

DYNEX CAPITAL INC  
Form 10-Q  
August 10, 2009

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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 ended June 30, 2009

or

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  
(State or other jurisdiction of  
incorporation or organization)

52-1549373  
(I.R.S. Employer  
Identification No.)

4991 Lake Brook Drive, Suite 100, Glen Allen,  
Virginia  
(Address of principal executive offices)

23060-9245  
(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 ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes ☐ No ☐

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

Large accelerated

filer

☐

Accelerated filer

☐

☐ (Do not check if a smaller reporting

Non-accelerated filer company)

Smaller reporting company ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes

☐

No

☐

On July 31, 2009, the registrant had 13,565,262 shares outstanding of common stock, \$0.01 par value, which is the registrant’s only class of common stock.

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DYNEX CAPITAL, INC.  
FORM 10-Q

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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

## DYNEX CAPITAL, INC.

CONDENSED CONSOLIDATEDBALANCE SHEETS

(amounts in thousands except share data)

	June 30, 2009 (unaudited)	December 31, 2008
<b>ASSETS</b>		
Agency MBS:		
Pledged to counterparties, at fair value	\$476,526	\$300,277
Unpledged, at fair value	31,506	11,299
Pending settlement, at fair value	23,514	—
	531,546	311,576
Securitized mortgage loans, net	233,214	243,827
Investment in joint venture	6,109	5,655
Other investments	8,298	12,735
	779,167	573,793
Cash and cash equivalents	32,200	24,335
Restricted cash	—	2,974
Other assets	7,165	6,089
	\$818,532	\$607,191
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>LIABILITIES</b>		
Repurchase agreements	\$472,532	\$274,217
Securitization financing	154,468	178,165
Obligation under payment agreement	8,555	8,534
Payable for securities pending settlement	23,595	—
Other liabilities	4,755	5,866
	663,905	466,782
<b>Commitments and Contingencies (Note 13)</b>		
<b>SHAREHOLDERS' EQUITY</b>		
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, 13,169,762 and 12,169,762 shares issued and outstanding, respectively	132	122
Additional paid-in capital	373,438	366,817
Accumulated other comprehensive income (loss)	3,968	(3,949 )
Accumulated deficit	(264,660 )	(264,330 )

	154,627	140,409
	\$818,532	\$607,191

See notes to unaudited condensed consolidated financial statements.

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## DYNEX CAPITAL, INC.

CONDENSED CONSOLIDATED STATEMENTSOF OPERATIONS (UNAUDITED)

(amounts in thousands except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Interest income:				
Investments	\$9,816	\$6,497	\$19,287	\$12,656
Cash and cash equivalents	3	177	9	501
	9,819	6,674	19,296	13,157
Interest expense	3,938	4,173	8,371	8,235
Net interest income	5,881	2,501	10,925	4,922
Provision for loan losses	(139 )	(321 )	(318 )	(347 )
Net interest income after provision for loan losses	5,742	2,180	10,607	4,575
Equity in income (loss) of joint venture	610	560	(144 )	(1,691 )
Gain (loss) on sale of investments, net	138	(43 )	221	2,050
Fair value adjustments, net	(507 )	(173 )	138	4,058
Other income	143	3,025	164	3,092
General and administrative expenses:				
Compensation and benefits	(1,069 )	(590 )	(1,953 )	(1,084 )
Other general and administrative expenses	(687 )	(663 )	(1,530 )	(1,385 )
Net income	4,370	4,296	7,503	9,615
Preferred stock dividends	(1,003 )	(1,003 )	(2,005 )	(2,005 )
Net income to common shareholders	\$3,367	\$3,293	\$5,498	\$7,610
Net income per common share:				
Basic	\$0.26	\$0.27	\$0.44	\$0.63
Diluted	\$0.25	\$0.26	\$0.44	\$0.59

See notes to unaudited condensed consolidated financial statements.

## DYNEX CAPITAL, INC.

## CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY (UNAUDITED)

Six Months Ended June 30, 2009 and 2008

(amounts in thousands)

	Preferred Stock	Common Stock	Additional Paid-in Capital	Accumulated Other Compre-hen- sive (Loss) Income	Accumulated Deficit	Total
Balance at December 31, 2008	\$41,749	\$122	\$366,817	\$ (3,949 )	\$ (264,330 )	\$140,409
Net income	—	—	—	—	7,503	7,503
Other comprehensive income:						
Change in market value of securities and other investments	—	—	—	7,431	—	7,431
Reclassification adjustment for equity in joint venture's other-than-temporary impairment	—	—	—	707	—	707
Reclassification adjustment for net gains included in net income	—	—	—	(221 )	—	(221 )
Total comprehensive income						15,420
Dividends on common stock	—	—	—	—	(5,828 )	(5,828 )
Dividends on preferred stock	—	—	—	—	(2,005 )	(2,005 )
Common stock issuance	—	10	6,573	—	—	6,583
Vesting of restricted stock	—	—	48	—	—	48
Balance at June 30, 2009	\$41,749	\$132	\$373,438	\$ 3,968	\$ (264,660 )	\$154,627
	Preferred Stock	Common Stock	Additional Paid-in Capital	Accumulated Other Compre-hen- sive (Loss) Income	Accumulated Deficit	Total
Balance at December 31, 2007	\$41,749	\$121	\$366,716	\$ 1,093	\$ (267,743 )	\$141,936
Cumulative effect of adoption of SFAS 159	—	—	—	—	943	943
Net income	—	—	—	—	9,615	9,615



Other comprehensive income:						
Change in market value of securities and other investments	—	—	—	(2,995 )	—	(2,995 )
Reclassification adjustment for net gains included in net income	—	—	—	(2,051 )	—	(2,051 )
Total comprehensive income						4,569
Dividends on common stock	—	—	—	—	(3,042 )	(3,042 )
Dividends on preferred stock	—	—	—	—	(2,005 )	(2,005 )
Stock option issuance	—	—	13	—	—	13
Grant and vesting of restricted stock	—	1	40	—	—	41
Balance at June 30, 2008	\$41,749	\$122	\$366,769	\$ (3,953 )	\$ (262,232 )	\$142,455

See notes to unaudited condensed consolidated financial statements.

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

	Six Months Ended June 30,	
	2009	2008
Operating activities:		
Net income	\$7,503	\$9,615
Adjustments to reconcile net income to cash provided by operating activities:		
Equity in loss of joint venture	144	1,691
Provision for loan losses	318	347
Gain on sale of investments, net	(221 )	(2,050 )
Fair value adjustments, net	(138 )	(4,058 )
Amortization and depreciation	1,093	(1,729 )
Stock based compensation expense (benefit)	351	(152 )
Net change in other assets and other liabilities	(2,813 )	(1,040 )
Net cash provided by operating activities	6,237	2,624
Investing activities:		
Principal payments received on securitized mortgage loans	10,566	19,175
Purchases of Agency MBS	(237,475 )	(142,911 )
Payments received on Agency MBS and other investments	49,536	7,714
Proceeds from sales of other investments	3,694	18,128
Purchases of other investments	—	(9,987 )
Proceeds from sales of Agency MBS	—	5,809
Other	(1,665 )	86
Net cash used by investing activities	(175,344 )	(101,986 )
Financing activities:		
Net borrowings under repurchase agreements	198,314	124,791
Principal payments on securitization financing	(7,880 )	(13,233 )
Decrease in restricted cash	2,974	—
Redemption of securitization financing	(15,492 )	—
Proceeds from sale of common stock	6,658	—
Dividends paid	(7,602 )	(5,047 )
Net cash provided by financing activities	176,972	106,511
Net increase in cash and cash equivalents	7,865	7,149
Cash and cash equivalents at beginning of period	24,335	35,352
Cash and cash equivalents at end of period	\$32,200	\$42,501
Supplemental disclosure of non-cash investing activities:		
Increase in Agency MBS pending settlement	\$23,514	\$—
Supplemental disclosure of non-cash financing activities:		
Increase in payable for securities pending settlement	\$23,595	\$—

See notes to unaudited condensed consolidated financial statements.

DYNEX CAPITAL, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2009

(amounts in thousands except share and per share data)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying unaudited 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 ("GAAP") 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 its taxable REIT subsidiary (together, "Dynex" or the "Company"). All intercompany balances and transactions have been eliminated in consolidation.

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 and six months ended June 30, 2009 are not necessarily indicative of the results that may be expected for the year ending December 31, 2009. Certain information and footnote disclosures normally included in the consolidated financial statements prepared in accordance with GAAP have been omitted. The unaudited condensed consolidated 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, 2008, filed with the Securities and Exchange Commission (the "SEC").

Consolidation of Subsidiaries

The Company consolidates entities in which it owns more than 50% of the voting equity and control does not rest with others and variable interest entities in which it is determined to be the primary beneficiary in accordance with Financial Interpretation No. 46(R) ("FIN 46(R)"). 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.

Federal Income Taxes

The Company believes it has complied with the requirements for qualification as a REIT under the Internal Revenue Code of 1986, as amended (the "Code"). As such, the Company believes that it qualifies as a REIT for federal income tax purposes, and that 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. The Company uses the calendar year for both tax and financial reporting purposes. There may be differences between taxable income and income computed in accordance with GAAP.

Investments

The Company's investments include Agency mortgage backed securities ("MBS"), securitized mortgage loans, investment in joint venture and other investments.

Agency MBS. Agency MBS are MBS issued or guaranteed by a federally chartered corporation, such as Federal National Mortgage Corporation, or Fannie Mae, or Federal Home Loan Mortgage Corporation, or Freddie Mac, or an agency of the U.S. government, such as Government National Mortgage Association, or Ginnie Mae. MBS issued or guaranteed by Fannie Mae, Freddie Mac and Ginnie Mae are commonly referred to as “Agency MBS”. The Company’s Agency MBS are comprised primarily of Hybrid Agency ARMs and Agency ARMs and, to a lesser

extent, fixed-rate Agency MBS. Hybrid Agency ARMs are MBS collateralized by hybrid adjustable rate mortgage loans. Hybrid adjustable rate mortgage loans are loans which have a fixed-rate of interest for a specified period (typically three to ten years) and which then adjust their interest rate at least annually to an increment over a specified interest rate index as further discussed below. Agency ARMs are MBS collateralized by adjustable rate mortgage loans which have interest rates that generally will adjust at least annually to an increment over a specified interest rate index. Agency ARMs also include Hybrid Agency ARMs that are past their fixed-rate periods.

Interest rates on the adjustable rate loans collateralizing the Hybrid Agency ARMs or Agency ARMs are based on specific index rates, such as the one-year constant maturity treasury, or CMT rate, the London Interbank Offered Rate, or LIBOR, the Federal Reserve U.S. 12-month cumulative average one-year CMT, or MTA, or the 11th District Cost of Funds Index, or COFI. These loans will typically have interim and lifetime caps on interest rate adjustments, or interest rate caps, limiting the amount that the rates on these loans may reset in any given period. All of the Company's Agency MBS are classified as available-for-sale, and substantially all of the Company's Agency MBS are pledged as collateral against repurchase agreements.

**Securitized Mortgage Loans.** Securitized mortgage loans consist of loans pledged to support the repayment of securitization financing bonds issued by the Company. Securitized mortgage loans are reported at amortized cost. An allowance has been established for currently existing estimated losses on such loans. Securitized mortgage loans can only be sold subject to the lien of the respective securitization financing indenture.

**Investment in Joint Venture.** The Company accounts for its investment in joint venture using the equity method as it does not exercise control over significant asset decisions such as buying, selling or financing nor is it the primary beneficiary under FIN 46(R). Under the equity method, the Company increases its investment for its proportionate share of net income and contributions to the joint venture and decreases its investment balance by recording its proportionate share of net loss and distributions.

The Company periodically reviews its investment in joint venture for other than temporary declines in market value. Any decline that is not expected to be recovered in the next twelve months is considered other than temporary, and an impairment charge is recorded as a reduction to the carrying value of the investment.

**Other Investments.** Other investments include non-Agency MBS and equity securities, and unsecuritized single-family and commercial mortgage loans. The unsecuritized mortgage loans are carried at amortized cost. Non-Agency MBS and equity securities are considered available-for-sale and are reported at fair value, with unrealized gains and losses excluded from earnings and reported as accumulated other comprehensive income.

Other investments also include real estate owned acquired through, or in lieu of, foreclosure in connection with the servicing of the delinquent tax lien receivables portfolio. Such investments are considered held for sale and are initially recorded at fair value less cost to sell (net realizable value) at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, management periodically performs valuations and adjusts the property to the lower of cost or net realizable value. Revenue and expenses related to and changes in the valuation of the real estate owned are included in other income (expense).

**Interest Income.** Interest income is recognized when earned according to the terms of the underlying investment and when, in the opinion of management, it is collectible. For loans, the accrual of interest is discontinued when, in the opinion of management, the interest is not collectible in the normal course of business, when the loan is significantly past due or when the primary servicer of the loan fails to advance the interest and/or principal due on the loan. For securities and other investments, the accrual of interest is discontinued when, in the opinion of management, it is probable that all amounts contractually due will not be collected. Loans are considered past due when the borrower fails to make a timely payment in accordance with the underlying loan agreement, inclusive of all applicable cure

periods. All interest accrued but not collected for investments that are placed on non-accrual status or are charged-off is reversed against interest income. Interest on these investments is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual status. Investments are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

## Repurchase Agreements

The Company uses repurchase agreements to finance certain of its investments. Under these repurchase agreements, the Company sells the securities to a lender and agrees to repurchase the same securities in the future for a price that is higher than the original sales price. The difference between the sales price that the Company receives and the repurchase price that the Company pays represents interest paid to the lender. Although structured as a sale and repurchase obligation, a repurchase agreement operates as a financing, in accordance with the provision of Statement of Financial Accounting Standards (“SFAS”) No. 140 “Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities” (“SFAS 140”), under which the Company pledges its securities as collateral to secure a loan, which is equal in value to a specified percentage of the estimated fair value of the pledged collateral. The Company retains beneficial ownership of the pledged collateral. At the maturity of a repurchase agreement, the Company is required to repay the loan and concurrently receives back its pledged collateral from the lender or, with the consent of the lender, the Company may renew the agreement at the then prevailing financing rate. A repurchase agreement lender may require the Company to pledge additional collateral in the event the estimated fair value of the existing pledged collateral declines. Repurchase agreement financing is recourse to the Company and the assets pledged. All of the Company’s repurchase agreements are based on the September 1996 version of the Bond Market Association Master Repurchase Agreement.

## Use of Estimates

The preparation of financial statements, in conformity with GAAP, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reported period. Actual results could differ from those estimates. The primary estimates inherent in the accompanying condensed consolidated financial statements are discussed below.

Fair Value, Pursuant to SFAS No. 157, “Fair Value Measurements” (“SFAS 157”), the fair value is the exchange price in an orderly transaction, that is not a forced liquidation or distressed sale, between market participants to sell an asset or transfer a liability in the market in which the reporting entity would transact for the asset or liability, that is, the principal or most advantageous market for the asset or liability. The transaction to sell the asset or transfer the liability is a hypothetical transaction at the measurement date, considered from the perspective of a market participant that holds the asset or liability. SFAS 157 provides a consistent definition of fair value which focuses on exit price and prioritizes, within a measurement of fair value, the use of market-based inputs over entity-specific inputs. In addition, SFAS 157 provides a framework for measuring fair value and establishes a three-level hierarchy for fair value measurements based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date.

The three levels of the valuation hierarchy established by SFAS 157 are as follows:

- Level 1 — Inputs are unadjusted, quoted prices in active markets for identical assets or liabilities at the measurement date. The types of assets and liabilities carried at Level 1 fair value generally are equity securities listed in active markets.
- Level 2 — Inputs (other than quoted prices included in Level 1) are either directly or indirectly observable for the asset or liability through correlation with market data at the measurement date and for the duration of the instrument’s anticipated life. Fair valued assets and liabilities that are generally included in this category are Agency MBS, which are valued based on the average of multiple dealer quotes that are active in the Agency MBS market.
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Level 3 — Inputs reflect management's best estimate of what market participants would use in pricing the asset or liability at the measurement date. Consideration is given to the risk inherent in the valuation technique and the risk inherent in the inputs to the model. Generally, assets and liabilities carried at fair value and included in this category are non-Agency MBS, delinquent property tax receivables and the obligation under payment agreement liability.

Estimates of fair value for financial instruments are based primarily on management's judgment. Since the fair value of the Company's financial instruments is based on estimates, actual fair values recognized may differ from those estimates recorded in the consolidated financial statements.

**Other-than-Temporary Impairments.** The Company evaluates all securities in its investment portfolio for other-than-temporary impairments. A security is generally defined to be impaired if the carrying value of such security exceeds its estimated fair value. Based on the provisions of Financial Accounting Standards Board ("FASB") Staff Position ("FSP") FAS 115-2 and 124-2, "Recognition and Presentation of Other-Than-Temporary Impairments" ("FSP 115-2 and 124-2"), a security is considered to be other-than-temporarily impaired if the present value of cash flows expected to be collected is less than the security's amortized cost basis (the difference being defined as the credit loss) or if the fair value of the security is less than the security's amortized cost basis and the investor intends, or more-likely-than-not will be required, to sell the security before recovery of the security's amortized cost basis. The charge to earnings is limited to the amount of credit loss if the investor does not intend, and it is more-likely-than-not that it will not be required, to sell the security before recovery of the security's amortized cost basis. Any remaining difference between fair value and amortized cost is recognized in other comprehensive income, net of applicable taxes. Otherwise, the entire difference between fair value and amortized cost is charged to earnings. 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. Securities normally are not placed on non-accrual status if the servicer continues to advance on the impaired loans in the security.

**Allowance for Loan Losses.** An allowance for loan losses has been estimated and established for currently existing probable losses for loans in the Company's investment portfolio that are considered impaired. 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 factors differ by loan type (e.g., single-family versus commercial) and collateral type (e.g., multifamily versus office property). 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 loan losses is established and evaluated on a pool basis. Otherwise, the allowance for loan losses is established and evaluated on a loan-specific basis. Provisions made to increase the allowance are charged as a current period expense. Single-family loans are considered impaired when they are 60 days past due. Commercial mortgage loans are evaluated on an individual basis for impairment. Commercial mortgage loans are secured by income-producing real estate and are evaluated for impairment when the debt service coverage ratio on the loan is less than 1:1 or when the loan is delinquent. Certain of the commercial mortgage loans are covered by loan guarantees that limit the Company's exposure on these loans.

Loans secured by low-income housing tax credit properties, with at least twelve months remaining in their tax credit compliance period, account for 46% of the Company's securitized commercial mortgage loan portfolio. Section 42 of the Code provides tax credits to investors in projects to construct or substantially rehabilitate properties that provide housing for qualifying low-income families. Failure to comply with certain income and rental restrictions required by Section 42 or default on a loan financing a Section 42 property during the compliance period can result in the recapture of previously received tax credits. The potential cost of tax credit recapture provides an incentive to the property owner to support the property during the compliance period.

**Amortization of Premiums/Discounts on Agency MBS.** Premiums and discounts on investments and obligations are amortized into interest income or expense, respectively, over the life of the related investment or obligation using the effective yield method in accordance with SFAS No. 91, "Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases."

Recent Accounting Pronouncements

On March 20, 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133" ("SFAS 161"). SFAS 161 provides for enhanced disclosures about how and why an entity uses derivatives and how and where those derivatives and related hedged items are reported in the entity's financial statements. SFAS 161 also requires certain tabular formats for disclosing such information. SFAS 161 is effective for fiscal years and interim periods beginning after November 15, 2008, with

early application encouraged. SFAS 161 applies to all entities and all derivative instruments and related hedged items accounted for under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." Among other things, SFAS 161 requires disclosures of an entity's objectives and strategies for using derivatives by primary underlying risk and certain disclosures about the potential future collateral or cash requirements as a result of contingent credit-related features. The adoption of SFAS 161 did not have an impact on the Company's financial statements.

On February 20, 2008, the FASB issued FSP 140-3, "Accounting for Transfers of Financial Assets and Repurchase Financing Transactions," ("FSP 140-3"), which provides guidance on accounting for transfers of financial assets and repurchase financings. FSP 140-3 presumes that an initial transfer of a financial asset and a repurchase financing are considered part of the same arrangement (i.e., a linked transaction) under SFAS 140. However, if certain criteria, as described in FSP 140-3, are met, the initial transfer and repurchase financing shall not be evaluated as a linked transaction and shall be evaluated separately under SFAS 140. If the linked transaction does not meet the requirements for sale accounting, the linked transaction shall generally be accounted for as a forward contract, as opposed to the current presentation, where the purchased asset and the repurchase liability are reflected separately on the balance sheet. FSP 140-3 is effective on a prospective basis for fiscal years beginning after November 15, 2008. The adoption of FSP 140-3 did not have an impact on the Company's financial statements.

On October 10, 2008, the FASB issued FSP 157-3, "Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active" ("FSP 157-3"). FSP 157-3 clarifies the application of SFAS 157, "Fair Value Measurements" in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. The issuance of FSP 157-3 did not have any impact on the Company's determination of fair value for its financial assets.

In April 2009, the FASB issued FSP 107-1 and APB 28-1, "Interim Disclosures about Fair Value of Financial Instruments" ("FSP 107-1 and APB 28-1") which amends disclosures about fair value of financial instruments. The FSP requires a public entity to provide disclosures about fair value of financial instruments in interim financial information. The Company elected to adopt the provisions of FSP 107-1 and APB 28-1 during the first quarter of 2009 and has included the required disclosures in its notes to unaudited condensed consolidated financial statements.

In April 2009, the FASB issued FSP 115-2 and 124-2 which clarifies other-than-temporary impairment. FSP 115-2 and 124-2 (i) changes existing guidance for determining whether an impairment of a debt security is other than temporary and (ii) replaces the existing requirement that the entity's management assert it has both the intent and ability to hold an impaired security until recovery with a requirement that management assert: (a) it does not have the intent to sell the security; and (b) it is more likely than not it will not have to sell the security before recovery of its cost basis. Under FSP 115-2 and 124-2 declines in the fair value of held-to-maturity and available-for-sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses to the extent the impairment is related to credit losses. The amount of impairment related to other factors is recognized in other comprehensive income. The Company adopted FSP 115-2 and 124-2 during the first quarter of 2009. The adoption of FSP 115-2 and 124-2 did not have a significant impact on the Company's financial statements.

In April 2009, the FASB issued FSP FAS 157-4, "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly" ("FSP 157-4") which clarifies the application of fair value accounting. FSP 157-4 affirms the objective of fair value when a market is not active, clarifies and includes additional factors for determining whether there has been a significant decrease in market activity, eliminates the presumption that all transactions are distressed unless proven otherwise, and requires an entity to disclose a change in valuation technique. The Company adopted FSP 157-4 during the first quarter of 2009. The adoption of FSP 157-4 did not have a significant impact on the Company's financial statements.

In May 2009, the FASB issued SFAS No. 165, "Subsequent Events" ("SFAS 165"). SFAS 165 establishes standards under which an entity shall recognize and disclose events that occur after a balance sheet date but before the related financial statements are issued or are available to be issued. SFAS 165 is effective for fiscal years and interim

periods ending after June 15, 2009. The Company's adoption of SFAS 165 on June 30, 2009 had no impact on the Company's consolidated financial position or results of operations.

In June 2009, the FASB issued SFAS No. 166, "Accounting for Transfers of Financial Assets - an amendment of FASB Statement No. 140" ("SFAS 166"). SFAS 166 amends SFAS 140 to improve the relevance and comparability of the information that a reporting entity provides in its financial statements about a transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows; and the transferor's continuing involvement, if any, in transferred financial assets. SFAS 166 is effective for interim and annual reporting periods that begin after November 15, 2009. The Company is currently assessing the impact, if any, that the adoption of SFAS 166 may have on its consolidated financial position and results of operations.

In June 2009, the FASB issued SFAS No. 167, "Amendments to FASB Interpretation No. 46(R)" ("SFAS 167"). SFAS 167 significantly changes the criteria for determining whether the consolidation of a variable interest entity is required. SFAS 167 also addresses the effect of changes required by SFAS 166 on FASB Interpretation No. 46(R), "Consolidation of Variable Interest Entities" ("FIN 46(R)") and concerns regarding the application of certain provisions of FIN 46(R), including concerns that the accounting and disclosures under FIN 46(R) do not always provide timely and useful information about an entity's involvement in a variable interest entity. SFAS 167 is effective for interim and annual reporting periods that begin after November 15, 2009. The Company is currently assessing the impact, if any, that the adoption of SFAS 167 may have on its consolidated financial position and results of operations.

In June 2009, the FASB also issued SFAS No. 168, "The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles - a replacement of FASB Statement No. 162" ("SFAS 168"). Upon the effective date of SFAS 168, the codification will become the sole source of authoritative GAAP recognized by the FASB. SFAS 168 is effective for fiscal years and interim periods ending after September 15, 2009. Adoption of SFAS 168 as of September 30, 2009 is not expected to have a material impact on the Company's consolidated financial position or results of operations as it does not alter existing GAAP.

#### NOTE 2 – NET INCOME PER COMMON SHARE

Net income per common share is presented on both a basic and diluted basis. Diluted net income per common share assumes the conversion of the convertible preferred stock into common stock, using the two-class method, and stock options, using the treasury stock method, but only if these items are dilutive. Each share of Series D preferred stock is convertible into one share of common stock. The following tables reconcile the numerator and denominator for both basic and diluted net income per common share for the three and six months ended June 30, 2009 and 2008.

	Three Months Ended June 30,		2008	
	2009	Weighted-Average Common Shares	Income	Weighted-Average Common Shares
Net income	\$4,370		\$4,296	
Preferred stock dividends	(1,003 )		(1,003 )	
Net income to common shareholders	3,367	12,987,784	3,293	12,169,762
Effect of dilutive items	1,003	4,222,001	1,003	4,228,905
Diluted	\$4,370	17,209,785	\$4,296	16,398,667

## Net income per common share:

Basic	\$ 0.26	\$0.27
Diluted	\$ 0.25	\$0.26

## Reconciliation of shares included in calculation of income per common share due to dilutive effect:

## Net effect of dilutive:

Convertible preferred stock	\$1,003	4,221,539	\$1,003	4,221,539
Stock options	—	462	—	7,366
	\$1,003	4,222,001	\$1,003	4,228,905

	Six Months Ended June 30,		2008	
	2009	Weighted-Average Common Shares	Income	Weighted-Average Common Shares
Net income	\$ 7,503		\$ 9,615	
Preferred stock dividends	(2,005 )		(2,005 )	
Net income to common shareholders	5,498	12,581,033	7,610	12,163,320
Effect of dilutive items	—	—	2,005	4,229,464
Diluted	\$ 5,498	12,581,033	\$ 9,615	16,392,784

## Net income common per share:

Basic	\$ 0.44	\$ 0.63
Diluted	\$ 0.44	\$ 0.59

## Reconciliation of shares included in calculation of income per common share due to dilutive effect:

## Net effect of dilutive:

Convertible preferred stock	\$ —	—	\$ 2,005	4,221,539
Stock options	—	—	—	7,925
	\$ —	—	\$ 2,005	4,229,464





The following securities were excluded from the calculation of diluted income per common share, as their inclusion would be anti-dilutive:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Shares issuable under stock option awards	70,000	50,000	95,000	50,000
Convertible preferred stock	–	–	4,221,539	–

### NOTE 3 – AGENCY MORTGAGE-BACKED SECURITIES

The following table presents the components of the Company's investment in Agency MBS as of June 30, 2009 and December 31, 2008:

	June 30, 2009	December 31, 2008
Principal/par value	\$512,882	\$307,548
Purchase premiums	10,524	3,585
Purchase discounts	(50 )	(59 )
Amortized cost	523,356	311,074
Gross unrealized gains	8,452	1,355
Gross unrealized losses	(262 )	(853 )
Fair value	\$531,546	\$311,576
Weighted average coupon	5.04 %	5.06 %
Weighted average months to reset	25	21

Principal/par value includes principal payments receivable on Agency MBS of \$2,510 and \$956 as of June 30, 2009 and December 31, 2008, respectively. Agency MBS fair value in the table above includes \$23,514 of securities that will settle in July 2009. The Company has recorded a liability of \$23,595 in payable for securities pending settlement in the accompanying unaudited condensed consolidated balance sheets for these securities, which includes the accrued interest the Company will have to pay on settlement.

The Company's investment in Agency MBS, including principal receivable on the securities, is comprised of \$364,166 of Hybrid Agency ARMs, \$167,233 of Agency ARMs and \$147 of fixed-rate Agency MBS.

The Company received principal payments of \$48,993 on its portfolio of Agency MBS and purchased approximately \$261,002 of Agency MBS during the six-month period ended June 30, 2009. The purchases were financed with repurchase agreements and the Company's equity capital.

## NOTE 4 – SECURITIZED MORTGAGE LOANS, NET

The following table summarizes the components of securitized mortgage loans at June 30, 2009 and December 31, 2008:

	June 30, 2009	December 31, 2008
Securitized mortgage loans:		
Commercial mortgage loans	\$157,320	\$164,032
Single-family mortgage loans	66,131	70,607
	223,451	234,639
Funds held by trustees, including funds held for defeasance	12,015	11,267
Accrued interest receivable	1,465	1,538
Unamortized discounts and premiums, net	378	90
Other	(174 )	–
Loans, at amortized cost	237,135	247,534
Allowance for loan losses	(3,921 )	(3,707 )
	\$233,214	\$243,827

All of the securitized mortgage loans are encumbered by securitization financing bonds (see Note 9). The Company identified \$23,658 of securitized commercial mortgage loans and \$3,410 of securitized single-family mortgage loans as being impaired at June 30, 2009. For loans that were impaired at June 30, 2009, the Company recognized \$414 and \$869 of interest income on impaired securitized commercial mortgage loans and \$103 and \$210 on impaired single-family mortgage loans for the three-month and six-month periods ended June 30, 2009, respectively.

## NOTE 5 – ALLOWANCE FOR LOAN LOSSES

The allowance for loan losses is included in securitized mortgage loans, net in the accompanying unaudited condensed consolidated balance sheets. The following table summarizes the aggregate activity for the allowance for loan losses for the three-month and six-month periods ended June 30, 2009 and 2008:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Allowance at beginning of period	\$3,782	\$2,745	\$3,707	\$2,721
Provision for loan losses	234	321	318	347
Charge-offs, net of recoveries	–	–	(9 )	(2 )
Allowance at end of period	\$4,016	\$3,066	\$4,016	\$3,066

The following table presents the components of the allowance for loan losses at June 30, 2009 and December 31, 2008:

	June 30, 2009	December 31, 2008
Securitized commercial mortgage loans	\$3,660	\$3,527
Securitized single-family mortgage loans	261	180
	3,921	3,707

Other mortgage loans	95	—
	\$4,016	\$3,707

The following table presents certain information on impaired commercial mortgage loans at December 31, 2008 and June 30, 2009:

	Investment in Impaired Loans	Allowance for Loan Losses	Investment in Excess of Allowance
December 31, 2008	\$24,022	\$3,527	\$20,495
June 30, 2009	\$23,658	\$3,655	\$20,003

#### NOTE 6 — INVESTMENT IN JOINT VENTURE

The Company, through a wholly-owned subsidiary, holds a 49.875% interest in a joint venture. The Company accounts for its investment in the joint venture using the equity method, under which it recognizes its proportionate share of the joint venture's earnings or loss and changes in accumulated other comprehensive income or loss.

The joint venture owns interests in commercial mortgage backed securities ("CMBS") and an investment in a payment agreement from the Company (see Note 10). Under the payment agreement, amounts received by the Company on certain securitized mortgage loans after payment on the associated securitization financing bonds outstanding are paid to the joint venture. During the three and six months ended June 30, 2009, the joint venture received \$400 and \$801 of payments under this payment agreement.

The joint venture's investments at June 30, 2009 were comprised of available-for-sale subordinate CMBS with an estimated fair value of \$2,446 and a financial instrument backed by commercial mortgage loans accounted for under SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS 159") with a fair value of \$8,555. See Note 11.

The Company recorded equity in the income of the joint venture of \$610 and a decrease of \$81 for its share in the accumulated other comprehensive loss of the joint venture for the three months ended June 30, 2009 resulting from the joint venture's ownership of CMBS. The Company recorded equity in the loss of the joint venture of \$144, which includes \$60 of amortization expense, and a decrease of \$597 for its share in the accumulated other comprehensive loss of the joint venture for the six months ended June 30, 2009.

The following tables present the condensed results of operations for the joint venture for the three and six months ended June 30, 2009 and 2008 and the financial condition as of June 30, 2009 and December 31, 2008 of the joint venture.

#### Condensed Statements of Operations

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Interest income	\$613	\$1,135	\$1,248	\$2,489
Fair value adjustment	584	418	21	(4,261 )
Other-than-temporary impairment	—	(240 )	(1,417 )	(1,204 )
Other income (expense)	27	(10 )	(20 )	(52 )
Net income (loss)	\$1,224	\$1,303	\$(168 )	\$(3,030 )

Condensed Balance Sheets

	June 30, 2009	December 31, 2008
Total assets	\$12,272	\$11,240
Total liabilities	\$24	\$21
Total members' capital	\$12,248	\$11,219

The other-than-temporary impairment of \$1,417 during the six months ended June 30, 2009 is related to the joint venture's investment in subordinate CMBS.

#### NOTE 7 – OTHER INVESTMENTS

The following table summarizes the Company's other investments at June 30, 2009 and December 31, 2008:

	June 30, 2009			December 31, 2008	
	Carrying Value	Weighted Average Yield		Carrying Value	Weighted Average Yield
Non-Agency MBS	\$ 6,697	7.98 %	\$	6,959	8.02 %
Equity securities of publicly traded companies	–			3,441	
	6,697			10,400	
Gross unrealized gains	372			802	
Gross unrealized losses	(1,256 )			(1,335 )	
	5,813			9,867	
Other mortgage loans, net	2,328			2,657	
Other	157			211	
	\$ 8,298		\$	12,735	

Non-Agency MBS consist principally of fixed-rate securities collateralized by single-family residential loans originated in 1994.

The Company sold approximately \$3,443 of equity securities during the six months ended June 30, 2009 on which it recognized a gain of \$221.

Other mortgage loans are comprised principally of unsecuritized mortgage loans originated predominately between 1986 and 1997. Of the approximately 28 mortgage loans that make up the balance, two loans were 60 days or more delinquent as of June 30, 2009, representing approximately 19% of the outstanding unpaid principal balance of the loans. An allowance for loan losses of \$95 was provided for these loans during the six months ended June 30, 2009.

#### NOTE 8 – REPURCHASE AGREEMENTS

The Company uses repurchase agreements, which are recourse to the Company, to finance certain of its investments. The following tables present the components of the Company's repurchase agreements by the type of securities collateralizing the repurchase agreement at June 30, 2009 and December 31, 2008, respectively.

		June 30, 2009		
Collateral Type	Balance	Weighted Average Rate		Fair Value of Collateral
Agency MBS	\$443,051	0.55 %		\$476,526
Securitization financing bonds (See Note 9)	29,481	2.13 %		42,212
	\$472,532	0.64 %		\$518,738

December 31, 2008

Collateral Type	Balance	Weighted Average Rate	Fair Value of Collateral
Agency MBS	\$274,217	2.70	% \$300,277
Securitization financing bonds	—	—	—
	\$274,217	2.70	% \$300,277

At June 30, 2009 and December 31, 2008, the repurchase agreements had the following maturities:

Original Maturity	June 30, 2009	December 31, 2008
30 days or less	\$459,357	\$38,617
31 to 60 days	13,175	187,960
61 to 90 days	–	47,640
	\$472,532	\$274,217

#### NOTE 9 – SECURITIZATION FINANCING

The Company, 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 and having varying repayment terms. The Company, on occasion, may retain bonds or redeem bonds and hold such bonds outstanding for possible future resale or reissuance. Payments received on securitized mortgage loans and any reinvestment income earned thereon are used to make payments on the bonds.

The obligations under the securitization financings are payable solely from the securitized mortgage loans and are otherwise non-recourse to the Company. 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 the Company'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.

The Company has three series of bonds remaining outstanding pursuant to three separate indentures. One series with a principal amount of \$26,173 is collateralized by \$66,131 in single-family mortgage loans. The two remaining series with principal amounts of \$306 and \$127,933, respectively, are collateralized by commercial mortgage loans with unpaid principal balances at June 30, 2009 of \$20,358 and \$136,962, respectively.

In May 2009, the Company redeemed a securitization financing bond collateralized by commercial mortgage loans at its then par value of \$15,493 and financed the redemption with an \$11,039 repurchase agreement. Because the redeemed bond is held by a subsidiary of the Company that is distinct from the bond's issuer, to which the bonds are a liability, the bond is eliminated in the consolidated financial statements but remains legally outstanding. The Company has the right to redeem the one remaining bond, with a par value of \$306, outstanding in this series but does not currently have any plans to call this bond. The Company also owns one securitization bond with a par value of \$32,687, which is rated "AAA" by two of the nationally recognized rating agencies. The bond, which is collateralized by single-family mortgage loans, was issued by the Company in 2002 and was redeemed in 2004. This bond is pledged as collateral to support repurchase agreement borrowings.



The components of securitization financing along with certain other information at June 30, 2009 and December 31, 2008 are summarized as follows:

	June 30, 2009		December 31, 2008	
	Bonds Outstanding	Range of Interest Rates	Bonds Outstanding	Range of Interest Rates
		6.7% -		6.6% -
Fixed-rate classes	\$ 128,239	8.8 %	\$ 149,598	8.8 %
Variable-rate classes	26,172	0.6 %	28,186	1.7 %
Accrued interest payable	883		1,008	
Unamortized net bond premium and deferred costs	(826 )		(627 )	
	\$ 154,468		\$ 178,165	
Range of stated maturities	2024-2027		2024-2027	
Estimated weighted average life	2.4 years		2.6 years	
Number of series	3		3	

At June 30, 2009, the weighted-average coupon on the bonds outstanding was 6.9%. The average effective rate on the bonds was 6.5% and 6.1% for the six months ended June 30, 2009 and the year ended December 31, 2008, respectively. The variable-rate bonds pay interest based on one-month LIBOR plus 30 basis points.

#### NOTE 10 – OBLIGATION UNDER PAYMENT AGREEMENT

Obligation under payment agreement represents the fair value of estimated future payments due to the joint venture discussed in Note 6. The amounts due under the payment agreement are based on the amounts received monthly by the Company on certain securitized mortgage loans with an unpaid principal balance, including defeased loans, of \$148,828 at June 30, 2009, after payment of the associated securitization financing bonds outstanding with an unpaid principal balance of \$127,933 at June 30, 2009. The present value of the payment agreement was determined based on the total estimated future payments discounted at a weighted average rate of 37.8%. The discount rate was derived from the implied spread to similar maturity interest rate swaps using the price quoted for the lowest rated tranche of CMBX.1 from the CMBX index managed by Markit. The Markit CMBX index is a synthetic tradeable index referencing a basket of 25 commercial mortgage-backed securities. Factors which significantly impact the valuation of the payment agreement include the credit performance of the underlying securitized mortgage loans, estimated prepayments on the loans and the weighted average discount rate used on the cash flows. The significant assumptions used in calculating the estimated fair value of the obligation under payment agreement are presented in the following table with their respective values as of June 30, 2009 and December 31, 2008.

	June 30, 2009		December 31, 2008	
Discount rate	37.8	%	36.5	%
Annual loss rate	2.0	%	0.8	%
Prepayment speed (CPR)	0.0	%(1)	0.0	%(1)

(1) Although no prepayments are modeled, the estimated cash flows assume the loans underlying the obligation prepay on the expiration of their lockout period, which is before their scheduled maturity.

The Company made payments to the joint venture of \$400 and \$801 for the three-month and six-month periods ended June 30, 2009, respectively, and \$403 and \$804, respectively, for the same periods in 2008 under the payment agreement. All of these payments were recorded as interest expense in the condensed financial statements.

#### NOTE 11 – FAIR VALUE MEASUREMENTS

Pursuant to SFAS No. 157, “Fair Value Measurements”, fair value is the exchange price in an orderly transaction, that is not a forced liquidation or distressed sale, between market participants to sell an asset or transfer a liability in the market in which the reporting entity would transact for the asset or liability, that is, the principal or most

advantageous market for the asset or liability. The transaction to sell the asset or transfer the liability is a hypothetical transaction at the measurement date, considered from the perspective of a market participant that holds the asset or liability. SFAS 157 provides a consistent definition of fair value which focuses on exit price and prioritizes, within a measurement of fair value, the use of market-based inputs over entity-specific inputs. In addition, SFAS 157 provides a framework for measuring fair value and establishes a three-level hierarchy for fair value measurements based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date.

The three levels of the valuation hierarchy established by SFAS 157 are as follows:

Level 1 — Inputs are unadjusted, quoted prices in active markets for identical assets or liabilities at the measurement date. The types of assets and liabilities carried at Level 1 fair value generally are equity securities listed in active markets.

Level 2 — Inputs (other than quoted prices included in Level 1) are either directly or indirectly observable for the asset or liability through correlation with market data at the measurement date and for the duration of the instrument's anticipated life. Fair valued assets and liabilities that are generally included in this category are Agency MBS, which are valued based on the average of multiple dealer quotes and an independent pricing service that are active in the Agency MBS market.

Level 3 — Inputs reflect management's best estimate of what market participants would use in pricing the asset or liability at the measurement date. Consideration is given to the risk inherent in the valuation technique and the risk inherent in the inputs to the model. Examples of assets and liabilities carried at fair value and included in this category are non-Agency MBS and the obligation under payment agreement liability.

The following table presents the Company's assets and liabilities at June 30, 2009, which are carried at fair value, segregated by the hierarchy level of the fair value estimate:

	Fair Value	Fair Value Measurements		
		Level 1	Level 2	Level 3
<b>Assets:</b>				
Agency MBS	\$ 531,546	\$ —	\$ 531,546	\$ —
Non-Agency MBS	5,813	—	—	5,813
Other	158	—	—	158
Total assets carried at fair value	\$ 537,517	\$ —	\$ 531,546	\$ 5,971
<b>Liabilities:</b>				
Obligation under payment agreement	\$ 8,555	\$ —	\$ —	\$ 8,555
Total liabilities carried at fair value	\$ 8,555	\$ —	\$ —	\$ 8,555

The following tables present the reconciliations of the beginning and ending balances of the Level 3 fair value estimates for the three-month and six-month periods ended June 30, 2009:

## Level 3 Fair Values

	Non-Agency MBS	Other	Total assets	Obligation under payment agreement
Balance at March 31, 2009	\$ 6,070	\$ 168	\$ 6,238	\$ (7,971 )
Total realized and unrealized gains (losses)				
Included in earnings	—	—	—	(584 )
Included in other comprehensive income (loss)	(124 )	(7 )	(131 )	—
Purchases, sales, issuances and other settlements, net	(133 )	(3 )	(136 )	—
Transfers in and/or out of Level 3	—	—	—	—
Balance at June 30, 2009	\$ 5,813	\$ 158	\$ 5,971	\$ (8,555 )

## Level 3 Fair Values

	Non-Agency MBS	Other	Total assets	Obligation under payment agreement
Balance at December 31, 2008	\$ 6,259	\$ 211	\$ 6,470	\$ (8,534 )
Total realized and unrealized gains (losses)				
Included in earnings	—	1	1	(21 )
Included in other comprehensive income (loss)	(184 )	(17 )	(201 )	—
Purchases, sales, issuances and other settlements, net	(262 )	(37 )	(299 )	—
Transfers in and/or out of Level 3	—	—	—	—
Balance at June 30, 2009	\$ 5,813	\$ 158	\$ 5,971	\$ (8,555 )

There were no assets or liabilities which were measured at fair value on a non-recurring basis during the three or six months ended June 30, 2009.

SFAS No. 107, "Disclosures about Fair Value of Financial Instruments" requires the disclosure of the estimated fair value of financial instruments. The following table presents the recorded basis and estimated fair values of the Company's financial instruments as of June 30, 2009 and December 31, 2008:

	June 30, 2009		December 31, 2008	
	Recorded Basis	Fair Value	Recorded Basis	Fair Value
Assets:				
Agency MBS	\$531,546	\$531,546	\$311,576	\$311,576
Securitized mortgage loans, net	233,214	193,946	243,827	201,252
Investment in joint venture	6,109	6,109	5,655	5,595
Other investments	8,298	8,054	12,735	12,358
Liabilities:				
Repurchase agreements	472,532	472,532	274,217	274,217

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Securitization financing	154,468	132,540	178,165	153,370
Payable for securities pending settlement	23,595	23,595	–	–
Obligation under payment agreement	8,555	8,555	8,534	8,534

## NOTE 12 – PREFERRED AND COMMON STOCK

The following table presents the preferred and common dividends declared from January 1, 2009 through June 30, 2009:

Declaration Date	Record Date	Payment Date	Dividend per Share	
			Common	Preferred
<b>Common Stock</b>				
March 20, 2009	March 31, 2009	April 30, 2009	0.23	–
June 16, 2009	June 30, 2009	July 31, 2009	0.23	–
<b>Preferred Stock</b>				
March 20, 2009	March 31, 2009	April 30, 2009	–	0.2375
June 16, 2009	June 30, 2009	July 31, 2009	–	0.2375

## Shelf Registration

On February 29, 2008, the Company filed a shelf registration statement on Form S-3, which became effective on April 17, 2008. The shelf registration permits the Company to sell up to \$1.0 billion of securities, including common stock, preferred stock, debt securities and warrants.

## Controlled Equity Offering Program

The Company initiated a controlled equity offering program (“CEOP”) on March 16, 2009 by filing a prospectus supplement under its shelf registration. The CEOP allows the Company to offer and sell, from time to time through Cantor Fitzgerald & Co. (“Cantor”) as agent, up to 3,000,000 shares of its common stock in negotiated transactions or transactions that are deemed to be “at the market offerings”, as defined in Rule 415 under the Securities Act of 1933, as amended, including sales made directly on the New York Stock Exchange or sales made to or through a market maker other than on an exchange.

During the six months ended June 30, 2009, the Company sold 990,000 shares of its common stock through the CEOP at an average price of \$6.90 per share, for which it received proceeds of \$6,658, net of \$175 in sales commission paid to Cantor. After this transaction, 2,010,000 shares of the Company’s common stock remain available for offer and sale under the CEOP.

Subsequent to June 30, 2009, in July 2009 the Company sold 402,250 shares of its common stock under the CEOP at an average price of \$8.27. The Company received \$3,226, which is net of \$100 of sales commissions, from the sale.

The following table presents the changes in the number of preferred and common shares outstanding:

	Shares	
	Preferred Series D	Common
December 31, 2008	4,221,539	12,169,762
Issuance of shares under the CEOP	-	990,000
Restricted shares granted (See Note 14)	-	10,000
June 30, 2009	4,221,539	13,169,762

NOTE 13 – COMMITMENTS AND CONTINGENCIES

The Company and its subsidiaries may be involved in certain litigation matters arising in the ordinary course of business from time to time. Although the ultimate outcome of these matters cannot be ascertained at this time, and the results of legal proceedings cannot be predicted with certainty, the Company believes, based on current

knowledge, that the resolution of these matters will not have a material adverse effect on the Company's financial position or results of operations.

Information on litigation arising out of the ordinary course of business is described below.

As noted in prior filings, one of the Company's subsidiaries, GLS Capital, Inc. ("GLS"), and the County of Allegheny, Pennsylvania 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"). Class action status has been certified in this matter, but a motion to reconsider is pending. In June 2009, the Court of Common Pleas held a hearing on the status of the legal claims of the plaintiffs primarily as a result of an opinion issued in August 2008 by the Pennsylvania Supreme Court in unrelated litigation which addressed many of the claims in this matter and which opinion was favorable to GLS relative to claims being made by the plaintiffs. As a result of that hearing, the Court of Common Pleas invited GLS to file a motion for summary judgment and scheduled argument on such motion for November 2009. The plaintiffs have not enumerated their damages in this matter, and the Company believes that the ultimate outcome of this litigation will not have a material impact on its financial condition, but may have a material impact on its reported results for a given year or period.

Dynex Capital, Inc. and Dynex Commercial, Inc. ("DCI"), a former affiliate of the Company 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 DCI et al. as previously discussed by the Company in prior filings. There has been no material change in this litigation since the Company's Annual Report on Form 10-K for the year ended December 31, 2008 filed on March 16, 2009.

Dynex Capital, Inc. and MERIT Securities Corporation, a subsidiary ("MERIT"), 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"), as previously discussed in prior filings. There has been no material change in this litigation since the Company's Annual Report on Form 10-K for the year ended December 31, 2008 filed on March 16, 2009.

Although no assurance can be given with respect to the ultimate outcome of these matters, the Company believes the resolution of these matters will not have a material effect on its financial condition but could materially affect its reported results for a given year or period.

#### NOTE 14 – STOCK BASED COMPENSATION

Pursuant to the Company's 2009 Stock and Incentive Plan, as approved by the shareholders at the Company's 2009 annual shareholders' meeting (the "2009 Stock and Incentive Plan"), the Company may grant to eligible employees, directors or consultants or advisors to the Company stock based compensation, including options, stock appreciation rights ("SARs"), stock awards, dividend equivalent rights, performance shares, and stock units. A total of 2,500,000 shares of common stock is available for issuance pursuant to the 2009 Stock and Incentive Plan.

The Company also has a 2004 Stock Incentive Plan, as approved by the Company's shareholders at its 2005 annual shareholders' meeting (the "2004 Stock Incentive Plan") under which it made awards to its employees and directors prior to 2009. The 2004 Stock Incentive Plan covers only those awards made prior to 2009, and no new awards will be made under this plan.

On May 15, 2009, the Company granted 10,000 shares of restricted stock to its non-employee directors under the 2009 Stock and Incentive Plan. The awards vest, subject to exceptions for death, disability or retirement, on May 14,



2010. Any directors that separate from the board prior to vesting forfeit their restricted stock. The fair value of the restricted stock on the grant date was \$7.47 per share for a total deferred compensation cost of \$75, which will be recognized in expense evenly over the vesting period.

The following table presents a summary of the activity for the SARs issued by the Company for the following periods:

	Three Months Ended June 30, 2009		Six Months Ended June 30, 2009	
	Number of Shares	Weighted-Average Exercise Price	Number of Shares	Weighted- Average Exercise Price
SARs outstanding at beginning of period	278,146	\$ 7.27	278,146	\$7.27
SARs granted	—	—	—	—
SARs forfeited or redeemed	—	—	—	—
SARs exercised	—	—	—	—
SARs outstanding at end of period	278,146	\$ 7.27	278,146	\$7.27
SARs vested and exercisable	219,396	\$ 7.37	219,396	\$7.37

The following table presents a summary of the activity for the options issued by the Company for the following periods:

	Three Months Ended June 30, 2009		Six Months Ended June 30, 2009	
	Number of Shares	Weighted-Average Exercise Price	Number of Shares	Weighted- Average Exercise Price
Options outstanding at beginning of period	110,000	\$ 8.55	110,000	\$8.55
Options granted	—	—	—	—
Options forfeited or redeemed	(15,000 )	8.30	(15,000 )	8.30
Options exercised	—	—	—	—
Options outstanding at end of period	95,000	\$ 8.59	95,000	\$8.59
Options vested and exercisable	95,000	\$ 8.59	95,000	\$8.59

The following table presents a summary of activity for the restricted stock issued by the Company for the following periods:

	Number of Shares	
	Three Months Ended June 30, 2009	Six Months Ended June 30, 2009
Restricted stock at beginning of period	22,500	30,000
Restricted stock granted	10,000	10,000
Restricted stock forfeited or redeemed	—	—
Restricted stock vested	—	(7,500 )
Restricted stock outstanding at end of period	32,500	32,500

The Company recognized a stock based compensation expense of \$255 and \$303 for the three and six months ended June 30, 2009, respectively, and a stock based compensation benefit of \$110 and \$193 for the three and six months

ended June 30, 2008, respectively. The total compensation cost related to non-vested awards was \$63 and \$113 at June 30, 2009 and 2008, respectively, and will be recognized as the awards vest.

As required by SFAS No. 123(R) "Share-Based Payment", stock options, which may be settled only in shares of common stock, have been treated as equity awards, with their fair value measured at the grant date, and SARs, which

may be settled only in cash, have been treated as liability awards, with their fair value measured at the grant date and remeasured at the end of each reporting period. The fair value of SARs was estimated at June 30, 2009 using the Black-Scholes option valuation model based upon the assumptions in the table below.

The following table describes the assumptions used in calculating the fair value of SARs outstanding at June 30, 2009.

	SARs Fair Value June 30, 2009
Expected volatility	24.17% - 31.47%
Weighted-average volatility	29.17%
Expected dividend yield	10.92% - 11.17%
Expected term (in months)	38
Risk-free rate	1.84%

## NOTE 15 – SUBSEQUENT EVENTS

The Company evaluated subsequent events through August 11, 2009, which is the date on which the Company issued its unaudited condensed consolidated financial statements.

The Company sold 402,250 shares of its common stock, during the period from June 30, 2009 to August 11, 2009, under its CEOP, as described in Note 12. The shares were sold at an average price of \$8.27 per share and generated net proceeds of approximately \$3,226, which is net of the sales commissions paid to Cantor.

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

The following discussion and analysis is provided to increase understanding of, and should be read in conjunction with, our condensed consolidated financial statements and accompanying notes included in this Quarterly Report on Form 10-Q and our Annual Report on Form 10-K for the year ended December 31, 2008. In addition to current and historical information, the following discussion and analysis contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements relate to our future business, financial condition or results of operations. For a description of certain factors that may have a significant impact on our future business, financial condition or results of operations, see “Forward-Looking Statements” at the end of this discussion and analysis.

## EXECUTIVE OVERVIEW

We are a specialty finance company organized as a real estate investment trust, or REIT, which invests in mortgage loans and securities on a leveraged basis. We invest in residential mortgage-backed securities, or MBS, issued or guaranteed by a federally chartered corporation, such as Federal National Mortgage Corporation, or Fannie Mae, or Federal Home Loan Mortgage Corporation, or Freddie Mac, or an agency of the U.S. government, such as Government National Mortgage Association, or Ginnie Mae. MBS issued or guaranteed by Fannie Mae, Freddie Mac and Ginnie Mae are commonly referred to as “Agency MBS”.

We have also invested in securitized single-family residential and commercial mortgage loans, non-Agency mortgage-backed securities, or non-Agency MBS, and, through a joint venture, commercial mortgage-backed securities ("CMBS"). Substantially all of these loans and securities, including those owned by the joint venture, consist of, or are secured by, first lien mortgages which were originated by us from 1992 to 1998. We are no longer originating loans.

Our primary investment activity for 2009 has been in Agency MBS, with approximately 68% of our investment portfolio as of June 30, 2009 invested in Agency MBS compared to 54% as of December 31, 2008. We have focused our investment strategy on Agency MBS as a result of attractive opportunities to invest in shorter-duration Agency MBS at reasonable prices and excellent spreads to financing costs. Our continued investment in Agency MBS is predicated on an evaluation of the risk adjusted returns available on Agency MBS compared to the risk adjusted returns on other uses of our capital. We may also invest in non-Agency MBS or CMBS depending on the nature and risks of the investment, its expected return and future economic and market conditions. Where economically beneficial to us, we may also invest additional capital in our securitized mortgage loan pools by purchasing, tendering for or redeeming the associated securitization financing in whole or in part. Our strategic decision regarding the allocation of capital to Agency MBS, non-Agency MBS, CMBS or loans is based on a number of factors including, but not limited to, current market conditions, the liquidity of the investment, expected returns and anticipated risks. Our investment activities are covered by an investment policy which has been approved by our board of directors. A discussion of the risks associated with our investment portfolio is provided below in Item 3. Quantitative and Qualitative Disclosures About Market Risk.

We have generally financed our investments through a combination of repurchase agreements, securitization financing, and equity capital. We employ leverage in order to increase the overall yield on our invested capital. Our primary source of income is net interest income, which is the excess of the interest income earned on our investments over the cost of financing these investments. We may occasionally sell investments prior to their maturity although our intention is generally to hold our investments on a long-term basis.

As a REIT, we are required to distribute to our shareholders as dividends at least 90% of our taxable income, which is our income as calculated for income tax purposes after consideration of our tax net operating loss carryforwards ("NOLs"). We may be able to manage our distribution requirements through the use of our NOLs, which were approximately \$150 million at December 31, 2008, to offset, partially or in total, our distribution requirements. Our use of NOLs to offset income distribution requirements will be tempered by our desire to continue to pay a reasonable dividend to our shareholders.

At June 30, 2009, we had total investments of approximately \$779.2 million. Our investments consisted of \$531.5 million of Agency MBS, \$67.3 million of securitized single-family residential mortgage loans and \$165.9 million of securitized commercial mortgage loans. We have a \$6.1 million investment in a joint venture which owns subordinate CMBS and cash. We also had \$5.8 million in non-Agency MBS and \$2.3 million of whole loans.

The Agency MBS is pledged as collateral to support \$443.1 million in repurchase agreement financing and the securitized single-family and commercial mortgage loans are pledged to support \$154.5 million in securitization financing. A securitization financing bond backed by single-family loans is pledged to support a \$18.5 million repurchase agreement financing. A securitization financing bond backed by multi-family commercial loans is pledged to support a \$11.0 million repurchase agreement financing. A further discussion of our investments and financing activity is included under "Financial Condition" below.

With respect to our investment in Agency MBS, we invest in Hybrid Agency ARMs and Agency ARMs and, to a lesser extent, fixed-rate Agency MBS. Hybrid Agency ARMs are MBS collateralized by hybrid adjustable mortgage loans, which have a fixed-rate of interest for a specified period (typically three to ten years) and which then reset their

interest rates at least annually to an increment over a specified interest rate index. Agency ARMs are MBS collateralized by adjustable rate mortgage loans which have interest rates that generally will adjust at least annually to an increment over a specified interest rate index. Agency ARMs may be collateralized by Hybrid Agency ARMs that are past their fixed-rate periods. At June 30, 2009, we had approximately \$364.3 million in Hybrid Agency ARMs, approximately \$167.2 million in Agency ARMs and \$0.1 million of fixed-rate Agency MBS.

The joint venture in which we invest owns the right to call certain CMBS at their current unpaid principal balance. Such CMBS had an outstanding balance of \$182.4 million at June 30, 2009, \$119.5 million of which are rated 'AAA' by two of the nationally recognized ratings agencies. The current economic and market conditions have made it unfeasible to redeem these bonds, and any future decision on whether to redeem these bonds will be based on the economic and market conditions at that time. The termination date for the joint venture was originally intended to be April 15, 2009, commensurate with the redemption of the CMBS discussed above. As the CMBS were not redeemed, the partnership remains in existence. We are currently working with our joint venture partner to determine what actions to take with regard to the joint venture. If the joint venture is terminated, we may purchase certain assets from the joint venture in connection with its termination.

### FINANCIAL CONDITION

The following table presents certain balance sheet accounts that had significant activity, which are discussed after the table.

(amounts in thousands)	June 30, 2009	December 31, 2008
Agency MBS, at fair value	\$531,546	\$311,576
Securitized mortgage loans, net	233,214	243,827
Investment in joint venture	6,109	5,655
Other investments	8,298	12,735
Repurchase agreements	472,532	274,217
Securitization financing	154,468	178,165
Obligation under payment agreement	8,555	8,534
Payable for securities pending settlement	23,595	—
Shareholders' equity	154,627	140,409

#### Agency MBS

Our Agency MBS investments, which are classified as available-for-sale and carried at fair value, are comprised as follows:

(amounts in thousands)	June 30, 2009	December 31, 2008
Agency MBS:		
Hybrid Agency ARMs	\$362,710	\$217,800
Agency ARMs	166,178	92,626
	528,888	310,426
Fixed-rate	147	194
	529,035	310,620
Principal receivable	2,511	956
	\$531,546	\$311,576

Agency MBS increased from \$311.6 million at December 31, 2008 to \$531.5 million at June 30, 2009 primarily as a result of our purchase of approximately \$261.0 million of Agency MBS, including \$23.5 million of Agency MBS

settling in July 2009, during the six-month period ended June 30, 2009. Partially offsetting the purchases was the receipt of \$49.0 million of principal on the securities during the six-month period ended June 30, 2009. At June 30, 2009, our Agency MBS portfolio had a weighted average of 25 months remaining until the rates on the underlying loans collateralizing the Agency MBS reset. The weighted average coupon on our portfolio of Agency MBS was 5.04% as of June 30, 2009. Approximately \$476.5 million of the Agency MBS are pledged to counterparties as security for repurchase agreement financing.



The average quarterly constant prepayment rate (“CPR”) realized on our Agency MBS portfolio was 19.9% and 14.8% for the second and first quarters of 2009, respectively.

#### Securitized Mortgage Loans, Net

Securitized mortgage loans are comprised of loans secured by first deeds of trust on single-family residential and commercial properties. The following table presents our net basis in these loans at amortized cost, which includes accrued interest receivable, discounts, premiums, deferred costs and reserves for loan losses, by the type of property collateralizing the loan.

(amounts in thousands)	June 30, 2009	December 31, 2008
Securitized mortgage loans, net:		
Commercial	\$165,883	\$171,963
Single-family	67,331	71,864
	\$233,214	\$243,827

Securitized commercial mortgage loans includes the loans pledged to two securitization trusts, which were issued in 1993 and 1997 and have outstanding principal balances, including defeased loans, of \$20.4 million and \$148.8 million, respectively, at June 30, 2009. The decrease in these loans was primarily related to principal payments, net of amounts received on loans entering defeasance, of \$6.1 million during the six months ended June 30, 2009, partially offset by \$0.2 million of net discount amortization. In addition, approximately \$0.1 million of reserves were provided for estimated loan losses during the six months ended June 30, 2009.

Securitized single-family mortgage loans includes loans pledged to one securitization trust, which was issued in 2002 using loans that were principally originated between 1992 and 1997. The decrease in the securitized single-family mortgage loans was primarily related to principal payments on the loans of \$4.5 million, \$2.9 million of which were unscheduled, and the provision of approximately \$0.1 million for estimated loan losses during the six months ended June 30, 2009.

#### Investment in Joint Venture

Investment in joint venture declined during the six months ended June 30, 2009 as a result of our interest in the net loss of the joint venture of \$0.1 million and other comprehensive loss of the joint venture of \$0.6 million. For discussion of the net loss of the joint venture see discussion under “Results of Operations.”

At June 30, 2009, the joint venture owns various interests in subordinate CMBS issued by two securitization trusts created in 1997 and 1998. The carrying value of these securities at June 30, 2009 was \$8.6 million and \$2.4 million respectively, relative to their principal balances of \$20.9 million and \$17.8 million. The joint venture also had cash and cash equivalents of \$1.3 million at June 30, 2009.

## Other Investments

Our other investments are comprised of non-Agency MBS and equity securities, which are classified as available-for-sale and carried at fair value, and other loans and investments, which are stated at amortized cost, as follows:

(amounts in thousands)	June 30, 2009	December 31, 2008
Non-Agency MBS	\$6,697	\$6,959
Equity securities of publicly traded companies	–	3,441
	6,697	10,400
Gross unrealized gains	372	802
Gross unrealized losses	(1,256 )	(1,335 )
	5,813	9,867
Other loans, net	2,328	2,657
Other	157	211
	\$8,298	\$12,735

Non-Agency MBS is primarily comprised of investment grade MBS issued by a subsidiary of the Company in 1994. The decline of \$0.3 million to \$6.7 million at June 30, 2009 was primarily related to the principal payments received on these securities during the six months ended June 30, 2009.

The Company sold its investment in equity securities during the six months ended June 30, 2009. The Company recognized a gain of approximately \$0.2 million and received proceeds of \$3.7 million on the sale.

Other loans declined approximately \$0.3 million to \$2.3 million during the six months ended June 30, 2009. Other loans, net is comprised primarily of seasoned residential and commercial mortgage loans. The decline is primarily related to the receipt of approximately \$0.3 million of principal on the mortgage loans and a \$0.1 million provision for loan losses.

## Repurchase Agreements

Repurchase agreements increased to \$472.5 million at June 30, 2009 from \$274.2 million at December 31, 2008. The increase is primarily related to the growth in our investment in Agency MBS, which we finance with repurchase agreements.

We also entered into two repurchase agreements during the six-month period ended June 30, 2009 to finance two securitization financing bonds. One of these repurchase agreements has a balance of \$18.5 million at June 30, 2009 and is collateralized by a securitization financing bond with a par value of \$32.7 million and an estimated fair value of \$26.8 million. The second repurchase agreement, which has a balance of \$11.0 million at June 30, 2009, was used to finance the redemption of a securitization financing bond with a par and estimated fair value of \$15.4 million at June 30, 2009.

## Securitization Financing

Securitization financing consists of fixed and variable-rate bonds as set forth in the table below. The table includes the unpaid principal balance of the bonds outstanding, accrued interest payable, discounts, premiums and deferred costs at June 30, 2009.

(amounts in thousands)	June 30, 2009	December 31, 2008
Securitization financing:		
Fixed-rate, secured by commercial mortgage loans	\$128,841	\$150,588
Variable-rate, secured by single-family mortgage loans	25,627	27,577
	\$154,468	\$178,165

The fixed-rate bonds were issued pursuant to two separate indentures (via two securitization trusts) and finance our securitized commercial mortgage loans, which are also fixed-rate. The fixed-rate bonds have a range of rates from 6.7% to 8.8% and a weighted average rate of 6.9% at June 30, 2009. The decrease in fixed-rate bonds is related to principal payments on the bonds during the six months ended June 30, 2009 of \$5.9 million and approximately \$0.3 million of bond premium and deferred cost amortization during the six months ended June 30, 2009.

Approximately \$15.5 million of the decrease in fixed-rate securitization financing was also related to the Company's redemption of a senior bond issued by one of the securitization trusts. The bond was redeemed at its par value and is currently financed with a repurchase agreement with a balance of \$11.0 million, which is discussed further in the repurchase agreement discussion above.

Our securitized single-family mortgage loans are financed by variable-rate securitization financing bonds issued pursuant to a single indenture. The \$2.0 million decline in the balance during the six months ended June 30, 2009 to \$25.6 million is primarily related to principal payments on the bonds of \$2.0 million.

## Shareholders' Equity

Shareholders' equity increased \$14.2 million from December 31, 2008 to \$154.6 million at June 30, 2009. The increase was primarily related to net income of \$7.5 million and a \$7.9 million improvement from an accumulated other comprehensive loss of \$3.9 million to accumulated other comprehensive income of \$4.0 million. The improvement in accumulated other comprehensive income was primarily related to an increase in the average price on our Agency MBS portfolio from 101.6 as of December 31, 2008 to 103.7 at June 30, 2009.

We also sold 990,000 shares of common stock under our Controlled Equity Offering Program ("CEOP") during the six-month period ended June 30, 2009. We received \$6.7 million for the sale of the stock, which resulted in a \$6.6 million increase in equity, after issuance costs.

The above increases were partially offset by common and preferred stock dividends of \$7.8 million during the six months ended June 30, 2009.

## Supplemental Discussion of Investments

The use of leverage limits the amount of equity capital invested in a particular asset while enhancing the potential overall returns on our equity capital invested. The amount of equity capital invested and the amount of financing for a particular investment are important considerations for us in managing our investment portfolio. The amount of equity capital invested in a particular investment also helps us to understand and manage our exposure to various risks. For

example, Agency MBS investments generally are believed to have limited credit risk but have a large amount of interest rate and financing risk. Conversely, investments in securitized mortgage loans, which are financed with securitization financing bonds, will have less financing and interest rate risk but more credit risk.

In the table below we have calculated our net invested capital using amounts for our investments and financing from the consolidated balance sheets and the estimated fair value of such net invested capital. For investments carried at

fair value in our financial statements, estimated fair value of net invested capital is equal to the basis as presented in the financial statements less the financing amount associated with that investment. For investments carried on an amortized cost basis, the estimated fair value of net invested capital is based on the present value of the projected cash flow from the investment, adjusted for the impact and assumed level of future prepayments and credit losses, less the projected principal and interest due on the associated financing. In general, because of the age of these investments, an active secondary market does not currently exist so management makes assumptions as to market expectations of prepayment speeds, losses and discount rates.

With respect to the joint venture, the estimated fair value for the CMBS held by the joint venture is based on the present value of the projected cash flow from the investment, adjusted for the impact and assumed level of future prepayments and credit losses, less the projected principal and interest due on the associated financing.

For purposes of the table below, we have attempted to calculate fair value of the investments based on what we believe to be reasonable assumptions that would be made by a reasonable buyer. If we actually were to have attempted to sell these investments at June 30, 2009, there can be no assurance that the amounts set forth in the table below could have been realized.

#### Estimated Fair Value of Net Investment

Investment	June 30, 2009 (amounts in thousands)			Estimated fair value of net invested capital
	Investment basis	Financing (1)	Net invested capital	
Agency MBS (2)	\$531,546	\$466,646	\$64,900	\$64,900
Securitized mortgage loans: (3)				
Single-family mortgage loans – 2002 Trust	67,331	44,136	23,195	15,364
Commercial mortgage loans – 1993 Trust	18,863	11,270	7,593	8,006
Commercial mortgage loans – 1997 Trust	147,020	137,099	9,921	–
	233,214	192,505	40,709	23,370
Investment in joint venture (4)	6,109	–	6,109	6,109
Other investments: (5)				
Non-Agency MBS	5,813	–	5,813	5,813
Other loans and investments	2,485	–	2,485	2,241
	8,298	–	8,298	8,054
Total	\$779,167	\$659,150	\$120,017	\$102,433

(1) Financing includes repurchase agreements, payable for securities pending settlement, and securitization financing issued to third parties. Financing for the 1997 Trust also includes the obligation under payment agreement, which at June 30, 2009 had a balance of \$8,555.

(2) Fair values are based on a third-party pricing service and dealer quotes.

(3) Fair values are based on discounted cash flows using assumptions set forth in the table below, inclusive of amounts invested in unredeemed securitization financing bonds.

(4) Fair value for investment in joint venture rep