

Invesco Mortgage Capital Inc.
Form 10-Q
August 17, 2015
Table of Contents

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2015

OR

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

For the transition period from _____ to _____
Commission file number 001-34385

(Exact Name of Registrant as Specified in Its Charter)

Maryland 26-2749336
(State or Other Jurisdiction of (I.R.S. Employer
Incorporation or Organization) Identification No.)

1555 Peachtree Street, N.E., Suite 1800 30309
Atlanta, Georgia
(Address of Principal Executive Offices) (Zip Code)
(404) 892-0896
(Registrant's Telephone Number, Including Area Code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

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

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

As of August 11, 2015, there were 123,142,068 outstanding shares of common stock of Invesco Mortgage Capital Inc.

Table of Contents

INVESCO MORTGAGE CAPITAL INC.
TABLE OF CONTENTS

	Page
<u>PART I FINANCIAL INFORMATION</u>	<u>2</u>
Item 1. <u>Financial Statements</u>	<u>2</u>
<u>Condensed Consolidated Balance Sheets as of June 30, 2015 (unaudited) and December 31, 2014</u>	<u>2</u>
<u>Unaudited Condensed Consolidated Statements of Operations for the three and six months ended June 30, 2015 and 2014</u>	<u>3</u>
<u>Unaudited Condensed Consolidated Statements of Comprehensive Income for the three and six months ended June 30, 2015 and 2014</u>	<u>4</u>
<u>Unaudited Condensed Consolidated Statement of Equity for the six months ended June 30, 2015</u>	<u>5</u>
<u>Unaudited Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2015 and 2014</u>	<u>6</u>
<u>Notes to Condensed Consolidated Financial Statements</u>	<u>7</u>
Item 2. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>42</u>
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	<u>71</u>
Item 4. <u>Controls and Procedures</u>	<u>74</u>
<u>PART II OTHER INFORMATION</u>	<u>75</u>
Item 1. <u>Legal Proceedings</u>	<u>75</u>
Item 1A. <u>Risk Factors</u>	<u>75</u>
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>75</u>
Item 3. <u>Defaults Upon Senior Securities</u>	<u>75</u>
Item 4. <u>Mine Safety Disclosures</u>	<u>75</u>
Item 5. <u>Other Information</u>	<u>75</u>
Item 6. <u>Exhibits</u>	<u>77</u>

Table of Contents

Explanatory Note

Restatement Background

On August 9, 2015, the Audit Committee of the Board of Directors of the Company concluded, based on the recommendation of management, that each of the Company's previously issued (i) consolidated financial statements as of and for the years ended December 31, 2013 and 2014, which were included in its Annual Report on Form 10-K for the year ended December 31, 2014, and (ii) interim consolidated financial statements as of and for the quarter ended March 31, 2013 and for all subsequent quarters through the quarter ended March 31, 2015 need to be restated and should no longer be relied upon. The Company filed Amendment No. 1 to its Annual Report on Form 10-K for the year ended December 31, 2014 and Amendment No. 1 to its Quarterly Report on Form 10-Q for the quarter ended March 31, 2015 on August 17, 2015. Prior period financial information in this Form 10-Q has been amended where necessary to reflect the restatement. Therefore, this Form 10-Q should be read in conjunction with the Company's Annual Report on Form 10-K/A for the year ended December 31, 2014. Additional information regarding the restatement is contained in those filings.

Table of Contents

PART I

ITEM 1. FINANCIAL STATEMENTS

INVESCO MORTGAGE CAPITAL INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

In thousands except share amounts	As of June 30, 2015 (Unaudited)	December 31, 2014 (As Restated)
ASSETS		
Mortgage-backed and credit risk transfer securities, at fair value	17,195,238	17,248,895
Residential loans, held-for-investment ⁽¹⁾	3,461,992	3,365,003
Commercial loans, held-for-investment	155,011	145,756
Cash and cash equivalents	87,003	164,144
Due from counterparties	65,107	57,604
Investment related receivable	37,123	38,717
Accrued interest receivable	70,076	66,044
Derivative assets, at fair value	20,504	24,178
Deferred securitization and financing costs	11,486	13,080
Other investments	114,553	106,498
Other assets	810	1,098
Total assets ⁽¹⁾	21,218,903	21,231,017
LIABILITIES AND EQUITY		
Liabilities:		
Repurchase agreements	13,174,860	13,622,677
Secured loans	1,550,000	1,250,000
Asset-backed securities issued by securitization trusts ⁽¹⁾	3,006,047	2,929,820
Exchangeable senior notes	400,000	400,000
Derivative liabilities, at fair value	189,669	254,026
Dividends and distributions payable	61,770	61,757
Investment related payable	165,634	17,008
Accrued interest payable	36,069	29,670
Collateral held payable	6,500	14,890
Accounts payable and accrued expenses	3,741	2,439
Due to affiliate	9,918	9,880
Total liabilities ⁽¹⁾	18,604,208	18,592,167
Equity:		
Preferred Stock, par value \$0.01 per share; 50,000,000 shares authorized:		
7.75% Series A Cumulative Redeemable Preferred Stock: 5,600,000 shares issued and outstanding (\$140,000 aggregate liquidation preference)	135,356	135,356
7.75% Fixed-to-Floating Series B Cumulative Redeemable Preferred Stock: 6,200,000 shares issued and outstanding (\$155,000 aggregate liquidation preference)	149,860	149,860
Common Stock, par value \$0.01 per share; 450,000,000 shares authorized; 123,140,501 and 123,110,454 shares issued and outstanding, respectively	1,231	1,231
Additional paid in capital	2,532,555	2,532,130
Accumulated other comprehensive income	388,495	424,592
Retained earnings (distributions in excess of earnings)	(621,191)	(632,854)

Edgar Filing: Invesco Mortgage Capital Inc. - Form 10-Q

Total stockholders' equity	2,586,306	2,610,315
Non-controlling interest	28,389	28,535
Total equity	2,614,695	2,638,850
Total liabilities and equity	21,218,903	21,231,017

The condensed consolidated balance sheets include assets of consolidated variable interest entities ("VIEs") that can only be used to settle obligations and liabilities of the VIEs for which creditors do not have recourse to the (1) Company. As of June 30, 2015 and December 31, 2014, total assets of the consolidated VIEs were \$3,477,252 and \$3,380,597, respectively, and total liabilities of the consolidated VIEs were \$3,014,810 and \$2,938,512, respectively. Refer to Note 3 - "Variable Interest Entities" for further discussion.

The accompanying notes are an integral part of these condensed consolidated financial statements.

Table of Contents

INVESCO MORTGAGE CAPITAL INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014 (As Restated)	2015	2014 (As Restated)
In thousands, except share amounts				
Interest Income				
Mortgage-backed and credit risk transfer securities	126,098	148,195	261,363	296,600
Residential loans ⁽¹⁾	30,247	20,471	59,621	38,175
Commercial loans	4,491	2,061	7,606	3,680
Total interest income	160,836	170,727	328,590	338,455
Interest Expense				
Repurchase agreements	40,931	47,822	84,241	96,893
Secured loans	1,553	176	3,017	176
Exchangeable senior notes	5,613	5,613	11,220	11,220
Asset-backed securities ⁽¹⁾	22,329	15,826	44,227	29,761
Total interest expense	70,426	69,437	142,705	138,050
Net interest income	90,410	101,290	185,885	200,405
(Reduction in) provision for loan losses	(70	) (50	) (132	) 157
Net interest income after (reduction in) provision for loan losses	90,480	101,340	186,017	200,248
Other Income (loss)				
Gain (loss) on investments, net	10,876	(20,197	) 13,048	(37,969
Equity in earnings of unconsolidated ventures	1,231	3,894	7,237	4,335
Gain (loss) on derivative instruments, net	56,003	(167,816	) (66,742	) (319,128
Realized and unrealized credit derivative income (loss), net	614	32,055	21,976	49,542
Other investment income (loss), net	1,673	—	779	—
Total other income (loss)	70,397	(152,064	) (23,702	) (303,220
Expenses				
Management fee – related party	9,343	9,327	18,758	18,662
General and administrative	1,952	2,376	3,679	4,388
Consolidated securitization trusts ⁽¹⁾	2,256	1,363	4,412	2,547
Total expenses	13,551	13,066	26,849	25,597
Net income (loss)	147,326	(63,790	) 135,466	(128,569
Net income (loss) attributable to non-controlling interest	1,685	(729	) 1,549	(1,462
Net income (loss) attributable to Invesco Mortgage Capital Inc.	145,641	(63,061	) 133,917	(127,107
Dividends to preferred stockholders	5,716	2,712	11,432	5,425
Net income (loss) attributable to common stockholders	139,925	(65,773	) 122,485	(132,532
Earnings (loss) per share:				
Net income (loss) attributable to common stockholders				
Basic	1.14	(0.53	) 0.99	(1.08
Diluted	1.04	(0.53	) 0.96	(1.08
Dividends declared per common share	0.45	0.50	0.90	1.00

⁽¹⁾ The condensed consolidated statements of operations include income and expenses of consolidated VIEs. Refer to Note 3 - “Variable Interest Entities” for further discussion.

The accompanying notes are an integral part of these condensed consolidated financial statements.

Table of Contents

INVESCO MORTGAGE CAPITAL INC. AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
 (Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014 (As Restated)	2015	2014 (As Restated)
In thousands				
Net income (loss)	147,326	(63,790)	135,466	(128,569)
Other comprehensive income (loss):				
Unrealized gain (loss) on mortgage-backed and credit risk transfer securities, net	(193,322)	244,615	(67,368)	406,312
Reclassification of unrealized (gain) loss on sale of mortgage-backed and credit risk transfer securities to gain (loss) on investments, net	(1,669)	20,766	(4,603)	32,484
Reclassification of amortization of net deferred losses on de-designated interest rate swaps to repurchase agreements interest expense	16,313	21,532	35,458	42,828
Total other comprehensive income (loss)	(178,678)	286,913	(36,513)	481,624
Comprehensive income (loss)	(31,352)	223,123	98,953	353,055
Less: Comprehensive income (loss) attributable to non-controlling interest	357	(2,553)	(1,133)	(4,036)
Less: Dividends to preferred stockholders	(5,716)	(2,712)	(11,432)	(5,425)
Comprehensive income (loss) attributable to common stockholders	(36,711)	217,858	86,388	343,594

The accompanying notes are an integral part of these condensed consolidated financial statements.

Table of ContentsINVESCO MORTGAGE CAPITAL INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENT OF EQUITY

For the six months ended June 30, 2015

(Unaudited)

In thousands except share amounts	Attributable to Common Stockholders										
	Series A Preferred Stock		Series B Preferred Stock		Common Stock		Additional Paid in Capital	Accumulated Other Comprehensive Income (loss)	Retained Earnings (Distributions in excess of earnings)	Total Stockholder Equity	Non-Controlling Interest
	Shares	Amount	Shares	Amount	Shares	Amount					
Balance at January 1, 2015 (As Restated)	5,600,000	135,356	6,200,000	149,860	123,110,454	1,231	2,532,130	424,592	(632,854)	2,610,315	2
Net income	—	—	—	—	—	—	—	—	133,917	133,917	1
Other comprehensive loss	—	—	—	—	—	—	—	(36,097)	—	(36,097)	(4)
Proceeds from issuance of common stock, net of offering costs	—	—	—	—	7,756	—	122	—	—	122	—
Stock awards	—	—	—	—	22,291	—	—	—	—	—	—
Common stock dividends	—	—	—	—	—	—	—	—	(110,822)	(110,822)	(1)
Common unit dividends	—	—	—	—	—	—	—	—	—	—	(1)
Preferred stock dividends	—	—	—	—	—	—	—	—	(11,432)	(11,432)	—
Amortization of equity-based compensation	—	—	—	—	—	—	303	—	—	303	4
Balance at June 30, 2015	5,600,000	135,356	6,200,000	149,860	123,140,501	1,231	2,532,555	388,495	(621,191)	2,586,306	2

The accompanying notes are an integral part of this condensed consolidated financial statement.

Table of Contents

INVESCO MORTGAGE CAPITAL INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

In thousands	Six Months Ended June 30,	
	2015	2014 (As Restated)
Cash Flows from Operating Activities		
Net income (loss)	135,466	(128,569)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Amortization of mortgage-backed and credit risk transfer securities premiums and (discounts), net	65,251	67,072
Amortization of residential loans and asset-backed securities premiums (discount), net	(254)	1,278
Amortization of commercial loan origination fees	(22)	—
(Reduction in) provision for loan losses	(132)	157
Unrealized (gain) loss on derivative instruments, net	(66,192)	181,621
Unrealized (gain) loss on credit derivatives, net	(11,867)	(41,844)
(Gain) loss on investments, net	(13,048)	37,969
Realized (gain) loss on derivative instruments, net	41,315	33,861
Realized (gain) loss on credit derivatives, net	2,468	—
Equity in earnings of unconsolidated ventures	(7,237)	(4,335)
Amortization of equity-based compensation	307	257
Amortization of deferred securitization and financing costs	1,594	1,459
Reclassification of amortization of net deferred losses on de-designated interest rate swaps to repurchase agreements interest expense	35,458	42,828
Non-cash interest income capitalized in commercial loans	—	(768)
(Gain) loss on foreign currency transactions, net	619	—
Changes in operating assets and liabilities:		
Increase in operating assets	(4,114)	(453)
Increase (decrease) in operating liabilities	7,846	(3,934)
Net cash provided by operating activities	187,458	186,599
Cash Flows from Investing Activities		
Purchase of mortgage-backed and credit risk transfer securities	(1,416,277)	(3,104,313)
Distributions from investment in unconsolidated ventures, net	6,432	4,708
Change in other investments	(7,250)	(8,500)
Principal payments from mortgage-backed and credit risk transfer securities	1,267,293	878,516
Proceeds from sale of mortgage-backed and credit risk transfer securities	242,543	2,451,742
Payments on sale of credit derivatives	(2,468)	—
Payment of premiums for interest rate swaptions	(1,485)	(7,738)
Payments for termination of futures/currency forward contracts, swaps, swaptions and TBAs	(33,577)	(10,586)
Purchase of residential loans held-for-investment	(372,305)	(557,763)
Principal payments from residential loans held-for-investment	271,700	55,213
Principal payments from commercial loans held-for-investment	63,131	401
Origination and advances of commercial loans, net of origination fees	(72,965)	(30,619)
Net cash used in investing activities	(55,228)	(328,939)
Cash Flows from Financing Activities		
Proceeds from issuance of common stock	122	135

Edgar Filing: Invesco Mortgage Capital Inc. - Form 10-Q

Repurchase of common stock	—	(21,128)
Cost of issuance of preferred stock	(14)	—
Due from counterparties	(10,026	)	(27,190
Collateral held payable	(8,390	)	(32,705
Proceeds from repurchase agreements	70,442,045		74,527,163
Principal repayments of repurchase agreements	(70,889,813	)	(75,255,615
Proceeds from asset-backed securities issued by securitization trusts	336,077		422,466
Principal repayments of asset-backed securities issued by securitization trusts	(255,848	)	(48,367
Proceeds from secured loans	600,000		1,585,247
Principal repayments on secured loans	(300,000	)	(960,247
Payments of deferred costs	—		(845
Payments of dividends and distributions	(123,524	)	(131,058
Net cash (used in) provided by financing activities	(209,371	)	57,856
Net change in cash and cash equivalents	(77,141	)	(84,484
Cash and cash equivalents, beginning of period	164,144		210,612
Cash and cash equivalents, end of period	87,003		126,128
Supplement Disclosure of Cash Flow Information			
Interest paid	103,352		95,066
Non-cash Investing and Financing Activities Information			
Net change in unrealized gain on mortgage-backed and credit risk transfer securities	(71,971	)	438,796
Dividends and distributions declared not paid	61,770		64,972
(Receivable) / payable for mortgage-backed and credit risk transfer securities sold / purchased, net	152,580		749,469
Repurchase agreements, not settled	(49)	—
Collateral held payable, not settled	—		(5,794
Net change in due from counterparties	2,523		(1,723
The accompanying notes are an integral part of these condensed consolidated financial statements.			

Table of Contents

INVESCO MORTGAGE CAPITAL INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1 – Organization and Business Operations

Invesco Mortgage Capital Inc. (the “Company”) is a Maryland corporation primarily focused on investing in, financing and managing residential and commercial mortgage-backed securities and mortgage loans. The Company is externally managed and advised by Invesco Advisers, Inc. (the “Manager”), a registered investment adviser and an indirect, wholly-owned subsidiary of Invesco Ltd. (“Invesco”), a leading independent global investment management firm. The Company conducts its business through IAS Operating Partnership LP (the “Operating Partnership”) as its sole general partner. As of June 30, 2015, the Company owned 98.9% of the Operating Partnership, and a wholly-owned subsidiary of Invesco owned the remaining 1.1%. The Company has one operating segment.

The Company primarily invests in:

Residential mortgage-backed securities (“RMBS”) that are guaranteed by a U.S. government agency such as the Government National Mortgage Association, or a federally chartered corporation such as the Federal National Mortgage Association (“Fannie Mae”) or the Federal Home Loan Mortgage Corporation (“Freddie Mac”) (collectively “Agency RMBS”);

RMBS that are not guaranteed by a U.S. government agency (“non-Agency RMBS”);

Credit risk transfer securities that are unsecured obligations issued by government-sponsored enterprises (“GSE CRT”);

Commercial mortgage-backed securities (“CMBS”);

Residential and commercial mortgage loans; and

Other real estate-related financing agreements.

The Company generally finances its investments through short- and long-term borrowings structured as repurchase agreements and secured loans. The Company finances its residential loans held-for-investment through asset-backed securities (“ABS”) issued by consolidated securitization trusts. The Company has also financed investments through the issuances of debt and equity and may utilize other forms of financing in the future.

The Company elected to be taxed as a real estate investment trust (“REIT”) for U.S. federal income tax purposes under the provisions of the Internal Revenue Code of 1986, as amended, commencing with the Company's taxable year ended December 31, 2009. To maintain the Company's REIT qualification, the Company is generally required to distribute at least 90% of its REIT taxable income to its stockholders annually. The Company operates its business in a manner that permits exclusion from the “Investment Company” definition under the Investment Company Act of 1940, as amended.

Note 2 – Summary of Significant Accounting Policies

Restatement Background

On August 9, 2015, the Audit Committee of the Board of Directors of the Company concluded, based on the recommendation of management, that each of the Company's previously issued (i) consolidated financial statements as of and for the years ended December 31, 2013 and 2014, which were included in its Annual Report on Form 10-K for the year ended December 31, 2014, and (ii) interim consolidated financial statements as of and for the quarter ended March 31, 2013 and for all subsequent quarters through the quarter ended March 31, 2015 need to be restated and should no longer be relied upon. The Company filed Amendment No. 1 to its Annual Report on Form 10-K for the year ended December 31, 2014 and Amendment No. 1 to its Quarterly Report on Form 10-Q for the quarter ended March 31, 2015 on August 17, 2015. Additional information regarding the restatement is contained in those filings. Prior period financial information in this Form 10-Q has been amended where necessary to reflect the restatement. Therefore, this Form 10-Q should be read in conjunction with the Company's Annual Report on Form 10-K/A for the year ended December 31, 2014.

Basis of Presentation and Consolidation

The Company filed Amendment No. 1 to its Annual Report on Form 10-K/A on August 17, 2015 (“Form 10-K/A”). Certain disclosures included in the Company's Form 10-K/A are not required to be included on an interim basis in the

Edgar Filing: Invesco Mortgage Capital Inc. - Form 10-Q

Company's quarterly reports on Form 10-Q. The Company has condensed or omitted these disclosures. Therefore, this Form

7

Table of Contents

10-Q should be read in conjunction with the Company's Annual Report on Form 10-K/A for the year ended December 31, 2014.

In the opinion of management, the condensed consolidated financial statements reflect all adjustments, consisting of normal recurring accruals, which are necessary for a fair presentation of the financial condition and results of operations for the periods presented. All significant intercompany transactions, balances, revenues and expenses are eliminated upon consolidation.

The condensed consolidated financial statements have been prepared in accordance with U.S. GAAP and consolidate the financial statements of the Company and its controlled subsidiaries. The condensed consolidated financial statements also include the consolidation of certain securitization trusts that meet the definition of a variable interest entity ("VIE") because the Company has been deemed to be the primary beneficiary of the securitization trusts. These securitization trusts hold pools of residential mortgage loans and issue series of asset-backed securities payable from the cash flows generated by the underlying pools of residential mortgage loans. The securitizations are non-recourse financing for the residential mortgage loans held-for-investment. Generally, a portion of the asset-backed securities issued by the securitization trusts is sold to unaffiliated third parties and the balance is purchased by the Company. The Company classifies the underlying residential mortgage loans owned by the securitization trusts as residential loans held-for-investment in its condensed consolidated balance sheets. The asset-backed securities issued to third parties are recorded as liabilities on the Company's condensed consolidated balance sheets. The Company records interest income on the residential loans held-for-investment, interest expense on the asset-backed securities issued to third parties and direct operating expenses incurred by the securitization trusts in the Company's condensed consolidated statements of operations. The Company eliminates all intercompany balances and transactions between itself and the consolidated securitization trusts. The Company records the initial underlying assets and liabilities of the consolidated securitization trusts at their fair value upon consolidation into the Company and, as such, no gain or loss is recorded upon consolidation. Refer to Note 3 - "Variable Interest Entities" for additional information regarding the impact of consolidation of securitization trusts.

The consolidated securitization trusts are VIEs because the securitization trusts do not have equity that meets the definition of U.S. GAAP equity at risk. In determining if a securitization trust should be consolidated, the Company evaluates whether it has both (i) the power to direct the activities of the securitization trust that most significantly impact its economic performance and (ii) the right to receive benefits from the securitization trust or the obligation to absorb losses of the securitization trust that could be significant. The Company's determination of whether it is the primary beneficiary of a securitization trust includes both a qualitative and quantitative analysis. The Company determined that it was the primary beneficiary of certain securitization trusts because it was involved in certain aspects of the design of the securitization trusts and has certain default oversight rights on defaulted residential loans. In addition, the Company owns the most subordinated class of asset-backed securities issued by the securitization trusts and has the obligation to absorb losses and right to receive benefits from the securitization trust that could potentially be significant to the securitization trust. The Company assesses modifications to VIEs on an ongoing basis to determine if a significant reconsideration event has occurred that would change the Company's initial consolidation assessment.

Use of Estimates

The preparation of condensed consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. Examples of estimates include, but are not limited to, estimates of the fair values of financial instruments, interest income on mortgage-backed and credit risk transfer securities, allowance for loan losses and other-than-temporary impairment charges. Actual results may differ from those estimates.

Translation of Foreign Currencies

The functional currency of the Company and its subsidiaries is U.S. dollars. Transactions in foreign currencies are recorded at the rates of exchange prevailing on the date of the transactions. At each balance sheet date, monetary assets and liabilities that are denominated in foreign currencies are remeasured at the rates prevailing at the balance sheet date. Gains and losses arising on revaluation are included in the condensed consolidated statement of operations.

The Company generally hedges interest rate and foreign currency exposure with derivative financial instruments. Refer to Note 8 - "Derivatives and Hedging Activities" for further information.

Table of Contents

Significant Accounting Policies

Included in Note 2 to the consolidated financial statements of the Company's 2014 Annual Report on Form 10-K/A is a summary of the Company's significant accounting policies. Provided below is a summary of additional accounting policies that are significant to the Company's consolidated financial condition and results of operations for the three and six months ended June 30, 2015.

Mortgage-Backed and Credit Risk Transfer Securities

All of the Company's mortgage-backed securities ("MBS") except for Agency interest-only securities ("Agency MBS IOs"), are classified as available-for-sale and reported at fair value. Fair value is determined by obtaining valuations from an independent source. If the fair value of a security is not available from a third-party pricing service, or such data appears unreliable, the Company may estimate the fair value of the security using a variety of methods including other pricing services, discounted cash flow analysis, matrix pricing, option adjusted spread models and other fundamental analysis of observable market factors.

The Company records its purchases of mortgage-backed and credit risk transfer securities on the trade date. Although the Company generally intends to hold most of its mortgage-backed and credit risk transfer securities until maturity, the Company may, from time to time, sell any of its mortgage-backed and credit risk transfer securities as part of its overall management of its investment portfolio.

Unrealized gains or losses on all MBS, except for Agency MBS IOs, are recorded in accumulated other comprehensive income, a separate component of stockholders' equity, until sale or disposition of the investment. Upon sale or disposition, the cumulative gain or loss previously reported in stockholders' equity is recognized in income.

Realized gains and losses from sales of MBS are determined based upon the specific identification method.

Agency MBS IOs are hybrid financial instruments that contain embedded derivatives. Agency MBS IOs are carried at fair value on the Company's consolidated balance sheet with changes in fair value recognized in the Company's condensed consolidated statement of operations because the embedded interest derivative in Agency MBS IOs cannot be reliably measured.

GSE CRTs are unsecured obligations of Fannie Mae and Freddie Mac. Coupon payments on the securities are based on LIBOR and principal payments are based on prepayments and defined credit events in a reference pool of mortgage loans that collateralize Agency RMBS. GSE CRTs are accounted for as hybrid financial instruments consisting of a debt host contract and an embedded derivative. GSE CRTs are measured at fair value. Unrealized gains or losses arising from changes in fair value of the debt host contract, excluding other-than-temporary impairment, are recognized in accumulated other comprehensive income, a separate component of stockholders' equity, until sale or disposition of the investment. Upon sale or disposition of the debt host contract, the cumulative gain or loss previously reported as a separate component of stockholders' equity is recognized in income. Realized gains and losses from sales of GSE CRTs are determined based upon the specific identification method. Realized and unrealized gains or losses arising from changes in fair value of the embedded derivative are recognized in realized and unrealized credit derivative income (loss), net in the Company's condensed consolidated statement of operations.

The Company considers its portfolio of Agency RMBS to be of high credit quality under applicable accounting guidance. For non-Agency RMBS, GSE CRTs and CMBS, the Company does not rely on ratings from third party agencies to determine the credit quality of the investment. The Company uses internal models that analyze the loans underlying each security and evaluates factors including, but not limited to, delinquency status, loan-to-value ratios, borrower credit scores, occupancy status and geographic concentration to estimate the expected future cash flows. The Company places reliance on these internal models in determining credit quality.

While non-Agency RMBS, GSE CRTs and CMBS with expected future losses would generally be purchased at a discount to par, the potential for a significant adverse change in expected cash flows remains. The Company therefore evaluates each security for other-than-temporary impairment at least quarterly.

The determination of whether a security is other-than-temporarily impaired involves judgments and assumptions based on subjective and objective factors. Consideration is given to (i) the length of time and the extent to which the fair value has been less than amortized cost, (ii) the financial condition and near-term prospects of recovery in fair value of the security, and (iii) the Company's intent and ability to retain its investment in the security for a period of

time sufficient to allow for any anticipated recovery in fair value.

The Company recognizes in earnings and reflects as a reduction in the cost basis of the security the amount of any other-than-temporary impairment related to credit losses or impairments on securities that the Company intends to sell or for which it is more likely than not that the Company will need to sell before recoveries. The amount of the other-than-temporary impairment on debt securities related to other factors is recorded consistent with changes in the fair value of all other available-

Table of Contents

for-sale securities as a component of condensed consolidated stockholders' equity in other comprehensive income or loss with no change to the cost basis of the security.

Residential Loans Held-For-Investment

Residential loans held-for-investment are residential mortgage loans held by consolidated securitization trusts.

Residential loans held-for-investment are carried at unpaid principal balance net of any premiums and an allowance for loan losses. The Company expects that it will be required to continue to consolidate the securitization trusts that hold the residential loans.

The Company establishes an allowance for residential loan losses based on the Company's estimate of credit losses.

The Company calculates expected losses by estimating the default rate and expected loss severities on the loans. The Company considers the following factors in its evaluation of the allowance for loan losses:

- Loan-to-value ratios, credit scores, geographic concentration and other observable data;
- Historical default rates of loans with similar characteristics; and
- Expected future macroeconomic trends including changes in home prices and the unemployment rate.

Commercial Loans Held-For-Investment

Commercial loans held-for-investment by the Company are carried at cost, net of any allowance for loan losses. An individual loan is considered impaired when it is deemed probable that the Company will not be able to recover its investment and any other anticipated future payments. The Company generally considers the following factors in evaluating whether a commercial loan is impaired:

• Loan-to-value ratios;

The most recent financial information available for each loan and associated properties, including net operating income, debt service coverage ratios, occupancy rates, rent rolls, as well as any other factors the Company considers relevant, including, but not limited to, specific loan trigger events that would indicate an adverse change in expected cash flows or payment delinquency;

• Economic trends, both macroeconomic as well as those directly affecting the properties associated with the loans, and the supply and demand trends in the market in which the subject property is located; and

• The loan sponsor or borrowing entity's ability to ensure that properties associated with the loan are managed and operated sufficiently.

Where an individual commercial loan is deemed to be impaired, the Company records an allowance to reduce the carrying value of the loan to the current present value of expected future cash flows discounted at the loan's effective interest rate, with a corresponding charge to provision for loan losses on the Company's condensed consolidated statements of operations.

Interest Income Recognition

Mortgage-Backed Securities

Interest income on MBS is accrued based on the outstanding principal balance of the securities and their contractual terms. Premiums or discounts are amortized or accreted into interest income over the life of the investment using the effective interest method. Interest income on the Company's non-Agency RMBS (and other prepayable mortgage-backed securities where the Company may not recover substantially all of its initial investment) is based on estimated cash flows. Management estimates, at the time of purchase, the future expected cash flows and determines the effective interest rate based on these estimated cash flows and the Company's purchase price. Over the life of the investments, these estimated cash flows are updated and a revised yield is computed based on the current amortized cost of the investment. In estimating these cash flows, there are a number of assumptions that are subject to uncertainties and contingencies, including the rate and timing of principal payments (prepayments, repurchases, defaults and liquidations), the pass through or coupon rate and interest rate fluctuations. These uncertainties and contingencies are difficult to predict and are subject to future events that may impact management's estimates and the Company's interest income.

For Agency RMBS that cannot be prepaid in such a way that the Company would not recover substantially all of its initial investment, interest income recognition is based on contractual cash flows. The Company does not estimate prepayments in applying the effective interest method.

Table of Contents

Credit Risk Transfer Securities

Interest income on credit risk transfer securities is accrued based on the coupon rate of the debt host contract which reflects the credit risk of GSE unsecured senior debt with a similar maturity. Premiums or discounts associated with the purchase of credit risk transfer securities are amortized or accreted into interest income over the life of the debt host contract using the effective interest method. The difference between the coupon rate on the hybrid instrument and the coupon rate on the GSE CRT debt host contract is considered premium income associated with the embedded derivative and is recorded in realized and unrealized credit derivative income (loss), net in the Company's condensed consolidated statement of operations.

Residential Loans

The Company recognizes interest income from residential loans on an accrual basis and amortizes the related premiums into interest income using the effective interest method over the weighted average life of these loans. In estimating the weighted average life of these loans, there are a number of assumptions that are subject to estimation, including the rate and timing of principal payments, defaults, loss severity given default and other factors. Coupon interest is recognized as revenue when earned and deemed collectible or until a loan becomes more than 90 days past due, at which point the loan is placed on nonaccrual status. Interest previously accrued for loans that have been placed on non-accrual status is reversed against interest income in the period the loan is placed in nonaccrual status. Residential loans delinquent more than 90 days or in foreclosure are characterized as delinquent. Cash principal and interest that is advanced from servicers after a loan becomes greater than 90 days past due is recorded as a liability due to the servicer. When a delinquent loan previously placed on nonaccrual status has cured, meaning all delinquent principal and interest have been remitted by the borrower, the loan is placed back on accrual status. Alternatively, nonaccrual loans may be placed back on accrual status if restructured and after the loan is considered re-performing. A restructured loan is considered re-performing when the loan has been current for at least 12 months.

Commercial Loans

The Company recognizes interest income from commercial loans when earned and deemed collectible, or until a loan becomes past due based on the terms of the loan agreement. Any related originating fees, net of origination cost are amortized into interest income using the effective interest method over the life of the loan. Interest received after a loan becomes past due or impaired is used to reduce the outstanding loan principal balance. When a delinquent loan previously placed on nonaccrual status has cured, meaning all delinquent principal and interest have been remitted by the borrower, the loan is placed back on accrual status. Alternately, loans that have been individually impaired may be placed back on accrual status if restructured and after the loan is considered re-performing. A restructured loan is considered re-performing when the loan has been current for at least 12 months.

Repurchase Agreements

Effective January 1, 2015, the Company adopted newly issued accounting guidance for repurchase financings. Under the new standard, the Company no longer applies the "linked" accounting model to instances where the Company purchases mortgage-backed and credit risk transfer securities and enters into repurchase agreements to finance the purchase with the same counterparty. Purchases of mortgage-backed and credit risk transfer securities and repurchase financings are considered separately, and the repurchase agreement component of the transaction is accounted for as a secured borrowing. The Company records the mortgage-backed and credit risk transfer securities and the related repurchase agreement financing on a gross basis in its condensed consolidated balance sheets, and the corresponding interest income and interest expense on a gross basis in its condensed consolidated statements of operations. None of the Company's repurchase financing transactions prior to January 1, 2015 qualified as linked transactions and therefore were not accounted for as derivatives. Accordingly, the Company did not record a cumulative effect adjustment to retained earnings as of January 1, 2015 as a result of adopting the new guidance.

Comprehensive Income

The Company's comprehensive income consists of net income, as presented in the condensed consolidated statements of operations, adjusted for changes in fair value of MBS classified as available for sale securities; changes in the fair value of the debt host contract associated with GSE CRTs; and amortization of repurchase agreement interest expense resulting from the de-designation of derivatives previously accounted for as cash flow hedges. Unrealized gains and

losses on the Company's MBS and the debt host contract associated with GSE CRTs are reclassified into net income upon their sale or termination.

Accounting for Derivative Financial Instruments

U.S. GAAP provides disclosure requirements for derivatives and hedging activities with the intent to provide users of financial statements with an enhanced understanding of: (i) how and why an entity uses derivative instruments; (ii) how derivative instruments and related hedged items are accounted for; and (iii) how derivative instruments and related hedged

Table of Contents

items affect an entity's financial position, financial performance, and cash flows. U.S. GAAP requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about the fair value of and gains and losses on derivative instruments, and disclosures about credit-risk-related contingent features in derivative instruments.

The Company records all derivatives on its condensed consolidated balance sheets at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative, whether the Company has elected to designate a derivative in a hedging relationship and apply hedge accounting and whether the hedging relationship has satisfied the criteria necessary to apply hedge accounting. Derivatives designated and qualifying as a hedge of the exposure to changes in the fair value of an asset, liability, or firm commitment attributable to a particular risk, such as interest rate risk, are considered fair value hedges. Derivatives designated and qualifying as a hedge of the exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges. Derivatives may also be designated as hedges of the foreign currency exposure of a net investment in a foreign operation. Hedge accounting generally provides for the matching of the timing of gain or loss recognition on the hedging instrument with the recognition of the changes in the fair value of the hedged asset or liability that are attributable to the hedged risk in a fair value hedge or the earnings effect of the hedged forecasted transactions in a cash flow hedge. The Company may enter into derivative contracts, such as credit default swaps, that are intended to economically hedge certain of its risks, even though hedge accounting does not apply or the Company elects not to apply hedge accounting under U.S. GAAP.

The Company is a party to hybrid financial instruments that contain embedded derivative instruments. At inception, the Company assesses whether the economic characteristics of the embedded derivative instruments are clearly and closely related to the economic characteristics of the remaining component of the financial instrument (i.e., the debt host contract), whether the financial instrument is remeasured to fair value through earnings and whether a separate instrument with the same terms as the embedded instrument would meet the definition of a derivative instrument. When it is determined that (1) the embedded instrument possesses economic characteristics that are not clearly and closely related to the economic characteristics of the debt host contract, (2) the financial instrument is not remeasured to fair value through earnings and (3) a separate instrument with the same terms would qualify as a derivative instrument, the embedded instrument qualifies as an embedded derivative that is separated from the debt host contract. The embedded derivative is recorded at fair value, and changes in fair value are recorded in realized and unrealized credit derivative income (loss), net in the Company's condensed consolidated statement of operations.

Effective December 31, 2013, the Company voluntarily discontinued hedge accounting for its interest rate swap agreements by de-designating the interest rate swaps as cash flow hedges. No interest rate swaps were terminated in conjunction with this action, and the Company's risk management and hedging practices were not impacted. However, the Company's accounting for these transactions changed beginning January 1, 2014. All of the Company's interest rate swaps had previously been accounted for as cash flow hedges under the applicable guidance. As a result of discontinuing hedge accounting, changes in the fair value of the interest rate swap agreements are recorded in gain (loss) on derivative instruments, net in the Company's condensed consolidated statements of operations, rather than in accumulated other comprehensive income (loss) ("AOCI"). Also, net interest paid or received under the interest rate swaps, which up through December 31, 2013 was recognized in interest expense, is now recognized in gain (loss) on derivative instruments, net on the Company's condensed consolidated statements of operations. The interest rate swaps continue to be reported as derivative assets or derivative liabilities on the Company's condensed consolidated balance sheets at their fair value.

As long as the forecasted transactions that were being hedged (i.e., rollovers of the Company's repurchase agreement borrowings) are still expected to occur, the balance in AOCI from the interest rate swap activity up through December 31, 2013 will remain in AOCI and be recognized in the Company's condensed consolidated statements of operations as interest expense over the remaining term of the interest rate swaps. Refer to Note 8 - "Derivatives and Hedging Activities" for further information.

The Company evaluates the terms and conditions of its holdings of swaptions, futures contracts, currency forward contracts and to-be-announced ("TBA") securities to determine if an instrument has the characteristics of an

investment or should be considered a derivative under U.S. GAAP. Accordingly swaptions, futures contracts, currency forward contracts and TBAs having the characteristics of derivatives are accounted for at fair value with such changes recognized in gain (loss) on derivative instruments, net in the condensed consolidated statements of operations. The fair value of these swaptions, futures contracts, currency forward contracts and TBAs is included in derivative assets or derivative liabilities on the condensed consolidated balance sheets.

Reclassifications

Certain prior period reported amounts have been reclassified to be consistent with the current presentation. Such reclassifications had no impact on net income or equity attributable to common stockholders.

Table of Contents

Recent Accounting Pronouncements Not Yet Adopted

In February 2015, the FASB issued modifications to existing consolidation guidance for reporting organizations that are required to evaluate whether they should consolidate certain legal entities. The guidance is effective for fiscal years and interim periods within those years beginning after December 15, 2015, and requires either a retrospective or a modified retrospective approach to adoption. Early adoption is permitted. The Company is currently evaluating the potential impact of the new guidance on its condensed consolidated financial statements, as well as the available transition methods.

In April 2015, the FASB issued guidance to amend the presentation of debt issuance cost related to a recognized debt liability. Under the new guidance, the debt issuance costs will be presented in the balance sheet as a direct deduction from the carrying amount of the recognized debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected under the new guidance. The standard is effective for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Early adoption is permitted. The guidance should be applied on a retrospective basis. The balance sheet of each individual period presented should be adjusted to reflect the period-specific effects of applying the new guidance. Upon adoption, an entity is required to comply with the applicable disclosures for a change in an accounting principle. These disclosures include the nature of and reason for the change in accounting principle, the transition method, a description of the prior-period information that has been retrospectively adjusted, and the effect of the change on the financial statement line items (i.e., debt issuance cost asset and the debt liability). The Company is currently evaluating the potential impact of the new guidance on its condensed consolidated financial statements.

Note 3 – Variable Interest Entities

The Company's maximum risk of loss in VIEs in which the Company is not the primary beneficiary at June 30, 2015 is presented in the table below.

\$ in thousands	Carrying Amount	Company's Maximum Risk of Loss
Non-Agency RMBS	2,800,650	2,800,650
CMBS	3,293,853	3,293,853
Total	6,094,503	6,094,503

Refer to Note 4 - "Mortgage-Backed and Credit Risk Transfer Securities" for additional details regarding these investments.

As discussed in Note 2 - "Summary of Significant Accounting Policies," the Company has determined that it is the primary beneficiary of certain securitization trusts. The following table presents a summary of the assets and liabilities of the Company's consolidated securitization trusts as of June 30, 2015 and December 31, 2014. Intercompany balances have been eliminated for purposes of this presentation.

\$ in thousands	June 30, 2015	December 31, 2014
Residential loans, held-for-investment	3,461,992	3,365,003
Accrued interest receivable	10,601	10,562
Deferred costs	4,659	5,032
Total assets	3,477,252	3,380,597
Accrued interest and accrued expenses payable	8,763	8,692
Asset-backed securities issued by securitization trusts	3,006,047	2,929,820
Total liabilities	3,014,810	2,938,512

The Company's risk with respect to each investment in a securitization trust is limited to its direct ownership in the securitization trust. The residential loans held by the consolidated securitization trusts are held solely to satisfy the liabilities of the securitization trusts, and the investors in the securitization trusts have no recourse to the general credit of the Company for the asset-backed securities issued by the securitization trusts. The assets of a consolidated securitization trust can only be used to satisfy the obligations of that trust. The Company is not contractually required

and has not provided any additional financial support to the securitization trusts for the period ended June 30, 2015.

Table of Contents

During the six months ended June 30, 2015, the Company invested in and consolidated one new securitization trust. The following table presents the balances of the assets and liabilities of the newly consolidated securitization trust before consolidation into the Company. The current period activity for the securitization trust is reflected in the Company's condensed consolidated financial statements.

\$ in thousands	2015
Residential loans, held-for-investment	372,305
Accrued interest receivable	1,236
Total assets	373,541
Accrued interest and accrued expenses payable	1,236
Asset-backed securities issued by securitization trusts	372,305
Total liabilities	373,541

The Company did not deconsolidate any securitization trusts during the six months ended June 30, 2015.

Residential Loans Held by Consolidated Securitization Trusts

Residential loans held by consolidated securitization trusts are carried at unpaid principal balance net of any premiums and discount and allowance for loan losses. The residential loans are secured by a lien on the underlying residential property.

The following table details the carrying value for residential loans held-for-investment at June 30, 2015 and December 31, 2014.

\$ in thousands	June 30, 2015	December 31, 2014
Principal balance	3,432,928	3,332,192
Unamortized premium (discount), net	29,674	33,553
Recorded investment	3,462,602	3,365,745
Allowance for loan losses	(610)	(742)
Carrying value	3,461,992	3,365,003

The following table summarizes residential loans held-for-investment at June 30, 2015 by year of origination.

\$ in thousands	2014	2013	2012	2011	2010	2009	2008	2007	Total
Portfolio									
Characteristics:									
Number of Loans	729	2,701	749	91	26	6	15	15	4,332
Current Principal Balance	544,236	2,085,412	650,894	97,650	25,006	2,747	14,769	12,214	3,432,928
Net Weighted Average Coupon Rate	3.48	% 3.45	% 3.25	% 3.39	% 3.74	% 3.69	% 5.02	% 4.62	% 3.43
Weighted Average Maturity (years)	28.96	28.06	27.53	25.99	25.47	24.01	23.15	22.10	27.98
Current Performance:									
Current	544,236	2,083,210	650,894	97,650	25,006	2,747	14,769	12,214	3,430,726
30 Days Delinquent	—	1,404	—	—	—	—	—	—	1,404
60 Days Delinquent	—	798	—	—	—	—	—	—	798
90+ Days Delinquent	—	—	—	—	—	—	—	—	—
Bankruptcy/Foreclosure	—	—	—	—	—	—	—	—	—
Total	544,236	2,085,412	650,894	97,650	25,006	2,747	14,769	12,214	3,432,928

Table of Contents

The following table summarizes the geographic concentrations of residential loans held-for-investment at June 30, 2015 based on principal balance outstanding.

State	Percent	
California	53.5	%
New York	7.5	%
Massachusetts	5.9	%
Illinois	3.7	%
Other states (none greater than 3%)	29.4	%
Total	100.0	%

The following table presents future contractual minimum annual principal payments of residential loans held-for-investment at June 30, 2015.

\$ in thousands	June 30, 2015
Scheduled Principal	
Within one year	60,651
One to three years	128,593
Three to five years	138,969
Greater than or equal to five years	3,104,715
Total	3,432,928

Allowance for Loan Losses on Residential Loans Held by Consolidated Securitization Trusts

As discussed in Note 2 - "Summary of Significant Accounting Policies," the Company establishes and maintains an allowance for loan losses on residential loans held by consolidated securitization trusts based on the Company's estimate of credit losses.

The following table summarizes the activity in the allowance for loan losses for the six months ended June 30, 2015 and 2014.

\$ in thousands	June 30, 2015	June 30, 2014
Balance at beginning of period	(742)	(884)
Charge-offs, net	—	—
Reduction in (provision for) loan losses	132	(157)
Balance at end of period	(610)	(1,041)

Asset-Backed Securities Issued by Securitization Trusts

Asset-backed securities issued by securitization trusts are recorded at principal balance net of unamortized premiums or discounts. Asset-backed securities issued by securitization trusts are issued in various tranches and have a weighted average contractual maturity of 28.63 years and 28.94 years at June 30, 2015 and December 31, 2014, respectively.

The investors in the asset-backed securities are not affiliated with the Company and have no recourse to the general credit of the Company.

Table of Contents

The asset-backed securities are collateralized by residential loans held in the securitization trusts as summarized in the following table at June 30, 2015 and December 31, 2014.

	June 30, 2015		December 31, 2014	
	ABS Outstanding	Residential loans Held as Collateral	ABS Outstanding	Residential loans Held as Collateral
\$ in thousands				
Principal balance	2,980,757	3,432,928	2,902,378	3,332,192
Interest-only securities	14,051	—	15,040	—
Unamortized premium	21,428	37,073	23,735	41,928
Unamortized discount	(10,189)	(7,399)	(11,333)	(8,375)
Allowance for loan losses	—	(610)	—	(742)
Carrying value	3,006,047	3,461,992	2,929,820	3,365,003
Range of weighted average interest rates	2.8% - 3.9%		2.8% - 4.0%	
Number of securitization trusts consolidated	11		10	

The following table presents the estimated principal repayment schedule of asset-backed securities issued by securitization trusts at June 30, 2015 based on estimated cash flows of the underlying residential mortgage loans, as adjusted for projected prepayments and losses on such loans. The estimated principal repayments may differ from actual amounts to the extent prepayments and/or loan losses vary.

\$ in thousands	June 30, 2015
Estimated principal repayment	
Within one year	394,635
One to three years	650,333
Three to five years	491,023
Greater than or equal to five years	1,444,766
Total	2,980,757

Table of Contents

Note 4 – Mortgage-Backed and Credit Risk Transfer Securities

The following tables summarize the Company's MBS and GSE CRT portfolio by asset type as of June 30, 2015 and December 31, 2014.

June 30, 2015

\$ in thousands	Principal Balance	Unamortized Premium (Discount)	Amortized Cost	Unrealized Gain/(Loss), net	Fair Value	Net Weighted Average Coupon (1)	Period-end Weighted Average Yield (2)	Quarterly Weighted Average Yield (3)	
Agency RMBS:									
15 year fixed-rate	1,638,413	80,151	1,718,564	18,756	1,737,320	3.76	% 2.55	% 2.04	%
30 year fixed-rate	4,052,970	271,686	4,324,656	32,002	4,356,658	4.28	% 2.84	% 2.69	%
ARM*	461,173	5,560	466,733	6,863	473,596	2.74	% 2.57	% 1.99	%
Hybrid ARM	3,337,388	65,372	3,402,760	25,639	3,428,399	2.74	% 2.51	% 1.88	%
Total Agency pass-through	9,489,944	422,769	9,912,713	83,260	9,995,973	3.57	% 2.66	% 2.27	%
Agency-CMO ⁽⁴⁾	2,063,207	(1,630,609)	432,598	6,268	438,866	2.25	% 4.49	% 3.15	%
Non-Agency RMBS ⁽⁵⁾⁽⁶⁾	3,261,947	(548,656)	2,713,291	87,359	2,800,650	3.44	% 3.84	% 4.39	%
GSE CRT ⁽⁷⁾	643,000	24,176	667,176	(1,280)	665,896	1.01	% 0.50	% 0.51	%
CMBS ⁽⁸⁾	3,422,375	(231,765)	3,190,610	103,243	3,293,853	4.43	% 4.43	% 4.40	%
Total	18,880,473	(1,964,085)	16,916,388	278,850	17,195,238	3.43	% 3.10	% 2.98	%

* Adjustable-rate mortgage ("ARM")

(1) Net weighted average coupon ("WAC") as of June 30, 2015 is presented net of servicing and other fees.

(2) Period-end weighted average yield is based on amortized cost as of June 30, 2015 and incorporates future prepayment and loss assumptions but excludes changes in anticipated interest rates.

Quarterly weighted average portfolio yield for the period was calculated by dividing interest income, including amortization of premiums and discounts, by the Company's average of the amortized cost of the investments. All yields are annualized.

(4) Agency collateralized mortgage obligation ("Agency-CMO") includes Agency MBS IOs which represent 33.0% of the balance based on fair value.

(5) Non-Agency RMBS held by the Company is 52.3% variable rate, 40.6% fixed rate, and 7.1% floating rate based on fair value.

(6) Of the total discount in non-Agency RMBS, \$328.1 million is non-accretable.

(7) GSE CRT weighted average coupon and weighted average yield excludes embedded derivative coupon interest recorded as realized and unrealized credit derivative income (loss), net.

(8) CMBS includes commercial real estate mezzanine loan pass-through certificates which represent 1.3% of the balance based on fair value.

Table of Contents

December 31, 2014 (As Restated)

\$ in thousands	Principal Balance	Unamortized Premium (Discount)	Amortized Cost	Unrealized Gain/ (Loss), net	Fair Value	Net Weighted Average Coupon (1)	Period-end Weighted Average Yield (2)	Quarterly Weighted Average Yield (3)	
Agency RMBS:									
15 year fixed-rate	1,236,297	60,764	1,297,061	30,040	1,327,101	4.05	% 2.60	% 2.66	%
30 year fixed-rate	4,432,301	297,311	4,729,612	60,681	4,790,293	4.29	% 2.97	% 3.05	%
ARM	531,281	9,068	540,349	6,433	546,782	2.83	% 2.27	% 2.29	%
Hybrid ARM	2,901,078	50,757	2,951,835	25,083	2,976,918	2.78	% 2.34	% 2.24	%
Total Agency pass-through	9,100,957	417,900	9,518,857	122,237	9,641,094	3.69	% 2.68	% 2.71	%
Agency-CMO ⁽⁴⁾	1,957,296	(1,502,785)	454,511	(3,616)	450,895	2.34	% 4.57	% 3.62	%
Non-Agency RMBS ⁽⁵⁾⁽⁶⁾	3,555,249	(583,890)	2,971,359	90,288	3,061,647	3.51	% 4.12	% 4.86	%
GSE CRT ⁽⁷⁾	615,000	25,814	640,814	(15,390)	625,424	1.03	% 0.49	% 0.48	%
CMBS ⁽⁸⁾	3,277,208	54,893	3,332,101	137,734	3,469,835	4.74	% 4.39	% 4.38	%
Total	18,505,710	(1,588,068)	16,917,642	331,253	17,248,895	3.61	% 3.24	% 3.36	%

(1) Net WAC as of December 31, 2014 is presented net of servicing and other fees.

(2) Period-end weighted average yield based on amortized cost as of December 31, 2014 incorporates future prepayment and loss assumptions but excludes changes in anticipated interest rates.

(3) Quarterly weighted average portfolio yield for the period was calculated by dividing interest income, including amortization of premiums and discounts, by the Company's average of the amortized cost of the investments. All yields are annualized.

(4) Agency-CMO includes Agency MBS IOs, which represent 29.1% of the balance based on fair value.

(5) Non-Agency RMBS held by the Company is 52.8% variable rate, 40.1% fixed rate, and 7.1% floating rate based on fair value.

(6) Of the total discount in non-Agency RMBS, \$405.5 million is non-accretable.

(7) GSE CRT weighted average coupon and weighted average yield excludes embedded derivative coupon interest recorded as realized and unrealized credit derivative income (loss), net.

(8) CMBS includes commercial real estate mezzanine loan pass-through certificates which represent 1.3% of the balance based on fair value.

The following table summarizes the Company's non-Agency RMBS portfolio by asset type as of June 30, 2015 and December 31, 2014.

\$ in thousands	June 30, 2015	% of Non-Agency	December 31, 2014	% of Non-Agency
Re-REMIC	843,834	30.1	1,000,635	32.7
Prime	885,329	31.6	969,849	31.7
Alt-A	649,380	23.2	694,467	22.7
Subprime/reperforming	422,107	15.1	396,696	12.9
Total Non-Agency	2,800,650	100.0	3,061,647	100.0

Table of Contents

The following table summarizes the credit enhancement provided to the Company's re-securitization of real estate mortgage investment conduit ("Re-REMIC") holdings as of June 30, 2015 and December 31, 2014.

Re-REMIC Subordination ⁽¹⁾	Percentage of Re-REMIC Holdings at Fair Value			
	June 30, 2015		December 31, 2014	
0% - 10%	8.2	%	7.0	%
10% - 20%	4.9	%	4.4	%
20% - 30%	12.4	%	11.9	%
30% - 40%	25.8	%	26.1	%
40% - 50%	33.4	%	31.8	%
50% - 60%	11.6	%	15.2	%
60% - 70%	3.7	%	3.6	%
Total	100.0	%	100.0	%

Subordination refers to the credit enhancement provided to the Re-REMIC tranche held by the Company by any junior Re-REMIC tranche or tranches in a resecuritization. This figure reflects the percentage of the balance of the (1) underlying securities represented by any junior tranche or tranches at the time of resecuritization. Generally, principal losses on the underlying securities in excess of the subordination amount would result in principal losses on the Re-REMIC tranche held by the Company. 17.8% of our Re-REMIC holdings are not senior classes. The components of the carrying value of the Company's MBS and GSE CRT portfolio at June 30, 2015 and December 31, 2014 are presented below.

\$ in thousands	June 30, 2015	December 31,
		2014 (As Restated)
Principal balance	18,880,473	18,505,710
Unamortized premium	543,615	550,071
Unamortized discount	(2,507,700)	(2,138,139)
Gross unrealized gains	398,127	439,513
Gross unrealized losses	(119,277)	(108,260)
Fair value	17,195,238	17,248,895

The following table summarizes the Company's MBS and GSE CRT portfolio according to estimated weighted average life classifications as of June 30, 2015 and December 31, 2014.

\$ in thousands	June 30, 2015	December 31,
		2014
Less than one year	381,820	440,471
Greater than one year and less than five years	6,429,884	7,997,709
Greater than or equal to five years	10,383,534	8,810,715
Total	17,195,238	17,248,895

Table of Contents

The following tables present the estimated fair value and gross unrealized losses of the Company's MBS and GSE CRTs by length of time that such securities have been in a continuous unrealized loss position at June 30, 2015 and December 31, 2014.

June 30, 2015

\$ in thousands	Less than 12 Months			12 Months or More			Total		
	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses	Number of Securities
Agency RMBS:									
15 year fixed-rate	595,506	(5,472)	24	76,112	(1,139)	5	671,618	(6,611)	29
30 year fixed-rate	707,370	(15,793)	29	1,182,287	(42,481)	45	1,889,657	(58,274)	74
Hybrid ARM	1,301,092	(7,768)	62	11,322	(143)	2	1,312,414	(7,911)	64
Total Agency pass-through	2,603,968	(29,033)	115	1,269,721	(43,763)	52	3,873,689	(72,796)	167
Agency-CMO	124,377	(1,734)	12	145,564	(9,577)	13	269,941	(11,311)	25
Non-Agency RMBS	268,298	(2,941)	25	377,133	(14,122)	28	645,431	(17,063)	53
GSE CRT ⁽¹⁾	226,203	(8,644)	12	37,876	(4,141)	2	264,079	(12,785)	14
CMBS	411,627	(4,986)	38	32,269	(336)	1	443,896	(5,322)	39
Total	3,634,473	(47,338)	202	1,862,563	(71,939)	96	5,497,036	(119,277)	298

(1) Balance includes unrealized losses on both the debt host contract and the embedded derivative.

December 31, 2014 (As Restated)

\$ in thousands	Less than 12 Months			12 Months or More			Total		
	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses	Number of Securities
Agency RMBS:									
15 year fixed-rate	10,897	(42)	1	105,644	(1,395)	6	116,541	(1,437)	7
30 year fixed-rate	137,680	(2,662)	5	1,756,894	(40,181)	62	1,894,574	(42,843)	67
ARM	24,074	(9)	1	3,719	(23)	1	27,793	(32)	2
Hybrid ARM	630,775	(1,544)	28	20,361	(197)	2	651,136	(1,741)	30
Total Agency pass-through	803,426	(4,257)	35	1,886,618	(41,796)	71	2,690,044	(46,053)	106
Agency-CMO	36,723	(6,192)	18	265,863	(9,481)	10	302,586	(15,673)	28
Non-Agency RMBS	573,122	(5,799)	34	354,532	(11,990)	21	927,654	(17,789)	55
GSE CRT ⁽¹⁾	306,603	(25,394)	13	—	—	—	306,603	(25,394)	13
CMBS	134,364	(277)	11	227,452	(3,074)	19	361,816	(3,351)	30
Total	1,854,238	(41,919)	111	2,734,465	(66,341)	121	4,588,703	(108,260)	232

(1) Balance includes unrealized losses on both the debt host contract and the embedded derivative.

Gross unrealized losses on the Company's Agency RMBS were \$72.8 million at June 30, 2015. Due to the inherent credit quality of Agency RMBS, the Company determined that at June 30, 2015, any unrealized losses on its Agency RMBS portfolio are temporary.

Gross unrealized losses on the Company's Agency-CMO, non-Agency RMBS, GSE CRT and CMBS were \$46.5 million at June 30, 2015. The Company does not consider these unrealized losses to be credit related, but rather due to non-credit related factors such as interest rate spreads, prepayment speeds, and market fluctuations. These investment securities are included in the Company's assessment for other-than-temporary impairment on a quarterly basis.

Table of Contents

The following table presents the impact of the Company's MBS and GSE CRT debt host contract on its accumulated other comprehensive income (loss) for the three and six months ended June 30, 2015 and 2014. The table excludes Agency MBS IOs because unrealized gains and losses on Agency MBS IOs are included in earnings on the condensed consolidated statements of operations.

\$ in thousands	Three Months ended June 30, 2015	Three Months ended June 30, 2014 (As Restated)	Six Months ended June 30, 2015	Six Months ended June 30, 2014 (As Restated)
Accumulated other comprehensive income (loss) from investment securities:				
Unrealized gain (loss) on MBS and GSE CRT at beginning of period	474,794	13,332	351,774	(160,083)
Unrealized gain (loss) on MBS and GSE CRT	(193,322)	244,615	(67,368)	406,312
Reclassification of unrealized (gain) loss on sale of MBS and GSE CRT to gain (loss) on investments, net	(1,669)	20,766	(4,603)	32,484
Balance at the end of period	279,803	278,713	279,803	278,713

During the three months ended June 30, 2015 and 2014, the Company reclassified \$1.7 million of net unrealized gains and \$20.8 million of net unrealized losses, respectively, from other comprehensive income into gain (loss) on investments, net as a result of the Company selling certain investments.

During the six months ended June 30, 2015 and 2014, the Company reclassified \$4.6 million of net unrealized gains and \$32.5 million of net unrealized losses, respectively, from other comprehensive income into gain (loss) on investments as a result of the Company selling certain investments. The following table summarizes the Company's gross realized gains and losses during the three and six months ended June 30, 2015 and 2014.

\$ in thousands	Three Months ended June 30, 2015	Three Months ended June 30, 2014 (As Restated)	Six Months ended June 30, 2015	Six Months ended June 30, 2014 (As Restated)
Gross realized gains on sale of investments	1,793	3,121	4,757	10,850
Gross realized losses on sale of investments	(124)	(23,887)	(154)	(43,334)
Net unrealized gains and losses on Agency MBS IOs	9,207	569	8,445	(5,485)
Total gains (loss) on investments, net	10,876	(20,197)	13,048	(37,969)

The Company assesses its investment securities for other-than-temporary impairment on a quarterly basis. When the fair value of an investment is less than its amortized cost at the balance sheet date of the reporting period for which impairment is assessed, the impairment is designated as either "temporary" or "other-than-temporary." The Company evaluates each security that has had a fair value less than amortized cost for nine or more consecutive months for other-than-temporary impairment. This analysis includes evaluating the loans in each security to determine estimated future cash flows. Loan characteristics reviewed include, but are not limited to, delinquency status, loan-to-value ratios, borrower credit scores, occupancy status and geographic concentration. To the extent a security is deemed impaired, the amount by which the amortized cost exceeds the security's market value would be considered other-than-temporary impairment.

The Company did not have other-than-temporary impairments for the three and six months ended June 30, 2015 and 2014.

Table of Contents

The following table presents components of interest income on the Company's MBS and GSE CRT portfolio for the three and six months ended June 30, 2015 and 2014. GSE CRT interest income excludes coupon interest associated with embedded derivatives recorded in realized and unrealized credit derivative income (loss), net.

For the three months ended June 30, 2015

\$ in thousands	Coupon Interest	Net (Premium Amortization)/Discount Accretion	Interest Income
Agency	94,394	(34,828)	59,566
Non-Agency	28,283	2,159	30,442
GSE CRT	1,618	(770)	848
CMBS	37,607	(2,423)	35,184
Other	58	—	58
Total	161,960	(35,862)	126,098

For the three months ended June 30, 2014 (As Restated)

\$ in thousands	Coupon Interest	Net (Premium Amortization)/Discount Accretion	Interest Income
Agency	105,094	(27,064)	78,030
Non-Agency	34,917	3,137	38,054
GSE CRT	1,221	(718)	503
CMBS	41,514	(9,901)	31,613
Other	(5)	—)	(5)
Total	182,741	(34,546)	148,195

For the six months ended June 30, 2015

\$ in thousands	Coupon Interest	Net (Premium Amortization)/Discount Accretion	Interest Income
Agency	188,766	(61,687)	127,079
Non-Agency	59,093	2,817	61,910
GSE CRT	3,186	(1,530)	1,656
CMBS	75,512	(4,851)	70,661
Other	57	—	57
Total	326,614	(65,251)	261,363

For the six months ended June 30, 2014 (As Restated)

\$ in thousands	Coupon Interest	Net (Premium Amortization)/Discount Accretion	Interest Income
Agency	210,577	(50,728)	159,849
Non-Agency	70,472	4,668	75,140
GSE CRT	2,399	(1,450)	949
CMBS	80,126	(19,562)	60,564
Other	98	—	98
Total	363,672	(67,072)	296,600

Table of Contents

Note 5 – Commercial Loans Held-for-Investment

The following table summarizes commercial loans held-for-investment as of June 30, 2015 and December 31, 2014 that were purchased or originated by the Company.

June 30, 2015

\$ in thousands	Number of loans	Principal Balance	Unamortized (fees)/ costs, net	Carrying value	Unfunded commitment
First mortgage loan	1	19,554	16	19,570	1,126
Mezzanine loans	6	135,665	(224	) 135,441	—
Total	7	155,219	(208	) 155,011	1,126

December 31, 2014

\$ in thousands	Number of loans	Principal Balance	Unamortized (fees)/ costs, net	Carrying value	Unfunded commitment
First mortgage loan	1	19,978	41	20,019	1,623
Subordinate interests:					
Mezzanine loans	4	71,643	(94	) 71,549	3,357
Other ⁽¹⁾	2	54,188	—	54,188	—
Total	7	145,809	(53	) 145,756	4,980

(1) Other subordinate interests include a B-note and a preferred equity investment.

These loans were not impaired, and no allowance for loan loss has been recorded as of June 30, 2015 and December 31, 2014.

Note 6 – Other Investments

The following table summarizes the Company's other investments as of June 30, 2015 and December 31, 2014.

\$ in thousands	June 30, 2015	December 31, 2014
FHLBI stock	69,750	62,500
Investments in unconsolidated ventures	44,803	43,998
Total	114,553	106,498

IAS Services LLC, the Company's wholly-owned subsidiary, is required to purchase and hold FHLBI stock as a condition of membership in the Federal Home Loan Bank of Indianapolis ("FHLBI"). The stock is recorded at cost. The Company has invested in unconsolidated ventures that are managed by an affiliate of the Company's Manager. The unconsolidated ventures invest in the Company's target assets. Refer to Note 15 - "Commitments and Contingencies" for additional details regarding the Company's commitments to these unconsolidated ventures.

Table of Contents

Note 7 – Borrowings

The Company has entered into repurchase agreements, secured loans and issued exchangeable senior notes to finance the majority of its portfolio of investments. The following table summarizes certain characteristics of the Company's borrowings at June 30, 2015 and December 31, 2014.

\$ in thousands	June 30, 2015			December 31, 2014		
	Amount Outstanding	Weighted Average Interest Rate	Weighted Average Remaining Maturity (days)	Amount Outstanding	Weighted Average Interest Rate	Weighted Average Remaining Maturity (days)
Repurchase Agreements:						
Agency RMBS	8,795,055	0.37	% 17	9,018,818	0.35	% 18
Non-Agency RMBS	2,452,975	1.54	% 43	2,676,626	1.51	% 36
GSE CRT	509,617	1.69	% 31	468,782	1.55	% 27
CMBS	1,417,213	1.34	% 27	1,458,451	1.32	% 26
Secured Loans	1,550,000	0.40	% 2,980	1,250,000	0.37	% 3,472
Exchangeable Senior Notes	400,000	5.00	% 989	400,000	5.00	% 1,170
Total	15,124,860	0.82	% 354	15,272,677	0.81	% 335

The Company finances its residential loans held-for-investment through asset-backed securities issued by securitization trusts. Refer to Note 3 - "Variable Interest Entities" for a discussion of asset-backed securities issued by securitization trusts.

Repurchase Agreements

Repurchase agreements bear interest at a contractually agreed upon rate and have maturities ranging from one month to twelve months. Repurchase agreements are accounted for as secured borrowings since the Company maintains effective control of the financed assets. Under the repurchase agreements, the respective lender retains the right to mark the underlying collateral to fair value. A reduction in the value of pledged assets would require the Company to provide additional collateral or fund margin calls. The Company intends to maintain a level of liquidity that will enable the Company to meet margin calls. In addition, the repurchase agreements are subject to certain financial covenants. The Company was in compliance with these covenants at June 30, 2015.

Table of Contents

The following tables summarize certain characteristics of the Company's repurchase agreements at June 30, 2015 and December 31, 2014.

June 30, 2015

\$ in thousands	Amount	Percent of Total	Company	
Repurchase Agreement Counterparties	Outstanding	Amount	Outstanding	MBS and GSE CRTs Held as Collateral
HSBC Securities (USA) Inc	1,202,021	9.2	%	1,239,389
Citigroup Global Markets Inc.	1,096,155	8.3	%	1,289,766 (1)
Royal Bank of Canada	1,071,275	8.1	%	1,293,195
South Street Securities LLC	882,368	6.7	%	928,294
CRT Capital Group LLC	753,422	5.7	%	791,630
Goldman, Sachs & Co.	676,719	5.1	%	816,439
Industrial and Commercial Bank of China Financial Services LLC	668,548	5.1	%	703,486
Mitsubishi UFJ Securities (USA), Inc.	666,581	5.1	%	700,639
J.P. Morgan Securities LLC	662,483	5.0	%	762,158
Banc of America Securities LLC	655,434	5.0	%	750,231 (2)
Pierpont Securities LLC	611,156	4.6	%	638,543
Wells Fargo Securities, LLC	602,134	4.6	%	725,679
Scotia Capital	544,117	4.1	%	565,837
BNP Paribas Securities Corp.	518,792	3.9	%	577,427
ING Financial Market LLC	490,120	3.7	%	521,261
Morgan Stanley & Co. Incorporated	474,048	3.6	%	519,377
Credit Suisse Securities (USA) LLC	468,477	3.6	%	611,182 (3)
KGS-Alpha Capital Markets, L.P.	406,091	3.1	%	427,033
All other counterparties (4)	724,919	5.5	%	821,890
Total	13,174,860	100.0	%	14,683,456

(1) Includes \$209.7 million of MBS held as collateral which are eliminated in consolidation.

(2) Includes \$124.3 million of MBS held as collateral which are eliminated in consolidation.

(3) Includes \$85.4 million of MBS held as collateral which are eliminated in consolidation.

(4) Represents amounts outstanding with eight counterparties.

Table of Contents

December 31, 2014

\$ in thousands	Amount Outstanding	Percent of Total Amount Outstanding	Company MBS and GSE CRTs Held as Collateral	
Repurchase Agreement Counterparties				
Credit Suisse Securities (USA) LLC	1,517,530	11.1	% 1,925,973	(1)
HSBC Securities (USA) Inc	1,190,769	8.7	% 1,225,194	
Royal Bank of Canada	1,057,798	7.8	% 1,278,612	
Citigroup Global Markets Inc.	979,247	7.2	% 1,157,265	(2)
South Street Securities LLC	961,938	7.1	% 1,020,054	
Banc of America Securities LLC	791,196	5.9	% 875,984	(3)
ING Financial Market LLC	767,733	5.6	% 820,166	
Mitsubishi UFJ Securities (USA), Inc.	710,058	5.2	% 744,836	
J.P. Morgan Securities LLC	698,856	5.1	% 814,896	
Industrial and Commercial Bank of China Financial Services LLC	682,193	5.0	% 716,989	
Wells Fargo Securities, LLC	627,071	4.6	% 754,706	
Pierpont Securities LLC	601,222	4.4	% 627,534	
Morgan Stanley & Co. Incorporated	589,950	4.3	% 632,002	
BNP Paribas Securities Corp.	559,658	4.1	% 622,749	
Scotia Capital	521,778	3.8	% 542,044	
KGS-Alpha Capital Markets, L.P.	407,920	3.0	% 430,241	
All other counterparties ⁽⁴⁾	957,760	7.1	% 1,071,019	
Total	13,622,677	100.0	% 15,260,264	

(1) Includes \$276.1 million of MBS held as collateral which are eliminated in consolidation.

(2) Includes \$20.3 million of MBS held as collateral which are eliminated in consolidation.

(3) Includes \$106.8 million of MBS held as collateral which are eliminated in consolidation.

(4) Represents amounts outstanding with ten counterparties.

Company MBS and GSE CRTs held by counterparties as security for repurchase agreements was \$14.7 billion and \$15.3 billion at June 30, 2015 and December 31, 2014, respectively. This represents a collateral ratio (Company MBS and GSE CRTs Held as Collateral/Amount Outstanding) of 111% and 112% for June 30, 2015 and December 31, 2014, respectively.

No cash collateral was held by the counterparties at June 30, 2015 and December 31, 2014.

Secured Loans

The Company's wholly-owned subsidiary, IAS Services LLC is a member of the FHLBI. As a member of the FHLBI, IAS Services LLC may borrow funds from the FHLBI in the form of secured advances.

As of June 30, 2015, IAS Services LLC, had \$1.55 billion in outstanding secured advances from the FHLBI and is approved for additional available uncommitted credit for borrowing of an amount up to \$2.5 billion. These secured advances have maturity dates ranging from 2020 to 2024 and have floating rates based on three-month LIBOR or the three-month FHLBI swap rate plus a spread. For the six months ended June 30, 2015, IAS Services LLC had average borrowings of \$1.53 billion with a weighted average borrowing rate of 0.39%.

The ability to borrow from the FHLBI is subject to the Company's continued creditworthiness, pledging of sufficient eligible collateral to secure advances, and compliance with certain agreements with FHLBI. Each advance requires approval by the FHLBI and is secured by collateral in accordance with FHLBI's credit and collateral guidelines. The FHLBI retains the right to mark the underlying collateral for FHLBI advances to fair value. A reduction in the value of pledged assets would require IAS Services LLC to provide additional collateral.

As of June 30, 2015, the FHLBI advances were collateralized by CMBS and Agency RMBS with a fair value of \$1.5 billion and \$387.4 million, respectively.

Table of Contents

As discussed in Note 6 - "Other Investments," IAS Services LLC is required to purchase and hold a certain amount of FHLBI stock, which is based, in part, upon the outstanding principal balance of secured advances from the FHLBI.

Note 8 – Derivatives and Hedging Activities

Credit Derivatives

As discussed in Note 2 - "Summary of Significant Accounting Policies", the Company's GSE CRTs are accounted for as hybrid financial instruments with an embedded derivative. At June 30, 2015 and December 31, 2014, terms of the GSE CRT embedded derivatives are:

\$ in thousand	June 30, 2015	December 31, 2014
Fair value amount	(10,372	) (21,495
Notional amount	643,000	615,000
Maximum potential amount of future undiscounted payments	643,000	615,000

In 2010, the Company entered into a credit default swap contract ("CDS"). The Company sold protection against losses on a specific pool of non-Agency RMBS in excess of a specified threshold. In exchange, the Company is paid a stated fixed rate fee of 3% of the notional amount of the CDS. As of June 30, 2015, the Company has not made any payments related to the CDS contract.

At June 30, 2015 and December 31, 2014, terms of the CDS are:

\$ in thousand	June 30, 2015	December 31, 2014
Fair value amount	1,140	396
Notional amount	30,079	36,684
Maximum potential amount of future undiscounted payments	30,079	36,684
Recourse provisions with third parties	—	—
Collateral held by counterparty	4,656	5,642

Interest Rate Swaps

The Company's repurchase agreements are usually settled on a short-term basis ranging from one to twelve months. At each settlement date, the Company refinances each repurchase agreement at the market interest rate at that time. In addition, the Company's secured loans have floating interest rates. As such, the Company is exposed to changing interest rates. The Company's objectives in using interest rate derivatives are to add stability to interest expense and to manage its exposures to interest rate movements. To accomplish this objective, the Company primarily uses interest rate swaps as part of its interest rate risk management strategy. Interest rate swaps involve the receipt of variable-rate amounts from a counterparty in exchange for the Company making fixed-rate payments over the life of the agreements without exchange of the underlying notional amount.

Effective December 31, 2013, the Company voluntarily discontinued cash flow hedge accounting for its interest rate swaps to gain greater flexibility in managing interest rate exposures. Amounts recorded in AOCI through December 31, 2013 related to cash flow hedges are reclassified to interest expense on repurchase agreements on the condensed consolidated statements of operations as interest is accrued and paid on the related repurchase agreements over the remaining life of the interest rate swap agreements. The Company reclassified \$16.3 million (June 30, 2014: \$21.5 million) and \$35.5 million (June 30, 2014: \$42.8 million) as an increase to interest expense for the three and six months ended June 30, 2015, respectively. During the next 12 months, the Company estimates that \$47.5 million will be reclassified as an increase to interest expense, repurchase agreements.

As a result of discontinuing hedge accounting, beginning January 1, 2014, changes in the fair value of the Company's interest rate swaps are recorded in gain (loss) on derivative instruments, net on the condensed consolidated statements of operations. Monthly net cash settlements under swaps are recorded in gain (loss) on derivative instruments, net on the condensed consolidated statements of operations.

Table of Contents

As of June 30, 2015, the Company had the following interest rate swaps outstanding:

\$ in thousands	Notional	Maturity Date	Fixed Interest Rate in Contract	
Counterparty				
Credit Suisse International	500,000	4/15/2016	2.27	%
The Bank of New York Mellon	500,000	4/15/2016	2.24	%
JPMorgan Chase Bank, N.A.	500,000	5/16/2016	2.31	%
Goldman Sachs Bank USA	500,000	5/24/2016	2.34	%
Goldman Sachs Bank USA	250,000	6/15/2016	2.67	%
Wells Fargo Bank, N.A.	250,000	6/15/2016	2.67	%
JPMorgan Chase Bank, N.A.	500,000	6/24/2016	2.51	%
Citibank, N.A.	500,000	10/15/2016	1.93	%
Deutsche Bank AG	150,000	2/5/2018	2.90	%
ING Capital Markets LLC	350,000	2/24/2018	0.95	%
ING Capital Markets LLC	300,000	5/5/2018	0.79	%
UBS AG	500,000	5/24/2018	1.10	%
ING Capital Markets LLC	400,000	6/5/2018	0.87	%
The Royal Bank of Scotland Plc	500,000	9/5/2018	1.04	%
Citibank, N.A. CME Clearing House (1)	300,000	2/5/2021	2.50	%
The Royal Bank of Scotland Plc CME Clearing House (1)	300,000	2/5/2021	2.69	%
Wells Fargo Bank, N.A.	200,000	3/15/2021	3.14	%
JPMorgan Chase Bank, N.A. (2)	500,000	5/24/2021	2.25	%
Citibank, N.A.	200,000	5/25/2021	2.83	%
HSBC Bank USA, National Association (3)	500,000	6/24/2021	2.44	%
HSBC Bank USA, National Association	550,000	2/24/2022	2.45	%
Deutsche Bank AG	1,000,000	6/9/2022	2.21	%
HSBC Bank USA, National Association	250,000	6/5/2023	1.91	%
The Royal Bank of Scotland Plc	500,000	8/15/2023	1.98	%
Goldman Sachs Bank USA CME Clearing House	600,000	8/24/2023	2.88	%
UBS AG	250,000	11/15/2023	2.23	%
HSBC Bank USA, National Association	500,000	12/15/2023	2.20	%
Morgan Stanley Capital Services, LLC	100,000	4/2/2025	2.04	%
Total	11,450,000		2.12	%

(1) Forward start date of February 2016

(2) Forward start date of May 2016

(3) Forward start date of June 2016

At June 30, 2015, the Company's counterparties held \$65.1 million in cash margin deposits and approximately \$141.1 million in Agency RMBS as collateral against its interest rate swaps, CDS and currency forward contracts. In addition, several counterparties posted \$12.3 million of securities and \$6.5 million of cash as collateral with the Company. Cash margin posted by the Company is classified as due from counterparties, and cash margin posted by counterparties that are restricted in use, if any, is classified as restricted cash. As of June 30, 2015 and December 31, 2014, the Company did not have any restricted cash. The Agency RMBS collateral posted by the Company is included in total mortgage-backed and credit risk transfer securities on the Company's condensed consolidated balance sheets. Cash collateral that is not restricted for use by the Company is included in cash and cash equivalents and the liability to return the collateral is included in collateral held payable on the condensed consolidated balance sheets. Non-cash collateral posted by counterparties to the Company would be recognized if any counterparty defaults or if the Company sold the pledged collateral. As of June 30, 2015 and December 31, 2014, the Company did not recognize any non-cash collateral held as collateral.

Table of Contents**Interest Rate Swaptions**

The Company has purchased interest rate swaptions to help mitigate the potential impact of increases or decreases in interest rates on the performance of a portion of the Company's investment portfolio (referred to as "convexity risk"). The interest rate swaptions provide the Company the option to enter into interest rate swap agreements for a predetermined notional amount, stated term and pay and receive interest rates in the future. The premium paid for interest rate swaptions is reported as an asset in the Company's condensed consolidated balance sheets. The premium is valued at an amount equal to the fair value of the swaption that would have the effect of closing the position adjusted for nonperformance risk, if any. The difference between the premium and the fair value of the swaption is reported in gain (loss) on derivative instruments, net in the Company's condensed consolidated statements of operations. If an interest rate swaption expires unexercised, the loss on the interest rate swaption would be equal to the premium paid. If the Company sells or exercises an interest rate swaption, the realized gain or loss on the interest rate swaption would be equal to the difference between the cash or the fair value of the underlying interest rate swap received and the premium paid. The Company had \$3.1 million (June 30, 2014: \$8.2 million) and \$7.7 million (June 30, 2014: \$23.3 million) of realized loss for the interest rate swaptions that expired unexercised during the three and six months ended June 30, 2015 and 2014, respectively. For the three and six months ended June 30, 2015 and 2014, the Company had \$2.3 million (June 30, 2014: \$4.7 million) and \$6.0 million (June 30, 2014: \$15.8 million) of unrealized gain, respectively, which represents the change in fair value of the Company's interest rate swaptions that are recognized directly in earnings.

As of June 30, 2015, the Company had the following outstanding interest rate swaptions:

Interest Rate Swaptions	Option	Cost	Fair Value	Average Months to Expiration	Notional Amount	Underlying Swap		
						Average Fixed Pay Rate	Average Receive rate	Average Term (Years)
Payer	< 6 Months	2,590	—	1.0	300,000	3.13	% 3M Libor	6.7
Total Payer		2,590	—	1.0	300,000	3.13	% 3M Libor	6.7
Receiver	> 6 Months	1,485	74	7.0	300,000	3M Libor	1.11 %	10.0
Total Receiver		1,485	74	7.0	300,000	3M Libor	1.11 %	10.0

TBAs, Futures and Currency Forward Contracts

The Company purchases or sells certain TBAs and U.S. Treasury futures contracts to help mitigate the potential impact of changes in interest rates on the performance of the Company's portfolio. Realized and unrealized gains and losses associated with the purchase or sales of the TBAs and U.S. Treasury futures contracts are recognized in gain (loss) on derivative instruments, net in the Company's condensed consolidated statements of operations.

The Company uses currency forward contracts to help mitigate the potential impact of changes in foreign currency exchange rates on the Company's investments denominated in foreign currencies. Realized and unrealized gains and losses associated with the purchases or sales of currency forward contracts are recognized in gain (loss) on derivative instruments, net in the Company's condensed consolidated statements of operations.

Table of Contents

The following table presents information with respect to the Company's derivative instruments:

\$ in thousands	Notional Amount as of January 1, 2015	Additions	Settlement, Termination, Expiration or Exercise	Notional Amount as of June 30, 2015	Amount of Realized Gain (Loss), net on Derivative Instruments (excluding net interest paid or received) for the six months ended June 30, 2015
Interest Rate Swaptions	1,050,000	300,000	(750,000)	600,000	(7,738)
Interest Rate Swaps	10,550,000	2,100,000	(1,200,000)	11,450,000	(31,881)
Sale of TBAs	198,000	248,000	(446,000)	—	(2,292)
Futures Contracts	127,400	120,900	(248,300)	—	(943)
Currency Forward Contracts	35,688	96,563	(63,416)	68,835	1,539
Total	11,961,088	2,865,463	(2,707,716)	12,118,835	(41,315)

Tabular Disclosure of the Effect of Derivative Instruments on the Balance Sheet

The table below presents the fair value of the Company's derivative financial instruments, as well as their classification on the condensed consolidated balance sheets as of June 30, 2015 and December 31, 2014.

\$ in thousands

Derivative Assets	Derivative Liabilities				
	As of June 30, 2015	As of December 31, 2014			
Balance Sheet	Fair Value	Fair Value	Balance Sheet	Fair Value	Fair Value
Interest Rate Swap Asset	18,276	22,772	Interest Rate Swap Liability	188,307	253,468
CDS Contract	1,140	396	TBAs	—	558
Interest Rate Swaptions	74	322	Currency Forward Contracts	1,362	—
Futures Contracts	—	89			
Currency Forward Contracts	1,014	599			

Embedded derivatives associated with GSE CRTs are recorded within mortgage-backed and credit risk transfer securities, at fair value, on the consolidated balance sheets. The fair value of the embedded derivatives associated with the GSE CRTs is a net liability of \$10.4 million as of June 30, 2015 (December 31, 2014: \$21.5 million net liability).

Tabular Disclosure of the Effect of Derivative Instruments on the Income Statement

The tables below present the effect of the Company's derivative financial instruments on the condensed consolidated statements of operations for the three and six months ended June 30, 2015 and 2014.

\$ in thousands

Derivative not designated as hedging instrument	Location of unrealized gain (loss) recognized in income on derivative	Three months ended June 30, 2015	Three Months ended June 30, 2014 (As Restated)
CDS Contract	Realized and unrealized credit derivative income (loss), net	806	(60)

Edgar Filing: Invesco Mortgage Capital Inc. - Form 10-Q

GSE CRT Embedded Derivatives	Realized and unrealized credit derivative income (loss), net	(4,915	) 27,990
Total		(4,109	) 27,930

30

Table of Contents

\$ in thousands

Derivative not designated as hedging instrument	Location of unrealized gain (loss) recognized in income on derivative	Six months ended June 30, 2015	Six Months ended June 30, 2014 (As Restated)
CDS Contract	Realized and unrealized credit derivative income (loss), net	744	(107)
GSE CRT Embedded Derivatives	Realized and unrealized credit derivative income (loss), net	11,123	41,951
Total		11,867	41,844

The following table summarizes the effect of interest rate swaps, swaption contracts, TBAs, futures contracts and currency forwards reported in gain (loss) on derivative instruments, net on the condensed consolidated statements of operations for the three and six months ended June 30, 2015 and 2014:

\$ in thousands	Three months ended June 30, 2015			
Derivative not designated as hedging instrument	Realized gain (loss) on settlement, termination, expiration or exercise, net	Contractual interest expense	Unrealized gain (loss), net	Gain (loss) on derivative instruments, net
Interest Rate Swaps	(12,826)	(46,011)	116,623	57,786
Interest Rate Swaptions	(3,050)	—	2,326	(724)
Currency Forward Contracts	664	—	(1,723)	(1,059)
Total	(15,212)	(46,011)	117,226	56,003
\$ in thousands	Six months ended June 30, 2015			
Derivative not designated as hedging instrument	Realized gain (loss) on settlement, termination, expiration or exercise, net	Contractual interest expense	Unrealized gain (loss), net	Gain (loss) on derivative instruments, net
Interest Rate Swaps	(31,881)	(91,619)	60,666	(62,834)
Interest Rate Swaptions	(7,738)	—	6,005	(1,733)
TBAs	(2,292)	—	558	(1,734)
Futures Contracts	(943)	—	(90)	(1,033)
Currency Forward Contracts	1,539	—	(947)	592
Total	(41,315)	(91,619)	66,192	(66,742)
\$ in thousands	Three months ended June 30, 2014			
Derivative not designated as hedging instrument	Realized gain (loss) on settlement, termination, expiration or exercise, net	Contractual interest expense	Unrealized gain (loss), net	Gain (loss) on derivative instruments, net
Interest Rate Swaps	—	(52,205)	(103,633)	(155,838)
Interest Rate Swaptions	(8,200)	—	4,654	(3,546)
TBAs	(1,400)	—	(1,938)	(3,338)

Edgar Filing: Invesco Mortgage Capital Inc. - Form 10-Q

Futures Contracts	(5,437	) —	343	(5,094)
Total	(15,037	) (52,205	) (100,574	) (167,816)

31

Table of Contents

\$ in thousands	Six months ended June 30, 2014			
	Realized gain (loss) on settlement, termination, expiration or exercise, net	Contractual interest expense	Unrealized gain (loss), net	Gain (loss) on derivative instruments, net
Derivative not designated as hedging instrument				
Interest Rate Swaps	—	(103,646	) (193,825	) (297,471
Interest Rate Swaptions	(23,275	) —	15,781	(7,494
TBAs	(1,400	) —	(1,235	) (2,635
Futures Contracts	(9,186	) —	(2,342	) (11,528
Total	(33,861	) (103,646	) (181,621	) (319,128

Credit-risk-related Contingent Features

The Company has agreements with each of its bilateral derivative counterparties. Some of those agreements contain a provision whereby if the Company defaults on any of its indebtedness, including default whereby repayment of the indebtedness has not been accelerated by the lender, the Company could be declared in default on its derivative obligations.

At June 30, 2015, the fair value of derivatives in a net liability position, which includes accrued interest but excludes any adjustment for non-performance risk related to these agreements, was \$124.3 million. The Company has minimum collateral posting thresholds with certain of its derivative counterparties and has posted collateral of \$141.1 million of Agency RMBS and \$65.1 million of cash as of June 30, 2015. If the Company had breached any of these provisions at June 30, 2015, it could have been required to settle its obligations under the agreements at their termination value.

In addition, as of June 30, 2015, the Company has an agreement with a central clearing counterparty. The fair value of such derivatives in a net liability position, which includes accrued interest but excludes any adjustment for non-performance risk related to this agreement, was \$63.7 million.

The Company was in compliance with all of the financial provisions of these counterparty agreements as of June 30, 2015.

Note 9 – Offsetting Assets and Liabilities

Certain of the Company's repurchase agreements and derivative transactions are governed by underlying agreements that generally provide for a right of setoff under master netting arrangements (or similar agreements) in the event of default or in the event of bankruptcy of either party to the transactions. Assets and liabilities subject to such arrangements are presented on a gross basis in the condensed consolidated balance sheets.

The following tables present information about the assets and liabilities that are subject to master netting agreements (or similar agreements) and can potentially be offset on the Company's condensed consolidated balance sheets at June 30, 2015 and December 31, 2014.

Offsetting of Derivative Assets

As of June 30, 2015

\$ in thousands	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Condensed Balance	Net Amounts of Assets presented in the Condensed	Gross Amounts Not Offset in the Condensed Consolidated Balance Sheets		
				Financial Instruments (1)	Collateral Received (4)	Net Amount
Description						

Edgar Filing: Invesco Mortgage Capital Inc. - Form 10-Q

		Sheets	Consolidated Balance Sheets				
Derivatives	20,504	—	20,504	(9,042	)	(11,462) —
Total	20,504	—	20,504	(9,042	)	(11,462) —

32

Table of Contents

Offsetting of Derivative Liabilities, Repurchase Agreements and Secured Loans
As of June 30, 2015

\$ in thousands Description	Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Condensed Consolidated Balance Sheets	Net Amounts of Liabilities presented in the Condensed Consolidated Balance Sheets	Gross Amounts Not Offset in the Condensed Consolidated Balance Sheets		
				Financial Instruments (2)(3)(5)	Collateral Posted (2)(4)(5)	Net Amount
Derivatives	189,669	—	189,669	(117,562)	(61,798)	10,309
Repurchase Agreements	13,174,860	—	13,174,860	(13,174,860)	—	—
Secured Loans	1,550,000	—	1,550,000	(1,550,000)	—	—
Total	14,914,529	—	14,914,529	(14,842,422)	(61,798)	10,309

Offsetting of Derivative Assets
As of December 31, 2014

\$ in thousands Description	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Condensed Consolidated Balance Sheets	Net Amounts of Assets presented in the Condensed Consolidated Balance Sheets	Gross Amounts Not Offset in the Condensed Consolidated Balance Sheets		
				Financial Instruments (1)	Collateral Received (4)	Net Amount
Derivatives	24,178	—	24,178	(5,277)	(18,901)	—
Total	24,178	—	24,178	(5,277)	(18,901)	—

Offsetting of Derivative Liabilities and Repurchase Agreements
As of December 31, 2014

\$ in thousands Description	Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Condensed Consolidated Balance Sheets	Net Amounts of Liabilities presented in the Condensed Consolidated Balance Sheets	Gross Amounts Not Offset in the Condensed Consolidated Balance Sheets		
				Financial Instruments (2)(3)	Collateral Posted (2)(4)	Net Amount

Edgar Filing: Invesco Mortgage Capital Inc. - Form 10-Q

Derivatives	254,026	—	254,026	(235,908	)	(18,118)	—
Repurchase Agreements	13,622,677	—	13,622,677	(13,622,677)	—		—
Secured Loans	1,250,000	—	1,250,000	(1,250,000)	—		
Total	15,126,703	—	15,126,703	(15,108,585	)	(18,118)	—

33

Table of Contents

- (1) Amounts represent derivatives in an asset position which could potentially be offset against derivatives in a liability position at June 30, 2015 and December 31, 2014, subject to a netting arrangement.
- (2) Amounts represent collateral pledged that is available to be offset against liability balances associated with repurchase agreements, secured loans and derivatives.
The fair value of securities pledged against the Company's borrowing under repurchase agreements was \$14.7 billion and \$15.3 billion at June 30, 2015 and December 31, 2014, respectively, including securities held as collateral that are eliminated in consolidation of \$419.4 million and \$403.2 million, respectively at June 30, 2015 and December 31, 2014.
Cash collateral received on the Company's derivatives was \$6.5 million and \$14.9 million at June 30, 2015 and December 31, 2014, respectively. Non-cash collateral received on the Company's derivatives was \$12.3 million and \$10.8 million at June 30, 2015 and December 31, 2014. Cash collateral posted by the Company on its derivatives was \$65.1 million and \$57.6 million at June 30, 2015 and December 31, 2014, respectively.
- (3) The fair value of securities pledged against IAS Services LLC's borrowing under secured loans was \$1.8 billion and \$1.5 billion at June 30, 2015 and December 31, 2014, respectively.
- (4) The fair value of securities pledged against IAS Services LLC's borrowing under secured loans was \$1.8 billion and \$1.5 billion at June 30, 2015 and December 31, 2014, respectively.
- (5) The fair value of securities pledged against IAS Services LLC's borrowing under secured loans was \$1.8 billion and \$1.5 billion at June 30, 2015 and December 31, 2014, respectively.

Note 10 – Fair Value of Financial Instruments

A three-level valuation hierarchy exists for disclosure of fair value measurements based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. Observable inputs reflect readily obtainable data from independent sources, while unobservable inputs reflect the Company's market assumptions. The three levels are defined as follows:

Level 1 Inputs – Quoted prices for identical instruments in active markets.

Level 2 Inputs – Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose inputs are observable or whose significant value drivers are observable.

Level 3 Inputs – Instruments with primarily unobservable value drivers.

Table of Contents

The following tables present the Company's assets and liabilities measured at fair value on a recurring basis.

	June 30, 2015			
	Fair Value Measurements Using:			
	Level 1	Level 2	Level 3	Total at Fair Value
Assets:				
Mortgage-backed and credit risk transfer securities ⁽¹⁾	—	17,205,610	(10,372	) 17,195,238
⁽²⁾ Derivative assets	—	19,364	1,140	20,504
Total assets	—	17,224,974	(9,232	) 17,215,742
Liabilities:				
Derivative liabilities	—	189,669	—	189,669
Total liabilities	—	189,669	—	189,669
	December 31, 2014 (As Restated)			
	Fair Value Measurements Using:			
	Level 1	Level 2	Level 3	Total at Fair Value
\$ in thousands				
Assets:				
Mortgage-backed and credit risk transfer securities ⁽¹⁾	—	17,270,390	(21,495	) 17,248,895
⁽²⁾ Derivative assets	89	23,693	396	24,178
Total assets	89	17,294,083	(21,099	) 17,273,073
Liabilities:				
Derivative liabilities	—	254,026	—	254,026
Total liabilities	—	254,026	—	254,026

(1) For more detail about the fair value of the Company's MBS and GSE CRTs, refer to Note 4 - "Mortgage-Backed and Credit Risk Transfer Securities."

As discussed in Note 2 "Summary of Significant Accounting Policies", the Company's GSE CRTs are accounted for as hybrid financial instruments with an embedded derivative. The hybrid instruments contain debt host contracts classified as Level 2 and embedded derivatives classified as Level 3. As of June 30, 2015, the net embedded derivative liability position of \$10.4 million includes \$3.5 million of embedded derivatives in an asset position and \$13.9 million of embedded derivatives in a liability position. As of December 31, 2014, the net embedded derivative liability position of \$21.5 million includes \$3.1 million of embedded derivatives in an asset position and \$24.6 million of embedded derivatives in a liability position.

The following table shows a reconciliation of the beginning and ending fair value measurements of the Company's GSE CRT embedded derivatives which the Company has valued utilizing Level 3 inputs:

\$ in thousands	June 30, 2015	December 31, 2014	
Beginning balance	(21,495) —	
Sales and settlements	2,468	—	
Total net gains / (losses) included in net income:			
Realized gains/(losses), net	(2,468) —	
Unrealized gains/(losses), net	11,123	(21,495)
Ending balance	(10,372) (21,495)

Table of Contents

The following table summarizes significant unobservable inputs used in the fair value measurement of the Company's GSE CRT embedded derivative:

\$ in thousands	Fair Value at June 30, 2015	Valuation Technique	Unobservable Input	Range	Weighted Average
GSE CRT Embedded Derivatives	(10,372	) Market Comparables	Prepayment Rate	6.23% - 18.16%	8.96 %
		Vendor Pricing	Default Rate	0.12% - 0.43%	0.18 %
\$ in thousands	Fair Value at December 31, 2014	Valuation Technique	Unobservable Input	Range	Weighted Average
GSE CRT Embedded Derivatives	(21,495	) Market Comparables	Prepayment Rate	4.46% - 8.98%	5.29 %
		Vendor Pricing	Default Rate	0.12% - 0.37%	0.18 %

These significant unobservable inputs change according to market conditions and security performance. Prepayment rate and default rate are used to estimate the maturity of GSE CRTs in order to identify GSE corporate debt with a similar maturity. Therefore, changes in prepayment rate and default rate do not have an explicit directional impact on the fair value measurement.

The following table shows a reconciliation of the beginning and ending fair value measurements of the Company's credit default swap ("CDS") contract, which the Company has valued utilizing Level 3 inputs:

\$ in thousands	June 30, 2015	December 31, 2014
Beginning balance	396	654
Unrealized gains/(losses), net	744	(258
Ending balance	1,140	396

The following table summarizes significant unobservable inputs used in the fair value measurement of the Company's CDS contract:

\$ in thousands	Fair Value at June 30, 2015	Valuation Technique	Unobservable Input	Range	Weighted Average
CDS Contract	1,140	Discounted cash flow	Swap Rate		0.47 %
			Discount Rate		0.70 %
			Credit Spread		0.49 %
			Constant Prepayment Rate	1.0% - 20.0%	5.41 %
			Constant Default Rate	0.7% - 100.0%	3.89 %
			Loss Severity	0.1% - 72.6%	40.69 %
\$ in thousands	Fair Value at December 31, 2014	Valuation Technique	Unobservable Input	Range	Weighted Average
CDS Contract	396	Discounted cash flow	Swap Rate		2.39 %
			Discount Rate		0.76 %
			Credit Spread		0.24 %
			Constant Prepayment Rate	1.0% - 20.0%	5.46 %
			Constant Default Rate	0.6% - 100.0%	4.15 %
			Loss Severity	1.1% - 62.3%	39.35 %

These significant unobservable inputs change according to market conditions and security performance expectations. Significant increases (decreases) in swap rate, discount rate, credit spread, constant prepayment rate, constant default rate or loss severity in isolation would result in a lower (higher) fair value measurement. Generally, a

change in the assumption used for the constant default rate would likely be accompanied by a directionally similar change in the assumptions

Table of Contents

used for swap rate, credit spread and loss severity and a directionally opposite change in the assumption used for discount rate and constant prepayment rate.

The following table presents the carrying value and estimated fair value of the Company's financial instruments that are not carried at fair value on the condensed consolidated balance sheets, at June 30, 2015 and December 31, 2014:

\$ in thousands	June 30, 2015		December 31, 2014	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Financial Assets				
Residential loans, held-for-investment	3,461,992	3,459,221	3,365,003	3,399,964
Commercial loans, held-for-investment	155,011	157,121	145,756	147,497
Other investments	114,553	114,553	106,498	106,498
Total	3,731,556	3,730,895	3,617,257	3,653,959
Financial Liabilities				
Repurchase agreements	13,174,860	13,180,757	13,622,677	13,630,571
Secured loans	1,550,000	1,550,000	1,250,000	1,250,000
Asset-backed securities issued by securitization trusts	3,006,047	3,009,131	2,929,820	2,930,422
Exchangeable senior notes	400,000	391,000	400,000	379,500
Total	18,130,907	18,130,888	18,202,497	18,190,493

The following describes the Company's methods for estimating the fair value for financial instruments.

The fair value of residential loans held-for-investment is a Level 3 fair value measurement which is based on an expected present value technique. This method discounts future estimated cash flows using rates the Company determined best reflect current market interest rates that would be offered for loans with similar characteristics and credit quality.

The fair value of commercial loans held-for-investment is a Level 3 fair value measurement. New commercial loans are carried at their unpaid principal balance until the end of the calendar year in which they were originated unless market factors indicate cost may not be a reliable indicator of fair value. Subsequent to the year of origination, commercial loan investments are valued on at least an annual basis by an independent third party valuation agent using a discounted cash flow technique.

The fair value of FHLBI stock, included in "Other investments," is a Level 3 fair value measurement. FHLBI stock may only be sold back to the FHLBI at its discretion at cost. As a result, the cost of the FHLBI stock approximates its fair value.

The fair value of investments in unconsolidated ventures, included in "Other investments," is a Level 3 fair value measurement. The fair value measurement is based on the net asset value per share of the Company's investments. The fair value of repurchase agreements is a Level 3 fair value measurement based on an expected present value technique. This method discounts future estimated cash flows using rates the Company determined best reflect current market interest rates that would be offered for repurchase agreements with similar characteristics and credit quality. The fair value of asset-backed securities issued by securitization trusts is a Level 3 fair value measurement based on valuations obtained from a third party pricing service. There is not an active trading market for many of the underlying asset-backed securities. Accordingly, these securities are valued by the third party pricing service by discounting future estimated cash flows using rates that best reflect current market interest rates that would be offered for securities with similar characteristics and credit quality.

The fair value of secured loans is a Level 3 fair value measurement. The secured loans have floating rates based on an index plus a spread. Accordingly, the interest rates on these secured loans are at market, and thus the carrying amount approximates fair value.

The fair value of the exchangeable senior notes issued is a Level 2 fair value measurement based on valuation obtained from a third-party pricing service.

Table of Contents

Note 11 – Related Party Transactions

The Company is externally managed and advised by Invesco Advisers, Inc. (the "Manager"), a wholly-owned subsidiary of Invesco Ltd. Under the terms of the management agreement, the Manager and its affiliates provide the Company with its management team, including its officers, along with appropriate support personnel. Each of the Company's officers is an employee of the Manager or one of its affiliates. The Company does not have any employees. The Manager is not obligated to dedicate any of its employees exclusively to the Company, nor are the Manager or its employees obligated to dedicate any specific portion of its or their time to the Company's business. The Manager is at all times subject to the supervision and oversight of the Company's Board of Directors and has only such functions and authority as the Company delegates to it.

The Company has invested \$80.4 million and \$149.3 million as of June 30, 2015 and December 31, 2014, respectively, in money market or mutual funds managed by affiliates of the Company's Manager. The investments are reported as cash and cash equivalents on the Company's condensed consolidated balance sheets.

Management Fee

For the three months ended June 30, 2015, the Company incurred management fees of \$9.3 million (June 30, 2014: \$9.3 million), of which \$9.2 million (June 30, 2014: \$9.3 million) was accrued but has not been paid.

For the six months ended June 30, 2015, the Company incurred management fees of \$18.8 million (June 30, 2014: \$18.7 million), of which \$9.2 million (June 30, 2014: \$9.3 million) was accrued but has not been paid.

Expense Reimbursement

The Company is required to reimburse its Manager for Company operating expenses incurred by the Manager, including directors and officers insurance, accounting services, auditing and tax services, filing fees, and miscellaneous general and administrative costs. The Company's reimbursement obligation is not subject to any dollar limitation.

The following table summarizes the costs originally paid by the Manager, incurred on behalf of the Company for the three and six months ended June 30, 2015 and 2014.

	Three Months Ended		Six Months Ended	
	June 30, 2015		June 30, 2015	
\$ in thousands	2015	2014	2015	2014
Incurred costs, prepaid or expensed	1,707	1,334	2,349	3,099
Total incurred costs, originally paid by the Manager	1,707	1,334	2,349	3,099

Termination Fee

A termination fee is due to the Manager upon termination of the management agreement by the Company. The termination fee is equal to three times the sum of the average annual management fee earned by the Manager during the 24-month period before termination, calculated as of the end of the most recently completed fiscal quarter.

Table of Contents

Note 12 – Stockholders’ Equity

Securities Convertible into Shares of Common Stock

The non-controlling interest holder of the Operating Partnership units, a wholly-owned Invesco subsidiary, has the right to cause the Operating Partnership to redeem their operating partnership ("OP Units") for cash equal to the market value of an equivalent number of shares of common stock, or at the Company’s option, the Company may purchase their OP Units by issuing one share of common stock for each OP Unit redeemed. The Company has also adopted an equity incentive plan which allows the Company to grant securities convertible into the Company’s common stock to its non-executive directors and employees of the Company's Manager and its affiliates.

Common Stock

The Company has a dividend reinvestment and stock purchase plan (the “DRSPP”) that allows participating stockholders to purchase shares of common stock directly from the Company. DRSPP participants may also automatically reinvest all or a portion of their dividends in exchange for additional shares of common stock. During the six months ended June 30, 2015, the Company issued 7,756 shares of common stock at an average price of \$15.75 under the DRSPP. The Company received total proceeds of approximately \$122,000.

Preferred Stock

Holders of the Company’s Series A Preferred Stock are entitled to receive dividends at an annual rate of 7.75% of the liquidation preference of \$25.00 per share or \$1.9375 per share per annum. The dividends are cumulative and payable quarterly in arrears.

Holders of the Company’s Series B Preferred Stock are entitled to receive dividends at an annual rate of 7.75% of the liquidation preference of \$25.00 per share or \$1.9375 per share per annum until December 27, 2024. After December 27, 2024, holders are entitled to receive dividends at a floating rate equal to three-month LIBOR plus a spread of 5.18% of the \$25.00 liquidation preference per annum. Dividends are cumulative and payable quarterly in arrears, with the first dividend payment date on December 29, 2014.

The Company may elect to redeem shares of preferred stock at its option after July 26, 2017 (with respect to the Series A Preferred Stock) and after December 27, 2024 (with respect to the Series B Preferred Stock) for \$25.00 per share, plus any accumulated and unpaid dividends through the date of the redemption. These shares are not redeemable, convertible into or exchangeable for any other property or any other securities of the Company prior to those times, except under circumstances intended to preserve the Company's qualification as a REIT or upon the occurrence of a change in control.

Share Repurchase Program

During the six months ended June 30, 2015, the Company did not repurchase any shares of its common stock. As of June 30, 2015, the Company had authority to purchase 14,841,784 additional shares of its common stock under its share repurchase program. The share repurchase program has no stated expiration date.

Share-Based Compensation

The Company has currently reserved 1,000,000 shares of common stock for issuance to its non-executive directors and officers and employees of the Manger and its affiliates under the terms of its 2009 Equity Incentive Plan (the "Incentive Plan"). Unless terminated earlier, the Incentive Plan will terminate in 2019, but will continue to govern the unexpired awards.

The Company recognized compensation expense of approximately \$85,000 (June 30, 2014: \$60,000) and approximately \$170,000 (June 30, 2014: \$112,000) related to the Company's non-executive directors for three and six months ended June 30, 2015 and 2014, respectively. During the three months ended June 30, 2015 and 2014, the Company issued 5,412 shares and 3,079 shares of stock, respectively, pursuant to the Incentive Plan to the Company’s non-executive directors. During the six months ended June 30, 2015 and 2014, the Company issued 10,744 shares and 5,824 shares of stock, respectively, pursuant to the Incentive Plan to the Company’s non-executive directors. The fair market value of the shares granted was determined by the closing stock market price on the date of the grant.

The Company recognized compensation expense of approximately \$67,000 (June 30, 2014: \$80,000) and \$137,000 (June 30, 2014: \$161,000) for the three and six months ended June 30, 2015, respectively, related to awards to employees of the Manager and its affiliates which is reimbursed by the Manager under the management agreement.

During March 2015, the Company issued 11,547 shares of common stock (net of tax withholding) to employees of the Manager and its affiliates in

39

Table of Contents

exchange for 17,783 restricted stock units that vested under the Incentive Plan. In addition, during the six months ended June 30, 2015, the Company awarded 17,652 restricted stock units to employees of the Manager and its affiliates.

Dividends

On June 15, 2015, we declared the following dividends:

a dividend of \$0.45 per share of common stock to be paid on July 28, 2015 to stockholders of record as of the close of business on June 26, 2015;

a dividend of \$0.4844 per share of Series A Preferred Stock to be paid on July 27, 2015 to stockholders of record as of the close of business on July 1, 2015; and

a dividend of \$0.4844 per share of Series B Preferred Stock to be paid on September 28, 2015 to stockholders of record as of the close of business on September 5, 2015.

Note 13 – Earnings per Common Share

Earnings per share for the three and six months ended June 30, 2015 and 2014 is computed as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014 (As Restated)	2015	2014 (As Restated)
\$ and share amounts in thousands				
Numerator (Income)				
Basic Earnings				
Net income (loss) available to common stockholders	139,925	(65,773)	122,485	(132,532)
Effect of dilutive securities:				
Income allocated to exchangeable senior notes	5,613	—	11,220	—
Income (loss) allocated to non-controlling interest	1,685	(729)	1,549	(1,462)
Dilutive net income (loss) available to stockholders	147,223	(66,502)	135,254	(133,994)
Denominator (Weighted Average Shares)				
Basic Earnings:				
Shares available to common stockholders	123,137	123,091	123,127	123,108
Effect of dilutive securities:				
Restricted stock awards	45	—	46	—
OP units	1,425	1,425	1,425	1,425
Exchangeable senior notes	16,836	—	16,836	—
Dilutive Shares	141,443	124,516	141,434	124,533

The following potential common shares were excluded from diluted earnings per common share for the three and six months ended June 30, 2014 as the effect would be anti-dilutive: 16,835,720 for the exchangeable senior notes, respectively, and 45,540 and 43,285 for restricted stock awards, respectively.

Table of Contents

Note 14 – Non-controlling Interest—Operating Partnership

Non-controlling interest represents the aggregate Operating Partnership Units in the Company's Operating Partnership held by a wholly-owned Invesco subsidiary. Income allocated to the non-controlling interest is based on the Unit Holders' ownership percentage of the Operating Partnership. The ownership percentage is determined by dividing the number of OP Units held by the Unit Holders by the total number of dilutive shares of common stock. The issuance of common stock ("Share" or "Shares") or OP Units changes the percentage ownership of both the Unit Holders and the holders of common stock. Since an OP unit is generally redeemable for cash or Shares at the option of the Company, it is deemed to be a Share equivalent. Therefore, such transactions are treated as capital transactions and result in an allocation between stockholders' equity and non-controlling interest in the accompanying condensed consolidated balance sheets. As of June 30, 2015 and December 31, 2014, non-controlling interest related to the outstanding 1,425,000 OP Units represented a 1.1% interest and 1.1% interest in the Operating Partnership, respectively. The following table presents the net income (loss) allocated and distributions paid to the Operating Partnership non-controlling interest for the three and six months ended June 30, 2015 and 2014.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014 (As Restated)	2015	2014 (As Restated)
\$ in thousands				
Net income (loss) allocated	1,685	(729)	1,549	(1,462)
Distributions paid	642	712	1,283	1,425

As of June 30, 2015 and December 31, 2014, distributions payable to the non-controlling interest were approximately \$641,000 and \$641,000, respectively.

Note 15 – Commitments and Contingencies

Commitments and Contingencies

Commitments and contingencies may arise in the ordinary course of business.

Off Balance Sheet Commitments

As discussed in Note 6 - "Other Investments", the Company has invested in unconsolidated ventures that are sponsored by an affiliate of the Company's Manager. The unconsolidated ventures are structured as partnerships, and the Company invests in the partnerships as a limited partner. The entities are structured such that capital commitments are to be drawn down over the life of the partnership as investment opportunities are identified. As of June 30, 2015 and December 31, 2014, the Company's undrawn capital and purchase commitments were \$26.3 million and \$31.0 million, respectively.

As discussed in Note 5 - "Commercial Loans Held-for-Investment", the Company purchases and originates commercial loans. As of June 30, 2015 and December 31, 2014, the Company has unfunded commitments on commercial loans held-for-investment of \$1.1 million and \$5.0 million, respectively.

The Company has entered into agreements with financial institutions to guarantee certain obligations of its subsidiaries. The Company would be required to perform under these guarantees in the event of certain defaults. The Company has not had prior claims or losses pursuant to these contracts and expects the risk of loss to be remote.

Note 16 – Subsequent Events

The Company has reviewed subsequent events occurring through the date that these condensed consolidated financial statements were issued, and determined that no subsequent events occurred that would require accrual or additional disclosure.

Table of Contents

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

In this quarterly report on Form 10-Q, or this "Report," we refer to Invesco Mortgage Capital Inc. and its consolidated subsidiaries as "we," "us," "our Company," or "our," unless we specifically state otherwise or the context indicates otherwise. We refer to our external manager, Invesco Advisers, Inc., as our "Manager," and we refer to the indirect parent company of our Manager, Invesco Ltd. together with its consolidated subsidiaries (which does not include us), as "Invesco." The following discussion should be read in conjunction with our condensed consolidated financial statements and the accompanying notes to our condensed consolidated financial statements, which are included in Item 1 of this Report, as well as the information contained in our most recent Form 10-K/A filed with the Securities and Exchange Commission (the "SEC").

Explanatory Note

On August 9, 2015, the Audit Committee of the Board of Directors of the Company concluded, based on the recommendation of management, that each of the Company's previously issued (i) consolidated financial statements as of and for the years ended December 31, 2013 and 2014, which were included in its Annual Report on Form 10-K for the year ended December 31, 2014, and (ii) interim consolidated financial statements as of and for the quarter ended March 31, 2013 and for all subsequent quarters through the quarter ended March 31, 2015 need to be restated and should no longer be relied upon. The Company filed Amendment No. 1 to its Annual Report on Form 10-K for the year ended December 31, 2014 and Amendment No. 1 to its Quarterly Report on Form 10-Q for the quarter ended March 31, 2015 on August 17, 2015. Prior period financial information in this Form 10-Q has been amended where necessary to reflect the restatement. Therefore, this Form 10-Q should be read in conjunction with the Company's Annual Report on Form 10-K/A for the year ended December 31, 2014.

Forward-Looking Statements

We make forward-looking statements in this Report and other filings we make with the SEC within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and such statements are intended to be covered by the safe harbor provided by the same. Forward-looking statements are subject to substantial risks and uncertainties, many of which are difficult to predict and are generally beyond our control. These forward-looking statements include information about possible or assumed future results of our business, investment strategies, financial condition, liquidity, results of operations, plans and objectives. When we use the words "believe," "expect," "anticipate," "estimate," "plan," "continue," "intend," "should," "may," "will," "could," "would," and any other similar expressions and future or conditional verbs such as "will," "may," "could," "should," and "would," and any other statement that necessarily depends on future events, we intend to identify forward-looking statements. Factors that could cause actual results to differ from those expressed in our forward-looking statements include, but are not limited to:

- our business and investment strategy;
- our investment portfolio;
- our projected operating results;
- general volatility of financial markets and effects of governmental responses, including actions and initiatives of the U.S. governmental agencies and changes to U.S. government policies, including the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), mortgage loan modification programs, actions and initiatives of foreign governmental agencies and central banks, and the completion of the Federal Reserve long-term asset purchases (quantitative easing or "QE"), and our ability to respond to and comply with such actions, initiatives and changes;
- the availability of financing sources, including our ability to obtain additional financing arrangements and the terms of such arrangements;
- financing and advance rates for our target assets;
- changes to our expected leverage;
- our expected investments;

- our expected book value per share of common stock;
- interest rate mismatches between our target assets and our borrowings used to fund such investments;
- the adequacy of our cash flow from operations and borrowings to meet our short-term liquidity needs;
- our ability to maintain sufficient liquidity to meet any margin calls;

Table of Contents

• changes in the credit rating of the U.S. government;

• changes in interest rates and interest rate spreads and the market value of our target assets;

• changes in prepayment rates on our target assets;

• the impact of any deficiencies in foreclosure practices of third parties and related uncertainty in the timing of collateral disposition;

• our reliance on third parties in connection with services related to our target assets;

• effects of hedging instruments on our target assets;

• rates of default or decreased recovery rates on our target assets;

• modifications to whole loans or loans underlying securities;

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

• the degree to which derivative contracts expose us to contingent liabilities;

• counterparty defaults;

• compliance with financial covenants in our financing arrangements;

• changes in governmental regulations, tax law and rates, and similar matters and our ability to respond to such changes;

• our ability to maintain our qualification as a real estate investment trust for U.S. federal income tax purposes;

• our ability to maintain our exception from the definition of “investment company” under the Investment Company Act of 1940, as amended (the “1940 Act”);

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

• availability of U.S. Government Agency guarantees with regard to payments of principal and interest on securities;

• the market price and trading volume of our capital stock;

• availability of qualified personnel of our Manager;

• the relationship with our Manager;

• estimates relating to taxable income and our ability to continue to make distributions to our stockholders in the future;

• estimates relating to fair value of our target assets and loan loss reserves;

• our understanding of our competition;

• changes to generally accepted accounting principles in the United States of America (“U.S. GAAP”);

• the impact of the Restatement and the adequacy of our disclosure controls and procedures over financial reporting;

and

• market trends in our industry, interest rates, real estate values, the debt securities markets or the general economy. 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 headings “Risk Factors,” “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and “Business.” 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 over time, and it is not possible 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.

The following discussion should be read in conjunction with our condensed consolidated financial statements and the accompanying notes to our condensed consolidated financial statements, which are included in this Report.

Overview

We are a Maryland corporation primarily focused on investing in, financing and managing residential and commercial mortgage-backed securities (“MBS”) and mortgage loans. We are externally managed and advised by Invesco Advisers, Inc., our Manager, a registered investment adviser and an indirect, wholly-owned subsidiary of Invesco Ltd., a leading independent

Table of Contents

global investment management firm. We elected to be taxed as a real estate investment trust (“REIT”) for U.S. federal income tax purposes under the provisions of the Internal Revenue Code of 1986, as amended (“Code”), commencing with our taxable year ended December 31, 2009. To maintain our REIT qualification, we are generally required to distribute at least 90% of our REIT taxable income to our stockholders annually. We operate our business in a manner that permits our exclusion from the definition of “Investment Company” under the 1940 Act.

Our objective is to provide attractive risk-adjusted returns to our investors, primarily through dividends and secondarily through capital appreciation. To achieve this objective, we primarily invest in the following:

Residential mortgage-backed securities (“RMBS”) that are guaranteed by a U.S. government agency such as the Government National Mortgage Association (“Ginnie Mae”) or a federally chartered corporation such as the Federal National Mortgage Association (“Fannie Mae”) or the Federal Home Loan Mortgage Corporation (“Freddie Mac”) (collectively “Agency RMBS”);

RMBS that are not guaranteed by a U.S. government agency (“non-Agency RMBS”);

Credit risk transfer securities that are unsecured obligations issued by government-sponsored enterprises (“GSE CRT”);

Commercial mortgage-backed securities (“CMBS”);

Residential and commercial mortgage loans; and

Other real estate-related financing arrangements.

We generally finance our investments through short- and long-term borrowings structured as repurchase agreements and secured loans. We finance our residential loans held-for-investment through asset-backed securities (“ABS”) issued by consolidated securitization trusts. We have also financed investments through the issuances of debt and equity and may utilize other forms of financing in the future.

Capital Activities

On June 15, 2015, we declared the following dividends:

a dividend of \$0.45 per share of common stock to be paid on July 28, 2015 to stockholders of record as of the close of business on June 26, 2015;

a dividend of \$0.4844 per share of Series A Preferred Stock to be paid on July 27, 2015 to stockholders of record as of the close of business on July 1, 2015; and

a dividend of \$0.4844 per share of Series B Preferred Stock to be paid on September 28, 2015 to stockholders of record as of the close of business on September 5, 2015.

We did not repurchase any shares of our common stock during the three and six months ended June 30, 2015.

Factors Impacting Our Operating Results

Our operating results can be affected by a number of factors and primarily depend on the level of our net interest income and the market value of our assets. The market value of our assets can be impacted by asset spreads and the supply of, and demand for, target assets in which we invest. Our net interest income, which includes the amortization of purchase premiums, reclassification of amortization of net deferred losses on de-designated interest rate swaps to repurchase agreements interest expense and accretion of purchase discounts, varies primarily as a result of changes in market interest rates and prepayment speeds, as measured by the constant prepayment rate (“CPR”) on our target assets. Interest rates and prepayment speeds vary according to the type of investment, conditions in the financial markets, competition and other factors, none of which can be predicted with any certainty.

Market Conditions

Macroeconomic factors that affect our business include credit spread premiums, market interest rates, Federal Reserve policy initiatives, residential and commercial real estate prices, employment conditions and inflation. The second quarter of 2015 saw domestic economic indicators improving from a weather-impacted first quarter. The yield curve reversed previous flattening as shorter maturity interest rates held relatively steady but longer-term rates moved meaningfully higher for the second quarter of 2015.

Domestic economic conditions continue to improve albeit slower than most would like to see. Payrolls averaged increases of just over 220,000 jobs per month for the second quarter after increasing 195,000 jobs per month in the first quarter of 2014.

Table of Contents

Consequently, the unemployment rate has continued to decline to 5.3% as of the end of second quarter 2015 from 5.6% at the end of 2014. Financial conditions trended somewhat weaker with term interest rates higher, increased interest rate volatility, credit spreads wider, and the broad U.S. equity market slightly lower. One factor pushing U.S. interest rates higher was the significant rate rise in Europe that began in late April, despite the quantitative easing being conducted by the European central bank. Still, the low interest rate environment, coupled with lower energy prices, should be supportive for U.S. economic growth, as policy rates are much lower than that which would be historically indicated by unemployment and inflation indicators alone. Countering the positive influence on the economy is weak capital investment, tepid wage and consumer debt growth, and the stronger dollar. Households are once again increasing their debt levels, albeit at a modest rate, which increases their ability to consume goods and services. Inflation data continues to indicate smaller increases than the Federal Reserve's 2% inflation target, with core personal consumption expenditures prices having increased 1.2% year-over-year through May 2015. Markets continue to try to discern the timing of the first interest rate increase by the Federal Reserve and expect that it will come later this year. That concern along with concerns about Greece defaulting on its debt, and potential contagion, and slowing growth, and weaker equity markets in China had a part to play in tighter financial conditions in the U.S. in the second quarter of 2015.

The interest rate environment has been broadly supportive for Agency RMBS and we believe it will continue to be. Range-bound interest rates create a good environment for MBS investors, as the prepayment option embedded in Agency RMBS is less onerous if interest rates are unlikely to fall nor rise dramatically. Further, continued tight residential mortgage loan underwriting standards restrict the ability of homeowners to refinance which is normally to the detriment of MBS investors. We believe QE in Europe and Japan will create international demand for Agency RMBS due to the relatively attractive yield and the government guarantee. Further, Agency RMBS investors saw the market impact from Federal Reserve tapering of Agency RMBS purchases in the fourth quarter of 2014 and that program ended with little noticeable impact on Agency RMBS valuations. There has been adequate demand from investors and limited supply of new Agency RMBS to offset the decline in demand from the Federal Reserve. Still, Agency MBS modestly underperformed equal duration U.S. Treasury notes during the second quarter reflecting worse financial conditions.

With respect to credit assets, CMBS yield spreads over comparable term interest rate swaps widened over the quarter as financial conditions deteriorated modestly and supply of CMBS increased. Spreads in GSE CRTs issued by Fannie Mae and Freddie Mac also widened over the second quarter of 2015 after narrowing during the first quarter of 2015. Legacy non-Agency RMBS saw very little spread change in the second quarter of 2015.

The impact of regulatory initiatives on the economy may also affect our business and our financial results. The Dodd-Frank Act, enacted in July 2010, contains numerous provisions affecting the financial and mortgage industries, many of which may affect our cost of doing business, may limit our investment opportunities and may affect the competitive balance within our industry and the markets in which we invest. For example, the Ability-to-Repay ("ATR") rule requires lenders to make a reasonable, good-faith determination that residential borrowers have a reasonable ability to repay a mortgage loan. In addition to the ATR rule, the Consumer Financial Protection Bureau adopted a Qualified Mortgage ("QM") framework that provides certain legal protections to residential mortgage loan lenders, which include restrictions on loan features, points and fees and borrower debt-to-income ratios. While we are not directly subject to compliance with the implementation of rules regarding the origination of residential mortgage loans, the impact of these regulations and others could affect our ability to securitize or invest in newly originated loans in the future.

In addition, the regulatory landscape for our repurchase agreement counterparties continues to evolve following the adoption of new capital rules which generally affects the manner in which banks lend. Regulators are also focused on liquidity requirements which will likely impact how banks fund themselves. While we are not directly subject to compliance with the implementation of rules regarding financial institutions, the effect of these regulations and others could affect our ability to finance our assets in the future.

On September 2, 2014, the Federal Housing Finance Agency ("FHFA"), proposed to revise its regulations governing Federal Home Loan Bank membership to, among other things, exclude captive insurance companies. However, the

proposed rules would permit existing captive insurers, such as our captive insurance company subsidiary IAS Services LLC, to remain members for a period of five years following the effective date of the final rules. In addition, the Federal Home Loan Bank of Indianapolis ("FHLBI") would be permitted to allow outstanding advances to IAS Services LLC that were made prior to the effective date of the final rules to honor contractual terms to maturity. Therefore, under the proposed rules, we do not expect there would be any impact to our existing FHLBI borrowings. The rules are subject to change prior to their final adoption. However, if the FHFA's rules are adopted substantially as proposed, we do not expect that the rules would have a material effect on our sources or costs of funding or our results of operations. The date set for the end of the comment period was January 23, 2015. The vast majority of the comments were against adoption of the proposed rule. The FHFA has not yet made a formal statement as to their intentions with respect to the proposed rule.

Table of Contents

Investment Activities

In the second quarter of 2015, our investment portfolio remained positioned to take advantage of compelling opportunities in both mortgage-backed and credit risk transfer securities and newly originated loans against a backdrop of improving housing and commercial real estate markets. We have over the last year and over the last quarter maintained a relatively equal allocation of our equity between residential credit, commercial credit and Agency RMBS.

The table below shows the allocation of our equity as of June 30, 2015, December 31, 2014 and June 30, 2014:

\$ in thousands	As of			
	June 30, 2015	December 31, 2014	June 30, 2014	
Agency RMBS	38	% 32	% 34	%
Residential Credit ⁽¹⁾	32	% 34	% 34	%
Commercial Credit ⁽²⁾	30	% 34	% 32	%
Total	100	% 100	% 100	%

(1) Non-Agency RMBS, GSE CRT and Residential Loans are considered residential credit.

(2) CMBS, Commercial Loans and Investments in unconsolidated ventures of \$44.8 million (which are included in Other Investments), are considered commercial credit.

The table below shows the breakdown of our investment portfolio as of June 30, 2015, December 31, 2014 and June 30, 2014:

\$ in thousands	As of		
	June 30, 2015	December 31, 2014	June 30, 2014
Agency RMBS:			
30 year fixed-rate, at fair value	4,356,658	4,790,293	6,239,995
15 year fixed-rate, at fair value	1,737,320	1,327,101	1,495,999
Hybrid ARM, at fair value	3,428,399	2,976,918	2,613,337
ARM, at fair value	473,596	546,782	561,284
Agency CMO, at fair value	438,866	450,895	510,435
Non-Agency RMBS, at fair value	2,800,650	3,061,647	3,282,525
GSE CRT, at fair value	665,896	625,424	506,635
CMBS, at fair value	3,293,853	3,469,835	3,037,579
Residential loans, at amortized cost	3,461,992	3,365,003	2,310,686
Commercial loans, at amortized cost	155,011	145,756	95,585
Total Investment portfolio	20,812,241	20,759,654	20,654,060

During the first half of 2015, we reinvested cash flows from our Agency RMBS portfolio into 15 year fixed-rate and Hybrid ARM Agency RMBS. Over the past twelve months, we have further reduced our overall sensitivity to interest rates by selling Agency RMBS collateralized by 30 year fixed-rate RMBS and reinvesting proceeds into Agency RMBS backed by 15 year fixed-rate and Hybrid ARM collateral. We have continued to hold certain 30 year fixed-rate Agency RMBS that have relatively short durations because they are collateralized by higher coupons. We expect these securities to prepay relatively slowly based on their seasoning and collateral attributes. Our sales of 30 year fixed-rate Agency RMBS over the past twelve months were primarily in 3% and 3.5% coupons or relatively newer vintage that have not experienced a high prepayment environment. Therefore, the average coupon of our 30 year fixed-rate Agency RMBS continued to increase to 4.28% at June 30, 2015, compared to 4.17% at June 30, 2014. In addition, we hold 15 year fixed-rate Agency RMBS, Agency Hybrid ARM RMBS and Agency ARM RMBS that we believe have lower durations and better cash flow certainty relative to current 30 year fixed-rate Agency RMBS. Further, we own Agency collateralized mortgage obligations ("CMOs"), some of which are interest-only securities, to hedge the risk of higher interest rates.

Our portfolio of investments that have credit exposure include non-Agency RMBS, GSE CRTs, CMBS and residential and commercial real estate loans. We use our proprietary models to perform a detailed review of each investment which often includes loan level analysis of expected performance. We do not place any reliance on ratings by various agencies as we believe our models more accurately evaluate the performance based on our assumptions about market conditions and are updated more frequently than agency ratings. As shown in the table above, we have increased our total exposure to credit assets as we believe

Table of Contents

the improving economy will provide better risk-adjusted returns for this asset class while having lower interest rate exposure relative to Agency RMBS.

With respect to our non-Agency RMBS portfolio, we primarily invest in RMBS collateralized by prime and Alt-A loans. In addition, we have invested in re-securitizations of real estate mortgage investment conduit ("Re-REMIC") RMBS and reperforming mortgage loans that we believe provide attractive risk adjusted returns. We also invest in GSE CRTs. Based on our view of the improving housing market and relative value opportunities, we increased holdings in GSE CRTs over the past twelve months as paydowns from principal repayments and limited dispositions have reduced our non-Agency RMBS holdings. GSE CRTs have the added benefit of paying a floating rate coupon, which reduces our need to hedge interest rate risk.

Our CMBS portfolio generally consists of assets originated before 2007, assets originated after 2010 ("CMBS 2.0") and multi-family CMBS issued by Freddie Mac under their "K" program. Over the past twelve months we have primarily invested in CMBS 2.0. Since June 30, 2014, we grew our CMBS portfolio \$256.3 million and grew the allocation of our CMBS holdings in our MBS and GSE CRT portfolio to approximately 19.2% as of June 30, 2015 from approximately 16.6% as of June 30, 2014.

During the first half of 2015, we invested in and consolidated one additional residential loan securitization trust collateralized by prime jumbo loans that were generally originated in 2011 or later. We believe these loans have high credit quality based on their risk characteristics, including but not limited to high FICO scores, low historical delinquencies and low loan-to-value ratios based on current estimated home values. We have invested in and consolidated 11 residential loan securitization trusts that hold \$3.5 billion of residential loans as of June 30, 2015. For further details on the residential loan portfolio, refer to Note 3 - "Variable Interest Entities" of our condensed consolidated financial statements.

During the first half of 2015, we originated two new commercial real estate loans, and two of our existing commercial real estate loans prepaid ahead of their contractual maturities. As of June 30, 2015, our commercial real estate loan portfolio includes a first mortgage loan and mezzanine loans we purchased or originated. For further details on our commercial loan portfolio, see Note 5 - "Commercial Loans Held-for-Investment" of our condensed consolidated financial statements.

Portfolio Characteristics

The table below represents the vintage of our MBS and GSE CRT credit assets as of June 30, 2015 as a percentage of the fair value:

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Total
Re-REMIC ⁽¹⁾	— %	— %	— %	— %	0.3 %	— %	0.6 %	4.0 %	17.0 %	7.7 %	0.5 %	— %	— %	30.1 %
Prime	0.5 %	1.5 %	4.7 %	3.7 %	9.9 %	2.2 %	— %	— %	0.1 %	— %	7.0 %	2.0 %	— %	31.6 %
Alt-A	— %	0.6 %	8.7 %	6.2 %	7.7 %	— %	— %	— %	— %	— %	— %	— %	— %	23.2 %
Subprime/reperforming	— %	— %	— %	0.1 %	0.4 %	— %	— %	— %	— %	— %	1.8 %	11.4 %	1.4 %	15.1 %
Total Non-Agency	0.5 %	2.1 %	13.4 %	10.0 %	18.3 %	2.2 %	0.6 %	4.0 %	17.1 %	7.7 %	9.3 %	13.4 %	1.4 %	100.0 %
GSE CRT	— %	— %	— %	— %	— %	— %	— %	— %	— %	— %	38.7 %	52.7 %	8.6 %	100.0 %
CMBS	— %	— %	4.4 %	10.1 %	0.5 %	— %	— %	7.4 %	22.6 %	12.3 %	13.7 %	27.6 %	1.4 %	100.0 %

For Re-REMICs, the table reflects the year in which the resecuritizations were issued. The vintage distribution of (1) the securities that collateralize the Company's Re-REMIC investments is 11.4% for 2005, 33.1% for 2006, and 55.5% for 2007.

Table of Contents

The tables below represent the geographic concentration of the underlying collateral for our MBS and GSE CRT credit assets as of June 30, 2015:

Non-Agency RMBS		GSE CRT		CMBS	
State	Percentage	State	Percentage	State	Percentage
California	42.2	California	22.2	California	15.9
Florida	6.8	Texas	5.6	New York	13.3
New York	6.7	Virginia	4.4	Texas	9.3
Virginia	3.8	New York	4.1	Florida	5.8
New Jersey	3.7	Illinois	4.0	Illinois	5.0
Maryland	3.6	Massachusetts	3.6	Pennsylvania	4.1
Washington	2.8	Florida	3.6	New Jersey	3.3
Illinois	2.7	Colorado	3.3	Virginia	2.8
Massachusetts	2.1	Washington	3.3	Ohio	2.7
Arizona	2.1	New Jersey	3.2	Maryland	2.6
Other	23.5	Other	42.7	Other	35.2
Total	100.0		100.0	Total	100.0

The following table displays certain characteristics of our residential loans held-for-investment at June 30, 2015 by year of origination.

\$ in thousands	2014	2013	2012	2011	2010	2009	2008	2007	Total
Portfolio Characteristics:									
Number of Loans	729	2,701	749	91	26	6	15	15	4,332
Current Principal Balance	544,236	2,085,412	650,894	97,650	25,006	2,747	14,769	12,214	3,432,928
Net Weighted Average Coupon Rate	3.48	% 3.45	% 3.25	% 3.39	% 3.74	% 3.69	% 5.02	% 4.62	% 3.43
Weighted Average Maturity (years)	28.96	28.06	27.53	25.99	25.47	24.01	23.15	22.10	27.98
Current Performance:									
Current	544,236	2,083,210	650,894	97,650	25,006	2,747	14,769	12,214	3,430,726
30 Days Delinquent	—	1,404	—	—	—	—	—	—	1,404
60 Days Delinquent	—	798	—	—	—	—	—	—	798
90+ Days Delinquent	—	—	—	—	—	—	—	—	—
Bankruptcy/Foreclosure	—	—	—	—	—	—	—	—	—
Total	544,236	2,085,412	650,894	97,650	25,006	2,747	14,769	12,214	3,432,928

The following table presents the geographic concentrations of our residential loans held-for-investment at June 30, 2015 based on principal balance outstanding:

State	Percent
California	53.5
New York	7.5
Massachusetts	5.9
Illinois	3.7
Other states (none greater than 3%)	29.4
Total	100.0

Financing and Other Liabilities

We enter into repurchase agreements to finance the majority of our target assets. These agreements are secured by our Agency RMBS, non-Agency RMBS, GSE CRTs and CMBS. In addition, these agreements are generally settled on a short-term basis, usually from one to twelve months, and bear interest at rates that have historically moved in close

relationship to the London Interbank Offer Rate (“LIBOR”). At each settlement date, we refinance each repurchase agreement at the market interest rate at that time. As of June 30, 2015, we had entered into repurchase agreements totaling \$13.2 billion (December 31, 2014: \$13.6 billion). The decrease in our repurchase agreement balance was due to replacing some of our repurchase borrowings with secured loans, as discussed below.

Table of Contents

Our wholly-owned subsidiary, IAS Services LLC, is a member of the FHLBI. As a member of the FHLBI, IAS Services LLC has borrowed funds from the FHLBI in the form of secured advances. As of June 30, 2015, IAS Services LLC had \$1.55 billion in outstanding long-term secured advances and is approved for additional available uncommitted credit for borrowing of an amount up to \$2.5 billion. Available uncommitted credit may be adjusted at the sole discretion of the FHLBI. For the three and six months ended June 30, 2015, IAS Services LLC had average borrowings of \$1.55 billion and \$1.53 billion with a weighted average borrowing rate of 0.40% and 0.39% .

We have also committed to invest up to \$120.6 million in unconsolidated ventures that are sponsored by an affiliate of our Manager. As of June 30, 2015, \$94.3 million of our commitment to these unconsolidated ventures has been called. We are committed to fund \$26.3 million in additional capital to fund future investments and cover future expenses should they occur.

We record a liability for mortgage-backed and credit risk transfer securities purchased, for which settlement has not taken place, as an investment related payable. As of June 30, 2015 and December 31, 2014, we had investment related payables of \$165.6 million, and \$17.0 million, respectively, of which no items were outstanding greater than thirty days. The change in balance was primarily due to an increase in unsettled MBS purchases as of June 30, 2015. We record a receivable for mortgage-backed and credit risk transfer securities sold for which settlement has not taken place as an investment related receivable. As of June 30, 2015 and December 31, 2014, the Company had investment related receivables of \$37.1 million and \$38.7 million, respectively, of which no items were outstanding greater than thirty days.

Hedging Instruments. We generally hedge as much of our interest rate and foreign exchange risk as we deem prudent in light of market conditions. No assurance can be given that our hedging activities will have the desired beneficial impact on our results of operations or financial condition. Our investment policies do not contain specific requirements as to the percentages or amount of risk that we are required to hedge.

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

- available interest rate hedging may not correspond directly with the interest rate risk for which protection is sought;
- the duration of the hedge may not match the duration of the related liability;
- the party owing money in the hedging transaction may default on its obligation to pay;
- the credit quality of the party owing money on the hedge may be downgraded to such an extent that it impairs our ability to sell or assign our side of the hedging transaction; and
- the value of derivatives used for hedging may be adjusted from time-to-time in accordance with accounting rules to reflect changes in fair value. Downward adjustments or mark-to-market losses would reduce our stockholders' equity.

As of June 30, 2015, we have entered into interest rate swap agreements designed to mitigate the effects of increases in interest rates under a portion of our borrowings. These swap agreements provide for fixed interest rates indexed off of one-month LIBOR and effectively fix the floating interest rates on \$11.5 billion (June 30, 2014: \$12.8 billion) of borrowings. The notional amount of interest rate swaps were reduced in line with the reduced interest rate risk in our portfolio after the reallocation away from longer duration 30 year MBS into shorter duration Agency 15 year and Hybrid ARM MBS. As of June 30, 2015, included in this amount are forward starting swaps with a total notional amount of \$1.6 billion, with starting dates ranging from February 5, 2016 to June 24, 2016. The change in the amount of interest rate swaps was due to our view of interest rate risk and the expected duration of our investment portfolio and liabilities.

As of June 30, 2015, we held \$300.0 million (June 30, 2014: \$750.0 million) in fixed pay interest rate swaptions as an asset with a fair value of \$0 (June 30, 2014: \$2.6 million) and \$300.0 million (June 30, 2014: \$0) in fixed receive interest rate swaptions as an asset with a fair value of \$74,000 (June 30, 2014: \$0). During the six months ended June 30, 2015, interest rate swaptions expired unexercised with a notional amount of approximately \$750.0 million (June 30, 2014: \$1.2 billion) and realized loss of \$7.7 million (June 30, 2014: \$23.3 million). We purchase interest rate swaptions to reduce the impact that interest rate volatility has on our portfolio. The change in the notional amount of swaptions held was due to our views on the potential for change in volatility.

As of June 30, 2015, we have no outstanding futures contracts. As of June 30, 2014, we held \$60.0 million in notional amount of short U.S. Treasury futures contracts as a liability with a fair value of \$347,000 and \$96.5 million in

notional amount as an asset with a fair value of \$596,000. During the six months ended June 30, 2015, we sold U.S. Treasury futures contracts of \$248.3 million (June 30, 2014: \$200.0 million) in notional amount and realized a net loss of \$943,000 (June 30, 2014: \$9.2 million). We periodically invest in U.S. Treasury futures contracts to help mitigate the potential impact of changes in interest rates on the performance of our portfolio.

As of June 30, 2015, we have no outstanding to-be-announced securities ("TBAs"). As of June 30, 2014, we held \$201.0 million in notional amount of TBAs as liability with a fair value of \$1.2 million. During the six months ended June 30, 2015, we settled TBAs of \$446.0 million (June 30, 2014: \$430.0 million) in notional amount and realized a net loss of \$2.3 million (June 30, 2014: \$1.4 million). TBAs are contracts for which we agree to purchase or deliver in the future Agency RMBS with

Table of Contents

certain principal and interest terms. We periodically purchase or sell certain TBAs to help mitigate the potential impact of changes in interest rates on the performance of our portfolio.

As of June 30, 2015, we held \$68.8 million (June 30, 2014: \$0) in notional amount of currency forward contracts as an asset with a fair value of \$1.0 million (2014: \$0), and a liability with a fair value of \$1.4 million (2014: \$0). During the six months ended June 30, 2015, we settled currency forward contracts of \$63.4 million (June 30, 2014: \$0) in notional amount and realized a net gain of \$1.5 million (June 30, 2014: \$0). We use currency forward contracts to help mitigate the potential impact of changes in foreign currency exchange rates on our investments denominated in foreign currencies.

Book Value per Share

Our book value per diluted common share was \$18.62 and \$18.82 as of June 30, 2015 and December 31, 2014, respectively. Book value per diluted common share is calculated as total equity less the liquidation preference of our Series A Preferred Stock (\$140.0 million) and Series B Preferred Stock (\$155.0 million); divided by total common shares outstanding plus Operating Partnership Units convertible into shares of common stock (1,425,000 shares). The change in our book value in second quarter of 2015 was primarily due to the change in valuation of our investment portfolio that is recorded in Other Comprehensive Income (Loss) on our condensed consolidated balance sheets. Refer to Note 4 – “Mortgage-Backed and Credit Risk Transfer Securities” of our condensed consolidated financial statements for the impact of changes in accumulated other comprehensive income on our investment portfolio. The values of our assets and liabilities change daily based on market conditions. Refer to Item 3. “Quantitative and Qualitative Disclosures About Market Risk” for interest rate risk and its impact on fair value.

Critical Accounting Policies

Our condensed consolidated financial statements are prepared in accordance with U.S. GAAP, which requires the use of estimates and assumptions that involve the exercise of judgment and use of assumptions as to future uncertainties. Accounting estimates and assumptions discussed in this section are those that we consider to be the most critical to an understanding of our financial statements because they involve significant judgments and uncertainties. All of these estimates reflect our best judgment about current, and for some estimates, future economic and market conditions and their effects based on information available as of the date of these financial statements. If conditions change from those expected, it is possible that the judgments and estimates described below could change, which may result in a change in valuation of our investment portfolio, future impairments of our MBS and GSE CRTs, change in our interest income recognition, allowance for loan losses, and a change in our tax liability among other effects.

Mortgage-Backed and Credit Risk Transfer Securities. We record our MBS except Agency MBS IOs as available-for-sale and report them at fair value. Agency MBS IOs and GSE CRTs are hybrid financial instruments reported at fair value. Fair value is determined by obtaining valuations from an independent source. If the fair value of a security is not available from a third-party pricing service, the Company may estimate the fair value of the security using a variety of methods including other pricing services, discounted cash flow analysis, matrix pricing, option adjusted spread models and other fundamental analysis of observable market factors. Various observable inputs are used to fair value our MBS and GSE CRTs which may change with market conditions. It is possible that changes in these inputs could change the valuation estimate and lead to impairment of our MBS and GSE CRT portfolio. Further information is provided in Note 2 - "Summary of Significant Accounting Policies" of our Annual Report on Form 10-K/A for the year ended December 31, 2014 and Note 4 - “Mortgage-Backed and Credit Risk Transfer Securities” of our condensed consolidated financial statements.

Other-than-temporary Impairment. We regularly review our available-for-sale portfolio for other-than-temporary impairment. This determination involves both qualitative and quantitative data. It is possible that estimates may be incorrect, economic conditions may change or we may be forced to sell the investment before recovery of our amortized cost. Further information is provided in Note 2 - "Summary of Significant Accounting Policies" of our Annual Report on Form 10-K/A for the year ended December 31, 2014 and Note 4 - “Mortgage-Backed and Credit Risk Transfer Securities” of our condensed consolidated financial statements.

Residential and Commercial Loans. Residential loans held-for-investment are carried at unpaid principal balance net of any allowance for loan losses. Commercial loans held-for-investment are carried at cost net of any allowance for

loan losses. An allowance for loan losses is established based on credit losses inherent in the portfolio. These estimates require consideration of various observable inputs including, but not limited to, historical loss experience, delinquency status, borrower credit scores, geographic concentrations and loan-to-value ratios, and are adjusted for current economic conditions as deemed necessary by management. In addition, since we have not incurred any direct losses on our portfolio, we use national historical credit performance information from a third party vendor to assist in our analysis. Changes in our estimates can significantly impact the allowance for loan losses and provision expense. It is also possible that we will experience credit losses that are different from our current estimates or that the timing of those losses may differ from our estimates. Further information on the

Table of Contents

allowance for loan losses is provided in Note 2 - "Summary of Significant Accounting Policies" of our Annual Report on Form 10-K/A for the year ended December 31, 2014.

Interest Income Recognition. Interest income on MBS is accrued based on the outstanding principal balance of the securities and their contractual terms. Premiums or discounts are amortized or accreted into interest income over the life of the investment using the effective interest method. Interest income on our non-Agency RMBS (and other prepayable mortgage-backed securities where we may not recover substantially all of our initial investment) is based on estimated cash flows. Management estimates, at the time of purchase, the future expected cash flows and determines the effective interest rate based on these estimated cash flows and our purchase price. Over the life of the investments, these estimated cash flows are updated and a revised yield is computed based on the current amortized cost of the investment. In estimating these cash flows, there are a number of assumptions that are subject to uncertainties and contingencies, including the rate and timing of principal payments (prepayments, repurchases, defaults and liquidations), the pass through or coupon rate and interest rate fluctuations. These uncertainties and contingencies are difficult to predict and are subject to future events that may impact management's estimates and interest income. Interest income recognition on our Agency RMBS that cannot be prepaid in such a way that we would not recover substantially all of our initial investment is based on contractual cash flows. We do not estimate prepayments in applying the effective interest method. Interest income from our residential loans is recognized on an accrual basis with the related premiums being amortized into interest income using the effective interest method over the weighted average life of these loans. As needed, these estimated cash flows are updated and a revised yield is computed based on the current amortized cost of the investment. Interest income from our commercial loans is recognized when earned and deemed collectible or until a loan becomes past due based on the terms of the loan agreement.

Accounting for Derivative Financial Instruments. We use derivatives to manage interest rate and currency exchange risk. The Company records all derivatives on its condensed consolidated balance sheets at fair value. Effective December 31, 2013, the Company voluntarily discontinued hedge accounting for its interest rate swap agreements by de-designating the interest rate swaps as cash flow hedges. As a result of discontinuing hedge accounting, changes in the fair value of the interest rate swaps are recorded in gain (loss) on derivative instruments, net in the Company's condensed consolidated statement of operations, rather than in accumulated other comprehensive income (loss). Further information is provided in Note 8 - "Derivatives and Hedging Activities" of our condensed consolidated financial statements.

Income Taxes. We have elected to be taxed as a REIT. Accordingly, we generally will not be subject to U.S. federal and applicable state and local corporate income tax to the extent that we make qualifying distributions and provided we satisfy on a continuing basis, through actual investment and operating results, the REIT requirements including certain asset, income, distribution and stock ownership tests. The REIT qualifications rules are complex and failure to apply them correctly could subject us to U.S. federal, state and local income taxes.

Expected Impact of New Authoritative Guidance on Future Financial Information

In February 2015, the FASB issued modifications to existing consolidation guidance for reporting organizations that are required to evaluate whether they should consolidate certain legal entities. The guidance is effective for fiscal years and interim periods within those years beginning after December 15, 2015, and requires either a retrospective or a modified retrospective approach to adoption. Early adoption is permitted. We are currently evaluating the potential impact of the new guidance on our condensed consolidated financial statements, as well as the available transition methods.

In April 2015, the FASB issued guidance to amend the presentation of debt issuance cost related to a recognized debt liability. Under the new guidance, the debt issuance costs will be presented in the balance sheet as a direct deduction from the carrying amount of the recognized debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected under the new guidance. The standard is effective for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Early adoption is permitted. The guidance should be applied on a retrospective basis. The balance sheet of each individual period presented should be adjusted to reflect the period-specific effects of applying the new guidance. Upon adoption, an

entity is required to comply with the applicable disclosures for a change in an accounting principle. These disclosures include the nature of and reason for the change in accounting principle, the transition method, a description of the prior-period information that has been retrospectively adjusted, and the effect of the change on the financial statement line items (i.e., debt issuance cost asset and the debt liability). We are currently evaluating the potential impact of the new guidance on our condensed consolidated financial statements.

Table of Contents

Results of Operations

The table below presents certain information from our condensed consolidated statements of operations for the three and six month periods ended June 30, 2015 and 2014.

\$ in thousands, except share data	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014 (As Restated)	2015	2014 (As Restated)
Interest Income				
Mortgage-backed and credit risk transfer securities	126,098	148,195	261,363	296,600
Residential loans ⁽¹⁾	30,247	20,471	59,621	38,175
Commercial loans	4,491	2,061	7,606	3,680
Total interest income	160,836	170,727	328,590	338,455
Interest Expense				
Repurchase agreements	40,931	47,822	84,241	96,893
Secured loans	1,553	176	3,017	176
Exchangeable senior notes	5,613	5,613	11,220	11,220
Asset-backed securities ⁽¹⁾	22,329	15,826	44,227	29,761
Total interest expense	70,426	69,437	142,705	138,050
Net interest income	90,410	101,290	185,885	200,405
(Reduction in) provision for loan losses	(70	) (50	) (132	) 157
Net interest income after (reduction in) provision for loan losses	90,480	101,340	186,017	200,248
Other Income (loss)				
Gain (loss) on investments, net	10,876	(20,197	) 13,048	(37,969
Equity in earnings of unconsolidated ventures	1,231	3,894	7,237	4,335
Gain (loss) on derivative instruments, net	56,003	(167,816	) (66,742	) (319,128
Realized and unrealized credit derivative income (loss), net	614	32,055	21,976	49,542
Other investment income (loss), net	1,673	—	779	—
Total other income (loss)	70,397	(152,064	) (23,702	) (303,220
Expenses				
Management fee – related party	9,343	9,327	18,758	18,662
General and administrative	1,952	2,376	3,679	4,388
Consolidated securitization trusts ⁽¹⁾	2,256	1,363	4,412	2,547
Total expenses	13,551	13,066	26,849	25,597
Net income (loss)	147,326	(63,790	) 135,466	(128,569
Net income (loss) attributable to non-controlling interest	1,685	(729	) 1,549	(1,462
Net income (loss) attributable to Invesco Mortgage Capital Inc.	145,641	(63,061	) 133,917	(127,107
Dividends to preferred stockholders	5,716	2,712	11,432	5,425
Net income (loss) attributable to common stockholders	139,925	(65,773	) 122,485	(132,532
Earnings (loss) per share:				
Net income (loss) attributable to common stockholders				
Basic	1.14	(0.53	) 0.99	(1.08
Diluted	1.04	(0.53	) 0.96	(1.08

Edgar Filing: Invesco Mortgage Capital Inc. - Form 10-Q

Dividends declared per common share	0.45	0.50	0.90	1.00
Weighted average number of shares of common stock:				
Basic	123,136,687	123,091,251	123,127,496	123,107,968
Diluted	141,442,817	124,516,251	141,433,923	124,532,968

The condensed consolidated statements of operations include income and expenses of consolidated variable (1) interest entities. Refer to Note 3 - "Variable Interest Entities" of our condensed consolidated financial statements for further discussion.

Table of Contents

Net Income (Loss) Summary

For the three months ended June 30, 2015, our net income attributable to common stockholders was \$139.9 million (June 30, 2014: \$65.8 million net loss) or \$1.14 basic earnings (June 30, 2014: \$0.53 basic loss) per average share available to common stockholders and \$1.04 diluted earnings (June 30, 2014: \$0.53 diluted loss) per average share available to common stockholders. The change in net income (loss) attributable to common stockholders for the three months ended June 30, 2015 versus 2014 is primarily attributable to realized and unrealized gains on derivative instruments of \$56.0 million in the 2015 period versus realized and unrealized losses on derivative instruments of \$167.8 million in the 2014 period.

For the six months ended June 30, 2015 our net income attributable to common stockholders was \$122.5 million (June 30, 2014: \$132.5 million net loss) or \$0.99 basic earnings (June 30, 2014: \$1.08 basic loss) per average share available to common stockholders and \$0.96 diluted earnings (June 30, 2014: 1.08 diluted loss) per average share available to common stockholders. The change in net income (loss) attributable to common stockholders for the six months ended June 30, 2015 versus 2014 is primarily attributable to lower realized and unrealized losses on derivative instruments of \$66.7 million in the 2015 period versus \$319.1 million in the 2014 period.

As a result of discontinuing hedge accounting, beginning January 1, 2014, changes in the fair value of the interest rate swap agreements are recorded in gain (loss) on derivative instruments, net in our condensed consolidated statements of operations, rather than in AOCI. For the three months ended June 30, 2015, we recognized an unrealized gain for the change in fair value of our interest rates swaps of \$116.6 million (June 30, 2014: \$103.6 million unrealized loss). For the six months ended June 30, 2015, we recognized an unrealized gain for the change in fair value of our interest rates swaps of \$60.7 million (June 30, 2014: \$193.8 million unrealized loss). In addition, during the three months ended June 30, 2015, we recognized reclassification of amortization of net deferred losses on de-designated interest rate swaps to repurchase agreements interest expense, previously recognized in other comprehensive income of \$16.3 million (June 30, 2014: \$21.5 million) and \$35.5 million (June 30, 2014: \$42.8 million) for the six months ended June 30, 2015. Reclassification of amortization of net deferred losses on de-designated interest rate swaps is recorded as interest expense in our condensed consolidated statements of operations.

Non-GAAP Financial Measures

We are presenting the following non-GAAP financial measures: core earnings (and by calculation, core earnings per share), effective interest income (and by calculation, effective yield), effective interest expense (and by calculation, effective cost of funds), effective net interest income (and by calculation, effective interest rate margin) and repurchase agreement debt-to-equity ratio. Our management uses these non-GAAP financial measures in our internal analysis of results and believes these measures are useful to investors for the reasons explained below. The most directly comparable U.S. GAAP measures are net income attributable to common stockholders (and by calculation, basic earnings (loss) per common share), total interest income (and by calculation, yield), total interest expense (and by calculation, cost of funds), net interest income (and by calculation, net interest rate margin) and total debt-to-equity ratio.

These non-GAAP financial measures should not be considered as substitutes for any measures derived in accordance with U.S. GAAP and may not be comparable to other similarly titled measures of other companies. An analysis of any non-GAAP financial measure should be made in conjunction with results presented in accordance with U.S. GAAP. Additional reconciling items may be added in the future to these non-GAAP measures if deemed appropriate.

Core Earnings

We calculate core earnings as U.S. GAAP net income (loss) attributable to common stockholders adjusted for (gain) loss on investments, net; realized (gain) loss on derivative instruments, net (excluding contractual net interest on interest rate swaps); unrealized (gain) loss on derivative instruments, net; realized and unrealized change in fair value of GSE CRT credit derivative income (loss), net; (gain) loss on foreign currency transactions, net; amortization of deferred swap losses on de-designation; and an adjustment attributable to non-controlling interest. We record changes in the valuation of our mortgage-backed securities and the valuation assigned to the debt host contract associated with our GSE CRTs in other comprehensive income on our consolidated balance sheets. We believe the presentation of core earnings provides a consistent measure of operating performance by excluding the impact of gains and losses

described above from operating results.

We believe that providing transparency into core earnings enables our investors to consistently measure, evaluate and compare our operating performance to that of our peers over multiple reporting periods. However, we caution that core earnings should not be considered as an alternative to net income (determined in accordance with U.S. GAAP), or as an indication of our cash flow from operating activities (determined in accordance with U.S. GAAP), a measure of our liquidity, or as an indication of amounts available to fund our cash needs, including our ability to make cash distributions.

Table of Contents

The table below provides a reconciliation of U.S. GAAP net income (loss) attributable to common stockholders to core earnings for the following periods:

	Three Months Ended		Six Months Ended	
	June 30,	2014	June 30,	2014
\$ in thousands, except per share data	2015	(As Restated)	2015	(As Restated)
Net income (loss) attributable to common stockholders	139,925	(65,773)	122,485	(132,532)
Adjustments:				
(Gain) loss on investments, net	(10,876)	20,197	(13,048)	37,969
Realized (gain) loss on derivative instruments, net (excluding contractual net interest on interest rate swaps of \$46,011, \$52,205, \$91,619 and \$103,646, respectively)	15,212	15,037	41,315	33,861
Unrealized (gain) loss on derivative instruments, net	(117,226)	100,574	(66,192)	181,621
Realized and unrealized change in fair value of GSE CRT credit derivative income (loss), net	6,591	(27,990)	(8,655)	(41,951)
(Gain) loss on foreign currency transactions, net	(996)	—	529	—
Amortization of net deferred swap losses on de-designation	16,313	21,532	35,458	42,828
Subtotal	(90,982)	129,350	(10,593)	254,328
Adjustment attributable to non-controlling interest	1,041	(1,480)	120	(2,900)
Core earnings	49,984	62,097	112,012	118,896
Basic income (loss) per common share	1.14	(0.53)	0.99	(1.08)
Core earnings per share attributable to common stockholders	0.41	0.50	0.91	0.97

Effective Interest Income / Effective Interest Expense / Effective Cost of Funds / Effective Net Interest Income / Effective Interest Rate Margin

We calculate effective interest income (and by calculation, effective yield) as U.S. GAAP total interest income adjusted for GSE CRT embedded derivative coupon interest that is recorded in realized and unrealized credit derivative income (loss), net. We add back GSE CRT embedded derivative coupon interest to our total interest income because we consider GSE CRT embedded derivative coupon interest a current component of our total interest income. We calculate effective interest expense (and by calculation, effective cost of funds) as U.S. GAAP total interest expense adjusted for net interest paid on our interest rate swaps that is recorded in gain (loss) on derivative instruments and the amortization of net deferred swap losses on de-designation. We view our interest rate swaps as an economic hedge against increases in future market interest rates on our floating rate borrowings. We add back the net payments we make on our interest rate swap agreements to our total U.S. GAAP interest expense because we use interest rate swaps to add stability to interest expense. We subtract amortization of net deferred losses on de-designated interest rate swaps because we do not consider the amortization a current component of our borrowing costs.

We calculate effective net interest income (and by calculation, effective interest rate margin) as U.S. GAAP net interest income adjusted for net interest paid on our interest rate swaps that is recorded in gain (loss) on derivative instruments, the amortization of net deferred losses on de-designation and GSE CRT embedded derivative coupon interest that is recorded in realized and unrealized credit derivative income (loss), net.

We believe the presentation of effective interest income, effective yield, effective interest expense, effective cost of funds, effective net interest income and effective interest rate margin measures, when considered together with U.S. GAAP financial measures, provide information that is useful to investors in understanding our borrowing costs and operating performance.

Table of Contents

The following table reconciles total interest income to effective interest income and yield to effective yield for the following periods:

\$ in thousands	Three Months Ended June 30, 2015			2014 (As Restated)		
	Reconciliation	Yield/Effective Yield		Reconciliation	Yield/Effective Yield	
Total interest income	160,836	3.12	%	170,727	3.41	%
Add: GSE CRT embedded derivative coupon interest recorded as realized and unrealized credit derivative income (loss), net	6,157	0.12	%	3,773	0.08	%
Effective interest income	166,993	3.24	%	174,500	3.49	%
\$ in thousands	Six Months Ended June 30, 2015			2014 (As Restated)		
	Reconciliation	Yield/Effective Yield		Reconciliation	Yield/Effective Yield	
Total interest income	328,590	3.20	%	338,455	3.43	%
Add: GSE CRT embedded derivative coupon interest recorded as realized and unrealized credit derivative income (loss), net	12,070	0.12	%	6,970	0.07	%
Effective interest income	340,660	3.32	%	345,425	3.50	%

The following tables reconcile total interest expense to effective interest expense and cost of funds to effective cost of funds for the following periods.

\$ in thousands	Three Months Ended June 30, 2015			2014		
	Reconciliation	Cost of Funds / Effective Cost of Funds		Reconciliation	Cost of Funds / Effective Cost of Funds	
Total interest expense	70,426	1.54	%	69,437	1.58	%
Less: Amortization of net deferred swap losses on de-designation	(16,313)	(0.36)	%	(21,532)	(0.49)	%
Add: Net interest paid - interest rate swaps	46,011	1.01	%	52,205	1.19	%
Effective interest expense	100,124	2.19	%	100,110	2.28	%
\$ in thousands	Six Months Ended June 30, 2015			2014		
	Reconciliation	Cost of Funds / Effective Cost of Funds		Reconciliation	Cost of Funds / Effective Cost of Funds	
Total interest expense	142,705	1.57	%	138,050	1.59	%
Less: Amortization of net deferred swap losses on de-designation	(35,458)	(0.39)	%	(42,828)	(0.49)	%
Add: Net interest paid - interest rate swaps	91,619	1.01	%	103,646	1.20	%
Effective interest expense	198,866	2.19	%	198,868	2.30	%

Table of Contents

The following tables reconcile net interest income to effective net interest income and net interest rate margin to effective interest rate margin for the following periods.

	Three Months Ended June 30, 2015			2014 (As Restated)		
	Reconciliation	Net Interest Rate Margin / Effective Interest Rate Margin		Reconciliation	Net Interest Rate Margin / Effective Interest Rate Margin	
\$ in thousands						
Net interest income	90,410	1.58	%	101,290	1.83	%
Add: Amortization of net deferred swap losses on de-designation	16,313	0.36	%	21,532	0.49	%
Add: GSE CRT embedded derivative coupon interest recorded as realized and unrealized credit derivative income (loss), net	6,157	0.12	%	3,773	0.08	%
Less: Net interest paid - interest rate swaps	(46,011)	(1.01)	%	(52,205)	(1.19)	%
Effective net interest income	66,869	1.05	%	74,390	1.21	%
	Six Months Ended June 30, 2015			2014 (As Restated)		
	Reconciliation	Net Interest Rate Margin / Effective Interest Rate Margin		Reconciliation	Net Interest Rate Margin / Effective Interest Rate Margin	
\$ in thousands						
Net interest income	185,885	1.63	%	200,405	1.84	%
Add: Amortization of net deferred swap losses on de-designation	35,458	0.39	%	42,828	0.49	%
Add: GSE CRT embedded derivative coupon interest recorded as realized and unrealized credit derivative income (loss), net	12,070	0.12	%	6,970	0.07	%
Less: Net interest paid - interest rate swaps	(91,619)	(1.01)	%	(103,646)	(1.20)	%
Effective net interest income	141,794	1.13	%	146,557	1.20	%

Table of Contents

Repurchase Agreement Debt-to-Equity Ratio

The tables below show the allocation of our equity to our target assets, our total debt-to-equity ratio, and our repurchase agreement debt-to-equity ratio as of June 30, 2015 and December 31, 2014. The mortgage REIT industry primarily uses repurchase agreements, which typically mature within one year, to finance investments. Improving our balance sheet by diversifying our liabilities away from repurchase agreements has been a focus of management over the past two years. Since we began using other longer-term means of financing our investments, such as our exchangeable senior notes, secured loans, and asset-backed securities issued by consolidated residential loan securitization trusts, we have reduced our reliance on repurchase agreements. Our weighted average remaining maturity on borrowings has increased from 60 days as of December 31, 2013 to 354 days as of June 30, 2015. We believe presenting our repurchase agreement debt-to-equity ratio, a non-GAAP financial measure of leverage, when considered together with U.S. GAAP financial measures, provides information that is useful to investors in understanding the Company's refinancing risks and gives investors a comparable statistic to those other mortgage REITs who almost exclusively borrow using short-term repurchase agreements that are subject to refinancing risk. June 30, 2015

\$ in thousands	Agency RMBS	Non-Agency RMBS ⁽⁶⁾	SE CRT ⁽⁶⁾	CMBS ⁽⁷⁾	Commercial Loans ⁽⁷⁾	Consolidated VIEs ⁽⁴⁾⁽⁶⁾	Other ⁽⁷⁾	Eliminations ⁽⁵⁾	Total
Investments	10,434,839	3,250,833	665,896	3,293,853	155,011	3,461,992	44,803	(450,183)	20,857,044
Cash and cash equivalents ⁽¹⁾	38,532	21,564	4,805	22,102	—	—	—	—	87,003
Derivative assets, at fair value ⁽²⁾	18,350	1,140	—	—	969	—	45	—	20,504
Other assets	147,504	7,034	527	67,452	1,155	25,859	6,667	(1,846)	254,352
Total assets	10,639,225	3,280,571	671,228	3,383,407	157,135	3,487,851	51,515	(452,029)	21,218,903
Repurchase agreements	8,795,055	2,452,975	509,617	1,417,213	—	—	—	—	13,174,860
Secured loans ⁽³⁾	324,756	—	—	1,225,244	—	—	—	—	1,550,000
Asset-backed securities issued by securitization trusts	—	—	—	—	—	3,456,230	—	(450,183)	3,006,047
Exchangeable senior notes	—	—	—	—	—	—	400,000	—	400,000
Derivative liabilities, at fair value	188,306	—	—	—	1,363	—	—	—	189,669
Other liabilities	201,603	20,209	9,306	29,937	—	18,534	5,889	(1,846)	283,632
Total liabilities	9,509,720	2,473,184	518,923	2,672,394	1,363	3,474,764	405,889	(452,029)	18,604,208
Allocated equity	1,129,505	807,387	152,305	711,013	155,772	13,087	(354,374)	—	2,614,695
Less equity associated with secured loans:									
Collateral pledged	(387,366)	—	—	(1,461,463)	—	—	—	—	(1,848,829)
Secured loans	324,756	—	—	1,225,244	—	—	—	—	1,550,000
Net equity (excluding secured loans)	1,066,895	807,387	152,305	474,794	NA	NA	NA	—	2,501,381

Total debt-to-equity ratio	8.1	3.0	3.3	3.7	—	NA	NA	NA	6.9
(8)									
Repurchase agreement debt-to-equity ratio	8.2	3.0	3.3	3.0	NA	NA	NA	NA	5.3
(9)									

(1) Cash and cash equivalents is allocated based on a percentage of equity for Agency RMBS, Non-Agency RMBS, GSE CRT and CMBS.

(2) Derivative assets are allocated based on the hedging strategy for each asset class.

(3) Secured loans are allocated based on amount of collateral pledged.

(4) Represents VIE assets and liabilities before intercompany eliminations. VIEs are securitized entities with no substantive equity at risk.

(5) Represents our ownership of asset-backed securities and accrued interest eliminated upon consolidation.

(6) Non-Agency RMBS, GSE CRT and Consolidated VIEs are considered residential credit.

(7) CMBS, Commercial Loans and Investments in unconsolidated ventures of \$44.8 million (which are included in Other), are considered commercial credit.

(8) Debt-to-equity ratio is calculated as the ratio of total debt (sum of repurchase agreements, secured loans, asset-backed securities issued by securitization trusts and exchangeable senior notes) to allocated equity.

(9) Repurchase agreement debt-to-equity ratio is calculated as the ratio of repurchase agreements to net equity (excluding secured loans).

Table of Contents

December 31, 2014

\$ in thousands	Agency RMBS	Non-Agency RMBS ⁽⁶⁾	GSE CRT ⁽⁶⁾	CMBS ⁽⁷⁾	Commercial Loans ⁽⁷⁾	Consolidated VIEs ⁽⁴⁾⁽⁶⁾	Other ⁽⁷⁾	Eliminations ⁽⁵⁾	Total
Investments	10,091,989	3,494,181	625,424	3,469,835	145,756	3,365,003	43,998	(432,534)	20,803,652
Cash and cash equivalents ⁽¹⁾	64,603	41,578	10,154	47,809	—	—	—	—	164,144
Derivative assets, at fair value ⁽²⁾	23,183	396	—	—	599	—	—	—	24,178
Other assets	111,817	13,742	15,639	75,209	1,030	15,591	7,888	(1,873)	239,043
Total assets	10,291,592	3,549,897	651,217	3,592,853	147,385	3,380,594	51,886	(434,407)	21,231,017
Repurchase agreements	9,018,818	2,676,626	468,782	1,458,451	—	—	—	—	13,622,677
Secured loans ⁽³⁾	—	—	—	1,250,000	—	—	—	—	1,250,000
Asset-backed securities issued by securitization trusts	—	—	—	—	—	3,362,354	—	(432,534)	2,929,820
Exchangeable senior notes	—	—	—	—	—	—	400,000	—	400,000
Derivative liabilities, at fair value	254,026	—	—	—	—	—	—	—	254,026
Other liabilities	56,894	21,351	5,233	37,589	—	10,563	5,887	(1,873)	135,644
Total liabilities	9,329,738	2,697,977	474,015	2,746,040	—	3,372,917	405,887	(434,407)	18,592,167
Allocated equity	961,854	851,920	177,202	846,813	147,385	7,677	(354,001)	—	2,638,850
Less equity associated with secured loans:									
Collateral pledged	—	—	—	(1,550,270)	—	—	—	—	(1,550,270)
Secured loans	—	—	—	1,250,000	—	—	—	—	1,250,000
Net equity (excluding secured loans)	961,854	851,920	177,202	546,543	NA	NA	NA	—	2,537,519
Total debt-to-equity ratio ⁽⁸⁾	9.4	3.1	2.6	3.2	—	NA	NA	NA	6.9
Repurchase agreement debt-to-equity ratio ⁽⁹⁾	9.4	3.1	2.6	2.7	NA	NA	NA	NA	5.4

(1) Cash and cash equivalents is allocated based on a percentage of equity for Agency RMBS, Non-Agency RMBS, GSE CRT and CMBS.

(2) Derivative assets are allocated based on the hedging strategy for each asset class.

(3) Secured loans are allocated based on amount of collateral pledged.

(4) Represents VIE assets and liabilities before intercompany eliminations. VIEs are securitized entities with no substantive equity at risk.

- (5) Represents our ownership of asset-backed securities and accrued interest eliminated upon consolidation.
- (6) Non-Agency RMBS, GSE CRT and Consolidated VIEs are considered residential credit.
- (7) CMBS, Commercial Loans and Investments in unconsolidated ventures of \$44.0 million (which are included in Other), are considered commercial credit.
- (8) Debt-to-equity ratio is calculated as the ratio of total debt (sum of repurchase agreements, secured loans, asset-backed securities issued by securitization trusts and exchangeable senior notes) to allocated equity.
- (9) Repurchase agreement debt-to-equity ratio is calculated as the ratio of repurchase agreements to net equity (excluding secured loans).

Table of Contents

Interest Income and Average Earning Asset Yield

The table below presents certain information for our portfolio for the three and six months ended June 30, 2015 and 2014.

\$ in thousands	Three Months Ended June 30,		Six Months Ended June 30,		
	2015	2014 (As Restated)	2015	2014 (As Restated)	
Average Balances*:					
Agency RMBS:					
15 year fixed-rate, at amortized cost	1,747,623	1,490,857	1,748,306	1,544,072	
30 year fixed-rate, at amortized cost	4,400,782	6,277,003	4,490,257	6,501,011	
ARM, at amortized cost	446,754	526,816	453,651	407,650	
Hybrid ARM, at amortized cost	3,270,461	2,441,988	3,069,675	2,154,029	
MBS-CMO, at amortized cost	438,549	505,949	442,374	490,979	
Non-Agency RMBS, at amortized cost	2,774,992	3,241,721	2,833,617	3,382,454	
GSE CRT, at amortized cost	662,188	418,606	656,298	366,900	
CMBS, at amortized cost	3,195,123	2,788,361	3,233,156	2,677,553	
Residential loans, at amortized cost	3,480,101	2,240,066	3,422,035	2,114,219	
Commercial loans, at amortized cost	158,312	94,541	152,231	86,653	
Average MBS and Loans portfolio	20,574,885	20,025,908	20,501,600	19,725,520	
Average Portfolio Yields ⁽¹⁾ :					
Agency RMBS:					
15 year fixed-rate	2.04	% 2.57	% 2.13	% 2.69	%
30 year fixed-rate	2.69	% 3.03	% 2.85	% 3.09	%
ARM	1.99	% 2.29	% 2.35	% 2.31	%
Hybrid ARM	1.88	% 2.23	% 2.06	% 2.28	%
MBS - CMO	3.15	% 3.42	% 3.44	% 3.77	%
Non-Agency RMBS	4.39	% 4.70	% 4.37	% 4.44	%
GSE CRT ⁽²⁾	0.51	% 0.48	% 0.50	% 0.52	%
CMBS	4.40	% 4.54	% 4.37	% 4.52	%
Residential loans	3.48	% 3.66	% 3.49	% 3.60	%
Commercial loans	8.55	% 8.72	% 8.54	% 8.49	%
Average Investment portfolio	3.12	% 3.41	% 3.20	% 3.43	%

* Average amounts for each period are based on weighted month-end balances.

(1) Average portfolio yield for the period was calculated by dividing interest income, including amortization of premiums and discounts, by our average of the amortized cost of the investments. All yields are annualized.

(2) GSE CRT average portfolio yield excludes embedded derivative coupon interest recorded as realized and unrealized credit derivative income (loss), net.

Our primary source of income is interest earned on our investment portfolio. We had average earning assets of approximately \$20.6 billion (June 30, 2014: \$20.0 billion) and earned interest income of \$160.8 million (June 30, 2014: \$170.7 million) for the three months ended June 30, 2015. The yield on our average investment portfolio was 3.12% (June 30, 2014: 3.41%).

We had average earning assets of approximately \$20.5 billion (June 30, 2014: \$19.7 billion) and earned interest income of \$328.6 million (June 30, 2014: \$338.5 million) for the six months ended June 30, 2015. The yield on our average investment portfolio was 3.20% (June 30, 2014: 3.43%).

Average assets increased during three and six months ended June 30, 2015 compared to 2014 primarily due to the addition of consolidated residential loan securitizations. We consolidated eleven residential loan securitizations as of June 30, 2015 compared to seven consolidated residential loan securitizations as of June 30, 2014. The yield on our

average investment portfolio declined for the three and six months ended June 30, 2015 primarily due to a change in portfolio composition and lower available reinvestment yields. We continue to evaluate our investment portfolio and make adjustments based on our views of the market opportunities. As of June 30, 2015, approximately 30% of our equity is allocated to investments in commercial credit; 32% is allocated to residential credit and 38% is allocated to Agency RMBS.

Table of Contents

Our interest income is subject to interest rate risk. Refer to Item 3. “Quantitative and Qualitative Disclosures about Market Risk” for more information relating to interest rate risk and its impact on our operating results.

The constant prepayment rate ("CPR") of our portfolio impacts the amount of premium and discount on the purchase of securities that is recognized into income. The table below shows the three month CPR for our RMBS and GSE CRT compared to bonds with similar characteristics (“Cohorts”).

	June 30, 2015		March 31, 2015	
	Company	Cohorts	Company	Cohorts
15 year Agency RMBS	10.7	15.1	9.4	12.7
30 year Agency RMBS	13.9	17.1	11.1	13.2
Agency Hybrid ARM RMBS	17.3	NA	14.2	NA
Non-Agency RMBS	14.0	NA	10.3	NA
GSE CRT	13.9	NA	9.5	NA
Weighted average CPR	14.4	NA	11.4	NA

Interest Expense and the Cost of Funds

The table below presents certain information related to our financing for the three and six months ended June 30, 2015 and 2014:

\$ in thousands	Three Months Ended		Six Months Ended		
	June 30, 2015	2014	June 30, 2015	2014	
Average Borrowings*:					
Agency RMBS ⁽¹⁾	9,166,962	10,040,134	9,099,236	9,865,448	
Non-Agency RMBS	2,534,973	2,790,149	2,584,839	2,895,918	
GSE CRT	495,605	307,237	475,057	261,052	
CMBS ⁽¹⁾	2,663,097	2,033,655	2,664,131	2,032,975	
Exchangeable senior notes	400,000	400,000	400,000	400,000	
Asset-backed securities issued by securitization trusts	3,023,497	1,975,573	2,974,056	1,870,367	
Total borrowed funds	18,284,134	17,546,748	18,197,319	17,325,760	
Maximum borrowings during the period ⁽²⁾	18,364,746	17,765,146	18,416,608	17,765,146	
Average Cost of Funds ⁽³⁾ :					
Agency RMBS ⁽¹⁾	0.35	% 0.32	% 0.35	% 0.34	%
Non-Agency RMBS	1.57	% 1.55	% 1.54	% 1.53	%
GSE CRT	1.63	% 1.50	% 1.66	% 1.47	%
CMBS ⁽¹⁾	0.92	% 1.24	% 0.91	% 1.31	%
Exchangeable senior notes	5.61	% 5.61	% 5.61	% 5.61	%
Asset-backed securities issued by securitization trusts	2.95	% 3.20	% 2.97	% 3.18	%
Unhedged cost of funds ⁽⁴⁾	1.18	% 1.09	% 1.18	% 1.10	%
Hedged / Effective cost of funds (non-GAAP measure)	2.19	% 2.28	% 2.19	% 2.30	%

* Average amounts for each period are based on weighted month-end balances.

(1) Agency RMBS and CMBS average borrowing and cost of funds include borrowings under repurchase agreements and secured loans.

(2) Amount represents the maximum borrowings at month-end during each of the respective periods.

(3) Average cost of funds is calculated by dividing annualized interest expense by our average borrowings.

(4) Excludes reclassification of amortization of net deferred losses on de-designated interest rate swaps to repurchase agreements interest expense.

Our largest expense is the interest expense on borrowed funds. We had average borrowed funds of \$18.3 billion (June 30, 2014: \$17.5 billion) and total interest expense of \$70.4 million (June 30, 2014: \$69.4 million) for the three months ended June 30, 2015. We had average borrowed funds of \$18.2 billion (June 30, 2014: \$17.3 billion) and total

interest expense of \$142.7 million (June 30, 2014: \$138.1 million) for the six months ended June 30, 2015. The increase in average borrowed funds and interest expense for the three and six months ended June 30, 2015 compared to 2014 was primarily the result of higher asset-backed security balances associated with new investments in consolidated residential loan securitizations. The Company

Table of Contents

consolidated eleven residential loan securitizations as of June 30, 2015 (seven consolidated residential loan securitizations as of June 30, 2014).

We compute our effective interest expense (non-GAAP measure) and effective cost of funds (non-GAAP measure) by including the net interest paid related to our interest rate swaps and excluding the reclassification of amortization of net deferred losses on de-designated interest rate swaps to repurchase agreements interest expense from our interest expense. Effective interest expense (non-GAAP measure) was \$100.1 million (June 30, 2014: \$100.1 million) for the three months ended June 30, 2015. Effective interest expense (non-GAAP measure) was \$198.9 million (June 30, 2014: \$198.9 million) for the six months ended June 30, 2015.

For the three months ended June 30, 2015, our cost of funds was 1.54% (June 30, 2014: 1.58%), and for the six months ended June 30, 2015, our cost of funds was 1.57% (June 30, 2014: 1.59%). For the three months ended June 30, 2015, our effective cost of funds (non-GAAP measure) was 2.19% (June 30, 2014: 2.28%), and for the six months ended June 30, 2015, our effective cost of funds (non-GAAP measure) was 2.19% (June 30, 2014: 2.30%). Our effective cost of funds declined in the three and six months ended June 30, 2015 versus the 2014 period primarily due to lower net interest paid on interest rate swaps.

Net Interest Income

Our net interest income, which equals interest income less interest expense, totaled \$90.4 million (June 30, 2014: \$101.3 million) for the three months ended June 30, 2015 and \$185.9 million (June 30, 2014: \$200.4 million) for the six months ended June 30, 2015. Our net interest rate margin, which equals the yield on our average assets for the period less the average cost of funds for the period, was 1.58% (June 30, 2014: 1.83%) for the three months ended June 30, 2015 and 1.63% (June 30, 2014: 1.84%) for the six months ended June 30, 2015. The decrease in net interest income and net interest margin was primarily the result of a lower average portfolio yield and higher average borrowed funds for the three and six months ended June 30, 2015 compared to 2014.

We compute our effective net interest income (non-GAAP measure) and effective interest rate margin (non-GAAP measure) by adding amortization of net deferred losses on de-designated interest rate swaps and subtracting net interest paid on our interest rate swaps to our net interest income. Our effective net interest income (non-GAAP measure) totaled \$66.9 million (June 30, 2014: \$74.4 million) for the three months ended June 30, 2015 and \$141.8 million (June 30, 2014: 146.6 million) for the six months ended June 30, 2015. Our effective interest rate margin (non-GAAP measure) was 1.05% (June 30, 2014: 1.21%) for the three months ended June 30, 2015 and 1.13% (June 30, 2014: 1.20%) for the six months ended June 30, 2015.

Refer to the table in the “Interest Income and Average Earning Asset Yield” section above for changes in average portfolio balance and yields.

Provision for Loan Losses

We evaluate our residential and commercial loans, held-for-investment to determine if it is probable that all amounts due under the terms of the loan agreements will be collected. Based upon this analysis, we recorded a decrease in the provision for loan losses of \$70,000 (June 30, 2014: \$50,000) for the three months ended June 30, 2015, and \$132,000 (June 30, 2014: \$157,000 increase) for the six months ended June 30, 2015. Our provision for loan losses is solely for residential loans held-for-investment by consolidated securitization trusts. The Company has evaluated the collectability of its commercial loans held-for-investment and determined that no provision for loan losses is required as of June 30, 2015.

Gain (Loss) on Investments, net

Gain (loss) on investments, net includes (i) gains and losses on sales of our investment portfolio; and (ii) the change in fair value of Agency MBS IOs.

As part of our investment process, our mortgage-backed and credit risk transfer securities are continuously reviewed to determine if they continue to meet our risk and return targets. This process involves looking at changing market assumptions and the impact those assumptions will have on the individual securities. Securities that do not meet our risk and return targets are sold. During the three months ended June 30, 2015, we sold mortgage-backed and credit risk transfer securities and recognized a net gain of \$1.7 million (June 30, 2014: \$20.8 million net loss) and a net gain of \$4.6 million (June 30, 2014: \$32.5 million net loss) for the six months ended June 30, 2015.

The Company accounts for Agency MBS IOs as hybrid financial instruments in their entirety at fair value with changes in fair value recognized in income in the Company's condensed consolidated statement of operations. Gain (loss) on Agency MBS IOs totaled \$9.2 million net gain (June 30, 2014: \$569,000 net gain) during the three months ended June 30, 2015 and \$8.4 million net gain (June 30, 2014: \$5.5 million net loss) for the six months ended June 30, 2015.

Table of Contents

Loss on Other-Than-Temporary Impaired Securities

For the three and six months ended June 30, 2015 and 2014, we did not recognize any losses on other-than-temporarily impaired securities in the condensed consolidated statements of operations. Refer to Note 4 – “Mortgage-Backed and Credit Risk Transfer Securities” of our condensed consolidated financial statements for the assessment of other-than-temporary impairment on our investment securities.

Equity in Earnings of Unconsolidated Ventures

For the three months ended June 30, 2015, we recorded equity in earnings of unconsolidated ventures of \$1.2 million (June 30, 2014: \$3.9 million). Equity in earnings of unconsolidated ventures decreased for the three months ended June 30, 2015 compared to 2014 primarily due to lower unrealized appreciation of underlying portfolio investments in the 2015 period.

For the six months ended June 30, 2015, we recorded equity in earnings of unconsolidated ventures of \$7.2 million (June 30, 2014: \$4.3 million). Equity in earnings of unconsolidated ventures increased for the six months ended June 30, compared to 2014 primarily due to higher unrealized appreciation of underlying portfolio investments in the 2015 period.

Gain (Loss) on Derivative Instruments, net

Our objectives in using interest rate derivatives are to add stability to interest expense and to manage our exposure to interest rate movements on our floating rate repurchase agreements and secured loans. To accomplish these objectives, we primarily use interest rate derivative instruments, including interest rate swaps, interest rate swaptions, U.S. Treasury futures contracts and TBAs as part of our interest rate risk management strategy. Interest rate swaps involve the receipt of variable-rate amounts from a counterparty in exchange for us making fixed-rate payments over the life of the agreements without exchange of the underlying notional amount. An interest rate swaption provides us the option to enter into an interest rate swap agreement for a predetermined notional amount, stated term and pay and receive interest rates in the future. The premium paid for interest rate swaptions is reported as an asset in our condensed consolidated balance sheets. The premium is valued at an amount equal to the fair value of the swaption that would have the effect of closing the position adjusted for nonperformance risk, if any. TBAs are reported on the balance sheet as an asset or liability at its fair value.

We also use currency forward contracts to help mitigate the potential impact of changes in foreign currency exchange rates on our investments denominated in foreign currencies.

Table of Contents

The tables below summarize our realized and unrealized gain (loss) on derivative instruments, net for the following periods:

\$ in thousands	Three Months Ended June 30, 2015			
	Realized gain (loss) on settlement, termination, expiration or exercise, net	Contractual interest expense	Unrealized gain (loss), net	Gain (loss) on derivative instruments, net
Derivative not designated as hedging instrument				
Interest Rate Swaps	(12,826)	(46,011)	116,623	57,786
Interest Rate Swaptions	(3,050)	—	2,326	(724)
TBAs	—	—	—	—
Futures Contracts	—	—	—	—
Currency Forward Contracts	664	—	(1,723)	(1,059)
Total	(15,212)	(46,011)	117,226	56,003
\$ in thousands	Six Months Ended June 30, 2015			
	Realized gain (loss) on settlement, termination, expiration or exercise, net	Contractual interest expense	Unrealized gain (loss), net	Gain (loss) on derivative instruments, net
Derivative not designated as hedging instrument				
Interest Rate Swaps	(31,881)	(91,619)	60,666	(62,834)
Interest Rate Swaptions	(7,738)	—	6,005	(1,733)
TBAs	(2,292)	—	558	(1,734)
Futures Contracts	(943)	—	(90)	(1,033)
Currency Forward Contracts	1,539	—	(947)	592
Total	(41,315)	(91,619)	66,192	(66,742)
\$ in thousands	Three Months Ended June 30, 2014			
	Realized gain (loss) on settlement, termination, expiration or exercise, net	Contractual interest expense	Unrealized gain (loss), net	Gain (loss) on derivative instruments, net
Derivative Instrument				
Interest Rate Swaps	—	(52,205)	(103,633)	(155,838)
Interest Rate Swaptions	(8,200)	—	4,654	(3,546)
TBAs	(1,400)	—	(1,938)	(3,338)
Futures Contracts	(5,437)	—	343	(5,094)
Total	(15,037)	(52,205)	(100,574)	(167,816)
\$ in thousands	Six Months Ended June 30, 2014			
	Realized gain (loss) on settlement, termination, expiration or exercise, net	Contractual interest expense	Unrealized gain (loss), net	Gain (loss) on derivative instruments, net
Derivative Instrument				
Interest Rate Swaps	—	(103,646)	(193,825)	(297,471)

Edgar Filing: Invesco Mortgage Capital Inc. - Form 10-Q

Interest Rate Swaptions	(23,275	) —	15,781	(7,494)
TBAs	(1,400	) —	(1,235	) (2,635)
Futures Contracts	(9,186	) —	(2,342	) (11,528)
Total	(33,861	) (103,646	) (181,621	) (319,128)

63

Table of Contents

Realized and Unrealized Credit Derivative Income (Loss), net

Realized and unrealized credit derivative income (loss), net includes (i) premium income and the change in fair value on the Company's sole credit default swap ("CDS"); and (ii) GSE CRT embedded derivative coupon interest, the change in fair value of GSE CRT embedded derivatives and realized gain (loss) on settlement of GSE CRT embedded derivatives.

The table below summarizes realized and unrealized credit derivative income (loss), net for the three and six months ended June 30, 2015 and 2014.

\$ in thousands	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014 (As Restated)	2015	2014 (As Restated)
CDS premium income	242	352	507	728
Change in fair value of CDS	806	(60)	744	(107)
GSE CRT embedded derivative coupon interest	6,157	3,773	12,070	6,970
Gain (loss) on settlement of GSE CRT embedded derivatives	(1,676)	—	(2,468)	—
Change in fair value of GSE CRT embedded derivatives	(4,915)	27,990	11,123	41,951
Total	614	32,055	21,976	49,542

Other Investment Income (Loss), net

Other investment income (loss), net primarily consists of income from FHLBI stock net of foreign exchange rate gains and losses related to a commercial loan investment denominated in a foreign currency which prepaid in the second quarter of 2015 before its contractual maturity.

Expenses

For the three months ended June 30, 2015, we incurred management fees of \$9.3 million (June 30, 2014: \$9.3 million) and \$18.8 million (June 30, 2014: \$18.7 million) for the six months ended June 30, 2015, which are payable to our Manager under our management agreement. Refer to Note 11 – “Related Party Transactions” of our condensed consolidated financial statements for a discussion of our relationship with our Manager.

For the three months ended June 30, 2015, our general and administrative expenses not covered under our management agreement amounted to \$2.0 million (June 30, 2014: \$2.4 million) and \$3.7 million (June 30, 2014: \$4.4 million) for the six months ended June 30, 2015. General and administrative expenses not covered under our management agreement primarily consist of directors and officers insurance, legal costs, accounting, auditing and tax services, filing fees, organization expenses associated with our consolidated securitization trusts and miscellaneous general and administrative costs. General and administrative costs in the three months ended June 30, 2015 were lower than the 2014 period primarily because the 2014 period included \$418,000 of consolidated securitization organization expenses incurred by the Company. General and administrative costs in the six months ended June 30, 2015 were lower than the 2014 period primarily because the 2014 period included \$656,000 of consolidated securitization organization expenses incurred by the Company.

For the three months ended June 30, 2015, consolidated securitization trust expenses totaled \$2.3 million (June 30, 2014: \$1.4 million) and \$4.4 million (June 30, 2014: \$2.5 million) for the six months ended June 30, 2015.

Consolidated securitization trust expenses consist of direct operating expenses incurred by consolidated residential loan securitizations. The increase in securitization trust expenses for the three and six months ended June 30, 2015 is primarily due to an increase in the number of consolidated residential loan securitizations from seven as of June 30, 2014 to eleven as of June 30, 2015.

Table of Contents

Net Income (loss) after Preferred Dividends and Return on Average Equity

For the three months ended June 30, 2015, our net income after preferred dividends was \$141.6 million (June 30, 2014: \$66.5 million net loss) and our annualized income on average equity was 23.04% (June 30, 2014: 10.77% annualized loss). The change in net income (loss) after preferred dividends and return on average equity was primarily attributable to realized and unrealized gains on derivative instruments of \$56.0 million in the 2015 period versus realized and unrealized losses on derivative instruments of \$167.8 million in the 2014 period. For the three months ended June 30, 2015, we recognized an unrealized gain for the change in fair value of our interest rates swaps of \$116.6 million (June 30, 2014: \$103.6 million unrealized loss). In addition, during the three months ended June 30, 2015, we recognized reclassification of amortization of net deferred losses on de-designated interest rate swaps to repurchase agreements interest expense previously recognized in other comprehensive income of \$16.3 million (June 30, 2014: \$21.5 million).

For the six months ended June 30, 2015, our net income after preferred dividends was \$124.0 million (June 30, 2014: \$134.0 million net loss) and our annualized income on average equity was 10.10% (June 30, 2014: 11.15% annualized loss). The change in net income (loss) after preferred dividends and return on average equity was primarily attributable to realized and unrealized losses on derivatives instruments of \$66.7 million in the 2015 period versus \$319.1 million in the 2014 period. For the six months ended June 30, 2015, we recognized an unrealized gain for the change in fair value of our interest rates swaps of \$60.7 million (June 30, 2014: \$193.8 million unrealized loss). In addition, during the six months ended June 30, 2015, we recognized reclassification of amortization of net deferred losses on de-designated interest rate swaps to repurchase agreements interest expense previously recognized in other comprehensive income of \$35.5 million (June 30, 2014: \$42.8 million).

Liquidity and Capital Resources

Liquidity is a measurement of our ability to meet potential cash requirements, including ongoing commitments to pay dividends, fund investments, repayment of borrowings and other general business needs. Our primary sources of funds for liquidity consist of the net proceeds from our common and preferred equity offerings, net cash provided by operating activities, proceeds from repurchase agreements and other financing arrangements and future issuances of equity and/or debt securities.

We currently believe that we have sufficient liquidity and capital resources available for the acquisition of additional investments, repayments on borrowings, margin requirements and the payment of cash dividends as required for continued qualification as a REIT. We generally maintain liquidity to pay down borrowings under repurchase arrangements to reduce borrowing costs and otherwise efficiently manage our long-term investment capital. Because the level of these borrowings can be adjusted on a daily basis, the level of cash and cash equivalents carried on our condensed consolidated balance sheets is significantly less important than our potential liquidity available under borrowing arrangements. However, there can be no assurance that we will maintain sufficient levels of liquidity to meet any margin calls.

We held cash and cash equivalents of \$87.0 million at June 30, 2015 (June 30, 2014: \$126.1 million). Our cash and cash equivalents decreased due to normal fluctuations in cash balances related to the timing of principal and interest payments, repayments of debt, and asset purchases and sales. Our operating activities provided net cash of approximately \$187.5 million for the six month period ended June 30, 2015 (June 30, 2014: \$186.6 million).

Our investing activities used net cash of \$55.2 million for the six month period ended June 30, 2015 (June 30, 2014: \$328.9 million). During the six month period ended June 30, 2015, we utilized cash to purchase \$1.4 billion (June 30, 2014: \$3.1 billion) of MBS and credit risk transfer securities and \$372.3 million (June 30, 2014: \$557.8 million) of residential loans. Cash used to purchase new investments was offset by proceeds from asset sales of \$242.5 million (June 30, 2014: \$2.5 billion), principal payments on MBS and credit risk transfer securities of \$1.3 billion (June 30, 2014: \$878.5 million) and principal repayments on residential loans of \$271.7 million (June 30, 2014: \$55.2 million). In addition, we originated or funded commercial loans of \$73.0 million (June 30, 2014: \$30.6 million) which was offset by principal repayments on commercial loans of \$63.1 million (June 30, 2014: \$0.4 million).

Our financing activities used net cash of \$209.4 million for the six month period ended June 30, 2015 (June 30, 2014: \$57.9 million). During the six months ended June 30, 2015, we utilized cash to repay repurchase agreements of \$447.8 million (June 30, 2014: \$728.5 million) and asset-backed securities issued by securitization trusts of \$255.8 million (June 30, 2014: \$48.4 million). Repayments on repurchase agreements were offset by net proceeds from our secured loans of \$300.0 million (June 30, 2014: \$625.0 million), and net proceeds from asset-backed securities issued by new consolidated securitization trusts of \$336.1 million (June 30, 2014: \$422.5 million).

As of June 30, 2015, our wholly-owned subsidiary, IAS Services LLC, had \$1.55 billion in outstanding secured advances from the FHLBI and is approved for additional available uncommitted credit for borrowing of an amount up to \$2.5 billion.

Table of Contents

Available uncommitted credit may be adjusted at the sole discretion of the FHLBI. As of June 30, 2015, the FHLBI advances were collateralized by CMBS and Agency RMBS with a fair value of \$1.5 billion and \$387.4 million, respectively.

As of June 30, 2015, the average margin requirement (weighted by borrowing amount), or the percentage amount by which the collateral value must exceed the loan amount, which we also refer to as the “haircut,” under our repurchase agreements for Agency RMBS was 4.6%, for non-Agency RMBS was 20.6%, for GSE CRT was 23.3% and for CMBS was 18.8%. Across our repurchase agreements for Agency RMBS, the haircuts range from a low of 3% to a high of 20%, for non-Agency RMBS ranges from a low of 10% to a high of 50%, GSE CRT ranges from a low of 25% to a high of 30% and for CMBS range from a low of 10% to a high of 25%. Our effective cost of funds (non-GAAP measure) was 2.19% (June 30, 2014: 2.28%) as of June 30, 2015. Declines in the value of our securities portfolio can trigger margin calls by our lenders under our repurchase agreements. An event of default or termination event would give some of our counterparties the option to terminate all repurchase transactions existing with us and require any amount due by us to the counterparties to be payable immediately.

Our total debt-to-equity ratio, which includes longer term financing, was 6.9x as of June 30, 2015 (December 31, 2014: 6.9x). Our repurchase agreement debt-to-equity ratio (non-GAAP measure) has declined from 5.4x at December 31, 2014 to 5.3x at June 30, 2015. Improving our balance sheet by diversifying our liabilities away from repurchase agreements has been a focus of management over the past two years. Since we began using other longer-term means of financing our investments, such as our exchangeable senior notes, secured loans, and asset-backed securities issued by consolidated residential loan securitization trusts, we have reduced our reliance on repurchase agreements. Our weighted average remaining maturity on borrowings has increased from 60 days as of December 31, 2013 to 354 days as of June 30, 2015.

In 2011, we implemented the DRSP. We have registered and reserved for issuance 15,000,000 shares of our common stock under the DRSP. Under the terms of the DRSP, stockholders who participate in the DRSP may purchase shares of our common stock directly from us, in cash investments up to \$10,000, or greater than \$10,000 if we grant a request for waiver. At our sole discretion, we may accept optional cash investments in excess of \$10,000 per month, which may qualify for a discount from the market price of 0% to 3%. The DRSP participants may also automatically reinvest all or a portion of their dividends for additional shares of our stock. During the six months ended June 30, 2015, we issued 7,756 shares of common stock (June 30, 2014: 8,235 shares) at an average price of \$15.75 (June 30, 2014: \$16.55) under the DRSP with total proceeds of approximately \$122,000 (June 30, 2014: \$136,000), of which no shares of common stock were issued under the waiver feature of the DRSP.

In December 2011, our board of directors approved a share repurchase program to purchase up to 7,000,000 shares of our common shares with no stated expiration date. In December 2013, our board of directors approved an additional share repurchase of up to 20,000,000 of our common shares with no expiration date. 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 Rules 10b5-1 and 10b-18 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. 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.

During the six months ended June 30, 2015, the Company did not repurchase any shares of its common stock. As of June 30, 2015, the Company had authority to purchase 14,841,784 additional shares of its common stock under its share repurchase program.

Effects of Margin Requirements, Leverage and Credit Spreads

Our securities have values that fluctuate according to market conditions and, as discussed above, the market value of our securities will decrease as prevailing interest rates or credit spreads increase. When the value of the securities pledged to secure a repurchase loan or a secured loan decreases to the point where the positive difference between the collateral value and the loan amount is less than the haircut, our lenders may issue a “margin call,” which means that the lender will require us to pay the margin call in cash or pledge additional collateral to meet that margin call, or increase

collateral requirements. Under our repurchase facilities and secured loans, our lenders have full discretion to determine the value of the securities we pledge to them. Most of our lenders will value securities based on recent trades in the market. Lenders also issue margin calls as the published current principal balance factors change on the pool of mortgages underlying the securities pledged as collateral when scheduled and unscheduled paydowns are announced monthly.

We experience margin calls and increased collateral requirements in the ordinary course of our business. In seeking to effectively manage the margin requirements established by our lenders, we maintain a position of cash and unpledged securities. We refer to this position as our “liquidity.” The level of liquidity we have available to meet margin calls is directly affected by our leverage levels, our haircuts and the price changes on our securities. If interest rates increase as a result of a

Table of Contents

yield curve shift or for another reason or if credit spreads widen, then the prices of our collateral (and our unpledged assets that constitute our liquidity) will decline, we will experience margin calls, and we will use our liquidity to meet the margin calls. There can be no assurance that we will maintain sufficient levels of liquidity to meet any margin calls or increased collateral requirements. If our haircuts increase, our liquidity will proportionately decrease. In addition, if we increase our borrowings, our liquidity will decrease by the amount of additional haircut on the increased level of indebtedness.

We intend to maintain a level of liquidity in relation to our assets that enables us to meet reasonably anticipated margin calls and increased collateral requirements but that also allows us to be substantially invested in securities. We may misjudge the appropriate amount of our liquidity by maintaining excessive liquidity, which would lower our investment returns, or by maintaining insufficient liquidity, which would force us to liquidate assets into unfavorable market conditions and harm our results of operations and financial condition.

We are subject to financial covenants in connection with our lending, derivatives and other agreements we enter into in the normal course of our business. We intend to continue to operate in a manner which complies with all of our financial covenants. Our lending and derivative agreements provide that we may be declared in default of our obligations if the following conditions occur:

• Our leverage ratio exceeds certain thresholds; and

• We fail to maintain stockholders' equity or market value above certain thresholds over specified time periods.

Forward-Looking Statements Regarding Liquidity

Based upon our current portfolio, leverage rate and available borrowing arrangements, we believe that cash flow from operations and available borrowing capacity will be sufficient to enable us to meet anticipated short-term (one year or less) liquidity requirements to fund our investment activities, pay fees under our management agreement, fund our distributions to stockholders and for other general corporate expenses.

Our ability to meet our long-term (greater than one year) liquidity and capital resource requirements will be subject to obtaining additional debt financing. We may increase our capital resources by obtaining long-term credit facilities or through public or private offerings of equity or debt securities, possibly including classes of preferred stock, common stock, and senior or subordinated notes. Such financing will depend on market conditions for capital raises and our ability to invest such offering proceeds. If we are unable to renew, replace or expand our sources of financing on substantially similar terms, it may have an adverse effect on our business and results of operations.

Table of Contents

Contractual Obligations

We have entered into an agreement with our Manager pursuant to which our Manager is entitled to receive a management fee and the reimbursement of certain expenses. The management fee is calculated and payable quarterly in arrears in an amount equal to 1.50% of our stockholders' equity, per annum. Our Manager uses the proceeds from its management fee in part to pay compensation to its officers and personnel who, notwithstanding that certain of those individuals are also our officers, receive no cash compensation directly from us. We are required to reimburse our Manager for operating expenses related to us incurred by our Manager, including certain salary expenses and other expenses relating to legal, accounting, due diligence and other services. Expense reimbursements to our Manager are made in cash on a monthly basis following the end of each month. Our reimbursement obligation is not subject to any dollar limitation. Refer to Note 11 – "Related Party Transactions" of our condensed consolidated financial statements for details of our reimbursements to our Manager.

Contractual Commitments

As of June 30, 2015, we had the following contractual commitments and commercial obligations:

\$ in thousands	Payments Due by Period				
	Total	Less than 1 year	1-3 years	3-5 years	After 5 years
Obligations of Invesco Mortgage Capital Inc.					
Repurchase agreements	13,174,860	13,174,860	—	—	—
Secured loans	1,550,000	—	—	300,000	1,250,000
Unfunded investments in unconsolidated ventures	26,288	5,702	20,586	—	—
Exchangeable senior notes	400,000	—	400,000	—	—
Participation interest	150	150	—	—	—
Commercial loans	1,126	1,126	—	—	—
Total contractual obligations ⁽¹⁾	15,152,424	13,181,838	420,586	300,000	1,250,000
Obligations of entities consolidated for financial reporting purposes					
Consolidated ABS ⁽²⁾	2,980,757	394,635	650,333	491,023	1,444,766
Anticipated interest payments on ABS ⁽³⁾	661,997	90,165	145,791	109,968	316,073
Total obligations of entities consolidated for financial reporting purposes	3,642,754	484,800	796,124	600,991	1,760,839
Total consolidated obligations and commitments	18,795,178	13,666,638	1,216,710	900,991	3,010,839

Excluded from total contractual obligations are the amounts due to our Manager under the management agreement, (1) as those obligations do not have fixed and determinable payments. Refer to "Contractual Obligations" above for further details.

All consolidated ABS issued by VIEs are collateralized by residential mortgage loans. The ABS obligations will (2) pay down as the principal balances of these residential mortgage loans pay down. The amounts shown are the estimated principal repayments, adjusted for projected prepayments and losses.

The anticipated interest payments on consolidated ABS issued by VIEs are calculated based on estimated principal (3) balances, adjusted for projected prepayments and losses.

As of June 30, 2015, we have approximately \$14.8 million, \$60.9 million and \$52.0 million in contractual interest payments related to our repurchase agreements, exchangeable senior notes and secured loans, respectively.

Off-Balance Sheet Arrangements

We have committed to invest up to \$120.6 million in unconsolidated ventures sponsored by an affiliate of our Manager. The unconsolidated ventures are structured as partnerships, and we invest in the partnerships as a limited partner. As of June 30, 2015, \$94.3 million of our commitment has been called. We are committed to fund \$26.3 million in additional capital to fund future investments and cover future expenses should they occur.

We also utilize credit derivatives, such as credit default swaps, to provide credit event protection based on a financial index or specific security in exchange for receiving a fixed-rate fee or premium over the term of the contract. These instruments enable us to synthetically assume the credit risk of a reference security, portfolio of securities or index of securities. The counterparty pays a premium to us and we agree to make a payment to compensate the counterparty for losses upon the occurrence of a specified credit event. Although contract specific, credit events generally include bankruptcy, failure to pay, restructuring, obligation acceleration, obligation default, or repudiation/moratorium. Upon the occurrence of a defined credit

Table of Contents

event, amounts due to the counterparty as set forth by the terms of the CDS agreement would be recorded as realized loss in the condensed consolidated statements of operations.

In 2010, we entered into a credit default swap contract ("CDS"). We sold protection against losses on a specific pool of non-Agency RMBS in excess of a specified threshold. In exchange, we are paid a stated fixed rate fee of 3% of the notional amount of the CDS. We are required to post collateral as security for potential loss payments. We posted collateral to secure potential loss payments of \$4.7 million as of June 30, 2015 (December 31, 2014: \$5.6 million). The remaining notional amount of the CDS at June 30, 2015 is \$30.1 million (December 31, 2014: \$36.7 million), and we estimated the fair market value of the CDS to be \$1.1 million at June 30, 2015 (December 31, 2014: \$396,000). As of June 30, 2015, we have not made any payments related to the CDS contract.

As of June 30, 2015, we have unfunded commitments on commercial loans of \$1.1 million (December 31, 2014: \$5.0 million).

Stockholders' Equity

During the six months ended June 30, 2015, we issued 7,756 shares (2014: 8,235 shares) of common stock at an average price of \$15.75 (2014: \$16.55) under the DRSP with total proceeds to us of approximately \$122,000 (2014: \$136,000).

During the six months ended June 30, 2015, the Company did not repurchase any shares of its common stock. During the six months ended June 30, 2014, we repurchased 1,438,213 shares of our common stock at an average repurchase price of \$14.69 per share for a net cost of \$21.1 million, including acquisition expenses. As of June 30, 2015, we had authority to purchase 14,841,784 additional shares of our common stock through this program.

Share-Based Compensation

The Company has currently reserved 1,000,000 shares of common stock for issuance to its independent directors and officers and employees of our Manager and its affiliates under the terms of its 2009 Equity Incentive Plan (the "Incentive Plan"). Unless terminated earlier, the Incentive Plan will terminate in 2019, but will continue to govern the unexpired awards.

We recognized compensation expense of approximately \$170,000 (June 30, 2014: \$112,000) related to our non-executive directors for the six months ended June 30, 2015. During the six months ended June 30, 2015, we issued 10,744 shares (June 30, 2014: 5,824 shares) of restricted stock pursuant to the Incentive Plan to our non-executive directors. The fair market value of the shares granted was determined by the closing stock market price on the date of the grant.

We recognized compensation expense of approximately \$137,000 (June 30, 2014: \$161,000) for the six months ended June 30, 2015 related to awards to employees of our Manager and its affiliates. Our Manager reimburses us for this compensation expense under the terms of our management agreement.

During March 2015, we issued 11,547 shares of common stock (net of tax withholding) to employees of our Manager and its affiliates in exchange for 17,783 restricted stock units that vested under the Incentive Plan. In addition, during the six months ended June 30, 2015, we awarded 17,652 restricted stock units to employees of our Manager and its affiliates. During the six months ended June 30, 2015, no units were forfeited.

Dividends

We intend to continue to make regular quarterly distributions to holders of our common stock and preferred stock. U.S. federal income tax law generally requires that a REIT distribute at least 90% of its REIT taxable income annually, determined without regard to the deduction for dividends paid and excluding net capital gains, and that it pay tax at regular corporate rates to the extent that it annually distributes less than 100% of its taxable income. Before we pay any dividend, whether for U.S. federal income tax purposes or otherwise, we must first meet both our operating requirements and debt service on our repurchase agreements and other debt payable. If our cash available for distribution is less than our taxable income, we could be required to sell assets or borrow funds to make cash distributions, or we may make a portion of the required distribution in the form of a taxable stock distribution or distribution of debt securities.

Inflation

Virtually all of our assets and liabilities are sensitive to interest rates. As a result, interest rates and other factors influence our performance far more than inflation. Changes in interest rates do not necessarily correlate with inflation rates or changes in inflation rates.

Unrelated Business Taxable Income

We have not engaged in transactions that would result in a portion of our income being treated as unrelated business taxable income.

Table of Contents

Other Matters

We believe that we satisfied each of the asset tests in Section 856(c)(4) of the Internal Revenue Code of 1986, as amended (the "Code") for the period ended June 30, 2015. We also believe that our revenue qualifies for the 75% source of income test and for the 95% source of income test rules for the period ended June 30, 2015. Consequently, we believe we met the REIT income and asset test as of June 30, 2015. We also met all REIT requirements regarding the ownership of our common stock and the distribution of dividends of our net income as of June 30, 2015.

Therefore, as of June 30, 2015, we believe that we qualified as a REIT under the Code.

At all times, we intend to conduct our business so that neither we nor our Operating Partnership nor the subsidiaries of our Operating Partnership are required to register as an investment company under the 1940 Act. If we were required to register as an investment company, then our use of leverage would be substantially reduced. Because we are a holding company that conducts our business through our Operating Partnership and the Operating Partnership's wholly-owned or majority-owned subsidiaries, the securities issued by these subsidiaries that are excepted from the definition of "investment company" under Section 3(c)(1) or Section 3(c)(7) of the 1940 Act, together with any other investment securities the Operating Partnership may own, may not have a combined value in excess of 40% of the value of the Operating Partnership's total assets (exclusive of U.S. government securities and cash items) on an unconsolidated basis, which we refer to as the 40% test. This requirement limits the types of businesses in which we are permitted to engage in through our subsidiaries. In addition, we believe neither we nor the Operating Partnership are considered an investment company under Section 3(a)(1)(A) of the 1940 Act because they do not engage primarily or hold themselves out as being engaged primarily in the business of investing, reinvesting or trading in securities. Rather, through the Operating Partnership's wholly-owned or majority-owned subsidiaries, we and the Operating Partnership are primarily engaged in the non-investment company businesses of these subsidiaries. IAS Asset I LLC and certain of the Operating Partnership's other subsidiaries that we may form in the future rely upon the exclusion from the definition of "investment company" under the 1940 Act provided by Section 3(c)(5)(C) of the 1940 Act, which is available for entities "primarily engaged in the business of purchasing or otherwise acquiring mortgages and other liens on and interests in real estate." This exclusion generally requires that at least 55% of each subsidiary's portfolio be comprised of qualifying assets and at least 80% be comprised of qualifying assets and real estate-related assets (and no more than 20% comprised of miscellaneous assets). We calculate that as of June 30, 2015, we conducted our business so as not to be regulated as an investment company under the 1940 Act.

Table of Contents

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

The primary components of our market risk are related to interest rate, principal prepayment and market value. 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.

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 repurchase agreements. Our repurchase agreements are typically of limited duration and will be periodically refinanced at current market rates. We mitigate this risk through utilization of derivative contracts, primarily interest rate swap agreements, TBAs and futures contracts.

Interest Rate Effect on Net Interest Income

Our operating results depend in large part upon differences between the yields earned on our investments and our cost of borrowing and interest rate hedging activities. Most of our repurchase agreements provide financing based on a floating rate of interest calculated on a fixed spread over LIBOR. The fixed spread will vary depending on the type of underlying asset which collateralizes the financing. Accordingly, the portion of our portfolio which consists of floating interest rate assets are match-funded utilizing our expected sources of short-term financing, while our fixed interest rate assets are not 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 increase in borrowing costs results in the 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 RMBS. If prepayments are slower or faster than assumed, the life of the 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. Hedging strategies involving the use of derivative securities are highly complex and may produce volatile returns.

Interest Rate Effects on Fair Value

Another component of interest rate risk is the effect that changes in interest rates will have on the market value of the assets that we acquire. We face the risk that the market value of our assets will increase or decrease at different rates than those 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 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.

The impact of changing interest rates on fair value can change significantly when interest rates change materially. Therefore, the volatility in the fair value of our assets could increase significantly in the event interest rates change materially. 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, changes in actual interest rates may have a material adverse effect on us.

Prepayment Risk

As we receive prepayments of principal on our investments, premiums paid on these investments are amortized against 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 accreted into interest income. In general, an increase in prepayment rates will accelerate the accretion of purchase discounts, thereby increasing the interest income earned on the investments.

Table of Contents

Extension Risk

We compute the projected weighted-average life of our investments based upon assumptions regarding the rate at which the borrowers will prepay the underlying mortgages. In general, when a fixed-rate or hybrid adjustable-rate security is acquired with 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, because the borrowing costs are fixed for the duration of the fixed-rate portion of the related target asset.

However, if prepayment rates decrease in a rising interest rate environment, then 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 hybrid adjustable-rate assets would remain fixed. This situation may also cause the market value of our hybrid adjustable-rate assets to decline, with little or no offsetting gain from the related hedging transactions. In extreme situations, we may be forced to sell assets to maintain adequate liquidity, which could cause us to incur losses.

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 pursuant to ASC Topic 320. The estimated fair value of these securities fluctuates primarily due to changes in interest rates 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.

The sensitivity analysis table presented below shows the estimated impact of an instantaneous parallel shift in the yield curve, up and down 50 and 100 basis points, on the market value of our interest rate-sensitive investments and net interest income, including net interest paid or received under interest rate swaps, at June 30, 2015, assuming a static portfolio. When evaluating the impact of changes in interest rates, prepayment assumptions and principal reinvestment rates are adjusted based on our Manager's expectations. The analysis presented utilized assumptions, models and estimates of our Manager based on our Manager's judgment and experience.

Change in Interest Rates	Percentage Change in Projected Net Interest Income	Percentage Change in Projected Portfolio Value	
+1.00%	10.17	% (1.17)%
+0.50%	17.15	% (0.54)%
-0.50%	(23.91	)% 0.13	%
-1.00%	(50.72	)% 0.06	%

Certain assumptions have been made in connection with the calculation of the information set forth in the foregoing interest rate sensitivity table and, as such, there can be no assurance that assumed events will occur or that other events will not occur that would affect the outcomes. The base interest rate scenario assumes interest rates at June 30, 2015. The analysis utilizes assumptions and estimates based on management's judgment and experience. Furthermore, while we generally expect to retain such assets and the associated interest rate risk to maturity, future purchases and sales of assets could materially change our interest rate risk profile.

Given the low interest rates at June 30, 2015, we applied a floor of 0% for all anticipated interest rates included in our assumptions. Because of this floor, we anticipate that any hypothetical interest rate shock decrease would have a limited positive impact on our funding costs; however, because prepayment speeds are unaffected by this floor, we expect that any increase in our prepayment speeds (occurring as a result of any interest rate decrease or otherwise) could result in an acceleration of our premium amortization on Agency and interest-only securities purchased at a premium, and accretion of discount on our non-Agency RMBS purchased at a discount. As a result, because this floor limits the positive impact of any interest rate decrease on our funding costs, hypothetical interest rate decreases could cause the fair value of our financial instruments and our net interest income to decline.

The information set forth in the interest rate sensitivity table above and all related disclosures constitutes forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act. Actual results could differ significantly from those estimated in the foregoing interest rate sensitivity table.

Table of Contents

Real Estate Risk

Residential and commercial property values are subject to volatility and may be adversely affected 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 the supply of housing stock); 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 suffer losses.

Credit Risk

We believe that our investment strategy will generally keep our credit losses and financing costs low. However, we retain the risk of potential credit losses on all of our residential and commercial mortgage investments. We seek to manage this risk through our pre-acquisition due diligence process. In addition, we re-evaluate the credit risk inherent in our investments on a regular basis pursuant to fundamental considerations such as GDP, unemployment, interest rates, retail sales, store closings/openings, corporate earnings, housing inventory, affordability and regional home price trends. We also review key loan credit metrics including, but not limited to, payment status, current loan-to-value ratios, current borrower credit scores and debt yields. These characteristics assist in determining the likelihood and severity of loan loss as well as prepayment and extension expectations. We then perform structural analysis under multiple scenarios to establish likely cash flow profiles and credit enhancement levels relative to collateral performance projections. This analysis allows us to quantify our opinions of credit quality and fundamental value, which are key drivers of portfolio management decisions.

Foreign Exchange Rate Risk

We have an investment in a commercial loan denominated in a foreign currency. We are exposed to foreign exchange risk on the balance of the loan and contractual payments of interest on the loan. We have hedged our foreign currency exposure on the loan by purchasing currency forward contracts.

Risk Management

To the extent consistent with maintaining our REIT qualification, we seek to manage risk exposure to protect our investment portfolio against the effects of major interest rate changes. We generally seek to manage this risk by:

- monitoring and adjusting, if necessary, the reset index and interest rate related to our target assets and our financings;
- attempting to structure our financing agreements to have a range of different maturities, terms, amortizations and interest rate adjustment periods;
- using hedging instruments, primarily interest rate swap agreements but also financial futures, options, interest rate cap agreements, floors and forward sales to adjust the interest rate sensitivity of our target assets and our borrowings; and
- actively managing, on an aggregate basis, the interest rate indices, interest rate adjustment periods, and gross reset margins of our target assets and the interest rate indices and adjustment periods of our financings.

Table of Contents

ITEM 4. CONTROLS AND PROCEDURES.

Our management is responsible for establishing and maintaining disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act) that are designed to ensure that information we are required to disclose in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include controls and procedures designed to ensure that the required information is accumulated and communicated to our management, including our principal executive and principal financial officers, as appropriate, to allow timely decisions regarding required disclosure.

We have evaluated, with the participation of our principal executive officer and principal financial officer, the effectiveness of our disclosure controls and procedures as of June 30, 2015. Based upon our evaluation, our principal executive officer and principal financial officer have concluded that, because a material weakness in our internal control over financial reporting existed at December 31, 2014 and had not been remediated by the end of the period covered by this Form 10-Q, our disclosure controls and procedures were not effective as of June 30, 2015. A "material weakness" is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements presented will not be prevented or detected on a timely basis. This material weakness in our internal control over financial reporting and our remediation actions are described below.

Notwithstanding the existence of the material weakness described below, we have performed additional analyses and other procedures to enable management to conclude that the consolidated financial statements included in this Form 10-Q present fairly, in all material respects, our financial position, results of operations and cash flows for the periods presented in conformity with GAAP.

There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives.

Changes in Internal Control over Financial Reporting

Except as noted below, there has been no change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act) during the quarter ended June 30, 2015 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Remedial Action

In connection with the preparation of our consolidated financial statements for the fiscal quarter ended June 30, 2015, we determined that we had been improperly accounting for GSE CRTs and Agency MBS IOs as investment securities under ASC 320 - Investments - Debt and Equity Securities instead of accounting for them as hybrid instruments and assessing them for embedded derivative features that may require bifurcation and separate accounting under ASC 815 - Derivatives and Hedging. Our controls over the analysis and review of the appropriate accounting treatment for our mortgage-backed and credit risk transfer securities were not appropriately designed to prevent a material error resulting from the misapplication of GAAP. Our management concluded that this deficiency constitutes a "material weakness" in our internal control over financial reporting. To remediate the material weakness in 2015, we are in the process of implementing certain changes in our internal controls. Specifically, we engaged an internationally recognized accounting firm to assist us in reviewing our accounting treatment for mortgage-backed and credit risk transfer securities. In addition, we are in the process of formalizing our technical accounting review and documentation procedures related to new investments.

We believe the actions described above will be sufficient to remediate the identified material weakness and strengthen our internal control over financial reporting. However, the new and enhanced controls have not operated for a sufficient amount of time to conclude that the material weakness has been remediated. We will continue to monitor the effectiveness of these controls and will make any further changes management determines appropriate. As we continue to evaluate and work to improve our internal control over financial reporting, management may determine to

take additional measures to address control deficiencies or determine to modify the remediation plan described above. We cannot assure you, however, when we will remediate such weakness, nor can we be certain of whether additional actions will be required or the costs of any such actions.

Table of Contents

PART II – OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

From time to time, we may be involved in various claims and legal actions arising in the ordinary course of business. As of June 30, 2015, we were not involved in any such legal proceedings.

ITEM 1A. RISK FACTORS.

There were no material changes during the period covered by this Report to the risk factors previously disclosed in our annual report on Form 10-K/A for the year ended December 31, 2014, as filed with the SEC on August 17, 2015. Additional risks not presently known, or that we currently deem immaterial, also may have a material adverse effect on our business, financial condition and results of operations.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.

During the three months ended June 30, 2015, the Company did not repurchase any shares of its common stock.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None.

ITEM 4. MINE SAFETY DISCLOSURES.

Not applicable.

ITEM 5. OTHER INFORMATION.

None.

ITEM 6. EXHIBITS.

A list of exhibits to this Form 10-Q is set forth on the Exhibit Index and is incorporated herein by reference.

Table of Contents

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.

INVESCO MORTGAGE CAPITAL INC.

August 17, 2015

By: /s/ Richard J. King
Richard J. King
President and Chief Executive Officer

August 17, 2015

By: /s/ Richard Lee Phegley, Jr.
Richard Lee Phegley, Jr.
Chief Financial Officer

Table of Contents

EXHIBIT INDEX

Item 6. Exhibits

Exhibit No.	Description
3.1	Articles of Amendment and Restatement of Invesco Mortgage Capital Inc. (incorporated by reference to Exhibit 3.1 to our Quarterly Report on Form 10-Q, filed with the Securities and Exchange Commission on August 12, 2009).
3.2	Articles Supplementary of 7.75% Series A Cumulative Redeemable Preferred Stock (incorporated by reference to Exhibit 3.3 to the Registrant's Registration Statement on Form 8-A, filed with the SEC on July 23, 2012).
3.3	Articles Supplementary of 7.75% Fixed-to-Floating Series B Cumulative Redeemable Preferred Stock (incorporated by reference to Exhibit 3.3 to the Registrant's Registration Statement on Form 8-A, filed with the SEC on September 8, 2014).
3.4	Amended and Restated Bylaws of Invesco Mortgage Capital Inc. (incorporated by reference to Exhibit 3.2 to Amendment No. 8 to our Registration Statement on Form S-11 (No. 333-151665), filed with the Securities and Exchange Commission on June 18, 2009).
10.1	Second Amendment to Management Agreement, dated as of July 1, 2015, by and among Invesco Advisers, Inc., Invesco Mortgage Capital Inc., and IAS Operating Partnership LP.
31.1	Certification of Richard J. King pursuant to Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Richard Lee Phegley, Jr. pursuant to Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Richard J. King pursuant to Rule 13a-14(b) and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Richard Lee Phegley, Jr. pursuant to Rule 13a-14(b) and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101	The following series of unaudited XBRL-formatted documents are collectively included herewith as Exhibit 101. The financial information is extracted from Invesco Mortgage Capital Inc.'s unaudited condensed consolidated interim financial statements and notes that are included in this Form 10-Q Report.
	101.INS XBRL Instance Document
	101.SCH XBRL Taxonomy Extension Schema Document
	101.CAL XBRL Taxonomy Calculation Linkbase Document

Edgar Filing: Invesco Mortgage Capital Inc. - Form 10-Q

101.LAB XBRL Taxonomy Label Linkbase Document

101.PRE XBRL Taxonomy Presentation Linkbase Document

101.DEF XBRL Taxonomy Definition Linkbase Document