

Invesco Mortgage Capital Inc.  
Form 10-Q  
August 07, 2018  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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FORM 10-Q

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(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, 2018

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)

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

1555 Peachtree Street, N.E., Suite 1800 Atlanta, Georgia	30309
(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, smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated filer	<input checked="" type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-Accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>
	(Do not check if a smaller reporting company)	Emerging growth company	<input type="checkbox"/>

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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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 3, 2018, there were 111,643,188 outstanding shares of common stock of Invesco Mortgage Capital Inc.

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## PART I

## ITEM 1. FINANCIAL STATEMENTS

## INVESCO MORTGAGE CAPITAL INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

\$ in thousands except share amounts	As of June 30, 2018	December 31, 2017
<b>ASSETS</b>		
Mortgage-backed and credit risk transfer securities, at fair value (including pledged securities of \$17,047,937 and \$17,560,811, respectively)	17,583,187	18,190,754
Commercial loans, held-for-investment	127,607	191,808
Cash and cash equivalents	70,254	88,381
Restricted cash	—	620
Due from counterparties	7,255	—
Investment related receivable	70,839	73,217
Derivative assets, at fair value	47,509	6,896
Other assets	108,124	105,580
Total assets	18,014,775	18,657,256
<b>LIABILITIES AND EQUITY</b>		
Liabilities:		
Repurchase agreements	13,702,321	14,080,801
Secured loans	1,650,000	1,650,000
Exchangeable senior notes, net	—	143,231
Derivative liabilities, at fair value	6,071	32,765
Dividends and distributions payable	50,201	50,193
Investment related payable	23,562	5,191
Accrued interest payable	18,886	17,845
Collateral held payable	39,748	7,327
Accounts payable and accrued expenses	1,705	2,200
Due to affiliate	10,558	10,825
Total liabilities	15,503,052	16,000,378
Commitments and contingencies (See Note 16):		
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
7.50% Fixed-to-Floating Series C Cumulative Redeemable Preferred Stock: 11,500,000 shares issued and outstanding (\$287,500 aggregate liquidation preference)	278,108	278,108
Common Stock, par value \$0.01 per share; 450,000,000 shares authorized; 111,643,188 and 111,624,159 shares issued and outstanding, respectively	1,116	1,116
Additional paid in capital	2,384,902	2,384,356
Accumulated other comprehensive income	89,461	261,029
Retained earnings (distributions in excess of earnings)	(551,632 )	(579,334 )
Total stockholders' equity	2,487,171	2,630,491
Non-controlling interest	24,552	26,387

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Total equity	2,511,723	2,656,878
Total liabilities and equity	18,014,775	18,657,256

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

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

\$ in thousands, except share amounts	Three Months		Six Months	
	Ended June 30, 2018	2017	Ended June 30, 2018	2017
Interest Income				
Mortgage-backed and credit risk transfer securities	147,548	121,027	296,551	239,900
Commercial loans	4,051	6,021	8,273	11,785
Total interest income	151,599	127,048	304,824	251,685
Interest Expense				
Repurchase agreements	69,389	36,072	128,974	66,019
Secured loans	8,471	4,535	15,398	7,948
Exchangeable senior notes	—	3,504	1,621	8,512
Total interest expense	77,860	44,111	145,993	82,479
Net interest income	73,739	82,937	158,831	169,206
Other Income (loss)				
Gain (loss) on investments, net	(36,377 )	11,175	(196,747 )	9,322
Equity in earnings (losses) of unconsolidated ventures	798	(154 )	1,694	(1,688 )
Gain (loss) on derivative instruments, net	67,169	(53,513 )	200,536	(48,051 )
Realized and unrealized credit derivative income (loss), net	735	21,403	3,900	41,358
Net loss on extinguishment of debt	—	(526 )	(26 )	(5,237 )
Other investment income (loss), net	(2,160 )	2,533	942	3,862
Total other income (loss)	30,165	(19,082 )	10,299	(434 )
Expenses				
Management fee – related party	10,102	9,027	20,323	17,828
General and administrative	1,525	1,608	3,281	3,692
Total expenses	11,627	10,635	23,604	21,520
Net income	92,277	53,220	145,526	147,252
Net income attributable to non-controlling interest	1,163	670	1,834	1,856
Net income attributable to Invesco Mortgage Capital Inc.	91,114	52,550	143,692	145,396
Dividends to preferred stockholders	11,106	5,716	22,213	11,432
Net income attributable to common stockholders	80,008	46,834	121,479	133,964
Earnings per share:				
Net income attributable to common stockholders				
Basic	0.72	0.42	1.09	1.20
Diluted	0.72	0.41	1.08	1.15
Dividends declared per common share	0.42	0.40	0.84	0.80

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

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

\$ in thousands	Three Months		Six Months	
	Ended June 30, 2018	2017	Ended June 30, 2018	2017
Net income	92,277	53,220	145,526	147,252
Other comprehensive income (loss):				
Unrealized gain (loss) on mortgage-backed and credit risk transfer securities, net	(47,929)	39,633	(180,246)	55,922
Reclassification of unrealized (gain) loss on sale of mortgage-backed and credit risk transfer securities to gain (loss) on investments, net	9,889	651	19,126	1,501
Reclassification of amortization of net deferred (gain) loss on de-designated interest rate swaps to repurchase agreements interest expense	(6,898 )	(6,369 )	(13,437 )	(12,667 )
Currency translation adjustments on investment in unconsolidated venture	486	139	798	(476 )
Total other comprehensive income (loss)	(44,452)	34,054	(173,759)	44,280
Comprehensive income (loss)	47,825	87,274	(28,233 )	191,532
Less: Comprehensive (income) loss attributable to non-controlling interest	(602 )	(1,099 )	357	(2,414 )
Less: Dividends to preferred stockholders	(11,106)	(5,716)	(22,213 )	(11,432 )
Comprehensive income (loss) attributable to common stockholders	36,117	80,459	(50,089 )	177,686

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

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CONDENSED CONSOLIDATED STATEMENT OF EQUITY

For the six months ended June 30, 2018

(Unaudited)

\$ in thousands except share amounts	Series A Preferred Stock		Series B Preferred Stock		Series C Preferred Stock		Common Stock		Attributable to Common Stockholders		Accumulated Other Comprehensive Income (Loss)	Retain Earnin (Distr in exc of earnin
	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount	Additional Paid in Capital			
Balance at December 31, 2017	5,600,000	135,356	6,200,000	149,860	11,500,000	278,108	111,624,159	1,116	2,384,356	261,029	(579,3	
Net income	—	—	—	—	—	—	—	—	—	—	143,69	
Other comprehensive income (loss)	—	—	—	—	—	—	—	—	—	(171,568)	—	
Stock awards	—	—	—	—	—	—	19,029	—	—	—	—	
Common stock dividends	—	—	—	—	—	—	—	—	—	—	(93,77	
Common unit dividends	—	—	—	—	—	—	—	—	—	—	—	
Preferred stock dividends	—	—	—	—	—	—	—	—	—	—	(22,21	
Amortization of equity-based compensation	—	—	—	—	—	—	—	—	262	—	—	
Rebalancing of ownership percentage of non-controlling interest	—	—	—	—	—	—	—	—	284	—	—	
Balance at June 30, 2018	5,600,000	135,356	6,200,000	149,860	11,500,000	278,108	111,643,188	1,116	2,384,902	89,461	(551,6	

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



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

	Six Months Ended June 30,	
\$ in thousands	2018	2017
<b>Cash Flows from Operating Activities</b>		
Net income	145,526	147,252
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of mortgage-backed and credit risk transfer securities premiums and (discounts), net	25,657	37,534
Realized and unrealized (gain) loss on derivative instruments, net	(217,159)	) 5,191
Realized and unrealized (gain) loss on credit derivatives, net	7,371	(29,707)
(Gain) loss on investments, net	196,747	(9,322)
(Income) loss from investments in unconsolidated ventures in excess of distributions received	(1,150)	) 2,106
Other amortization	(13,052)	) (11,656)
Net loss on extinguishment of debt	26	5,237
(Gain) loss on foreign currency transactions, net	1,099	(2,229)
Changes in operating assets and liabilities:		
(Increase) decrease in operating assets	2,267	(2,497)
Increase (decrease) in operating liabilities	435	(3,016)
Net cash provided by operating activities	147,767	138,893
<b>Cash Flows from Investing Activities</b>		
Purchase of mortgage-backed and credit risk transfer securities	(1,213,558)	) (2,533,663)
(Contributions to) distributions from investments in unconsolidated ventures, net	(1,077)	) 7,408
Change in other assets	—	(3,457)
Principal payments from mortgage-backed and credit risk transfer securities	1,061,392	1,081,479
Proceeds from sale of mortgage-backed and credit risk transfer securities	387,726	572,616
Proceeds from/ (payments for) settlement or termination of forwards, swaps and futures, net	149,852	(25,311)
Net change in due from counterparties and collateral held payable	25,165	1,771
Principal payments from commercial loans held-for-investment	64,814	—
Origination and advances of commercial loans, net of origination fees	(1,677)	) (3,170)
Net cash provided by (used in) investing activities	472,637	(902,327)
<b>Cash Flows from Financing Activities</b>		
Due from counterparties - secured loans	—	(1,246)
Proceeds from repurchase agreements	72,281,324	63,154,822
Principal repayments of repurchase agreements	(72,659,696)	(62,200,623)
Extinguishment of exchangeable senior notes	(143,433)	) (185,386)
Payments of deferred costs	(167)	) —
Payments of dividends and distributions	(117,179)	) (101,852)
Net cash (used in) provided by financing activities	(639,151)	) 665,715
Net change in cash, cash equivalents and restricted cash	(18,747)	) (97,719)
Cash, cash equivalents and restricted cash, beginning of period	89,001	161,788
Cash, cash equivalents and restricted cash, end of period	70,254	64,069
<b>Supplement Disclosure of Cash Flow Information</b>		
Interest paid	158,027	97,003
<b>Non-cash Investing and Financing Activities Information</b>		

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Net change in unrealized gain (loss) on mortgage-backed and credit risk transfer securities	(161,120	) 57,423
Dividends and distributions declared not paid	50,201	50,930
Net change in investment related payable (receivable)	(18,871	) (163,489 )
Net change in repurchase agreements, not settled	(108	) 4,081
Change in due from counterparties and collateral held payable	—	86,450

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

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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", "we") is a Maryland corporation primarily focused on investing in, financing and managing residential and commercial mortgage-backed securities 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. ("Invesco"), a leading independent global investment management firm. We conduct our business through IAS Operating Partnership LP (the "Operating Partnership"), as its sole general partner. As of June 30, 2018, we owned 98.7% of the Operating Partnership, and a wholly-owned subsidiary of Invesco owned the remaining 1.3%. We have one operating segment.

We primarily invest 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 or the Federal Home Loan Mortgage Corporation (collectively "Agency RMBS");  
Commercial mortgage-backed securities ("CMBS") 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 or the Federal Home Loan Mortgage Corporation (collectively "Agency CMBS");  
RMBS that are not guaranteed by a U.S. government agency ("non-Agency RMBS");  
CMBS that are not guaranteed by a U.S. government agency ("non-Agency CMBS");  
Credit risk transfer securities that are unsecured obligations issued by government-sponsored enterprises ("GSE CRT");  
Residential and commercial mortgage loans; and  
Other real estate-related financing agreements.

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 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 exclusion from the "Investment Company" definition under the Investment Company Act of 1940.

Note 2 – Summary of Significant Accounting Policies

Basis of Presentation and Consolidation

Certain disclosures included in our Annual Report on Form 10-K are not required to be included on an interim basis in our quarterly reports on Form 10-Q. We have condensed or omitted these disclosures. Therefore, this Form 10-Q should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2017.

The condensed consolidated financial statements have been prepared in accordance with U.S. GAAP and consolidate the financial statements of the Company and our controlled subsidiaries. All significant intercompany transactions, balances, revenues and expenses are eliminated upon consolidation. In the opinion of management, the condensed consolidated financial statements reflect all adjustments, consisting of normal recurring accruals, which are necessary for a fair statement of our financial condition and results of operations for the periods presented.

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.



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### Significant Accounting Policies

There have been no changes to our accounting policies included in Note 2 to the consolidated financial statements of our Annual Report on Form 10-K for the year ended December 31, 2017, other than the significant accounting policy disclosed below.

#### Restricted Cash

Restricted cash represents cash posted with the Federal Home Loan Bank of Indianapolis ("FHLBI") as collateral for secured loans and cash posted with counterparties as collateral for various derivative instruments. Cash held by counterparties as collateral is legally restricted and is not available for general corporate purposes.

#### Accounting Pronouncements Recently Adopted

Effective January 1, 2018, we adopted the accounting guidance that amends certain aspects of recognition, measurement, presentation, and disclosure of financial assets and liabilities. The standard requires that all equity investments, other than those accounted for as equity method investments, be measured at fair value with changes recognized in income. As of January 1, 2018, we had three types of equity investments: investments in unconsolidated ventures, an investment in an exchange traded fund, and an investment in FHLBI stock. Our investments in unconsolidated ventures are accounted for as equity method investments, and our investment in an exchange-traded fund is measured at fair value with changes recognized in income. While the standard eliminates the cost method for equity investments without readily determinable fair values, it does allow an election to record equity investments without readily determinable fair values at cost, less impairment, and plus or minus adjustments for observable price changes. We have elected to record our investment in FHLBI stock at cost, less impairment. As such, the adoption of this accounting guidance did not impact our financial condition or results of operations. The standard also amends certain disclosure requirements for financial instruments. Refer to Note 4 - "Mortgage-Backed and Credit Risk Transfer Securities" for a tabular summary of the fair value of our available-for-sale securities and securities accounted for under the fair value option by asset type.

Effective January 1, 2018, we adopted the accounting guidance intended to reduce diversity in how restricted cash and certain transactions are classified in the statement of cash flows. The new guidance requires that the statement of cash flows explains the difference during the period in the total of cash, cash equivalents and amounts generally described as restricted cash or restricted cash equivalents. We adopted the accounting standard on a retrospective basis, which required us to restate our statement of cash flows for the six months ended June 30, 2017. The adoption resulted in a \$15.5 million decrease in net cash provided by operating activities, \$17.3 million decrease in net cash used in investing activities and \$1.8 million decrease in net cash provided by financing activities. We included restricted cash of \$620,000 as of December 31, 2017 in our reconciliation of cash, cash equivalents and restricted cash on the condensed consolidated statements of cash flows. We did not have any restricted cash as of June 30, 2018.

#### Pending Accounting Pronouncements

In June 2016, new accounting guidance was issued for reporting credit losses for assets measured at amortized cost and available-for-sale securities. The new guidance significantly changes how entities will measure credit losses for most financial assets, including loans, that are not measured at fair value through net income. The guidance replaces the existing "incurred loss" model with an "expected loss" model for instruments measured at amortized cost, and requires entities to record allowances for available-for-sale debt securities rather than reduce the carrying amount, as they do today under the other-than-temporary impairment model. The new guidance also simplifies the accounting model for purchased credit-impaired debt securities and loans. We are required to adopt the new guidance in the first quarter of 2020 by recording a cumulative effect adjustment to retained earnings as of January 1, 2020. We are currently evaluating the potential impacts of the new guidance on our consolidated financial statements.

In June 2018, new accounting guidance was issued that aligns the measurement and classification for stock-based payments to non-employees with the guidance for stock-based payments to employees. Under the new guidance, the measurement of equity-classified non-employee awards will be fixed at the grant date. We are required to adopt the new guidance in the first quarter of 2019 by recording a cumulative effect adjustment to retained earnings as of January 1, 2019. We are currently evaluating the potential impacts of the new guidance on our consolidated financial

statements.

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Note 3 - Variable Interest Entities ("VIEs")

Our maximum risk of loss in VIEs in which we are not the primary beneficiary at June 30, 2018 is presented in the table below.

\$ in thousands	Carrying Amount	Company's Maximum Risk of Loss
Non-Agency CMBS	3,151,237	3,151,237
Non-Agency RMBS	1,220,076	1,220,076
Investments in unconsolidated ventures	28,997	28,997
Total	4,400,310	4,400,310

Refer to Note 4 - "Mortgage-Backed and Credit Risk Transfer Securities" and Note 6 - "Other Assets" for additional details regarding these investments.

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Note 4 – Mortgage-Backed and Credit Risk Transfer Securities

The following tables summarize our mortgage-backed securities ("MBS") and GSE CRT portfolio by asset type as of June 30, 2018 and December 31, 2017.

June 30, 2018

\$ in thousands	Principal/ Notional Balance	Unamortized Premium (Discount)	Amortized Cost	Unrealized Gain/ (Loss), net	Fair Value	Period- end Weighted Average Yield <sup>(1)</sup>	Quarterly Weighted Average Yield <sup>(2)</sup>
Agency RMBS:							
15 year fixed-rate	2,532,605	85,680	2,618,285	(95,101 )	2,523,184	2.32 %	1.99 %
30 year fixed-rate	7,602,464	284,277	7,886,741	(221,602 )	7,665,139	3.14 %	2.95 %
ARM*	215,178	1,300	216,478	(1,677 )	214,801	2.58 %	2.43 %
Hybrid ARM	1,566,739	23,143	1,589,882	(22,831 )	1,567,051	2.56 %	2.28 %
Total Agency RMBS pass-through	11,916,986	394,400	12,311,386	(341,211 )	11,970,175	2.88 %	2.65 %
Agency-CMO <sup>(3)</sup>	995,408	(745,565 )	249,843	(11,027 )	238,816	3.26 %	3.04 %
Agency CMBS	150,268	1,940	152,208	19	152,227	3.46 %	3.63 %
Non-Agency CMBS <sup>(4)</sup>	3,871,603	(700,887 )	3,170,716	(19,479 )	3,151,237	5.02 %	4.95 %
Non-Agency RMBS <sup>(5)(6)(7)</sup>	2,945,105	(1,851,911 )	1,093,194	126,882	1,220,076	7.09 %	7.12 %
GSE CRT <sup>(8)</sup>	744,545	22,913	767,458	83,198	850,656	2.81 %	3.37 %
Total	20,623,915	(2,879,110 )	17,744,805	(161,618 )	17,583,187	3.53 %	3.36 %

\* Adjustable-rate mortgage ("ARM")

(1) Period-end weighted average yield is based on amortized cost as of June 30, 2018 and incorporates future prepayment and loss assumptions.

Quarterly weighted average yield for the period was calculated by dividing interest income, including amortization (2) of premiums and discounts, by the average balance of the amortized cost of the investments. All yields are annualized.

(3) Agency collateralized mortgage obligation ("Agency-CMO") includes interest-only securities ("Agency IO"), which represent 79.3% of principal/notional balance, 17.0% of amortized cost and 16.1% of fair value.

(4) Non-Agency CMBS includes interest-only securities which represent 15.7% of principal/notional balance, 0.5% of amortized cost and 0.6% of fair value.

(5) Non-Agency RMBS held by us is 47.6% variable rate, 46.0% fixed rate and 6.4% floating rate based on fair value.

(6) Of the total discount in non-Agency RMBS, \$190.7 million is non-accretable calculated using the principal/notional balance and based on estimated future cash flows of the securities.

(7) Non-Agency RMBS includes interest-only securities ("Non-Agency IO") which represent 55.7% of principal/notional balance, 2.4% of amortized cost and 2.3% of fair value.

(8) GSE CRT weighted average yield excludes coupon interest associated with embedded derivatives not accounted for under the fair value option that is recorded as realized and unrealized credit derivative income (loss), net.



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December 31, 2017

\$ in thousands	Principal/Notional Balance	Unamortized Premium (Discount)	Amortized Cost	Unrealized Gain/ (Loss), net	Fair Value	Period-end Weighted Average Yield <sup>(1)</sup>	Quarterly Weighted Average Yield <sup>(2)</sup>
Agency RMBS:							
15 year fixed-rate	2,917,307	119,120	3,036,427	(61,645 )	2,974,782	2.17 %	1.98 %
30 year fixed-rate	7,354,211	295,977	7,650,188	(9,648 )	7,640,540	3.09 %	2.90 %
ARM	238,486	1,609	240,095	1,105	241,200	2.60 %	2.36 %
Hybrid ARM	1,696,148	26,066	1,722,214	(2,829 )	1,719,385	2.54 %	2.25 %
Total Agency RMBS pass-through	12,206,152	442,772	12,648,924	(73,017 )	12,575,907	2.79 %	2.58 %
Agency-CMO <sup>(3)</sup>	1,226,539	(942,290 )	284,249	(10,306 )	273,943	2.91 %	2.74 %
Non-Agency CMBS <sup>(4)</sup>	3,879,775	(704,097 )	3,175,678	40,739	3,216,417	4.92 %	4.77 %
Non-Agency RMBS <sup>(5)(6)(7)</sup>	2,785,704	(1,661,683 )	1,124,021	133,587	1,257,608	7.19 %	7.18 %
GSE CRT <sup>(8)</sup>	757,183	24,306	781,489	85,390	866,879	2.45 %	2.79 %
Total	20,855,353	(2,840,992 )	18,014,361	176,393	18,190,754	3.42 %	3.27 %

(1) Period-end weighted average yield is based on amortized cost as of December 31, 2017 and incorporates future prepayment and loss assumptions.

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

(3) Agency collateralized mortgage obligation ("Agency-CMO") includes interest-only securities ("Agency IO"), which represent 81.8% of principal (notional) balance, 20.9% of amortized cost and 18.7% of fair value.

(4) Non-Agency CMBS includes interest-only securities which represent 15.8% of principal/notional balance, 0.5% of amortized cost and 0.6% of fair value.

(5) Non-Agency RMBS held by us is 52.2% variable rate, 37.8% fixed rate, and 10.0% floating rate based on fair value.

(6) Of the total discount in non-Agency RMBS, \$195.3 million is non-accretable calculated using the principal/notional balance and based on estimated future cash flows of the securities.

(7) Non-Agency RMBS includes interest-only securities, which represent 51.5% of principal/notional balance, 2.0% of amortized cost and 1.8% of fair value.

(8) GSE CRT weighted average yield excludes coupon interest associated with embedded derivatives not accounted for under the fair value option that is recorded as realized and unrealized credit derivative income (loss), net.

The following table presents the fair value of our available-for-sale securities and securities accounted for under the fair value option by asset type as of June 30, 2018 and December 31, 2017. We have elected the fair value option for all of our RMBS IOs, our MBS purchased on or after September 1, 2016 and our GSE CRTs purchased on or after August 24, 2015. As of June 30, 2018 and December 31, 2017, approximately 41% and 36%, respectively, of our MBS and GSE CRTs are accounted for under the fair value option.

\$ in thousands	June 30, 2018			December 31, 2017		
	Available-for-sale Securities	Securities under Fair Value Option	Total Fair Value	Available-for-sale Securities	Securities under Fair Value Option	Total Fair Value

Agency RMBS:

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15 year fixed-rate	2,170,906	352,278	2,523,184	2,842,440	132,342	2,974,782
30 year fixed-rate	2,216,755	5,448,384	7,665,139	2,467,871	5,172,669	7,640,540
ARM*	214,801	—	214,801	241,200	—	241,200
Hybrid ARM	1,535,502	31,549	1,567,051	1,719,385	—	1,719,385
Total RMBS Agency pass-through	6,137,964	5,832,211	11,970,175	7,270,896	5,305,011	12,575,907
Agency-CMO	182,293	56,523	238,816	203,351	70,592	273,943
Agency CMBS	—	152,227	152,227	—	—	—
Non-Agency CMBS	2,294,341	856,896	3,151,237	2,376,413	840,004	3,216,417
Non-Agency RMBS	1,075,371	144,705	1,220,076	1,236,178	21,430	1,257,608
GSE CRT	619,553	231,103	850,656	635,537	231,342	866,879
Total	10,309,522	7,273,665	17,583,187	11,722,375	6,468,379	18,190,754

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The components of the carrying value of our MBS and GSE CRT portfolio at June 30, 2018 and December 31, 2017 are presented below.

\$ in thousands	June 30, 2018		
	MBS and GSE CRT Securities	Interest-Only Securities	Total
Principal/ notional balance	17,743,581	2,880,334	20,623,915
Unamortized premium	471,489	—	471,489
Unamortized discount	(552,058 )	(2,798,541 )	(3,350,599 )
Gross unrealized gains <sup>(1)</sup>	253,314	7,010	260,324
Gross unrealized losses <sup>(1)</sup>	(415,201 )	(6,741 )	(421,942 )
Fair value	17,501,125	82,062	17,583,187
	December 31, 2017		
\$ in thousands	MBS and GSE CRT Securities		
	MBS and GSE CRT Securities	Interest-Only Securities	Total
Principal/ notional balance	17,974,390	2,880,963	20,855,353
Unamortized premium	521,626	—	521,626
Unamortized discount	(577,344 )	(2,785,274 )	(3,362,618 )
Gross unrealized gains <sup>(1)</sup>	336,543	5,113	341,656
Gross unrealized losses <sup>(1)</sup>	(155,146 )	(10,117 )	(165,263 )
Fair value	18,100,069	90,685	18,190,754

Gross unrealized gains and losses includes gains (losses) recognized in net income for securities accounted for as derivatives or under the fair value option as well as gains (losses) for available-for-sale securities which are (1) recognized as adjustments to other comprehensive income. Realization occurs upon sale or settlement of such securities. Further detail on the components of our total gains (losses) on investments, net for the three and six months ended June 30, 2018 and 2017 is provided later in this Note 4.

The following table summarizes our MBS and GSE CRT portfolio according to estimated weighted average life classifications as of June 30, 2018 and December 31, 2017.

\$ in thousands	June 30, 2018	December 31, 2017
Less than one year	135,350	135,559
Greater than one year and less than five years	6,166,267	7,934,836
Greater than or equal to five years	11,281,570	10,120,359
Total	17,583,187	18,190,754

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The following tables present the estimated fair value and gross unrealized losses of our MBS and GSE CRTs by length of time that such securities have been in a continuous unrealized loss position at June 30, 2018 and December 31, 2017.

June 30, 2018

\$ 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
<b>Agency RMBS:</b>									
15 year fixed-rate	385,423	(5,524 )	87	1,780,406	(92,961 )	127	2,165,829	(98,485 )	214
30 year fixed-rate	5,930,551	(182,696 )	212	890,051	(50,074 )	58	6,820,602	(232,770 )	270
ARM	157,531	(2,230 )	17	530	(26 )	1	158,061	(2,256 )	18
Hybrid ARM	852,306	(12,652 )	94	436,416	(12,707 )	46	1,288,722	(25,359 )	140
<b>Total Agency RMBS pass-through <sup>(1)</sup></b>	<b>7,325,811</b>	<b>(203,102 )</b>	<b>410</b>	<b>3,107,403</b>	<b>(155,768 )</b>	<b>232</b>	<b>10,433,214</b>	<b>(358,870 )</b>	<b>642</b>
Agency-CMO <sup>(2)</sup>	149,189	(9,756 )	43	71,796	(3,873 )	5	220,985	(13,629 )	48
Agency CMBS <sup>(3)</sup>	69,365	(78 )	1	—	—	—	69,365	(78 )	1
Non-Agency CMBS <sup>(4)</sup>	1,842,373	(35,757 )	136	207,220	(11,547 )	17	2,049,593	(47,304 )	153
Non-Agency RMBS <sup>(5)</sup>	250,751	(1,687 )	30	50,145	(374 )	7	300,896	(2,061 )	37
<b>Total</b>	<b>9,637,489</b>	<b>(250,380 )</b>	<b>620</b>	<b>3,436,564</b>	<b>(171,562 )</b>	<b>261</b>	<b>13,074,053</b>	<b>(421,942 )</b>	<b>881</b>

(1) Amounts disclosed includes Agency RMBS with a fair value of \$5.3 billion for which the fair value option has been elected. Such securities have unrealized losses of \$177.0 million.

(2) Amounts disclosed includes Agency IO and Agency-CMO with fair value of \$22.4 million and \$18.0 million, respectively, for which the fair value option has been elected. These Agency IO and Agency-CMO securities have unrealized losses of \$6.5 million and \$856,000, respectively.

(3) Fair value option has been elected for all Agency CMBS.

(4) Amounts disclosed includes Non-Agency CMBS with a fair value of \$693.4 million for which the fair value option has been elected. Such securities have unrealized losses of \$21.8 million.

(5) Amounts disclosed includes Non-Agency RMBS and Non-Agency IO with a fair value of \$111.2 million and \$10.7 million, respectively for which the fair value option has been elected. Such securities have unrealized losses of \$4,000 and \$247,000, respectively.

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December 31, 2017

\$ 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	111,020	(321 )	26	2,406,021	(67,285 )	133	2,517,041	(67,606 )	159
30 year fixed-rate	3,677,576	(20,730 )	107	963,547	(27,158 )	56	4,641,123	(47,888 )	163
ARM	101,173	(902 )	12	—	—	—	101,173	(902 )	12
Hybrid ARM	614,321	(4,189 )	73	517,642	(8,091 )	47	1,131,963	(12,280 )	120
Total Agency RMBS pass-through <sup>(1)</sup>	4,504,090	(26,142 )	218	3,887,210	(102,534 )	236	8,391,300	(128,676 )	454
Agency-CMO <sup>(2)</sup>	75,299	(10,433 )	44	81,988	(2,309 )	5	157,287	(12,742 )	49
Non-Agency CMBS <sup>(3)</sup>	892,553	(17,612 )	81	135,139	(3,792 )	12	1,027,692	(21,404 )	93
Non-Agency RMBS <sup>(4)</sup>	84,439	(709 )	15	96,263	(1,732 )	11	180,702	(2,441 )	26
Total	5,556,381	(54,896 )	358	4,200,600	(110,367 )	264	9,756,981	(165,263 )	622

(1) Amounts disclosed includes Agency RMBS with a fair value of \$3.4 billion for which the fair value option has been elected. Such securities have unrealized losses of \$22.8 million.

(2) Amounts disclosed includes Agency IO and Agency-CMO with fair value of \$36.5 million and \$9.5 million, respectively, for which the fair value option has been elected. These Agency IO and Agency-CMO securities have unrealized losses of \$10.1 million and \$88,000, respectively.

(3) Amounts disclosed includes Non-Agency CMBS with a fair value of \$596.0 million for which the fair value option has been elected. Such securities have unrealized losses of \$8.9 million.

(4) Amounts disclosed includes Non-Agency IO with a fair value of \$530,000 for which the fair value option has been elected. Such securities have unrealized losses of \$39,000.

Gross unrealized losses on our Agency RMBS, Agency CMBS and CMO were \$366.1 million at June 30, 2018 (December 31, 2017: \$131.3 million). Due to the inherent credit quality of Agency RMBS, Agency CMBS and Agency-CMO, we determined that at June 30, 2018 and December 31, 2017, any unrealized losses on these securities are not other than temporary.

Gross unrealized losses on our Agency IO, non-Agency RMBS and non-Agency CMBS were \$55.9 million (December 31, 2017: \$33.9 million) at June 30, 2018. We did not consider these unrealized losses to be credit related, but rather due to non-credit related factors such as interest rates, prepayment speeds, and market fluctuations. These investment securities are included in our assessment for other-than-temporary impairment on a quarterly basis. We assess our investment securities for other-than-temporary impairment ("OTTI") 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." This analysis includes a determination of estimated future cash flows through an evaluation of the characteristics of the underlying loans and the structural features of the investment. Underlying loan characteristics reviewed include, but are not limited to, delinquency status, loan-to-value ratios, borrower credit scores, occupancy status and geographic concentration.

The following table summarizes OTTI included in earnings for the three and six months ended June 30, 2018 and 2017:

\$ in thousands	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
RMBS interest-only securities	2,089	3,585	6,398	3,876

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Non-Agency RMBS <sup>(1)</sup>	—	513	50	754
Total	2,089	4,098	6,448	4,630

(1) Amounts disclosed relate to credit losses on debt securities for which a portion of an other-than-temporary impairment was recognized in other comprehensive income.

OTTI on RMBS interest-only securities was recorded as a reclassification from an unrealized to realized loss within gain (loss) on investments, net on the condensed consolidated statements of operations because we account for these securities under

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the fair value option. As of June 30, 2018, we did not intend to sell the securities and determined that it was not more likely than not that we will be required to sell the securities.

The following table summarizes the components of our total gain (loss) on investments, net for the three and six months ended June 30, 2018 and 2017.

\$ in thousands	Three Months		Six Months	
	Ended June 30, 2018	2017	Ended June 30, 2018	2017
Gross realized gains on sale of investments	35	1,311	35	2,215
Gross realized losses on sale of investments	(11,560)	(1,962)	(20,797)	(3,873)
Other-than-temporary impairment losses	(2,089)	(4,098)	(6,448)	(4,630)
Net unrealized gains and losses on MBS accounted for under the fair value option	(22,941)	7,715	(170,136)	4,113
Net unrealized gains and losses on GSE CRT accounted for under the fair value option	182	8,195	616	11,474
Net unrealized gains and losses on trading securities	(4)	14	(17)	23
Total gain (loss) on investments, net	(36,377)	11,175	(196,747)	9,322

The following tables present components of interest income recognized on our MBS and GSE CRT portfolio for the three and six months ended June 30, 2018 and 2017. GSE CRT interest income excludes coupon interest associated with embedded derivatives not accounted for under the fair value option that is recorded as realized and unrealized credit derivative income (loss), net.

For the three months ended June 30, 2018

\$ in thousands	Coupon Interest	Net (Premium Amortization)/Discount Accretion	Interest Income
Agency RMBS and CMBS	105,430	(22,275)	83,155
Non-Agency CMBS	38,101	1,195	39,296
Non-Agency RMBS	13,195	5,159	18,354
GSE CRT	7,180	(696)	6,484
Other	259	—	259
Total	164,165	(16,617)	147,548

For the three months ended June 30, 2017

\$ in thousands	Coupon Interest	Net (Premium Amortization)/Discount Accretion	Interest Income
Agency RMBS and CMBS	91,979	(27,775)	64,204
Non-Agency CMBS	31,506	(1,852)	29,654
Non-Agency RMBS	18,131	3,734	21,865
GSE CRT	5,556	(347)	5,209
Other	95	—	95
Total	147,267	(26,240)	121,027

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For the six months ended June 30, 2018

\$ in thousands	Coupon Interest	Net (Premium Amortization)/Discount Accretion	Interest Income
Agency RMBS and CMBS	213,747	(45,497 )	168,250
Non-Agency CMBS	75,394	2,621	78,015
Non-Agency RMBS	27,207	10,336	37,543
GSE CRT	13,705	(1,393 )	12,312
Other	431	—	431
Total	330,484	(33,933 )	296,551

For the six months ended June 30, 2017

\$ in thousands	Coupon Interest	Net (Premium Amortization)/Discount Accretion	Interest Income
Agency RMBS and CMBS	183,210	(56,353 )	126,857
Non-Agency CMBS	61,182	(4,486 )	56,696
Non-Agency RMBS	38,745	8,121	46,866
GSE CRT	10,043	(718 )	9,325
Other	156	—	156
Total	293,336	(53,436 )	239,900

## Note 5 – Commercial Loans Held-for-Investment

The following table summarizes purchased or originated commercial mezzanine loans held-for-investment as of June 30, 2018 and December 31, 2017.

\$ in thousands	Number of loans	Principal Balance	Unamortized (fees)/ costs, net	Carrying value	Weighted Average Coupon	Weighted Average Years to Maturity <sup>(1)</sup>
June 30, 2018	5	127,638	(31 )	127,607	8.96 %	0.7
December 31, 2017	8	191,894	(86 )	191,808	8.52 %	1.2

Weighted average years to maturity is based on the contractual maturity date. Certain loans may contain either an (1) option to prepay or an option to extend beyond their contractual maturity dates as specified in the respective loan agreements.

These loans were not impaired, and no allowance for loan loss has been recorded as of June 30, 2018 and December 31, 2017 based on our analysis of credit quality factors as described in Note 2 - "Summary of Significant Accounting Policies" included in the consolidated financial statements of our Annual Report on Form 10-K for the year ended December 31, 2017.

## Note 6 – Other Assets

The following table summarizes our other assets as of June 30, 2018 and December 31, 2017.

\$ in thousands	June 30, 2018	December 31, 2017
FHLBI stock	74,250	74,250
Investments in unconsolidated ventures	28,997	25,972
Investment in exchange-traded fund	3,962	3,979
Prepaid expenses and other assets	915	1,379
Total	108,124	105,580

IAS Services LLC, our wholly-owned subsidiary, is required to purchase and hold FHLBI stock as a condition of membership in the FHLBI. The stock is recorded at cost.

We have invested in unconsolidated ventures that are managed by an affiliate of our Manager. The unconsolidated ventures invest in our target assets. Refer to Note 16 - "Commitments and Contingencies" for additional details



regarding our commitments to these unconsolidated ventures.

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We have invested in an exchange-traded fund that is managed by an affiliate of our Manager. The exchange-traded fund invests in our target assets.

## Note 7 – Borrowings

We have financed the majority of our investment portfolio through repurchase agreements, secured loans and exchangeable senior notes. The following tables summarize certain characteristics of our borrowings at June 30, 2018 and December 31, 2017. Refer to Note 8 - "Collateral Positions" for collateral pledged under our repurchase agreements and secured loans.

June 30, 2018

\$ in thousands	Amount Outstanding	Weighted Average Interest Rate	Weighted Average Remaining Maturity (days)	
Repurchase Agreements:				
Agency RMBS	10,537,934	2.13 %		22
Agency CMBS	133,417	2.10 %		30
Non-Agency CMBS	1,450,627	3.25 %		23
Non-Agency RMBS	917,106	3.28 %		23
GSE CRT	663,237	3.18 %		23
Total Repurchase Agreements	13,702,321	2.38 %		23
Secured Loans	1,650,000	2.18 %		2,136
Total Borrowings	15,352,321	2.36 %		250

December 31, 2017

\$ in thousands	Amount Outstanding	Weighted Average Interest Rate	Weighted Average Remaining Maturity (days)	
Repurchase Agreements:				
Agency RMBS	11,111,755	1.58 %		25
Non-Agency CMBS	1,396,330	2.61 %		9
Non-Agency RMBS	915,225	2.77 %		31
GSE CRT	657,491	2.78 %		24
Total Repurchase Agreements	14,080,801	1.82 %		25
Secured Loans	1,650,000	1.52 %		2,317
Exchangeable Senior Notes <sup>(1)</sup>	143,410	5.00 %		74
Total Borrowings	15,874,211	1.82 %		263

<sup>(1)</sup> The carrying value of exchangeable senior notes was \$143.2 million as of December 31, 2017. The carrying value was net of unamortized debt issuance costs of \$179,000 as of December 31, 2017.

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The following table shows the aggregate amount of maturities of our outstanding borrowings:

\$ in thousands	As of
Borrowings maturing within:	June 30, 2018
7/1/2018 - 6/30/2019	13,702,321
7/1/2019 - 6/30/2020	300,000
7/1/2020 - 6/30/2021	100,000
7/1/2021 - 6/30/2022	—
7/1/2022 - 6/30/2023	—
Thereafter	1,250,000
Total	15,352,321

The following tables summarize certain characteristics of our repurchase agreements and secured loans at June 30, 2018 and December 31, 2017.

June 30, 2018

\$ in thousands	Amount Outstanding	Percent of Total Amount Outstanding	MBS and GSE CRT Pledged as Collateral (1)
Repurchase Agreement Counterparties:			
HSBC	1,808,727	11.8 %	1,897,787
ING Financial Market	1,348,953	8.8 %	1,425,690
Royal Bank of Canada	1,024,743	6.7 %	1,232,629
E D & F Man Capital Markets	981,383	6.4 %	1,034,330
Industrial and Commercial Bank of China	964,543	6.3 %	1,018,444
Mirae Asset Securities	955,053	6.2 %	1,011,962
MUFG Securities	800,043	5.2 %	865,731
Citigroup	739,881	4.8 %	862,726
Amherst Pierpont Securities	534,560	3.5 %	563,108
KGS-Alpha Capital Markets	468,171	3.0 %	497,673
JP Morgan	433,950	2.8 %	505,625
South Street Securities	391,157	2.5 %	410,702
Societe Generale	373,836	2.4 %	471,416
Goldman Sachs	331,685	2.2 %	424,913
Mizuho Securities	285,212	1.9 %	302,605
BNP Paribas Securities	280,800	1.8 %	312,536
Guggenheim Liquidity Services	270,239	1.8 %	285,207
Natixis Securities	264,068	1.7 %	296,149
Bank of Nova Scotia	236,178	1.5 %	251,630
Wells Fargo Securities	218,878	1.4 %	263,463
All other counterparties (2)	990,261	6.6 %	1,120,124
Total Repurchase Agreement Counterparties	13,702,321	89.3 %	15,054,450
Secured Loans Counterparty:			
FHLBI	1,650,000	10.7 %	1,910,709
Total	15,352,321	100.0 %	16,965,159

Amount pledged as collateral is measured at fair value as described in Note 2 - "Summary of Significant

(1) Accounting Policies" included in the consolidated financial statements of our Annual Report on Form 10-K for the year ended December 31, 2017.

(2) Represents amounts outstanding with nine counterparties.

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December 31, 2017

\$ in thousands	Amount Outstanding	Percent of Total Amount Outstanding	MBS and GSE CRT Pledged as Collateral (1)
Repurchase Agreement Counterparties:			
HSBC	1,745,684	11.2 %	1,839,411
ING Financial Markets	1,482,603	9.4 %	1,571,061
Royal Bank of Canada	1,144,856	7.3 %	1,375,285
Industrial and Commercial Bank of China	1,038,844	6.6 %	1,102,543
E D & F Man Capital Markets	1,028,437	6.5 %	1,085,429
Mirae Asset Securities	958,756	6.1 %	1,018,664
MUFG Securities	865,201	5.5 %	936,071
Citigroup	724,094	4.6 %	841,977
Amherst Pierpont Securities	722,080	4.6 %	764,713
KGS-Alpha Capital Markets	461,098	2.9 %	491,313
JP Morgan	451,941	2.9 %	523,590
Societe Generale	386,737	2.5 %	495,093
BNP Paribas Securities	348,340	2.2 %	388,091
South Street Securities	332,623	2.1 %	354,689
Goldman Sachs	324,152	2.1 %	419,713
Mizuho Securities	310,835	2.0 %	330,555
Guggenheim Liquidity Services	306,081	1.9 %	322,452
Bank of Nova Scotia	289,705	1.8 %	301,715
Natixis Securities	275,764	1.8 %	302,291
All other counterparties (2)	882,970	5.5 %	1,058,759
Total Repurchase Agreement Counterparties	14,080,801	89.5 %	15,523,415
Secured Loans Counterparty:			
FHLBI	1,650,000	10.5 %	1,927,496
Total	15,730,801	100.0 %	17,450,911

Amount pledged as collateral is measured at fair value as described in Note 2 - "Summary of Significant (1) Accounting Policies" included in the consolidated financial statements of our Annual Report on Form 10-K for the year ended December 31, 2017.

(2) Represents amounts outstanding with seven counterparties.

**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 we maintain effective control of the financed assets. Repurchase agreements are subject to certain financial covenants. We were in compliance with these covenants at June 30, 2018.

Our repurchase agreement collateral ratio (MBS and GSE CRTs pledged as collateral/Amount Outstanding) was 110% as of June 30, 2018 (December 31, 2017: 110%).

**Secured Loans**

Our wholly-owned captive insurance 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 loans.

As of June 30, 2018, IAS Services LLC had \$1.65 billion in outstanding secured loans from the FHLBI. These secured loans have floating rates that are based on the three-month FHLB swap rate plus a spread. For the six months ended June 30, 2018, IAS Services LLC had weighted average borrowings of \$1.65 billion with a weighted average

borrowing rate of 1.87% and a weighted average maturity of 5.9 years.

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The Federal Housing Finance Agency's ("FHFA") final rule governing Federal Home Loan Bank membership (the "FHFA Rule") became effective on February 19, 2016. The FHFA Rule permits existing captive insurance companies, such as IAS Services LLC, to remain members until February 2021. New advances or renewals that mature after February 2021 are prohibited. The FHLBI has indicated it will honor the contractual maturity dates of existing advances to IAS Services LLC that were made prior to February 19, 2016 and extend beyond February 2021. We do not expect there to be any impact to our existing FHLBI borrowings under the FHFA rule. The ability to borrow from the FHLBI is subject to our continued creditworthiness, pledging of sufficient eligible collateral to secure advances, and compliance with certain agreements with FHLBI and FHFA rules.

As discussed in Note 6 - "Other Assets," 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 loans from the FHLBI.

Exchangeable Senior Notes

In 2013, our wholly-owned subsidiary, IAS Operating Partnership LP, issued \$400 million in aggregate principal amount of Exchangeable Senior Notes (the "Notes") due March 15, 2018. We retired a portion of the Notes prior to their maturity and fully retired the Notes upon their maturity on March 15, 2018. We did not incur a loss on retirement of the Notes in the three months ended June 30, 2018. In the three months ended June 30, 2017, we retired \$31.2 million of the Notes for a repurchase price of \$31.6 million. In the six months ended June 30, 2018, we retired \$143.4 million (2017: \$181.2 million) of the Notes for a repurchase price of \$143.4 million (2017: \$185.4 million). Accrued interest payable on the Notes was approximately \$2.1 million as of December 31, 2017.

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## Note 8 - Collateral Positions

The following table summarizes the fair value of collateral that we have pledged and held under our repurchase agreements, secured loans, interest rate swaps, futures contracts and currency forward contracts as of June 30, 2018 and December 31, 2017. Refer to Note 2 - "Summary of Significant Accounting Policies - Fair Value Measurements" of our consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2017 for a description of how we determine fair value. RMBS, CMBS and GSE CRT collateral pledged is included in mortgage-backed and credit risk transfer securities on our condensed consolidated balance sheets. Cash collateral pledged on secured loans, bilateral interest rate swaps and currency forward contracts is classified as restricted cash on our condensed consolidated balance sheets. Cash collateral pledged on futures contracts is classified as due from counterparties on our condensed consolidated balance sheets.

Cash collateral held on bilateral swaps that is not restricted for use is included in cash and cash equivalents on our condensed consolidated balance sheets and the liability to return the collateral is included in collateral held payable. Non-cash collateral held is only recognized if the counterparty defaults or if we sell the pledged collateral. As of June 30, 2018 and December 31, 2017, we did not recognize any non-cash collateral held.

\$ in thousands	As of	
	June 30, 2018	December 31, 2017
Collateral Pledged		
Repurchase Agreements:		
Agency RMBS	11,166,220	11,788,765
Agency CMBS	140,714	—
Non-Agency CMBS	1,809,084	853,446
Non-Agency RMBS	1,130,621	1,737,831
GSE CRT	807,811	1,143,373
Total repurchase agreements collateral pledged	15,054,450	15,523,415
Secured Loans:		
Agency RMBS	642,808	623,181
Non-Agency CMBS	1,267,901	1,304,315
Total secured loans collateral pledged	1,910,709	1,927,496
Interest Rate Swaps, Futures Contracts and Currency Forward Contracts:		
Agency RMBS <sup>(1)</sup>	82,778	109,900
Cash	7,255	620
Total interest rate swaps, futures contracts and currency forward contracts collateral pledged	90,033	110,520
Total:		
Mortgage-backed and credit risk transfer securities	17,047,937	17,560,811
Cash	7,255	620
Total collateral pledged	17,055,192	17,561,431
Collateral Held	June 30, 2018	December 31, 2017
Interest Rate Swaps:		
Cash	39,748	7,327
Total collateral held	39,748	7,327

During the first quarter of 2018, we determined that the amount disclosed as Agency RMBS collateral pledged on our interest rate swaps was understated by \$86.2 million in our report on Form 10-K as of December 31, 2017. We (1) concluded that the error in the amount disclosed was immaterial. We have revised the total amount of pledged securities disclosed parenthetically on our condensed consolidated balance sheet as of December 31, 2017 presented in this report on Form 10-Q and within the table above.





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### Repurchase Agreements

Collateral pledged with our repurchase agreement counterparties is segregated in our books and records. The repurchase agreement counterparties have the right to resell and repledge the collateral posted but have the obligation to return the pledged collateral, or substantially the same collateral if agreed to by us, upon maturity of the repurchase agreement. Under the repurchase agreements, the respective lender retains the contractual right to mark the underlying collateral to fair value as determined by a pricing service agreed to by the respective lender and us. We would be required to provide additional collateral or fund margin calls if the value of pledged assets declined. We intend to maintain a level of liquidity that will enable us to meet margin calls.

### Secured Loans

The ability to borrow from the FHLBI is subject to our continued creditworthiness, pledging of sufficient eligible collateral to secure advances, and compliance with certain agreements with FHLBI and FHFA rules. Collateral pledged with the FHLBI is held in trust for the benefit of the FHLBI and is not commingled with our other assets. The FHLBI does not have the right to resell or repledge collateral posted unless an event of default occurs. The FHLBI retains the right to mark the underlying collateral for FHLBI advances to fair value as determined by the FHLBI in its sole discretion. IAS Services LLC would be required to provide additional collateral or fund margin calls if the value of pledged assets declines.

### Interest Rate Swaps

Collateral pledged with our interest rate swap counterparties is segregated in our books and records. We have two types of interest rate swap agreements: bilateral interest rate swaps that are governed by an International Swaps and Derivatives Association ("ISDA") agreement and interest rate swaps that are centrally cleared by a registered clearing organization such as the Chicago Mercantile Exchange ("CME") and LCH. Clearnet Limited ("LCH") through a Futures Commission Merchant ("FCM"). Interest rate swaps that are governed by an ISDA agreement provide for bilateral collateral pledging based on the counterparties' market value. The counterparties have the right to repledge the collateral posted, but have the obligation to return the pledged collateral, or substantially the same collateral, if agreed to by us, as the market value of the interest rate swaps change.

We are required to pledge initial margin and daily variation margin for our interest rate swaps that are centrally cleared. The FCM determines the fair value of our centrally cleared swaps, including daily variation margin. The daily variation margin payment for centrally cleared interest rate swaps is characterized as settlement of the derivative itself rather than collateral. Accordingly, cash collateral pledged on our centrally cleared interest rate swaps is settled against the fair value of these swaps.

### Futures Contracts

We are required to pledge initial margin and daily variation margin for our futures contracts that is based on the fair value of our contracts as determined by our FCM. The daily variation margin payment for our futures contracts is characterized as settlement of the futures contract itself rather than collateral. Accordingly, cash collateral pledged on our futures contracts is settled against the fair value of these contracts.

### Currency Forward Contracts

Collateral pledged with our currency forward counterparty is segregated in our books and records. Eligible collateral to be pledged can be in the form of cash or securities. Our currency forward contract provides for bilateral collateral pledging based on the counterparties' market value. The counterparties have the right to repledge the collateral posted, but have the obligation to return the pledged collateral, or substantially the same collateral, if agreed to by us, as the market value of the currency forward contracts change.



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## Note 9 – Derivatives and Hedging Activities

The following table summarizes changes in the notional amount of our derivative instruments during 2018:

\$ in thousands	Notional Amount as of December 31, 2017	Additions	Settlement, Termination, Expiration or Exercise	Notional Amount as of June 30, 2018
Interest Rate Swaps <sup>(1)</sup> <sup>(2)</sup>	8,620,000	1,500,000	(1,250,000 )	8,870,000
Futures Contracts	—	715,000	(430,000 )	285,000
Currency Forward Contracts	76,859	156,754	(156,159 )	77,454
Credit Derivatives	553,493	—	(11,683 )	541,810
Total	9,250,352	2,371,754	(1,847,842 )	9,774,264

(1) Notional amount as of June 30, 2018 excludes \$1.6 billion of interest rate swaps with forward start dates.

(2) Notional amount as of December 31, 2017 excludes \$500.0 million of interest rate swaps with forward start dates.

## Interest Rate Swaps

Our repurchase agreements are usually settled on a short-term basis ranging from one to twelve months. At each settlement date, we typically refinance each repurchase agreement at the market interest rate at that time. In addition, our secured loans have floating interest rates. As such, we are exposed to changing interest rates. Our objectives in using interest rate derivatives are to add stability to interest expense and to manage our exposures to interest rate movements. To accomplish these objectives, we primarily use interest rate swaps as part of our interest rate risk management strategy. Interest rate swaps involve making fixed-rate payments to a counterparty in exchange for the receipt of variable-rate amounts over the life of the agreements without exchange of the underlying notional amount. Amounts recorded in accumulated other comprehensive income ("AOCI") before we discontinued cash flow hedge accounting for our interest rate swaps 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. We reclassified \$6.9 million as a decrease (June 30, 2017: \$6.4 million as a decrease) and \$13.4 million as a decrease (June 30, 2017: \$12.7 million as a decrease) to interest expense for the three and six months ended June 30, 2018, respectively. During the next 12 months, we estimate that \$24.2 million will be reclassified as a decrease to interest expense, repurchase agreements. As of June 30, 2018, \$110.6 million (December 31, 2017: \$123.9 million) of unrealized gains on discontinued cash flow hedges, net are still included in accumulated other comprehensive income and will be reclassified to interest expense over a period of time through December 15, 2023.

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As of June 30, 2018, we had the following interest rate swaps outstanding:

\$ in thousands	Index	Notional	Maturity Date	Fixed Interest Rate in Contract	
Counterparty					
CME Central Clearing	1-month LIBOR	300,000	2/5/2021	2.50	%
CME Central Clearing	1-month LIBOR	300,000	2/5/2021	2.69	%
Wells Fargo Bank, N.A.	1-month LIBOR	200,000	3/15/2021	3.14	%
CME Central Clearing	3-month LIBOR	500,000	5/24/2021	2.25	%
Citibank, N.A.	1-month LIBOR	200,000	5/25/2021	2.83	%
CME Central Clearing	3-month LIBOR	500,000	6/24/2021	2.44	%
HSBC Bank USA, National Association	1-month LIBOR	550,000	2/24/2022	2.45	%
CME Central Clearing	3-month LIBOR	1,000,000	6/9/2022	2.21	%
CME Central Clearing	3-month LIBOR	1,000,000	8/14/2022	1.87	%
The Royal Bank of Scotland Plc	1-month LIBOR	500,000	8/15/2023	1.98	%
CME Central Clearing	1-month LIBOR	600,000	8/24/2023	2.88	%
HSBC Bank USA, National Association	1-month LIBOR	500,000	12/15/2023	2.20	%
CME Central Clearing	3-month LIBOR	450,000	1/12/2024	2.10	%
CME Central Clearing	3-month LIBOR	450,000	1/25/2024	2.15	%
LCH Central Clearing	3-month LIBOR	1,000,000	2/6/2025	2.77	%
CME Central Clearing	3-month LIBOR	100,000	4/2/2025	2.04	%
LCH Central Clearing	3-month LIBOR	220,000	8/31/2027	2.12	%
CME Central Clearing	3-month LIBOR	250,000	5/24/2028	2.78	%
CME Central Clearing	3-month LIBOR	250,000	5/24/2028	2.39	%
Total		8,870,000		2.37	%

As of June 30, 2018, we had the following additional interest rate swaps outstanding with forward start dates:

\$ in thousands	Index	Notional	Maturity Date	Fixed Interest Rate in Contract	
Counterparty					
LCH Central Clearing (1)	3-month LIBOR	600,000	2/5/2026	2.64	%
LCH Central Clearing (2)	1-month LIBOR	200,000	7/3/2028	2.78	%
LCH Central Clearing (3)	3-month LIBOR	200,000	3/17/2031	2.74	%
LCH Central Clearing (4)	1-month LIBOR	600,000	8/24/2033	3.18	%
Total		1,600,000		2.87	%

(1) Forward start date of 2/5/2021

(2) Forward start date of 7/2/2018

(3) Forward start date of 3/15/2021

(4) Forward start date of 8/24/2023

Refer to Note 8 - "Collateral Positions" for further information regarding our collateral pledged to and received from our interest rate swap counterparties.

#### Futures and Currency Forward Contracts

We purchase or sell U.S. Treasury futures contracts to help mitigate the potential impact of changes in interest rates on the performance of our investment portfolio. We recognize realized and unrealized gains and losses associated with the purchases or sales of U.S. Treasury futures contracts in gain (loss) on derivative instruments, net in our condensed consolidated statements of operations.

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. We recognize realized and unrealized gains and losses associated with the purchases or sales of currency forward contracts in gain (loss) on derivative instruments, net in our condensed consolidated statements of operations. As of June 30, 2018, we have \$50.8 million (December 31, 2017: \$49.7 million) of notional amount of forward contracts denominated in Pound Sterling and \$26.7 million (December 31, 2017: \$27.2 million) of notional amount of forward contracts denominated in Euro.



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Credit Derivatives

Our GSE CRTs purchased prior to August 24, 2015 are accounted for as hybrid financial instruments consisting of a debt host contract and an embedded credit derivative. Embedded derivatives associated with GSE CRTs are recorded within mortgage-backed and credit risk transfer securities, at fair value, on the condensed consolidated balance sheets. At June 30, 2018 and December 31, 2017, terms of the GSE CRT embedded derivatives are:

	June 30, December	
\$ in thousands	2018	31, 2017
Fair value amount	38,029	45,400
Notional amount	541,810	553,493
Maximum potential amount of future undiscounted payments	541,810	553,493

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

The table below presents the fair value of our derivative financial instruments, as well as their classification on the condensed consolidated balance sheets as of June 30, 2018 and December 31, 2017.

\$ in thousands		Derivative Liabilities			
Derivative Assets	As of June 30, 2018	As of December 31, 2017	As of June 30, 2018	As of December 31, 2017	
Balance Sheet	Fair Value	Fair Value	Balance Sheet	Fair Value	Fair Value
Interest Rate Swaps Asset	44,122	6,896	Interest Rate Swaps Liability	3,415	31,548
Currency Forward Contracts	3,387	—	Currency Forward Contracts	—	1,217
			Futures Contracts	2,656	—

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

The tables below present the effect of our credit derivatives on the condensed consolidated statements of operations for the three and six months ended June 30, 2018 and 2017.

\$ in thousands		Three months ended June 30, 2018		
Derivative not designated as hedging instrument	GSE CRT Realized embedded gain. derivative (loss), coupon net interest	Unrealized gain (loss), net	Realized and unrealized credit derivative income (loss), net	
GSE CRT Embedded Derivatives	-5,638	(4,903 )	735	

\$ in thousands		Three months ended June 30, 2017		
Derivative not designated as hedging instrument	GSE CRT Realized embedded gain. derivative (loss), coupon net interest	Unrealized gain (loss), net	Realized and unrealized credit derivative income (loss), net	
GSE CRT Embedded Derivatives	-5,844	15,559	21,403	

\$ in thousands		Six months ended June 30, 2018		
Derivative not designated as hedging instrument	GSE CRT Realized embedded gain	Unrealized gain	Realized and	

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hedging instrument	(loss), net	unrealized
	derivative (loss), net	credit
	coupon	derivative
	interest	income
		(loss), net
GSE CRT Embedded Derivatives	-11,271 (7,371 )	3,900

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\$ in thousands	Six months ended June 30, 2017			
	Realized gain (loss), net	GSE CRT Embedded Derivative Coupon Interest	Unrealized gain (loss), net	Realized and unrealized credit derivative income (loss), net
Derivative not designated as hedging instrument				
GSE CRT Embedded Derivatives	-1,651	29,707		41,358

The following table summarizes the effect of interest rate swaps, futures contracts and currency forward contracts reported in gain (loss) on derivative instruments, net on the condensed consolidated statements of operations for the three and six months ended June 30, 2018 and 2017:

\$ in thousands	Three Months Ended June 30, 2018			
	Realized gain (loss) on derivative instruments, net	Contractual net interest expense	Unrealized gain (loss), net	Gain (loss) on derivative instruments, net
Derivative not designated as hedging instrument				
Interest Rate Swaps	34,273	(4,511 )	32,985	62,747
Futures Contracts	640	—	(1,044 )	(404 )
Currency Forward Contracts	1,361	—	3,465	4,826
Total	36,274	(4,511 )	35,406	67,169

\$ in thousands	Three Months Ended June 30, 2017			
	Realized gain (loss) on derivative instruments, net	Contractual net interest expense	Unrealized gain (loss), net	Gain (loss) on derivative instruments, net
Derivative not designated as hedging instrument				
Interest Rate Swaps	(38,512)	(19,966 )	7,975	(50,503 )
Currency Forward Contracts	(1,717 )	—	(1,293 )	(3,010 )
Total	(40,229)	(19,966 )	6,682	(53,513 )

\$ in thousands	Six Months Ended June 30, 2018			
	Realized gain (loss) on derivative instruments, net	Contractual net interest expense	Unrealized gain (loss), net	Gain (loss) on derivative instruments, net
Derivative not designated as hedging instrument				
Interest Rate Swaps	156,546	(16,623 )	65,359	205,282
Futures Contracts	(4,637 )	—	(2,656 )	(7,293 )
Currency Forward Contracts	(2,057 )	—	4,604	2,547
Total	149,852	(16,623 )	67,307	200,536

\$ in thousands Six Months Ended June 30, 2017

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Derivative not designated as hedging instrument	Realized gain (loss) on derivative instruments, net	Contractual net interest expense	Unrealized gain (loss), net	Gain (loss) on derivative instruments, net
Interest Rate Swaps	(22,518)	(42,860 )	20,925	(44,453 )
Currency Forward Contracts	(2,793 )	—	(805 )	(3,598 )
Total	(25,311)	(42,860 )	20,120	(48,051 )

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## Credit-risk-related Contingent Features

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

At June 30, 2018, the fair value of derivatives in a net liability position, which includes accrued interest but excludes any adjustment for non-performance risk related to bilateral interest rate swap agreements, was \$3.5 million. We have minimum collateral posting thresholds with certain of our derivative counterparties and have pledged collateral of \$5.3 million of Agency RMBS as of June 30, 2018 related to bilateral interest rate swap agreements. If we had breached any of these provisions at June 30, 2018, we could have been required to settle our obligations under these agreements at their termination value.

We also have an agreement with a clearing counterparty for our interest rate swaps that includes cross default provisions. The fair value of our centrally cleared interest rate derivative contracts, which includes accrued interest and variation margin but excludes any adjustment for non-performance risk, was a net asset of \$6.7 million as of June 30, 2018.

We were in compliance with all of the financial provisions of these counterparty agreements as of June 30, 2018.

## Note 10 – Offsetting Assets and Liabilities

Certain of our repurchase agreements and derivative transactions are governed by underlying agreements that generally provide for a right of offset 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 our condensed consolidated balance sheets at June 30, 2018 and December 31, 2017. The daily variation margin payment for centrally cleared interest rate swaps is characterized as settlement of the derivative itself rather than collateral. As of June 30, 2018, our derivative asset of \$6.7 million (December 31, 2017: derivative liability of \$10.3 million) related to centrally cleared interest rate swaps is not included in the table below as a result of this characterization of daily variation margin.

## Offsetting of Derivative Assets

As of June 30, 2018

\$ 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		Net Amount
				Financial Instruments	Collateral Received	
Derivatives <sup>(1)</sup> <sup>(3)</sup>	40,773	—	40,773	—	(39,389)	1,384

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As of June 30, 2018

\$ 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 <sup>(2)</sup>	Cash Collateral Pledged	Net Amount
Derivatives <sup>(3)</sup>	6,071	—	6,071	(3,415	) (2,656	) —
Repurchase Agreements <sup>(4)</sup>	13,702,321	—	13,702,321	(13,702,321	) —	—
Secured Loans <sup>(5)</sup>	1,650,000	—	1,650,000	(1,650,000	) —	—
Total	15,358,392	—	15,358,392	(15,355,736	) (2,656	) —

Offsetting of Derivative Assets  
As of December 31, 2017

\$ 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	Cash Collateral Pledged	Net Amount
Derivatives <sup>(1)(3)</sup>	6,896	—	6,896	— (6,896	) —	—

Offsetting of Derivative Liabilities and Repurchase Agreements  
As of December 31, 2017

\$ 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 <sup>(2)</sup>	Cash Collateral Pledged	Net Amount
Derivatives <sup>(3)</sup>	22,445	—	22,445	(21,169	) (620	) 656
Repurchase Agreements <sup>(4)</sup>	14,080,801	—	14,080,801	(14,080,801	) —	—
Secured Loans <sup>(5)</sup>	1,650,000	—	1,650,000	(1,650,000	) —	—
Total	15,753,246	—	15,753,246	(15,751,970	) (620	) 656



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- (1) Amounts represent derivatives in an asset position which could potentially be offset against derivatives in a liability position at June 30, 2018 and December 31, 2017, 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 our derivatives was \$82.8 million (December 31, 2017: \$109.9 million) at June 30, 2018, of which \$77.4 million (December 31, 2017: \$86.2 million) relates to initial margin pledged on centrally cleared interest rate swaps. Centrally cleared interest rate swaps are excluded from the tables above. Cash collateral received on our derivatives was \$39.7 million and \$7.3 million at June 30, 2018 and December 31, 2017, respectively.
- (3) Cash collateral pledged by us on our futures contracts and currency forward contracts were \$7.3 million and \$620,000 at June 30, 2018 and December 31, 2017, respectively. Cash collateral pledged on our centrally cleared interest rate swaps is settled against the fair value of these swaps and therefore excluded from the tables above at June 30, 2018 and December 31, 2017, respectively.
- (4) The fair value of securities pledged against our borrowing under repurchase agreements was \$15.1 billion and \$15.5 billion at June 30, 2018 and December 31, 2017, respectively.
- (5) The fair value of securities pledged against IAS Services LLC's borrowings under secured loans was \$1.9 billion at June 30, 2018 and December 31, 2017, respectively.

## Note 11 – 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 our 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.

The following tables present our assets and liabilities measured at fair value on a recurring basis.

\$ in thousands	June 30, 2018				Total at Fair Value
	Level 1	Level 2	Level 3	Using: NAV as a practical expedient (3)	
Assets:					
Mortgage-backed and credit risk transfer securities <sup>(1)(2)</sup>	—	17,545,158	38,029	—	17,583,187
Derivative assets	—	47,509	—	—	47,509
Other assets <sup>(4)</sup>	3,962	—	—	28,997	32,959
Total assets	3,962	17,592,667	38,029	28,997	17,663,655
Liabilities:					
Derivative liabilities	2,656	3,415	—	—	6,071
Total liabilities	2,656	3,415	—	—	6,071

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\$ in thousands	December 31, 2017				
	Fair Value Measurements Using:				Total at Fair Value
	Level 1	Level 2	Level 3	NAV as a practical expedient (3)	
<b>Assets:</b>					
Mortgage-backed and credit risk transfer securities <sup>(1)(2)</sup>	—	18,145,354	45,400	—	18,190,754
Derivative assets	—	6,896	—	—	6,896
Other assets <sup>(4)</sup>	3,979	—	—	25,972	29,951
<b>Total assets</b>	<b>3,979</b>	<b>18,152,250</b>	<b>45,400</b>	<b>25,972</b>	<b>18,227,601</b>
<b>Liabilities:</b>					
Derivative liabilities	—	32,765	—	—	32,765
<b>Total liabilities</b>	<b>—</b>	<b>32,765</b>	<b>—</b>	<b>—</b>	<b>32,765</b>

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

Our GSE CRTs purchased prior to August 24, 2015 are accounted for as hybrid financial instruments with an embedded derivative. The hybrid financial instruments consist of debt host contracts classified as Level 2 and embedded derivatives classified as Level 3. As of June 30, 2018, the net embedded derivative asset position of \$38.0 million includes \$39.4 million of embedded derivatives in an asset position and \$1.4 million of embedded derivatives in a liability position. As of December 31, 2017, the net embedded derivative asset position of \$45.4 million includes \$46.5 million of embedded derivatives in an asset position and \$1.1 million of embedded derivatives in a liability position.

Investments in unconsolidated ventures are valued using the net asset value ("NAV") as a practical expedient and are not subject to redemption, although investors may sell or transfer their interest at the approval of the general partner of the underlying funds. As of June 30, 2018 and December 31, 2017, the weighted average remaining term of investments in unconsolidated ventures is 2.2 and 1.9 years, respectively.

(4) Includes \$4.0 million and \$4.0 million of investment in an exchange-traded fund as of June 30, 2018 and December 31, 2017, respectively.

The following table shows a reconciliation of the beginning and ending fair value measurements of our GSE CRT embedded derivatives, which we have valued utilizing Level 3 inputs:

\$ in thousands	Three Months		Six Months	
	Ended June 30, 2018	Ended June 30, 2017	Ended June 30, 2018	Ended June 30, 2017
Beginning balance	42,932	31,243	45,400	17,095
Unrealized credit derivative gains (losses), net	(4,903)	15,559	(7,371)	29,707
Ending balance	38,029	46,802	38,029	46,802

The following tables summarize significant unobservable inputs used in the fair value measurement of our GSE CRT embedded derivatives:

\$ in thousands	Fair Value at June 30, 2018	Valuation Technique	Unobservable Input	Range	Weighted
					Average
GSE CRT Embedded Derivatives	38,029	Market Comparables, Vendor Pricing Valuation	Weighted average life Unobservable	2.8 - 6.4 years	4.6 years Weighted

\$ in thousands	Fair Value at December 31, 2017	Technique	Input	Range	Average
GSE CRT Embedded Derivatives	45,400	Market Comparables, Vendor Pricing	Weighted average life	2.6 - 6.8 years	4.8 years

These significant unobservable inputs change according to market conditions and security performance. We estimate the weighted average life of GSE CRTs in order to identify GSE corporate debt with a similar maturity. We obtain our weighted average life estimates from a third party provider. Although weighted average life is a significant input, changes in weighted average life may not have an explicit directional impact on the fair value measurement.



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The following table presents the carrying value and estimated fair value of our financial instruments that are not carried at fair value on the condensed consolidated balance sheets at June 30, 2018 and December 31, 2017:

\$ in thousands	June 30, 2018		December 31, 2017	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
<b>Financial Assets</b>				
Commercial loans, held-for-investment	127,607	127,770	191,808	191,930
Other assets	74,250	74,250	74,250	74,250
<b>Total</b>	<b>201,857</b>	<b>202,020</b>	<b>266,058</b>	<b>266,180</b>
<b>Financial Liabilities</b>				
Repurchase agreements	13,702,321	13,702,411	14,080,801	14,080,460
Secured loans	1,650,000	1,650,000	1,650,000	1,650,000
Exchangeable senior notes	—	—	143,231	143,948
<b>Total</b>	<b>15,352,321</b>	<b>15,352,411</b>	<b>15,874,032</b>	<b>15,874,408</b>

The following describes our methods for estimating the fair value for financial instruments.

The estimated fair value of commercial loans held-for-investment is a Level 3 fair value measurement. Subsequent to the origination or purchase, commercial loan investments are valued on a monthly basis by an independent third party valuation agent using a discounted cash flow technique.

The estimated fair value of FHLBI stock, included in "Other assets," 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 estimated 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 we determined best reflect current market interest rates that would be offered for repurchase agreements with similar characteristics and credit quality. The estimated 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 and the spread is typically consistent with those demanded in the market. Accordingly, the interest rates on these secured loans are at market, and thus the carrying amount approximates fair value.

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

#### Note 12 – Related Party Transactions

Under the terms of our management agreement, our Manager and its affiliates provide us with our management team, including our officers and appropriate support personnel. Each of our officers is an employee of our Manager or one of its affiliates. We do not have any employees. Our Manager is not obligated to dedicate any of its employees exclusively to us, nor is our Manager obligated to dedicate any specific portion of time to our business. During the three and six months ended June 30, 2018, we reimbursed our Manager \$217,000 (June 30, 2017: \$202,000) and \$431,000 (June 30, 2017: \$387,000), respectively, for costs of support personnel that are fully dedicated to our business.

We have invested \$24.2 million as of June 30, 2018 (December 31, 2017: \$74.4 million) in money market or mutual funds managed by affiliates of our Manager. The investments are reported as cash and cash equivalents on our condensed consolidated balance sheets.

#### Management Fee Expense

We pay our Manager a management fee equal to 1.50% of our stockholders' equity per annum. The fee is calculated and payable quarterly in arrears. For purposes of calculating the management fee, stockholders' equity is equal to the sum of the net proceeds from all issuances of equity securities since inception including proceeds from the issuance of operating partnership units to an affiliate of our Manager, plus retained earnings at the end of the most recently completed calendar quarter (without taking into account any non-cash equity compensation expense incurred in current or prior periods), less any amount paid to repurchase common stock since inception. Stockholder's equity

excludes (i) any unrealized gains, losses or other items that do not affect realized net income (regardless of whether such items are included in other comprehensive income or loss, or in net income); (ii) cumulative net realized losses that are not attributable to permanently impaired investments and that relate to the investments for which market movement is accounted for in other comprehensive income; provided, however, that such adjustment shall not exceed cumulative unrealized net gains in other comprehensive income; (iii) one-time events pursuant to

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changes in U.S. GAAP; and (iv) certain non-cash items after discussions between our Manager and our independent directors and approval by a majority of our independent directors.

We do not pay any management fees on our investments in unconsolidated ventures that are managed by an affiliate of our Manager.

**Expense Reimbursement**

We are required to reimburse our Manager for our operating expenses incurred on our behalf, including directors and officers insurance, accounting services, auditing and tax services, filing fees, and miscellaneous general and administrative costs. Our reimbursement obligation is not subject to any dollar limitation.

The following table summarizes the costs incurred on our behalf by our Manager for the three and six months ended June 30, 2018 and 2017.

	Three Months Ended June 30,		Six Months Ended June 30,	
\$ in thousands	2018	2017	2018	2017
Incurring costs, prepaid or expensed	1,300	1,249	2,792	2,794
Incurring costs, charged against equity as a cost of raising capital	2	—	167	—
Total incurred costs, originally paid by our Manager	1,302	1,249	2,959	2,794

**Termination Fee**

If we terminate our management agreement, we owe our Manager a termination fee equal to three times the sum of our average annual management fee during the 24-month period before termination, calculated as of the end of the most recently completed fiscal quarter.

**Note 13 – Stockholders' Equity****Preferred Stock**

Holders of our 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. Dividends are cumulative and payable quarterly in arrears.

Holders of our 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.

In August 2017, we completed a public offering of 11,500,000 shares of 7.50% Fixed-to-Floating Series C Cumulative Redeemable Preferred Stock at the price of \$25.00 per share. Holders of our Series C Preferred Stock are entitled to receive dividends at an annual rate of 7.50% of the liquidation preference of \$25.00 per share or \$1.875 per share per annum until September 27, 2027. After September 27, 2027, holders are entitled to receive dividends at a floating rate equal to three-month LIBOR plus a spread of 5.289% of the \$25.00 liquidation preference per annum. Dividends are cumulative and payable quarterly in arrears.

As of July 27, 2017, we had the option to redeem shares of Series A Preferred Stock for \$25.00 per share, plus any accumulated and unpaid dividends through the date of redemption. We have the option to redeem shares of Series B Preferred Stock after December 27, 2024 and shares of Series C Preferred Stock after September 27, 2027 for \$25.00 per share, plus any accumulated and unpaid dividends through the date of the redemption. Shares of Series B and Series C Preferred Stock 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 our qualification as a REIT or upon the occurrence of a change in control.

**Common Stock**

In December 2017, we entered into an equity distribution agreement with a placement agent under which we may sell up to 17,000,000 shares of our common stock from time to time in at-the-market or privately negotiated transactions. These shares are registered with the SEC under our automatic shelf registration statement (as amended and/or

supplemented). As of June 30, 2018, we have not sold any shares of common stock under the equity distribution agreement.

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## 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 units ("OP Units") for cash equal to the market value of an equivalent number of shares of common stock, or at our option, we may purchase their OP Units by issuing one share of common stock for each OP Unit redeemed. We also have an equity incentive plan which allows us to grant securities convertible into our common stock to our independent directors and employees of our Manager and its affiliates.

## Share Repurchase Program

During the three and six months ended June 30, 2018 and 2017, we did not repurchase any shares of our common stock. As of June 30, 2018, we had authority to purchase 18,239,082 shares of our common stock through our share repurchase program. The share repurchase program has no stated expiration date.

## Share-Based Compensation

We established the 2009 Equity Incentive Plan for grants of common stock and other equity based awards to our independent directors and officers and employees of our Manager and its affiliates (the "Incentive Plan"). Under the Incentive Plan, a total of 1,000,000 shares of common stock are authorized for issuance. Unless terminated earlier, the Incentive Plan will terminate in 2019, but will continue to govern the unexpired awards. As of June 30, 2018, 771,823 shares of common stock remain available for future issuance under the Incentive Plan.

We recognized compensation expense of approximately \$106,000 (June 30, 2017: \$112,000) and approximately \$199,000 (June 30, 2017: \$197,000) for shares issued to our independent directors under the Incentive Plan for the three and six months ended June 30, 2018. During the three months ended June 30, 2018 and 2017, we issued 6,465 shares and 5,292 shares of common stock, respectively, to our independent directors. During the six months ended June 30, 2018 and 2017, we issued 13,642 shares and 10,748 shares of common stock, respectively, to our independent directors. The fair market value of the shares granted was determined by the closing stock market price on the date of the grant. The grants vested immediately.

We recognized compensation expense of approximately \$30,000 (June 30, 2017: \$35,000) and approximately \$44,000 (June 30, 2017: \$66,000) for the three and six months ended June 30, 2018 for restricted stock units awarded to employees of our Manager and its affiliates under the Incentive Plan. Our Manager reimburses us for the cost of these restricted stock awards under the terms of our management agreement. At June 30, 2018 there was approximately \$276,000 of total unrecognized compensation cost related to restricted stock unit awards that is expected to be recognized over a period of up to 45 months, with a weighted-average remaining vesting period of 20 months.

The following table summarizes the activity related to restricted stock units awarded to employees of our Manager and its affiliates for the three and six months ended June 30, 2018.

	Three Months Ended June 30, 2018		Six Months Ended June 30, 2018	
	Restricted Stock Units	Weighted Average Grant Date Fair Value <sup>(1)</sup>	Restricted Stock Units	Weighted Average Grant Date Fair Value <sup>(1)</sup>
Unvested at the beginning of the period	19,185	\$ 14.56	19,827	\$ 14.35
Shares granted during the period	—	—	7,055	15.37
Shares vested during the period	—	—	(7,697)	14.75
Unvested at the end of the period	19,185	\$ 14.56	19,185	\$ 14.56

(1) The grant date fair value of restricted stock awards is based on the closing market price of our common stock at the grant date.



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## Accumulated Other Comprehensive Income

The following tables present the components of total other comprehensive income (loss), net and accumulated other comprehensive income ("AOCI") for the three and six months ended June 30, 2018 and 2017. The tables exclude gains and losses on MBS and GSE CRTs that are accounted for under the fair value option.

\$ in thousands	Three Months Ended June 30, 2018			Total
	Equity method investments	Available-for-sale securities	Derivatives and hedging	
Total other comprehensive income/(loss)				
Unrealized gain (loss) on mortgage-backed and credit risk transfer securities, net	—	(47,929 )	—	(47,929 )
Reclassification of unrealized (gain) loss on sale of mortgage-backed and credit risk transfer securities to gain (loss) on investments, net	—	9,889	—	9,889
Reclassification of amortization of net deferred (gain) loss on de-designated interest rate swaps to repurchase agreements interest expense	—	—	(6,898 )	(6,898 )
Currency translation adjustments on investment in unconsolidated venture	486	—	—	486
Total other comprehensive income/(loss)	486	(38,040 )	(6,898 )	(44,452 )
AOCI balance at beginning of period	1,255	14,660	117,437	133,352
Total other comprehensive income/(loss)	486	(38,040 )	(6,898 )	(44,452 )
Other comprehensive income/(loss) attributable to non-controlling interest	(5 )	479	87	561
AOCI balance at end of period	1,736	(22,901 )	110,626	89,461
\$ in thousands	Three Months Ended June 30, 2017			Total
	Equity method investments	Available-for-sale securities	Derivatives and hedging	
Total other comprehensive income/(loss)				
Unrealized gain (loss) on mortgage-backed and credit risk transfer securities, net	—	39,633	—	39,633
Reclassification of unrealized (gain) loss on sale of mortgage-backed and credit risk transfer securities to gain (loss) on investments, net	—	651	—	651
Reclassification of amortization of net deferred (gain) loss on de-designated interest rate swaps to repurchase agreements interest expense	—	—	(6,369 )	(6,369 )
Currency translation adjustments on investment in unconsolidated venture	139	—	—	139
Total other comprehensive income/(loss)	139	40,284	(6,369 )	34,054
AOCI balance at beginning of period	(512)	161,381	142,896	303,765
Total other comprehensive income/(loss)	139	40,284	(6,369 )	34,054
Other comprehensive income/(loss) attributable to non-controlling interest	(2 )	(508 )	81	(429 )
Rebalancing of ownership percentage of non-controlling interest	—	1	—	1
AOCI balance at end of period	(375)	201,158	136,608	337,391





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\$ in thousands	Six Months Ended June 30, 2018			
	Equity method investments	Available-for-sale securities	Derivatives and hedging	Total
Total other comprehensive income/(loss)				
Unrealized gain (loss) on mortgage-backed and credit risk transfer securities, net	—	(180,246 )	—	(180,246)
Reclassification of unrealized (gain) loss on sale of mortgage-backed and credit risk transfer securities to gain (loss) on investments, net	—	19,126	—	19,126
Reclassification of amortization of net deferred (gain) loss on de-designated interest rate swaps to repurchase agreements interest expense	—		(13,437 )	(13,437 )
Currency translation adjustments on investment in unconsolidated venture	798	—	—	798
Total other comprehensive income/(loss)	798	(161,120 )	(13,437 )	(173,759)
AOCI balance at beginning of period	947	136,188	123,894	261,029
Total other comprehensive income/(loss)	798	(161,120 )	(13,437 )	(173,759)
Other comprehensive income/(loss) attributable to non-controlling interest	(9 )	2,031	169	2,191
AOCI balance at end of period	1,736	(22,901 )	110,626	89,461
	Six Months Ended June 30, 2017			
\$ in thousands	Equity method investments	Available-for-sale securities	Derivatives and hedging	Total
Total other comprehensive income/(loss)				
Unrealized gain (loss) on mortgage-backed and credit risk transfer securities, net	—	55,922	—	55,922
Reclassification of unrealized (gain) loss on sale of mortgage-backed and credit risk transfer securities to gain (loss) on investments, net	—	1,501	—	1,501
Reclassification of amortization of net deferred (gain) loss on de-designated interest rate swaps to repurchase agreements interest expense	—	—	(12,667 )	(12,667 )
Currency translation adjustments on investment in unconsolidated venture	(476)	—	—	(476 )
Total other comprehensive income/(loss)	(476)	57,423	(12,667 )	44,280
AOCI balance at beginning of period	95	144,458	149,115	293,668
Total other comprehensive income/(loss)	(476)	57,423	(12,667 )	44,280
Other comprehensive income/(loss) attributable to non-controlling interest	6	(724 )	160	(558 )
Rebalancing of ownership percentage of non-controlling interest	—	1	—	1
AOCI balance at end of period	(375)	201,158	136,608	337,391

Amounts recorded in AOCI before we discontinued cash flow hedge accounting for our interest rate swaps 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 original life of the interest rate swap agreements.



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## Dividends

On June 15, 2018, we declared the following dividends:

a dividend of \$0.42 per share of common stock to be paid on July 26, 2018 to stockholders of record as of the close of business on June 27, 2018; and

a dividend of \$0.4844 per share of Series A Preferred Stock to be paid on July 25, 2018 to stockholders of record as of the close of business on July 1, 2018.

On May 2, 2018, we declared the following dividends:

a dividend of \$0.4844 per share of Series B Preferred Stock payable on June 27, 2018 to stockholders of record as of the close of business on June 5, 2018; and

a dividend of \$0.46875 per share of Series C Preferred Stock payable on June 27, 2018 to stockholders of record as of the close of business on June 5, 2018.

## Note 14 – Earnings per Common Share

Earnings per share for the three and six months ended June 30, 2018 and 2017 is computed as follows:

In thousands except per share amounts	Three Months		Six Months	
	Ended June 30, 2018	2017	Ended June 30, 2018	2017
Numerator (Income)				
Basic Earnings:				
Net income available to common stockholders	80,008	46,834	121,479	133,964
Effect of dilutive securities:				
Income allocated to exchangeable senior notes	—	3,504	1,621	8,512
Income allocated to non-controlling interest	1,163	670	1,834	1,856
Dilutive net income available to stockholders	81,171	51,008	124,934	144,332
Denominator (Weighted Average Shares)				
Basic Earnings:				
Shares available to common stockholders	111,641	111,608	111,635	111,603
Effect of dilutive securities:				
Restricted stock awards	19	20	19	20
Non-controlling interest OP units	1,425	1,425	1,425	1,425
Exchangeable senior notes	—	10,507	2,389	12,782
Dilutive Shares	113,085	123,560	115,468	125,830
Earnings per share:				
Net income attributable to common stockholders				
Basic	0.72	0.42	1.09	1.20
Diluted	0.72	0.41	1.08	1.15

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## Note 15 – Non-controlling Interest - Operating Partnership

Non-controlling interest represents the aggregate ownership interest of a wholly-owned Invesco subsidiary in our 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 or repurchase of common stock ("Share" or "Shares") or OP Units changes the percentage ownership of both the Unit Holders and the common stockholders. Since an OP unit is generally redeemable for cash or Shares at our option, it is deemed to be a Share equivalent. Therefore, such transactions are treated as capital transactions and result in a reallocation between stockholders' equity and non-controlling interest in the accompanying condensed consolidated balance sheets. As of June 30, 2018 and December 31, 2017, non-controlling interest related to the outstanding 1,425,000 OP Units represented a 1.3% interest in the Operating Partnership.

Income allocated to the non-controlling interest is based on the Unit Holders' ownership percentage of the Operating Partnership. 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, 2018 and 2017.

	Three Months Ended June 30,		Six Months Ended June 30,	
\$ in thousands	2018	2017	2018	2017
Net income allocated	1,163	670	1,834	1,856
Distributions paid	598	570	1,197	1,140

As of June 30, 2018 and December 31, 2017, distributions payable to the non-controlling interest were \$598,500 and \$598,500, respectively.

## Note 16 – Commitments and Contingencies

## Commitments and Contingencies

Commitments and contingencies may arise in the ordinary course of business. Our material off-balance sheet commitments as of June 30, 2018 are discussed below.

As discussed in Note 6 - "Other Assets", we have invested in unconsolidated ventures that are sponsored by an affiliate of our Manager. The unconsolidated ventures are structured as partnerships, and we invest 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, 2018 and December 31, 2017, our undrawn capital and purchase commitments were \$7.5 million and \$10.2 million, respectively.

As discussed in Note 5 - "Commercial Loans Held-for-Investment", we purchase and originate commercial loans. As of June 30, 2018 and December 31, 2017, we have unfunded commitments on commercial loans held-for-investment of \$2.7 million and \$4.8 million, respectively.

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

## Note 17 – Subsequent Events

We have 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.

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ITEM MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF  
2. 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 filed with the Securities and Exchange Commission (the “SEC”).

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, monetary policy actions of the Federal Reserve, including actions relating to its agency mortgage-backed securities portfolio and the continuation of re-investment of principal payments, 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 diluted common share;
- 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;
- 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;



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- 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, zoning, insurance, eminent domain and 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 adequacy of our disclosure controls and procedures and internal controls 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. 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 or a federally chartered corporation such as the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation (collectively “Agency RMBS”);
- Commercial mortgage-backed securities (“CMBS”) 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 or the Federal Home Loan Mortgage Corporation (collectively “Agency CMBS”);





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RMBS that are not guaranteed by a U.S. government agency (“non-Agency RMBS”);  
CMBS that are not guaranteed by a U.S. government agency (“non-Agency CMBS”);  
Credit risk transfer securities that are unsecured obligations issued by government-sponsored enterprises (“GSE CRT”);  
Residential and commercial mortgage loans; and  
Other real estate-related financing arrangements.

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. 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. We are externally managed and advised by Invesco Advisers, Inc., our Manager, which is an indirect, wholly-owned subsidiary of Invesco Ltd.

Capital Activities

On June 15, 2018, we declared the following dividends:

a dividend of \$0.42 per share of common stock to be paid on July 26, 2018 to stockholders of record as of the close of business on June 27, 2018; and

a dividend of \$0.4844 per share of Series A Preferred Stock to be paid on July 25, 2018 to stockholders of record as of the close of business on July 1, 2018.

On May 2, 2018, we declared the following dividends:

a dividend of \$0.4844 per share of Series B Preferred Stock payable on June 27, 2018 to stockholders of record as of the close of business on June 5, 2018; and

a dividend of \$0.46875 per share of Series C Preferred Stock payable on June 27, 2018 to stockholders of record as of the close of business on June 5, 2018.

During the six months ended June 30, 2018, we did not repurchase any shares of our common stock.

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. Our net interest income, which includes the amortization of purchase premiums 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. The market value of our assets can be impacted by credit spread premiums (yield advantage over U.S. Treasury notes) and the supply of, and demand for, target assets in which we invest.

Market Conditions

Macroeconomic factors that affect our business include credit spread premiums, market interest rates, governmental policy initiatives, residential and commercial real estate prices, credit availability, consumer personal income, corporate earnings, employment conditions, financial conditions and inflation.

Financial conditions improved during the second quarter of 2018, reflecting a rebound in equity markets and a decrease in volatility. The total return on the S&P 500 Index was 2.9% and the NASDAQ was 6.3% higher for the second quarter, while the CBOE SPX Volatility Index (VIX) decreased by 19%. Interest rates on U.S. Treasuries were higher across the maturity spectrum, with short term rates increasing more than long term rates. U.S. Treasury two year, five year and 10 year rates were higher by 26, 17 and 11 basis points, respectively. Investors continued to be encouraged by the positive impacts that tax reform and easing of banking regulatory burdens are having on the economy. This optimism is tempered by concerns that strained foreign relations and escalating trade disputes could lead to a broader trade war which could negatively impact the economy.

The labor market showed continued strength during the second quarter, with increases in non-farm payrolls averaging over 210,000 jobs per month, down slightly from an average of 218,000 jobs the previous quarter. The strength in the labor market continues to boost consumer confidence, as the University of Michigan Consumer Sentiment Index

remains near multi-year highs. The consensus forecast for full-year 2018 gross domestic product (“GDP”) has increased to 2.9%, after coming in at 2.3% for 2017.

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While the overall inflation picture remains relatively subdued, some indicators have begun to increase. The U.S. Personal Consumption Expenditure Core (“PCE”) Price Index has increased to 1.96%, just below the Federal Reserve’s inflation target of 2%. The consensus forecast for Core PCE in 2018 and 2019 is now 1.9% and 2.1%, respectively. Energy prices were higher during the second quarter, with the price of WTI Crude up over 15%, while the broader Commodity Research Bureau (“CRB”) Commodity Price Index increased by 2.6%. Given the strength of the overall economy, the Federal Reserve’s Open Market Committee raised the federal funds rate to a range of 1.75% to 2.00% during their June meeting, which caused short-term interest rates to increase. The inflation outlook continues to have meaningful implications for future Federal Reserve monetary policy. We expect the interest rate environment to remain relatively volatile, as the Federal Reserve continues to signal a willingness to increase the federal funds rate. During the second quarter, the performance of Agency RMBS was positive. Both 15 and 30 year fixed-rate Agency RMBS slightly outperformed similar duration Treasuries, while Hybrid ARM Agency RMBS were flat to similar duration Treasuries. The outlook for Agency RMBS remains mixed, as the potential for increased interest rate volatility and the continued tapering of reinvestment activity by the Federal Reserve weighs on the market. On the positive side, a higher interest rate environment has the potential to spur investment demand on the part of both foreign and domestic banks, while at the same time keeping refinancing activity muted.

During the second quarter, credit spreads (defined as the yield in excess of risk-free rates) on non-Agency CMBS and GSE CRT securities tightened modestly, reflecting improving real estate values and strong investor demand. Financing markets remained steady during the quarter, though repurchase agreement rates moved higher in line with increases in the federal funds rate.

As we move into the third quarter of 2018, we expect that the U.S. will continue to experience moderate economic growth, and that core inflation will remain at or below the Federal Reserve’s policy objective of 2%, which should allow the Federal Reserve to continue its efforts to tighten monetary policy. Investor concerns include historically high valuations across both the equity and fixed income markets, the potential for additional protectionist trade policies, and the prospect of further increases in interest rates and price volatility.

**Investment Activities**

The table below shows the allocation of our equity as of June 30, 2018, December 31, 2017 and June 30, 2017:

\$ in thousands	As of			
	June 30, 2018	December 31, 2017	June 30, 2017	
Agency RMBS and Agency CMBS	48 %	45 %	41 %	
Commercial Credit <sup>(1)</sup>	33 %	35 %	33 %	
Residential Credit <sup>(2)</sup>	19 %	20 %	26 %	
Total	100 %	100 %	100 %	

<sup>(1)</sup> Non-Agency CMBS, commercial loans and investments in unconsolidated ventures (which are included in Other

Assets on our condensed consolidated balance sheet), are considered commercial credit.

<sup>(2)</sup> Non-Agency RMBS and GSE CRT are considered residential credit.

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The table below shows the breakdown of our investment portfolio as of June 30, 2018, December 31, 2017 and June 30, 2017:

\$ in thousands	As of		
	June 30, 2018	December 31, 2017	June 30, 2017
Agency RMBS:			
30 year fixed-rate, at fair value	7,665,139	7,640,540	5,069,116
15 year fixed-rate, at fair value	2,523,184	2,974,782	3,276,780
Hybrid ARM, at fair value	1,567,051	1,719,385	1,934,015
ARM, at fair value	214,801	241,200	274,574
Agency CMO, at fair value	238,816	273,943	298,266
Agency CMBS, at fair value	152,227	—	—
Non-Agency CMBS, at fair value	3,151,237	3,216,417	2,777,516
Non-Agency RMBS, at fair value	1,220,076	1,257,608	1,575,840
GSE CRT, at fair value	850,656	866,879	877,177
Commercial loans, at amortized cost	127,607	191,808	278,866
Investments in unconsolidated ventures	28,997	25,972	23,311
Total Investment portfolio	17,739,791	18,408,534	16,385,461

During the six months ended June 30, 2018, we purchased \$1.1 billion of Agency RMBS and CMBS, \$192.6 million of non-Agency CMBS and \$123.4 million of non-Agency RMBS. As of June 30, 2018 our holdings of 30 year fixed-rate Agency RMBS represent approximately 43% of our total investment portfolio versus 42% as of December 31, 2017 and 31% as of June 30, 2017. We have continued to increase our holdings of 30 year fixed-rate Agency RMBS over the past 12 months as the return on equity profile for these securities remains attractive. We have also increased our holdings of non-Agency CMBS over the past twelve months based on our view that these assets should continue to benefit from property price appreciation and limited supply.

We have continued to hold 15 year fixed-rate Agency RMBS and commercial real estate loans that have relatively low interest rate risk, which reduces our book value per diluted common share volatility. Additionally, we hold Hybrid ARM Agency RMBS and ARM Agency RMBS that we believe have lower durations and better cash flow certainty relative to current coupon 30 year fixed-rate Agency RMBS. Further, we own Agency collateralized mortgage obligations ("CMOs"), some of which are interest-only securities ("IOs").

Our portfolio of investments that have credit exposure include non-Agency CMBS, non-Agency RMBS, GSE CRTs and commercial real estate loans. Rather than relying on the rating agencies, we utilize proprietary models as well as third party applications to quantify and monitor the credit risk associated with our portfolio holdings. Our analysis generally begins at the underlying asset level, where we gather detailed information on loan, borrower, and property characteristics that inform our expectations for future performance. In addition to base case cash flow projections, we perform a range of scenario stresses to gauge the sensitivity of returns to potential deviations in underlying asset behavior. We perform this detailed credit analysis at the time of initial purchase and regularly throughout the holding period of each investment.

Our non-Agency CMBS portfolio generally consists of assets originated during and after 2010. These assets continue to benefit from rating agency upgrades, property price appreciation and limited supply. Non-Agency CMBS investments represent approximately 18% of our total investment portfolio as of June 30, 2018.

With respect to our non-Agency RMBS portfolio, we primarily invest in securities 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 securitizations of reperforming mortgage loans ("RPL") that we believe provide attractive risk adjusted returns. We also invest in GSE CRTs, which have the added benefit of paying a floating rate coupon, reducing our need to hedge interest rate risk. The majority of our GSE CRT holdings are concentrated in 2013 and 2014 vintages, where reference loans have significant embedded home price appreciation. From a fundamental perspective, we continue to view GSE CRT as an attractive asset class based on our positive outlook for U.S. home prices and the

strong performance of reference mortgage loans to date.

As of June 30, 2018, our commercial real estate loan portfolio includes five mezzanine loans that we either purchased or originated. Our commercial real estate loan portfolio represents approximately 1% of our total investment portfolio and has a weighted average maturity of 0.7 years. Our largely floating rate commercial real estate loan portfolio had a weighted average

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yield of 9.12% during the three months ended June 30, 2018 and continues to benefit from favorable fundamentals and increasing LIBOR. The commercial real estate loan portfolio's weighted average loan-to-value ratio is approximately 67%, based on the most recently attained independent property appraisals and the relevant loan amounts. For further details on our commercial loan portfolio, see Note 5 - "Commercial Loans Held-for-Investment" of our condensed consolidated financial statements. We evaluate the collectibility of our commercial loans held-for investment using the factors described in Note 2 - "Summary of Significant Accounting Policies" of our consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2017. We determined that no allowance for loan losses for our commercial loans was required as of June 30, 2018.

**Portfolio Characteristics**

The table below illustrates the vintage distribution of our non-Agency RMBS, GSE CRT and non-Agency CMBS portfolio as of June 30, 2018 as a percentage of the fair value:

	2003-2007	2008-2010	2011	2012	2013	2014	2015	2016	2017	2018	Total
Prime	21.0 %	2.6 %	— %	— %	12.5 %	10.4 %	2.3 %	0.3 %	— %	10.1 %	59.2 %
Alt-A	29.5 %	— %	— %	— %	— %	— %	— %	— %	— %	— %	29.5 %
Re-REMIC <sup>(1)</sup>	0.7 %	5.0 %	2.7 %	1.8 %	0.9 %	— %	— %	— %	— %	— %	11.1 %
Subprime/RPL	0.2 %	— %	— %	— %	— %	— %	— %	— %	— %	— %	0.2 %
Total Non-Agency	51.4 %	7.6 %	2.7 %	1.8 %	13.4 %	10.4 %	2.3 %	0.3 %	— %	10.1 %	100.0 %
GSE CRT	— %	— %	— %	— %	31.4 %	35.8 %	6.9 %	22.3 %	3.6 %	— %	100.0 %
Non-Agency CMBS	— %	3.7 %	19.0 %	12.2 %	15.6 %	34.8 %	4.6 %	2.0 %	8.0 %	0.1 %	100.0 %

<sup>(1)</sup> Reflects the year in which the re-securitizations were issued. The vintage distribution of the securities that collateralize our Re-REMIC investments is 6.8% for 2005, 4.8% for 2006, and 88.4% for 2007.

The following table summarizes the credit enhancement provided to our Re-REMIC holdings as of June 30, 2018 and December 31, 2017.

Re-REMIC Subordination <sup>(1)</sup>	Percentage of Re-REMIC Holdings at Fair Value			
	June 30, 2018		December 31, 2017	
0% - 10%	41.5	%	34.5	%
10% - 20%	3.5	%	3.7	%
20% - 30%	14.3	%	12.3	%
30% - 40%	16.0	%	18.4	%
40% - 50%	4.8	%	9.6	%
50% - 60%	18.3	%	19.7	%
60% - 70%	1.6	%	1.8	%
Total	100.0	%	100.0	%

Subordination refers to the credit enhancement provided to the Re-REMIC tranche held by us by any junior Re-REMIC tranche or tranches in a resecuritization. This figure reflects the percentage of the balance of the <sup>(1)</sup>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 us. 63.5% of our Re-REMIC holdings are not senior tranches.

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The tables below represent the geographic concentration of the underlying collateral for our non-Agency RMBS, GSE CRT and non-Agency CMBS portfolio as of June 30, 2018:

Non-Agency RMBS State	Percentage	GSE CRT State	Percentage	Non-Agency CMBS State	Percentage
California	44.1 %	California	18.9 %	California	16.3 %
New York	8.9 %	Texas	6.0 %	New York	14.3 %
Florida	6.5 %	New York	4.5 %	Texas	9.2 %
New Jersey	4.1 %	Virginia	4.3 %	Florida	6.6 %
Virginia	3.2 %	Florida	4.3 %	Pennsylvania	3.7 %
Massachusetts	3.2 %	Illinois	3.9 %	Illinois	3.6 %
Maryland	2.9 %	Massachusetts	3.4 %	New Jersey	3.6 %
Illinois	2.4 %	Washington	3.3 %	Michigan	3.3 %
Washington	2.4 %	New Jersey	3.3 %	Ohio	3.0 %
Texas	2.4 %	Pennsylvania	3.1 %	Virginia	2.8 %
Other	19.9 %	Other	45.0 %	Other	33.6 %
Total	100.0 %	Total	100.0 %	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 mortgage-backed and credit risk transfer securities. Repurchase 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 LIBOR. At each settlement date, we refinance each repurchase agreement at the market interest rate at that time. As of June 30, 2018, we had entered into repurchase agreements totaling \$13.7 billion (December 31, 2017: \$14.1 billion). Our wholly-owned captive insurance subsidiary, IAS Services, is a member of the Federal Home Loan Bank of Indianapolis ("FHLBI"). As a member of the FHLBI, IAS Services has borrowed funds from the FHLBI in the form of secured loans. As of June 30, 2018, IAS Services had \$1.65 billion in outstanding secured loans. For the six months ended June 30, 2018, IAS Services had weighted average borrowings of \$1.65 billion with a weighted average borrowing rate of 1.87% and a weighted average maturity of 5.9 years.

The following table presents the amount of collateralized borrowings outstanding under repurchase agreements and secured loans as of the end of each quarter, the average amount outstanding during the quarter and the maximum balance outstanding during the quarter:

Quarter Ended	Collateralized borrowings under repurchase agreements and secured loans		
	Quarter-end balance	Average quarterly balance	Maximum balance of any quarter-end
June 30, 2017	13,768,948	13,716,749	13,768,948
September 30, 2017	15,738,838	15,010,514	15,738,838
December 31, 2017	15,730,801	15,762,094	15,815,972
March 31, 2018	15,561,137	15,536,093	15,561,137
June 30, 2018	15,352,321	15,275,972	15,352,321

In 2013, our wholly-owned subsidiary, IAS Operating Partnership LP, issued \$400.0 million in aggregate principal amount of Exchangeable Senior Notes (the "Notes"). We retired a portion of the Notes prior to their maturity and fully retired the Notes upon their maturity on March 15, 2018. We utilized proceeds from repurchase agreement borrowings to retire the Notes.

We have also committed to invest up to \$122.8 million in unconsolidated ventures that are sponsored by an affiliate of our Manager. As of June 30, 2018, \$115.3 million of our commitment to these unconsolidated ventures has been called. We are committed to fund \$7.5 million in additional capital to fund future investments and cover future expenses should they occur.

Hedging Instruments.

As of June 30, 2018, we have entered into interest rate swap agreements designed to mitigate the effects of increases in interest rates for a portion of our borrowings. Under these swap agreements, we pay fixed interest rates and receive floating



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interest rates indexed off of one- or three-month LIBOR, effectively fixing the floating interest rates on \$8.9 billion (December 31, 2017: \$8.6 billion) of borrowings. As of June 30, 2017, we received interest based on one-month LIBOR on \$3.2 billion of our swaps and interest based on three-month LIBOR on \$5.7 billion of our swaps.

During the six months ended June 30, 2018, we entered into new swaps with a notional amount of \$1.5 billion to hedge the interest rates on the associated repurchase agreement debt and existing swaps with a notional amount of \$1.25 billion expired. In addition, we entered into forward starting swaps with a notional amount of \$1.6 billion that effectively extend the maturities of existing interest rate swaps at June 30, 2018.

As of June 30, 2018, we have entered into U.S. Treasury futures contracts that are designed to help mitigate the potential impact of changes in interest rates on the performance of our investment portfolio. During the six months ended June 30, 2018, we entered into contracts with a notional amount of \$715.0 million and realized a net loss of \$4.6 million. As of June 30, 2018 we held \$285.0 million in notional amount of futures contracts as a liability with a fair value of \$2.7 million. As of December 31, 2017, we had no outstanding futures contracts.

As of June 30, 2018, we held \$77.5 million (December 31, 2017: \$76.9 million) in notional amount of currency forward contracts. During the six months ended June 30, 2018, we settled currency forward contracts of \$156.2 million (June 30, 2017: \$131.6 million) in notional amount and realized a net loss of \$2.1 million (June 30, 2017: \$2.8 million net loss). As of June 30, 2018, we have \$50.8 million (December 31, 2017: \$49.7 million) of notional amount of forward contracts denominated in Pound Sterling and \$26.7 million (December 31, 2017: \$27.2 million) of notional amount of forward contracts denominated in Euro. 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 Diluted Common Share**

We calculate book value per diluted common share as follows:

	As of	
In thousands except per share amounts	June 30, 2018	December 31, 2017
Numerator (adjusted equity):		
Total equity	2,511,723	2,656,878
Less: Liquidation preference of Series A Preferred Stock	(140,000 )	(140,000 )
Less: Liquidation preference of Series B Preferred Stock	(155,000 )	(155,000 )
Less: Liquidation preference of Series C Preferred Stock	(287,500 )	(287,500 )
Total adjusted equity	1,929,223	2,074,378
Denominator (number of shares - diluted):		
Common stock outstanding	111,643	111,624
Non-controlling interest OP units	1,425	1,425
Number of shares - diluted	113,068	113,049
Book value per diluted common share	17.06	18.35

Our book value per diluted common share decreased 7.0% as of June 30, 2018 compared to December 31, 2017 primarily due to rising interest rates driving a decrease in the valuations of our mortgage-backed securities portfolio that exceeded the increase in the valuations of our interest rate hedges. Refer to Item 3. "Quantitative and Qualitative Disclosures About Market Risk" for interest rate risk and its impact on fair value.

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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.

There have been no significant changes to our critical accounting policies that are disclosed in our most recent Form 10-K for the year ended December 31, 2017, other than the significant accounting policy disclosed below.

Restricted Cash

Restricted cash represents cash posted with the FHLBI as collateral for secured loans and cash posted with counterparties as collateral for various derivative instruments. Cash held by counterparties as collateral is legally restricted and is not available for general corporate purposes.

Recent Accounting Standards

See Part I, Item 1, Financial Statements Note 2 - "Accounting Pronouncements Recently Adopted" and "Pending Accounting Pronouncements".

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## Results of Operations

The table below presents certain information from our condensed consolidated statements of operations for the three and six months ended June 30, 2018 and 2017.

\$ in thousands, except share data	Three Months Ended June 30,		Six Months Ended June 30,		
	2018	2017	2018	2017	
<b>Interest Income</b>					
Mortgage-backed and credit risk transfer securities	147,548	121,027	296,551	239,900	
Commercial loans	4,051	6,021	8,273	11,785	
Total interest income	151,599	127,048	304,824	251,685	
<b>Interest Expense</b>					
Repurchase agreements	69,389	36,072	128,974	66,019	
Secured loans	8,471	4,535	15,398	7,948	
Exchangeable senior notes	—	3,504	1,621	8,512	
Total interest expense	77,860	44,111	145,993	82,479	
Net interest income	73,739	82,937	158,831	169,206	
<b>Other Income (loss)</b>					
Gain (loss) on investments, net	(36,377	) 11,175	(196,747	) 9,322	
Equity in earnings (losses) of unconsolidated ventures	798	(154	) 1,694	(1,688	)
Gain (loss) on derivative instruments, net	67,169	(53,513	) 200,536	(48,051	)
Realized and unrealized credit derivative income (loss), net	735	21,403	3,900	41,358	
Net loss on extinguishment of debt	—	(526	) (26	) (5,237	)
Other investment income (loss), net	(2,160	) 2,533	942	3,862	
Total other income (loss)	30,165	(19,082	) 10,299	(434	)
<b>Expenses</b>					
Management fee – related party	10,102	9,027	20,323	17,828	
General and administrative	1,525	1,608	3,281	3,692	
Total expenses	11,627	10,635	23,604	21,520	
Net income	92,277	53,220	145,526	147,252	
Net income attributable to non-controlling interest	1,163	670	1,834	1,856	
Net income attributable to Invesco Mortgage Capital Inc.	91,114	52,550	143,692	145,396	
Dividends to preferred stockholders	11,106	5,716	22,213	11,432	
Net income attributable to common stockholders	80,008	46,834	121,479	133,964	
<b>Earnings per share:</b>					
Net income (loss) attributable to common stockholders					
Basic	0.72	0.42	1.09	1.20	
Diluted	0.72	0.41	1.08	1.15	
Dividends declared per common share	0.42	0.40	0.84	0.80	
<b>Weighted average number of shares of common stock:</b>					
Basic	111,640,630	111,607,924	111,634,900	111,603,218	
Diluted	113,084,816	123,560,625	115,467,670	125,830,020	

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## Interest Income and Average Earning Asset Yields

The table below presents information related to our average earning assets and earning asset yields for the three and six months ended June 30, 2018 and 2017.

\$ in thousands	Three Months Ended June 30,		Six Months Ended June 30,		
	2018	2017	2018	2017	
Average Balances <sup>(1)</sup> :					
Agency RMBS:					
15 year fixed-rate, at amortized cost	2,648,396	3,374,039	2,763,406	3,444,975	
30 year fixed-rate, at amortized cost	7,805,977	4,852,769	7,818,321	4,657,799	
ARM, at amortized cost	220,960	276,272	226,103	283,502	
Hybrid ARM, at amortized cost	1,595,131	1,996,026	1,630,813	2,143,014	
Agency - CMO, at amortized cost	254,642	309,113	264,210	318,728	
Agency CMBS, at amortized cost	50,179	—	25,228	—	
Non-Agency CMBS, at amortized cost	3,177,398	2,663,808	3,185,442	2,620,014	
Non-Agency RMBS, at amortized cost	1,030,949	1,483,354	1,057,619	1,637,336	
GSE CRT, at amortized cost	769,821	796,050	773,263	780,954	
Commercial loans, at amortized cost	178,080	278,052	185,767	276,524	
Average earning assets	17,731,533	16,029,483	17,930,172	16,162,846	
Average Earning Asset Yields <sup>(2)</sup> :					
Agency RMBS:					
15 year fixed-rate	1.99	% 1.97	% 2.02	% 2.00	%
30 year fixed-rate	2.95	% 2.83	% 2.96	% 2.74	%
ARM	2.43	% 2.27	% 2.37	% 2.29	%
Hybrid ARM	2.28	% 2.29	% 2.26	% 2.29	%
Agency - CMO	3.04	% 0.34	% 2.76	% 0.46	%
Agency CMBS	3.63	% —	% 3.63	% —	%
Non-Agency CMBS	4.95	% 4.45	% 4.90	% 4.33	%
Non-Agency RMBS	7.12	% 5.90	% 7.10	% 5.72	%
GSE CRT <sup>(3)</sup>	3.37	% 2.62	% 3.18	% 2.39	%
Commercial loans	9.12	% 8.69	% 8.98	% 8.59	%
Average earning asset yields	3.42	% 3.17	% 3.40	% 3.11	%

(1) Average amounts for each period are based on weighted month-end balances.

Average earning asset yields for the period were calculated by dividing interest income, including amortization of (2) premiums and discounts, by the average balance of the amortized cost of the investments. All yields are annualized.

GSE CRT average earning asset yields exclude coupon interest associated with embedded derivatives on securities (3) not accounted for under the fair value option that is recorded as realized and unrealized credit derivative income (loss), net under U.S. GAAP.

Our primary source of income is interest earned on our investment portfolio. We had average earning assets of approximately \$17.7 billion for the three months ended June 30, 2018 (June 30, 2017: \$16.0 billion). We had average earning assets of approximately \$17.9 billion for the six months ended June 30, 2018 (June 30, 2017: \$16.2 billion). Average earning assets increased for the three and six months ended June 30, 2018 primarily because we issued \$287.5 million of Series C Preferred Stock in August 2017 and invested the proceeds in 30 year fixed-rate Agency RMBS and CMBS.



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We earned total interest income of \$151.6 million (June 30, 2017: \$127.0 million) and \$304.8 million (June 30, 2017: \$251.7 million) for the three and six months ended June 30, 2018. Our interest income includes coupon interest and net premium amortization on MBS and GSE CRTs as well as interest income on commercial loans as shown in the table below.

\$ in thousands	Three Months		Six Months	
	Ended June 30, 2018	2017	Ended June 30, 2018	2017
Interest Income				
MBS and GSE CRT - coupon interest	164,165	147,267	330,484	293,336
MBS and GSE CRT - net premium amortization	(16,617)	(26,240)	(33,933)	(53,436)
MBS and GSE CRT - interest income	147,548	121,027	296,551	239,900
Commercial loans	4,051	6,021	8,273	11,785
Total interest income	151,599	127,048	304,824	251,685

MBS and GSE CRT interest income increased \$26.5 million and \$56.7 million, respectively, for the three and six months ended June 30, 2018 compared to 2017 primarily due to the purchase of 30 year Agency RMBS and non-Agency CMBS with the proceeds from our August 2017 Series C Preferred Stock offering and lower net premium amortization. Net premium amortization decreased \$9.6 million and \$19.5 million, respectively, for the three and six months ended June 30, 2018 compared to 2017 primarily due to slower prepayment speeds on 30 year fixed-rate Agency RMBS and purchases of non-Agency CMBS securities at a discount over the last 12 months. Interest income on our floating rate commercial real estate loans decreased \$2.0 million and \$3.5 million, respectively, during the three and six months ended June 30, 2018 primarily due to commercial loan payoffs. The balance of our commercial loans held-for-investment decreased to \$127.6 million as of June 30, 2018 compared to \$278.9 million as of June 30, 2017.

Our average earning asset yields increased 25 and 29 basis points, respectively, during the three and six months ended June 30, 2018 compared to 2017 due to purchases of new securities at higher yields, slower prepayment speeds and higher index rates on floating and adjustable assets.

Prepayment Speeds

Our RMBS and GSE CRT portfolio is subject to inherent prepayment risk primarily driven by changes in interest rates, which impacts the amount of premium and discount on the purchase of these securities that is recognized into interest income. Expected future prepayment speeds on our RMBS and GSE CRT portfolio are estimated on a quarterly basis. Generally, in an environment of falling interest rates, prepayment speeds will increase as homeowners are more likely to prepay their existing mortgage and refinance into a lower borrowing rate. If the actual prepayment speed during the period is faster than estimated, the amortization on securities purchased at a premium to par value will be accelerated, resulting in lower interest income recognized. Conversely, for securities purchased at a discount to par value, interest income will be reduced in periods where prepayment speeds were slower than expected. The standard measure of prepayment speeds is the constant prepayment rate, also known as the conditional prepayment rate or "CPR". CPR measures prepayments as a percentage of the current outstanding loan balance and is expressed as a compound annual rate. The table below provides the three month constant prepayment rate for our RMBS and GSE CRTs as of June 30, 2018, March 31, 2018, June 30, 2017 and March 31, 2017.

	As of			
	June 30, 2018	March 31, 2018	June 30, 2017	March 31, 2017
15 year fixed-rate Agency RMBS	10.6	9.2	9.5	8.1
30 year fixed-rate Agency RMBS	8.2	7.1	9.2	10.8
ARM/ Hybrid ARM Agency RMBS	15.7	14.4	16.3	15.7
Non-Agency RMBS	12.0	11.6	12.6	13.3
GSE CRT	9.8	9.5	9.7	13.1

Weighted average CPR	10.2	9.2	11.2	11.7
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The following table presents net premium amortization recognized on our MBS and GSE CRT portfolio for the three and six months ended June 30, 2018 and 2017.

\$ in thousands, except share data	Three Months		Six Months	
	Ended June 30, 2018	2017	Ended June 30, 2018	2017
Agency RMBS and CMBS	(22,275)	(27,775)	(45,497)	(56,353)
Non-Agency CMBS	1,195	(1,852)	2,621	(4,486)
Non-Agency RMBS	5,159	3,734	10,336	8,121
GSE CRT	(696)	(347)	(1,393)	(718)
Net (premium amortization) discount accretion	(16,617)	(26,240)	(33,933)	(53,436)

Net premium amortization decreased compared to the same periods in 2017 primarily due to slower prepayment speeds on 30 year fixed-rate Agency RMBS in the three and six months ended June 30, 2018 and purchases of non-Agency CMBS securities at a discount over the last 12 months.

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.

## Interest Expense and the Cost of Funds

The table below presents the components of interest expense for the three and six months ended June 30, 2018 and 2017:

\$ in thousands	Three Months		Six Months	
	Ended June 30, 2018	2017	Ended June 30, 2018	2017
Interest Expense				
Interest expense on repurchase agreement borrowings	76,287	42,441	142,411	78,686
Amortization of net deferred (gain) loss on de-designated interest rate swaps	(6,898)	(6,369)	(13,437)	(12,667)
Repurchase agreements interest expense	69,389	36,072	128,974	66,019
Secured loans	8,471	4,535	15,398	7,948
Exchangeable senior notes	—	3,504	1,621	8,512
Total interest expense	77,860	44,111	145,993	82,479

We enter into repurchase agreements to finance the majority of our target assets. These agreements are secured by our mortgage-backed and credit risk transfer securities. 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 LIBOR. At each settlement date, we typically refinance each repurchase agreement at the market interest rate at that time.

Our interest expense on repurchase agreement borrowings rose \$33.8 million and \$63.7 million, respectively, for the three and six months ended June 30, 2018 compared to 2017 primarily due to an increase in average borrowings. We increased our average borrowings in the second half of 2017 after investing the proceeds of our August 2017 offering of Series C Preferred Stock. Interest expense on repurchase agreement borrowings was also impacted by increases in the federal funds rate over the past 12 months.

Our repurchase agreement interest expense as reported in our condensed consolidated statement of operations includes amortization of net deferred gains and losses on de-designated interest rate swaps as summarized in the table above. Amortization of net deferred gains on de-designated interest rate swaps decreased our total interest expense by \$6.9 million and \$13.4 million, respectively, during the three and six months ended June 30, 2018 and \$6.4 million and \$12.7 million, respectively, during the three and six months ended June 30, 2017. Amounts recorded in AOCI before we discontinued cash flow hedge accounting for our interest rate swaps 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. During the next twelve months, we estimate that \$24.2 million of net deferred gains on de-designated interest rate swaps will be reclassified from other comprehensive income and recorded as a decrease to interest expense.



During the three and six months ended June 30, 2018, interest expense for our secured loans increased \$3.9 million and \$7.5 million, respectively, compared to the same periods in 2017 due to higher borrowing rates. Borrowing rates on our secured loans are based on the three-month FHLB swap rate plus a spread. For the six months ended June 30, 2018, the

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weighted average borrowing rate on our secured loans was 1.87% as compared to 0.96% for the six months ended June 30, 2017.

During the three and six months ended June 30, 2018, interest expense on exchangeable senior notes decreased \$3.5 million and \$6.9 million, respectively, compared to the same periods in 2017 because we retired \$256.6 million of the Notes during 2017 and the remaining balance of the Notes when they matured on March 15, 2018.

Our total interest expense during the three months ended June 30, 2018 increased \$33.7 million from the same period in 2017 primarily due to the \$37.8 million increase in interest expense on repurchase agreements borrowings and secured loans in the 2018 period offset by a \$3.5 million decrease in interest expense on the Notes as discussed above. Our total interest expense during the six months ended June 30, 2018 increased \$63.5 million from the same period in 2017 primarily due to a \$71.2 million increase in interest expense on repurchase agreements borrowings and secured loans in the 2018 period that was partially offset by a \$6.9 million decrease in interest expense on the Notes as discussed above.

The table below presents information related to our borrowings and cost of funds for the three and six months ended June 30, 2018 and 2017:

\$ in thousands	Three Months Ended June 30,		Six Months Ended June 30,		
	2018	2017	2018	2017	
Average Borrowings <sup>(1)</sup> :					
Agency RMBS <sup>(2)</sup>	11,146,252	9,665,651	11,286,117	9,691,612	
Agency CMBS	43,984	—	22,114	—	
Non-Agency CMBS <sup>(2)</sup>	2,556,166	2,239,854	2,549,519	2,205,758	
Non-Agency RMBS	861,598	1,155,529	876,318	1,283,001	
GSE CRT	667,972	655,715	671,245	628,122	
Exchangeable senior notes	—	238,530	57,767	292,009	
Total average borrowings	15,275,972	13,955,279	15,463,080	14,100,502	
Maximum borrowings during the period <sup>(3)</sup>	15,352,321	13,986,752	15,674,202	14,484,038	
Average Cost of Funds <sup>(4)</sup> :					
Agency RMBS <sup>(2)</sup>	1.98	% 1.10	% 1.82	% 0.99	%
Agency CMBS	2.38	% —	% 2.38	% —	%
Non-Agency CMBS <sup>(2)</sup>	2.68	% 1.63	% 2.48	% 1.49	%
Non-Agency RMBS	3.19	% 2.47	% 3.05	% 2.32	%
GSE CRT	3.16	% 2.51	% 3.02	% 2.39	%
Exchangeable senior notes	—	% 5.88	% 5.58	% 5.83	%
Cost of funds	2.04	% 1.26	% 1.89	% 1.17	%
Effective cost of funds (non-GAAP measure) <sup>(5)</sup>	2.34	% 2.01	% 2.28	% 1.96	%

(1) Average amounts for each period are based on weighted month-end balances.

(2) Agency RMBS and non-Agency CMBS average borrowings and average cost of funds include borrowings under repurchase agreements and secured loans.

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

(4) Average cost of funds is calculated by dividing annualized interest expense excluding amortization of net deferred gain (loss) on de-designated interest rate swaps by our average borrowings.

(5) For a reconciliation of cost of funds to effective cost of funds, see "Non-GAAP Financial Measures."

Total average borrowings rose \$1.3 billion and \$1.4 billion, respectively, in the three and six months ended June 30, 2018 compared to 2017 primarily because we entered into repurchase agreements to finance our increased holdings of 30 year fixed-rate Agency RMBS and non-Agency CMBS. The increase in our average cost of funds for three and six months ended June 30, 2018 versus 2017 was primarily due to increases in the federal funds rate over the past twelve months.



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## Net Interest Income

The table below presents the components of net interest income for the three and six months ended June 30, 2018 and 2017:

\$ in thousands	Three Months Ended		Six Months	
	June 30, 2018	2017	Ended June 30, 2018	2017
Interest Income				
Mortgage-backed and credit risk transfer securities	147,548	121,027	296,551	239,900
Commercial loans	4,051	6,021	8,273	11,785
Total interest income	151,599	127,048	304,824	251,685
Interest Expense				
Interest expense on repurchase agreement borrowings	76,287	42,441	142,411	78,686
Amortization of net deferred (gain) loss on de-designated interest rate swaps	(6,898 )	(6,369 )	(13,437 )	(12,667 )
Repurchase agreements interest expense	69,389	36,072	128,974	66,019
Secured loans	8,471	4,535	15,398	7,948
Exchangeable senior notes	—	3,504	1,621	8,512
Total interest expense	77,860	44,111	145,993	82,479
Net interest income	73,739	82,937	158,831	169,206
Net interest rate margin	1.38 %	1.91 %	1.51 %	1.94 %

Our net interest income, which equals interest income less interest expense, totaled \$73.7 million (June 30, 2017: \$82.9 million) and \$158.8 million (June 30, 2017: \$169.2 million) for the three and six months ended June 30, 2018, respectively. The decrease in net interest income for the three and six months ended June 30, 2018 was primarily due to an increase in interest expense driven by higher average borrowings and borrowing rates exceeding the increase in interest income on higher average earning assets.

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 1.38% (June 30, 2017: 1.91%) and 1.51% (June 30, 2017: 1.94%) for the three and six months ended June 30, 2018, respectively. The decrease in net interest rate margin for the three and six months ended June 30, 2018 compared to the same periods in 2017 was primarily due to increases in the federal funds rate in 2017 and 2018 that had a greater impact on our average cost of funds than on our average earning asset yields.

## Gain (Loss) on Investments, net

The table below summarizes the components of gain (loss) on investments, net for the three and six months ended June 30, 2018 and 2017:

\$ in thousands	Three Months		Six Months	
	Ended June 30, 2018	2017	Ended June 30, 2018	2017
Realized gains and losses on sale of investments	(11,525)	(651 )	(20,762 )	(1,658 )
Other-than-temporary impairment losses	(2,089 )	(4,098 )	(6,448 )	(4,630 )
Net unrealized gains and losses on MBS accounted for under the fair value option	(22,941)	7,715	(170,136)	4,113
Net unrealized gains and losses on GSE CRT accounted for under the fair value option	182	8,195	616	11,474
Net unrealized gains and losses on trading securities	(4 )	14	(17 )	23
Total gain (loss) on investments, net	(36,377)	11,175	(196,747)	9,322

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. During the three months ended June 30, 2018, we sold \$210.0 million of mortgage-backed securities (June 30, 2017: \$182.0 million) and realized

losses of \$11.5 million (June 30,

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2017: net losses of \$651,000). During the six months ended June 30, 2018, we sold \$408.5 million of mortgage-backed securities (June 30, 2017: \$627.6 million) and realized losses of \$20.8 million (June 30, 2017: net losses of \$1.7 million).

We assess our 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." For additional information regarding our assessment analysis of other-than temporary impairment on our investment securities, refer to Note 4 – "Mortgage-Backed and Credit Risk Transfer Securities" of our condensed consolidated financial statements.

We have elected the fair value option for all of our RMBS IOs, our MBS purchased on or after September 1, 2016 and our GSE CRTs purchased on or after August 24, 2015. Under the fair value option, changes in fair value are recognized in income in the condensed consolidated statements of operations and are reported as a component of gain (loss) on investments, net. As of June 30, 2018, \$7.3 billion (December 31, 2017: \$6.5 billion) or 41.4% (December 31, 2017: 35.6%) of our MBS and GSE CRT are accounted for under the fair value option.

Equity in Earnings (Losses) of Unconsolidated Ventures

For the three months ended June 30, 2018, we recorded equity in earnings of unconsolidated ventures of \$798,000 (June 30, 2017: equity in losses of \$154,000). For the six months ended June 30, 2018, we recorded equity in earnings of unconsolidated ventures of \$1.7 million (June 30, 2017: equity in losses of \$1.7 million). We recorded equity in earnings for the three and six months ended June 30, 2018 primarily due to realized and unrealized gains on the underlying portfolio investments. We recorded losses for the three and six months ended June 30, 2017 primarily due to unrealized losses on the underlying portfolio investments.

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.

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.

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, 2018			
	Realized			
Derivative not designated as hedging instrument	gain (loss) on derivative instruments, net	Contractual net interest expense	Unrealized gain (loss), net	Gain (loss) on derivative instruments, net
Interest Rate Swaps	34,273	(4,511 )	32,985	62,747
Futures Contracts	640	—	(1,044 )	(404 )
Currency Forward Contracts	1,361	—	3,465	4,826
Total	36,274	(4,511 )	35,406	67,169
\$ in thousands	Three months ended June 30, 2017			
	Realized			
Derivative not designated as hedging instrument	gain (loss) on derivative instruments, net	Contractual net interest expense	Unrealized gain (loss), net	Gain (loss) on derivative instruments, net

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Interest Rate Swaps	(38,512)	(19,966 )	7,975	(50,503 )
Currency Forward Contracts	(1,717 )	—	(1,293 )	(3,010 )
Total	(40,229)	(19,966 )	6,682	(53,513 )

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\$ in thousands	Six Months Ended June 30, 2018			
	Realized			
Derivative not designated as hedging instrument	gain (loss) on derivative instruments, net	Contractual net interest expense	Unrealized gain (loss), net	Gain (loss) on derivative instruments, net
Interest Rate Swaps	156,546	(16,623 )	65,359	205,282
Futures Contracts	(4,637 )	—	(2,656 )	(7,293 )
Currency Forward Contracts	(2,057 )	—	4,604	2,547
Total	149,852	(16,623 )	67,307	200,536
\$ in thousands	Six Months Ended June 30, 2017			
	Realized			
Derivative not designated as hedging instrument	gain (loss) on derivative instruments, net	Contractual net interest expense	Unrealized gain (loss), net	Gain (loss) on derivative instruments, net
Interest Rate Swaps	(22,518)	(42,860 )	20,925	(44,453 )
Currency Forward Contracts	(2,793 )	—	(805 )	(3,598 )
Total	(25,311)	(42,860 )	20,120	(48,051 )

As of June 30, 2018 and December 31, 2017, we held the following interest rate swaps whereby we receive interest at a one-month and three-month LIBOR rate:

\$ in thousands	As of June 30, 2018				As of December 31, 2017			
Derivative instrument	Notional Amounts (1)	Average Fixed Pay Rate	Average Receive Rate	Average Maturity (Years)	Notional Amounts (2)	Average Fixed Pay Rate	Average Receive Rate	Average Maturity (Years)
Interest Rate Swaps	8,870,000	2.37 %	2.24 %	4.9	8,620,000	2.11 %	1.48 %	4.2

(1) Excludes \$1.6 billion of notional amount for interest rate swaps with forward start dates.

(2) Excludes \$500.0 million of notional amount for interest rate swaps with forward start dates.

Realized and Unrealized Credit Derivative Income (Loss), net

The table below summarizes the components of realized and unrealized credit derivative income (loss), net for the three and six months ended June 30, 2018 and 2017.

\$ in thousands	Three Months Ended June 30, 2018		Six Months Ended June 30, 2017	
GSE CRT embedded derivative coupon interest	5,638	5,844	11,271	11,651
Change in fair value of GSE CRT embedded derivatives	(4,903)	15,559	(7,371)	29,707
Total	735	21,403	3,900	41,358

In the three and six months ended June 30, 2018, we recorded a decrease of \$20.7 million and \$37.5 million, respectively, in realized and unrealized credit derivative income (loss), net compared to the same period in 2017 because the increases in valuation of the debt host contracts exceeded the increases in valuation of the hybrid financial instruments.





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## Net Loss on Extinguishment of Debt

We retired a portion of our Exchangeable Senior Notes (the "Notes") prior to their maturity and fully retired the Notes upon their maturity on March 15, 2018. We did not incur a loss on retirement of the Notes in the three months ended June 30, 2018.

In the three months ended June 30, 2017, we retired \$31.2 million of the Notes for a repurchase price of \$31.6 million. In the six months ended June 30, 2018, we retired \$143.4 million (2017: \$181.2 million) of the Notes for a repurchase price of \$143.4 million (2017: \$185.4 million). We realized a net loss on extinguishment of debt of \$526,000 in the three months ended June 30, 2017 and losses of \$26,000 and \$5.2 million, respectively in the six months ended June 30, 2018 and 2017.

## Other Investment Income (Loss), net

Other investment income (loss), net consists of (i) quarterly dividends from FHLBI stock and an investment in an exchange-traded fund and (ii) foreign exchange rate gains and losses related to a commercial loan investment denominated in a foreign currency. The table below summarizes the components of other investment income (loss), net for the three and six months ended June 30, 2018 and 2017.

	Three Months		Six Months	
	Ended June		Ended June	
	30,	30,	30,	30,
\$ in thousands	2018	2017	2018	2017
Dividend income	807	802	2,094	1,618
Gain (loss) on foreign currency transactions, net	(2,966)	1,731	(1,152)	2,244
Total	(2,159)	2,533	942	3,862

We are 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. We earn dividend income on our investment in FHLBI stock, and the amount of our dividend income varies based upon the number of shares that we are required to own and the dividend declared per share.

We incurred foreign exchange gains (losses) on the revaluation of a commercial loan investment (notional amount of £34.5 million) for the three and six months ended June 30, 2018 and 2017 due to the fluctuation in the Pound Sterling/ U.S. Dollar foreign exchange rate. We enter into currency forward contracts as an economic hedge against our foreign currency exposure. Changes in the fair value of our currency forward contracts are recognized in gain (loss) derivative instruments, net in the condensed consolidated statements of operations. During the three and six months ended June 30, 2018, we recognized net gains of \$4.8 million (June 30, 2017: net losses of \$3.0 million) and \$2.5 million (June 30, 2017: net losses of \$3.6 million), respectively, on our currency forward contracts.

## Expenses

For the three months ended June 30, 2018, we incurred management fees of \$10.1 million (June 30, 2017: \$9.0 million) and \$20.3 million (June 30, 2017: \$17.8 million) for the six months ended June 30, 2018, which are payable to our Manager under our management agreement. Management fees increased for the three and six months ended June 30, 2018 compared to the same periods in 2017 because the Company issued preferred stock in August 2017. Refer to Note 12 – "Related Party Transactions" of our condensed consolidated financial statements for a discussion of our relationship with our Manager and a description of how our fees are calculated.

For the three months ended June 30, 2018, our general and administrative expenses not covered under our management agreement amounted to \$1.5 million (June 30, 2017: \$1.6 million) and \$3.3 million (June 30, 2017: \$3.7 million) for the six months ended June 30, 2018. 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, and miscellaneous general and administrative costs. General and administrative costs were lower for the three and six months ended June 30, 2018 versus 2017 primarily due to higher professional fees in the 2017 period.



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Net Income (Loss) attributable to Common Stockholders

For the three months ended June 30, 2018, our net income attributable to common stockholders was \$80.0 million (June 30, 2017: \$46.8 million) or \$0.72 basic and diluted net income per average share available to common stockholders (June 30, 2017: \$0.42 basic and \$0.41 diluted net income per average share available to common stockholders). The change in net income attributable to common stockholders was primarily due to (i) net loss on investments of \$36.4 million in the 2018 period compared to net gain on investments of \$11.2 million in the 2017 period, (ii) net gain on derivative instruments of \$67.2 million in the 2018 period compared to net loss on derivative instruments of \$53.5 million in the 2017 period, (iii) net credit derivative income of \$735,000 in the 2018 period compared to net credit derivative income of \$21.4 million in the 2017 period and (iv) dividends to preferred stockholders of \$11.1 million in the 2018 period compared to \$5.7 million in the 2017 period. Dividends to preferred stockholders for the three months ended June 30, 2018 increased compared to 2017 due to the issuance of \$287.5 million of Series C Preferred Stock in August 2017.

For the six months ended June 30, 2018 our net income attributable to common stockholders was \$121.5 million (June 30, 2017: \$134.0 million) or \$1.09 basic and \$1.08 diluted net income per average share available to common stockholders (June 30, 2017: \$1.20 basic and \$1.15 diluted net income per average share available to common stockholders). The change in net income (loss) attributable to common stockholders was primarily due to (i) net gain on derivative instruments of \$200.5 million in the 2018 period compared to net loss on derivative instruments of \$48.1 million in the 2017 period, (ii) net loss on investments of \$196.8 million compare to net gain of \$9.3 million in the 2017 period, (iii) net credit derivative income of \$3.9 million in the 2018 period compared to net credit derivative income of \$41.4 million in the 2017 period and (iv) a \$10.4 million decrease in net interest income.

For further information on the changes in net gains or losses on investments, changes in net gains on derivative instruments, realized and unrealized credit derivative income (loss), net and preferred dividends, see preceding discussion under "Gain (Loss) on Investments, net," "Gain (Loss) on Derivative Instruments, net," "Realized and Unrealized Credit Derivative Income (Loss), net," and "Capital Activities."

Non-GAAP Financial Measures

We use the following non-GAAP financial measures to analyze the Company's operating results and believe these financial measures are useful to investors in assessing our performance as further discussed below:

- core earnings (and by calculation, core earnings per common 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.

The most directly comparable U.S. GAAP measures are:

- net income (loss) attributable to common stockholders (and by calculation, basic earnings (loss) per common share),
- total interest income (and by calculation, earning asset yields),
- total interest expense (and by calculation, cost of funds),
- net interest income (and by calculation, net interest rate margin), and
- debt-to-equity ratio.

The non-GAAP financial measures used by management should be analyzed in conjunction with U.S. GAAP financial measures and should not be considered substitutes for U.S. GAAP financial measures. In addition, the non-GAAP financial measures may not be comparable to similarly titled non-GAAP financial measures of our peer companies.

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## 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; unrealized (gain) loss on derivative instruments, net; realized and unrealized (gain) loss on GSE CRT embedded derivatives, net; (gain) loss on foreign currency transactions, net; amortization of net deferred (gain) loss on de-designated interest rate swaps; net loss on extinguishment of debt; and cumulative adjustments attributable to non-controlling interest. We may add and have added additional reconciling items to our core earnings calculation as appropriate.

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 exclude the impact of gains and losses because gains and losses are not accounted for consistently under U.S. GAAP. Under U.S. GAAP, certain gains and losses are reflected in net income whereas other gains and losses are reflected in other comprehensive income. For example, the majority of our mortgage-backed securities are classified as available-for-sale securities, and we record changes in the valuation of these securities in other comprehensive income on our condensed consolidated balance sheets. We elected the fair value option for our mortgage-backed securities purchased on or after September 1, 2016, and changes in the valuation of these securities are recorded in other income (loss) in our condensed consolidated statements of operations. In addition, certain gains and losses represent one-time events.

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.

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		Six Months	
	Ended June 30,		Ended June 30,	
\$ in thousands, except per share data	2018	2017	2018	2017
Net income (loss) attributable to common stockholders	80,008	46,834	121,479	133,964
Adjustments:				
(Gain) loss on investments, net	36,377	(11,175)	196,747	(9,322 )
Realized (gain) loss on derivative instruments, net <sup>(1)</sup>	(36,274)	40,229	(149,852)	25,311
Unrealized (gain) loss on derivative instruments, net <sup>(1)</sup>	(35,406)	(6,682 )	(67,307 )	(20,120 )
Realized and unrealized (gain) loss on GSE CRT embedded derivatives, net <sup>(2)</sup>	4,903	(15,559)	7,371	(29,707 )
(Gain) loss on foreign currency transactions, net <sup>(3)</sup>	2,966	(1,731 )	1,152	(2,244 )
Amortization of net deferred (gain) loss on de-designated interest rate swaps <sup>(4)</sup>	(6,898 )	(6,369 )	(13,437 )	(12,667 )
Net loss on extinguishment of debt	—	526	26	5,237
Subtotal	(34,332)	(761 )	(25,300 )	(43,512 )
Cumulative adjustments attributable to non-controlling interest	432	10	318	549
Core earnings attributable to common stockholders	46,108	46,083	96,497	91,001
Basic income (loss) per common share	0.72	0.42	1.09	1.20
Core earnings per share attributable to common stockholders <sup>(5)</sup>	0.41	0.41	0.86	0.82

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- (1) U.S. GAAP gain (loss) on derivative instruments, net on the condensed consolidated statements of operations includes the following components:

\$ in thousands	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Realized gain (loss) on derivative instruments, net	36,274	(40,229)	149,852	(25,311)
Unrealized gain (loss) on derivative instruments, net	35,406	6,682	67,307	20,120
Contractual net interest expense on interest rate swaps	(4,511)	(19,966)	(16,623)	(42,860)
Gain (loss) on derivative instruments, net	67,169	(53,513)	200,536	(48,051)

- (2) U.S. GAAP realized and unrealized credit derivative income (loss), net on the condensed consolidated statements of operations includes the following components:

\$ in thousands	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Realized and unrealized gain (loss) on GSE CRT embedded derivatives, net	(4,903)	15,559	(7,371)	29,707
GSE CRT embedded derivative coupon interest	5,638	5,844	11,271	11,651
Realized and unrealized credit derivative income (loss), net	735	21,403	3,900	41,358

- (3) U.S. GAAP other investment income (loss) net on the condensed consolidated statements of operations includes the following components:

\$ in thousands	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Dividend income	807	802	2,094	1,618
Gain (loss) on foreign currency transactions, net	(2,966)	1,731	(1,152)	2,244
Other investment income (loss), net	(2,159)	2,533	942	3,862

- (4) U.S. GAAP repurchase agreements interest expense on the condensed consolidated statements of operations includes the following components:

\$ in thousands	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Interest expense on repurchase agreements borrowings	76,287	42,441	142,411	78,686
Amortization of net deferred (gain) loss on de-designated interest rate swaps	(6,898)	(6,369)	(13,437)	(12,667)
Repurchase agreements interest expense	69,389	36,072	128,974	66,019

- (5) Core earnings per share attributable to common stockholders is equal to core earnings divided by the basic weighted average number of common shares outstanding.

Core earnings for the three months ended June 30, 2018 remained relatively unchanged from the same period in 2017. The change in core earnings reflects (i) a \$5.5 million increase in effective net interest income and (ii) equity in earnings of unconsolidated ventures of \$798,000 for the three months ended June 30, 2018 compared to equity in

losses of \$154,000 for the same period in 2017 that was partially offset by \$5.4 million increase in preferred stock dividends and a \$1.0 million increase in management fees. Higher effective net interest income, preferred stock dividends and management fees were driven by investment of the proceeds of our \$287.5 million Series C Preferred Stock offering in August 2017.

Core earnings for the six months ended June 30, 2018 increased \$5.5 million from the same period in 2017 primarily due to (i) a \$14.7 million increase in effective net interest income and (ii) equity in earnings of unconsolidated ventures of \$1.7 million for the six months ended June 30, 2018 compared to equity in losses of \$1.7 million for the same period in 2017, that was partially offset by \$10.8 million increase in preferred stock dividends and a \$2.5 million increase in management fees. Higher effective net interest income, preferred stock dividends and management fees were driven by investment of the proceeds of our \$287.5 million Series C Preferred Stock offering in August 2017.

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Effective Interest Income / Effective Yield / 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 as realized and unrealized credit derivative income (loss), net. We include our GSE CRT embedded derivative coupon interest in effective interest income because GSE CRT coupon interest is not accounted for consistently under U.S. GAAP. We account for GSE CRTs purchased prior to August 24, 2015 as hybrid financial instruments, but we have elected the fair value option for GSE CRTs purchased on or after August 24, 2015. Under U.S. GAAP, coupon interest on GSE CRTs accounted for using the fair value option is recorded as interest income, whereas coupon interest on GSE CRTs accounted for as hybrid financial instruments is recorded as realized and unrealized credit derivative income (loss). 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 irrespective of whether we elected the fair value option for the GSE CRT or accounted for the GSE CRT as a hybrid financial instrument.

We calculate effective interest expense (and by calculation, effective cost of funds) as U.S. GAAP total interest expense adjusted for contractual net interest expense on our interest rate swaps that is recorded as gain (loss) on derivative instruments, net and the amortization of net deferred gains (losses) on de-designated interest rate swaps that is recorded as repurchase agreements interest expense. 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 exclude the amortization of net deferred gains (losses) on de-designated interest rate swaps from our calculation of effective interest expense 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 expense on our interest rate swaps that is recorded as gain (loss) on derivative instruments, amortization of net deferred gains (losses) on de-designated interest rate swaps that is recorded as repurchase agreements interest expense and GSE CRT embedded derivative coupon interest that is recorded as 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.

The following tables reconcile total interest income to effective interest income and yield to effective yield for the following periods:

	Three Months Ended June 30,					
	2018			2017		
\$ in thousands	Reconciliation	Yield/Effective Yield	%	Reconciliation	Yield/Effective Yield	%
Total interest income	151,599	3.42	%	127,048	3.17	%
Add: GSE CRT embedded derivative coupon interest recorded as realized and unrealized credit derivative income (loss), net	5,638	0.13	%	5,844	0.15	%
Effective interest income	157,237	3.55	%	132,892	3.32	%
	Six Months Ended June 30,					
	2018			2017		
\$ in thousands	Reconciliation	Yield/Effective Yield	%	Reconciliation	Yield/Effective Yield	%
Total interest income	304,824	3.40	%	251,685	3.11	%
Add: GSE CRT embedded derivative coupon interest recorded as realized and unrealized credit derivative income (loss), net	11,270	0.13	%	11,651	0.15	%



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Effective interest income	316,094	3.53	%	263,336	3.26	%
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Our effective interest income increased in the three and six months ended June 30, 2018 versus the same periods in 2017 primarily due to higher average earning assets. The increase in effective yield for the three and six months ended June 30, 2018

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versus the same periods in 2017 was primarily due to slower prepayment speeds and higher index rates on floating and adjustable rate assets.

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

	Three Months Ended June 30,					
	2018			2017		
\$ in thousands	Reconciling	Effective	Cost of Funds /	Reconciling	Effective	Cost of Funds /
			Cost of Funds			Cost of Funds
Total interest expense	77,860	2.04	%	44,111	1.26	%
Add (Less): Amortization of net deferred gain (loss) on de-designated interest rate swaps	6,898	0.18	%	6,369	0.18	%
Add: Contractual net interest expense on interest rate swaps recorded as gain (loss) on derivative instruments, net	4,511	0.12	%	19,966	0.57	%
Effective interest expense	89,269	2.34	%	70,446	2.01	%

	Six Months Ended June 30,					
	2018			2017		
\$ in thousands	Reconciling	Effective	Cost of Funds /	Reconciling	Effective	Cost of Funds /
			Cost of Funds			Cost of Funds
Total interest expense	145,993	1.89	%	82,479	1.17	%
Add (Less): Amortization of net deferred gain (loss) on de-designated interest rate swaps	13,437	0.17	%	12,667	0.18	%
Add: Contractual net interest expense on interest rate swaps recorded as gain (loss) on derivative instruments, net	16,624	0.22	%	42,860	0.61	%
Effective interest expense	176,054	2.28	%	138,006	1.96	%

Our effective interest expense and effective cost of funds increased during the three and six months ended June 30, 2018 compared to the same period in 2017 primarily due to increased borrowings and higher interest rates. See the preceding caption "Interest Expense and Cost of Funds" for further discussion of these variances.

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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,			
	2018	2017		
		Net		Net
		Interest		Interest
		Rate		Rate
\$ in thousands	Reconciliation	Margin / Effective	Reconciliation	Margin / Effective
		Interest		Interest
		Rate		Rate
		Margin		Margin
Net interest income	73,739	1.38 %	82,937	1.91 %
Add (Less): Amortization of net deferred (gain) loss on de-designated interest rate swaps	(6,898 )	(0.18 )%	(6,369 )	(0.18 )%
Add: GSE CRT embedded derivative coupon interest recorded as realized and unrealized credit derivative income (loss), net	5,638	0.13 %	5,844	0.15 %
Less: Contractual net interest expense on interest rate swaps recorded as gain (loss) on derivative instruments, net	(4,511 )	(0.12 )%	(19,966)	(0.57 )%
Effective net interest income	67,968	1.21 %	62,446	1.31 %

	Six Months Ended June 30,			
	2018	2017		
		Net		Net
		Interest		Interest
		Rate		Rate
\$ in thousands	Reconciliation	Margin / Effective	Reconciliation	Margin / Effective
		Interest		Interest
		Rate		Rate
		Margin		Margin
Net interest income	158,831	1.51 %	169,206	1.94 %
Add (Less): Amortization of net deferred (gain) loss on de-designated interest rate swaps	(13,437 )	(0.17 )%	(12,667 )	(0.18 )%
Add: GSE CRT embedded derivative coupon interest recorded as realized and unrealized credit derivative income (loss), net	11,270	0.13 %	11,651	0.15 %
Less: Contractual net interest expense on interest rate swaps recorded as gain (loss) on derivative instruments, net	(16,623 )	(0.22 )%	(42,860 )	(0.61 )%
Effective net interest income	140,041	1.25 %	125,330	1.30 %

Effective net interest income for the three and six months ended June 30, 2018 increased from the same period in 2017 primarily due to lower contractual net interest expense on interest rate swaps. Contractual net interest expense on interest rate swaps decreased from \$20.0 million for the three months ended June 30, 2017 to \$4.5 million for the three months ended June 30, 2018 and from \$42.9 million for the six months ended June 30, 2017 to \$16.6 million for the six months ended June 30, 2018 primarily as a result of higher LIBOR rates in 2018.

Effective interest rate margin decreased for the three and six months ended June 30, 2018 compared to the same periods in 2017 primarily due to increases in the federal funds rate over the past twelve months that had a greater impact on our average cost of funds than on our average earning asset yields.



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## Repurchase Agreement Debt-to-Equity Ratio

The tables below show the allocation of our equity to our target assets, our debt-to-equity ratio, and our repurchase agreement debt-to-equity ratio as of June 30, 2018 and December 31, 2017. Our debt-to-equity ratio is calculated in accordance with U.S. GAAP and is the ratio of total debt (sum of repurchase agreements, secured loans and exchangeable senior notes) to total equity. We present a repurchase agreement debt-to-equity ratio, a non-GAAP financial measure of leverage, because the mortgage REIT industry primarily uses repurchase agreements, which typically mature within one year, to finance investments. We believe that presenting our repurchase agreement debt-to-equity ratio, when considered together with our U.S. GAAP financial measure of debt-to-equity ratio, provides information that is useful to investors in understanding our 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, 2018

\$ in thousands	Agency RMBS and CMBS	Commercial Credit <sup>(1)</sup>	Residential Credit <sup>(2)</sup>	Total
Investments	12,361,217	3,307,841	2,070,733	17,739,791
Cash and cash equivalents <sup>(3)</sup>	33,312	23,077	13,865	70,254
Derivative assets, at fair value <sup>(4)</sup>	44,122	3,387	—	47,509
Other assets	86,210	64,389	6,622	157,221
Total assets	12,524,861	3,398,694	2,091,220	18,014,775
Repurchase agreements	10,671,351	1,450,627	1,580,343	13,702,321
Secured loans <sup>(5)</sup>	555,099	1,094,901	—	1,650,000
Derivative liabilities, at fair value <sup>(4)</sup>	6,071	—	—	6,071
Other liabilities	94,556	29,017	21,037	144,610
Total liabilities	11,327,077	2,574,545	1,601,380	15,503,002
Total equity (allocated)	1,197,784	824,149	489,840	2,511,773
Adjustments to calculate repurchase agreement debt-to-equity ratio:				
Net equity in unsecured assets <sup>(6)</sup>	—	(157,905 )	—	(157,905 )
Collateral pledged against secured loans	(642,808 )	(1,267,901 )	—	(1,910,709 )
Secured loans	555,099	1,094,901	—	1,650,000
Equity related to repurchase agreement debt	1,110,075	493,244	489,840	2,093,159
Debt-to-equity ratio <sup>(7)</sup>	9.4	3.1	3.2	6.1
Repurchase agreement debt-to-equity ratio <sup>(8)</sup>	9.6	2.9	3.2	6.5

(1) Investments in non-Agency CMBS, commercial loans and investments in unconsolidated joint ventures are included in commercial credit.

(2) Investments in non-Agency RMBS and GSE CRT are included in residential credit.

(3) Cash and cash equivalents are allocated based on a percentage of equity for each asset class.

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

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

(6) Net equity in unsecured assets includes commercial loans, investments in unconsolidated joint ventures and other.

(7) Debt-to-equity ratio is calculated as the ratio of total debt (sum of repurchase agreements and secured loans) to total equity.

(8) Repurchase agreement debt-to-equity ratio is calculated as the ratio of repurchase agreements to equity related to repurchase agreement debt.



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December 31, 2017

\$ in thousands	Agency RMBS	Commercial Credit <sup>(1)</sup>	Residential Credit <sup>(2)</sup>	Exchangeable Senior Notes and Other	Total
Investments	12,849,851	3,434,196	2,124,487	—	18,408,534
Cash and cash equivalents <sup>(3)</sup>	39,630	31,069	17,682	—	88,381
Restricted cash	—	620	—	—	620
Derivative assets, at fair value <sup>(4)</sup>	6,896	—	—	—	6,896
Other assets	77,893	64,284	6,669	3,979	152,825
Total assets	12,974,270	3,530,169	2,148,838	3,979	18,657,256
Repurchase agreements	11,111,755	1,396,330	1,572,716	—	14,080,801
Secured loans <sup>(5)</sup>	533,463	1,116,537	—	—	1,650,000
Exchangeable senior notes	—	—	—	143,231	143,231
Derivative liabilities, at fair value <sup>(4)</sup>	31,548	1,217	—	—	32,765
Other liabilities	51,840	24,742	14,888	2,111	93,581
Total liabilities	11,728,606	2,538,826	1,587,604	145,342	16,000,378
Total equity (allocated)	1,245,664	991,343	561,234	(141,363)	2,656,878
Adjustments to calculate repurchase agreement debt-to-equity ratio:					
Net equity in unsecured assets and exchangeable senior notes <sup>(6)</sup>	—	(217,780)	—	141,363	(76,417)
Collateral pledged against secured loans	(623,181)	(1,304,315)	—	—	(1,927,496)
Secured loans	533,463	1,116,537	—	—	1,650,000
Equity related to repurchase agreement debt	1,155,946	585,785	561,234	—	2,302,965
Debt-to-equity ratio <sup>(7)</sup>	9.3	2.5	2.8	NA	6.0
Repurchase agreement debt-to-equity ratio <sup>(8)</sup>	9.6	2.4	2.8	NA	6.1

(1) Investments in non-Agency CMBS, commercial loans and investments in unconsolidated joint ventures are included in commercial credit.

(2) Investments in non-Agency RMBS and GSE CRT are included in residential credit.

(3) Cash and cash equivalents are allocated based on a percentage of equity for each asset class.

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

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

(6) Net equity in unsecured assets and exchangeable senior notes includes commercial loans, investments in unconsolidated joint ventures, exchangeable senior notes and other.

(7) Debt-to-equity ratio is calculated as the ratio of total debt (sum of repurchase agreements, secured loans and exchangeable senior notes) to total equity.

(8) Repurchase agreement debt-to-equity ratio is calculated as the ratio of repurchase agreements to equity related to repurchase agreement debt.

## 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

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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, cash equivalents and restricted cash of \$70.3 million at June 30, 2018 (June 30, 2017: \$64.1 million).

Our cash, cash equivalents and restricted cash increased 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 \$147.8 million for the six months ended June 30, 2018 (June 30, 2017: \$138.9 million).

Our investing activities provided net cash of \$472.6 million in the six months ended June 30, 2018 compared to net cash used in investing activities of \$902.3 million in the six months ended June 30, 2017. We invested \$1.2 billion in mortgage-backed and credit risk transfer securities during the six months ended June 30, 2018 compared to investments of \$2.5 billion in mortgage-backed and credit risk transfer securities in the six months ended June 30, 2017. We generated \$1.1 billion from principal payments of mortgage-backed and credit risk transfer securities during the six months ended June 30, 2018 (June 30, 2017: \$1.1 billion) and \$387.7 million (June 30 2017: \$572.6 million) from the sales of mortgage-backed and credit risk transfer securities. We also generated \$64.8 million in proceeds from commercial loan repayments in the six months ended June 30, 2018.

Our financing activities used net cash of \$639.2 million for the six months ended June 30, 2018 compared to net cash provided by financing activities of \$665.7 million in the six months ended June 30, 2017. We used cash of \$378.4 million to make net principal repayments on repurchase agreements (June 30, 2017: net proceeds of \$1.0 billion). We also used cash of \$143.4 million (June 30, 2017: \$185.4 million) to extinguish our exchangeable senior notes and to pay dividends of \$117.2 million (June 30, 2017: \$101.9 million).

As of June 30, 2018, our wholly-owned subsidiary, IAS Services, had \$1.65 billion in outstanding secured loans from the FHLBI. As of June 30, 2018, the FHLBI secured loans were collateralized by non-Agency CMBS and Agency RMBS with a fair value of \$1.3 billion and \$642.8 million, respectively.

As of June 30, 2018, the average margin requirement (weighted by borrowing amount), or the percentage amount by which the collateral value must exceed the loan amount (also refer to as the "haircut") under our repurchase agreements was 4.9% for Agency RMBS, 19.6% for non-Agency RMBS, 18.4% for GSE CRT and 18.0% for non-Agency CMBS. Across our repurchase agreement facilities, the haircuts range from a low of 3.0% to a high of 20.0% for Agency RMBS, a low of 8.0% to a high of 35.0% for non-Agency RMBS, a low of 14.5% to a high of 25% for GSE CRT, a low of 5.0% to a high of 30.0% for non-Agency CMBS. 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.

#### 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. 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 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.

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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 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.

**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. Refer to Note 12 - "Related Party Transactions" of our condensed consolidated financial statements for a description of adjustments made to our stockholders' equity for purposes of calculating our management fee. 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. Our reimbursement obligation is not subject to any dollar limitation. Refer to Note 12 - "Related Party Transactions" of our condensed consolidated financial statements for details of our reimbursements to our Manager.

As of June 30, 2018, we had the following contractual obligations:

\$ in thousands	Payments Due by Period				
	Total	Less than 1 year	1-3 years	3-5 years	After 5 years
Repurchase agreements	13,702,321	13,702,321	—	—	—
Secured loans	1,650,000	—	400,000	—	1,250,000
Total <sup>(1)</sup>	15,352,321	13,702,321	400,000	—	1,250,000

(1) Excluded from total contractual obligations are the amounts due to our Manager under the management agreement, as those obligations do not have fixed and determinable payments.

As of June 30, 2018, we have approximately \$37.8 million and \$211.6 million in contractual interest payments related to our repurchase agreements and secured loans, respectively.

**Off-Balance Sheet Arrangements**

We have committed to invest up to \$122.8 million in unconsolidated ventures that are sponsored by an affiliate of our Manager. As of June 30, 2018, \$115.3 million of our commitment to these unconsolidated ventures has been called. We are committed to fund \$7.5 million in additional capital to fund future investments and cover future expenses should they occur.

As of June 30, 2018, we have unfunded commitments on commercial loans of \$2.7 million (December 31, 2017: \$4.8 million).



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## Share-Based Compensation

We established the 2009 Equity Incentive Plan for grants of common stock and other equity based awards to our independent directors and officers and employees of our Manager and its affiliates (the "Incentive Plan"). Under the Incentive Plan, a total of 1,000,000 shares of common stock are authorized for issuance. Unless terminated earlier, the Incentive Plan will terminate in 2019, but will continue to govern the unexpired awards. As of June 30, 2018, 771,823 shares of common stock remain available for future issuance under the Incentive Plan.

We recognized compensation expense of approximately \$106,000 (June 30, 2017: \$112,000) and approximately \$199,000 (June 30, 2017: \$197,000) for shares issued to our independent directors under the Incentive Plan for the three and six months ended June 30, 2018, respectively. During the three months ended June 30, 2018 and 2017, we issued 6,465 shares and 5,292 shares of common stock, respectively, to our independent directors. During the six months ended June 30, 2018 and 2017, we issued 13,642 shares and 10,748 shares of common stock, respectively, to our independent directors. The fair market value of the shares granted was determined by the closing stock market price on the date of the grant. The grants vested immediately.

We recognized compensation expense of approximately \$30,000 (June 30, 2017: \$35,000) and approximately \$44,000 (June 30, 2017: \$66,000) for the three and six months ended June 30, 2018, respectively, for restricted stock units awarded to employees of our Manager and its affiliates under the Incentive Plan. Our Manager reimburses us for the cost of these restricted stock awards under the terms of our management agreement. At June 30, 2018 there was approximately \$276,000 of total unrecognized compensation cost related to restricted stock unit awards that is expected to be recognized over a period of up to 45 months, with a weighted-average remaining vesting period of 20 months.

The following table summarizes the activity related to restricted stock units awarded to employees of our Manager and its affiliates for the three and six months ended June 30, 2018.

	Three Months Ended June 30, 2018		Six Months Ended June 30, 2018	
	Restricted Stock Units	Weighted Average Grant Date Fair Value <sup>(1)</sup>	Restricted Stock Units	Weighted Average Grant Date Fair Value <sup>(1)</sup>
Unvested at the beginning of the period	19,185	\$ 14.56	19,827	\$ 14.35
Shares granted during the period	—	—	7,055	15.37
Shares vested during the period	—	—	(7,697)	14.75
Unvested at the end of the period	19,185	\$ 14.56	19,185	\$ 14.56

(1) The grant date fair value of restricted stock awards is based on the closing market price of our common stock at the grant date.

## 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.

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### 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, 2018, and that our proposed method of operation will permit us to satisfy the asset tests, gross income tests, and distribution and stock ownership requirements for our taxable year that will end on December 31, 2018.

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, 2018, we conducted our business so as not to be regulated as an investment company under the 1940 Act.

### 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.



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### 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.

### Spread Risk

We employ a variety of spread risk management techniques that seek to mitigate the influences of spread changes on our book value and our liquidity to help us achieve our investment objectives. We refer to the difference between interest rates on our investments and interest rates on risk free instruments as spreads. The yield on our investments changes over time due to the level of risk free interest rates, the creditworthiness of the security, and the price of the perceived risk. The change in the market yield of our interest rate hedges also changes primarily with the level of risk free interest rates. We manage spread risk through careful asset selection, sector allocation, regulating our portfolio value-at-risk, and maintaining adequate liquidity. Changes in spreads impact our book value and our liquidity and could cause us to sell assets and to change our investment strategy in order to maintain liquidity and preserve book value.

### 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.

### 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.

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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, 2018, 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%	(24.29	)%	(1.54	)%
+0.50%	(11.25	)%	(0.70	)%
-0.50%	6.22	%	0.50	%
-1.00%	1.75	%	0.73	%

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, 2018. 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, 2018, 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 securities purchased at a premium, and accretion of discount on our securities 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.

**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.



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Foreign Exchange Rate Risk

We have an investment in a commercial loan denominated in foreign currency and an investment in an unconsolidated joint venture whose net assets and results of operations are exposed to foreign currency translation risk when translated in U.S. dollars upon consolidation. We seek to hedge our foreign currency exposures 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.

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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.

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, 2018. Based upon our evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed by us 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 applicable rules and forms, and that it is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure. 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

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, 2018 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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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, 2018, 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 for the year ended December 31, 2017, as filed with the SEC on February 20, 2018.

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, 2018, we did not repurchase any shares of our 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.

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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 7, 2018 By: /s/ John M. Anzalone  
John M. Anzalone  
Chief Executive Officer

August 7, 2018 By: /s/ R. Lee Phegley, Jr.  
R. Lee Phegley, Jr.  
Chief Financial Officer



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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 Articles Supplementary of 7.50% Fixed-to-Floating Series C Cumulative Redeemable Preferred Stock (incorporated by reference to Exhibit 3.4 to the Registrant's Registration Statement on Form 8-A, filed with the SEC on August 11, 2017).
- 3.5 Amended and Restated Bylaws of Invesco Mortgage Capital Inc., incorporated by reference to Exhibit 3.1 to the Current Report on Form 8-K, filed with the SEC on February 17, 2017.
- 31.1 Certification of John M. Anzalone pursuant to Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of R. 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 John M. Anzalone 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 R. 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
- 101.LAB XBRL Taxonomy Label Linkbase Document

101.PRE XBRL Taxonomy Presentation Linkbase Document

101.DEF XBRL Taxonomy Definition Linkbase Document