

Edgar Filing: Ellington Residential Mortgage REIT - Form 10-Q

Ellington Residential Mortgage REIT
Form 10-Q
August 05, 2015

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

FORM 10-Q

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

For the quarterly period ended June 30, 2015

OR

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

For the transition period from _____ to _____
Commission file number 001-35896
Ellington Residential Mortgage REIT
(Exact Name of Registrant as Specified in Its Charter)

Maryland 46-0687599
(State or Other Jurisdiction of Incorporation) (IRS Employer Identification No.)
53 Forest Avenue
Old Greenwich, CT 06870
(Address of principal executive offices, zip code)
(203) 698-1200
(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 Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large Accelerated Filer Accelerated Filer
Non-Accelerated Filer (do not check if a smaller reporting company) Smaller Reporting Company

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

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

Class Outstanding at July 31, 2015
Common Shares of Beneficial Interest, \$0.01 par value per share 9,149,274

ELLINGTON RESIDENTIAL MORTGAGE REIT

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PART I. FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements (unaudited)

ELLINGTON RESIDENTIAL MORTGAGE REIT
CONSOLIDATED BALANCE SHEET
(UNAUDITED)

	June 30, 2015	December 31, 2014
(In thousands except for share amounts)		
ASSETS		
Cash and cash equivalents	\$43,978	\$45,237
Mortgage-backed securities, at fair value	1,334,823	1,393,303
Due from brokers	26,145	18,531
Financial derivatives—assets, at fair value	4,541	3,072
Reverse repurchase agreements	58,859	13,987
Receivable for securities sold	45,045	41,834
Interest receivable	4,522	4,793
Other assets	536	317
Total Assets	\$1,518,449	\$1,521,074
LIABILITIES AND SHAREHOLDERS' EQUITY		
LIABILITIES		
Repurchase agreements	\$1,264,479	\$1,323,080
Payable for securities purchased	32,504	4,227
Due to brokers	1,503	583
Financial derivatives—liabilities, at fair value	4,007	8,700
U.S. Treasury securities sold short, at fair value	51,184	13,959
Dividend payable	5,032	5,032
Accrued expenses	709	890
Management fee payable	592	551
Interest payable	1,211	687
Total Liabilities	1,361,221	1,357,709
SHAREHOLDERS' EQUITY		
Preferred shares, par value \$0.01 per share, 100,000,000 shares authorized; (0 shares issued and outstanding, respectively)	—	—
Common shares, par value \$0.01 per share, 500,000,000 shares authorized; (9,149,274 and 9,149,274 shares issued and outstanding, respectively)	91	91
Additional paid-in-capital	181,342	181,282
Accumulated deficit	(24,205	) (18,008)
Total Shareholders' Equity	157,228	163,365
Total Liabilities and Shareholders' Equity	\$1,518,449	\$1,521,074

See Notes to Consolidated Financial Statements

ELLINGTON RESIDENTIAL MORTGAGE REIT
CONSOLIDATED STATEMENT OF OPERATIONS
(UNAUDITED)

	Three Month Period Ended June 30, 2015	Three Month Period Ended June 30, 2014	Six Month Period Ended June 30, 2015	Six Month Period Ended June 30, 2014
(In thousands except for per share amounts)				
INTEREST INCOME (EXPENSE)				
Interest income	\$9,841	\$11,575	\$20,121	\$23,534
Interest expense	(1,520)	(1,070)	(2,778)	(2,225)
Total net interest income	8,321	10,505	17,343	21,309
EXPENSES				
Management fees	592	567	1,202	1,159
Professional fees	135	137	278	276
Other operating expenses	538	613	1,201	1,276
Total expenses	1,265	1,317	2,681	2,711
OTHER INCOME (LOSS)				
Net realized gains (losses) on mortgage-backed securities	1,442	382	8,164	(2,643)
Net realized losses on financial derivatives	(3,842)	(11,155)	(12,585)	(14,564)
Change in net unrealized gains (losses) on mortgage-backed securities	(17,722)	25,424	(12,536)	43,005
Change in net unrealized gains (losses) on financial derivatives	13,256	(12,789)	6,162	(30,585)
Total other income (loss)	(6,866)	1,862	(10,795)	(4,787)
NET INCOME	\$190	\$11,050	\$3,867	\$13,811
NET INCOME PER COMMON SHARE:				
Basic and Diluted	\$0.02	\$1.21	\$0.42	\$1.51
CASH DIVIDENDS PER COMMON SHARE:				
Dividends declared	\$0.55	\$0.55	\$1.10	\$1.10

See Notes to Consolidated Financial Statements

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ELLINGTON RESIDENTIAL MORTGAGE REIT
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
(UNAUDITED)

	Common Shares	Common Shares, par value	Preferred Shares	Preferred Shares, par value	Additional Paid-in-Capital	Accumulated (Deficit) Earnings	Total
(In thousands except for share amounts)							
BALANCE, December 31, 2013	9,139,842	\$91	—	\$—	\$ 181,147	\$(14,058)	\$167,180
Share based compensation					56		56
Dividends declared						(10,054)	(10,054)
Net income						13,811	13,811
BALANCE, June 30, 2014	9,139,842	\$91	—	\$—	\$ 181,203	\$(10,301)	\$170,993
BALANCE, December 31, 2014	9,149,274	\$91	—	\$—	\$ 181,282	\$(18,008)	\$163,365
Share based compensation					60		60
Dividends declared						(10,064)	(10,064)
Net income						3,867	3,867
BALANCE, June 30, 2015	9,149,274	\$91	—	\$—	\$ 181,342	\$(24,205)	\$157,228

See Notes to Consolidated Financial Statements

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ELLINGTON RESIDENTIAL MORTGAGE REIT
CONSOLIDATED STATEMENT OF CASH FLOWS
(UNAUDITED)

	Six Month Period Ended June 30, 2015	Six Month Period Ended June 30, 2014
(In thousands)		
Cash flows provided by (used in) operating activities:		
Net income	\$3,867	\$13,811
Reconciliation of net income to net cash provided by (used in) operating activities:		
Net realized (gains) losses on mortgage-backed securities	(8,164	) 2,643
Change in net unrealized (gains) losses on mortgage-backed securities	12,536	(43,005)
Net realized losses on financial derivatives	12,585	14,564
Change in net unrealized (gains) losses on financial derivatives	(6,162	) 30,585
Amortization of premiums and accretion of discounts (net)	5,110	3,186
Share based compensation	60	56
(Increase) decrease in assets:		
Due from brokers	(7,614	) 5,009
Interest receivable	271	(1,003)
Other assets	(219	) (435)
Increase (decrease) in liabilities:		
Due to brokers	920	(15,468)
Accrued expenses	(181	) 107
Interest payable	524	(159)
Management fees payable	41	(33)
Net cash provided by operating activities	13,574	9,858
Cash flows provided by (used in) investing activities:		
Purchases of mortgage-backed securities	(951,817	) (963,724)
Proceeds from sale of mortgage-backed securities	956,197	958,571
Principal repayments of mortgage-backed securities	68,538	44,051
Proceeds from investments sold short	468,417	13,036
Repurchase of investments sold short	(430,046	) (13,049)
Proceeds from disposition of financial derivatives	8,819	6,989
Purchase of financial derivatives	(21,404	) (21,553)
Payments made on reverse repurchase agreements	(6,175,441	) (29,129)
Proceeds from reverse repurchase agreements	6,130,569	29,129
Net cash provided by investing activities	53,832	24,321
Cash flows provided by (used in) financing activities:		
Offering costs paid	—	(32)
Dividends paid	(10,064	) (9,597)
Borrowings under repurchase agreements	1,485,330	3,065,991
Repayments of repurchase agreements	(1,543,931	) (3,090,745)
Cash used in financing activities	(68,665	) (34,383)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(1,259	) (204)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	45,237	50,112
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$43,978	\$49,908
Supplemental disclosure of cash flow information:		
Interest paid	\$2,254	\$2,385

Dividends payable	\$5,032	\$5,027
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See Notes to Consolidated Financial Statements

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ELLINGTON RESIDENTIAL MORTGAGE REIT
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2015

(UNAUDITED)

1. Organization and Investment Objective

Ellington Residential Mortgage REIT, or "EARN," was formed as a Maryland real estate investment trust, or "REIT," on August 2, 2012, and commenced operations on September 25, 2012. EARN conducts its business through its wholly owned subsidiaries, EARN OP GP LLC, or the "General Partner," and Ellington Residential Mortgage LP, or the "Operating Partnership," which were formed as a Delaware limited liability company and a Delaware limited partnership, respectively, on July 31, 2012 and commenced operations on September 25, 2012. The Operating Partnership conducts its business of acquiring, investing in, and managing residential mortgage-related and real estate-related assets through its wholly owned subsidiaries. EARN, the General Partner, the Operating Partnership, and their consolidated subsidiaries are hereafter defined as the "Company."

Ellington Residential Mortgage Management LLC, or the "Manager," serves as the Manager of the Company pursuant to the terms of a management agreement (the "Management Agreement"). The Manager is an affiliate of Ellington Management Group, L.L.C., or "EMG," an investment management firm that is registered as an investment adviser with a 20-year history of investing in a broad spectrum of mortgage-backed securities and related derivatives, with an emphasis on the residential mortgage-backed securities, or "RMBS," market. In accordance with the terms of the Management Agreement and the Services Agreement, as discussed in Note 10, the Manager is responsible for administering the Company's business activities and day-to-day operations, and performs certain services, subject to oversight by the Board of Trustees. See Notes 8 and 10 for further information on the Management Agreement.

The Company acquires and manages RMBS, for which the principal and interest payments are guaranteed by a U.S. government agency or a U.S. government-sponsored entity, or "Agency RMBS," and RMBS that do not carry such guarantees, or "non-Agency RMBS," such as RMBS backed by prime jumbo, Alternative A-paper, manufactured housing, and subprime residential mortgage loans. Agency RMBS include both Agency pools and Agency collateralized mortgage obligations, or "CMOs," and non-Agency RMBS primarily consist of non-Agency CMOs, both investment grade and non-investment grade. The Company may also acquire and manage mortgage servicing rights, residential mortgage loans, and other mortgage- and real estate-related assets. The Company may also invest in other instruments including, but not limited to, forward-settling To-Be-Announced Agency pass-through certificates, or "TBAs," interest rate swaps and swaptions, U.S. Treasury securities, Eurodollar and U.S. Treasury futures, other financial derivatives, and cash equivalents. The Company's targeted investments may range from unrated first loss securities to AAA senior securities.

The Company made the election to be taxed as a REIT under the Internal Revenue Code of 1986, as amended, or "the Code," commencing with the Company's short taxable year ended December 31, 2013. As a REIT, the Company is required to distribute annually at least 90% of its taxable income. As long as the Company continues to qualify as a REIT, it will not be subject to U.S. federal or state corporate taxes on its taxable income to the extent that it distributes all of its annual taxable income to its shareholders. It is the intention of the Company to distribute at least 100% of its taxable income, after application of available tax attributes, within the limits prescribed by the Code, which may extend into the subsequent taxable year.

2. Significant Accounting Policies

(A) Basis of Presentation: The Company's unaudited interim consolidated financial statements have been prepared in conformity with generally accepted accounting principles in the United States of America, or "U.S. GAAP." Entities in which the Company has a controlling financial interest, through ownership of the majority of the entities' voting equity interests, or through other contractual right that give the Company control, are consolidated by the Company. All inter-company balances and transactions have been eliminated. The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates and those differences could be material. In management's opinion, all material adjustments, considered necessary for a fair

presentation of the Company's interim consolidated financial statements have been included and are only of a normal recurring nature. Interim results are not necessarily indicative of the results that may be expected for the entire fiscal year. The information included in this Quarterly Report on Form 10-Q should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2014.

(B) Valuation: The Company applies ASC 820-10, Fair Value Measurement and Disclosures ("ASC 820-10"), to its holdings of financial instruments. ASC 820-10 establishes a three-level valuation hierarchy for disclosure of fair value

measurements. The valuation hierarchy is based upon the observability of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

Level 1—inputs to the valuation methodology are observable and reflect quoted prices (unadjusted) for identical assets or liabilities in active markets. Currently, the types of financial instruments the Company generally includes in this category are, exchange-traded derivatives, and cash equivalents;

Level 2—inputs to the valuation methodology other than quoted prices included in Level 1 are observable for the asset or liability, either directly or indirectly. Currently, the types of financial instruments that the Company generally includes in this category are Agency RMBS, non-Agency RMBS determined to have sufficiently observable market data, U.S. Treasury securities, actively traded derivatives such as TBAs, interest rate swaps, and swaptions; and

Level 3—inputs to the valuation methodology are unobservable and significant to the fair value measurement. Currently, this category includes RMBS where there is less price transparency.

For certain financial instruments, the various inputs that management uses to measure fair value for such financial instrument may fall into different levels of the fair value hierarchy. In such cases, the determination of which category within the fair value hierarchy is appropriate for such financial instrument is based on the lowest level of input that is significant to the fair value measurement. The assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the financial instrument. The Company may use valuation techniques consistent with the market and income approaches to measure the fair value of its assets and liabilities. The market approach uses third-party valuations and information obtained from market transactions involving identical or similar assets or liabilities. The income approach uses projections of the future economic benefits of an instrument to determine its fair value, such as in the discounted cash flow methodology. The inputs or methodology used for valuing financial instruments are not necessarily an indication of the risk associated with investing in these financial instruments. Transfers between levels of the fair value hierarchy are assumed to occur at the end of the reporting period.

Summary Valuation Techniques

For financial instruments that are traded in an "active market," the best measure of fair value is the quoted market price. However, many of the Company's financial instruments are not traded in an active market. Therefore, management generally uses third-party valuations when available. If third-party valuations are not available, management uses other valuation techniques, such as the discounted cash flow methodology. The following are summary descriptions, for the various categories of financial instruments, of the valuation methodologies management uses in determining fair value of the Company's financial instruments in such categories. Management utilizes such methodologies to assign a good faith fair value (the estimated price that, in an orderly transaction at the valuation date, would be received to sell an asset, or paid to transfer a liability, as the case may be) to each such financial instrument. Valuations for fixed rate RMBS pass-throughs issued by a U.S government agency or government-sponsored enterprise, or "GSE," are typically based on observable pay-up data (pay-ups are price premiums for specified categories of fixed rate pools relative to their TBA counterparts) or models that use observable market data, such as interest rates and historical prepayment speeds, and are validated against third-party valuations. With respect to the Company's other RMBS investments and TBAs, management seeks to obtain at least one third-party valuation, and often obtains multiple valuations when available. Management has been able to obtain third-party valuations on the vast majority of these instruments and expects to continue to solicit third-party valuations in the future. Management generally values each financial instrument at the average of third-party valuations received and not rejected as described below. Third-party valuations are not binding, and while management generally does not adjust the valuations it receives, management may challenge or reject a valuation when, based on its validation criteria, management determines that such valuation is unreasonable or erroneous. Furthermore, based on its validation criteria, management may determine that the average of the third-party valuations received for a given instrument does not result in what management believes to be the fair value of such instrument, and in such circumstances management may override this average with its own good faith valuation. The validation criteria may take into account output from management's own models, recent trading activity in the same or similar instruments, and valuations received from third parties. The use of proprietary models requires the use of a significant amount of judgment and the application of various assumptions including, but not limited to, assumptions concerning future

prepayment rates and default rates.

Given their relatively high level of price transparency, Agency RMBS pass-throughs and TBAs are typically designated as Level 2 assets, although Agency interest only and inverse interest only RMBS are currently designated as Level 3 assets since they generally have less price transparency. Non-Agency RMBS are generally classified as either Level 2 or Level 3 based on analysis of available market data such as recent trades, executable bids, and reported "market color." Furthermore, the methodology used by the third-party valuation providers is reviewed at least annually by management, so as to ascertain whether such providers are utilizing observable market data to determine the valuations that they provide.

Interest rate swaps and swaptions are typically valued based on internal models that use observable market data, including applicable interest rates in effect as of the measurement date; the model-generated valuations are then typically compared to counterparty valuations for reasonableness. These financial derivatives are generally designated as Level 2 instruments.

The Company's repurchase and reverse repurchase agreements are carried at cost, which approximates fair value. Repurchase agreements and reverse repurchase agreements are classified as Level 2 assets and liabilities based on the adequacy of the collateral and their short term nature.

The Company's valuation process, including the application of validation criteria, is overseen by the Manager's Valuation Committee. The Valuation Committee includes senior level executives from various departments within the Manager, and each quarter the Valuation Committee reviews and approves the valuations of the Company's investments. The valuation process also includes a monthly review by the Company's third party administrator. The goal of this review is to replicate various aspects of the Company's valuation process based on the Company's documented procedures.

Because of the inherent uncertainty of valuation, the estimated fair value of the Company's financial instruments may differ significantly from the values that would have been used had a ready market for the financial instruments existed, and the differences could be material to the consolidated financial statements.

(C) Accounting for Mortgage-Backed Securities: Purchases and sales of investments are recorded on trade date and realized and unrealized gains and losses are calculated based on identified cost.

The Company has chosen to make a fair value election pursuant to ASC 825-10, Financial Instruments, for its mortgage-backed securities portfolio. Electing the fair value option allows the Company to record changes in fair value in the Consolidated Statement of Operations, which, in management's view, more appropriately reflects the results of operations for a particular reporting period as all securities activities will be recorded in a similar manner. As such, mortgage-backed securities are recorded at fair value on the Consolidated Balance Sheet and the period change in fair value is recorded in current period earnings on the Consolidated Statement of Operations as a component of Change in net unrealized gains (losses) on mortgage-backed securities.

(D) Interest Income: Coupon interest income on investment securities is accrued based on the outstanding principal balance or notional amount and the current coupon rate on each security. The Company amortizes premiums and accretes discounts on its fixed income securities. For RMBS that are deemed to be of high credit quality at the time of purchase, premiums and discounts are generally amortized/accreted into interest income over the life of such securities using the effective interest method. For securities whose cash flows vary depending on prepayments, an effective yield retroactive to the time of purchase is periodically recomputed based on actual prepayments and changes in projected prepayment activity, and a catch-up adjustment is made to amortization to reflect the cumulative impact of the change in effective yield. For RMBS that are deemed not to be of high credit quality at the time of purchase, interest income is recognized based on the effective interest method. For purposes of determining the effective interest rate, management estimates the future expected cash flows of its investment holdings based on assumptions including, but not limited to, assumptions for future prepayment rates, default rates, and loss severities (each of which may in turn incorporate various macro-economic assumptions, such as future housing prices). These assumptions are re-evaluated not less than quarterly. Principal write-offs are generally treated as realized losses. Changes in projected cash flows, as applied to the current amortized cost of the security, may result in a prospective change in the yield/interest income recognized on such securities.

The Company's accretion of discounts and amortization of premiums on securities for U.S. federal and other tax purposes is likely to differ from the accounting treatment under U.S. GAAP of these items as described above.

(E) Cash and Cash Equivalents: Cash and cash equivalents include cash and short term investments with original maturities of three months or less at the date of acquisition. Cash equivalents are recorded at cost plus accrued interest, which approximates fair value. Cash and cash equivalents typically include amounts held in an interest bearing overnight account and amounts held in money market funds, and these balances generally exceed insured limits.

(F) Due from brokers/Due to brokers: Due from brokers and Due to brokers accounts on the Consolidated Balance Sheet include collateral transferred to or received from counterparties, including clearinghouses, along with receivables and payables for open and/or closed derivative positions.

(G) Financial Derivatives: The Company may enter into various types of financial derivatives subject to its investment guidelines, which include restrictions associated with maintaining qualification as a REIT. The Company's financial derivatives are predominantly subject to bilateral collateral arrangements or clearing in accordance with the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. The Company may be required to deliver or may receive cash or securities as collateral upon entering into derivative transactions. In addition, changes in the relative value of financial derivative

transactions may require the Company or the counterparty to post or receive additional collateral. In the case of cleared financial derivatives, the clearinghouse becomes the Company's counterparty and a futures commission merchant acts as intermediary between the Company and the clearinghouse with respect to all facets of the related transaction, including the posting and receipt of required collateral. Collateral received by the Company is reflected on the Consolidated Balance Sheet as "Due to Brokers." Conversely, collateral posted by the Company is reflected as "Due from Brokers" on the Consolidated Balance Sheet. The types of financial derivatives that have been utilized by the Company to date are interest rate swaps, TBAs, swaptions, and futures.

Swaps: The Company has entered into interest rate swaps, which are contractual agreements whereby one party pays a floating interest rate on a notional principal amount and receives a fixed rate payment on the same notional principal, or vice versa, for a fixed period of time.

Swaps change in value with movements in interest rates or total return of the reference securities. During the term of swap contracts, changes in value are recognized as unrealized gains or losses on the Consolidated Statement of Operations. When a contract is terminated, the Company realizes a gain or loss equal to the difference between the proceeds from (or cost of) the closing transaction and the Company's basis in the contract, if any. Periodic payments or receipts required by swap agreements are recorded as unrealized gains or losses when accrued and realized gains or losses when received or paid. Upfront payments paid and/or received by the Company to open swap contracts are recorded as an asset and/or liability on the Consolidated Balance Sheet and are recorded as a realized gain or loss on the termination date.

TBA Securities: The Company has transacted in the forward settling TBA market. A TBA position is a forward contract for the purchase ("long position") or sale ("short position") of Agency RMBS at a predetermined price, face amount, issuer, coupon, and maturity on an agreed-upon future delivery date. For each TBA contract and delivery month, a uniform settlement date for all market participants is determined by the Securities Industry and Financial Markets Association. The specific Agency RMBS to be delivered into the contract at the settlement date are not known at the time of the transaction. The Company typically does not take delivery of TBAs, but rather enters into offsetting transactions and settles the associated receivable and payable balances with its counterparties. The Company primarily uses TBAs to mitigate interest rate risk, but from time to time it also holds net long positions in certain TBA securities as a means of acquiring exposure to Agency RMBS.

TBAs are accounted for by the Company as financial derivatives. The difference between the contract price and the fair value of the TBA position as of the reporting date is included in Change in net unrealized gains (losses) on financial derivatives, in the Consolidated Statement of Operations. Upon settlement of the TBA contract, the realized gain (loss) on the TBA contract is equal to the net cash amount received (paid).

Options: The Company has entered into swaption contracts. It may purchase or write put, call, straddle, or other similar options contracts. The Company enters into options contracts primarily to help mitigate interest rate risk. When the Company purchases an options contract, the option asset is initially recorded at an amount equal to the premium paid, if any, and is subsequently marked-to-market. Premiums paid for purchasing options contracts that expire unexercised are recognized on the expiration date as realized losses. If an options contract is exercised, the premium paid is subtracted from the proceeds of the sale or added to the cost of the purchase to determine whether the Company has realized a gain or loss on the related investment transaction. When the Company writes an options contract, the option liability is initially recorded at an amount equal to the premium received, if any, and is subsequently marked-to-market. Premiums received for writing options contracts that expire unexercised are recognized on the expiration date as realized gains. If an options contract is exercised, the premium received is subtracted from the cost of the purchase or added to the proceeds of the sale to determine whether the Company has realized a gain or loss on the related investment transaction. When the Company enters into a closing transaction, the Company will realize a gain or loss depending upon whether the amount from the closing transaction is greater or less than the premiums paid or received. In general, the Company's options contracts contain forward-settling premiums. In this case, no money is exchanged upfront; instead, the agreed-upon premium is paid by the buyer upon expiration of the options contract, regardless of whether or not the options contract is exercised.

Futures Contracts: A futures contract is an exchange-traded agreement to buy or sell an asset for a set price on a future date. Initial margin deposits are made upon entering into futures contracts and can be either in the form of cash or

securities. During the period the futures contract is open, changes in the value of the contract are recognized as unrealized gains or losses by marking-to-market to reflect the current market value of the contract. Variation margin payments are made or received periodically, depending upon whether unrealized losses or gains are incurred. When the contract is closed, the Company records a realized gain or loss equal to the difference between the proceeds of the closing transaction and the Company's basis in the contract.

Financial derivative assets are included in Financial derivatives—assets, at fair value on the Consolidated Balance Sheet while financial derivative liabilities are included in Financial derivatives—liabilities, at fair value on the Consolidated Balance Sheet.

(H) Repurchase Agreements and Reverse Repurchase Agreements: The Company enters into repurchase agreements with third-party broker-dealers, whereby it sells securities under agreements to repurchase at an agreed upon price and date. The Company also enters into reverse repurchase agreement transactions with third-party broker-dealers, whereby it purchases securities under agreements to resell at an agreed upon price and date. The Company accounts for repurchase agreements as collateralized borrowings, with the initial sale price representing the amount borrowed, and with the future repurchase price consisting of the amount borrowed plus interest, at the implied interest rate of the repurchase agreement, on the amount borrowed over the term of the repurchase agreement. The interest rate on a repurchase agreement or a reverse repurchase agreement is based on competitive market rates (or competitive market spreads, in the case of agreements with floating interest rates) at the time such agreement is entered into. When the Company enters into a repurchase agreement, the lender establishes and maintains an account containing cash and/or securities having a value not less than the repurchase price, including accrued interest, of the repurchase agreement. Repurchase and reverse repurchase agreements that are conducted with the same counterparty can be reported on a net basis if they meet the requirements under the authoritative guidance. Repurchase agreements and reverse repurchase agreements are carried at their contractual amounts, which approximate fair value.

(I) U.S. Treasury Securities: The Company may purchase or sell short U.S. Treasury securities to help mitigate the potential impact of changes in interest rates on the performance of its portfolio. The Company may borrow securities under reverse repurchase agreements to enable it to deliver U.S. Treasury securities that it has sold short.

(J) Offering Costs/Deferred Offering Costs: Offering costs are charged against shareholders' equity and typically include legal, accounting, printing, and other fees associated with the cost of raising equity capital.

(K) Share Based Compensation: The Company applies the provisions of ASC 718, Compensation—Stock Compensation ("ASC 718"), with regard to its equity incentive plans. ASC 718 covers a wide range of share-based compensation arrangements including share options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. ASC 718 requires that compensation cost relating to share-based payment transactions be recognized in financial statements. The cost is measured based on the fair value of the equity or liability instruments issued.

(L) Dividends: Dividends payable are recorded on the declaration date.

(M) Expenses: Expenses are recognized as incurred on the Consolidated Statement of Operations.

(N) Earnings Per Share: In accordance with the provisions of ASC 260, Earnings per Share, the Company calculates basic income (loss) per share by dividing net income (loss) for the period by the weighted average of the Company's common shares outstanding for that period. Diluted income (loss) per share takes into account the effect of dilutive instruments, such as share options and warrants, and uses the average share price for the period in determining the number of incremental shares that are to be added to the weighted average number of shares outstanding.

(O) Share Repurchases: Common shares that are repurchased by the Company subsequent to issuance decrease the total number of shares issued and outstanding.

(P) Income Taxes: The Company has elected to be taxed as a REIT under Sections 856 to 860 of the Code. As a REIT, the Company is generally not subject to corporate-level federal and state income tax on net income it distributes to its stockholders. To qualify as a REIT, the Company must meet a number of organizational and operational requirements, including the distribution of at least 90% of its annual taxable income to shareholders. Even if the Company qualifies as a REIT, it may be subject to certain federal, state, local and foreign taxes on its income and property and to federal income and excise taxes on its undistributed taxable income.

The Company follows the authoritative guidance on accounting for and disclosure of uncertainty on tax positions, which requires management to determine whether a tax position of the company is more likely than not to be sustained upon examination by the applicable taxing authority, including resolution of any related appeals of the litigation process, based on the technical merits of the position. For uncertain tax positions, the tax benefit to be recognized is measured as the largest amount of benefit that is greater than fifty percent likely of being realized upon ultimate settlement. The Company did not have any unrecognized tax benefits at June 30, 2015. In the normal course

of business, the Company may be subject to examination by federal, state, local, and foreign jurisdictions, where applicable, for the current period, 2014, 2013, and 2012 (its open tax years). The Company may take positions with respect to certain tax issues which depend on legal interpretation of facts or applicable tax regulations. Should the relevant tax regulators successfully challenge any of such positions, the Company might be found to have a tax liability that has not been recorded in the accompanying consolidated financial statements. Also,

management's conclusions regarding the authoritative guidance may be subject to review and adjustment at a later date based on changing tax laws, regulations, and interpretations thereof. There were no amounts accrued for penalties or interest as of or during the periods presented in these consolidated financial statements.

(Q) Recent Accounting Pronouncements: Under the Jumpstart Our Business Startups Act, or the "JOBS Act," the Company meets the definition of an "emerging growth company." The Company has elected to follow the extended transition period for complying with new or revised U.S. accounting standards pursuant to Section 107(b) of the JOBS Act. As a result, the Company will comply with new or revised accounting standards on the relevant dates on which adoption of such standards is required for non-public entities.

In June 2014, the FASB issued ASU No. 2014-11, Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures ("ASU 2014-11"). This amends ASC 860, Transfers and Servicing ("ASC 860"), to require disclosure of repurchase-to-maturity transactions to be accounted for as secured borrowings rather than sales of an asset, and transfers of financial assets with a contemporaneous repurchase agreement will no longer be evaluated to determine whether they should be accounted for on a combined basis as forward contracts. The new guidance also prescribes additional disclosures particularly on the nature of collateral pledged under repurchase agreements accounted for as secured borrowings. ASU 2014-11 is effective for annual periods beginning after December 15, 2014 and interim periods beginning after December 31, 2015. The adoption of ASC 860, as amended by ASU 2014-11 is not expected to have a material impact on the Company's consolidated financial statements.

In August 2014, the FASB issued ASU 2014-15, Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern ("ASU 2014-15"). ASU 2014-15 requires management to perform interim and annual assessments of an entity's ability to continue as a going concern and to provide disclosure if events or conditions arise that would place substantial doubt on the entity's ability to continue as a going concern. ASU 2014-15 is effective for the annual period ending after December 15, 2016, and subsequent interim and annual periods with early adoption permitted. The adoption of ASU 2014-15 is not expected to have a material impact on the Company's consolidated financial statements.

In February 2015, the FASB issued ASU 2015-02, Amendments to the Consolidation Analysis ("ASU 2015-02"). This amends ASC 810, Consolidation (ASC "810"), to improve targeted areas of consolidation guidance by simplifying the requirements of consolidation and placing more emphasis on risk of loss when determining a controlling financial interest. ASU 2015-02 is effective for annual periods beginning after December 15, 2016 and interim periods beginning after December 15, 2017 with early adoption permitted. The adoption of ASU 2015-02 is not expected to have a material impact on the Company's consolidated financial statements.

3. Mortgage-Backed Securities

The following tables present details of the Company's mortgage-backed securities portfolio at June 30, 2015 and December 31, 2014, respectively. The Company's Agency RMBS include mortgage pass-through certificates and CMOs representing interests in or obligations backed by pools of residential mortgage loans issued or guaranteed by a U.S. government agency or GSE. The non-Agency RMBS portfolio is not issued or guaranteed by the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, or any agency of the U.S. Government and is therefore subject to greater credit risk.

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By RMBS Type –
June 30, 2015:

	Current Principal	Unamortized Premium (Discount)	Amortized Cost	Gross Unrealized			Weighted Average		
				Gains	Losses	Fair Value	Coupon	Yield	Weighted Average Life(Years) ⁽¹⁾
Agency RMBS:									
15-year fixed rate mortgages	\$157,422	\$7,728	\$165,150	\$1,138	\$(230)	\$166,058	3.38%	2.29%	5.15
20-year fixed rate mortgages	9,250	526	9,776	158	—	9,934	4.00%	2.88%	6.10
30-year fixed rate mortgages	958,490	58,729	1,017,219	11,658	(4,634)	1,024,243	4.07%	3.08%	8.51
Adjustable rate mortgages	38,594	2,382	40,976	137	(116)	40,997	4.25%	2.80%	3.59
Reverse mortgages	50,788	5,803	56,591	331	(689)	56,233	4.77%	2.64%	6.65
Interest only securities	n/a	n/a	7,270	323	(523)	7,070	3.49%	3.40%	2.36
Total Agency RMBS	1,214,544	75,168	1,296,982	13,745	(6,192)	1,304,535	3.98%	2.95%	7.49
Non-Agency RMBS	44,386	(15,774)	28,612	2,164	(488)	30,288	2.64%	9.97%	5.10
Total RMBS	\$1,258,930	\$59,394	\$1,325,594	\$15,909	\$(6,680)	\$1,334,823	3.94%	3.10%	7.41

Average lives of RMBS are generally shorter than stated contractual maturities. Average lives are affected by the (1)contractual maturities of the underlying mortgages, scheduled periodic payments of principal, and unscheduled prepayments of principal.

For the six month period ended June 30, 2015, the weighted average holdings of RMBS investments based on amortized cost was \$1.327 billion.

December 31, 2014:

	Current Principal	Unamortized Premium (Discount)	Amortized Cost	Gross Unrealized			Weighted Average		
				Gains	Losses	Fair Value	Coupon	Yield	Weighted Average Life(Years) ⁽¹⁾
Agency RMBS:									
15-year fixed rate mortgages	\$130,720	\$6,304	\$137,024	\$1,113	\$(109)	\$138,028	3.40%	2.46%	5.43
20-year fixed rate mortgages	9,764	577	10,341	227	—	10,568	4.00%	3.04%	6.92

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30-year fixed rate mortgages	1,042,550	61,089	1,103,639	20,379	(1,764)	1,122,254	4.09%	3.29%	8.48
Adjustable rate mortgages	41,710	2,813	44,523	90	(330)	44,283	4.60%	3.08%	5.97
Reverse mortgages	31,412	2,741	34,153	300	(28)	34,425	4.91%	2.56%	4.74
Interest only securities	n/a	n/a	10,780	1,190	(726)	11,244	4.04%	11.82%	2.68
Total Agency RMBS	1,256,156	73,524	1,340,460	23,299	(2,957)	1,360,802	4.05%	3.24%	7.54
Non-Agency RMBS	50,668	(20,377)	30,291	2,896	(686)	32,501	2.29%	10.76%	4.97
Total RMBS	\$1,306,824	\$53,147	\$1,370,751	\$26,195	\$(3,643)	\$1,393,303	3.99%	3.41%	7.45

Average lives of RMBS are generally shorter than stated contractual maturities. Average lives are affected by the (1) contractual maturities of the underlying mortgages, scheduled periodic payments of principal, and unscheduled prepayments of principal.

For the year ended December 31, 2014, the weighted average holdings of RMBS investments based on amortized cost was \$1.363 billion.

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By Estimated Weighted Average Life

As of June 30, 2015:

(\$ in thousands)	Agency RMBS			Agency Interest Only Securities			Non-Agency RMBS		
	Fair Value	Amortized Cost	Weighted Average Coupon	Fair Value	Amortized Cost	Weighted Average Coupon	Fair Value	Amortized Cost	Weighted Average Coupon
Estimated Weighted Average Life									
Less than three years	\$26,578	\$26,529	5.18 %	\$3,858	\$4,234	3.07 %	\$2,501	\$1,637	3.07 %
Greater than three years and less than seven years	250,836	249,101	3.74 %	3,212	3,036	4.61 %	18,544	18,838	3.52 %
Greater than seven years and less than eleven years	1,005,138	999,021	4.06 %	—	—	— %	9,243	8,137	0.58 %
Greater than eleven years	14,913	15,061	3.66 %	—	—	— %	—	—	— %
Total	\$1,297,465	\$1,289,712	4.02 %	\$7,070	\$7,270	3.49 %	\$30,288	\$28,612	2.64 %

As of December 31, 2014:

(\$ in thousands)	Agency RMBS			Agency Interest Only Securities			Non-Agency RMBS		
	Fair Value	Amortized Cost	Weighted Average Coupon	Fair Value	Amortized Cost	Weighted Average Coupon	Fair Value	Amortized Cost	Weighted Average Coupon
Estimated Weighted Average Life									
Less than three years	\$18,428	\$18,418	5.13 %	\$5,197	\$5,563	3.42 %	\$2,837	\$1,785	3.02 %
Greater than three years and less than seven years	410,759	405,739	4.12 %	6,047	5,217	5.19 %	17,660	17,662	2.63 %
Greater than seven years and less than eleven years	920,371	905,523	4.00 %	—	—	— %	12,004	10,844	1.28 %
Total	\$1,349,558	\$1,329,680	4.05 %	\$11,244	\$10,780	4.04 %	\$32,501	\$30,291	2.29 %

The following table reflects the components of interest income on the Company's RMBS for the three and six month periods ended June 30, 2015:

(\$ in thousands)	Three Month Period Ended June 30, 2015			Six Month Period Ended June 30, 2015		
	Coupon Interest	Net Amortization	Interest Income	Coupon Interest	Net Amortization	Interest Income
Agency RMBS	\$12,187	\$(3,085)	\$9,102	\$24,678	\$(6,044)	\$18,634
Non-Agency RMBS	296	427	723	579	883	1,462
Total	\$12,483	\$(2,658)	\$9,825	\$25,257	\$(5,161)	\$20,096

The following table reflects the components of interest income on the Company's RMBS for the three and six month periods ended June 30, 2014:

(\$ in thousands)	Three Month Period Ended June 30, 2014			Six Month Period Ended June 30, 2014		
	Coupon Interest	Net Amortization	Interest Income	Coupon Interest	Net Amortization	Interest Income

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Agency RMBS	\$13,052	\$(2,287) \$10,765	\$26,069	\$(4,043) \$22,026
Non-Agency RMBS	338	468	806	644	857	1,501
Total	\$13,390	\$(1,819) \$11,571	\$26,713	\$(3,186) \$23,527

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4. Valuation

The following tables present the Company's financial instruments measured at fair value on:

June 30, 2015:

(In thousands)

Description	Level 1	Level 2	Level 3	Total
Assets:				
Cash equivalents	\$20,000	\$—	\$—	\$20,000
Mortgage-backed securities, at fair value:				
Agency RMBS:				
15-year fixed rate mortgages	\$—	\$166,058	\$—	\$166,058
20-year fixed rate mortgages	—	9,934	—	9,934
30-year fixed rate mortgages	—	1,024,243	—	1,024,243
Adjustable rate mortgages	—	40,997	—	40,997
Reverse mortgages	—	56,233	—	56,233
Interest only securities	—	—	7,070	7,070
Non-Agency RMBS	—	24,732	5,556	30,288
Mortgage-backed securities, at fair value	—	1,322,197	12,626	1,334,823
Financial derivatives—assets, at fair value:				
TBAs				
Fixed payer interest rate swaps	—	906	—	906
Total financial derivatives—assets, at fair value	—	3,635	—	3,635
Total mortgage-backed securities and financial derivatives—assets, at fair value	\$—	4,541	—	4,541
Total mortgage-backed securities and financial derivatives—assets, at fair value				
\$—	\$1,326,738	\$12,626	\$1,339,364	
Liabilities:				
U.S. Treasury securities sold short, at fair value	\$—	\$(51,184)	\$—	\$(51,184)
Financial derivatives—liabilities, at fair value:				
TBAs				
Fixed payer interest rate swaps	—	(677)	—	(677)
Fixed payer swaptions	—	(3,313)	—	(3,313)
Total financial derivatives—liabilities, at fair value	—	(17)	—	(17)
Total U.S. Treasury securities sold short and financial derivatives—liabilities, at fair value	—	(4,007)	—	(4,007)
Total U.S. Treasury securities sold short and financial derivatives—liabilities, at fair value	\$—	\$(55,191)	\$—	\$(55,191)

There were no transfers of financial instruments between Levels 1 and 2 of the fair value hierarchy during the six month period ended June 30, 2015.

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December 31, 2014:

(In thousands)

Description	Level 1	Level 2	Level 3	Total
Assets ⁽¹⁾ :				
Cash equivalents	\$35,000	\$—	\$—	\$35,000
Mortgage-backed securities, at fair value:				
Agency RMBS:				
15-year fixed rate mortgages	\$—	\$138,028	\$—	\$138,028
20-year fixed rate mortgages	—	10,568	—	10,568
30-year fixed rate mortgages	—	1,122,254	—	1,122,254
Adjustable rate mortgages	—	44,283	—	44,283
Reverse mortgages	—	34,425	—	34,425
Interest only securities	—	—	11,244	11,244
Non-Agency RMBS				
Mortgage-backed securities, at fair value	—	1,371,977	21,326	1,393,303
Financial derivatives—assets, at fair value:				
TBAs	—	476	—	476
Fixed payer interest rate swaps	—	2,518	—	2,518
Fixed payer swaptions	—	78	—	78
Total financial derivatives—assets, at fair value	—	3,072	—	3,072
Total mortgage-backed securities and financial derivatives—assets, at fair value	\$—	\$1,375,049	\$21,326	\$1,396,375
Liabilities:				
U.S. Treasury securities sold short, at fair value	\$—	\$(13,959)	\$—	\$(13,959)
Financial derivatives—liabilities, at fair value:				
TBAs	—	(1,674)	—	(1,674)
Fixed payer interest rate swaps	—	(7,026)	—	(7,026)
Total financial derivatives—liabilities, at fair value	—	(8,700)	—	(8,700)
Total U.S. Treasury securities sold short and financial derivatives—liabilities, at fair value	\$—	\$(22,659)	\$—	\$(22,659)

(1) Conformed to current period presentation.

There were no transfers of financial instruments between Levels 1 or 2 of the fair value hierarchy during the year ended December 31, 2014.

The following tables present additional information about the Company's investments which are measured at fair value for which the Company has utilized Level 3 inputs to determine fair value:

Three month period ended June 30, 2015:

(In thousands)	Non-Agency RMBS	Agency RMBS	
Beginning balance as of March 31, 2015	\$5,826	\$6,443	
Purchases	—	602	
Proceeds from sales	—	—	
Principal repayments	(525) —	
(Amortization)/accretion, net	285	(618)
Net realized gains (losses)	—	—	
Change in net unrealized gains (losses)	(30	) 643
Transfers:			
Transfers into level 3	—	—	
Transfers out of level 3	—	—	
Ending balance as of June 30, 2015	\$5,556	\$7,070	

All amounts of net realized and changes in net unrealized gains (losses) in the table above are reflected in the accompanying Consolidated Statement of Operations. The table above incorporates changes in net unrealized gains (losses) for both Level 3 financial instruments held by the Company at June 30, 2015, as well as Level 3 financial instruments disposed of by the Company during the three month period ended June 30, 2015. For Level 3 financial instruments held by the Company at June 30, 2015, change in net unrealized gains (losses) of \$(30) thousand and \$0.6 million, for the three month period ended June 30, 2015 relate to non-Agency RMBS and Agency RMBS, respectively.

Three month period ended June 30, 2014:

(In thousands)	Non-Agency RMBS	Agency RMBS	
Beginning balance as of March 31, 2014	\$32,045	\$15,924	
Purchases	4,504	—	
Proceeds from sales	(1,993) —	
Principal repayments	(1,468) —	
(Amortization)/accretion, net	468	(762)
Net realized gains (losses)	168	—	
Change in net unrealized gains (losses)	1,944	(886)
Transfers:			
Transfers into level 3	—	—	
Transfers out of level 3	—	—	
Ending balance as of June 30, 2014	\$35,668	\$14,276	

All amounts of net realized and changes in net unrealized gains (losses) in the table above are reflected in the accompanying Consolidated Statement of Operations. The table above incorporates changes in net unrealized gains (losses) for both Level 3 financial instruments held by the Company at June 30, 2014, as well as Level 3 financial instruments disposed of by the Company during the three month period ended June 30, 2014. For Level 3 financial instruments held by the Company at June 30, 2014, change in net unrealized gains (losses) of \$2.0 million and \$(0.9) million, for the three month period ended June 30, 2014 relate to non-Agency RMBS and Agency RMBS, respectively.

Six month period ended June 30, 2015:

(In thousands)	Non-Agency RMBS	Agency RMBS
Beginning balance as of December 31, 2014	\$10,082	\$11,244
Purchases	—	1,701
Proceeds from sales	(2,861	) (4,538
Principal repayments	(935) —
(Amortization)/accretion, net	596	(1,274
Net realized gains	791	601
Change in net unrealized gains (losses)	(659	) (664
Transfers:		
Transfers into level 3	3,343	—
Transfers out of level 3	(4,801) —
Ending balance as of June 30, 2015	\$5,556	\$7,070

All amounts of net realized and changes in net unrealized gains (losses) in the table above are reflected in the accompanying Consolidated Statement of Operations. The table above incorporates changes in net unrealized gains (losses) for both Level 3 financial instruments held by the Company at June 30, 2015, as well as Level 3 financial instruments disposed of by the Company during the three month period ended June 30, 2015. For Level 3 financial instruments held by the Company at June 30, 2015, change in net unrealized gains (losses) of \$54 thousand and \$0.2 million, for the six month period ended June 30, 2015 relate to non-Agency RMBS and Agency RMBS, respectively. At June 30, 2015, the Company transferred \$4.8 million of non-Agency RMBS from Level 3 to Level 2. These assets were transferred from Level 3 to Level 2 based on an increased volume of observed trading of these and similar assets. This increase in observed trading activity has led to greater price transparency for these assets, thereby making a Level 2 designation appropriate in the Company's view. However, changes in the volume of observable inputs for these assets, such as a decrease in observed trading, could impact price transparency, and thereby cause a change in the level designation for these assets in future periods.

At June 30, 2015, the Company transferred \$3.3 million of non-Agency RMBS from Level 2 to Level 3. Since year end, these securities have exhibited indications of a reduced level of price transparency. Examples of such indications include wider spreads and/or higher delinquencies relative to similar securities and a reduction in observable transactions or executable quotes involving these and similar securities. Changes in these indications could impact price transparency, and thereby cause a change in the level designation in future periods.

Six month period ended June 30, 2014:

(In thousands)	Non-Agency RMBS	Agency RMBS
Beginning balance as of December 31, 2013	\$30,681	\$13,527
Purchases	12,168	4,096
Proceeds from sales	(7,416	) (1,282
Principal repayments	(2,572) —
(Amortization)/accretion, net	857	(1,420
Net realized gains	373	358
Change in net unrealized gains (losses)	1,577	(1,003
Transfers:		
Transfers into level 3	—	—
Transfers out of level 3	—	—
Ending balance as of June 30, 2014	\$35,668	\$14,276

All amounts of net realized and changes in net unrealized gains (losses) in the table above are reflected in the accompanying Consolidated Statement of Operations. The table above incorporates changes in net unrealized gains (losses) for both Level 3 financial instruments held by the Company at June 30, 2014, as well as Level 3 financial instruments disposed of by the Company during the six month period ended June 30, 2014. For Level 3 financial instruments held by the Company at June 30, 2014, change in net unrealized gains (losses) of \$1.8 million and \$(0.8) million, for the six month period ended June 30, 2014 relate to non-Agency RMBS and Agency RMBS, respectively. The following tables identify the significant unobservable inputs that affect the valuation of the Company's Level 3 assets and liabilities as of June 30, 2015 and December 31, 2014:

June 30, 2015:

Description	Fair Value (In thousands)	Valuation Technique	Significant Unobservable Input	Range		Weighted Average ⁽¹⁾	
				Min	Max		
Non-Agency RMBS	3,343	Market quotes	Non-Binding Third-Party Valuation	\$53.75	\$61.34		\$ 56.37
Non-Agency RMBS	2,213	Discounted Cash Flows	Yield	11.4	% 21.4	% 15.7	%
			Projected Collateral Prepayments	31.4	% 41.1	% 36.9	%
			Projected Collateral Losses	3.1	% 3.3	% 3.2	%
			Projected Collateral Recoveries	4.4	% 8.8	% 6.3	%
			Projected Collateral Scheduled Amortization	51.2	% 56.8	% 53.6	%
						100.0	%
Agency RMBS—Interest Only Securities	4,845	Market quotes	Non-Binding Third-Party Valuation	\$4.27	\$21.63		\$ 11.41
Agency RMBS—Interest Only Securities	2,225	Option Adjusted Spread ("OAS")	LIBOR OAS ⁽²⁾	(1,289)	635	(384)	
			Projected Collateral Prepayments	60.3	% 87.9	% 76.8	%
			Projected Collateral Scheduled Amortization	12.1	% 39.7	% 23.2	%
						100.0	%

(1)Averages are weighted based on the fair value of the related instrument.

(2)Shown in basis points.

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December 31, 2014:

Description	Fair Value (In thousands)	Valuation Technique	Significant Unobservable Input	Range		Weighted Average ⁽¹⁾	
				Min	Max		
Non-Agency RMBS	\$7,819	Market quotes	Non-Binding Third-Party Valuation	\$21.38	\$84.91	\$	\$54.11
Non-Agency RMBS	2,263	Discounted Cash Flows	Yield	6.3	% 6.3	% 6.3	%
			Projected Collateral Prepayments	35.9	% 35.9	% 35.9	%
			Projected Collateral Losses	7.5	% 7.5	% 7.5	%
			Projected Collateral Recoveries	11.0	% 11.0	% 11.0	%
			Projected Collateral Scheduled Amortization	45.6	% 45.6	% 45.6	%
						100.0	%
Agency RMBS–Interest Only Securities	7,006	Market quotes	Non-Binding Third-Party Valuation	\$4.74	\$20.38	\$	\$13.35
Agency RMBS–Interest Only Securities	4,238	Option Adjusted Spread ("OAS")	LIBOR OAS ⁽²⁾	83	1,952	490	
			Projected Collateral Prepayments	63.3	% 92.3	% 75.2	%
			Projected Collateral Scheduled Amortization	7.7	% 36.7	% 24.8	%
						100.0	%

(1) Averages are weighted based on the fair value of the related instrument.

(2) Shown in basis points.

Third-party non-binding valuations are validated by comparing such valuations to internally generated prices based on the Company's models and to recent trading activity in the same or similar instruments. For those instruments valued using discounted cash flows, collateral prepayments, losses, recoveries, and scheduled amortization are projected over the remaining life of the collateral and expressed as a percentage of the collateral's current principal balance. For those assets valued using the LIBOR Option Adjusted Spread, or "OAS," valuation methodology, cash flows are projected using the Company's models over multiple interest rate scenarios, and these projected cash flows are then discounted using the LIBOR rates implied by each interest rate scenario. The LIBOR OAS of an asset is then computed as the unique constant yield spread that, when added to all LIBOR rates in each interest rate scenario generated by the model, will equate (a) the expected present value of the projected asset cash flows over all model scenarios to (b) the actual current market price of the asset. LIBOR OAS is therefore model-dependent. Generally speaking, LIBOR OAS measures the additional yield spread over LIBOR that an asset provides at its current market price after taking into account any interest rate options embedded in the asset.

Material changes in any of the inputs above in isolation could result in a significant change to reported fair value measurements. Fair value measurements are impacted by the interrelationships of these inputs. For example, a higher expectation of collateral prepayments will generally result in a lower expectation of collateral losses. Conversely, higher losses will generally result in lower prepayments.

5. Financial Derivatives

The Company is exposed to certain risks arising from both its business operations and economic conditions. Specifically, the Company's primary source of financing is repurchase agreements and the Company enters into financial derivative and other instruments to manage exposure to variable cash flows on portions of its borrowings under those repurchase agreements. Since the interest rates on repurchase agreements typically change with market interest rates such as LIBOR, the Company is exposed to constantly changing interest rates, which accordingly affects cash flows associated with these rates on its borrowings. To mitigate the effect of changes in these interest rates and their related cash flows, the Company may enter into a variety of derivative contracts, including interest rate swaps, swaptions, and TBAs. Additionally, from time to time, the Company may use short positions in U.S. Treasury securities to mitigate its interest rate risk.

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The following table details fair value of the Company's holdings of financial derivatives as of June 30, 2015 and December 31, 2014:

	June 30, 2015 (In thousands)	December 31, 2014
Financial derivatives—assets, at fair value:		
TBA securities purchase contracts	\$48	\$387
TBA securities sale contracts	858	89
Fixed payer interest rate swaps	3,635	2,518
Swaptions	—	78
Total financial derivatives—assets, at fair value:	4,541	3,072
Financial derivatives—liabilities, at fair value:		
TBA securities purchase contracts	—	(5)
TBA securities sale contracts	(677	) (1,669)
Fixed payer interest rate swaps	(3,313	) (7,026)
Swaptions	(17) —
Total financial derivatives—liabilities, at fair value:	(4,007	) (8,700)
Total	\$534	\$(5,628)

Interest Rate Swaps

The following tables provide information about the Company's interest rate swaps as of June 30, 2015 and December 31, 2014:

June 30, 2015:

Remaining Maturity	Notional Amount (In thousands)	Fair Value	Weighted Average		Remaining Years to Maturity
			Pay Rate	Receive Rate	
2016	\$48,000	\$(191)	0.80	% 0.28	% 1.28
2017	74,750	(676)	1.21	0.28	2.10
2018	71,529	(1)	1.11	0.28	2.79
2020	88,000	96	1.62	0.28	4.79
2022	27,700	8	2.04	0.28	6.82
2023	131,164	758	2.13	0.28	7.90
2024	12,900	(474)	2.73	0.28	8.95
2025	90,290	1,737	2.21	0.26	9.79
2043	29,089	(935)	3.06	0.28	27.90
Total	\$573,422	\$322	1.76	% 0.28	% 6.76

December 31, 2014:

Remaining Maturity	Notional Amount (In thousands)	Fair Value	Weighted Average		Remaining Years to Maturity
			Pay Rate	Receive Rate	
2016	\$48,000	\$(91)	) 0.80	% 0.23	% 1.77
2017	74,750	(388)	) 1.21	0.24	2.59
2018	10,000	167	0.84	0.23	3.33
2020	23,500	471	1.42	0.23	5.38
2023	209,350	140	2.13	0.23	8.40
2024	12,900	(605)	) 2.73	0.23	9.45
2043	46,320	(4,202)	) 3.12	0.23	28.42
Total	\$424,820	\$(4,508)	) 1.87	% 0.23	% 8.56

Interest Rate Swaptions

The following tables provide information about the Company's swaptions as of June 30, 2015 and December 31, 2014.
June 30, 2015:

Option Type	Fair Value	Months to Expiration	Underlying Swap		
			Notional Amount	Term (Years)	Fixed Rate
(\$ in thousands)					
Straddle	\$(17)	) 0.5	\$9,700	10	3.00%

December 31, 2014:

Option Type	Fair Value	Months to Expiration	Underlying Swap		
			Notional Amount	Term (Years)	Fixed Rate
(\$ in thousands)					
Straddle	\$78	6.5	\$9,700	10	3.00%

TBAs

The Company transacts in the forward settling TBA market. Pursuant to these TBA transactions, the Company agrees to purchase or sell, for future delivery, Agency RMBS with certain principal and interest terms and certain types of underlying collateral, but the particular Agency RMBS to be delivered is not identified until shortly before the TBA settlement date. TBAs are liquid and have quoted market prices and represent the most actively traded class of MBS. The Company primarily uses TBAs to mitigate interest rate risk, typically in the form of short positions. However, from time to time the Company also invests in TBAs as a means of acquiring additional exposure to Agency RMBS, or for speculative purposes, including holding long positions. Overall, the Company typically holds a net short position.

The Company does not generally take delivery of TBAs; rather, it settles the associated receivable and payable with its trading counterparties on a net basis. Transactions with the same counterparty for the same TBA that result in a reduction of the position are treated as extinguished.

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As of June 30, 2015 and December 31, 2014, the Company had outstanding contracts to purchase ("long positions") and sell ("short positions") TBA securities as follows:

TBA Securities	June 30, 2015				December 31, 2014			
	Notional Amount ⁽¹⁾	Cost Basis ⁽²⁾	Market Value ⁽³⁾	Net Carrying Value ⁽⁴⁾	Notional Amount ⁽¹⁾	Cost Basis ⁽²⁾	Market Value ⁽³⁾	Net Carrying Value ⁽⁴⁾
(In thousands)								
Purchase contracts:								
Assets	\$41,508	\$41,433	\$41,481	\$48	\$53,319	\$54,757	\$55,144	\$387
Liabilities	—	—	—	—	15,000	15,603	15,598	(5)
	41,508	41,433	41,481	48	68,319	70,360	70,742	382
Sale contracts:								
Assets	(214,926)	(230,900)	(230,042)	858	(79,090)	(85,730)	(85,641)	89
Liabilities	(313,059)	(330,828)	(331,505)	(677)	(525,986)	(559,219)	(560,888)	(1,669)
	(527,985)	(561,728)	(561,547)	181	(605,076)	(644,949)	(646,529)	(1,580)
Total TBA securities, net	\$(486,477)	\$(520,295)	\$(520,066)	\$229	\$(536,757)	\$(574,589)	\$(575,787)	\$(1,198)

(1) Notional amount represents the principal balance of the underlying Agency RMBS.

(2) Cost basis represents the forward price to be paid for the underlying Agency RMBS.

(3) Market value represents the current market value of the underlying Agency RMBS (on a forward delivery basis) as of period end.

Net carrying value represents the difference between the market value of the TBA contract as of period end and the

(4) cost basis and is reported in Financial derivatives-assets at fair value and Financial derivatives-liabilities at fair value on the Consolidated Balance Sheet.

The tables below detail the average notional values of the Company's financial derivatives, using absolute value of month end notional values, for the six month period ended June 30, 2015 and the year ended December 31, 2014:

Derivative Type	Six Month Period Ended June 30, 2015	Year Ended December 31, 2014
	(In thousands)	
Interest rate swaps	\$469,450	\$566,379
TBAs	659,667	545,646
Interest rate swaptions	9,700	20,631

Gains and losses on the Company's financial derivatives for the three and six month periods ended June 30, 2015 and 2014 are summarized in the tables below:

Three Month Period Ended June 30, 2015

Derivative Type	Net Realized Gains (Losses) on Periodic Settlements of Interest Rate Swaps	Net Realized Gains (Losses) Other Than Periodic Settlements of Interest Rate Swaps	Net Realized Gains (Losses) on Financial Derivatives	Change in Net Unrealized Gains (Losses) on Accrued Periodic Settlements of Interest Rate Swaps	Change in Net Unrealized Gains (Losses) Other Than on Accrued Periodic Settlements of Interest Rate Swaps	Change in Net Unrealized Gains (Losses) on Financial Derivatives
	(In thousands)	\$(2,148)	\$(1,366)	\$(3,514)	\$270	\$11,794

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Fixed payer interest rate swaps Swaptions		—	—		(333) (333)
TBAs		(328) (328)	1,525	1,525	
Total	\$(2,148) \$(1,694) \$(3,842) \$270	\$12,986	\$13,256	

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Three Month Period Ended June 30, 2014

Derivative Type	Net Realized Gains (Losses) on Periodic Settlements of Interest Rate Swaps	Net Realized Gains (Losses) Other Than Periodic Settlements of Interest Rate Swaps	Net Realized Gains (Losses) on Financial Derivatives	Change in Net Unrealized Gains (Losses) on Accrued Periodic Settlements of Interest Rate Swaps	Change in Net Unrealized Gains (Losses) Other Than on Accrued Periodic Settlements of Interest Rate Swaps	Change in Net Unrealized Gains (Losses) on Financial Derivatives
(In thousands)						
Fixed payer interest rate swaps	\$ (4,102)	\$ 80	\$ (4,022)	\$ 1,744	\$ (10,646)	\$ (8,902)
Swaptions		—	—		(201)	(201)
TBAs		(7,133)	(7,133)		(3,686)	(3,686)
Total	\$ (4,102)	\$ (7,053)	\$ (11,155)	\$ 1,744	\$ (14,533)	\$ (12,789)

Six Month Period Ended June 30, 2015

Derivative Type	Net Realized Gains (Losses) on Periodic Settlements of Interest Rate Swaps	Net Realized Gains (Losses) Other Than Periodic Settlements of Interest Rate Swaps	Net Realized Gains (Losses) on Financial Derivatives	Change in Net Unrealized Gains (Losses) on Accrued Periodic Settlements of Interest Rate Swaps	Change in Net Unrealized Gains (Losses) Other Than on Accrued Periodic Settlements of Interest Rate Swaps	Change in Net Unrealized Gains (Losses) on Financial Derivatives
(In thousands)						
Fixed payer interest rate swaps	\$ (2,855)	\$ (4,807)	\$ (7,662)	\$ (581)	\$ 5,412	\$ 4,831
Swaptions		—	—		(96)	(96)
TBAs		(4,923)	(4,923)		1,427	1,427
Total	\$ (2,855)	\$ (9,730)	\$ (12,585)	\$ (581)	\$ 6,743	\$ 6,162

Six Month Period Ended June 30, 2014

Derivative Type	Net Realized Gains (Losses) on Periodic Settlements of Interest Rate Swaps	Net Realized Gains (Losses) Other Than Periodic Settlements of Interest Rate Swaps	Net Realized Gains (Losses) on Financial Derivatives	Change in Net Unrealized Gains (Losses) on Accrued Periodic Settlements of Interest Rate Swaps	Change in Net Unrealized Gains (Losses) Other Than on Accrued Periodic Settlements of Interest Rate Swaps	Change in Net Unrealized Gains (Losses) on Financial Derivatives
(In thousands)						
Fixed payer interest rate swaps	\$ (4,896)	\$ 3,511	\$ (1,385)	\$ 160	\$ (24,710)	\$ (24,550)
Swaptions		—	—		(838)	(838)
TBAs		(13,198)	(13,198)		(5,197)	(5,197)
Futures		19	19		—	—
Total	\$ (4,896)	\$ (9,668)	\$ (14,564)	\$ 160	\$ (30,745)	\$ (30,585)

As of June 30, 2015, the Company also held short positions in U.S. Treasury securities, with a principal amount of \$51.4 million and a fair value of \$51.2 million. As of December 31, 2014, the Company also held short positions in U.S. Treasury securities, with a principal amount of \$13.9 million and a fair value of \$14.0 million.

6. Borrowings under Repurchase Agreements

The Company enters into repurchase agreements. A repurchase agreement involves the sale of an asset to a counterparty together with a simultaneous agreement to repurchase the transferred asset or similar asset from such counterparty at a future date. The Company accounts for its repurchase agreements as collateralized borrowings, with the transferred assets effectively serving as collateral for the related borrowing. The Company's repurchase agreements typically range in term from 30 to 180 days. The principal economic terms of each repurchase agreement—such as loan amount, interest rate, and maturity date—are typically negotiated on a transaction-by-transaction basis. Other terms and conditions, such as relating to events of default, are typically governed under the Company's master repurchase agreements. Absent an event of default, the Company maintains

beneficial ownership of the transferred securities during the term of the repurchase agreement and receives the related principal and interest payments. Interest rates on these borrowings are generally fixed based on prevailing rates corresponding to the terms of the borrowings, and interest is paid at the termination of the repurchase agreement at which time the Company may enter into a new repurchase agreement at prevailing market rates with the same counterparty, repay that counterparty and possibly negotiate financing terms with a different counterparty, or choose to no longer finance the related asset. In response to a decline in the fair value of the transferred securities, whether as a result of changes in market conditions, security paydowns, or other factors, repurchase agreement counterparties will typically make a margin call, whereby the Company will be required to post additional securities and/or cash as collateral with the counterparty in order to re-establish the agreed-upon collateralization requirements. In the event of increases in fair value of the transferred securities, the Company generally can require the counterparty to post collateral with it in the form of cash or securities. The Company is generally permitted to sell or re-pledge any securities posted by the counterparty as collateral; however, upon termination of the repurchase agreement the Company must return to the counterparty the same security that had been posted. The contractual amount (loan amount) of the Company's repurchase agreements approximates fair value, as the debt is short-term in nature. At any given time, the Company seeks to have its outstanding borrowings under repurchase agreements with several different counterparties in order to reduce the exposure to any single counterparty. As of June 30, 2015 and December 31, 2014, the Company had outstanding borrowings under repurchase agreements with eleven and ten counterparties, respectively.

The following table details the Company's outstanding borrowings under repurchase agreements as of June 30, 2015 and December 31, 2014:

Remaining Days to Maturity	June 30, 2015			December 31, 2014		
	Borrowings Outstanding	Weighted Average Interest Rate	Remaining Days to Maturity	Borrowings Outstanding	Weighted Average Interest Rate	Remaining Days to Maturity
	(In thousands)					
30 days or less	\$172,255	0.36	% 16	\$437,633	0.33	% 15
31-60 days	136,666	0.36	46	417,009	0.34	44
61-90 days	432,874	0.41	77	333,580	0.36	72
91-120 days	165,617	0.42	107	—	—	—
121-150 days	191,503	0.44	136	—	—	—
151-180 days	165,564	0.48	166	85,917	0.41	165
301-330 days	—	—	—	48,941	0.47	317
Total	\$1,264,479	0.41	% 90	\$1,323,080	0.35	% 60

Repurchase agreements involving underlying investments that the Company sold prior to year end, for settlement following year end, are shown using their original maturity dates even though such repurchase agreements may be expected to be terminated early upon settlement of the sale of the underlying investment. Not included above are repurchase agreements that the Company may have entered into prior to period end for which delivery of the borrowed funds is not scheduled until after period end in the amount of \$2.4 million as of June 30, 2015. As of December 31, 2014 there were no reverse repurchase agreements entered into prior to December 31, 2014 for which delivery of the borrowed funds was not scheduled until after December 31, 2014.

As of June 30, 2015 and December 31, 2014, the fair value of Agency RMBS transferred as collateral under outstanding borrowings under repurchase agreements was \$1.3 billion and \$1.4 billion, respectively. Collateral transferred under outstanding borrowings as of June 30, 2015 includes Agency RMBS in the amount of \$29.2 million that were sold prior to period end but for which such sale had not yet settled. Collateral transferred under outstanding borrowings as of December 31, 2014 includes Agency RMBS in the amount of \$41.8 million that were sold prior to period end but for which such sale had not yet settled. In addition the Company posted net cash collateral of \$14.4 million and additional securities with a fair value of \$13.8 million as of June 30, 2015 as a result of margin calls from various counterparties. The Company posted additional net cash collateral of \$5.7 million and additional securities

with a fair value of \$2.1 million as of December 31, 2014 as a result of margin calls from various counterparties. The Company also held investments with an aggregate value of approximately \$0.4 million, as of December 31, 2014, which were received to satisfy collateral requirements for various repurchase agreements.

7. Offsetting of Assets and Liabilities

The Company records financial instruments at fair value as described in Note 2. All financial instruments are recorded on a gross basis on the Consolidated Balance Sheet. In connection with its financial derivatives, repurchase agreements, and related trading agreements, the Company and its counterparties are required to pledge collateral. Cash or other collateral is exchanged as required with each of the Company's counterparties in connection with open derivative positions and repurchase agreements.

The following tables present information about certain assets and liabilities representing financial instruments as of June 30, 2015 and December 31, 2014. The Company has not previously entered into master netting agreements with any of its counterparties. Certain of the Company's repurchase and reverse repurchase agreements and financial derivative transactions are governed by underlying agreements that generally provide a right of offset in the event of default or in the event of a bankruptcy of either party to the transaction.

June 30, 2015:

Description	Amount of Assets (Liabilities) Presented in the Consolidated Balance Sheet ⁽¹⁾	Financial Instruments Available for Offset	Financial Instruments Transferred or Pledged as Collateral ⁽²⁾⁽³⁾	Cash Collateral (Received) Pledged ⁽²⁾⁽³⁾	Net Amount
(In thousands)					
Assets:					
Financial derivatives—assets	\$4,541	\$(3,227)	\$—	\$(35)	\$1,279
Reverse repurchase agreements	58,859	(58,859)	—	—	—
Liabilities:					
Financial derivatives—liabilities	(4,007)	3,227	—	497	(283)
Repurchase agreements	(1,264,479)	58,859	1,191,184	14,436	—

(1) In the Company's Consolidated Balance Sheet, all balances associated with the repurchase agreements and financial derivatives are presented on a gross basis.

(2) For the purpose of this presentation, for each row the total amount of financial instruments transferred or pledged and cash collateral (received) or pledged may not exceed the applicable gross amount of assets or (liabilities) as presented here. Therefore, the Company has reduced the amount of financial instruments transferred or pledged as collateral related to the Company's repurchase agreements and cash collateral pledged on the Company's financial derivative assets and liabilities. Total financial instruments transferred or pledged as collateral on the Company's repurchase agreements as of June 30, 2015 were \$1.32 billion. As of June 30, 2015 total cash collateral on financial derivative assets and financial derivative liabilities excludes \$1.6 million and \$7.4 million of net excess cash collateral.

(3) When collateral is pledged to or pledged by a counterparty, it is often pledged or posted with respect to all positions with such counterparty, and in such cases such collateral cannot be specifically identified as relating to a specific asset or liability. As a result, in preparing the above table, the Company has made assumptions in allocating pledged or posted collateral among the various rows.

December 31, 2014:

Description	Amount of Assets (Liabilities) Presented in the Consolidated Balance Sheet ⁽¹⁾	Financial Instruments Available for Offset	Financial Instruments Transferred or Pledged as Collateral ⁽²⁾⁽³⁾	Cash Collateral (Received) Pledged ⁽²⁾⁽³⁾	Net Amount
(In thousands)					
Assets:					
Financial derivatives—assets	\$3,072	\$(2,722)	\$—	\$—	\$350
Reverse repurchase agreements	13,987	(13,987)	—	—	—
Liabilities:					

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Financial derivatives—liabilities	(8,700)	2,722	—	5,783	(195)
Repurchase agreements	(1,323,080)	13,987	1,303,360	5,733	—	

(1) In the Company's Consolidated Balance Sheet, all balances associated with the repurchase agreements and financial derivatives are presented on a gross basis.

(2) For the purpose of this presentation, for each row the total amount of financial instruments transferred or pledged and cash collateral (received) or pledged may not exceed the applicable gross amount of assets or (liabilities) as presented here. Therefore the Company has reduced the amount of financial instruments transferred or pledged as collateral related to the Company's repurchase agreements and cash collateral pledged on the Company's financial derivative assets and liabilities. Total financial instruments transferred or pledged as collateral on the Company's repurchase agreements as of December

31, 2014 were \$1.39 billion. As of December 31, 2014 total cash collateral on financial derivative assets and liabilities excludes \$0.5 million and \$6.3 million, respectively of net excess cash collateral.

(3) When collateral is pledged to or pledged by a counterparty, it is often pledged or posted with respect to all positions with such counterparty, and in such cases such collateral cannot be specifically identified as relating to a specific asset or liability. As a result, in preparing the above table, the Company has made assumptions in allocating pledged or posted collateral among the various rows.

8. Management Fees

The Manager receives an annual management fee in an amount equal to 1.50% per annum of shareholders' equity (as defined in the Management Agreement) as of the end of each fiscal quarter (before deductions for any management fee with respect to such fiscal period). The management fee is payable quarterly in arrears. For both the three month periods ended June 30, 2015 and 2014, the total management fee incurred was approximately \$0.6 million. For both the six month periods ended June 30, 2015 and 2014, the total management fee incurred was approximately \$1.2 million.

Effective January 1, 2015 the Company entered into a Third Amended and Restated Management Agreement with the Manager, which replaces and supersedes the Second Amended and Restated Management Agreement. The Third Amended and Restated Management Agreement was adopted and executed for the primary purpose of redefining shareholders' equity. Shareholders' equity per the Second Amended and Restated Management Agreement had the definition as described below. Effective January 1, 2015, shareholders' equity is defined in the Third Amended and Restated Management Agreement, as of the end of any fiscal quarter, as (a) the sum of (1) the net proceeds from any issuances of common shares or other equity securities of the Company or the Operating Partnership (without double counting) since inception, plus (2) the Company's and the Operating Partnership's (without double counting) retained earnings or accumulated deficit calculated in accordance with U.S. GAAP at the end of the most recently completed fiscal quarter (without taking into account any non-cash equity compensation expense incurred in current or prior periods), less (b) any amount that the Company or the Operating Partnership has paid to repurchase common shares, limited partnership interests in the Operating Partnership or other equity securities since inception. Shareholders' equity excludes (1) non-cash equity compensation expenses that have impacted shareholders' equity as reported in the financial statements prepared in accordance with U.S. GAAP, and (2) one-time events pursuant to changes in U.S. GAAP, and certain non-cash items not otherwise described above, in each case, after discussions between the Manager and the Company's independent trustees and approval by a majority of the Company's independent trustees. From inception through December 31, 2014, Shareholders' equity is defined in the Management Agreement, as of the end of any fiscal quarter, as (a) the sum of (1) the net proceeds from any issuances of common shares or other equity securities of the Company or the Operating Partnership (without double counting) since inception, plus (2) the Company's and the Operating Partnership's (without double counting) retained earnings or accumulated deficit calculated in accordance with U.S. GAAP at the end of the most recently completed fiscal quarter (without taking into account any non-cash equity compensation expense incurred in current or prior periods), less (b) any amount that the Company or the Operating Partnership has paid to repurchase common shares, limited partnership interests in the Operating Partnership or other equity securities since inception. Shareholders' equity excludes (1) any unrealized gains, losses, or non-cash equity compensation expenses that have impacted shareholders' equity as reported in the financial statements prepared in accordance with U.S. GAAP, regardless of whether such items are included in net income, and (2) one-time events pursuant to changes in U.S. GAAP, and certain non-cash items not otherwise described above, in each case, after discussions between the Manager and the Company's independent trustees and approval by a majority of the Company's independent trustees.

9. Earnings Per Share

Basic earnings per share, or "EPS," is calculated by dividing net income (loss) for the period by the weighted average of the Company's common shares outstanding for the period. Diluted EPS takes into account the effect of outstanding dilutive instruments, such as share options and warrants, if any, and uses the average share price for the period in determining the number of incremental shares that are to be added to the weighted average number of shares outstanding. As of June 30, 2015 and 2014, the Company did not have any dilutive instruments outstanding.

The following table presents a reconciliation of the earnings/(losses) and shares used in calculating basic EPS for the three and six month periods ended June 30, 2015 and 2014:

(In thousands except for share amounts)	Three Month Period Ended June 30, 2015	Three Month Period Ended June 30, 2014	Six Month Period Ended June 30, 2015	Six Month Period Ended June 30, 2014
Numerator:				
Net income	\$ 190	\$ 11,050	\$ 3,867	\$ 13,811
Denominator:				
Basic and diluted weighted average shares outstanding	9,149,274	9,139,842	9,149,274	9,139,842
Basic and Diluted Earnings Per Share	\$0.02	\$ 1.21	\$0.42	\$ 1.51

10. Related Party Transactions

Management Agreement

The Company is party to a management agreement with the Manager, which provides for an initial term through September 24, 2017, and which will be renewed automatically each year thereafter for an additional one-year period, subject to certain termination rights. The Company is externally managed and advised by the Manager. Pursuant to the terms of the Management Agreement, the Manager provides the Company with its management team, including its officers and appropriate support personnel. The Company does not have any employees. The Manager is responsible for the day-to-day operations of the Company.

Services Agreement

The Manager and EMG are parties to a services agreement, pursuant to which EMG is required to provide to the Manager sufficient personnel, services, and resources to enable the Manager to carry out its obligations and responsibilities under the Management Agreement. The Company is a named third-party beneficiary to the services agreement and, as a result, has, as a non-exclusive remedy, a direct right of action against EMG in the event of any breach by the Manager of any of its duties, obligations, or agreements under the Management Agreement that arise out of or result from any breach by EMG of its obligations under the services agreement. The services agreement will terminate upon the termination of the Management Agreement. Pursuant to the services agreement, the Manager makes certain payments to EMG in connection with the services provided. The Manager and EMG have overlapping ownership and are under common control.

Expense Reimbursement

Under the terms of the Management Agreement the Company is required to reimburse the Manager for operating expenses related to the Company that are incurred by the Manager, including expenses relating to legal, accounting, due diligence, other services, and all other costs and expenses. The Company's reimbursement obligation is not subject to any dollar limitation. Expenses will be reimbursed in cash within 60 days following delivery of the expense statement by the Manager; provided, however, that such reimbursement may be offset by the Manager against amounts due to the Company from the Manager. The Company will not reimburse the Manager for the salaries and other compensation of the Manager's personnel except that the Company will be responsible for expenses incurred by the Manager in employing certain dedicated or partially dedicated personnel as further described below.

The Company reimburses the Manager for the allocable share of the compensation, including, without limitation, wages, salaries, and employee benefits paid or reimbursed, as approved by the Compensation Committee of the Board of Trustees, to certain dedicated or partially dedicated personnel who spend all or a portion of their time managing the Company's affairs, based upon the percentage of time devoted by such personnel to the Company's affairs. In their capacities as officers or personnel of the Manager or its affiliates, such personnel will devote such portion of their time to the Company's affairs as is necessary to enable the Company to operate its business.

For the six month periods ended June 30, 2015 and 2014, the Company reimbursed the Manager \$1.0 million and \$1.2 million, respectively, for previously incurred operating and compensation expenses.

Termination Fee

The Management Agreement requires the Company to pay a termination fee to the Manager in the event of (1) the Company's termination or non-renewal of the Management Agreement without cause or (2) the Manager's termination

of the Management Agreement upon a default by the Company in the performance of any material term of the Management Agreement. Such termination fee will be equal to 5% of Shareholders' Equity, as defined in the Management Agreement (see Note 8 above) as of the month-end preceding termination.

Registration Rights Agreement

The Company is a party to a registration rights agreement with an affiliate of EMG and with the Blackstone Tactical Opportunities Funds (the "Blackstone Funds") pursuant to which the Company has granted its initial investors and each of their permitted transferees and other holders of the Company's "registrable common shares" (as such term is defined in the registration rights agreement) who become parties to the registration rights agreement with certain demand and/or piggy-back registration and shelf takedown rights.

11. Capital

The Company has authorized 500,000,000 common shares, \$0.01 par value per share, and 100,000,000 preferred shares, \$0.01 par value per share. The Board of Trustees may authorize the issuance of additional shares of either class. As of both June 30, 2015 and December 31, 2014, there were 9,149,274 common shares outstanding. No preferred shares have been issued.

The below table details cash dividends declared by the Board of Trustees during the six month period ended June 30, 2015:

	Dividend Per Share	Dividend Amount (In thousands)	Declaration Date	Record Date	Payment Date
First Quarter	\$0.55	\$5,032	March 11, 2015	March 31, 2015	April 27, 2015
Second Quarter	\$0.55	\$5,032	June 16, 2015	June 30, 2015	July 27, 2015

The below table details cash dividends declared by the Board of Trustees during the six month period ended June 30, 2014:

	Dividend Per Share	Dividend Amount (In thousands)	Declaration Date	Record Date	Payment Date
First Quarter	\$0.55	\$5,027	March 12, 2014	March 31, 2014	April 28, 2014
Second Quarter	\$0.55	\$5,027	June 17, 2014	June 30, 2014	July 25, 2014

On August 13, 2013, the Company's Board of Trustees approved the adoption of a \$10 million share repurchase program. The program, which is open-ended in duration, allows the Company to make repurchases from time to time on the open market or in negotiated transactions. Repurchases are at the Company's discretion, subject to applicable law, share availability, price and the Company's financial performance, among other considerations. No purchases have been made under the program to date.

Distribution Policy

The timing and frequency of distributions will be determined by the Board of Trustees based upon a variety of factors deemed relevant by the Company's trustees, including restrictions under applicable law, capital requirements of the Company, and the REIT requirements of the Code. Distributions to shareholders generally will be taxable as ordinary income, although a portion of such distributions may be designated as long-term capital gain or qualified dividend income, or may constitute a return of capital. The Company will furnish annually to each shareholder a statement setting forth distributions paid or deemed paid during the preceding year and their U.S. federal income tax treatment. It is the intention of the Company to distribute at least 100% of its taxable income, after application of available tax attributes, within the limits prescribed by the Internal Revenue Code, which may extend into the subsequent taxable year.

12. Commitments and Contingencies

From time to time, the Company may become involved in various claims and legal actions arising in the ordinary course of business. Management is not aware of any significant contingencies at June 30, 2015.

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

In this Quarterly Report on Form 10-Q, except where the context suggests otherwise, "EARN," "we," "us," and "our" refer to Ellington Residential Mortgage REIT and its subsidiaries, our "Manager" refers to Ellington Residential Mortgage Management LLC, our external manager, and "Ellington" refers to Ellington Management Group, L.L.C. and its affiliated investment advisory firms.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

When used in this quarterly report on Form 10-Q, in future filings with the Securities and Exchange Commission ("SEC") or in press releases or other written or oral communications, statements which are not historical in nature, including those containing words such as "believe," "expect," "anticipate," "estimate," "project," "plan," "continue," "intend," "should," "would," "could," "goal," "objective," "will," "may," "seek" or similar expressions, are intended to identify "forward-looking statements" 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, and, as such, may involve known and unknown risks, uncertainties, and assumptions.

Forward-looking statements are based on our beliefs, assumptions, and expectations of our future performance, taking into account all information currently available to us. These beliefs, assumptions and expectations are subject to risks and uncertainties and can change as a result of many possible events or factors, not all of which are known to us. If a change occurs, our business, financial condition, liquidity and results of operations may vary materially from those expressed in our forward-looking statements. The following factors are examples of those that could cause actual results to vary from our forward-looking statements: changes in interest rates and the market value of our securities; our use and dependence on leverage; the impact of Fannie Mae and Freddie Mac being placed into conservatorship and related events, including the lack of certainty as to the future roles and structures of these entities and changes to legislation and regulations affecting these entities; market volatility; changes in the prepayment rates on the mortgage loans underlying the securities we own and intend to acquire; changes in rates of default and/or recovery rates on our non-agency assets; our ability to borrow to finance our assets and the costs of such borrowings; changes in government regulations affecting our business; our ability to maintain our exclusion from registration under the Investment Company Act of 1940, as amended (the "Investment Company Act"); and risks associated with investing in real estate related assets, including changes in business conditions and the general economy. These and other risks, uncertainties and factors, including the risk factors described under Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2014 as filed with the SEC, could cause our actual results to differ materially from those projected in any forward-looking statements we make. All forward-looking statements speak only as of the date on which they are made. New risks and uncertainties arise over time and it is not possible to predict those events or how they may affect us. Except as required by law, we are not obligated to, and do not intend to, update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Executive Summary

We are a Maryland real estate investment trust, or "REIT," formed in August 2012 that specializes in acquiring, investing in, and managing residential mortgage- and real estate-related assets. Our primary objective is to generate attractive current yields and risk-adjusted total returns for our shareholders by making investments that we believe compensate us appropriately for the risks associated with them. We seek to attain this objective by constructing and actively managing a portfolio comprised primarily of residential mortgage-backed securities, or "RMBS," for which the principal and interest payments are guaranteed by a U.S. government agency or a U.S. government-sponsored entity, or "Agency RMBS," and, to a lesser extent, RMBS that do not carry such guarantees, or "non-Agency RMBS," such as RMBS backed by prime jumbo, Alternative A-paper, manufactured housing, and subprime residential mortgage loans. We also may opportunistically acquire and manage other types of residential mortgage-related and real estate-related asset classes, such as residential mortgage loans, and mortgage servicing rights, or "MSRs." We believe that being able to combine Agency RMBS with non-Agency RMBS and other residential mortgage- and real estate-related asset classes enables us to balance a range of mortgage-related risks.

We were formed through an initial strategic venture among affiliates of Ellington, an investment management firm and registered investment adviser with a 20-year history of investing in a broad spectrum of mortgage-backed securities and related derivatives, with an emphasis on the RMBS market, and the Blackstone Tactical Opportunity Funds, or the "Blackstone Funds." These initial investors made an aggregate investment of approximately \$31.5

million on September 25, 2012. On May 6, 2013, we closed our initial public offering of our common shares, pursuant to which we sold 6,450,000 of our common shares to the public at a price of \$20.00 per share. Concurrent with the initial public offering, we completed a private placement with our initial investors pursuant to which we issued 1,050,000 common shares at a purchase price of \$20.00 per share, resulting in gross proceeds of \$21.0 million. Total gross proceeds to us from the initial public offering and concurrent private placement were \$150.0 million. Proceeds to us, net of offering costs, were approximately \$148.5 million.

We are externally managed and advised by our Manager, an affiliate of Ellington.

We use leverage in our Agency RMBS strategy and, while we have not done so to date, we may use leverage in our non-Agency RMBS strategy as well, although we expect such leverage to be lower. We have financed our purchases of Agency RMBS exclusively through repurchase agreements, which we account for as collateralized borrowings. As of June 30, 2015, we had outstanding borrowings under repurchase agreements in the amount of \$1.3 billion with eleven counterparties.

We have elected to be taxed as a REIT for U.S. federal income tax purposes. Accordingly, we generally will not be subject to U.S. federal income taxes on our taxable income that we distribute currently to our shareholders as long as we maintain our qualification as a REIT. We intend to conduct our operations so that neither we nor any of our subsidiaries is required to register as an investment company under the Investment Company Act of 1940, as amended.

As of June 30, 2015, our book value per share was \$17.18 as compared to \$17.71 as of March 31, 2015 and \$17.86 as of December 31, 2014.

Trends and Recent Market Developments

Key trends and recent market developments for the mortgage-backed security, or "MBS," market include the following:

U.S. Federal Reserve and U.S. Monetary Policy—The U.S. Federal Reserve, or "Federal Reserve," continues to monitor the U.S. economy to determine when it should begin increasing its target interest rate, and it is maintaining its existing policy of reinvesting principal payments from its U.S. Treasury security and Agency RMBS holdings;

Global Macroeconomic Events—Various macroeconomic events in the second quarter led to increased volatility in global financial markets and spread widening in U.S. fixed income markets;

Housing and Mortgage Market Statistics—Data released by S&P Indices for its S&P/Case-Shiller Home Price Indices for May 2015 showed that the pace of home price appreciation remained relatively modest; meanwhile the Freddie Mac survey 30-year mortgage rate ended the second quarter of 2015 at 4.08%, increasing from 3.70% at the end of the first quarter;

Prepayment Rate Trends—Prepayment rates fell slightly during the second quarter of 2015 as compared to the first quarter, driven primarily by a rise in mortgage rates;

Government Sponsored Enterprise, or "GSE," and Government Agency Developments—In early 2015, the Federal Housing Finance Agency, or "FHFA," and the GSEs continued to announce program and policy changes and clarifications intended to increase mortgage credit availability;

Portfolio Overview and Outlook—The second quarter of 2015 was marked by ongoing significant interest rate volatility. While interest rates had been down sharply in the first quarter of 2015, global interest rates rose sharply during the second quarter and Agency RMBS spreads widened. Gains on our interest rate hedges partially offset asset losses. Non-Agency RMBS held up relatively well during the second quarter and continued to exhibit price stability relative to the broader financial markets.

Federal Reserve and U.S. Monetary Policy

In its July 2015 statement, the Federal Open Market Committee, or "FOMC," maintained the target range for the federal funds rate at 0% to 0.25%. The FOMC also indicated that, based on its assessment of labor market conditions, inflationary pressures and expectations, and other factors, it will be appropriate to raise the target rate when it has seen further improvement in the labor market and is reasonably confident that inflation will move to its 2% inflation objective over the medium term. The FOMC also noted that it continues to expect that, with appropriate policy accommodation, economic activity will expand at a moderate pace. Currently the FOMC anticipates that economic conditions may warrant keeping the target rate below normal long-run levels for "some time," even once employment and inflation have reached levels consistent with the Federal Reserve's mandate.

The 10-year U.S. Treasury yield increased by 43 basis points over the course of the second quarter of 2015, rising from 1.92% as of March 31, 2015 to 2.35% as of June 30, 2015. While interest rates have still dropped overall since the Federal Reserve's initial taper announcement in December 2013, we believe that there remains substantial risk that interest rates could continue the more recent trend of increasing, driven by a tightening of Federal Reserve monetary policy in response to employment and economic growth in the United States and other factors. The risk of rising interest rates reinforces the importance of our ability, subject to our qualifying and maintaining our qualification as a

REIT, to hedge interest rate risk in both our Agency RMBS and non-Agency MBS portfolios using a variety of tools, including TBAs, interest rate swaps, and various other instruments. Additional uncertainty surrounds the Federal Reserve's timeline to curtail its reinvestment of

principal payments from its U.S. Treasury security and Agency RMBS holdings. The current pace of monthly reinvestments under this program is approximately \$30 billion, thus providing significant market support.

Global Macroeconomic Events

Global financial markets, especially outside the U.S., experienced a heightened level of volatility in the second quarter, primarily driven by macroeconomic events, overall market illiquidity, and increased quantitative easing measures by central banks. In Europe, uncertainty surrounding Greece's standing in the Eurozone and fears of a Greek economic collapse caused European stock markets to experience their worst quarter since June 2013. In China, amidst significant stock market volatility and signs of an overall economic slowdown, the People's Bank of China lowered benchmark interest rates for the fourth time since November 2014, and announced a selective cut in the reserve requirement ratio for banks, following two earlier reductions in February and April 2015. Finally, global fixed income assets experienced a significant sell-off over the course of the quarter. The yield on German 10-year bonds soared, rising 90 basis points from April 19th through June 10th, when it reached 0.98%, its highest level since September 2014. While the U.S. equities markets exhibited relative resilience during the second quarter, the increased global market volatility led to significant spread widening in the U.S. fixed income markets.

Housing and Mortgage Market Statistics

The following table demonstrates the decline in residential mortgage delinquencies and foreclosure inventory on a national level, as reported by CoreLogic in its May 2015 and April 2015 National Foreclosure Reports:

Number of Units (In thousands)	As of		
	May 2015	March 2015	May 2014
Seriously Delinquent Mortgages ⁽¹⁾	1,344	1,428	1,737
Foreclosure Inventory	491	534	676

(1) Seriously Delinquent Mortgages are ninety days and over in delinquency and include foreclosures and real estate owned, or "REO," property.

As the above table indicates, both the number of seriously delinquent mortgages and the number of homes in foreclosure have declined significantly over the past year. This decline supports the thesis that as many homeowners have re-established equity in their homes through recovering real estate prices, they have become less likely to become delinquent and default on their mortgages.

Monthly housing starts provide another indicator of market fundamentals. The following table shows the trailing three-month average housing starts for the periods referenced:

	June 2015	March 2015
Single-family ⁽¹⁾	704	643
Multi-family ⁽¹⁾	427	324

(1) Shown in thousands of units:

Source: U.S. Census Bureau

Three month trailing single-family housing starts increased by 9.5% from March 2015 to June 2015, while multi-family housing starts increased by approximately 31.8% during the same period. Even though home prices have recovered meaningfully over the last few years, this recovery still has not translated into notable growth in single-family housing starts.

Data released by S&P Indices for its S&P/Case-Shiller Home Price Indices for May 2015 showed that, on average, home prices had increased from February 2015 by 3.2% for its 20-City Composite and by 2.9% for its 10-City Composite. Home price appreciation has been relatively modest in 2014 and the first half of 2015, following strong appreciation in 2013. According to the report, home prices remain below the peak levels of 2006, but, on average, are back to their December 2004 and February 2005 levels for the 10- and 20-City Composites, respectively. Finally, as indicated in the table above, as of May 2015, the national inventory of foreclosed homes fell to 491,000 units, a 27.4% decline when compared to May 2014; this represented the forty-third consecutive month with a year-over-year decline and the lowest level since December 2007. As a result, there are many fewer unsold foreclosed homes overhanging the housing market than there were a year ago. We believe that near-term home price trends are more likely to be driven by fundamental factors such as economic growth, mortgage rates, and affordability, rather than by technical factors such as shadow inventory. Shadow inventory represents the number of properties that are seriously delinquent, in foreclosure, or held as REO by mortgage servicers, but not currently listed on the multiple listing service.

On July 2, 2015, the U.S. Bureau of Labor Statistics, or "BLS," reported that, as of June 2015, the U.S. unemployment rate declined to 5.3%. Another, perhaps more relevant, measure of labor market conditions is employment growth, which was

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relatively robust during the second quarter. The BLS reported that non-farm payrolls rose by 223,000 during June, a strong report after some softness earlier in the quarter. While it is difficult to quantify the relationship between employment data and the housing and mortgage markets, we believe that current levels of unemployment and job creation are generally supportive of the housing market. While the housing market is also currently supported by low mortgage rates, it faces a number of potential headwinds. These include high interest rate volatility, the constraining effects of still-tight credit standards on both housing starts and new loan originations, and the uneven pace of the recovery of the U.S. economy.

Prepayment Rate Trends

Prepayment rates fell slightly during the second quarter of 2015 as compared to the first quarter, primarily in response to the increase in mortgage rates. In addition, in the first quarter there had been an initial spike in certain refinancings in response to the reduction of mortgage insurance premiums in January by the Federal Housing Administration, and in the second quarter the effects of this reduction began to tail off. Overall, the pace of refinancings experienced in the second quarter was more in line with the stable levels seen throughout 2014. The relatively muted level of prepayment activity as interest rates broadly declined in recent years has in large part been the result of: (i) home price declines during the financial crisis, which has left some borrowers with minimal or negative home equity; (ii) more restrictive underwriting guidelines, even for refinancings; and (iii) increased origination costs, especially related to underwriting and compliance. These factors have resulted in substantial variations in prepayment rates between Agency pools as a function of loan-to-value, or "LTV," ratio, loan balance, credit score, geography, property type, loan purpose, and other factors. In recognition of the importance of these underlying characteristics on prepayment behavior, the MBS market continues to promote the creation of "specified" Agency pools that emphasize or de-emphasize many of these characteristics, such as pools where the principal balance of every underlying mortgage loan is below \$85,000. The Making Homes Affordable, or "MHA," refinancing program, which was initiated in response to the housing market crisis, has facilitated the origination of many of these kinds of specified Agency pools. The extension of the MHA refinancing program into 2015 should sustain creation of such pools in the coming years. We expect that the ongoing origination of Agency pools with a wide variety of loan characteristics will continue to create opportunities for us to exploit the resulting differences in prepayments.

The Freddie Mac survey 30-year fixed mortgage rate ended the second quarter at 4.08%, a 38-basis point increase since the end of the first quarter. The Refinance Index published by the Mortgage Bankers Association, or "MBA," decreased consistently throughout the quarter to levels not seen since 2014, after spiking significantly during the first quarter of 2015. Similarly, the MBA's Market Composite Index, a measure of mortgage application volume, also fell during the second quarter of 2015 after spiking during the first quarter of 2015. Despite a decline in refinancing activity, the housing market is showing signs of recovery, as housing turnover increased during the second quarter as a result of stronger home sales. Existing home sales increased 3.2% month-over-month in June 2015, coming in at a seasonally adjusted annualized rate of 5.49 million, the highest monthly rate since February 2007. Finally, the MBA Purchase Index, a widely followed weekly measurement of nationwide home loan applications, reached 214.3 on June 5, 2015, a high not seen since June 2013, and has remained elevated since then.

The figure below illustrates the relationship between the Freddie Mac survey 30-year fixed mortgage rate and the MBA Refinance Index since September 2012. Generally speaking, over the period from September 2012 through September 2013, mortgage rates and the level of refinancing activity were nearly linearly correlated. However, as the figure shows, from September 2013 through mid-2014 there was a decoupling of these two time series, and as a result the MBA Refinance Index has been meaningfully lower since late 2013 than one might have expected based on the nearly linear relationship that had existed between the two indices from September 2012 to September 2013. However, the increases in refinancings in October 2014 and January 2015 clearly reflect the decline in average mortgage rates during the same periods.

While the number of refinancing applications has been consistently low relative to interest rates since September 2013, the table below illustrates that the average refinanced loan size has increased over that same time period, with a 23.3% increase from September 2013 through June 2015. In the October 2014, January 2015, and March 2015 refinancing spikes, average refinanced loan size also spiked significantly. These trends suggest strongly that higher balance loans are becoming increasingly more prepayment sensitive relative to lower balance loans.

GSE/Government Agency Developments

On April 17, 2015, the FHFA announced that it would not change the general level of guarantee fees, or "g-fees," on new Fannie Mae and Freddie Mac originations, but that it would make certain minor and targeted fee adjustments, including removing the 25 basis point adverse market charge established in 2008, and applying small, targeted fee increases to a subset of Fannie Mae and Freddie Mac loans. G-fees are the fees charged by the GSEs to include mortgage loans in Agency pools, and thereby insure the mortgage loans against loss. Since these fees are passed on to borrowers whose loans are originated for inclusion in Agency pools, increased g-fees have the effect of reducing housing affordability for GSE borrowers, but potentially make it more attractive for private lenders to compete with the GSEs.

On May 8, 2015, FHFA Director Mel Watt announced that the Home Affordable Modification Program, or "HAMP," and the Home Affordable Refinance Program, or "HARP," both previously scheduled to end on December 31, 2015, will be extended through the end of 2016. In his prepared remarks, Director Watt noted that this will be the final extension for HAMP, and that he anticipated that it will also be the final extension for HARP, emphasizing that neither program was intended to be permanent. He also stated that the FHFA would be exploring other possible streamlined refinancing solutions for GSE loans.

The FHFA continues to work with Fannie Mae and Freddie Mac to build a Common Securitization Platform to be utilized by both agencies, which the FHFA believes will improve the liquidity of GSE securities and housing finance markets more broadly. On May 15, 2015, the FHFA released an updated plan for its Single Security structure, part of its broader efforts to develop a Common Securitization Platform. It noted that while individual loans and pools will still be either Fannie Mae guaranteed or Freddie Mac guaranteed, a single TBA security will be traded into which both Fannie Mae and Freddie Mac pools may be delivered. This plan will likely be implemented gradually over the next few years.

To date, no definitive legislation has been enacted with respect to a possible unwinding of the GSEs or a material reduction in their roles in the U.S. mortgage market. There have been several proposals offered by members of Congress,

including the Corker-Warner bill introduced in June 2013, the Johnson-Crapo bill introduced in March 2014, the Partnership to Strengthen Homeownership Act introduced in July 2014, and a Senate draft bill introduced in May 2015 by Senator Richard Shelby that pushes for increased credit risk transfers to private investors. To date, the GSEs have engaged predominantly in "second-loss" risk sharing transactions, where the GSEs bear losses on their mortgage pools up to a capped amount first, before private investors bear any losses. Furthermore, these risk sharing transactions to date have generally been "back-end" transactions, where the GSE seeks to offload its risk only after it has actually issued guarantees on a defined pool of mortgages. Under the Shelby bill, not only would the GSEs be required to engage in significant and increasing levels of risk sharing transactions generally, but for the first time the GSEs would be required to engage both in "first-loss" risk sharing transactions and in "front-end" risk sharing transactions. Many of these proposed bills could potentially increase private capital flows to the mortgage sector while reducing taxpayer risk. Though it appears unlikely that any of these bills will be passed in their current form, features may be incorporated into future proposals.

Portfolio Overview and Outlook

Agency

As of June 30, 2015, the value of our long Agency bond portfolio was \$1.305 billion, as compared to \$1.357 billion as of March 31, 2015.

Our Agency RMBS portfolio is principally comprised of "specified pools." Specified pools are fixed rate Agency pools with special characteristics, such as pools comprised of low loan balance mortgages, pools comprised of mortgages backed by investor properties, pools containing mortgages originated through the government-sponsored "Making Homes Affordable" refinancing programs, and pools containing mortgages with various other characteristics. During the year, our Agency RMBS purchasing activity continued to focus primarily on specified pools, especially those with higher coupons.

The second quarter was marked by significant volatility. The 10-year U.S. Treasury yield began the second quarter at 1.92%, and while it initially dipped lower in the early part of the quarter, its overall trend during the quarter was decidedly higher, as it ended the quarter at 2.35%. In addition, the yield curve steepened, as the 2-year U.S. Treasury yield increased only 0.09%, to 0.64%. The average rate for a fixed rate 30-year conventional mortgage also increased sharply over the course of the second quarter, climbing 0.38% to 4.08% as of June 30, 2015. As a result of this sharp increase, refinancing activity slowed, especially in the latter half of the second quarter.

Yield spreads on Agency RMBS generally widened in the second quarter. The drop in mortgage rates that had occurred in the first quarter led to increased refinancings, and therefore increased Agency pool production, in the first half of the second quarter; this increased supply was then exacerbated by the reduced purchase activity of the Federal Reserve. Even though demand from banks, money managers, and foreign investors has remained strong, the demand could not keep up with the added supply. Given the recent increase in interest rates, we believe that the level of supply will likely decline in the coming quarters. While in the first quarter specified pools had benefited from their prepayment protection features relative to their generic or TBA counterparts, this trend reversed in the second quarter as interest rates rose, and as a result TBA roll prices improved and pay-ups cheapened. Pay-ups are price premiums for specified pools relative to their TBA counterparts. In addition to cheapening on account of the fundamental decline in the value of prepayment protection, pay-ups cheapened further as a result of several technical factors, including an increase in prices for TBA rolls (giving TBAs an added carry advantage) and a general shift in sentiment away from prepayment protected assets. The weighted average market pay-up for our specified pools decreased to 0.81% as of June 30, 2015 from 1.12% as of March 31, 2015.

We took advantage of the volatility in pay-ups to harvest some gains early in the quarter, and then re-establish our exposure to pay-ups at cheaper levels later in the quarter. Our portfolio turnover for the quarter was 20% (as measured by sales and excluding paydowns), and we captured net realized gains of \$1.4 million, excluding hedges.

Over the course of the second quarter, our interest rate hedges, which were largely concentrated in interest rate swaps and short TBA positions, generated gains that significantly offset net realized and unrealized losses from our long portfolio. We believe that there remains a heightened risk of substantial interest rate and prepayment volatility in the near term, thus reinforcing the importance of our ability to hedge our risks using a variety of tools, including TBAs. During the second quarter, we continued to focus our Agency RMBS purchasing activity primarily on specified pools, especially those with higher coupons. As of June 30, 2015, the weighted average coupon on our fixed rate specified

pools was 3.97% as compared to 4.00% as of March 31, 2015. We also continued to be active in the reverse mortgage pool sector, adding to our holdings during the early part of the quarter. Our reverse mortgage pool purchase activity continued to be focused on new issue pools. Our Agency RMBS portfolio also includes a small allocation to Agency IOs, including Agency IOs on reverse mortgage pools, and we slightly increased our holdings of Agency IOs during the quarter.

We expect to continue to target specified pools that, taking into account their particular composition and based on our prepayment projections: (1) should generate attractive yields relative to other Agency RMBS and U.S. Treasury securities, (2) should have less prepayment sensitivity to government policy shocks, and/or (3) should create opportunities for trading gains once the market recognizes their value, which for newer pools may come only after several months, when actual prepayment experience can be observed. We believe that our research team, our proprietary prepayment models, and our extensive databases remain essential tools in our implementation of this strategy.

Our net Agency premium as a percentage of our long Agency RMBS holdings is one metric that we use to measure our overall prepayment risk. Net Agency premium represents the total premium (excess of market value over outstanding principal balance) on long Agency RMBS holdings less the total premium on related net short TBA positions. The lower our net Agency premium, the less we believe we are exposed to market-wide increases in Agency RMBS prepayments. As of June 30, 2015, our net Agency premium as a percentage of fair value on long Agency RMBS holdings was approximately 3.8% as compared to 4.7%, as of March 31, 2015. Excluding TBA positions used to hedge our long Agency RMBS portfolio, our Agency premium as a percentage of fair value was approximately 6.4% and 7.7% as of June 30, 2015 and March 31, 2015, respectively. These percentages may fluctuate from period to period based on market factors, including interest rates and mortgage rates, as well as with respect to the net percentages, the degree to which we hedge prepayment risk with short TBAs. We believe that our focus on purchasing pools with specific prepayment characteristics provides a measure of protection against prepayments.

Non-Agency

As of June 30, 2015, the value of our long non-Agency portfolio was \$30.3 million, as compared to \$31.7 million as of March 31, 2015, representing an decrease of 4.5%.

During the second quarter, as global fixed-income markets generally experienced a significant sell-off, the market for non-Agency RMBS held up relatively well compared to other sectors. More stable non-agency RMBS performed particularly well, as there continues to be little forced selling, available supply is dwindling as outstanding deals continue to amortize, and as domestic insurance companies continue to be attracted to the relatively high yields. On the fundamental side, modestly increasing home prices and overall improvements in mortgage delinquency and foreclosure rates continue to support non-Agency RMBS valuations. Notwithstanding the overall positive performance trend, we believe that careful loan-level analysis continues to be very important in security selection.

Financing

Through the first half of 2015, we have found access to repo financing widely available for our Agency RMBS assets. However, under the Dodd-Frank Wall Street Reform and Consumer Protection Act, bank capital treatment of repo transactions has become more onerous, thereby making it less attractive for banks to provide repo financing. While large banks still dominate the repo market, non-bank firms, not subject to the same regulations as large banks, are becoming more active in providing repo financing. The vast majority of our outstanding repo financing is provided by larger banks and dealers; however, in limited amounts, we have also entered into repo agreements with smaller non-bank dealers. In general, we continue to see strong appetite and competitive terms from both types of lenders.

Critical Accounting Policies

Our consolidated financial statements have been prepared in conformity with generally accepted accounting principles in the United States of America, or "U.S. GAAP." Entities in which we have a controlling financial interest, through ownership of the majority of the entities' voting equity interests, or through other contractual right that give us control, are consolidated by us. All inter-company balances and transactions have been eliminated.

Certain of our critical accounting policies require management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. We believe that all of the decisions and assessments upon which our consolidated financial statements are based were reasonable at the time made based upon information available to us at that time. We rely on our Manager and Ellington's experience and analysis of historical and current market data in order to arrive at what we believe to be reasonable estimates. See Note 2 to the consolidated financial statements included in this Quarterly Report on Form 10-Q for a complete discussion of our significant accounting policies. We have identified our most critical accounting policies to be the following:

Valuation: We apply ASC 820-10, Fair Value Measurement and Disclosures ("ASC 820-10"), to our holdings of financial instruments. ASC 820-10 establishes a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy is based upon the observability of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

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Level 1—inputs to the valuation methodology are observable and reflect quoted prices (unadjusted) for identical assets or liabilities in active markets. Currently, the types of financial instruments we generally include in this category are, exchange-traded derivatives, and cash equivalents,

Level 2—inputs to the valuation methodology other than quoted prices included in Level 1 are observable for the asset or liability, either directly or indirectly. Currently, the types of financial instruments that we generally include in this category are Agency RMBS, non-Agency RMBS determined to have sufficiently observable market data, U.S.

Treasury securities, actively traded derivatives such as TBAs, interest rate swaps, and swaptions, and

Level 3—inputs to the valuation methodology are unobservable and significant to the fair value measurement. Currently, this category includes RMBS where there is less price transparency.

See the notes to our consolidated financial statements for more information on valuation.

Accounting for Mortgage-Backed Securities: Investments in mortgage-backed securities are recorded on trade date.

We have chosen to make a fair value election pursuant to ASC 825-10, Financial Instruments, for our mortgage-backed securities portfolio. Electing the fair value option allows us to record changes in fair value in our Consolidated Statement of Operations, which, in our view, more appropriately reflects the results of our operations for a particular reporting period as all securities activities will be recorded in a similar manner. As such, the mortgage-backed securities are recorded at fair market value on our Consolidated Balance Sheet and the period change in fair value is recorded in current period earnings on our Consolidated Statement of Operations as a component of Change in net unrealized gains (losses) on mortgage-backed securities.

Realized gains or losses on sales of mortgage-backed securities are included in Net realized gains (losses) on mortgage-backed securities on the Consolidated Statement of Operations, and are recorded at the time of disposition. The cost of positions sold is calculated based on identified cost. Principal write-offs are generally treated as realized losses.

Interest Income: Coupon interest income on investment securities is accrued based on the outstanding principal balance and the current coupon rate on each security. We amortize premiums and accrete discounts on our fixed income investments.

Our accretion of discounts and amortization of premiums on securities for U.S. federal and other tax purposes is likely to differ from the accounting treatment under U.S. GAAP of these items as described above.

See the notes to our consolidated financial statements for more information on amortization of premiums and accretion of discounts.

Income Taxes: We made an election to be taxed as a REIT for U.S. federal income tax purposes. As a REIT, we generally are not subject to corporate-level federal and state income tax on net income we distribute to our stockholders. To qualify as a REIT, we must meet a number of organizational and operational requirements, including a requirement to distribute at least 90% of our taxable income to our stockholders. Even if we qualify as a REIT, we may be subject to certain federal, state, local and foreign taxes on our income and property and to federal income and excise taxes on our undistributed taxable income. We follow the authoritative guidance on accounting for and disclosure of uncertainty on tax positions, which requires management to determine whether a tax position is more likely than not to be sustained upon examination by the applicable taxing authority, including resolution of any related appeals of the litigation process, based on the technical merits of the position. For uncertain tax positions, the tax benefit to be recognized is measured as the largest amount of benefit that is greater than fifty percent likely of being realized upon ultimate settlement. In the normal course of business, we may be subject to examination by federal, state, local, and foreign jurisdictions, where applicable, for the current period, 2014, 2013 or 2012 (our open tax years). We may take positions with respect to certain tax issues which depend on legal interpretation of facts or applicable tax regulations. Should the relevant tax regulators successfully challenge any such positions; we might be found to have a tax liability that has not been recorded in the accompanying consolidated financial statements. Also, management's conclusions regarding the authoritative guidance may be subject to review and adjustment at a later date based on changing tax laws, regulations, and interpretations thereof. There were no amounts accrued for penalties or interest as of or during the periods presented in the consolidated financial statements included in this Quarterly Report on Form 10-Q.

"Emerging Growth Company" Status: On April 5, 2012, the Jumpstart Our Business Startups Act, or the "JOBS Act," was signed into law. The JOBS Act contains provisions that, among other things, reduce certain reporting

requirements for qualifying public companies. Because we qualify as an "emerging growth company," we may, under Section 7(a)(2)(B) of the Securities Act of 1933, or "the Securities Act," delay adoption of new or revised accounting standards applicable to public companies until such standards would otherwise apply to private companies. We may take advantage of this extended transition period until the first to occur of the date that we (i) are no longer an "emerging growth company" or (ii) affirmatively and irrevocably opt out of this extended transition period. We have elected to take advantage of the benefits of this extended transition period. As a result, our financial statements may not be comparable to those of other public companies that comply with such new or revised accounting standards. Until the date that we are no longer an "emerging growth company" or

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affirmatively and irrevocably opt out of the exemption provided by Securities Act Section 7(a)(2)(B), upon issuance of a new or revised accounting standard that applies to our financial statements and that has a different effective date for public and private companies, we will disclose the date on which adoption is required for non-emerging growth companies and the date on which we will adopt the recently issued accounting standard.

Recent Accounting Pronouncements

Refer to the notes to our consolidated financial statements for a description of relevant recent accounting pronouncements.

Financial Condition

Investment portfolio

The following tables summarize our mortgage-backed securities portfolio of as of June 30, 2015 and December 31, 2014:

June 30, 2015:

	Current Principal	Unamortized Premium (Discount)	Amortized Cost	Gross Unrealized		Fair Value	Weighted Average		Weighted Average Life(Years) ⁽¹⁾
				Gains	Losses		Coupon	Yield	
Agency RMBS:									
15-year fixed rate mortgages	\$157,422	\$7,728	\$165,150	\$1,138	\$(230)	\$166,058	3.38%	2.29%	5.15
20-year fixed rate mortgages	9,250	526	9,776	158	—	9,934	4.00%	2.88%	6.10
30-year fixed rate mortgages	958,490	58,729	1,017,219	11,658	(4,634)	1,024,243	4.07%	3.08%	8.51
Adjustable rate mortgages	38,594	2,382	40,976	137	(116)	40,997	4.25%	2.80%	3.59
Reverse mortgages	50,788	5,803	56,591	331	(689)	56,233	4.77%	2.64%	6.65
Interest only securities	n/a	n/a	7,270	323	(523)	7,070	3.49%	3.40%	2.36
Total Agency RMBS	1,214,544	75,168	1,296,982	13,745	(6,192)	1,304,535	3.98%	2.95%	7.49
Non-Agency RMBS	44,386	(15,774)	28,612	2,164	(488)	30,288	2.64%	9.97%	5.10
Total RMBS	\$1,258,930	\$59,394	\$1,325,594	\$15,909	\$(6,680)	\$1,334,823	3.94%		