, 2016	\$24,2140.59	%	3.30	%
For The Quarter Ended March 31, 2016	\$9,725 0.25	%	1.33	%
For The Quarter Ended December 31, 2015	\$18,6000.48	%	2.45	%
For The Quarter Ended September 30, 2015	\$17,8630.45	%	2.18	%

In connection with the Internalization and the termination of the Management Agreement with our former manager, we became internally managed and hired employees. Thus, as of August 5, 2015, we began to incur compensation and benefits costs. Compensation and benefits costs have effectively replaced the management fee as the cost to operate our business. Compensation and benefit costs for the quarter and nine months ended September 30, 2016 were \$7 million and \$19 million, respectively.

G&A expenses for the quarter ended September 30, 2016 and 2015 were approximately \$4 million and \$9 million, respectively. For the nine months ended September 30, 2016 and 2015 such expenses were approximately \$13 million and \$22 million, respectively. The G&A expenses primarily comprised of auditing fees, market data and research, consulting fees, software, legal and rent expenses. We did not incur any deal expenses for the quarter ended September 30, 2016, compared to \$13 million for the nine months ended September 30, 2016, related to the securitization of our seasoned subprime mortgage pools. For the quarter and nine months ended September 30, 2015 the deal expenses were \$2 million and \$5 million, respectively.

We did not incur any management fees during the quarter and nine months ended September 30, 2016, due to the Internalization. During the quarter and nine months ended September 30, 2015, management fees incurred net of expense recoveries was \$3 million and \$18 million, respectively.

Servicing Fees

Servicing fees paid by our consolidated VIEs were approximately \$10 million and \$6 million for the quarters ended September 30, 2016 and 2015, respectively. For the nine months ended September 30, 2016 and 2015, these servicing fees were approximately \$23 million and \$19 million, respectively. These servicing fees are related to the consolidation of the whole loan securitization vehicles and are paid from interest income earned by the VIEs. The increase in servicing fees for the period ended September 30, 2016 was driven by the creation of additional securitizations in second quarter of 2016. The servicing fees range from 25 to 50 basis points of unpaid principal balances of our consolidated VIEs.

Core earnings

Core earnings is a non-GAAP measure and is defined as GAAP net income excluding unrealized gains on the aggregate portfolio, impairment losses, realized gains on sales of investments, realized gains or losses on futures, realized gains or losses on swap terminations, gain on deconsolidation, extinguishment of debt and certain other non-recurring gains or losses. As defined, core earnings include interest income and expense as well as realized losses on interest rate swaps used to hedge interest rate risk. Management believes that the presentation of core earnings is useful to investors because it can provide a useful measure of comparability to our other REIT peers, but has important limitations. We believe core earnings as described above helps evaluate our financial performance without the impact of certain transactions but is of limited usefulness as an analytical tool. Therefore, core earnings should not be viewed in isolation and is not a substitute for net income or net income per basic share computed in accordance with GAAP.

The following table provides GAAP measures of net income and net income per basic share available to common stockholders for the periods presented and details with respect to reconciling the line items to core earnings and related per average basic common share amounts:

	For the Quarters Ended				
	September 30, 2016	June 30, 2016	March 31, 2016	December 31, 2015	September 30, 2015
	(dollars in thousands, except per share data)				
GAAP Net income	\$172,817	\$74,127	\$83,098	\$115,380	\$(48,259)
Adjustments:					
Net other-than-temporary credit impairment losses	11,574	20,955	10,678	14,696	17,832
Net unrealized (gains) losses on derivatives	(27,628)	(22,100)	101,110	(46,842)	71,540
Net unrealized (gains) losses on financial instruments at fair value	(32,999)	(30,347)	(16,871)	69,793	40,955
Net realized (gains) losses on sales of investments	(3,079)	(6,631)	2,674	(34,285)	(3,539)
(Gains) losses on extinguishment of debt	45	—	1,766	(8,906)	19,915
Realized (gains) losses on terminations of interest rate swaps	—	60,158	458	(754)	—
Net realized (gains) losses on Futures ⁽¹⁾	7,823	(635)	21,609	(9,018)	9,309
Total other (gains) losses	—	—	—	256	—
Other income	—	—	(95,000)	—	—
Core Earnings	\$128,553	\$95,527	\$109,522	\$100,320	\$107,753
GAAP net income per basic common share	\$0.92	\$0.39	\$0.44	\$0.61	\$(0.24)
Core earnings per basic common share ⁽²⁾	\$0.68	\$0.51	\$0.58	\$0.53	\$0.54

(1) Included in net realized gains (losses) on derivatives in the Consolidated Statement of Operations.

(2) We note that core and taxable earnings will typically differ, and may materially differ, due to differences on realized gains and losses on investments and related hedges, credit loss recognition, timing differences in premium amortization, accretion of discounts, equity compensation and other items.

Our core earnings for the quarter ended September 30, 2016 were \$129 million or \$0.68 per average basic common share, compared to \$108 million or \$0.54 per average basic common share for the quarter ended September 30, 2015. Core earnings increased for the quarter ended September 30, 2016 as compared to the same period of 2015 as a result of increase in net interest income and a decrease in expenses.

Net Income (Loss) and Return on Average Equity

The table below shows our Net Income, Economic Net Interest Income and Core Earnings, each as a percentage of average equity. Return on average equity is defined as our GAAP net income (loss) as a percentage of average equity. Average equity is defined as the average of our beginning and ending equity balance for the period reported. Economic Net Interest Income and Core Earnings are non-GAAP measures as defined in previous sections.

	Return on Average Equity	Economic Net Interest Income/Average Equity *	Core Earnings/Average Equity
	(Ratios have been annualized)		
For The Quarter Ended September 30, 2016	23.04 %	20.18 %	17.14 %
For The Quarter Ended June 30, 2016	10.09 %	17.61 %	13.00 %
For The Quarter Ended March 31, 2016	11.34 %	17.28 %	14.95 %
For The Quarter Ended December 31, 2015	15.22 %	16.52 %	13.23 %
For The Quarter Ended September 30, 2015	(5.89) %	16.43 %	13.14 %

For The Year Ended December 31, 2015	7.52	%	17.12	%	14.20	%
For The Year Ended December 31, 2014	16.99	%	14.06	%	12.70	%

* Includes effect of realized losses on interest rate swaps.

Return on average equity increased by 2,893 basis points for the quarter ended September 30, 2016 as compared to the same period of 2015. This was primarily due to an increase in our net income by \$221 million to \$173 million for the quarter ended September 30, 2016 as compared to a loss of \$48 million, for the quarter ended September 30, 2015. Economic net interest income as a percentage of average equity increased by 375 basis points and core earnings as a percentage of average equity

increased by 400 basis points for the quarter ended September 30, 2016 compared to the quarter ended September 30, 2015. This was primarily driven by the allocation of the Company's portfolio from Agency RMBS to seasoned subprime loans.

Financial Condition

Estimated Economic Book Value

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

GAAP requires us to consolidate certain securitizations and re-securitization transactions where we have determined that we are the primary beneficiary. In these transactions, we transfer assets to the trusts, which issue tranches of senior and subordinate securities. We sell the senior tranches and therefore have no continuing involvement in these trusts other than being a holder of securities issued by the trusts. However, with respect to certain VIEs collateralized by loans held for investment, we have the ability to approve loan modifications and determine the course of action to be taken as it relates to loans in technical default, including whether or not to proceed with foreclosure. The securities we own that were issued by the trusts are predominantly subordinated interests in those trusts. Certain representation and warranties we made with respect to the assets transferred to the trust are presented as if we own 100% of the trust.

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

Because we are unable to dispose of, monetize or pledge the RMBS or loans we transferred into the trusts, we also present our estimated economic book value. In contrast to GAAP book value, our estimated economic book value considers only the assets we own or are able to dispose of, pledge, or otherwise monetize. Accordingly, our estimated economic book value does not include assets or liabilities for which we have no direct ownership, specifically the assets of the securitization and re-securitization trusts or RMBS from the consolidated trusts that were sold to third parties.

At September 30, 2016, the difference between GAAP book value and estimated economic book value was \$240 million, or \$1.28 per share. At December 31, 2015, the difference between GAAP book value and estimated economic book value was \$196 million, or \$1.05 per share. This difference is primarily driven by the value of the RMBS assets we have retained in these re-securitization transactions as compared to the value of consolidated loans and securities net of RMBS assets sold, but treated as a secured financing on the statement of financial condition. In these re-securitization transactions, we have generally retained the subordinated, typically non-rated, first loss notes or certificates issued by the securitization trusts. These securities are complex, typically locked out as to principal repayment, relatively illiquid, and do not necessarily appreciate or depreciate in tandem with the broader Non-Agency RMBS market or with the loans or securities owned by the trusts. As the senior securities pay off, we expect the

difference between our economic and our GAAP book value to decrease. The tables below present the adjustments to GAAP book value that we believe are necessary to adequately reflect our calculation of estimated economic book value as of September 30, 2016 and December 31, 2015.

61

September 30, 2016

(dollars in thousands, except per share data)

GAAP Book Value	\$ 3,036,800
GAAP Book Value per Share	\$ 16.18

Economic Adjustments:

Assets of Consolidated VIEs	(10,816,733)
Non-Recourse Liabilities of Consolidated VIEs	7,572,177
Interests in VIEs eliminated in consolidation	3,004,546

Total Adjustments - Net	(240,010)
Total Adjustments - Net (per share)	(1.28)

Economic Book Value	\$ 2,796,790
Economic Book Value per Share	\$ 14.90

December 31, 2015

(dollars in thousands, except per share data)

GAAP Book Value	\$ 2,946,188
GAAP Book Value per Share	\$ 15.70

Economic Adjustments:

Assets of Consolidated VIEs	(6,908,910)
Non-Recourse Liabilities of Consolidated VIEs	4,249,911
Interests in VIEs eliminated in consolidation	2,462,713

Total Adjustments - Net	(196,286)
Total Adjustments - Net (per share)	(1.05)

Economic Book Value	\$ 2,749,902
Economic Book Value per Share	\$ 14.65

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

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

Portfolio Review

During the nine months ended September 30, 2016, on an aggregate basis, we purchased \$5.7 billion of assets, sold \$2.7 billion of invested assets, and received \$1.6 billion million in principal payments related to our Agency, Non-Agency RMBS and Securitized Loans portfolio.

The following table summarizes certain characteristics of our portfolio at September 30, 2016 and December 31, 2015.

62

	September 30, 2016	December 31, 2015	
Interest earning assets at period-end ⁽¹⁾	\$ 16,708,822	\$ 14,959,081	
Interest bearing liabilities at period-end	\$ 13,389,696	\$ 11,689,250	
GAAP Leverage at period-end	4.4:1	4.0:1	
GAAP Leverage at period-end (recourse)	1.9:1	2.5:1	
Economic Leverage at period-end (recourse)	2.1:1	2.7:1	
Portfolio Composition, at amortized cost			
Non-Agency RMBS	8.9	% 10.4	%
Senior	3.9	% 4.7	%
Senior, interest only	1.9	% 1.9	%
Subordinated	3.0	% 3.7	%
Subordinated, interest only	0.1	% 0.1	%
RMBS transferred to consolidated VIEs	7.9	% 10.1	%
Agency MBS	27.2	% 46.0	%
Residential	17.9	% 37.2	%
Commercial	8.3	% 6.8	%
Interest-only	1.0	% 2.0	%
Securitized loans held for investment	56.0	% 33.5	%
Fixed-rate percentage of portfolio	88.0	% 84.7	%
Adjustable-rate percentage of portfolio	12.0	% 15.3	%
Annualized yield on average interest earning assets for the periods ended	6.2	% 6.0	%
Annualized cost of funds on average borrowed funds for the periods ended ⁽²⁾	2.8	% 2.5	%

(1) Excludes cash and cash equivalents.

(2) Includes the effect of realized losses on interest rate swaps.

GAAP leverage at period-end is calculated as a ratio of our repurchase agreements and securitized debt liabilities over GAAP book value. GAAP recourse leverage is calculated as a ratio of our repurchase agreements over GAAP book value. Economic recourse leverage is calculated as a ratio of our repurchase agreements over economic book value. Please refer to a discussion in “Estimated economic book value” section in the discussion of financial condition for details on our economic book value.

The following table presents details of each asset class in our portfolio at September 30, 2016 and December 31, 2015. The principal or notional value represents the interest income earning balance of each class. The weighted average figures are weighted by each investment’s respective principal/notional value in the asset class.

Edgar Filing: CHIMERA INVESTMENT CORP - Form 10-Q

September 30, 2016

	Principal or Notional Value at Period-End (dollars in thousands)	Weighted Average Amortized Cost Basis	Weighted Average Fair Value	Weighted Average Coupon	Weighted Average Yield at Period-End (%)	Weighted Average 3 Month CPR at Period-End (%)	Weighted Average 12 Month CPR at Period-End (%)	Weighted Average Delinquency Pipeline 60+	Weighted Average Loss Severity (%)	Weighted Average Credit Enhancement (%)	Weighted Average During the Quarter (dollars in thousands)	Principal Writedowns
Non-Agency Mortgage-Backed Securities												
Senior	\$899,853	\$68.23	\$75.89	2.8 %	7.3 %	13.0 %	12.7 %	22.4 %	54.5 %	9.4 %	\$4,321	
Senior, interest only	\$5,700,358	\$5.28	\$5.02	2.0 %	11.6 %	13.6 %	13.3 %	18.5 %	54.9 %	0.0 %	\$—	
Subordinated	\$668,946	\$69.83	\$81.74	3.4 %	10.3 %	13.0 %	13.7 %	15.8 %	49.0 %	16.2 %	\$4,686	
Subordinated, interest only	\$269,868	\$5.26	\$5.00	1.1 %	12.0 %	10.4 %	10.8 %	12.7 %	44.6 %	0.0 %	\$—	
RMBS transferred to consolidated VIEs	\$2,441,708	\$50.78	\$78.13	4.5 %	21.1 %	14.8 %	13.0 %	19.1 %	56.5 %	1.4 %	\$18,268	
Agency Mortgage-Backed Securities												
Residential	\$2,672,093	\$105.20	\$107.09	3.9 %	2.7 %	18.5 %	13.5 %	0.2 %	N/A	N/A	\$—	
Commercial	\$1,273,235	\$102.61	\$105.56	3.6 %	2.9 %	0.1 %	0.1 %	2.5 %	N/A	N/A	\$—	
Interest-only	\$3,474,731	\$4.71	\$4.52	0.9 %	3.8 %	8.3 %	6.6 %	0.4 %	N/A	N/A	\$—	
Securitized loans	\$9,030,908	\$97.30	\$98.79	6.8 %	6.1 %	11.7 %	10.4 %	2.5 %	46.2 %	N/A	\$30,097	

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

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

December 31, 2015

	Principal or Notional Value at Period-End (dollars in thousands)	Weighted Average Amortized Cost Basis	Weighted Average Fair Value	Weighted Average Coupon	Weighted Average Yield at Period-End (%)	Weighted Average 3 Month CPR at Period-End (%)	Weighted Average 12 Month CPR at Period-End (%)	Weighted Average Delinquency Pipeline 60+	Weighted Average Loss Severity (%)	Weighted Average Credit Enhancement (%)	Weighted Average During the Quarter (dollars in thousands)	Principal Writedowns
Non-Agency Mortgage-Backed Securities												
Senior	\$947,992	\$69.97	\$72.97	2.0 %	5.1 %	11.8 %	11.5 %	26.2 %	57.8 %	10.5 %	\$4,531	
Senior, interest only	\$5,388,159	\$4.93	\$4.23	1.6 %	12.5 %	13.7 %	13.6 %	19.5 %	54.9 %	0.0 %	\$—	
Subordinated	\$762,466	\$69.25	\$79.26	3.2 %	8.8 %	11.5 %	14.7 %	15.5 %	54.5 %	14.6 %	\$3,572	
Subordinated, interest only	\$284,931	\$5.34	\$3.95	1.2 %	10.9 %	9.7 %	11.3 %	14.5 %	43.0 %	0.0 %	\$—	
RMBS transferred to consolidated VIEs	\$2,741,748	\$52.47	\$78.07	4.5 %	17.7 %	12.4 %	11.9 %	19.9 %	61.6 %	1.2 %	\$33,677	

Agency

Mortgage-Backed
Securities

Residential	\$5,045,418	\$105.07	\$104.41	3.7 %	2.8 %	8.5 %	17.0 %	0.1 %	N/A	N/A	\$—
Commercial	\$952,091	\$102.27	\$102.28	3.4 %	3.0 %	0.8 %	3.1 %	0.0 %	N/A	N/A	\$—
Interest-only	\$6,722,472	\$4.17	\$4.06	0.8 %	3.4 %	6.3 %	9.9 %	0.2 %	N/A	N/A	\$—
Securitized loans	\$4,787,918	\$99.54	\$100.15	6.6 %	5.8 %	8.9 %	9.2 %	3.8 %	58.0 %	N/A	\$11,822

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

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

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

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

Accretable Discount	For the Quarters Ended				
	September 30, 2016	October 30, 2016	March 31, 2016	December 31, 2015	September 30, 2015
	(dollars in thousands)				
Balance, beginning of period	\$917,953	\$920,434	\$954,448	\$1,003,385	\$1,035,492
Accretion of discount	(44,455)	(42,297)	(45,481)	(43,520)	(41,498)
Purchases	8,959	5,601	191	1,845	6,194
Sales and deconsolidation	(14,386)	(20,590)	—	(35,144)	(22,645)
Transfers from/(to) credit reserve, net	13,178	54,805	11,276	27,882	25,842
Balance, end of period	\$881,249	\$917,953	\$920,434	\$954,448	\$1,003,385

Non-Accretable Difference	For the Quarters Ended				
	September 30, 2016	October 30, 2016	March 31, 2016	December 31, 2015	September 30, 2015
	(dollars in thousands)				
Balance, beginning of period	\$820,737	\$836,437	\$837,718	\$879,440	\$1,001,560
Principal Writedowns	(27,274)	(5,711)	(26,672)	(27,064)	(32,587)
Purchases	3,594	18,548	25,989	27,855	13,279
Sales and deconsolidation	(1,757)	(6,109)	—	(29,347)	(94,802)
Net other-than-temporary credit impairment losses	11,574	20,955	10,678	14,716	17,832
Transfers to/(from) credit reserve, net	(13,178)	(54,805)	(11,276)	(27,882)	(25,842)
Balance, end of period	\$793,696	\$820,737	\$836,437	\$837,718	\$879,440

Liquidity and Capital Resources

General

Liquidity measures our ability to meet cash requirements, including ongoing commitments to repay our borrowings, purchase RMBS, mortgage loans and other assets for our portfolio, pay dividends and other general business needs. Our principal sources of capital and funds for additional investments primarily include earnings, paydowns and sales from our investments, borrowings under securitizations and re-securitizations, repurchase agreements and other financing facilities, and proceeds from equity offerings.

To meet our short term (one year or less) liquidity needs, we expect to continue to borrow funds in the form of repurchase agreements and, subject to market conditions, other types of financing. The terms of the repurchase

transaction borrowings under our master repurchase agreements generally conform to the terms in the standard master repurchase agreement as published by the Securities Industry and Financial Markets Association, or SIFMA, as to repayment, margin requirements and the segregation of all securities we have initially sold under the repurchase transaction. In addition, each lender typically requires that we include supplemental terms and conditions to the standard master repurchase agreement. Typical supplemental terms and conditions include changes to the margin maintenance requirements, cross default provisions, required haircuts (or

the percentage that is subtracted from the value of RMBS that collateralizes the financing), purchase price maintenance requirements, and requirements that all disputes related to the repurchase agreement be litigated or arbitrated in a particular jurisdiction. These provisions may differ for each of our lenders.

We also expect to meet our short term liquidity needs by relying on the cash flows generated by our investments. These cash flows are primarily comprised of monthly principal and interest payments received on our investments. We may also sell our investments and utilize those proceeds to meet our short term liquidity needs or enter into non-recourse financing of our assets through sales of securities to third parties of loan securitizations or RMBS re-securitization transactions.

Based on our current portfolio, leverage ratio and available borrowing arrangements, we believe our assets will be sufficient to enable us to meet anticipated short-term liquidity requirements. However, a decline in the value of our collateral could cause a temporary liquidity shortfall due to the timing of margin calls on the financing arrangements and the actual receipt of the cash related to principal paydowns. If our cash resources are at any time insufficient to satisfy our liquidity requirements, we may have to sell investments, potentially at a loss, or issue debt or additional equity securities in a common stock offering.

To meet our longer term liquidity needs (greater than one year), we expect our principal sources of capital and funds to continue to be provided by earnings, paydowns and sales from our investments, borrowings under securitizations and re-securitizations, repurchase agreements and other financing facilities, as well as proceeds from equity offerings.

In addition to the principal sources of capital described above, we may enter into warehouse facilities and use longer dated structured repurchase agreements. The use of any particular source of capital and funds will depend on market conditions, availability of these facilities, and the investment opportunities available to us.

Current Period

We held cash and cash equivalents of approximately \$157 million and \$114 million at September 30, 2016 and December 31, 2015, respectively. As a result of our operating, investing and financing activities described above, our cash position increased by \$43 million from December 31, 2015 to September 30, 2016.

Our operating activities provided net cash of approximately \$264 million and \$254 million for the nine months ended September 30, 2016 and 2015, respectively. The cash provided by our operations is primarily due to interest received in excess of interest paid during the period. For the nine months ended September 30, 2016 and 2015, interest received net of interest paid was \$425 million and \$471 million, respectively. This cash received was offset in part by payments on derivatives of \$61 million and \$100 million, for termination of swaps for the nine months ended September 30, 2016 and 2015, respectively.

Our investing activities used cash of \$1.5 billion and provided cash of \$2.0 billion for the nine months ended September 30, 2016 and 2015, respectively. During the nine months ended September 30, 2016, we purchased investments of \$5.7 billion, primarily securitized loans held for investments. This cash used was offset in part by cash received on sales of investments of \$2.7 billion, primarily Agency RMBS, and principal repayments of \$1.6 billion. During the nine months ended September 30, 2015 we purchased investments of \$4.5 billion, primarily Agency RMBS. This use of cash was offset during the period from sales of investments of \$4.9 billion and principal repayments of \$1.7 billion during the first nine months of 2015. The purchases and sales activity was primarily due to our re-balancing of our Agency portfolio to maximize spread income and provide liquidity for purchases of seasoned subprime mortgage loan pools and non-Agency RMBS.

Our financing activities provided cash of \$1.3 billion, and used cash of \$2.3 billion for the nine months ended September 30, 2016 and 2015, respectively. During the nine months ended September 30, 2016, we received cash of \$4.2 billion on debt issuance. This cash provided was offset in part by net proceeds paid on repurchase agreements of \$1.6 billion, repayment of principal on our securitized debt of \$921 million, and dividends paid of \$364 million. During the nine months ended September 30, 2015, we paid net proceeds of \$1.3 billion on our repurchase agreements. We also repaid principal of our securitized debt of \$1.6 million and paid dividends of \$290 million. During the third quarter of 2015, we also paid \$213 million to acquire common stock outstanding. These uses of cash were offset, in part, by receipt of cash on debt issuance of \$1.1 billion.

Our economic recourse leverage is 2.1:1 and 2.7:1 for the period ended September 30, 2016 and the year ended December 31, 2015, respectively. Our recourse leverage excludes the securitized debt which can only be repaid from the proceeds on the assets securing this debt in their respective VIEs. Our recourse leverage is presented as a ratio of our repurchase agreements, which are recourse to the assets of the Company, to our economic net equity calculated as a part of our economic book value. The decrease in economic recourse leverage is driven by the sale of higher leverage agency positions to acquire residential mortgage loans.

We believe that our cash balances provide an appropriate level of liquidity. Even though we have unrestricted Agency MBS investments, we expect to meet our future cash needs primarily from principal and interest payments on our portfolio and do not anticipate we will need to sell unrestricted Agency MBS investments to meet our liquidity needs. We expect to continue to finance our MBS portfolio largely through repurchase agreements and loans through the securitization market. In addition, we may from time to time sell securities or issue debt as a source of cash to fund new purchases.

At September 30, 2016 and December 31, 2015 the remaining maturities on our RMBS repurchase agreements were as follows.

	September 30, 2016	December 31, 2015
	(dollars in thousands)	
Overnight	\$—	\$—
1 to 29 days	2,856,171	3,312,902
30 to 59 days	432,336	2,501,513
60 to 89 days	920,977	246,970
90 to 119 days	842,876	430,026
Greater than or equal to 120 days	765,159	947,928
Total	\$5,817,519	\$7,439,339
Average days to maturity	72 Days	77 Days

We collateralize the repurchase agreements we use to finance our operations with our MBS investments. Our counterparties negotiate a ‘haircut’, which is the difference expressed in percentage terms between the fair value of the collateral and the amount the counterparty will lend to us, when we enter into a financing transaction. The size of the haircut reflects the perceived risk associated with holding the MBS by the lender. The haircut provides lenders with a cushion for daily market value movements that reduce the need for a margin call to be issued or margin to be returned as normal daily increases or decreases in MBS market values occur. At September 30, 2016, and December 31, 2015, the weighted average haircut on our repurchase agreements collateralized by Agency MBS was 5.5% and 5.3%, respectively. At September 30, 2016, the weighted average haircut on our repurchase agreements collateralized by Non-Agency MBS was 32.6% compared to 32.9% at December 31, 2015. At September 30, 2016, the weighted average borrowing rates for our repurchase agreements collateralized by Agency MBS and Non-Agency MBS were 0.81% and 2.76%, respectively. At December 31, 2015, the weighted average borrowing rates for our repurchase agreements collateralized by Agency MBS and Non-Agency MBS were 0.64% and 2.44%, respectively.

As the fair value of the Non-Agency MBS is more difficult to determine, as well as more volatile period to period than Agency MBS, the Non-Agency MBS typically requires a larger haircut. In addition, when financing assets using standard form of SIFMA Master Repurchase Agreements, the counterparty to the agreement typically nets its exposure to us on all outstanding repurchase agreements and issues margin calls if movement of the fair values of the assets in the aggregate exceeds their allowable exposure to us. A decline in asset fair values could create a margin call, or may create no margin call depending on the counterparty’s specific policy. In addition, counterparties consider a number of factors, including their aggregate exposure to us as a whole and the number of days remaining before the repurchase transaction closes prior to issuing a margin call. See Note 5 to our Consolidated Financial Statements for a discussion on how we determine the fair values of the RMBS collateralizing our repurchase agreements.

The table below presents our average daily repurchase balance and the repurchase balance at each period end for the periods presented. Our balance at period-end tends to fluctuate from the average daily balances due to the adjusting of the size of our portfolio by using leverage. Our average repurchase agreement balance for the quarter ended September 30, 2016 decreased compared to our average repurchase agreement balance for the quarter ended

September 30, 2015 due to lower borrowings related to our Agency portfolio. We continue to deploy capital for strategic purchases of investments.

Period	Average Repurchase Balance	Repurchase Balance at Period End
Quarter End September 30, 2016	\$5,869,382	\$5,817,519
Quarter End June 30, 2016	\$6,863,960	\$5,856,263
Quarter End March 31, 2016	\$7,496,925	\$7,545,631
Quarter End December 31, 2015	\$7,392,083	\$7,439,339
Quarter End September 30, 2015	\$7,016,080	\$7,150,821

We are not required to maintain any specific debt-to-equity ratio. We believe the appropriate leverage for the particular assets we are financing depends on the credit quality and risk of those assets. At September 30, 2016 and December 31, 2015, the carrying value of our total debt was approximately \$13.4 billion and \$11.7 billion, respectively, which represented a debt-to-equity ratio for both periods of approximately 4.4:1 and 4.0:1, respectively. We include our repurchase agreements and securitized debt in the numerator of our debt-to-equity ratio and stockholders' equity as the denominator.

At September 30, 2016, we had repurchase agreements with 24 counterparties. All of our repurchase agreements are secured by Agency and Non-Agency RMBS or, in limited circumstances, cash. Under these repurchase agreements we may not be able to reclaim our collateral but still be obligated to pay our repurchase obligations. We mitigate this risk by spreading our exposure to multiple counterparties, as well as ensuring all our counterparties are highly rated. Therefore, we believe the risk of loss of our collateral posted is mitigated by the terms of our agreements. As of September 30, 2016 and December 31, 2015, we had \$7.3 billion and \$8.8 billion, respectively, of securities pledged against our repurchase agreement obligations.

Our repurchase agreements have original maturities ranging from 14 to 728 days and a weighted average original maturity of 126 days. We expect to renew each of our repurchase agreements at maturity. When we renew our repurchase agreements, there is a risk that we will not be able to obtain as favorable an interest rate as a result of rising rates. We offset the risk of our repurchase agreements primarily through the use of interest rate swaps, swaptions and treasury futures. The average remaining maturities on our interest rate swaps at September 30, 2016 range from 3 years to 18 years and have a weighted average maturity of approximately 8 years. We use these interest rate derivatives to protect the portfolio from short term changes in interest rates. We currently have one swap counterparty. When our interest rate swaps are in a net loss position (expected cash payments are in excess of expected cash receipts on the swaps), we post collateral as required by the terms of our swap agreements. As of September 30, 2016, we have posted \$131 million of cash as collateral to our swap counterparty. We have four swaption counterparties and we have posted \$12 million of securities as collateral to our swaption counterparties. We have two futures counterparties, and we have posted \$10 million of cash as a collateral to our futures counterparties.

Secured Debt Financing Transactions

During the first quarter of 2016, the Company acquired securitized debt collateralized by loans with an amortized cost balance of \$44 million for \$46 million. This transaction resulted in a net loss on the extinguishment of debt of \$2 million. This loss is reflected in earnings for the nine months ended September 30, 2016. Additionally, during the nine months ended September 30, 2016, we issued new debt, collateralized by these same loans held for investment, with an unpaid principal balance of \$100 million for \$98 million.

During the second quarter of 2016, we acquired controlling interests in several trusts collateralized by seasoned residential subprime mortgage loans. As we held the controlling interest, we consolidated the assets and liabilities, increasing our investments in mortgage loans by \$5.0 billion and secured debt by \$4.2 billion. The investment was

financed through a combination of cash raised from sale of investments, securitized financing and additional repurchase agreements.

During the quarter ended September 30, 2016, the Company acquired securitized debt collateralized by Non-Agency RMBS with an amortized cost balance of \$4 million for \$4 million. This transaction resulted in a net loss on the extinguishment of debt of \$45 thousand. This loss is reflected in earnings for the quarter and nine months ended September 30, 2016.

During the third quarter of 2015, we called securitized debt, collateralized by loans held for investment with an unpaid principal balance of \$508 million at par. Additionally, during the quarter, we issued new debt, collateralized by these same loans held for investment, with an unpaid principal balance of \$521 million for \$515 million. During the nine months ended September 30, 2015, we called securitized debt, collateralized by loans held for investment with an unpaid principal balance of \$739 million at par. Additionally, during the nine months ended September 30, 2015, we issued new debt, collateralized by these same loans held for investment, with an unpaid principal balance of \$798 million for a proceeds of \$791 million.

Also, during the third quarter of 2015, we purchased outstanding debt with an unpaid principal amount of \$155 million for \$135 million. This outstanding debt acquired is part of a securitization vehicle which has a call date in 2016.

Subsequent to September 30, 2016, the Company exercised its call option to retire securitized debt, collateralized by loans held for investment with an unpaid principal amount of \$563 million at par.

Exposure to European Financial Counterparties

Our Agency RMBS are primarily financed with repurchase agreements. We secure our borrowings under these agreements by pledging our Agency RMBS as collateral to the lender. The collateral we pledge exceeds the amount of the borrowings under each agreement, typically with the extent of over-collateralization being at least 3% of the amount borrowed. If the counterparty to the repurchase agreement defaults on its obligations and we are not able to recover our pledged assets, we are at risk of losing the over-collateralized amount. The amount of this exposure is the difference between the amount loaned to us plus interest due to the counterparty and the fair value of the collateral pledged by us to the lender including accrued interest receivable on such collateral.

We also use interest rate swaps to manage our interest rate risks. Under these swap agreements, we pledge Agency RMBS or cash as collateral as part of a margin arrangement for interest rate swaps that are in an unrealized loss position. If swap counterparty were to default on its obligation, we would be exposed to a loss to the extent that the amount of our Agency RMBS pledged exceeded the unrealized loss on the associated swaps and we were not able to recover the excess collateral.

Over the past several years, several large European financial institutions have experienced financial difficulty and have been either rescued by government assistance or by other large European banks or institutions. Some of these financial institutions or their U.S. subsidiaries have provided us financing under repurchase agreements or we have entered into interest rate swaps with such institutions. We have entered into repurchase agreements or interest rate swaps with 6 counterparties as of September 30, 2016 that is either domiciled in Europe or is a U.S.-based subsidiary of a European-domiciled financial institution. The following table summarizes our exposure to such counterparties at September 30, 2016:

September 30, 2016

Country	Number of Counterparties	Repurchase Agreement Financing	Interest Rate Swaps at Fair Value	Exposure ⁽¹⁾	Exposure as a Percentage of Total Assets
(dollars in thousands)					
France	2	\$ 150,330	\$(84,451)	\$ 31,409	0.18 %
Netherlands	1	181,440	—	9,524	0.06 %
Switzerland	1	892,618	—	476,528	2.78 %
United Kingdom	2	208,654	—	21,855	0.13 %
Total	6	\$ 1,433,042	\$(84,451)	\$ 539,316	3.15 %

(1) Represents the amount of securities pledged as collateral to each counterparty less the aggregate of repurchase agreement financing and unrealized loss on swaps for each counterparty.

At September 30, 2016, we did not use credit default swaps or other forms of credit protection to hedge the exposures summarized in the table above.

If the European credit crisis continues to impact these major European financial institutions, it is possible that it will also impact the operations of their U.S. subsidiaries. Our financings and operations could be adversely affected by such events. We monitor our exposure to our repurchase agreement and swap counterparties on a regular basis, using various methods, including review of recent rating agency actions, financial relief plans, credit spreads or other developments and by monitoring the amount of cash and securities collateral pledged and the associated loan amount under repurchase agreements or the fair value of swaps with our counterparties. We make reverse margin calls on our counterparties to recover excess collateral as permitted by the agreements governing our financing arrangements or interest rate swaps, or may try to take other actions to reduce the amount of our exposure to a counterparty when necessary.

Stockholders' Equity

Other than as discussed below under "Restricted Stock Grants," we did not issue any shares during the quarters ended September 30, 2016 and 2015. During the quarters ended September 30, 2016 and 2015, the Company declared dividends to

common shareholders of \$0.48 per share to common shareholders totaling \$91 million, respectively. During the nine months ended September 30, 2016, the Company declared regular dividends to common shareholders totaling \$271 million, or \$1.44 per share, and a special dividend of \$94 million, or \$0.50 per share. For the nine months ended September 30, 2015, the Company declared dividends to common shareholders totaling \$289 million, or \$1.44 per share.

Subsequent to September 30, 2016, the Company sold 5,800,000 shares of 8.00% Series A Cumulative Redeemable Preferred Stock, par value \$0.01 per share (the "Series A Preferred Stock"), at a public offering price of \$25.00 per share. The Series A Preferred Stock is redeemable at \$25.00 per share plus accrued and unpaid dividends (whether or not authorized or declared) exclusively at the Company's option commencing in October, 2021, subject to the Company's right, under limited circumstances, to redeem the Series A Preferred Stock prior to that date. The Series A Preferred Stock is entitled to receive a dividend at a rate of 8.0% per year on the \$25.00 liquidation preference before the common stock is paid any dividends and is senior to the common stock with respect to distributions upon liquidation, dissolution or winding up. This transaction was completed in October, 2016, pursuant to which we received proceeds, net of offering costs, of \$140 million.

Restricted Stock Grants

We granted 266,200 shares of restricted stock during first quarter of 2016, to the executive officers of the Company as compensation related to services provided in 2015. Additionally, during the first quarter of 2016, the Company granted certain of its employees 179,600 Performance Share Units ("PSU") awards. PSU awards are designed to align compensation with the Company's future performance.

At September 30, 2016 and December 31, 2015, there were approximately 484,870 and 71,000 unvested shares of restricted stock issued to our employees, respectively.

Contractual Obligations and Commitments

The following tables summarize our contractual obligations at September 30, 2016 and December 31, 2015. The estimated principal repayment schedule of the securitized debt is based on expected cash flows of the residential mortgage loans or RMBS, as adjusted for expected principal writedowns on the underlying collateral of the debt.

September 30, 2016

(dollars in thousands)

Contractual Obligations	Within One Year	One to Three Years	Three to Five Years	Greater Than or Equal to Five Years	Total
Repurchase agreements for RMBS	\$5,710,794	\$106,725	\$—	\$—	\$5,817,519
Securitized debt, collateralized by Non-Agency RMBS	118,371	98,894	30,361	32,158	279,784
Securitized debt at fair value, collateralized by loans held for investment	1,174,427	1,917,720	1,497,626	2,646,354	7,236,127
Interest expense on RMBS repurchase agreements ⁽¹⁾	22,659	1,030	—	—	23,689
Interest expense on securitized debt ⁽¹⁾	301,901	504,071	365,440	675,037	1,846,449
Total	\$7,328,152	\$2,628,440	\$1,893,427	\$3,353,549	\$15,203,568

(1) Interest is based on variable rates in effect as of September 30, 2016.

December 31, 2015
(dollars in thousands)

Contractual Obligations	Within One Year	One to Three Years	Three to Five Years	Greater Than or Equal to Five Years	Total
Repurchase agreements for RMBS	\$7,180,496	\$258,841	\$—	\$—	\$7,439,337
Securitized debt, collateralized by Non-Agency RMBS	137,642	178,191	60,872	52,280	428,985
Securitized debt at fair value, collateralized by loans held for investment	591,171	941,704	734,291	1,502,663	3,769,829
Interest expense on RMBS repurchase agreements ⁽¹⁾	24,974	2,099	—	—	27,073
Interest expense on securitized debt ⁽¹⁾	144,515	263,056	221,412	466,405	1,095,388
Total	\$8,078,798	\$1,643,891	\$1,016,575	\$2,021,348	\$12,760,612

(1) Interest is based on variable rates in effect as of December 31, 2015.

Off-Balance Sheet Arrangements

We do not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. Further, we have not guaranteed any obligations of unconsolidated entities nor do we have any commitment or intent to provide funding to any such entities.

Capital Expenditure Requirements

At September 30, 2016 and December 31, 2015, we had no material commitments for capital expenditures.

Dividends

To qualify as a REIT, we must pay annual dividends to our stockholders of at least 90% of our taxable income (subject to certain adjustments). We intend to pay regular quarterly dividends to our stockholders. Before we pay any dividend, we must first meet any operating requirements and scheduled debt service on our financing facilities and other debt payable.

Inflation

A significant portion of our assets and liabilities are interest rate sensitive in nature. As a result, interest rates and other factors influence our performance far more so than does inflation. Changes in interest rates do not necessarily correlate with inflation rates or changes in inflation rates. Our consolidated financial statements are prepared in accordance with GAAP and our distributions will be determined by our Board of Directors consistent with our obligation to distribute to our stockholders at least 90% of our REIT taxable income on an annual basis in order to maintain our REIT qualification; in each case, our activities and financial condition are measured with reference to historical cost or fair market value without considering inflation.

Critical Accounting Policies and Estimates

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

For a discussion of the Company's critical accounting policies and estimates, see "Critical Accounting Policies and Estimates" in Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" included in the Company's Annual Report on Form 10-K for the year ended December 31, 2015.

Recent Accounting Pronouncements

Refer to Note 2(p) in the Notes to Consolidated Financial Statements for a discussion of accounting guidance recently adopted by the Company or expected to be adopted by the Company in the future.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

The primary components of our market risk are related to credit risk, interest rate risk, prepayment risk, market value risk and real estate risk. While we do not seek to avoid risk completely, we believe the risk can be quantified from historical experience and we seek to actively manage that risk, to earn sufficient compensation to justify taking those risks and to maintain capital levels consistent with the risks we undertake.

Credit Risk

We are subject to credit risk in connection with our investments in Non-Agency RMBS and residential mortgage loans and face more credit risk on assets we own which are rated below "AAA." The credit risk related to these investments pertains to the ability and willingness of the borrowers to pay, which is assessed before credit is granted or renewed and periodically reviewed throughout the loan or security term. We believe that residual loan credit quality, and thus the quality of our assets, is primarily determined by the borrowers' credit profiles and loan characteristics. We use a comprehensive credit review process. Our analysis of loans includes borrower profiles, as well as valuation and appraisal data. We use compensating factors such as liquid assets, low loan to value ratios and regional unemployment statistics in evaluating loans. Our resources include a proprietary portfolio management system, as well as third party software systems. We may utilize a third party due diligence firm to perform an independent underwriting review to ensure compliance with existing guidelines. In addition to statistical sampling techniques, we create adverse credit and valuation samples, which we individually review. We reject loans that fail to conform to our standards and do not meet our underwriting criteria. Once we own a loan, our surveillance process includes ongoing analysis through our proprietary data and servicer files. Additionally, the Non-Agency RMBS and other ABS which we acquire for our portfolio are reviewed by us to ensure that they satisfy our risk based criteria. Our review of Non-Agency RMBS and other ABS includes utilizing a proprietary portfolio management system. Our review of Non-Agency RMBS and other ABS is based on quantitative and qualitative analysis of the risk-adjusted returns on Non-Agency RMBS and other ABS. This analysis includes an evaluation of the collateral characteristics supporting the RMBS such as borrower payment history, credit profiles, geographic concentrations, credit enhancement, seasoning, and other pertinent factors.

Interest Rate Risk

Interest rate risk is highly sensitive to many factors, including governmental, monetary and tax policies, domestic and international economic and political considerations and other factors beyond our control. We are subject to interest rate risk in connection with our investments and our related debt obligations, which are generally repurchase agreements, warehouse facilities and securitization/re-securitization vehicles. Our repurchase agreements and warehouse facilities may be of limited duration that is periodically refinanced at current market rates. We intend to mitigate this risk through utilization of derivative contracts, primarily interest rate swap agreements, swaptions, futures and mortgage options.

Interest Rate Effects on Net Interest Income

Our operating results depend, in large part, on differences between the income from our investments and our borrowing costs. Most of our warehouse facilities and repurchase agreements provide financing based on a floating rate of interest calculated on

a fixed spread over LIBOR. The fixed spread varies depending on the type of underlying asset which collateralizes the financing. Accordingly, the portion of our portfolio which consists of floating interest rate assets will be match-funded utilizing our expected sources of short-term financing, while our fixed interest rate assets will not be match-funded. During periods of rising interest rates, the borrowing costs associated with our investments tend to increase while the income earned on our fixed interest rate investments may remain substantially unchanged. This will result in a narrowing of the net interest spread between the related assets and borrowings and may even result in losses. Further, during this portion of the interest rate and credit cycles, defaults could increase and result in credit losses to us, which could adversely affect our liquidity and operating results. Such delinquencies or defaults could also have an adverse effect on the spread between interest-earning assets and interest-bearing liabilities. Hedging techniques are partly based on assumed levels of prepayments of our fixed-rate and hybrid adjustable-rate mortgage loans and RMBS. If prepayments are slower or faster than assumed, the life of the mortgage loans and RMBS will be longer or shorter, which would reduce the effectiveness of any hedging strategies we may use and may cause losses on such transactions.

Interest Rate Effects on Fair Value

Another component of interest rate risk is the effect changes in interest rates will have on the fair value of the assets we acquire. We face the risk that the fair value of our assets will increase or decrease at different rates than that of our liabilities, including our hedging instruments. We primarily assess our interest rate risk by estimating the duration of our assets and the duration of our liabilities. Duration essentially measures the market price volatility of financial instruments as interest rates change. We generally calculate duration using various financial models and empirical data. Different models and methodologies can produce different duration numbers for the same securities.

It is important to note that the impact of changing interest rates on fair value can change significantly when interest rates change beyond 100 basis points from current levels. Therefore, the volatility in the fair value of our assets could increase significantly when interest rates change beyond 100 basis points. In addition, other factors impact the fair value of our interest rate-sensitive investments and hedging instruments, such as the shape of the yield curve, market expectations as to future interest rate changes and other market conditions. Accordingly, in the event of changes in actual interest rates, the change in the fair value of our assets would likely differ from that shown below and such difference might be material and adverse to our stockholders.

Interest Rate Cap Risk

We may also invest in adjustable-rate mortgage loans and RMBS. These are mortgages or RMBS in which the underlying mortgages are typically subject to periodic and lifetime interest rate caps and floors, which limit the amount by which the security's interest yield may change during any given period. However, our borrowing costs pursuant to our financing agreements will not be subject to similar restrictions. Therefore, in a period of increasing interest rates, interest rate costs on our borrowings could increase without limitation by caps, while the interest-rate yields on our adjustable-rate mortgage loans and RMBS would effectively be limited. This problem will be magnified to the extent we acquire adjustable-rate RMBS that are not based on mortgages which are fully indexed. In addition, the mortgages or the underlying mortgages in an RMBS may be subject to periodic payment caps that result in some portion of the interest being deferred and added to the principal outstanding. This could result in our receipt of less cash income on our adjustable-rate mortgages or RMBS than we need in order to pay the interest cost on our related borrowings. These factors could lower our net interest income or cause a net loss during periods of rising interest rates, which would harm our financial condition, cash flows and results of operations.

Interest Rate Mismatch Risk

We fund a substantial portion of our acquisitions of RMBS with borrowings that, after the effect of hedging, have interest rates based on indices and re-pricing terms similar to, but of somewhat shorter maturities than, the interest rate indices and re-pricing terms of the mortgages and RMBS. In most cases the interest rate indices and re-pricing terms of our mortgage assets and our funding sources will not be identical, thereby creating an interest rate mismatch between assets and liabilities. Our cost of funds would likely rise or fall more quickly than would our earnings rate on assets. During periods of changing interest rates, such interest rate mismatches could negatively impact our financial condition, cash flows and results of operations. To mitigate interest rate mismatches, we may utilize the hedging strategies discussed above. Our analysis of risks is based on our experience, estimates, models and assumptions. These analyses rely on models which utilize estimates of fair value and interest rate sensitivity. Actual economic conditions or implementation of investment decisions by our management may produce results that differ significantly from the estimates and assumptions used in our models and the projected results shown in this Form 10-Q.

Our profitability and the value of our portfolio (including derivatives) may be adversely affected during any period as a result of changing interest rates. The following table quantifies the potential changes in net interest income and portfolio value for our Agency MBS portfolio should interest rates go up or down 50 and 100 basis points, assuming parallel movements in the yield

curves. All changes in income and value are measured as percentage changes from the projected net interest income and portfolio value at the base interest rate scenario. The base interest rate scenario assumes interest rates at September 30, 2016 and various estimates regarding prepayment and all activities are made at each level of rate change. Actual results could differ significantly from these estimates.

Change in Interest Rate	September 30, 2016		
	Projected Percentage Change in Projected Portfolio Percentage Value with Change in Net Interest Income ⁽¹⁾	Effect of Interest Rate Swaps and Hedging Transactions ⁽²⁾	
-100 Basis Points	(23.06)%	0.33 %	%
-50 Basis Points	(12.71)%	0.26 %	%
Base Interest Rate	—	—	
+50 Basis Points	11.93 %	(0.55)%	%
+100 Basis Points	20.56 %	(1.39)%	%

(1) Change in annual economic net interest income. Includes interest expense on interest rate swaps.

(2) Projected Percentage Change in Portfolio Value is based on instantaneous moves in interest rates.

Prepayment Risk

As we receive prepayments of principal on these investments, premiums and discounts on such investments will be amortized or accreted into interest income. In general, an increase in prepayment rates will accelerate the amortization of purchase premiums, thereby reducing the interest income earned on the investments. Conversely, discounts on such investments are accelerated and accreted into interest income increasing interest income.

Extension Risk

Management computes the projected weighted-average life of our investments based on assumptions regarding the rate at which the borrowers will prepay the underlying mortgages. In general, when fixed-rate or hybrid adjustable-rate mortgage loans or RMBS are acquired via borrowings, we may, but are not required to, enter into an interest rate swap agreement or other hedging instrument that effectively fixes our borrowing costs for a period close to the anticipated average life of the fixed-rate portion of the related assets. This strategy is designed to protect us from rising interest rates as the borrowing costs are effectively fixed for the duration of the fixed-rate portion of the related assets. However, if prepayment rates decrease in a rising interest rate environment, the life of the fixed-rate portion of the related assets could extend beyond the term of the swap agreement or other hedging instrument. This could have a negative impact on our results from operations, as borrowing costs would no longer be fixed after the end of the hedging instrument while the income earned on the fixed and hybrid adjustable-rate assets would remain fixed. In extreme situations, we may be forced to sell assets to maintain adequate liquidity, which could cause us to incur losses.

Basis Risk

We seek to limit our interest rate risk by hedging portions of our portfolio through interest rate swaps and other types of hedging instruments. Interest rate swaps are generally tied to underlying Treasury benchmark interest rates. Basis risk relates to the risk of the spread between our RMBS and underlying hedges widening. Such a widening may cause a decline in the fair value of our RMBS that is greater than the increase in fair value of our hedges resulting in a net decline in book value. The widening of mortgage-backed securities yields and Treasury benchmark interest rates may result from a variety of factors such as anticipated or actual monetary policy actions or other market factors.

Market Risk

Market Value Risk

Our available-for-sale securities are reflected at their estimated fair value with unrealized gains and losses excluded from earnings and reported in other comprehensive income if no OTTI has been recognized in earnings. The estimated fair value of these securities fluctuates primarily due to changes in interest rates, prepayment speeds, market liquidity, credit quality, and other factors. Generally, in a rising interest rate environment, the estimated fair value of these securities would be expected to decrease; conversely, in a decreasing interest rate environment, the estimated fair value of these securities would be expected to increase. As market volatility increases or liquidity decreases, the fair value of our investments may be adversely impacted.

Real Estate Market Risk

We own assets secured by real property and may own real property directly in the future. Residential property values are subject to volatility and may be affected adversely by a number of factors, including, but not limited to, national, regional and local economic conditions (which may be adversely affected by industry slowdowns and other factors); local real estate conditions (such as an oversupply of housing); changes or continued weakness in specific industry segments; construction quality, age and design; demographic factors; and retroactive changes to building or similar codes. In addition, decreases in property values reduce the value of the collateral and the potential proceeds available to a borrower to repay our loans, which could also cause us to incur losses.

Risk Management

To the extent consistent with maintaining our REIT status, we seek to manage risk exposure to protect our portfolio of residential mortgage loans, RMBS, and other assets and related debt against the effects of major interest rate changes. We generally seek to manage risk by:

- monitoring and adjusting, if necessary, the reset index and interest rate related to our RMBS and our financings;
- attempting to structure our financing agreements to have a range of different maturities, terms, amortizations and interest rate adjustment periods;
- using derivatives, financial futures, swaps, options, caps, floors and forward sales to adjust the interest rate sensitivity of our investments and our borrowings;
- using securitization financing to lower average cost of funds relative to short-term financing vehicles further allowing us to receive the benefit of attractive terms for an extended period of time in contrast to short term financing and maturity dates of the investments not included in the securitization; and
- actively managing, on an aggregate basis, the interest rate indices, interest rate adjustment periods, and gross reset margins of our investments and the interest rate indices and adjustment periods of our financings.

Our efforts to manage our assets and liabilities are concerned with the timing and magnitude of the re-pricing of assets and liabilities. We attempt to control risks associated with interest rate movements. Methods for evaluating interest rate risk include an analysis of our interest rate sensitivity “gap,” which is the difference between interest-earning assets and interest-bearing liabilities maturing or re-pricing within a given time period. A gap is considered positive when the amount of interest-rate sensitive assets exceeds the amount of interest-rate sensitive liabilities. A gap is considered negative when the amount of interest-rate sensitive liabilities exceeds interest-rate sensitive assets. During a period of rising interest rates, a negative gap would tend to adversely affect net interest income, while a positive gap would tend to result in an increase in net interest income. During a period of falling interest rates, a negative gap would tend to result in an increase in net interest income, while a positive gap would tend to affect net interest income adversely. Because different types of assets and liabilities with the same or similar maturities may react differently to changes in

overall market rates or conditions, changes in interest rates may affect net interest income positively or negatively even if an institution were perfectly matched in each maturity category.

The following table sets forth the estimated maturity or re-pricing of our interest-earning assets and interest-bearing liabilities at September 30, 2016. The amounts of assets and liabilities shown within a particular period were determined in accordance with the contractual terms of the assets and liabilities, except adjustable-rate loans, and securities are included in the period in which their interest rates are first scheduled to adjust and not in the period in which they mature and includes the effect of the interest rate swaps. The interest rate sensitivity of our assets and liabilities in the table could vary substantially based on actual prepayments.

September 30, 2016
(dollars in thousands)

	Within 3 Months	3-12 Months	1 Year to 3 Years	Greater than 3 Years	Total			
Rate sensitive assets	\$432,463	\$1,451,922	\$114	\$14,836,659	\$16,721,158			
Cash equivalents	156,608	—	—	—	156,608			
Total rate sensitive assets	\$589,071	\$1,451,922	\$114	\$14,836,659	\$16,877,766			
Rate sensitive liabilities	7,346,689	6,033,696	1,686	—	13,382,071			
Interest rate sensitivity gap	\$(6,757,618)	\$(4,581,774)	\$(1,572)	\$14,836,659	\$3,495,695			
Cumulative rate sensitivity gap	\$(6,757,618)	\$(11,339,392)	\$(11,340,964)	\$3,495,695				
Cumulative interest rate sensitivity gap as a percentage of total rate sensitive assets	(40)%	(67)%	(67)%	21	%

Our analysis of risks is based on our management's experience, estimates, models and assumptions. These analyses rely on models which utilize estimates of fair value and interest rate sensitivity. Actual economic conditions or implementation of investment decisions by our management may produce results that differ significantly from the estimates and assumptions used in our models and the projected results shown in the above tables and in this Form 10-Q. These analyses contain certain forward-looking statements and are subject to the safe harbor statement set forth under the heading, "Special Note Regarding Forward-Looking Statements."

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this report, an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934) was performed under the supervision and with the participation of the Company's senior management, including the Chief Executive Officer and the Chief Financial Officer. Based on that evaluation, the Company's management, including the Chief Executive Officer and the Chief Financial Officer, concluded that the Company's disclosure controls and procedures were effective as of the end of the period covered by this report.

(b) Changes in Internal Control over Financial Reporting

As required by Rule 13a-15(d) under the Exchange Act, the Company's management, including its Chief Executive Officer and Chief Financial Officer, has evaluated the Company's internal control over financial reporting to determine whether any changes occurred during the period covered by this quarterly report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. Based on that evaluation, there has been no such change during the third quarter of 2016.

PART II. Other Information

Item 1. Legal Proceedings

None.

Item 1A. Risk Factors

Under “Part I — Item 1A — Risk Factors” of our 2015 Form 10-K, we set forth risk factors related to (i) risks associated with adverse developments in the mortgage finance and credit markets, (ii) risks associated with our management, (iii) risks related to our business, (iv) risks related to our investments, (v) regulatory and legal risks, (vi) risks related to our common stock (vii) tax risks, and (viii) risks associated with our prior late filings and related matters. You should carefully consider the risk factors set forth in our 2015 Form 10-K. As of the date hereof, there have been no material changes to the risk factors set forth in our Form 10-K for the year ended December 31, 2015.

Item 6. Exhibits

EXHIBIT INDEX

Exhibit Number	Description
3.1	Articles of Amendment and Restatement of Chimera Investment Corporation (filed as Exhibit 3.1 to the Company's Registration Statement on Amendment No. 1 to Form S-11 (File No. 333-145525) filed on September 27, 2007 and incorporated herein by reference).
3.2	Articles of Amendment to the Articles of Amendment and Restatement of Chimera Investment Corporation (filed as Exhibit 3.1 to the Company's Report on Form 8-K filed on May 28, 2009 and incorporated herein by reference).
3.3	Articles of Amendment to the Articles of Amendment and Restatement of Chimera Investment Corporation (filed as Exhibit 3.1 to the Company's Report on Form 8-K filed on November 5, 2010 and incorporated herein by reference).
3.4	Articles of Amendment to the Articles of Amendment and Restatement of Chimera Investment Corporation (filed as Exhibit 3.1 to the Company's Report on Form 8-K filed on April 6, 2015 and incorporated herein by reference).
3.5	Articles of Amendment to the Articles of Amendment and Restatement of Chimera Investment Corporation (filed as Exhibit 3.2 to the Company's Report on Form 8-K filed on April 6, 2015 and incorporated herein by reference).
3.6	Articles Supplementary to the Articles of Amendment and Restatement of Chimera Investment Corporation designating the Company's 8.00% Series A Cumulative Redeemable Preferred Stock, par value \$0.01 per share (incorporated by reference to Exhibit 3.1 to the Registrant's Current Report on Form 8-K filed October 12, 2016).
3.7	Amended and Restated Bylaws of Chimera Investment Corporation (filed as Exhibit 3.1 to the Company's Report on Form 8-K filed on October 23, 2015 and incorporated herein by reference).
4.1	Specimen Common Stock Certificate of Chimera Investment Corporation (filed as Exhibit 4.1 to the Company's Registration Statement on Amendment No. 1 to Form S-11 (File No. 333-145525) filed on September 27, 2007 and incorporated herein by reference).
4.2	Form of Series A Preferred Stock Certificate (incorporated by reference to Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed October 12, 2016).
31.1	Certification of Matthew Lambiase, Chief Executive Officer and President of the Registrant, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Robert Colligan, Chief Financial Officer of the Registrant, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Matthew Lambiase, Chief Executive Officer and President of the Registrant, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Robert Colligan, Chief Financial Officer of the Registrant, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURES

Pursuant to the requirements 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.

CHIMERA INVESTMENT CORPORATION

By: /s/ Matthew Lambiase
Matthew Lambiase
(Chief Executive Officer and President
and duly authorized officer of the registrant)

Date: November 3, 2016

By: /s/ Robert Colligan
Robert Colligan
(Chief Financial Officer
and principal financial officer of the registrant)

Date: November 3, 2016