DYNEX CAPITAL INC
Form 10-Q
May 15, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period March 31, 2007

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission File Number: 1-9819

DYNEX CAPITAL, INC.
(Exact name of registrant as specified in its charter)

Virginia	**52-1549373**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
4551 Cox Road, Suite 300, Glen Allen, Virginia	**23060-6740**
(Address of principal executive offices)	(Zip Code)

(804) 217-5800
(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 þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer o Accelerated filer o Non-accelerated filer þ

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

On April 30, 2007, the registrant had 12,136,262 shares outstanding of common stock, $.01 par value, which is the registrant's only class of common stock.

DYNEX CAPITAL, INC.
FORM 10-Q

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements

DYNEX CAPITAL, INC.
CONDENSED CONSOLIDATED
BALANCE SHEETS (UNAUDITED)
(amounts in thousands except share data)

		March 31, 2007		December 31, 2006
ASSETS				
Cash and cash equivalents	$	57,843	$	56,880
Other assets		4,705		6,111
		62,548		62,991
Investments:				
Securitized finance receivables:				
Commercial mortgage loans, net		224,173		228,466
Single-family mortgage loans, net		106,654		117,838
		330,827		346,304
Investment in joint venture		38,847		37,388
Securities		16,452		13,143
Other investments		2,671		2,802
Other loans		3,645		3,929
		392,442		403,566
	$	454,990	$	466,557
LIABILITIES AND SHAREHOLDERS' EQUITY				
LIABILITIES				
Securitization financing	$	206,615	$	211,564
Repurchase agreements secured by securitization financing		86,926		95,978
Obligation under payment agreement		16,847		16,299
Other liabilities		6,132		6,178
		316,520		330,019
Commitments and Contingencies (Note 11)				
SHAREHOLDERS' EQUITY				
Preferred stock, par value $0.01 per share, 50,000,000 shares authorized,				
9.5% Cumulative Convertible Series D, 4,221,539 shares issued and				
outstanding ($43,218 aggregate liquidation preference)		41,749		41,749
Common stock, par value $0.01 per share, 100,000,000 shares authorized,				
12,136,262 and 12,131,262 shares issued outstanding, respectively		121		121
Additional paid-in capital		366,674		366,637
Accumulated other comprehensive income		1,618		663
Accumulated deficit		(271,692)		(272,632)
		138,470		136,538

	$ 454,990	$ 466,557

See notes to unaudited condensed consolidated financial statements.

DYNEX CAPITAL, INC.
CONDENSED CONSOLIDATED STATEMENTS
OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS) (UNAUDITED)
(amounts in thousands except share data)

	Three Months Ended March 31, 2007		Three Months Ended March 31, 2006	
Interest income:				
Securitized finance receivables	$	7,025	$	13,886
Securities		324		546
Other investments		739		227
Other loans		127		107
		8,215		14,766
Interest and related expenses:				
Non-recourse securitization financing		4,096		10,988
Repurchase agreements		1,258		1,515
Obligation under payment agreement		367		-
Other		34		(25)
		5,755		12,478
Net interest income		2,460		2,288
Recapture of loan losses		523		119
Net interest income after recapture of loan losses		2,983		2,407
Equity in earnings of joint venture		630		-
Other (expense) income		(545)		133
General and administrative expenses		(1,126)		(1,327)
Net income		1,942		1,213
Preferred stock charge		(1,003)		(1,036)
Net income to common shareholders	$	939	$	177
Change in net unrealized gain on :				
Investments classified as available-for-sale		126		364
Investment in joint venture		829		-
Comprehensive income	$	2,897	$	1,577
Net income per common share:				
Basic and diluted	$	0.08	$	0.01

See notes to unaudited condensed consolidated financial statements.

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DYNEX CAPITAL, INC.
CONDENSED CONSOLIDATED STATEMENTS
OF CASH FLOWS (UNAUDITED)
(amounts in thousands)

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006
Operating activities:		
Net income	$ 1,942	$ 1,213
Adjustments to reconcile net income to cash provided by operating activities:		
Equity in earnings of joint venture	(630)	-
Recapture of loan losses	(523)	(119)
(Loss) gain on sale of investments	6	(24)
Amortization and depreciation	(335)	365
Net change in other assets and other liabilities	1,407	75
Net cash and cash equivalents provided by operating activities	1,867	1,510
Investing activities:		
Principal payments received on investments	15,578	27,435
Purchase of securities and other investments	(5,591)	(16,168)
Payments received on securities, other investments and loans	2,811	5,883
Proceeds from sales of securities and other investments	83	104
Other	937	69
Net cash and cash equivalents provided by investing activities	13,818	17,323
Financing activities:		
Principal payments on securitization financing	(4,657)	(13,009)
Net repayments on repurchase agreements	(9,100)	(12,190)
Issuance (retirement) of common stock	37	(137)
Retirement of preferred stock	-	(14,072)
Dividends paid	(1,002)	(1,370)
Net cash and cash equivalents used for financing activities	(14,722)	(40,778)
Net increase (decrease) in cash and cash equivalents	963	(21,945)
Cash and cash equivalents at beginning of period	56,880	45,235
Cash and cash equivalents at end of period	$ 57,843	$ 23,290

See notes to unaudited condensed consolidated financial statements.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
DYNEX CAPITAL, INC.

March 31, 2007
(amounts in thousands except share and per share data)

NOTE 1 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and do not include all of the information and notes required by accounting principles generally accepted in the United States of America, hereinafter referred to as “generally accepted accounting principles,” for complete financial statements. The condensed consolidated financial statements include the accounts of Dynex Capital, Inc. and its qualified real estate investment trust ("REIT") subsidiaries and taxable REIT subsidiary (together, “Dynex” or the “Company”). All intercompany balances and transactions have been eliminated in consolidation.

The Company consolidates entities in which it owns more than 50% of the voting equity and control does not rest with others. The Company follows the equity method of accounting for investments with greater than 20% and less than a 50% interest in partnerships and corporate joint ventures or when it is able to influence the financial and operating policies of the investee but owns less than 50% of the voting equity. For all other investments, the cost method is applied.

The Company believes it has complied with the requirements for qualification as a REIT under the Internal Revenue Code (the “Code”). To the extent the Company qualifies as a REIT for federal income tax purposes, it generally will not be subject to federal income tax on the amount of its income or gain that is distributed as dividends to shareholders.

In the opinion of management, all significant adjustments, consisting of normal recurring accruals considered necessary for a fair presentation of the condensed consolidated financial statements have been included. The financial statements presented are unaudited. Operating results for the three months ended March 31, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007. Certain information and footnote disclosures normally included in the consolidated financial statements prepared in accordance with generally accepted accounting principles have been omitted. The unaudited financial statements included herein should be read in conjunction with the financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2006, filed with the Securities and Exchange Commission.

The preparation of financial statements, in conformity with generally accepted accounting principles, 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 revenue and expenses during the reporting period. Actual results could differ from those estimates. The primary estimates inherent in the accompanying condensed consolidated financial statements are discussed below.

The Company uses estimates in establishing fair value for its financial instruments. Securities classified as available-for-sale are carried in the accompanying financial statements at estimated fair value. Estimates of fair value for securities are based on market prices provided by certain dealers, when available. When market prices are not available, fair value estimates are determined by calculating the present value of the projected cash flows of the instruments using market-based assumptions such as estimated future interest rates and estimated market spreads to applicable indices for comparable securities, and using collateral based assumptions such as prepayment rates and

credit loss assumptions based on the most recent performance and anticipated performance of the underlying collateral.

The Company also has credit risk on loans in its portfolio as discussed in Note 4. An allowance for loan losses has been estimated and established for currently existing losses in the loan portfolio, which are deemed probable as to their occurrence. The allowance for loan losses is evaluated and adjusted periodically by management based on the actual and estimated timing and amount of probable credit losses. Provisions made to increase the allowance for loan losses are presented as provision for losses in the accompanying condensed consolidated statements of operations. The Company's actual credit losses may differ from those estimates used to establish the allowance.

Certain amounts for 2006 have been reclassified to conform to the presentation adopted in 2007.

Adoption of New Accounting Standards

On January 1, 2007, the Company adopted FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" (FIN 48). FIN 48 prescribes a recognition threshold and measurement attributes for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Company's adoption of FIN 48 did not have a material impact on the Company's financial statements.

On January 1, 2007, the Company adopted SFAS 156, "Accounting for Servicing of Financial Assets — An Amendment of FASB Statement No. 140." This Statement amends FASB Statement No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities", with respect to the accounting for separately recognized servicing assets and servicing liabilities. This Statement requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract in certain situations and to initially measure those servicing assets and servicing liabilities at fair value, if practicable. The Company elected the option to measure its servicing rights at fair value at each reporting date with changes in fair value recorded in its earnings. The Company's adoption of FAS 156 did not have a material impact on the Company's financial statements.

Effective January 1, 2007, the Company adopted FAS No. 155, "Accounting for Certain Hybrid Instruments" (FAS 155), an amendment to FAS 133 and FAS 140. Among other things, FAS 155: (i) permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation; (ii) clarified which interest-only strips and principal-only strips are not subject to the requirements of FAS 133; (iii) established a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation; (iv) clarified that concentrations of credit risk in the form of subordination are not embedded derivatives; and (v) amended FAS 140 to eliminate the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument.

Securitized interests which only contain an embedded derivative that is tied to the prepayment risk of the underlying prepayable financial assets and for which the investor does not control the right to accelerate the settlement of such financial assets are excluded under a scope exception adopted by the FASB. None of the Company's assets were subject to FAS 155 as a result of this scope exception. Therefore, the Company has continued to record changes in the market value of its investment securities through other comprehensive income, a component of stockholders' equity. Therefore, the adoption of FAS 155 did not have any impact on the Company's financial position, results of operations or cash flows. However, if future investments by the Company in securitized financial assets do not meet the scope exception to FAS 155, the Company's results of operations may exhibit future volatility if such investments are required to be bifurcated or marked to market value in their entirety through the income statement.

NOTE 2 — NET INCOME PER COMMON SHARE

Net income per common share is presented on both a basic and diluted per common share basis. Diluted net income per common share assumes the conversion of the convertible preferred stock into common stock, using the if-converted method and stock appreciation rights, to the extent that there are rights outstanding, using the treasury stock method, but only if these items are dilutive. The Series D preferred stock is convertible into one share of common stock for each share of preferred stock. The following table reconciles the numerator and denominator for both the basic and diluted net income per common share for the three months ended March 31, 2007 and 2006.

	Three Months Ended March 31,			
	2007		2006	
	Income	Weighted-Average Number of Shares	Income	Weighted-Average Number of Shares
Net income	$ 1,942		$ 1,213	
Preferred stock charge	(1,003)		(1,036)	
Net income to common shareholders	$ 939	12,133,151	$ 177	12,161,682
Effect of dividends and additional shares of preferred stock	-	-	-	-
Diluted	$ 939	12,133,151	$ 177	12,161,682
Net income per share:				
Basic and diluted		$ 0.08		$ 0.01
Reconciliation of shares included in calculation of earnings per share due to dilutive effect:				
Incremental shares of options	-	426	-	-
	$ 939	12,133,577	$ -	-
Reconciliation of shares not included in calculation of earnings per share due to anti-dilutive effect:				
Dividends and assumed conversion of Series D preferred stock	$ 1,003	4,221,539	$ 1,036	4,362,259
Expense and incremental shares of stock appreciation rights and options	-	52,468	-	93,589
	$ 1,003	4,274,007	$ 1,036	4,455,848

NOTE 3 — SECURITIZED FINANCE RECEIVABLES

The following table summarizes the components of securitized finance receivables at March 31, 2007 and December 31, 2006:

	March 31, 2007	December 31, 2006
Collateral:		
Commercial mortgage loans , unpaid principal	$ 220,215	$ 225,463
Single-family mortgage loans , unpaid principal	105,054	116,060
	325,269	341,523
Funds held by trustees, including funds held for defeasance	7,297	7,351
Accrued interest receivable	2,302	2,380
Unamortized discounts and premiums, net	(503)	(455)
Loans, at amortized cost	334,365	350,799
Allowance for loan losses	(3,538)	(4,495)
	$ 330,827	$ 346,304

The commercial mortgage loans are encumbered by non-recourse securitization financing.

NOTE 4 — ALLOWANCE FOR LOAN LOSSES

The Company reserves for probable estimated credit losses on loans in its investment portfolio. The following table summarizes the aggregate activity for the allowance for loan losses for the three months ended March 31, 2007 and 2006:

	Three Months Ended March 31, 2007	2006
Allowance at beginning of period	$ 4,495	$ 19,035
Recapture of loan losses	(523)	(119)
Charge-offs, net of recoveries	(434)	(3)
Allowance at end of period	$ 3,538	$ 18,913

The Company identified $12,401 of impaired commercial loans at March 31, 2007, none of which were delinquent, compared to $13,266 of impaired commercial loans at December 31, 2006, one of which was delinquent and had an unpaid principal balance of $3,170. This delinquent commercial loan was settled in March 2007 resulting in a charge-off of $437.

NOTE 5 — INVESTMENT IN JOINT VENTURE

The Company holds a 49.875% interest in a joint venture, Copperhead Ventures, LLC, which it accounts for using the equity method, under which it recognizes its proportionate share of the joint venture’s earnings and comprehensive income. The Company’s interest in the earnings and other comprehensive income of the joint venture for the three months ended March 31, 2007 were $630 and $829, respectively.

The joint venture had total assets at March 31, 2007 of $76,368, which were comprised primarily of $39,123 of cash and cash equivalents, $33,175 of available for sale securities backed by commercial mortgage loans, and other assets of $4,070.

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NOTE 6 — SECURITIES

The following table summarizes the fair value of the Company's securities classified as available-for-sale, at March 31, 2007 and December 31, 2006:

	March 31, 2007		December 31, 2006	
	Fair Value	Effective Interest Rate	Fair Value	Effective Interest Rate
Securities, available-for-sale:				
Adjustable-rate mortgage securities	$ 3,765	5.44%	$ -	-%
Fixed-rate mortgage securities	10,877	7.18%	11,362	7.22%
Equity securities	1,152		1,151	
	15,794			
Gross unrealized gains	668		636	
Gross unrealized losses	(10)		(6)	
	$ 16,452		$ 13,143	

NOTE 7 — OTHER INVESTMENTS

The following table summarizes the Company's other investments at March 31, 2007 and December 31, 2006:

	March 31, 2007	December 31, 2006
Delinquent property tax receivable securities	$ 2,164	$ 2,227
Real estate owned	507	575
	$ 2,671	$ 2,802

Delinquent property tax receivable securities includes an unrealized gain of $140 and $41 at March 31, 2007 and December 31, 2006, respectively. Real estate owned is acquired from foreclosures on delinquent property tax receivables. During the three months ended March 31, 2007 and March 31, 2006, the Company collected an aggregate of $223 and $609, respectively, on delinquent property tax receivables and securities, including net sales proceeds from related real estate owned.

NOTE 8 - OTHER LOANS

The following table summarizes Dynex's carrying basis for other loans at March 31, 2007 and December 31, 2006, respectively.

	March 31, 2007	December 31, 2006
Single-family mortgage loans	$ 3,034	$ 3,345
Multifamily and commercial mortgage loan participations	955	962
	3,989	4,307
Unamortized discounts	(344)	(378)
	$ 3,645	$ 3,929

NOTE 9 -SECURITIZATION FINANCING

Dynex, through limited-purpose finance subsidiaries, has issued bonds pursuant to indentures in the form of non-recourse securitization financing. Each series of securitization financing may consist of various classes of bonds,

either at fixed or variable rates of interest. Payments received on securitized finance receivables and any reinvestment income thereon are used to make payments on the securitization financing. The obligations under the securitization financings are payable solely from the securitized finance receivables and are otherwise non-recourse

to Dynex. The stated maturity date for each class of bonds is generally calculated based on the final scheduled payment date of the underlying collateral pledged. The actual maturity of each class will be directly affected by the rate of principal prepayments on the related collateral. Each series is also subject to redemption at Dynex's option according to specific terms of the respective indentures. As a result, the actual maturity of any class of a series of securitization financing is likely to occur earlier than its stated maturity. If Dynex does not exercise its option to redeem a class or classes of bonds when it first has the right to do so, the interest rates on the bonds not redeemed will automatically increase by 0.30% to 0.83%.

Dynex may retain certain bond classes of securitization financing issued, including investment grade classes, financing these retained bonds with equity. As these limited-purpose finance subsidiaries are included in the consolidated financial statements of Dynex, such retained bonds are eliminated in the consolidated financial statements, while the associated repurchase agreements outstanding, if any, are included as recourse debt.

The components of non-recourse securitization financing along with certain other information at March 31, 2007 and December 31, 2006 are summarized as follows:

	March 31, 2007		December 31, 2006	
	Bonds Outstanding	**Range of Interest Rates**	**Bonds Outstanding**	**Range of Interest Rates**
Fixed-rate classes	$ 201,820	6.6% - 8.8%	$ 206,478	6.6% - 8.8%
Accrued interest payable	1,396		1,428	
Deferred costs	(2,742)		(2,848)	
Unamortized net bond premium	6,141		6,506	
	$ 206,615		$ 211,564	
Range of stated maturities	2024-2027		2024-2027	
Estimated weighted average life	4.1 years		4.3 years	
Number of series	2		2	

At March 31, 2007, the weighted-average effective rate of the fixed rate classes was 6.9%. The average effective rate of interest for securitization financing was 7.7%, and 8.1%, for the three months ended March 31, 2007 and the year ended December 31, 2006, respectively.

NOTE 10 - REPURCHASE AGREEMENTS

The Company uses repurchase agreements, which are recourse to the Company, to finance certain of its investments. The Company had repurchase agreements of $86,926 and $95,978, at March 31, 2007 and December 31, 2006, respectively, which are collateralized by certain of the Company's retained interests in a prior securitization. The repurchase agreements mature monthly and have a weighted average rate of 0.10% over one-month LIBOR (5.32% at March 31, 2007). The securitization financing bonds collateralizing these repurchase agreements have a fair value of $96,581 at March 31,2007.

NOTE 11 — PREFERRED STOCK

At March 31, 2007 and December 31, 2006, the total liquidation preference, which includes accrued dividends payable, on the Series D Preferred Stock was $43,218. There was $1,003 ($0.2375 per share) of accrued dividends payable on the Series D Preferred Stock at March 31, 2007 and December 31, 2006, respectively.

NOTE 12 — COMMITMENTS AND CONTINGENCIES

As discussed in the Company’s Annual Report on Form 10-K for the year ended December 31, 2006, the Company and certain of its subsidiaries are defendants in litigation. The following discussion is the current status of the litigation.

One of the Company's subsidiaries, GLS Capital, Inc. ("GLS"), and the County of Allegheny, Pennsylvania ("Allegheny County"), are defendants in a class action lawsuit filed in 1997 in the Court of Common Pleas of Allegheny County, Pennsylvania (the "Court of Common Pleas"). Plaintiffs allege that GLS illegally charged the taxpayers of Allegheny County certain attorney fees, costs and expenses, and interest, in the collection of delinquent property tax receivables owned by GLS. Plaintiffs were seeking class certification status, and in October 2006, the Court of Common Pleas certified the class action status of the litigation. In its Order certifying the class action, the Court of Common Pleas left open the possible decertification of the class if the fees, costs and expenses charged by GLS are in accordance with public policy considerations as well as Pennsylvania statute and relevant ordinance. The Company successfully sought the stay of this action pending the outcome of other litigation before the Pennsylvania Supreme Court in which GLS is not directly involved but has filed an Amicus brief in support of the defendants. Several of the allegations in that lawsuit are similar to those being made against GLS in this litigation. Plaintiffs have not enumerated its damages in this matter, and we believe that the ultimate outcome of this litigation will not have a material impact on the Company's financial condition, but may have a material impact on its reported results for the particular period presented.

Dynex Capital, Inc. and Dynex Commercial, Inc. ("DCI"), a former affiliate and now known as DCI Commercial, Inc., are appellees (or "respondents") in the Court of Appeals for the Fifth Judicial District of Texas at Dallas, related to the matter of Basic Capital Management et al (collectively, "BCM" or "the Plaintiffs") versus Dynex Commercial, Inc. et al. The appeal seeks to overturn a judgment from a lower court in the Company's and DCI's favor which denied recovery to Plaintiffs and to have a judgment entered in favor of Plaintiffs based on a jury award for damages, all of which was set aside by the trial court as discussed further below. In the alternative, Plaintiffs are seeking a new trial. The appeal relates to a suit filed against the Company and DCI in 1999, alleging, among other things, that DCI and Dynex Capital, Inc. failed to fund tenant improvement or other advances allegedly required on various loans made by DCI to BCM, which loans were subsequently acquired by the Company; that DCI breached an alleged $160 million "master" loan commitment entered into in February 1998; and that DCI breached another alleged loan commitment of approximately $9 million. The original trial commenced in January 2004, and, in February 2004, the jury in the case rendered a verdict in favor of one of the Plaintiffs and against the Company on the alleged breach of the loan agreements for tenant improvements and awarded that Plaintiff damages in the amount of $0.25 million. The jury entered a separate verdict against DCI in favor of BCM under two mutually exclusive damage models, for $2.2 million and $25.6 million, respectively. The jury found in favor of DCI on the alleged $9 million loan commitment, but did not find in favor of DCI for counterclaims made against BCM. The jury also awarded the Plaintiffs attorneys' fees in the amount of $2.1 million. After considering post-trial motions, the presiding judge entered judgment in favor of the Company and DCI, effectively overturning the verdicts of the jury and dismissing damages awarded by the jury. DCI is a former affiliate of Dynex Capital, Inc., and management does not believe that the Company will have any obligation for amounts, if any, awarded to the Plaintiffs as a result of the actions of DCI. The Court of Appeals heard oral arguments in this matter in April 2006 but has not yet rendered its decision.

Dynex Capital, Inc. and MERIT Securities Corporation, a subsidiary, are defendants in a putative class action complaint alleging violations of the federal securities laws in the United States District Court for the Southern District of New York ("District Court") by the Teamsters Local 445 Freight Division Pension Fund ("Teamsters"). The complaint was filed on February 11, 2005, and purports to be a class action on behalf of purchasers between February 2000 and May 2004 of MERIT Series 12 and MERIT Series 13 securitization financing bonds (the "Bonds"), which are collateralized by manufactured housing loans. The complaint seeks unspecified damages and alleges, among other things, misrepresentations in connection with the issuance of and subsequent reporting on the Bonds. The complaint initially named the Company's former president and its current Chief Operating Officer as defendants. On February 10, 2006, the District Court dismissed the claims against the former president and current Chief Operating Officer, but did not dismiss the claims against Dynex Capital, Inc. or MERIT ("together, the Corporate Defendants"). The Corporate Defendants moved to certify an interlocutory appeal of this order to the United States Court of Appeals for the Second Circuit ("Second Circuit"). On June 2, 2006, the District Court granted the Corporate Defendants' motion. On September 14, 2006, the Second Circuit granted the Corporate Defendants' petition to accept the certified order for interlocutory

appeal. On March 2, 2007, the parties completed briefing in the Second Circuit and are awaiting oral argument. The Company has evaluated the allegations made in the complaint and believes them to be without merit and intends to vigorously defend itself against them.

Although no assurance can be given with respect to the ultimate outcome of the above litigation, the Company believes the resolution of these lawsuits will not have a material effect on its consolidated balance sheet but could materially affect its consolidated results of operations in a given period or year.

NOTE 13 — STOCK BASED COMPENSATION

Pursuant to Dynex's 2004 Stock Incentive Plan, as approved by the shareholders at Dynex's 2005 annual shareholders' meeting (the "Stock Incentive Plan"), Dynex may grant to eligible officers, directors and employees stock options, stock appreciation rights ("SARs") and restricted stock awards. An aggregate of 1,500,000 shares of common stock is available for distribution pursuant to the Employee Incentive Plan. Dynex may also grant dividend equivalent rights ("DERs") in connection with the grant of options or SARs.

On January 3, 2007, Dynex granted 82,500 SARs to certain of its officers under the Stock Incentive Plan. The SARs vest over the next four years in equal annual installments, expire on December 31, 2013 and have an exercise price of $7.06 per share, which was the market price of the stock on the grant date. The weighted-average grant-date fair value of the SAR grant was $2.71 per share.

Dynex recognized stock-based compensation expense of $72 and $145 during the three months ended March 31, 2007 and 2006, respectively. The total compensation cost related to non-vested awards not yet recognized was $486 and $435 at March 31, 2007 and 2006, respectively.

The fair value of SARs and options awarded is estimated on the date of grant using the Black-Scholes option valuation model using the assumptions in the table below.

	SARs Granted		
	January 3, 2005	**January 12, 2006**	**January 3, 2007**
Expected volatility	13.9%-16.9%	14.4%-19.1%	17.4%-27.2%
Weighted-average volatility	14.8%	17.0%	21.5%
Expected dividends	0%	0%	0%
Expected term (in months)	33	42	54
Risk-free rate	4.54%	4.56%	4.58%

NOTE 14 — RECENT ACCOUNTING PRONOUNCEMENTS

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities." SFAS 159 permits entities to choose to measure many financial instruments, and certain other items, at fair value. SFAS 159 applies to reporting periods beginning after November 15, 2007. We are currently evaluating the potential impact on adoption of SFAS 159.

In September 2006, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 157, "Fair Value Measurements", which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. SFAS 157 is effective for fiscal years beginning after November 15, 2007 and all interim periods within those fiscal years. Earlier application is permitted provided that the reporting entity has not yet issued interim or annual financial statements for that fiscal year. The Company is currently evaluating the impact, if any, that SFAS 157 may have on the Company's financial statements.

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

The following discussion and analysis of the financial condition and results of operations of the Company for the three months ended March 31, 2007 should be read in conjunction with the Company's Unaudited Condensed Consolidated Financial Statements and the accompanying Notes to Unaudited Condensed Consolidated Financial Statements included in this report.

The Company is a specialty finance company organized as a real estate investment trust (REIT) that invests in loans and securities consisting principally of single-family residential and commercial mortgage loans. The Company finances these loans and securities through a combination of non-recourse securitization financing, repurchase agreements, and equity. Dynex employs financing in order to increase the overall yield on its invested capital.

The Company continues to focus its efforts in the near-term on managing its current investment portfolio to maximize cash flow, while evaluating longer-term opportunities for redeployment of its capital. The Company has substantial tax net operating loss carryforwards, which can be used to offset future taxable income through approximately 2019.

CRITICAL ACCOUNTING POLICIES

The discussion and analysis of the Company's financial condition and results of operations are based in large part upon its consolidated financial statements, which have been prepared in conformity with accounting principles generally accepted in the United States of America. The preparation of the financial statements 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 revenue and expenses during the reported period. Actual results could differ from those estimates.

Critical accounting policies are defined as those that are reflective of significant judgments or uncertainties, and which may result in materially different results under different assumptions and conditions, or the application of which may have a material impact on the Company's financial statements. The following are the Company's critical accounting policies.

Consolidation of Subsidiaries. The consolidated financial statements represent our accounts after the elimination of inter-company transactions. We consolidate entities in which we own more than 50% of the voting equity and control of the entity does not rest with others. We follow the equity method of accounting for investments with greater than 20% and less than a 50% interest in partnerships and corporate joint ventures or when we are able to influence the financial and operating policies of the investee but own less than 50% of the voting equity. For all other investments, the cost method is applied.

Securitization. We have securitized loans and securities in a securitization financing transaction by transferring financial assets to a wholly owned trust, and the trust issues non-recourse bonds pursuant to an indenture. Generally, we retain some form of control over the transferred assets, and/or the trust is not deemed to be a qualified special purpose entity. In instances where the trust is deemed not to be a qualified special purpose entity, the trust is included in our consolidated financial statements. A transfer of financial assets in which we surrender control over those assets is accounted for as a sale to the extent that consideration other than beneficial interests in the transferred assets is received in exchange. For accounting and tax purposes, the loans and securities financed through the issuance of bonds in a securitization financing transaction are treated as our assets, and the associated bonds issued are treated as our debt as securitization financing. We may retain certain of the bonds issued by the trust, and we generally will transfer collateral in excess of the bonds issued. This excess is typically referred to as over-collateralization. Each securitization trust generally provides us with the right to redeem, at our option, the remaining outstanding bonds prior to their maturity date.

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Impairments. We evaluate all securities in our investment portfolio for other-than-temporary impairments. A security is generally defined to be other-than-temporarily impaired if, for a maximum period of three consecutive quarters, the carrying value of such security exceeds its estimated fair value and we estimate, based on projected future cash flows or other fair value determinants, that the fair value will remain below the carrying value for the foreseeable future. If an other-than-temporary impairment is deemed to exist, we record an impairment charge to adjust the carrying value of the security down to its estimated fair value. In certain instances, as a result of the other-than-temporary impairment analysis, the recognition or accrual of interest will be discontinued and the security will be placed on non-accrual status.

We consider an investment to be impaired if the fair value of the investment is less than its recorded cost basis. Impairments of other investments are generally considered to be other-than-temporary when the fair value remains below the carrying value for three consecutive quarters. If the impairment is determined to be other-than-temporary, an impairment charge is recorded in order to adjust the carrying value of the investment to its estimated value.

Allowance for Loan Losses. We have credit risk on loans pledged in securitization financing transactions and classified as securitized finance receivables in our investment portfolio. An allowance for loan losses has been estimated and established for currently existing probable losses. Factors considered in establishing an allowance include current loan delinquencies, historical cure rates of delinquent loans, and historical and anticipated loss severity of the loans as they are liquidated. The allowance for loan losses is evaluated and adjusted periodically by management based on the actual and estimated timing and amount of probable credit losses, using the above factors, as well as industry loss experience. Where loans are considered homogeneous, the allowance for losses is established and evaluated on a pool basis. Otherwise, the allowance for losses is established and evaluated on a loan-specific basis. Provisions made to increase the allowance are a current period expense to operations. Single-family loans are considered impaired when they are 60-days past due. Commercial mortgage loans are evaluated on an individual basis for impairment. Generally, a commercial loan with a debt service coverage ratio of less than one is considered impaired. However, based on the attributes of the respective loan, or the attributes of the underlying real estate which secures the loan, commercial loans with a debt service ratio less than one may not be considered impaired; conversely, commercial loans with a debt service coverage ratio greater than one may be considered impaired. Certain of the commercial mortgage loans are covered by loan guarantees that limit our exposure on these loans. The level of allowance for loan losses required for these loans is reduced by the amount of applicable loan guarantees. The Company's actual credit losses may differ from the estimates used to establish the allowance.

FINANCIAL CONDITION

Below is a discussion of the Company's financial condition.

(amounts in thousands except per share data)	March 31, 2007	December 31, 2006
Investments:		
Securitized finance receivables	$ 330,827	$ 346,304
Investment in joint venture	38,847	37,388
Securities	16,452	13,143
Other investments	2,671	2,802
Other loans	3,645	3,929
Securitization financing	206,615	211,564
Repurchase agreements	86,926	95,978
Obligation under payment agreement	16,847	16,299
Shareholders' equity	138,470	136,538

Common book value per share	$ 7.93	$ 7.78

Securitized finance receivables. Securitized finance receivables decreased to $330.8 million at March 31, 2007 compared to $346.3 million at December 31, 2006. This decrease of $15.5 million is primarily the result of $15.6 million of principal payments during the quarter, including $9.9 million and $2.5 million of unscheduled principal payments on single-family and commercial mortgage loans, respectively.

Investment in joint venture. Investment in joint venture increased to $38.8 million at March 31, 2007 from $37.4 million at December 31, 2006. This increase of $1.4 million is primarily the result of the Company recognizing its interest in the earnings of the joint venture of $0.7 million and its interest in the increase in the value of the joint venture's available for sale securities of $0.8 million included in other comprehensive income.

Securities. Securities increased during the three months ended March 31, 2007 by $3.4 million, to $16.5 million at March 31, 2007 from $13.1 million at December 31, 2006 due primarily to the purchase of a $5.6 million adjustable-rate mortgage backed security. This increase was partially offset by principal payments of $2.4 million received on the securities during the quarter.

Other investments. Other investments at March 31, 2007 consist primarily of a security collateralized by delinquent property tax receivables. Other investments decreased from $2.8 million at December 31, 2006 to $2.7 million at March 31, 2007. This decrease is primarily the result of net collections on the tax liens, including proceeds from the sale of real estate owned, of $0.2 million during the quarter, offset by an increase in the value of the securitized liens of $0.1 million.

Other loans. Other loans decreased by $0.3 million from $3.9 million at December 31, 2006 to $3.6 million at March 31, 2007 primarily as the result of scheduled and unscheduled principal payments during the period.

Securitization financing. Securitization financing decreased $5.0 million, from $211.6 million at December 31, 2006 to $206.6 million at March 31, 2007. This decrease was primarily a result of principal payments received of $4.7 million on the associated finance receivables pledged which were used to pay down the securitization financing in accordance with the respective indentures and amortization of bond premiums of $0.3 million.

Repurchase Agreements. The balance of repurchase agreements declined to $86.9 million at March 31, 2007 from $96.0 million at December 31, 2006. The decrease was due to net repayments of $9.1 during the period as a result of principal received on the underlying securities being financed.

Obligation under payment agreement. The obligation under payment agreement increased to $16.8 million at March 31, 2007 from $16.3 million at December 31, 2006. The increase was primarily a result of an increase in the Company's estimated future payments to be made under this agreement of $0.6 million and $0.3 million of discount amortization during the quarter. Those increases were partially offset by payments made under the agreement of $0.4 million during the quarter.

Shareholders' equity. Shareholders' equity increased to $138.5 million at March 31, 2007 from $136.5 million at December 31, 2006 primarily as a result of the Company's earnings of $1.9 million for the quarter and a $1.0 million increase in unrealized gains on available for sale securities. These increases were partially offset by preferred stock dividends of $1.0 million.

Supplemental Discussion of Investments

The Company evaluates and manages its investment portfolio in large part based on its net capital invested in that particular investment. Net capital invested is generally defined as the cost basis of the investment net of the associated financing for that investment. For securitized finance receivables, because the securitization financing is recourse only to the finance receivables pledged and is, therefore, not a general obligation of the Company, the risk on the

Company's investment in securitized finance receivables from an economic point of view is limited to its net retained investment in the securitization trust.

Below is the net basis of the Company's investments as of March 31, 2007. Included in the table is an estimate of the fair value of the net investment. The fair value of the net investment in securitized finance receivables is based on the present value of the projected cash flow from the collateral, adjusted for the impact and assumed level of future prepayments and credit losses, less the projected principal and interest due on the securitization financing bonds owned by third parties. The fair value of securities is based on quotes obtained from third-party dealers, or, as is the case for the majority of our investments, calculated by discounting estimated future cash flows at market rates. For securities and other investments, the Company may employ leverage to enhance its overall returns on the net capital invested in these particular assets.

	March 31, 2007			
(amounts in thousands)	**Amortized cost basis**	**Financing**	**Net basis**	**Fair value of net basis**
Securitized finance receivables: [1]				
Single family mortgage loans	$ 107,022	$ 86,926	$ 20,096	$ 20,621
Commercial mortgage loans	227,343	206,615	20,728	21,125
Allowance for loan losses	(3,538)	-	(3,538)	-
	330,827	293,541	37,286	41,746
Securities: [2]				
Investment grade single-family	14,165	-	14,165	14,439
Non-investment grade single-family	356	-	356	548
Equity and other	1,274	-	1,274	1,464
	15,795	-	15,795	16,451
Investment in joint venture[3]	38,847	-	38,847	38,080
Obligation under payment agreement[1]	-	16,847	(16,847)	(17,157)
Other loans and investments[2]	6,176	-	6,176	7,050
Net unrealized gain	797	-	797	-
Total	$ 392,442	$ 310,388	$ 82,054	$ 86,170

[1] Fair values for securitized finance receivables and the obligation under payment agreement are based on discounted cash flows using assumptions set forth in the table below, inclusive of amounts invested in redeemed securitization financing bonds.

[2] Fair values of securities are based on dealer quotes, if available. Where dealer quotes are not available, fair values are calculated as the net present value of expected future cash flows, discounted at 16%. Expected cash flows for both securitized finance receivables and securities were based on the forward LIBOR curve as of March 31, 2007, and incorporate the resetting of the interest rates on the adjustable rate assets to a level consistent with projected prevailing rates. Increases or decreases in interest rates and index levels from those used would impact the calculation of fair value, as would differences in actual prepayment speeds and credit losses versus the assumptions set forth above.

[3] Fair value for investment in joint venture represents Dynex's share of the joint assets valued using methodologies and assumptions consistent with Note 1 and 2 above.

The following table summarizes the assumptions used in estimating fair value for our net investment in securitized finance receivables and the cash flow related to those net investments during 2007.

	Fair Value Assumptions				
Loan type	Weighted-average prepayment speeds	Losses	Weighted-average discount rate[5]	Projected cash flow termination date	*(amounts in thousands)* 2007 Cash Flows [1]
Single-family mortgage loans	30% CPR	0.2% annually	16%	Anticipated final maturity 2024	$831
Commercial mortgage loans[2]	[3]	0.8% annually	16%	[4]	$572

[1] Represents the excess of the cash flows received on the collateral pledged over the cash flow required to service the related securitization financing.
[2] Includes loans pledged to two different securitization trusts.
[3] Assumed CPR speeds generally are governed by underlying pool characteristics, prepayment lock-out provisions, and yield maintenance provisions. Loans currently delinquent in excess of 30 days are assumed liquidated in six months at a loss amount that is calculated for each loan based on its specific facts.
[4] Cash flow termination dates are modeled based on the repayment dates of the loans or optional redemption dates of the underlying securitization financing bonds.
[5] Represents management's estimate of the market discount rate that would be used by a third party in valuing these or similar assets.

The following table presents the Net Basis of Investments included in the "Estimated Fair Value of Net Investment" table above by their rating classification. Investments in the unrated and non-investment grade classification primarily include other loans that have not been given a rating but that are substantially seasoned and performing loans. Securitization over-collateralization generally includes the excess of the securitized finance receivable collateral pledged over the outstanding bonds issued by the securitization trust.

(amounts in thousands)	March 31, 2007
Cash and cash equivalents	$ 57,843
Investments:	
AAA rated and agency MBS fixed income securities	23,181
AA and A rated fixed income securities	1,892
Unrated and non-investment grade	8,521
Securitization over-collateralization	9,613
Investment in joint venture	38,847
	$ 82,054

Supplemental Discussion of Common Equity Book Value

We believe that our shareholders, as well as shareholders of other companies in the mortgage REIT industry, consider book value per common share an important measure. Our reported book value per common share is based on the carrying value our assets and liabilities as recorded in the consolidated financial statements in accordance with generally accepted accounting principles. A substantial portion of our assets are carried on a historical, or amortized, cost basis and not at estimated fair value. The table included in the "Supplemental Discussion of Investments" section above compares the amortized cost basis of our investments to their estimated fair value based on assumptions set forth in the table.

We believe that book value per common share, adjusted to reflect the carrying value of investments at their fair value (hereinafter referred to as "Adjusted Common Equity Book Value"), is also a meaningful measure for our shareholders, representing effectively our estimated going-concern value. The following table calculates Adjusted Common Equity Book Value and Adjusted Common Equity Book Value per share using the estimated fair value information contained in the "Estimated Fair Value of Net Investment" table above. The amounts set forth in the table in the Adjusted Common Equity Book Value column include all of our assets and liabilities at their estimated fair values, and exclude any value attributable to our tax net operating loss carryforwards and other matters that might impact our value.

	March 31, 2007	
(amounts in thousands)	**Book Value**	**Adjusted Common Equity Book Value**
Total investment assets (per table above)	$ 82,054	$ 86,170
Cash and cash equivalents	57,843	57,843
Other assets and liabilities, net	(1,427)	(1,427)
	138,470	142,586
Less: Preferred stock redemption value	(42,215)	(42,215)
Common equity book value and adjusted book value	$ 96,255	$ 100,371
Common equity book value per share and adjusted book value per share	$ 7.93	$ 8.27

RESULTS OF OPERATIONS

(amounts in thousands except per share information)	Three Months Ended March 31, 2007	2006
Net interest income	$ 2,460	$ 2,288
Recapture of loan losses	523	119
Net interest income after recapture of loan losses	2,983	2,407
Equity in earnings of joint venture	630	-
Other (expense) income	(545)	133
General and administrative expenses	(1,126)	(1,327)
Net income	1,942	1,213
Preferred stock charge	(1,003)	(1,036)
Net income to common shareholders	939	177
Net income per common share:		
Basic and diluted	$ 0.08	$ 0.01

Three Months Ended March 31, 2007 Compared to Three Months Ended March 31, 2006. Net interest income increased from $2.3 million to $2.5 million for the quarter ended March 31, 2007 from the same period in 2006 primarily as a result of the derecognition of a pool of securitized commercial mortgage loans in the third quarter of 2006 that contributed $0.5 million of net interest expense for the first quarter of 2006. Interest income on cash and cash equivalents also increased by $0.5 million as a result of an increase in the average balance of cash and cash equivalents and an increase in their yield of 0.72%. These increases were offset by $0.4 million of interest expense recognized on the obligation under payment agreement during the first quarter of 2007, which was not outstanding during the first quarter of 2006, and the continued decline in the Company’s investment portfolio of higher yielding assets.

Net interest income after recapture of loan losses for the three months ended March 31, 2007 increased to $3.0 million from $2.4 million for the same period for 2006. Recapture of provision for loan losses increased $0.4 million for the first quarter of 2007 from $0.1 million for the first quarter of 2006 due primarily to improvement in the performance of the Company’s commercial mortgage loan portfolio and the settlement of a delinquent loan at a lower than anticipated loss.

The Company recognized $0.6 million of equity in earnings of a joint venture, which it formed with in the third quarter of 2006. The joint venture’s earnings are primarily derived from interest income earned on commercial mortgage backed securities and cash equivalents.

The Company reported $0.5 million of other expense for the first quarter of 2007 compared to other income of $0.1 million for the same period in 2006. The first quarter other expense is primarily related to the expense recognized for the increase in the Company’s obligation under payment agreement discussed above.

General and administrative expense decreased to $1.1 million for the three-months ended March 31, 2007 from $1.3 million for the same period in 2006. This decrease was primarily the result of the reductions in expenses associated with the Company’s tax lien servicing operations in Pennsylvania, which were reduced during 2006 and closed effective February 2007.

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The following table summarizes the average balances of interest-earning assets and their average effective yields, along with the average interest-bearing liabilities and the related average effective interest rates, for each of the periods presented. Assets that are on non-accrual status are excluded from the table below for each period presented.

Average Balances and Effective Interest Rates

	Three Months Ended March 31,			
	2007		2006	
	Average Balance	Effective Rate	Average Balance	Effective Rate
Interest-earning assets:[1]				
Securitized finance receivables[2]	$ 342,239	8.20%	$ 723,881	7.67%
Securities	13,143	9.87%	35,617	6.09%
Other loans	3,733	13.58%	5,184	8.23%
Total interest-earning assets	$ 359,115	8.32%	$ 764,682	7.59%
Interest-bearing liabilities:				
Non-recourse securitization financing[3]	$ 208,434	7.65%	$ 507,482	8.48%
Repurchase agreements	92,705	5.43%	128,395	4.72%
Total interest-bearing liabilities	$ 301,139	6.97%	$ 635,877	7.72%
Net interest spread [3]		1.35%		(0.13)%
Net yield on average interest-earning assets[3][4]		2.48%		1.18%
Cash and cash equivalents	$ 56,595	5.22%	$ 20,156	4.50%
Net yield on average interest-earning assets, including cash and cash equivalents		2.85%		1.26%

(1) Average balances exclude adjustments made in accordance with Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities" to record available-for-sale securities at fair value.

(2) Average balances exclude funds held by trustees and bond issuance costs for the three months ended March 31, 2007 and 2006, respectively.

(3) Effective rates are calculated excluding non-interest related collateralized bond expenses. If included, the effective rate on interest-bearing liabilities would be 7.49% and 7.85% for the three months ended March 31, 2007 and 2006, respectively.

(4) Net yield on average interest-earning assets reflects net interest income excluding non-interest related collateralized bond expenses divided by average interest earning assets for the period, annualized.

The net interest spread increased 148 basis points, to 1.35% for the three months ended March 31, 2007 from negative 0.13% for the same period in 2006. The net yield on average interest earning assets for the three months ended March 31, 2007 increased relative to the same period in 2006, to 2.48% from 1.18%. The increase in the Company's net interest spread can be attributed primarily to a decrease of 75 basis points in the effective rate on interest-bearing liabilities combined with an increase of 73 basis points in the effective rate on interest-earning assets.

The first quarter of 2006 in the above table includes a pool of securitized commercial mortgage loans and the related non-recourse financing that was derecognized in the third quarter of 2006. This pool of securitized commercial mortgage loans generated net interest expense of $0.6 million for the first quarter of 2006, and its derecognition was responsible for approximately 88 basis points of the improvement in the net interest spread.

An additional 30 basis points of net interest spread increase related to improvement in the net interest spread on our securitized adjustable rate single-family mortgage loans. The rates on these loans continued to reset higher faster than the rates on the repurchase agreements financing these loans, which are based on LIBOR. Net interest spread was also helped during the first quarter of 2007 by lower level yield amortization.

The following table summarizes the amount of change in interest income and interest expense due to changes in interest rates versus changes in volume:

	Three Months Ended March 31, 2007 vs. 2006		
(amounts in thousands)	Rate	Volume	Total
Securitized finance receivables	$ 910	$ (7,767)	$ (6,857)
Securities	231	(449)	(218)
Other loans	56	(36)	20
Total interest income	1,197	(8,252)	(7,055)
Securitization financing	(967)	(5,809)	(6,766)
Repurchase agreements	203	(460)	(257)
Total interest expense	(764)	(6,269)	(7,033)
Net interest income	$ 1,961	$ (1,983)	$ (22)

Note: The change in interest income and interest expense due to changes in both volume and rate, which cannot be segregated, has been allocated proportionately to the change due to volume and the change due to rate. This table excludes non-interest related dividends on equity securities, securitization financing costs, other interest expense and provision for credit losses.

From March 31, 2006 to March 31, 2007, average interest-earning assets declined $406 million, or approximately 53%. The decline in interest earning assets resulted primarily from the derecognition of a pool of securitized commercial mortgage loans during the third quarter of 2006 and scheduled and unscheduled payments on the Company's adjustable-rate single-family mortgage loans.

Credit Exposures. The Company's predominate securitization structure is non-recourse securitization financing, whereby loans and securities are pledged to a trust, and the trust issues bonds pursuant to an indenture. Generally these securitization structures use over-collateralization, subordination, third-party guarantees, reserve funds, bond insurance, mortgage pool insurance or any combination of the foregoing as a form of credit enhancement. From an economic point of view, the Company generally has retained a limited portion of the direct credit risk in these securities. In many instances, the Company retained the "first-loss" credit risk on pools of loans that it has securitized.

The following table summarizes the aggregate principal amount of certain investments of the Company; the direct credit exposure retained by the Company (represented by the amount of over-collateralization pledged and subordinated securities owned by the Company), net of the credit reserves and discounts maintained by the Company in its financial statements for such exposure; and the actual credit losses incurred for each quarter presented. Credit Exposure, Net of Credit Reserves is based on the credit risk retained by the Company, from an economic point of view, for the loans and securities pledged to the securitization trust. The table includes any subordinated security retained by the Company. The Company's Credit Exposure, Net of Credit Reserves declined from the first quarter 2006 by $9.7 million due to the derecognition of $279.0 million of receivables and $254.5 million of related financing, the Company's interests in which were contributed to a joint venture.

The table excludes other forms of credit enhancement from which the Company benefits, and based upon the performance of the underlying loans, may provide additional protection against losses. These additional protections include loss reimbursement guarantees with a remaining balance of $14.9 million and a remaining deductible aggregating $0.5 million on $14.4 million of securitized single family mortgage loans which are subject to such

reimbursement agreements; guarantees aggregating $6.9 million of securitized commercial mortgage loans with an

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outstanding loan principal balance of $73.0 million, whereby losses on such loans would need to exceed the respective guarantee amount before the Company would incur credit losses; and $51.1 million of securitized single family mortgage loans which are subject to various mortgage pool insurance policies whereby losses would need to exceed the remaining stop loss of at least 100% on such policies before the Company would incur losses. This table excludes any credit exposure on unsecuritized other loans and other investments.

Credit Reserves and Actual Credit Losses
($ in millions)

	Outstanding Loan Principal Balance	Credit Exposure, Net Of Credit Reserves	Actual Credit Losses	Credit Exposure, Net Of Credit Reserves To Outstanding Loan Balance
2006, Quarter 1	$ 724.4	$ 32.0	$ 0.5	4.42%
2006, Quarter 2	693.8	33.1	6.6	4.77%
2006, Quarter 3	378.2	21.5	0.1	5.68%
2006, Quarter 4	361.3	22.4	0.0	6.20%
2007, Quarter 1	344.6	22.3	0.4	6.47%

The following tables summarize single-family mortgage loan and commercial mortgage loan delinquencies as a percentage of the outstanding commercial securitized finance receivables balance for those securities in which we have retained a portion of the direct credit risk. The delinquencies as a percentage of all outstanding securitized finance receivables balance have decreased to 3.0% at March 31, 2007 from 7.8% at March 31, 2006 primarily as a result of the liquidation or prepayment of several delinquent commercial loans since the first quarter 2006. We monitor and evaluate our exposure to credit losses and have established reserves based upon anticipated losses, general economic conditions and trends in the investment portfolio. At March 31, 2007, management believes the level of credit reserves is appropriate for currently existing losses within these loan pools.

Single family mortgage loan delinquencies as a percentage of the outstanding loan balance increased by approximately 0.79% to 9.04% at March 31, 2007 from 8.25% at March 31, 2006 and decreased by 0.80% from 9.84% at December 31, 2006. The decrease in delinquencies from December 31, 2006 is due to loans that paid in full or cured. The following table provides the percentage of delinquent single family loans.

Single-Family Loan Delinquency Statistics

December 31,	30 to 59 days delinquent	60 to 89 days delinquent	90 days and over delinquent (1)	Total
2006, Quarter 1	4.50%	0.85%	2.90%	8.25%
2006, Quarter 2	4.51%	1.09%	2.68%	8.28%
2006, Quarter 3	4.56%	1.28%	2.83%	8.67%
2006, Quarter 4	4.90%	1.89%	3.05%	9.84%
2007, Quarter 1	4.60%	0.08%	3.64%	9.04%

For commercial mortgage loans, there were no delinquencies at March 31, 2007, down from 1.36% percent of the outstanding securitized finance receivables at December 31, 2006 as a previously delinquent commercial loan liquidated in March 2007. The improvement in commercial loan delinquencies over the last four quarters is the result of continued seasoning of the loans, improving economic conditions nationwide, the contribution of and resultant risk

sharing of a commercial loan securitization with a joint-venture arrangement and the prepayment or liquidation of previously delinquent loans. The joint venture, in which the Company has a 49.875%, currently has a single delinquent commercial mortgage loan with an unpaid principal balance of $1.4 million.

Commercial Mortgage Loan Delinquency Statistics [1]

December 31,	30 to 59 days delinquent	60 to 89 days delinquent	90 days and over delinquent [1]	Total
2006, Quarter 1	1.25%	-%	6.38%	7.63%
2006, Quarter 2	1.09%	-%	5.15%	6.24%
2006, Quarter 3	-%	-%	1.33%	1.33%
2006, Quarter 4	-%	-%	1.36%	1.36%
2007, Quarter 1	-%	-%	-%	-%

[1] *Includes foreclosures and real estate owned.*

RECENT ACCOUNTING PRONOUNCEMENTS

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In September 2006, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 157, "Fair Value Measurements", which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. SFAS 157 is effective for fiscal years beginning after November 15, 2007 and all interim periods within those fiscal years. Earlier application is permitted provided that the reporting entity has not yet issued interim or annual financial statements for that fiscal year. The Company is currently evaluating the impact, if any, that SFAS 157 may have on the Company's financial statements.

LIQUIDITY AND CAPITAL RESOURCES

The Company has historically financed its operations from a variety of sources. The Company's primary source of funding for its operations today is the cash flow generated from the investment portfolio, which includes net interest income and principal payments and prepayments on these investments. From the cash flow on our investment portfolio, the Company currently funds operating overhead costs, including the servicing of delinquent property tax receivables, pays the dividend on the Series D Preferred Stock and services any remaining recourse debt. The Company's investment portfolio continues to provide positive cash flow, which can be utilized for reinvestment purposes.

Cash flows from the investment portfolio for the quarter ended March 31, 2007 were approximately $4.6 million, which includes approximately $2.4 million in principal payments on securities. These cash flows are after payment of principal and interest on the securitization financing and repurchase agreements financing those investments.

Excluding any cash flow derived from the sale or re-securitization of assets, and assuming that short-term interest rates remain stable, the Company anticipates that the cash flow from its investment portfolio will sequentially decline in 2007 as the investment portfolio continues to pay down, absent meaningful reinvestment of capital. The Company anticipates, however, that it will have sufficient cash flow from the investment portfolio to meet all of its current obligations on both a short-term and long-term basis.

At March 31, 2007, the Company had unused capacity on uncommitted repurchase agreement lines of approximately $10.3 million and cash and equivalents of $57.8 million.

The Company intends to maintain high levels of liquidity for the foreseeable future given the lack of compelling reinvestment opportunities as a result of the absolute low level of interest rates, the flat yield curve, and the historically tight spreads on fixed income instruments.

The Company currently utilizes a combination of equity, securitization financing and repurchase agreement financing to finance its investment portfolio. Securitization financing is recourse only to the assets pledged as collateral to support the financing and is not otherwise recourse to the Company. At March 31, 2007, the Company had $206.6 million of non-recourse securitization financing outstanding, all of which carries a fixed rate of interest. The maturity of each class of securitization financing is directly affected by the rate of principal prepayments on the related collateral and is not subject to margin call risk. Each series is also subject to redemption according to specific terms of the respective indentures, generally on the earlier of a specified date or when the remaining balance of the bonds equals 35% or less of the original principal balance of the bonds.

Repurchase agreement financing is recourse to the assets pledged and to the Company. Repurchase agreement financing is not committed financing to the Company, and it generally renews or rolls every 30-days. The amounts advanced to the Company by the repurchase agreement counterparty are determined largely based on the fair value of the asset pledged to the counterparty.

FORWARD-LOOKING STATEMENTS

Certain written statements in this Form 10-Q made by the Company that are not historical fact constitute "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. All statements contained in this Item as well as those discussed elsewhere in this Report addressing the results of operations, our operating performance, events, or developments that we expect or anticipate will occur in the future, including statements relating to investment strategies, net interest income growth, earnings or earnings per share growth, and market share, as well as statements expressing optimism or pessimism about future operating results, are forward-looking statements. The forward-looking statements are based upon management's views and assumptions as of the date of this Report, regarding future events and operating performance and are applicable only as of the dates of such statements. Such forward-looking statements may involve factors that could cause the actual results of the Company to differ materially from historical results or from any results expressed or implied by such forward-looking statements. The Company cautions the public not to place undue reliance on forward-looking statements, which may be based on assumptions and anticipated events that do not materialize.

Factors that may cause actual results to differ from historical results or from any results expressed or implied by forward-looking statements include the following:

Reinvestment. Asset yields today are generally lower than those assets sold or repaid, due to lower overall interest rates and more competition for these assets. We have generally been unable to find investments which have acceptable risk adjusted yields. As a result, our net interest income has been declining, and may continue to decline in the future, resulting in lower earnings per share over time. In order to maintain our investment portfolio size and our earnings, we need to reinvest a portion of the cash flows we receive into new interesting earning assets. If we are unable to find suitable reinvestment opportunities, the net interest income on our investment portfolio and investment cash flows could be negatively impacted.

Economic Conditions. We are affected by general economic conditions. An increase in the risk of defaults and credit risk resulting from an economic slowdown or recession could result in a decrease in the value of our investments and the over-collateralization associated with its securitization transactions. As a result of our being heavily invested in short-term high quality investments, a worsening economy, however, could also benefit us by creating opportunities for us to invest in assets that become distressed as a result of the worsening conditions. These changes could have an

effect on our financial performance and the performance on our securitized loan pools.

Investment Portfolio Cash Flow. Cash flows from the investment portfolio fund our operations, the preferred stock dividend, and repayments of outstanding debt, and are subject to fluctuation due to changes in interest rates, repayment rates and default rates and related losses, particularly given the high degree of internal structural leverage inherent in our securitized investments. Based on the performance of the underlying assets within the securitization structure, cash flows which may have otherwise been paid to us as a result of our ownership interest may be retained within the structure. Cash flows from the investment portfolio are likely to sequentially decline until we meaningfully begin to reinvest our capital. There can be no assurances that we will be able to find suitable investment alternatives for our capital, nor can there be assurances that we will meet our reinvestment and return hurdles.

Defaults. Defaults by borrowers on loans we securitized may have an adverse impact on our financial performance, if actual credit losses differ materially from our estimates or exceed reserves for losses recorded in the financial statements. The allowance for loan losses is calculated on the basis of historical experience and management's best estimates. Actual default rates or loss severity may differ from our estimate as a result of economic conditions. Actual defaults on adjustable-rate mortgage loans may increase during a rising interest rate environment. In addition, commercial mortgage loans are generally large dollar balance loans, and a significant loan default may have an adverse impact on our financial results. Such impact may include higher provisions for loan losses and reduced interest income if the loan is placed on non-accrual.

Interest Rate Fluctuations. Our income and cash flow depends on our ability to earn greater interest on our investments than the interest cost to finance these investments. Interest rates in the markets served by us generally rise or fall with interest rates as a whole. Approximately $253 million of our investments, including loans and securities currently pledged as securitized finance receivables and securities, are fixed-rate and approximately $91 million of our investments are variable rate. We currently finance these fixed-rate assets through $207 million of fixed rate securitization financing and $87 million of variable rate repurchase agreements. The net interest spread for these investments could decrease during a period of rapidly rising short-term interest rates, since the investments generally have interest rates which reset on a delayed basis and have periodic interest rate caps; the related borrowing has no delayed resets or such interest rate caps.

Third-party Servicers. Our loans and loans underlying securities are serviced by third-party service providers. As with any external service provider, we are subject to the risks associated with inadequate or untimely services. Many borrowers require notices and reminders to keep their loans current and to prevent delinquencies and foreclosures. A substantial increase in our delinquency rate that results from improper servicing or loan performance in general could harm our ability to securitize our real estate loans in the future and may have an adverse effect on our earnings.

Prepayments. Prepayments by borrowers on loans we securitized may have an adverse impact on our financial performance. Prepayments are expected to increase during a declining interest rate or flat yield curve environment. Our exposure to rapid prepayments is primarily (i) the faster amortization of premium on the investments and, to the extent applicable, amortization of bond discount, and (ii) the replacement of investments in its portfolio with lower yielding investments.

Competition. The financial services industry is a highly competitive market in which we compete with a number of institutions with greater financial resources. In purchasing portfolio investments and in issuing securities, we compete with other mortgage REITs, investment banking firms, savings and loan associations, commercial banks, mortgage bankers, insurance companies, federal agencies and other entities, many of which have greater financial resources and a lower cost of capital than we do. Increased competition in the market and our competitors greater financial resources have adversely affected Dynex, and may continue to do so. Competition may also continue to keep pressure on spreads resulting in us being unable to reinvest our capital on an acceptable risk-adjusted basis.

Regulatory Changes. Our businesses as of March 31, 2007 were not subject to any material federal or state regulation or licensing requirements. However, changes in existing laws and regulations or in the interpretation thereof, or the introduction of new laws and regulations, could adversely affect us and the performance of our securitized loan pools or our ability to collect on our delinquent property tax receivables. We are a REIT and are required to meet certain tests in order to maintain our REIT status as described in the earlier discussion of "Federal Income Tax Considerations." If we should fail to maintain our REIT status, we would not be able to hold certain investments and would be subject to income taxes.

Section 404 of the Sarbanes-Oxley Act of 2002. Based on our current market capitalization, we do anticipate that we will be required to be compliant with the provisions of Section 404 of the Sarbanes-Oxley Act of 2002 in 2007. However, the measurement date for determining the compliance deadline is June 30, 2007. Failure to be compliant may result in doubt in the capital markets about the quality and adequacy of our internal disclosure controls. This could result in our having difficulty in or being unable to raise additional capital in these markets in order to finance our operations and future investments.

Other. The following risks, which are discussed in more detail in the Company's Annual Report on Form 10-K for the period ended December 31, 2006, could also affect our results of operations, financial condition and cash flows:

· We may be unable to invest in new assets with attractive yields, and yields on new assets in which we do invest may not generate attractive yields, resulting in a decline in our earnings per share over time.

· Our ownership of certain subordinate interests in securitization trusts subjects us to credit risk on the underlying loans, and we provide for loss reserves on these loans as required under GAAP.

· Certain investments employ internal structural leverage as a result of the securitization process, and are in the most subordinate position in the capital structure, which magnifies the potential impact of adverse events on our cash flows and reported results.

· Our efforts to manage credit risk may not be successful in limiting delinquencies and defaults in underlying loans or losses on our investments.

· Prepayments of principal on our investments, and the timing of prepayments, may impact our reported earnings and our cash flows.

· We finance a portion of our investment portfolio with short-term recourse repurchase agreements which subjects us to margin calls if the assets pledged subsequently decline in value.

· We may be subject to the risks associated with inadequate or untimely services from third-party service providers, which may harm our results of operations.

· Interest rate fluctuations can have various negative effects on us, and could lead to reduced earnings and/or increased earnings volatility.

· Our reported income depends on accounting conventions and assumptions about the future that may change.

· Failure to qualify as a REIT would adversely affect our dividend distributions and could adversely affect the value of our securities.

· Maintaining REIT status may reduce our flexibility to manage our operations.

- We may fail to properly conduct our operations so as to avoid falling under the definition of an investment company pursuant to the Investment Company Act of 1940.

- We are dependent on certain key personnel.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Market risk generally represents the risk of loss that may result from the potential change in the value of a financial instrument due to fluctuations in interest and foreign exchange rates and in equity and commodity prices. Market risk is inherent to both derivative and non-derivative financial instruments, and accordingly, the scope of our market risk management extends beyond derivatives to include all market risk sensitive financial instruments. As a financial services company, net interest income comprises the primary component of Dynex's earnings and cash flows. The Company is subject to risk resulting from interest rate fluctuations to the extent that there is a gap between the amount of the Company's interest-earning assets and the amount of interest-bearing liabilities that are prepaid, mature or re-price within specified periods.

The Company monitors the aggregate cash flow, projected net yield and estimated market value of its investment portfolio under various interest rate and prepayment assumptions. While certain investments may perform poorly in an increasing or decreasing interest rate environment, other investments may perform well, and others may not be impacted at all.

The Company focuses on the sensitivity of its investment portfolio cash flow, and measures such sensitivity to changes in interest rates. Changes in interest rates are defined as instantaneous, parallel, and sustained interest rate movements in 100 basis point increments. The Company estimates its interest income cash flow for the next twenty-four months assuming interest rates over such time period follow the forward LIBOR curve (based on 90-day Eurodollar futures contracts) as of March 31, 2007. Once the base case has been estimated, cash flows are projected for each of the defined interest rate scenarios. Those scenario results are then compared against the base case to determine the estimated change to cash flow. Cash flow changes from interest rate swaps, caps, floors or any other derivative instrument are included in this analysis.

The following table summarizes the Company's net interest income cash flow and market value sensitivity analyses as of March 31, 2007. These analyses represent management's estimate of the percentage change in net interest margin cash flow and value expressed as a percentage change of shareholders' equity, given a shift in interest rates, as discussed above. Certain investments, with a carrying value of $2.7 million at March 31, 2007, are not considered to be interest rate sensitive and are excluded from the analysis below. The "Base" case represents the interest rate environment as it existed as of March 31, 2007, at which time one-month LIBOR was 5.32% and six-month LIBOR was 5.33%. The base case net interest margin cash flow is $11.2 million, excluding net interest margin on cash and cash equivalents, and $19.0 million, including net interest margin on cash and cash equivalents.

The analysis is heavily dependent upon the assumptions used in the model. The effect of changes in future interest rates, the shape of the yield curve or the mix of assets and liabilities may cause actual results to differ significantly from the modeled results. In addition, certain financial instruments provide a degree of "optionality." The most significant option affecting our portfolio is the borrowers' option to prepay the loans. The model applies prepayment rate assumptions representing management's estimate of prepayment activity on a projected basis for each collateral

pool in the investment portfolio. The model applies the same prepayment rate assumptions for all five cases indicated below. The extent to which borrowers utilize the ability to exercise their option may cause actual results to significantly differ from the analysis. Furthermore, the projected results assume no additions or subtractions to our portfolio, and no change to Dynex's liability structure. Historically, there have been significant changes in the Company's investment portfolio and the liabilities incurred by the Company. As a result of anticipated prepayments on assets in the investment portfolio, there are likely to be such changes in the future.

	Projected Change in Net Interest Margin Cash Flow From Base Case		
Basis Point Increase (Decrease) in Interest Rates	**Excluding Cash and Cash Equivalents**	**Including Cash and Cash Equivalents**	**Projected Change in Value, Expressed as a Percentage of Shareholders' Equity**
+200	(3.7)%	14.2%	(0.2)%
+100	(0.7)%	7.7%	(0.0)%
Base	-	-	-
-100	0.9%	(7.6)%	0.0%
-200	4.8%	(13.5)%	0.3%

The Company's interest rate risk is related both to the rate of change in short term interest rates and to the level of short-term interest rates. Approximately $253 million of Dynex's investment portfolio is comprised of loans or securities that have coupon rates that are fixed. Approximately $91 million of its investment portfolio as of March 31, 2007 was comprised of loans or securities that have coupon rates which adjust over time (subject to certain periodic and lifetime limitations) in conjunction with changes in short-term interest rates. Approximately 69%, 11% and 10% of the adjustable-rate loans underlying our securitized finance receivables are indexed to and reset based upon the level of six-month LIBOR, one-year constant maturity treasury rate (CMT) and prime rate, respectively.

Generally, during a period of rising short-term interest rates, our net interest income earned and the corresponding cash flow on our investment portfolio will decrease. The decrease of the net interest spread results from (i) fixed-rate loans and investments financed with variable-rate debt, (ii) the lag in resets of the adjustable-rate loans underlying the securitized finance receivables relative to the rate resets on the associated borrowings, and (iii) rate resets on the adjustable-rate loans which are generally limited to 1% every six months or 2% every twelve months and subject to lifetime caps, while the associated borrowings have no such limitation. As to item (i), the Company has substantially limited its interest rate risk by match funding fixed rate assets and variable rate assets. As to items (ii) and (iii), as short-term interest rates stabilize and the adjustable-rate loans reset, the net interest margin may be partially restored as the yields on the adjustable-rate loans adjust to market conditions.

Net interest income may increase following a fall in short-term interest rates. This increase may be temporary as the yields on the adjustable-rate loans adjust to the new market conditions after a lag period. The net interest spread may also be increased or decreased by the proceeds or costs of interest rate swap, cap or floor agreements, to the extent that Dynex has entered into such agreements.

Item 4. Controls and Procedures

(a) Evaluation of disclosure controls and procedures.

Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed in the Company's reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in the Company's reports filed under the Exchange Act is accumulated and communicated to management, including the Company's management, as appropriate, to allow timely decisions regarding required disclosures.

As of the end of the period covered by this report, the Company carried out an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Rule 13a-15 under the Exchange Act. This evaluation was carried out under the supervision and with the participation of the Company's management, including the Company's Principal Executive Officer and Principal Financial Officer. Based upon that evaluation, the Company's management concluded that the Company's disclosure controls and procedures are effective.

In conducting its review of disclosure controls, management concluded that sufficient disclosure controls and procedures did exist to ensure that information required to be disclosed in the Company's reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

(b) Changes in internal controls.

The Company's management is also responsible for establishing and maintaining adequate internal control over financial reporting. There were no changes in the Company's internal controls or in other factors that could materially affect, or are reasonably likely to materially affect the Company's internal controls over financial reporting. There were also no significant deficiencies or material weaknesses in such internal controls requiring corrective actions.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

As discussed in the Company's Annual Report on Form 10-K for the year ended December 31, 2006, the Company and certain of its subsidiaries are defendants in litigation. The following discussion is the current status of the litigation.

One of the Company's subsidiaries, GLS Capital, Inc. ("GLS"), and the County of Allegheny, Pennsylvania ("Allegheny County"), are defendants in a class action lawsuit filed in 1997 in the Court of Common Pleas of Allegheny County, Pennsylvania (the "Court of Common Pleas"). Plaintiffs allege that GLS illegally charged the taxpayers of Allegheny County certain attorney fees, costs and expenses, and interest, in the collection of delinquent property tax receivables owned by GLS. Plaintiffs were seeking class certification status, and in October 2006, the Court of Common Pleas certified the class action status of the litigation. In its Order certifying the class action, the Court of Common Pleas left open the possible decertification of the class if the fees, costs and expenses charged by GLS are in accordance with public policy considerations as well as Pennsylvania statute and relevant ordinance. The Company successfully sought the stay of this action pending the outcome of other litigation before the Pennsylvania

Supreme Court in which GLS is not directly involved but has filed an Amicus brief in support of the defendants. Several of the allegations in that lawsuit are similar to those being made against GLS in this litigation. Plaintiffs have not enumerated its damages in this matter, and management believes that the ultimate outcome of this litigation will not have a material impact on the Company's financial condition, but may have a material impact on its reported results for the particular period presented.

Dynex Capital, Inc. and Dynex Commercial, Inc. ("DCI"), a former affiliate and now known as DCI Commercial, Inc., are appellees (or "respondents") in the Court of Appeals for the Fifth Judicial District of Texas at Dallas, related to the matter of Basic Capital Management et al (collectively, "BCM" or "the Plaintiffs") versus Dynex Commercial, Inc. et al. The appeal seeks to overturn a judgment from a lower court in the Company's and DCI's favor which denied recovery to Plaintiffs and to have a judgment entered in favor of Plaintiffs based on a jury award for damages, all of which was set aside by the trial court as discussed further below. In the alternative, Plaintiffs are seeking a new trial. The appeal relates to a suit filed against us and DCI in 1999, alleging, among other things, that DCI and Dynex Capital, Inc. failed to fund tenant improvement or other advances allegedly required on various loans made by DCI to BCM, which loans were subsequently acquired by the Company; that DCI breached an alleged $160 million "master" loan commitment entered into in February 1998; and that DCI breached another alleged loan commitment of approximately $9 million. The original trial commenced in January 2004, and, in February 2004, the jury in the case rendered a verdict in favor of one of the Plaintiffs and against the Company on the alleged breach of the loan agreements for tenant improvements and awarded that Plaintiff damages in the amount of $0.25 million. The jury entered a separate verdict against DCI in favor of BCM under two mutually exclusive damage models, for $2.2 million and $25.6 million, respectively. The jury found in favor of DCI on the alleged $9 million loan commitment, but did not find in favor of DCI for counterclaims made against BCM. The jury also awarded the Plaintiffs attorneys' fees in the amount of $2.1 million. After considering post-trial motions, the presiding judge entered judgment in favor of the Company and DCI, effectively overturning the verdicts of the jury and dismissing damages awarded by the jury. DCI is a former affiliate of the Company, and management believes that the Company will have no obligation for amounts, if any, awarded to the Plaintiffs as a result of the actions of DCI. The Court of Appeals heard oral arguments in this matter in April 2006 but has not yet rendered its decision.

Dynex Capital, Inc. and MERIT Securities Corporation, a subsidiary, are defendants in a putative class action complaint alleging violations of the federal securities laws in the United States District Court for the Southern District of New York ("District Court") by the Teamsters Local 445 Freight Division Pension Fund ("Teamsters"). The complaint was filed on February 11, 2005, and purports to be a class action on behalf of purchasers between February 2000 and May 2004 of MERIT Series 12 and MERIT Series 13 securitization financing bonds (the "Bonds"), which are collateralized by manufactured housing loans. The complaint seeks unspecified damages and alleges, among other things, misrepresentations in connection with the issuance of and subsequent reporting on the Bonds. The complaint initially named the Company's former president and its current Chief Operating Officer as defendants. On February 10, 2006, the District Court dismissed the claims against the former president and the Company's current Chief Operating Officer, but did not dismiss the claims against Dynex Capital, Inc. or MERIT ("together, the Corporate Defendants"). The Corporate Defendants moved to certify an interlocutory appeal of this order to the United States Court of Appeals for the Second Circuit ("Second Circuit"). On June 2, 2006, the District Court granted the Corporate Defendants' motion. On September 14, 2006, the Second Circuit granted the Corporate Defendants' petition to accept the certified order for interlocutory appeal. On March 2, 2007, the parties completed briefing in the Second Circuit and are awaiting oral argument. The Company has evaluated the allegations made in the complaint and believes them to be without merit and intends to vigorously defend itself against them.

Although no assurance can be given with respect to the ultimate outcome of the above litigation, the Company believes the resolution of these lawsuits will not have a material effect on its consolidated balance sheet but could materially affect its consolidated results of operations in a given period or year.

Item 1A. Risk Factors

There have been no material changes to the risk factors disclosed in Item 1A - Risk Factors of the Company's Annual Report on Form 10-K for the year ended December 31, 2006 (the "Form 10-K"). The materialization of any risks and uncertainties identified in the Company's Forward Looking Statements contained herein together with those previously disclosed in the Form 10-K or those that are presently unforeseen could result in significant adverse effects on the Company's financial condition, results of operations and cash flows. See Item 2. "Management's Discussion and Analysis of Financial Condition and Results of Operations - Forward Looking Statements" in this Quarterly Report on Form 10-Q.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

On February 26, 2007, the Company issued 5,000 shares of its common stock following the exercise of stock options by one of its directors. The exercise price of the stock options was $7.43 per share. The Company relied upon Section 4(2) of the Securities Act of 1933 for the exemption from registration for this issuance.

Item 3. Defaults Upon Senior Securities

None

Item 4. Submission of Matters to a Vote of Security Holders

Not applicable

Item 5. Other Information

None

Item 6. Exhibits

31.1 Certification of Principal Executive Officer and Principal Financial Officer pursuant to Section 302 (filed herewith).

32.1 Certification of Principal Executive Officer and Principal Financial Officer pursuant to Section 906 (filed herewith).

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

DYNEX CAPITAL, INC.

Date: May 15, 2007

/s/ Stephen J. Benedetti
Stephen J. Benedetti
Executive Vice President and Chief Operating Officer
(Principal Executive Officer and Principal Financial Officer)

EXHIBIT INDEX

Exhibit No.

31.1	Certification of Principal Executive Officer and Principal Financial Officer pursuant to Section 302 (filed herewith).
32.1	Certification of Principal Executive Officer and Principal Financial Officer pursuant to Section 906 (filed herewith).