

MFA FINANCIAL, INC.
Form 10-Q
November 04, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2014

OR

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

For the transition period from _____ to _____

Commission File Number: 1-13991

MFA FINANCIAL, INC.
(Exact name of registrant as specified in its charter)

Maryland (State or other jurisdiction of incorporation or organization)	13-3974868 (I.R.S. Employer Identification No.)
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350 Park Avenue, 20th Floor, New York, New York (Address of principal executive offices)	10022 (Zip Code)
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(212) 207-6400
(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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting

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company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

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

369,079,139 shares of the registrant’s common stock, \$0.01 par value, were outstanding as of October 30, 2014.

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MFA FINANCIAL, INC.

CONSOLIDATED BALANCE SHEETS

(In Thousands Except Per Share Amounts)	September 30, 2014 (Unaudited)	December 31, 2013
Assets:		
Mortgage-backed securities (“MBS”):		
Agency MBS, at fair value (\$5,765,633 and \$6,142,306 pledged as collateral, respectively)	\$ 6,174,176	\$ 6,519,221
Non-Agency MBS, at fair value (\$2,178,412 and \$1,778,067 pledged as collateral, respectively)	3,311,062	2,569,766
Non-Agency MBS transferred to consolidated variable interest entities (“VIEs”) (1)	1,452,264	2,282,371
Securities obtained and pledged as collateral, at fair value	442,370	383,743
Cash and cash equivalents	423,891	565,370
Restricted cash	43,751	37,520
Interest receivable	32,499	35,828
Derivative instruments:		
MBS linked transactions, net (“Linked Transactions”), at fair value	190,681	28,181
Interest rate swap agreements (“Swaps”), at fair value	4,322	13,000
Goodwill	7,189	7,189
Prepaid and other assets (See Notes 2(d) and 15)	160,572	29,719
Total Assets	\$ 12,242,777	\$ 12,471,908
Liabilities:		
Repurchase agreements	\$ 8,125,723	\$ 8,339,297
Securitized debt (2)	156,276	366,205
Obligation to return securities obtained as collateral, at fair value	442,370	383,743
8% Senior Notes due 2042 (“Senior Notes”)	100,000	100,000
Accrued interest payable	12,172	14,726
Swaps, at fair value	35,493	28,217
Dividends and dividend equivalents rights (“DERs”) payable	74,126	73,643
Accrued expenses and other liabilities	42,873	23,826
Total Liabilities	\$ 8,989,033	\$ 9,329,657
Commitments and contingencies (See Note 10)		
Stockholders’ Equity:		
Preferred stock, \$.01 par value; 7.50% Series B cumulative redeemable; 8,050 shares authorized; 8,000 shares issued and outstanding (\$200,000 aggregate liquidation preference)	\$ 80	\$ 80
Common stock, \$.01 par value; 886,950 shares authorized; 368,721 and 365,125 shares issued and outstanding, respectively	3,687	3,651
Additional paid-in capital, in excess of par	3,002,549	2,972,369
Accumulated deficit	(570,106)	(571,544)
Accumulated other comprehensive income	817,534	737,695
Total Stockholders’ Equity	\$ 3,253,744	\$ 3,142,251
Total Liabilities and Stockholders’ Equity	\$ 12,242,777	\$ 12,471,908

(1) Non-Agency MBS transferred to consolidated VIEs represent assets of the consolidated VIEs that can be used only to settle the obligations of each respective VIE.

Securitized Debt represents third-party liabilities of consolidated VIEs and excludes liabilities of the VIEs acquired (2) by the Company that eliminate on consolidation. The third-party beneficial interest holders in the VIEs have no recourse to the general credit of the Company. (See Notes 10 and 15 for further discussion.)

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

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CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

(In Thousands, Except Per Share Amounts)	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2014	2013	2014	2013
Interest Income:				
Agency MBS	\$33,066	\$36,158	\$110,004	\$116,982
Non-Agency MBS	48,571	43,131	135,199	128,175
Non-Agency MBS transferred to consolidated VIEs	29,303	39,172	105,510	116,641
Cash and cash equivalent investments	20	21	63	93
Interest Income	\$110,960	\$118,482	\$350,776	\$361,891
Interest Expense:				
Repurchase agreements	\$35,935	\$37,113	\$109,354	\$105,185
Securitized debt	1,415	2,830	5,471	9,381
Senior Notes	2,008	2,007	6,023	6,020
Interest Expense	\$39,358	\$41,950	\$120,848	\$120,586
Net Interest Income	\$71,602	\$76,532	\$229,928	\$241,305
Other Income, net:				
Unrealized net gains and net interest income from Linked Transactions	\$2,559	\$544	\$9,586	\$1,785
Unrealized losses on TBA short positions	—	(8,724)	—	(8,724)
Gain on sales of MBS and U.S. Treasury securities, net	13,880	13,680	25,303	19,678
Other, net	1,251	55	1,543	165
Other Income, net	\$17,690	\$5,555	\$36,432	\$12,904
Operating and Other Expense:				
Compensation and benefits	\$5,970	\$5,294	\$18,378	\$15,851
Other general and administrative expense	3,831	3,434	11,461	10,175
Excise tax and interest	—	—	1,175	2,000
Impairment of resecuritization related costs	—	2,031	—	2,031
Other investment related operating expenses	609	—	1,550	—
Operating and Other Expense	\$10,410	\$10,759	\$32,564	\$30,057
Net Income	\$78,882	\$71,328	\$233,796	\$224,152
Less Preferred Stock Dividends	3,750	3,750	11,250	10,000
Less Issuance Costs of Redeemed Preferred Stock	—	—	—	3,947
Net Income Available to Common Stock and Participating Securities	\$75,132	\$67,578	\$222,546	\$210,205
Earnings per Common Share - Basic and Diluted	\$0.20	\$0.19	\$0.60	\$0.58

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Dividends Declared per Share of Common Stock	\$0.20	\$0.50	(1) \$0.60	\$1.44	(1)(2)
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(1) Includes a special dividend of \$0.28 per share declared on August 1, 2013.

(2) Includes a special dividend of \$0.50 per share declared on March 4, 2013.

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

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CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(UNAUDITED)

(In Thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Net income	\$78,882	\$71,328	\$233,796	\$224,152
Other Comprehensive (Loss)/Income:				
Unrealized (loss)/gain on Agency MBS, net	(14,937	) 15,469	46,000	(152,302)
Unrealized (loss)/gain on Non-Agency MBS, net	(28,473	) 16,381	70,973	62,455
Reclassification adjustment for MBS sales included in net income	(13,589	) (15,158)	(21,180)	(17,398)
Unrealized gain/(loss) on derivative hedging instruments, net	23,500	(19,934)	(16,401)	10,930
Reclassification of unrealized loss on de-designated derivative hedging instruments	—	—	447	—
Other Comprehensive (Loss)/Income	(33,499	) (3,242)	79,839	(96,315)
Comprehensive income before preferred stock dividends and issuance costs of redeemed preferred stock	\$45,383	\$68,086	\$313,635	\$127,837
Dividends declared on preferred stock	(3,750	) (3,750)	(11,250)	(10,000)
Issuance costs of redeemed preferred stock	—	—	—	(3,947)
Comprehensive Income Available to Common Stock and Participating Securities	\$41,633	\$64,336	\$302,385	\$113,890

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

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MFA FINANCIAL, INC.

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY
(UNAUDITED)

(In Thousands, Except Per Share Amounts)	Nine Months Ended September 30, 2014	
	Dollars	Shares
Preferred Stock, 7.50% Series B Cumulative Redeemable - Liquidation Preference \$25.00 per Share:		
Balance at September 30, 2014 and December 31, 2013	\$80	8,000
Common Stock, Par Value \$.01:		
Balance at December 31, 2013	\$3,651	365,125
Issuance of common stock (1)	36	3,690
Repurchase of shares of common stock (1)	—	(94)
Balance at September 30, 2014	\$3,687	368,721
Additional Paid-in Capital, in excess of Par:		
Balance at December 31, 2013	\$2,972,369	
Issuance of common stock, net of expenses (1)	26,335	
Equity-based compensation expense	4,357	
Accrued dividends attributable to stock-based awards	(164)	
Repurchase of shares of common stock (1)	(348)	
Balance at September 30, 2014	\$3,002,549	
Accumulated Deficit:		
Balance at December 31, 2013	\$(571,544)	
Net income	233,796	
Dividends declared on common stock	(220,724)	
Dividends declared on preferred stock	(11,250)	
Dividends attributable to DERs	(384)	
Balance at September 30, 2014	\$(570,106)	
Accumulated Other Comprehensive Income:		
Balance at December 31, 2013	\$737,695	
Change in unrealized gains on MBS, net	95,793	
Change in unrealized losses on derivative hedging instruments, net	(15,954)	
Balance at September 30, 2014	\$817,534	
Total Stockholders' Equity at September 30, 2014	\$3,253,744	

(1) For the nine months ended September 30, 2014, includes approximately \$721,000 (94,073 shares) surrendered for tax purposes related to equity-based compensation awards.

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

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MFA FINANCIAL, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

(In Thousands)	Nine Months Ended September 30,	
	2014	2013
Cash Flows From Operating Activities:		
Net income	\$233,796	\$224,152
Adjustments to reconcile net income to net cash provided by operating activities:		
Gain on sales of MBS and U.S. Treasury securities	(25,303	) (19,678)
Accretion of purchase discounts on MBS and other investments	(68,871	) (48,322)
Amortization of purchase premiums on MBS	25,986	47,198
Depreciation and amortization on fixed assets and other assets	936	3,133
Equity-based compensation expense	4,357	2,946
Unrealized (losses)/gains on derivative instruments	(2,542	) 8,318
Decrease in interest receivable	3,318	6,193
Increase in prepaid and other assets	(19,824	) (5,146)
(Decrease)/increase in accrued expenses and other liabilities, and excise tax and interest	(6,434	) 10,837
Increase/(decrease) in accrued interest payable on financial instruments	32,080	(2,503)
Net cash provided by operating activities	\$177,499	\$227,128
Cash Flows From Investing Activities:		
Principal payments on MBS and other investments	\$1,470,390	\$2,231,495
Proceeds from sale of MBS and U.S. Treasury securities	103,625	493,613
Purchases of MBS and other investments	(1,068,713	) (1,532,982)
Additions to leasehold improvements, furniture and fixtures	(383	) (272)
Net cash provided by investing activities	\$504,919	\$1,191,854
Cash Flows From Financing Activities:		
Principal payments on repurchase agreements	\$(62,567,398)	\$(60,312,234)
Proceeds from borrowings under repurchase agreements	62,353,824	60,127,933
Proceeds from issuance of securitized debt	—	76,485
Principal payments on securitized debt	(208,702	) (303,608)
Payments made on obligation to return securities obtained as collateral	—	(200,050)
Maturity of obligation to return securities obtained as collateral	—	(275,402)
Cash disbursements on financial instruments underlying Linked Transactions	(2,738,961	) (254,155)
Cash received from financial instruments underlying Linked Transactions	2,583,744	243,325
Payments made for margin calls on repurchase agreements and Swaps	(111,800	) (61,402)
Proceeds from reverse margin calls on repurchase agreements and Swaps	70,900	2,000
Proceeds from issuances of common stock	26,371	67,409
Payments made for redemption of Series A Preferred Stock	—	(96,000)
Proceeds from issuance of Series B Preferred Stock	—	200,000
Payments made for preferred stock offering costs	—	(6,684)
Payments made to repurchase common stock	—	(27)
Dividends paid on preferred stock	(11,250	) (10,000)
Dividends paid on common stock and DERs	(220,625) (514,013)
Net cash used in financing activities	\$(823,897) \$(1,316,423)

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Net (decrease)/increase in cash and cash equivalents	\$(141,479)	\$102,559
Cash and cash equivalents at beginning of period	\$565,370	\$401,293
Cash and cash equivalents at end of period	\$423,891	\$503,852
Non-cash Investing and Financing Activities:		
MBS recorded upon de-linking of Linked Transactions	\$36,258	\$—
Net increase in securities obtained as collateral/obligation to return securities obtained as collateral	\$63,691	\$221,578
Dividends and DERs declared and unpaid	\$74,126	\$81,171

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

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MFA FINANCIAL, INC.

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2014

1. Organization

MFA Financial, Inc. (the “Company”) was incorporated in Maryland on July 24, 1997 and began operations on April 10, 1998. The Company has elected to be treated as a real estate investment trust (“REIT”) for federal income tax purposes. In order to maintain its qualification as a REIT, the Company must comply with a number of requirements under federal tax law, including that it must distribute at least 90% of its annual REIT taxable income to its stockholders. (See Notes 2(n) and 11)

2. Summary of Significant Accounting Policies

(a) Basis of Presentation and Consolidation

The interim unaudited consolidated financial statements of the Company have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission (the “SEC”). Certain information and note disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) have been condensed or omitted according to these SEC rules and regulations. Management believes that the disclosures included in these interim financial statements are adequate to make the information presented not misleading. The accompanying consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2013. In the opinion of management, all normal and recurring adjustments necessary to present fairly the financial condition of the Company at September 30, 2014 and results of operations for all periods presented have been made. The results of operations for the nine months ended September 30, 2014 should not be construed as indicative of the results to be expected for the full year.

The accompanying consolidated financial statements of the Company have been prepared on the accrual basis of accounting in accordance with GAAP. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although the Company’s estimates contemplate current conditions and how it expects them to change in the future, it is reasonably possible that actual conditions could be worse than anticipated in those estimates, which could materially impact the Company’s results of operations and its financial condition. Management has made significant estimates in several areas, including other-than-temporary impairment (“OTTI”) on Agency and Non-Agency MBS (Note 3), valuation of Agency and Non-Agency MBS (Notes 3 and 14), derivative instruments (Notes 5 and 14) and income recognition on certain Non-Agency MBS purchased at a discount (Note 3). In addition, estimates are used in the determination of taxable income used in the assessment of REIT compliance and contingent liabilities for related taxes, penalties and interest (Note 2(n)). Actual results could differ from those estimates.

The consolidated financial statements of the Company include the accounts of all subsidiaries; significant intercompany accounts and transactions have been eliminated. Certain prior period amounts have been reclassified to conform to the current period presentation.

(b) Agency and Non-Agency MBS (including Non-Agency MBS transferred to a consolidated VIE)

The Company has investments in residential MBS that are issued or guaranteed as to principal and/or interest by a federally chartered corporation, such as Fannie Mae or Freddie Mac, or any agency of the U.S. Government, such as Ginnie Mae (collectively, “Agency MBS”), and residential MBS that are not guaranteed by any U.S. Government agency or any federally chartered corporation (“Non-Agency MBS”), as described in Note 3.

Designation

The Company generally intends to hold its MBS until maturity; however, from time to time, it may sell any of its securities as part of the overall management of its business. As a result, all of the Company’s MBS are designated as “available-for-sale” and, accordingly, are carried at their fair value with unrealized gains and losses excluded from earnings (except when an OTTI is recognized, as discussed below) and reported in accumulated other comprehensive income/(loss) (“AOCI”), a component of stockholders’ equity.

Upon the sale of an investment security, any unrealized gain or loss is reclassified out of AOCI to earnings as a realized gain or loss using the specific identification method.

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MFA FINANCIAL, INC.

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2014

Revenue Recognition, Premium Amortization and Discount Accretion

Interest income on securities is accrued based on the outstanding principal balance and their contractual terms. Premiums and discounts associated with Agency MBS and Non-Agency MBS assessed as high credit quality at the time of purchase are amortized into interest income over the life of such securities using the effective yield method. Adjustments to premium amortization are made for actual prepayment activity.

Interest income on the Non-Agency MBS that were purchased at a discount to par value and/or are considered to be of less than high credit quality is recognized based on the security's effective interest rate which is the security's internal rate of return ("IRR"). The IRR is determined using management's estimate of the projected cash flows for each security, which are based on the Company's observation of current information and events and include assumptions related to fluctuations in interest rates, prepayment speeds and the timing and amount of credit losses. On at least a quarterly basis, the Company reviews and, if appropriate, makes adjustments to its cash flow projections based on input and analysis received from external sources, internal models, and its judgment about interest rates, prepayment rates, the timing and amount of credit losses, and other factors. Changes in cash flows from those originally projected, or from those estimated at the last evaluation, may result in a prospective change in the IRR/interest income recognized on these securities or in the recognition of OTTI. (See Note 3)

Based on the projected cash flows from the Company's Non-Agency MBS purchased at a discount to par value, a portion of the purchase discount may be designated as non-accretable purchase discount ("Credit Reserve"), which effectively mitigates the Company's risk of loss on the mortgages collateralizing such MBS and is not expected to be accreted into interest income. The amount designated as Credit Reserve may be adjusted over time, based on the actual performance of the security, its underlying collateral, actual and projected cash flow from such collateral, economic conditions and other factors. If the performance of a security with a Credit Reserve is more favorable than forecasted, a portion of the amount designated as Credit Reserve may be reallocated to accretable discount and recognized into interest income over time. Conversely, if the performance of a security with a Credit Reserve is less favorable than forecasted, the amount designated as Credit Reserve may be increased, or impairment charges and write-downs of such securities to a new cost basis could result.

Determination of MBS Fair Value

In determining the fair value of the Company's MBS, management considers a number of observable market data points, including prices obtained from pricing services, brokers and repurchase agreement counterparties, dialogue with market participants, as well as management's observations of market activity. (See Note 14)

Impairments/OTTI

When the fair value of an investment security is less than its amortized cost at the balance sheet date, the security is considered impaired. The Company assesses its impaired securities on at least a quarterly basis and designates such impairments as either "temporary" or "other-than-temporary." If the Company intends to sell an impaired security, or it is more likely than not that it will be required to sell the impaired security before its anticipated recovery, then the Company must recognize an OTTI through charges to earnings equal to the entire difference between the investment's amortized cost and its fair value at the balance sheet date. If the Company does not expect to sell an other-than-temporarily impaired security, only the portion of the OTTI related to credit losses is recognized through charges to earnings with the remainder recognized through AOCI on the consolidated balance sheets. Impairments

recognized through other comprehensive income/(loss) (“OCI”) do not impact earnings. Following the recognition of an OTTI through earnings, a new cost basis is established for the security and may not be adjusted for subsequent recoveries in fair value through earnings. However, OTTIs recognized through charges to earnings may be accreted back to the amortized cost basis of the security on a prospective basis through interest income. The determination as to whether an OTTI exists and, if so, the amount of credit impairment recognized in earnings is subjective, as such determinations are based on factual information available at the time of assessment as well as the Company’s estimates of the future performance and cash flow projections. As a result, the timing and amount of OTTIs constitute material estimates that are susceptible to significant change. (See Note 3)

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MFA FINANCIAL, INC.

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2014

Non-Agency MBS that are assessed to be of less than high credit quality and on which impairments are recognized have experienced, or are expected to experience, credit-related adverse cash flow changes. The Company's estimate of cash flows for its Non-Agency MBS is based on its review of the underlying mortgage loans securing the MBS. The Company considers information available about the past and expected future performance of underlying mortgage loans, including timing of expected future cash flows, prepayment rates, default rates, loss severities, delinquency rates, percentage of non-performing loans, Fair Isaac Corporation ("FICO") scores at loan origination, year of origination, loan-to-value ratios ("LTVs"), geographic concentrations, as well as reports by credit rating agencies, such as Moody's Investors Services, Inc. ("Moody's"), Standard & Poor's Corporation ("S&P"), or Fitch, Inc. (collectively, "Rating Agencies"), general market assessments, and dialogue with market participants. As a result, significant judgment is used in the Company's analysis to determine the expected cash flows for its Non-Agency MBS. In determining the OTTI related to credit losses for securities that were purchased at significant discounts to par and/or are considered to be of less than high credit quality, the Company compares the present value of the remaining cash flows expected to be collected at the purchase date (or last date previously revised) against the present value of the cash flows expected to be collected at the current financial reporting date. The discount rate used to calculate the present value of expected future cash flows is the current yield used for income recognition purposes. Impairment assessment for Non-Agency MBS that were purchased at prices close to par and are considered to be of high credit quality involves comparing the present value of the remaining cash flows expected to be collected against the amortized cost of the security at the assessment date. The discount rate used to calculate the present value of the expected future cash flows is based on the instrument's IRR.

Balance Sheet Presentation

The Company's MBS pledged as collateral against repurchase agreements and Swaps are included in MBS on the consolidated balance sheets with the fair value of the MBS pledged disclosed parenthetically. Purchases and sales of securities are recorded on the trade date. However, if on the purchase settlement date, a repurchase agreement is used to finance the purchase of an MBS with the same counterparty and such transactions are determined to be linked, then the MBS and linked repurchase borrowing will be reported on the same settlement date as Linked Transactions. (See Notes 2(o) and 5)

(c) Securities Obtained and Pledged as Collateral/Obligation to Return Securities Obtained as Collateral

The Company has obtained securities as collateral under collateralized financing arrangements in connection with its financing strategy for Non-Agency MBS. Securities obtained as collateral in connection with these transactions are recorded on the Company's consolidated balance sheets as an asset along with a liability representing the obligation to return the collateral obtained, at fair value. While beneficial ownership of securities obtained remains with the counterparty, the Company has the right to sell the collateral obtained or to pledge it as part of a subsequent collateralized financing transaction. (See Note 2(j) for Repurchase Agreements and Reverse Repurchase Agreements)

(d) Residential Whole Loans

Residential whole loans included in the Company's consolidated balance sheets are comprised of pools of fixed and adjustable rate residential mortgage loans acquired through a consolidated trust. The Company has elected to account for these loans as credit impaired as they were acquired at discounted prices that reflect, in part, the credit history of the borrower. In addition, many of the borrowers have previously experienced payment delinquencies and the amount owed on the mortgage loan may exceed the value of the property pledged as collateral. Consequently, the Company has assessed that these loans have a higher likelihood of default than newly originated mortgage loans with LTVs of

80% or less to credit worthy borrowers. The Company believes that amounts paid to acquire residential whole loans represent fair market value at the date of acquisition. Residential whole loans are initially recorded at fair value with no allowance for loan losses. Subsequent to acquisition, the recorded amount reflects the original investment amount, plus accretion of interest income, less principal and interest cash flows received and principal amounts forgiven or otherwise charged off as they are considered not recoverable. Residential whole loans are presented in Prepaid and other assets in the Company's consolidated balance sheets at carrying value, which reflects the recorded amount net of any allowance for loan losses established subsequent to acquisition.

The Company may aggregate into pools loans acquired in the same fiscal quarter that are assessed as having similar risk characteristics. For each pool established, or on an individual loans basis for loans not aggregated into pools, the Company estimates at acquisition and periodically on at least a quarterly basis, the principal and interest cash flows expected to be collected. The difference between the cash flows expected to be collected and the carrying amount of the loans is referred to as the "accretable yield". This amount is accreted as interest income over the life of the loans using an effective interest rate (level yield) methodology. Interest income recorded each period reflects the amount of accretable yield recognized and not the coupon interest payments

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received on the underlying loans. The difference between contractually required principal and interest payments and the cash flows expected to be collected, referred to as the “nonaccretable difference,” includes estimates of both the impact of prepayments and expected credit losses over the life of the underlying loans.

A decrease in expected cash flows in subsequent periods may indicate impairment at the pool and/or individual loan level thus requiring the establishment of an allowance for loan losses by a charge to the provision for loan losses. The allowance for loan losses represents the present value of cash flows expected at acquisition that are no longer expected to be received at the relevant measurement date. An increase in expected cash flows in subsequent periods initially reduces any previously established allowance for loan losses by the increase in the present value of cash flows expected to be collected, and results in a recalculation of the amount of accretable yield. The adjustment of accretable yield due to an increase in expected cash flows is accounted for prospectively as a change in estimate and results in reclassification from nonaccretable difference to accretable yield. (See Note 15)

(e) Cash and Cash Equivalents

Cash and cash equivalents include cash on deposit with financial institutions and investments in money market funds and U. S. Treasury Bills, all of which have original maturities of three months or less. Cash and cash equivalents may also include cash pledged as collateral to the Company by its repurchase agreement and/or Swap counterparties as a result of reverse margin calls (i.e., margin calls made by the Company). The Company did not hold any cash pledged by its counterparties at September 30, 2014 or December 31, 2013. The Company’s investments in overnight money market funds, which are not bank deposits and are not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency were \$314.9 million and \$534.4 million at September 30, 2014 and December 31, 2013, respectively. (See Notes 7 and 14)

(f) Restricted Cash

Restricted cash represents the Company’s cash held by its counterparties as collateral against the Company’s Swaps and/or repurchase agreements. Restricted cash, which earns interest, is not available to the Company for general corporate purposes, but may be applied against amounts due to counterparties to the Company’s repurchase agreements and/or Swaps, or returned to the Company when the collateral requirements are exceeded or at the maturity of the Swap or repurchase agreement. The Company had aggregate restricted cash held as collateral against its Swaps and repurchase agreements of \$43.8 million at September 30, 2014 and \$37.5 million held as collateral against its Swaps at December 31, 2013. (See Notes 5, 6, 7 and 14)

(g) Goodwill

At September 30, 2014 and December 31, 2013, the Company had goodwill of \$7.2 million, which represents the unamortized portion of the excess of the fair value of its common stock issued over the fair value of net assets acquired in connection with its formation in 1998. Goodwill is tested for impairment at least annually, or more frequently under certain circumstances, at the entity level. Through September 30, 2014, the Company had not recognized any impairment against its goodwill.

(h) Depreciation

Leasehold Improvements and Other Depreciable Assets

Depreciation is computed on the straight-line method over the estimated useful life of the related assets or, in the case of leasehold improvements, over the shorter of the useful life or the lease term. Furniture, fixtures, computers and related hardware have estimated useful lives ranging from five to eight years at the time of purchase.

(i) Resecuritization and Senior Notes Related Costs

Resecuritization related costs are costs associated with the issuance of beneficial interests by consolidated VIEs and incurred by the Company in connection with various resecuritization transactions completed by the Company. Senior Notes related costs are costs incurred by the Company in connection with the issuance of its Senior Notes in April, 2012. These costs may include underwriting, rating agency, legal, accounting and other fees. Such costs, which reflect deferred charges, are included on the Company's consolidated balance sheets in Prepaid and other assets. These deferred charges are amortized as an adjustment to interest expense using the effective interest method, based upon the actual repayments of the associated beneficial interests issued to third parties and over the stated legal maturity of the Senior Notes. The Company periodically reviews the recoverability of

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these deferred costs and in the event an impairment charge is required, such amount shall be included within Operating and other expense on the Company's consolidated statement of operations.

(j) Repurchase Agreements and Reverse Repurchase Agreements

The Company finances the acquisition of a significant portion of its MBS with repurchase agreements. Under repurchase agreements, the Company sells securities to a lender and agrees to repurchase the same securities in the future for a price that is higher than the original sale price. The difference between the sale price that the Company receives and the repurchase price that the Company pays represents interest paid to the lender. Although legally structured as sale and repurchase transactions, the Company accounts for repurchase agreements as secured borrowings, with the exception of certain repurchase agreements accounted for as components of Linked Transactions. (See Note 2(o) below.) Under its repurchase agreements, the Company pledges its securities as collateral to secure the borrowing, which is equal in value to a specified percentage of the fair value of the pledged collateral, while the Company retains beneficial ownership of the pledged collateral. At the maturity of a repurchase financing, unless the repurchase financing is renewed with the same counterparty, the Company is required to repay the loan including any accrued interest and concurrently receives back its pledged collateral from the lender. With the consent of the lender, the Company may renew a repurchase financing at the then prevailing financing terms. Margin calls, whereby a lender requires that the Company pledge additional securities or cash as collateral to secure borrowings under its repurchase financing with such lender, are routinely experienced by the Company when the value of the MBS pledged as collateral declines as a result of principal amortization and prepayments or due to changes in market interest rates, spreads or other market conditions. The Company also may make margin calls on counterparties when collateral values increase.

The Company's repurchase financings typically have terms ranging from one month to six months at inception, but may also have longer or shorter terms. Should a counterparty decide not to renew a repurchase financing at maturity, the Company must either refinance elsewhere or be in a position to satisfy the obligation. If, during the term of a repurchase financing, a lender should default on its obligation, the Company might experience difficulty recovering its pledged assets which could result in an unsecured claim against the lender for the difference between the amount loaned to the Company plus interest due to the counterparty and the fair value of the collateral pledged by the Company to such lender, including accrued interest receivable or such collateral. (See Notes 2(o), 5, 6, 7 and 14)

In addition to the repurchase agreement financing arrangements discussed above, as part of its financing strategy for Non-Agency MBS, the Company has entered into contemporaneous repurchase and reverse repurchase agreements with a single counterparty. Under a typical reverse repurchase agreement, the Company buys securities from a borrower for cash and agrees to sell the same securities in the future for a price that is higher than the original purchase price. The difference between the purchase price the Company originally paid and the sale price represents interest received from the borrower. In contrast, the contemporaneous repurchase and reverse repurchase transactions effectively resulted in the Company pledging Non-Agency MBS as collateral to the counterparty in connection with the repurchase agreement financing and obtaining U.S. Treasury securities as collateral from the same counterparty in connection with the reverse repurchase agreement. No net cash was exchanged between the Company and counterparty at the inception of the transactions. Securities obtained and pledged as collateral are recorded as an asset on the Company's consolidated balance sheets. Interest income is recorded on the reverse repurchase agreement and interest expense is recorded on the repurchase agreement on an accrual basis. Both the Company and the counterparty have the right to make daily margin calls based on changes in the value of the collateral obtained and/or pledged. The Company's liability to the counterparty in connection with this financing arrangement is recorded on the Company's consolidated balance sheets and disclosed as "Obligation to return securities obtained as collateral." (See Note 2(c))

(k) Equity-Based Compensation

Compensation expense for equity based awards is recognized ratably over the vesting period of such awards, based upon the fair value of such awards at the grant date. With respect to awards granted in 2009 and prior years, the Company has applied a zero forfeiture rate for these awards, as they were granted to a limited number of employees, and historical forfeitures have been minimal. Forfeitures, or an indication that forfeitures are expected to occur, may result in a revised forfeiture rate and would be accounted for prospectively as a change in estimate.

During 2010, the Company granted certain restricted stock units (“RSUs”) that vest after either two or four years of service and provided that certain criteria are met, which are based on a formula that includes changes in the Company’s closing stock price over a two- or four-year period and dividends declared on the Company’s common stock during those periods. From 2011 through 2013, the Company granted certain RSUs that vest annually over a one or three-year period, provided that certain criteria are met,

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which are based on a formula that includes changes in the Company's closing stock price over the annual vesting period and dividends declared on the Company's common stock during those periods. During 2014, the Company made grants of RSUs certain of which generally cliff vest after a three-year period and certain of which generally cliff vest after a three-year period subject to the achievement of a market-based condition that is based on a formula tied to the Company's achievement of average total stockholder return during the three-year period. Such criteria constitute a "market condition" which impacts the amount of compensation expense recognized for these awards. Specifically, the uncertainty regarding whether the market condition will be achieved is reflected in the grant date fair valuation of the RSUs, which in addition to estimates regarding the amount of RSUs expected to be forfeited during the associated service period, determines the amount of compensation expense that is recognized. Compensation expense is not reversed should the market condition not be achieved, while differences in actual forfeiture experience relative to estimated forfeitures will result in adjustments to the timing and amount of compensation expense recognized.

The Company has awarded DERs that may be attached to or awarded separately from other equity based awards. Compensation expense for separately awarded DERs is based on the grant date fair value of such awards and is recognized over the vesting period. Payments pursuant to these DERs are charged to stockholders' equity. Payments pursuant to DERs that are attached to equity based awards are charged to stockholders' equity to the extent that the attached equity awards are expected to vest. Compensation expense is recognized for payments made for DERs to the extent that the attached equity awards do not or are not expected to vest and grantees are not required to return payments of dividends or DERs to the Company. (See Notes 2(l) and 13)

(l) Earnings per Common Share ("EPS")

Basic EPS is computed using the two-class method, which includes the weighted-average number of shares of common stock outstanding during the period and other securities that participate in dividends, such as the Company's unvested restricted stock and RSUs that have non-forfeitable rights to dividends and DERs attached to/associated with RSUs and vested stock options to arrive at total common equivalent shares. In applying the two-class method, earnings are allocated to both shares of common stock and securities that participate in dividends based on their respective weighted-average shares outstanding for the period. For the diluted EPS calculation, common equivalent shares are further adjusted for the effect of dilutive unexercised stock options and RSUs outstanding that are unvested and have dividends that are subject to forfeiture using the treasury stock method. Under the treasury stock method, common equivalent shares are calculated assuming that all dilutive common stock equivalents are exercised and the proceeds, along with future compensation expenses associated with such instruments, are used to repurchase shares of the Company's outstanding common stock at the average market price during the reported period. (See Note 12)

(m) Comprehensive Income/(Loss)

The Company's comprehensive income/(loss) available to common stock and participating securities includes net income, the change in net unrealized gains/(losses) on its MBS and derivative hedging instruments, (to the extent that such changes are not recorded in earnings), adjusted by realized net gains/(losses) reclassified out of AOCI for MBS and de-designated derivative hedging instruments and is reduced by dividends declared on the Company's preferred stock and issuance costs of redeemed preferred stock.

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(n) U.S. Federal Income Taxes

The Company has elected to be taxed as a REIT under the provisions of the Internal Revenue Code of 1986, as amended, (the “Code”) and the corresponding provisions of state law. The Company expects to operate in a manner that will enable it to satisfy the various requirements to maintain its status as a REIT. In order to maintain its status as a REIT, the Company must, among other things, distribute at least 90% of its REIT taxable income (excluding net long-term capital gains) to stockholders in the timeframe permitted by the Code. As long as the Company maintains its status as a REIT, the Company will not be subject to regular Federal income tax to the extent that it distributes 100% of its REIT taxable income (including net long-term capital gains) to its stockholders within the permitted timeframe. Should this not occur, the Company would be subject to federal taxes at prevailing corporate tax rates on the difference between its REIT taxable income and the amounts deemed to be distributed for that tax year. As the Company’s objective is to distribute 100% of its REIT taxable income to its stockholders within the permitted timeframe, no provision for current or deferred income taxes has been made in the accompanying consolidated financial statements. Should the Company incur a liability for corporate income tax, such amounts would be recorded as REIT income tax expense on the Company’s consolidated statements of operations. Furthermore, if the Company fails to distribute during each calendar year, or by the end of January following the calendar year in the case of distributions with declaration and record dates falling in the last three months of the calendar year, at least the sum of (i) 85% its REIT ordinary income for such year; (ii) 95% of its REIT capital gain income for such year and; (iii) any undistributed taxable income from prior periods, the Company will be subject to a 4% nondeductible excise tax on the excess of such required distribution over the amounts actually distributed. To the extent that the Company incurs interest, penalties or related excise taxes in connection with its tax obligations, including as a result of its assessment of uncertain tax positions, such amounts shall be included within Operating and other expense on the Company’s consolidated statements of operations.

Based on its analysis of any potential uncertain tax positions, the Company concluded that it does not have any material uncertain tax positions that meet the relevant recognition or measurement criteria as of September 30, 2014, December 31, 2013, or September 30, 2013. The Company filed its 2013 tax return prior to September 15, 2014. The Company’s tax returns for tax years 2009 through 2013 are open to examination.

(o) Derivative Financial Instruments

The Company uses a variety of derivative instruments to economically hedge a portion of its exposure to market risks, including interest rate risk, prepayment risk and extension risk. The objective of the Company’s risk management strategy is to reduce fluctuations in net book value over a range of interest rate scenarios. In particular, the Company attempts to mitigate the risk of the cost of its variable rate liabilities increasing during a period of rising interest rates. The Company’s derivative instruments are primarily comprised of Swaps, the majority of which are designated as cash flow hedges against the interest rate risk associated with its borrowings. During 2013, the Company also entered into forward contracts for the sale of Agency MBS securities on a generic pool, or to-be-announced basis (“TBA short positions”) and Linked Transactions. TBA short positions and Linked Transactions are not designated as hedging instruments.

Linked Transactions

It is presumed that the initial transfer of a financial asset (i.e., the purchase of an MBS by the Company) and contemporaneous repurchase financing of such MBS with the same counterparty are considered part of the same arrangement, or a “linked transaction,” unless certain criteria are met. The two components of a linked transaction

(MBS purchase and repurchase financing) are not reported separately but are evaluated on a combined basis and reported as a forward (derivative) contract and are presented as “Linked Transactions” on the Company’s consolidated balance sheets. Changes in the fair value of the assets and liabilities underlying Linked Transactions and associated interest income and expense are reported as “unrealized net gains/(losses) and net interest income from Linked Transactions” on the Company’s consolidated statements of operations and are not included in OCI. However, if certain criteria are met, the initial transfer (i.e., the purchase of a security by the Company) and repurchase financing will not be treated as a Linked Transaction and will be evaluated and reported separately, as an MBS purchase and repurchase financing. When or if a transaction is no longer considered to be linked, the MBS and repurchase financing will be reported on a gross basis. In this case, the fair value of the MBS at the time the transactions are no longer considered linked will become the cost basis of the MBS, and the income recognition yield for such MBS will be calculated prospectively using this new cost basis. (See Notes 5 and 14)

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Swaps

The Company documents its risk-management policies, including objectives and strategies, as they relate to its hedging activities and the relationship between the hedging instrument and the hedged liability for all Swaps designated as hedging transactions. The Company assesses, both at inception of a hedge and on a quarterly basis thereafter, whether or not the hedge is “highly effective.”

Swaps are carried on the Company’s balance sheets at fair value, as assets, if their fair value is positive, or as liabilities, if their fair value is negative. Changes in the fair value of the Company’s Swaps designated in hedging transactions are recorded in OCI provided that the hedge remains effective. Changes in fair value for any ineffective amount of a Swap are recognized in earnings. The Company has not recognized any change in the value of its existing Swaps designated as hedges through earnings as a result of hedge ineffectiveness.

The Company discontinues hedge accounting on a prospective basis and recognizes changes in the fair value through earnings when: (i) it is determined that the derivative is no longer effective in offsetting cash flows of a hedged item (including forecasted transactions); (ii) it is no longer probable that the forecasted transaction will occur; or (iii) it is determined that designating the derivative as a hedge is no longer appropriate.

Although permitted under certain circumstances, the Company does not offset cash collateral receivables or payables against its net derivative positions. (See Notes 5, 7 and 14)

TBA Short Positions

During 2013, the Company entered into TBA short positions as a means of managing interest rate risk and MBS basis risk associated with its investment and financing activities. A TBA short position is a forward contract for the sale of Agency MBS at a predetermined price, face amount, issuer, coupon and stated maturity on an agreed-upon future date. The specific Agency MBS that could be delivered into the contract upon the settlement date, published each month by the Securities Industry and Financial Markets Association (“SIFMA”), are not known at the time of the transaction.

The Company accounts for TBA short positions as derivative instruments since it cannot assert that it is probable at inception and throughout the term of the TBA contract that it will physically deliver the agency security upon settlement of the contract. The Company presents TBA short positions as either derivative assets or liabilities, at fair value on its consolidated balance sheets. Gains and losses associated with TBA short positions are reported in Other income on the Company’s consolidated statements of operations.

The Company did not have any TBA short positions at September 30, 2014 and December 31, 2013.

(p) Fair Value Measurements and the Fair Value Option for Financial Assets and Financial Liabilities

The Company’s presentation of fair value for its financial assets and liabilities is determined within a framework that stipulates that the fair value of a financial asset or liability is an exchange price in an orderly transaction between market participants to sell the asset or transfer the liability in the market in which the reporting entity would transact for the asset or liability, that is, the principal or most advantageous market for the asset or liability. The transaction to sell the asset or transfer the liability is a hypothetical transaction at the measurement date, considered from the perspective of a market participant that holds the asset or owes the liability. This definition of fair value focuses on exit price and prioritizes the use of market-based inputs over entity-specific inputs when determining fair value. In

addition, the framework for measuring fair value establishes a three-level hierarchy for fair value measurements based upon the observability of inputs to the valuation of an asset or liability as of the measurement date. (See Note 14)

Although permitted under GAAP to measure many financial instruments and certain other items at fair value, the Company has not elected the fair value option for any of its assets or liabilities. If the fair value option is elected, unrealized gains and losses on such items for which fair value is elected would be recognized in earnings at each subsequent reporting date. A decision to elect the fair value option for an eligible financial instrument, which may be made on an instrument by instrument basis, is irrevocable.

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(q) Variable Interest Entities and Other Consolidated Special Purpose Entities

An entity is referred to as a VIE if it meets at least one of the following criteria: (i) the entity has equity that is insufficient to permit the entity to finance its activities without additional subordinated financial support of other parties; or (ii) as a group, the holders of the equity investment at risk lack (a) the power to direct the activities of an entity that most significantly impact the entity's economic performance; (b) the obligation to absorb the expected losses; or (c) the right to receive the expected residual returns; or (iii) have disproportional voting rights and the entity's activities are conducted on behalf of the investor that has disproportionately few voting rights.

The Company consolidates a VIE when it has both the power to direct the activities that most significantly impact the economic performance of the VIE and a right to receive benefits or absorb losses of the entity that could be potentially significant to the VIE. The Company is required to reconsider its evaluation of whether to consolidate a VIE each reporting period, based upon changes in the facts and circumstances pertaining to the VIE.

The Company has entered into securitization transactions which result in the Company consolidating the VIEs that were created to facilitate the transactions and to which the underlying assets in connection with the securitizations were transferred. In determining the accounting treatment to be applied to these securitization transactions, the Company evaluated whether the entities used to facilitate these transactions were VIEs and, if so, whether they should be consolidated. Based on its evaluation, the Company concluded that the VIEs should be consolidated. If the Company had determined that consolidation was not required, it would have then assessed whether the transfer of the underlying assets would qualify as a sale or should be accounted for as secured financings under GAAP.

Prior to the completion of its initial securitization transaction in October 2010, the Company had not transferred assets to VIEs or Qualifying Special Purpose Entities ("QSPEs") and other than acquiring MBS issued by such entities, had no other involvement with VIEs or QSPEs. (See Note 15)

The Company also includes in its consolidated balance sheets certain financial assets and liabilities that are acquired/issued by trusts and/or other special purpose entities that have been evaluated as being required to be consolidated by the Company under the applicable accounting guidance.

(r) Offering Costs Related to Issuance and Redemption of Preferred Stock

Offering costs related to issuance of preferred stock are recorded as a reduction in Additional paid-in capital, a component of stockholders' equity, at the time such preferred stock is issued. On redemption of preferred stock, any excess of the fair value of the consideration transferred to the holders of the preferred stock over the carrying amount of the preferred stock in the Company's consolidated balance sheets is included in the determination of Net Income Available to Common Stock and Participating Securities in the calculation of EPS. (See Notes 11 and 12)

(s) New Accounting Standards and Interpretations

Accounting Standards Adopted in 2014

Financial Services - Investment Companies

In June 2013, the Financial Accounting Standard Board ("FASB") issued Accounting Standards Update ("ASU") 2013-08, Financial Services - Investment Companies: Amendments to the Scope, Measurement, and Disclosure Requirements

(“ASU 2013-08”). In general, the amendments of this ASU: (i) revise the definition of an investment company; (ii) require an investment company to measure non-controlling ownership interests in other investment companies at fair value rather than using the equity method of accounting; and (iii) require information to be disclosed concerning the status of the entity and any financial support provided, or contractually required to be provided, by the investment company to its investees. The Company’s adoption of ASU 2013-08 beginning on January 1, 2014 did not have a material impact on the Company’s consolidated financial statements as the FASB has decided to retain the current U.S. GAAP scope exception from investment company accounting and financial reporting for real estate investment trusts.

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3. MBS

The Company's MBS are comprised of Agency MBS and Non-Agency MBS which include MBS issued prior to 2008 ("Legacy Non-Agency MBS") and MBS backed by re-performing/non-performing loans ("RPL/NPL MBS"). These MBS are secured by: (i) hybrid mortgages ("Hybrids"), which have interest rates that are fixed for a specified period of time and, thereafter, generally adjust annually to an increment over a specified interest rate index; (ii) adjustable-rate mortgages ("ARMs"); (iii) mortgages that have interest rates that reset more frequently (collectively, "ARM-MBS"); and (iv) 15 year and longer-term fixed rate mortgages. MBS do not have a single maturity date, and further, the mortgage loans underlying ARM-MBS do not all reset at the same time.

The Company pledges a significant portion of its MBS as collateral against its borrowings under repurchase agreements and Swaps. Non-Agency MBS that are accounted for as components of Linked Transactions are not reflected in the tables set forth in this note, as they are accounted for as derivatives. (See Notes 5 and 7)

Agency MBS: Agency MBS are guaranteed as to principal and/or interest by a federally chartered corporation, such as Fannie Mae or Freddie Mac, or an agency of the U.S. Government, such as Ginnie Mae. The payment of principal and/or interest on Ginnie Mae MBS is explicitly backed by the full faith and credit of the U.S. Government. Since the third quarter of 2008, Fannie Mae and Freddie Mac have been under the conservatorship of the Federal Housing Finance Agency, which significantly strengthened the backing for these government-sponsored entities.

Non-Agency MBS (including Non-Agency MBS transferred to consolidated VIEs): The Company's Non-Agency MBS are secured by pools of residential mortgages, which are not guaranteed by an agency of the U.S. Government or any federally chartered corporation. Credit risk associated with Non-Agency MBS is regularly assessed as new information regarding the underlying collateral becomes available and based on updated estimates of cash flows generated by the underlying collateral.

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The following tables present certain information about the Company's MBS at September 30, 2014 and December 31, 2013:

September 30, 2014

(In Thousands)	Principal/ Current Face	Purchase Premiums	Accretible Purchase Discounts	Discount Designated as Credit Reserve and OTTI (1)	Amortized Cost (2)	Fair Value	Gross Unrealized Gains	Gross Unrealized Losses	Net Unrealized Gain/(Loss)
Agency MBS:									
Fannie Mae	\$4,825,285	\$183,663	\$(73)	\$—	\$5,008,875	\$5,079,098	\$102,619	\$(32,396)	\$70,223
Freddie Mac	1,050,873	40,421	—	—	1,093,168	1,083,010	11,130	(21,288)	(10,158)
Ginnie Mae	11,559	199	—	—	11,758	12,068	310	—	310
Total Agency MBS	5,887,717	224,283	(73)	—	6,113,801	6,174,176	114,059	(53,684)	60,375
Non-Agency MBS:									
Expected to Recover Par (3)(4)	315,003	624	(31,304)	—	284,323	311,950	29,035	(1,408)	27,627
Expected to Recover Less Than Par (3)(5)	5,014,820	—	(395,047)	(929,100)	3,690,673	4,451,376	762,425	(1,722)	760,703
Total Non-Agency MBS	5,329,823	624	(426,351)	(929,100)	3,974,996	4,763,326	791,460	(3,130)	788,330
Total MBS	\$11,217,540	\$224,907	\$(426,424)	\$(929,100)	\$10,088,797	\$10,937,502	\$905,519	\$(56,814)	\$848,705

December 31, 2013

(In Thousands)	Principal/ Current Face	Purchase Premiums	Accretible Purchase Discounts	Discount Designated as Credit Reserve and OTTI (1)	Amortized Cost (2)	Fair Value	Gross Unrealized Gains	Gross Unrealized Losses	Net Unrealized Gain/(Loss)
Agency MBS:									
Fannie Mae	\$5,092,410	\$181,710	\$(87)	\$—	\$5,274,033	\$5,315,363	\$96,516	\$(55,186)	\$41,330
Freddie Mac	1,171,841	44,967	—	—	1,217,927	1,190,670	9,842	(37,099)	(27,257)
Ginnie Mae	12,668	218	—	—	12,886	13,188	302	—	302
Total Agency MBS	6,276,919	226,895	(87)	—	6,504,846	6,519,221	106,660	(92,285)	14,375
Non-Agency MBS:									
Expected to Recover Par	234,187	638	(24,450)	—	210,375	230,738	21,720	(1,357)	20,363

(3)(4) Expected to Recover Less Than Par (3)(5) Total	5,381,851	—	(435,589)	(1,043,037)	3,903,225	4,621,399	720,566	(2,392)	718,174
Non-Agency MBS	5,616,038	638	(460,039)	(1,043,037)	4,113,600	4,852,137	742,286	(3,749)	738,537
Total MBS	\$11,892,957	\$227,533	\$(460,126)	\$(1,043,037)	\$10,618,446	\$11,371,358	\$848,946	\$(96,034)	\$752,912

(1) Discount designated as Credit Reserve and amounts related to OTTI are generally not expected to be accreted into interest income. Amounts disclosed at September 30, 2014 reflect Credit Reserve of \$897.7 million and OTTI of \$31.4 million. Amounts disclosed at December 31, 2013 reflect Credit Reserve of \$998.5 million and OTTI of \$44.5 million.

(2) Includes principal payments receivable of \$1.9 million and \$1.1 million at September 30, 2014 and December 31, 2013, respectively, which are not included in the Principal/Current Face.

(3) Based on management's current estimates of future principal cash flows expected to be received.

(4) Includes RPL/NPL MBS which had a \$26.5 million Principal/Current face, \$26.7 million amortized cost and \$26.6 million fair value at September 30, 2014. At December 31, 2013, RPL/NPL MBS had a \$3.9 million Principal/Current face, amortized cost and fair value.

(5) At September 30, 2014 and December 31, 2013, the Company expected to recover approximately 83% and 81%, respectively, of the then-current face amount of Non-Agency MBS.

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MFA FINANCIAL, INC.

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2014

Unrealized Losses on MBS and Impairments

The following table presents information about the Company's MBS that were in an unrealized loss position at September 30, 2014:

Unrealized Loss Position For:

(Dollars in Thousands)	Less than 12 Months			12 Months or more			Total	
	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses
Agency MBS:								
Fannie Mae	\$451,536	\$ 1,639	46	\$1,316,459	\$ 30,757	143	\$1,767,995	\$ 32,396
Freddie Mac	28,903	184	3	702,935	21,104	103	731,838	21,288
Total Agency MBS	480,439	1,823	49	2,019,394	51,861	246	2,499,833	53,684
Non-Agency MBS:								
Expected to Recover Par (1)	29,826	333	3	22,309	1,075	8	52,135	1,408
Expected to Recover Less Than Par (1)	66,674	654	9	20,041	1,068	7	86,715	1,722
Total Non-Agency MBS	96,500	987	12	42,350	2,143	15	138,850	3,130
Total MBS	\$576,939	\$ 2,810	61	\$2,061,744	\$ 54,004	261	\$2,638,683	\$ 56,814

(1) Based on management's current estimates of future principal cash flows expected to be received.

At September 30, 2014, the Company did not intend to sell any of its MBS that were in an unrealized loss position, and it is "more likely than not" that the Company will not be required to sell these MBS before recovery of their amortized cost basis, which may be at their maturity. With respect to Non-Agency MBS held by consolidated VIEs, the ability of any entity to cause the sale by the VIE prior to the maturity of these Non-Agency MBS is either specifically precluded, or is limited to specified events of default, none of which has occurred to date.

Gross unrealized losses on the Company's Agency MBS were \$53.7 million at September 30, 2014. Agency MBS are issued by Government Sponsored Entities ("GSEs") that enjoy either the implicit or explicit backing of the full faith and credit of the U.S. Government. While the Company's Agency MBS are not rated by any rating agency, they are currently perceived by market participants to be of high credit quality, with risk of default limited to the unlikely event that the U.S. Government would not continue to support the GSEs. In addition, the GSEs are currently profitable on a stand-alone basis with such profits being remitted to the U.S. Treasury. Given the credit quality inherent in Agency MBS, the Company does not consider any of the current impairments on its Agency MBS to be credit related. In assessing whether it is more likely than not that it will be required to sell any impaired security before its anticipated recovery, which may be at its maturity, the Company considers for each impaired security, the significance of each investment, the amount of impairment, the projected future performance of such impaired securities, as well as the Company's current and anticipated leverage capacity and liquidity position. Based on these analyses, the Company determined that at September 30, 2014 any unrealized losses on its Agency MBS were temporary.

Unrealized losses on the Company's Non-Agency MBS (including Non-Agency MBS transferred to consolidated VIEs) were \$3.1 million at September 30, 2014. Based upon the most recent evaluation, the Company does not consider these unrealized losses to be indicative of OTTI and does not believe that these unrealized losses are credit

related, but are rather due to non-credit related factors. The Company has reviewed its Non-Agency MBS that are in an unrealized loss position to identify those securities with losses that are other-than-temporary based on an assessment of changes in expected cash flows for such MBS, which considers recent bond performance and expected future performance of the underlying collateral.

The Company did not recognize any credit-related OTTI losses through earnings related to its MBS during the three and nine months ended September 30, 2014 and 2013.

Non-Agency MBS on which OTTI is recognized have experienced, or are expected to experience, credit-related adverse cash flow changes. The Company's estimate of cash flows for its Non-Agency MBS is based on its review of the underlying mortgage loans securing these MBS. The Company considers information available about the structure of the securitization, including structural credit enhancement, if any, and the past and expected future performance of underlying mortgage loans, including timing

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of expected future cash flows, prepayment rates, default rates, loss severities, delinquency rates, percentage of non-performing loans, FICO scores at loan origination, year of origination, loan-to-value ratios, geographic concentrations, as well as Rating Agency reports, general market assessments, and dialogue with market participants. Changes in the Company's evaluation of each of these factors impacts the cash flows expected to be collected at the OTTI assessment date. For Non-Agency MBS purchased at a discount to par that were assessed for OTTI during the quarter, such cash flow estimates indicated that the amount of expected losses decreased compared to the previous OTTI assessment date. These positive cash flow changes are primarily driven by recent improvements in loan-to-value ratios due to loan amortization and home price appreciation, which, in turn, positively impacts the Company's estimates of default rates and loss severities for the underlying collateral. In addition, voluntary prepayments (i.e. loans that prepay in full with no loss) have generally trended higher for these MBS which also positively impacts the Company's estimate of expected loss. Overall, the combination of higher voluntary prepayments and lower loan-to-value ratios supports the Company's assessment that such MBS are not other-than-temporarily impaired. Significant judgment is used in both the Company's analysis of the expected cash flows for its Non-Agency MBS and any determination of the credit component of OTTI.

The following table presents a roll-forward of the credit loss component of OTTI on the Company's Non-Agency MBS for which a non-credit component of OTTI was previously recognized in OCI. Changes in the credit loss component of OTTI are presented based upon whether the current period is the first time OTTI was recorded on a security or a subsequent OTTI charge was recorded.

(In Thousands)	Three Months Ended September 30, 2014	Nine Months Ended September 30, 2014
Credit loss component of OTTI at beginning of period	\$36,115	\$36,115
Additions for credit related OTTI not previously recognized	—	—
Subsequent additional credit related OTTI recorded	—	—
Credit loss component of OTTI at end of period	\$36,115	\$36,115

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Purchase Discounts on Non-Agency MBS

The following tables present the changes in the components of the Company's purchase discount on its Non-Agency MBS between purchase discount designated as Credit Reserve and OTTI and accretable purchase discount for the three and nine months ended September 30, 2014 and 2013:

(In Thousands)	Three Months Ended September 30, 2014		Three Months Ended September 30, 2013	
	Discount Designated as Credit Reserve and OTTI (1)	Accretable Discount (1)(2)	Discount Designated as Credit Reserve and OTTI (1)	Accretable Discount (1)(2)
Balance at beginning of period	\$ (986,842)	\$ (436,111)	\$ (1,264,971)	\$ (396,581)
Accretion of discount	—	25,504	—	19,556
Realized credit losses	20,733	—	48,642	—
Purchases	(4,200)	272	(851)	879
Sales	21,024	4,169	27,178	4,248
Transfers/release of credit reserve	20,185	(20,185)	71,010	(71,010)
Balance at end of period	\$ (929,100)	\$ (426,351)	\$ (1,118,992)	\$ (442,908)

(In Thousands)	Nine Months Ended September 30, 2014		Nine Months Ended September 30, 2013	
	Discount Designated as Credit Reserve and OTTI (3)	Accretable Discount (2)(3)	Discount Designated as Credit Reserve and OTTI (3)	Accretable Discount (2)(3)
Balance at beginning of period	\$ (1,043,037)	\$ (460,039)	\$ (1,380,506)	\$ (371,626)
Accretion of discount	—	78,701	—	48,305
Realized credit losses	69,129	—	137,324	—
Purchases	(70,535)	25,314	(74,238)	30,533
Sales	34,780	10,236	38,150	10,158
Transfers/release of credit reserve	80,563	(80,563)	160,278	(160,278)
Balance at end of period	\$ (929,100)	\$ (426,351)	\$ (1,118,992)	\$ (442,908)

The Company reallocated \$333,000 of purchase discount designated as accretable purchase discount to Credit Reserve on Non-Agency MBS underlying Linked Transactions during the three months ended September 30, 2014.

(1) The Company did not reallocate any purchase discount designated as Credit Reserve to accretable purchase discount on Non-Agency MBS underlying Linked Transactions during the three months ended September 30, 2013.

(2) Together with coupon interest, accretable purchase discount is recognized as interest income over the life of the security.

(3) During the nine months ended September 30, 2014, the Company reallocated \$218,000 of purchase discount designated as accretable purchase discount to Credit Reserve on Non-Agency MBS underlying Linked Transactions. In addition, the Company reallocated \$129,000 of purchase discount designated as Credit Reserve to accretable purchase discount on Non-Agency MBS underlying Linked Transactions during the nine months ended

September 30, 2013.

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Impact of MBS on AOCI

The following table presents the impact of the Company's MBS on its AOCI for the three and nine months ended September 30, 2014 and 2013:

(In Thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
AOCI from MBS:				
Unrealized gain on MBS at beginning of period	\$905,704	\$700,871	\$752,912	\$824,808
Unrealized (loss)/gain on Agency MBS, net	(14,937)	15,469	46,000	(152,302)
Unrealized (loss)/gain on Non-Agency MBS, net	(28,473)	16,381	70,973	62,455
Reclassification adjustment for MBS sales included in net income	(13,589)	(15,158)	(21,180)	(17,398)
Change in AOCI from MBS	(56,999)	16,692	\$95,793	\$(107,245)
Balance at end of period	\$848,705	\$717,563	\$848,705	\$717,563

Sales of MBS

During the three and nine months ended September 30, 2014, the Company sold certain Non-Agency MBS for \$61.6 million and \$103.6 million, realizing gross gains of \$13.9 million and \$25.3 million, respectively. During the three and nine months ended September 30, 2013, the Company sold certain Non-Agency MBS for \$102.2 million and \$118.2 million, realizing gross gains of \$13.7 million and \$19.7 million, respectively. The Company has no continuing involvement with any of the sold MBS.

MBS Interest Income

The following table presents the components of interest income on the Company's Agency MBS for the three and nine months ended September 30, 2014 and 2013:

(In Thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Coupon interest	\$46,529	\$51,997	\$145,864	\$163,986
Effective yield adjustment (1)	(13,463)	(15,839)	(35,860)	(47,004)
Agency MBS interest income	\$33,066	\$36,158	\$110,004	\$116,982

(1) Includes amortization of premium paid net of accretion of purchase discount. For Agency MBS, interest income is recorded at an effective yield, which reflects net premium amortization based on actual prepayment activity.

The following table presents components of interest income for the Company's Non-Agency MBS (including MBS transferred to consolidated VIEs) for the three and nine months ended September 30, 2014 and 2013:

(In Thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013

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Coupon interest	\$52,396	\$62,802	\$162,148	\$196,688
Effective yield adjustment (1)	25,478	19,501	78,561	48,128
Non-Agency MBS interest income	\$77,874	\$82,303	\$240,709	\$244,816

(1) The effective yield adjustment is the difference between the net income calculated using the net yield, which is based on management's estimates of future cash flows for Non-Agency MBS, less the current coupon yield.

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4. Interest Receivable

The following table presents the Company's interest receivable by investment category at September 30, 2014 and December 31, 2013:

(In Thousands)	September 30, 2014	December 31, 2013
MBS interest receivable:		
Fannie Mae	\$12,599	\$13,760
Freddie Mac	2,728	3,110
Ginnie Mae	18	19
Non-Agency MBS	17,127	18,917
Total MBS interest receivable	32,472	35,806
Money market and other investments	27	22
Total interest receivable	\$32,499	\$35,828

5. Derivative Instruments

The Company's derivative instruments are primarily comprised of Swaps, the majority of which are designated as cash flow hedges against the interest rate risk associated with its borrowings. The Company has also entered into Linked Transactions, which are not designated as hedging instruments. The following table presents the fair value of the Company's derivative instruments and their balance sheet location at September 30, 2014 and December 31, 2013:

Derivative Instrument	Designation	Balance Sheet Location	September 30, 2014 Notional Amount	September 30, 2014 Fair Value	December 31, 2013
(In Thousands)					
Linked Transactions	Non-Hedging	Assets	N/A	\$190,681	\$28,181
Non-cleared legacy Swaps (1)	Hedging	Assets	\$450,000	\$4,322	\$4,925
Cleared Swaps (2)	Hedging	Assets	\$—	\$—	\$8,075
Non-cleared legacy Swaps (1)	Hedging	Liabilities	\$880,892	\$(8,187)	\$(24,437)
Cleared Swaps (2)	Hedging	Liabilities	\$2,550,000	\$(27,306)	\$(3,780)

(1) Non-cleared legacy Swaps include Swaps executed and settled bilaterally with counterparties without the use of an organized exchange or central clearing house.

(2) Cleared Swaps include Swaps executed bilaterally with a counterparty in the over-the-counter market but then novated to a central clearing house, whereby the central clearing house becomes the counterparty to both of the original counterparties.

Linked Transactions

The Company's Linked Transactions are evaluated on a combined basis, reported as forward (derivative) instruments and presented as assets on the Company's consolidated balance sheets at fair value. The fair value of Linked Transactions reflect the value of the underlying Non-Agency MBS, linked repurchase agreement borrowings and accrued interest receivable/payable on such instruments. The Company's Linked Transactions are not designated as

hedging instruments and, as a result, the change in the fair value and net interest income from Linked Transactions is reported in other income on the Company's consolidated statements of operations.

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The following tables present certain information about the Legacy Non-Agency MBS and RPL/NPL MBS and repurchase agreements underlying the Company's Linked Transactions at September 30, 2014 and December 31, 2013:

Linked Transactions at September 30, 2014

Linked Repurchase Agreements	Linked MBS			Fair Value	Amortized Cost	Par/Current Face	Weighted	
	Balance	Average Interest Rate					Average Coupon Rate	
Maturity or Repricing								
(Dollars in Thousands)			(Dollars in Thousands)					
Within 30 days	\$786,207	1.48 %	Legacy Non-Agency MBS	\$65,656	\$60,588	\$71,982	4.38 %	
>30 days to 90 days	5,600	1.35 %	RPL/NPL MBS	916,652	915,839	917,332	3.36 %	
Total	\$791,807	1.48 %	Total	\$982,308	\$976,427	\$989,314	3.44 %	

Linked Transactions at December 31, 2013

Linked Repurchase Agreements	Linked MBS			Fair Value	Amortized Cost	Par/Current Face	Weighted	
	Balance	Average Interest Rate					Average Coupon Rate	
Maturity or Repricing								
(Dollars in Thousands)			(Dollars in Thousands)					
Within 30 days	\$93,835	1.76 %	Legacy Non-Agency MBS	\$39,280	\$35,028	\$42,199	3.92 %	
>30 days to 90 days	8,902	1.44 %	RPL/NPL MBS	91,510	91,469	92,231	3.97 %	
Total	\$102,737	1.73 %	Total	\$130,790	\$126,497	\$134,430	3.96 %	

At September 30, 2014, Linked Transactions also included approximately \$709,000 of associated accrued interest receivable and \$529,000 of accrued interest payable. At December 31, 2013, Linked Transactions also included approximately \$210,000 of associated accrued interest receivable and \$82,000 of accrued interest payable.

The following table presents certain information about the components of the unrealized net gains and net interest income from Linked Transactions included in the Company's consolidated statements of operations for the three and nine months ended September 30, 2014 and 2013:

(In Thousands)	Three Months Ended		Nine Months Ended	
	September 30, 2014	2013	September 30, 2014	2013
Interest income attributable to MBS underlying Linked Transactions	\$6,625	\$1,109	\$11,591	\$2,431
Interest expense attributable to linked repurchase agreement borrowings underlying Linked Transactions	(2,246)	(275)	(3,719)	(552)
Change in fair value of Linked Transactions included in earnings	(1,820)	(290)	1,714	(94)

Unrealized net gains and net interest income from Linked Transactions	\$2,559	\$544	\$9,586	\$1,785
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MFA FINANCIAL, INC.

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

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Swaps

Consistent with market practice, the Company has agreements with its Swap counterparties that provide for the posting of collateral based on the fair values of its derivative contracts. Through this margining process, either the Company or its derivative counterparty may be required to pledge cash or securities as collateral. In addition, Swaps novated to and cleared by a central clearing house are subject to initial margin requirements. Certain derivative contracts provide for cross collateralization with repurchase agreements with the same counterparty.

A number of the Company's Swap contracts include financial covenants, which, if breached, could cause an event of default or early termination event to occur under such agreements. Such financial covenants include minimum net worth requirements and maximum debt-to-equity ratios. If the Company were to cause an event of default or trigger an early termination event pursuant to one of its Swap contracts, the counterparty to such agreement may have the option to terminate all of its outstanding Swap contracts with the Company and, if applicable, any close-out amount due to the counterparty upon termination of the Swap contracts would be immediately payable by the Company. The Company was in compliance with all of its financial covenants through September 30, 2014. At September 30, 2014, the aggregate fair value of assets needed to immediately settle Swap contracts that were in a liability position to the Company, if so required, was approximately \$37.7 million, including accrued interest payable of approximately \$2.2 million.

The following table presents the assets pledged as collateral against the Company's Swap contracts at September 30, 2014 and December 31, 2013:

(In Thousands)	September 30, 2014	December 31, 2013
Agency MBS, at fair value	\$67,431	\$73,859
Restricted cash	35,351	37,520
Total assets pledged against Swaps	\$102,782	\$111,379

The use of derivative hedging instruments exposes the Company to counterparty credit risk. In the event of a default by a derivative counterparty, the Company may not receive payments to which it is entitled under its derivative agreements, and may have difficulty recovering its assets pledged as collateral against such agreements. If, during the term of a derivative contract, a counterparty should file for bankruptcy, the Company may experience difficulty recovering its assets pledged as collateral which could result in the Company having an unsecured claim against such counterparty's assets for the difference between the fair value of the derivative and the fair value of the collateral pledged to such counterparty.

The Company's derivative hedging instruments, or a portion thereof, could become ineffective in the future if the associated repurchase agreements that such derivatives hedge fail to exist or fail to have terms that match those of the derivatives that hedge such borrowings.

The Company's Swaps designated as hedging transactions have the effect of modifying the repricing characteristics of the Company's repurchase agreements and cash flows for such liabilities. To date, no cost has been incurred at the inception of a Swap (except for certain transaction fees related to entering in to Swaps cleared through a central clearing house), pursuant to which the Company agrees to pay a fixed rate of interest and receive a variable interest rate, generally based on one-month or three-month London Interbank Offered Rate ("LIBOR"), on the notional amount of the Swap. The Company did not recognize any change in the value of its existing Swaps designated as hedges

through earnings as a result of hedge ineffectiveness during the three and nine months ended September 30, 2014 and 2013.

At September 30, 2014, the Company had Swaps designated in hedging relationships with an aggregate notional amount of \$3.881 billion, which had net unrealized losses of \$31.2 million, and extended 49 months on average with a maximum term of approximately 107 months.

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The following table presents certain information with respect to the Company's Swap activity during the three and nine months ended September 30, 2014:

(Dollars in Thousands)	Three Months Ended September 30, 2014	Nine Months Ended September 30, 2014
New Swaps:		
Aggregate notional amount	\$—	\$400,000
Weighted average fixed-pay rate	—	% 1.95
Initial maturity date	N/A	5 years to 7 years
Number of new Swaps	—	Four
Swaps amortized/expired:		
Aggregate notional amount	\$46,322	\$564,320
Weighted average fixed-pay rate	2.84	% 2.05

The following table presents information about the Company's Swaps at September 30, 2014 and December 31, 2013:

Maturity (1)	September 30, 2014			December 31, 2013		
	Notional Amount	Weighted Average Fixed-Pay Interest Rate	Weighted Average Variable Interest Rate (2)	Notional Amount	Weighted Average Fixed-Pay Interest Rate	Weighted Average Variable Interest Rate (2)
(Dollars in Thousands)						
Within 30 days	\$56,861	4.67	% 0.17	% \$17,635	3.90	% 0.21
Over 30 days to 3 months	63,860	2.19	0.17	24,216	3.93	0.21
Over 3 months to 6 months	410,171	1.90	0.16	476,147	1.80	0.17
Over 6 months to 12 months	300,000	2.06	0.16	167,043	3.22	0.18
Over 12 months to 24 months	50,000	2.13	0.15	710,171	1.97	0.17
Over 24 months to 36 months	450,000	0.56	0.16	150,000	1.03	0.17
Over 36 months to 48 months	550,000	1.49	0.15	350,000	0.58	0.17
Over 48 months to 60 months	200,000	1.71	0.15	550,000	1.49	0.17
Over 60 months to 72 months	1,500,000	2.22	0.15	—	—	—
Over 72 months to 84 months	200,000	2.20	0.15	1,500,000	2.22	0.17
Over 84 months (3)	100,000	2.75	0.15	100,000	2.75	0.17
Total Swaps	\$3,880,892	1.90	% 0.16	% \$4,045,212	1.91	% 0.17

(1) Each maturity category reflects contractual amortization and/or maturity of notional amounts.

(2) Reflects the benchmark variable rate due from the counterparty at the date presented, which rate adjusts monthly or quarterly based on one-month or three-month LIBOR, respectively.

(3) Reflects one Swap with a maturity date of July 2023.

The following table presents the net impact of the Company's derivative hedging instruments on its interest expense and the weighted average interest rate paid and received for such Swaps for the three and nine months ended September 30, 2014 and 2013:

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(Dollars in Thousands)	Three Months Ended		Nine Months Ended			
	September 30,		September 30,			
	2014	2013	2014	2013		
Interest expense attributable to Swaps	\$17,491	\$15,888	\$53,129	\$40,884		
Weighted average Swap rate paid	1.91	% 2.07	% 1.92	% 2.15	%	
Weighted average Swap rate received	0.16	% 0.20	% 0.16	% 0.20	%	%

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MFA FINANCIAL, INC.

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TBA Short Positions

During 2013, the Company entered into TBA short positions as a means of managing interest rate risk and MBS basis risk associated with its investment and financing activities. A TBA short position is a forward contract for the sale of Agency MBS at a predetermined price, face amount, issuer, coupon and stated maturity on an agreed-upon future date. The specific Agency MBS that could be delivered into the contract upon the settlement date, published each month by SIFMA, are not known at the time of the transaction.

The Company accounts for TBA short positions as derivative instruments since it cannot assert that it is probable at inception and throughout the term of the TBA contract that it will physically deliver the agency security upon settlement of the contract. The Company presents TBA short positions as either derivative assets or liabilities, at fair value on its consolidated balance sheets. Gains and losses associated with TBA short positions are reported in Other income on the Company's consolidated statements of operations. During the three and nine months ended September 30, 2013, the Company recognized an unrealized loss of \$8.7 million on TBA short positions. The Company did not have any TBA short positions at September 30, 2014 and December 31, 2013.

Impact of Derivative Hedging Instruments on AOCI

The following table presents the impact of the Company's derivative hedging instruments on its AOCI for the three and nine months ended September 30, 2014 and 2013:

(In Thousands)	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2014	2013	2014	2013
AOCI from derivative hedging instruments:				
Balance at beginning of period	\$ (54,671)	\$ (31,967)	\$ (15,217)	\$ (62,831)
Unrealized gain/(loss) on Swaps, net	23,500	(19,934)	(16,401)	10,930
Reclassification of unrealized loss on de-designated Swaps	—	—	447	—
Balance at end of period	\$ (31,171)	\$ (51,901)	\$ (31,171)	\$ (51,901)

Counterparty Credit Risk from Use of Swaps

By using Swaps, the Company is exposed to counterparty credit risk if counterparties to the derivative contracts do not perform as expected. If a counterparty fails to perform, the Company's counterparty credit risk is equal to the amount reported as a derivative asset on its consolidated balance sheets to the extent that amount exceeds collateral obtained from the counterparty or, if in a net liability position, the extent to which collateral posted exceeds the liability to the counterparty. The amounts reported as a derivative asset/(liability) are derivative contracts in a gain/(loss) position, and to the extent subject to master netting arrangements, net of derivatives in a loss/(gain) position with the same counterparty and collateral received/(pledged). The Company attempts to minimize counterparty credit risk through credit approvals, limits, monitoring procedures, executing master netting arrangements and obtaining collateral, where appropriate. Counterparty credit risk related to the Company's Swaps is considered in determining fair value of such derivatives and its assessment of hedge effectiveness.

6. Repurchase Agreements

The Company's repurchase agreements are collateralized by the Company's MBS and U.S. Treasury securities (obtained as part of a reverse repurchase agreement) and cash, and bear interest that is generally LIBOR-based. (See Note 7) At September 30, 2014, the Company's borrowings under repurchase agreements had a weighted average remaining term-to-interest rate reset of 26 days and an effective repricing period of 21 months, including the impact of related Swaps. At December 31, 2013, the Company's borrowings under repurchase agreements had a weighted average remaining term-to-interest rate reset of 25 days and an effective repricing period of 24 months, including the impact of related Swaps.

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The following table presents information with respect to the Company's borrowings under repurchase agreements and associated assets pledged as collateral at September 30, 2014 and December 31, 2013:

(Dollars in Thousands)	September 30, 2014	December 31, 2013
Repurchase agreement borrowings secured by Agency MBS	\$5,417,797	