CUMBERLAND PHARMACEUTICALS INC
Form 8-K
February 03, 2017

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 8-K
CURRENT REPORT
Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Date of Report (Date of Earliest Event Reported): February 3, 2017 (January 30, 2017)

Cumberland Pharmaceuticals Inc.
____
(Exact name of registrant as specified in its charter)

Tennessee	001-33637	62-1765329
(State or other jurisdiction of incorporation)	(Commission File Number)	(I.R.S. Employer Identification No.)
2525 West End Avenue, Suite 950, Nashville, Tennessee		37203
(Address of principal executive offices)		(Zip Code)

Registrant's telephone number, including area code: (615) 255-0068
Not Applicable
____
Former name or former address, if changed since last report

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions:

[ ] Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)
[ ] Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)
[ ] Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))
[ ] Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

Item 8.01 Other Events.

On January 30, 2017, the Company issued a press release announcing the Appeals Court ruling in favor of Cumberland in a patent case associated with its Acetadote product. A copy of the press release is furnished as Exhibit 99.1 as well as the Company's updated risk disclosure related to Acetadote at Exhibit 99.2.

SIGNATURES

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

Cumberland Pharmaceuticals Inc.

February 3, 2017 By: Michael Bonner

Name: Michael Bonner
Title: Chief Financial Officer

iodic interest costs of derivative instruments. Please refer to "Loss on Derivative Instruments, Net" for more information on net periodic interest costs.

Net Interest Income and Net Interest Spread

The table below presents net interest income and net interest spread for our interest-earning assets and interest-bearing liabilities for the periods indicated:

	Year Ended December 31,			
	2016		2015	
($ in thousands)	Amount	Yield	Amount	Yield
Interest income	$91,898	2.82%	$100,244	2.71%
Interest expense	25,231	0.85%	22,605	0.68%
Net interest income/spread	$66,667	1.97%	77,639	2.03%
Average interest earning assets [(1)]	$3,236,903		$3,685,936	
Average balance of borrowings [(2)]	$2,912,426		$3,269,711	

(1) Average balances are calculated as a simple average of the daily amortized cost and exclude unrealized gains and losses as well as securities pending settlement if applicable.

(2) Average balances are calculated as a simple average of the daily borrowings outstanding for both repurchase agreement and non-recourse collateralized financing.

Net interest income and net interest spread decreased for the year ended December 31, 2016 compared to the year ended December 31, 2015 primarily due to a smaller investment portfolio and higher borrowing costs during the year ended December 31, 2016.

Adjusted Net Interest Income

Adjusted net interest income decreased to $64.0 million for the year ended December 31, 2016 from $75.4 million for the year ended December 31, 2015 primarily due to a smaller investment portfolio and higher borrowing costs during the year ended December 31, 2016.

Loss on Derivative Instruments, Net

The following table provides information on our financial instruments accounted for as derivative instruments for the periods indicated:

($ in thousands)	Year Ended December 31, 2016			2015		
Type of Derivative Instrument	Net Periodic Interest Costs	Change in Fair Value [(1)]	Total	Net Periodic Interest Costs	Change in Fair Value [(1)]	Total
Receive-fixed interest rate swaps	$5,072	$(2,557)	$2,515	$5,036	$1,486	$6,522
Pay-fixed interest rate swaps	(7,533)	4,227	(3,306)	(10,766)	(17,921)	(28,687)
Eurodollar futures	—	(4,815)	(4,815)	—	(20,963)	(20,963)
Loss on derivative instruments, net	$(2,461)	$(3,145)	$(5,606)	$(5,730)	$(37,398)	$(43,128)

(1) Amount shown includes unrealized gains (losses) from current and forward starting derivative instruments and realized gains (losses) from terminated derivative instruments.

Due to hedge repositioning during the year ended December 31, 2016, we terminated derivatives which had a change in fair value of $(25.2) million, net of periodic interest costs. In the latter part of the year, we increased our hedge positions to mitigate rising interest rates. As a result of the increase in interest rates during the second half of 2016, our derivatives, including the additional positions added, increased in fair value by $19.6 million, net of periodic interest costs, which partially offset losses related to the decline in fair value of our terminated derivative positions. We terminated derivatives which had a change in fair value of $(22.5) million, net of periodic interest costs, as part of our hedge repositioning during 2015.

The table below provides additional information regarding the average notional balances and weighted average net pay-fixed rates of our receive-fixed and pay-fixed interest rate swaps effective during the periods indicated:

($ in thousands)	Year Ended December 31, 2016	2015
Average notional balance [(1)]	$488,128	$567,767
Weighted average net pay-fixed rate [(1)]	0.99 %	1.23 %

(1) Amounts exclude forward-starting interest rate swaps.

Loss on Sale of Investments, Net

The following tables provide information related to our loss on sale of investments, net for the periods indicated:

($ in thousands)	Year Ended December 31, 2016 Amortized cost basis sold	(Loss) gain on sale of investments, net	2015 Amortized cost basis sold	(Loss) gain on sale of investments, net
Agency RMBS	$57,187	$ (3,010)	$177,430	$ (2,865)
Agency CMBS	—	—	149,964	(604)
Non-Agency CMBS	34,868	(1,228)	31,341	(566)
Agency CMBS IO	—	—	43,398	1,698
Non-Agency CMBS IO	—	—	48,766	1,359

Total	$92,055	$ (4,238)	$450,899	$ (978)

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Agency RMBS we sold during the year ended December 31, 2016 were lower yielding ARMs that were at or near their interest rate reset periods and which were expected to reset at interest rates lower than their current coupon. Non-Agency CMBS sold during the year ended December 31, 2016 were yielding significantly below the portfolio average. Sale proceeds were primarily used to pay down repurchase agreement borrowings throughout the majority of 2016. During the fourth quarter of 2016, we began reinvesting a portion of sale proceeds primarily in Agency CMBS and CMBS IO as yields on available investments and risk adjusted returns improved relative to earlier in 2016.

We sold certain adjustable-rate Agency RMBS during 2015 in order to reduce our exposure to prepayment risk. The majority of our Agency CMBS sales during the year ended December 31, 2015 were completed during the second quarter in order to manage our liquidity and leverage.

General and Administrative Expenses

General and administrative expenses for the year ended December 31, 2016 decreased $3.0 million compared to the year ended December 31, 2015 due to lower compensation and benefits expenses as well as lower legal expenses.

Other Comprehensive Income (Loss)

The following table provides detail on the changes in fair value by type of MBS which are recorded as unrealized gains (losses) in other comprehensive income on our consolidated statements of operations for the periods indicated:

	Year Ended December 31,	
($ in thousands)	2016	2015
Adjustable-rate Agency RMBS	$2,709	$(2,085)
Non-Agency RMBS	762	(781)
Agency CMBS	(16,640)	(19,048)
Non-Agency CMBS	(631)	(101)
Agency CMBS IO	(4,110)	(7,902)
Non-Agency CMBS IO	(1,680)	(7,666)
Unrealized (loss) gain on available-for-sale investments	$(19,590)	$(37,583)

During the year ended December 31, 2016, the decrease in fair value of MBS of $(19.6) million was primarily due to the overall increase in interest rates from December 31, 2015 to December 31, 2016, which occurred primarily in the fourth quarter of 2016. During the year ended December 31, 2015, the decrease in fair value of MBS of $(37.6) million was due to increase in interest rates as well as overall widening in credit spreads.

LIQUIDITY AND CAPITAL RESOURCES

Our primary sources of liquidity include borrowings under repurchase arrangements and monthly principal and interest payments we receive on our investments. Additional sources may also include proceeds from the sale of investments, equity offerings, and payments received from counterparties from interest rate swap agreements. We use our liquidity to purchase investments and to pay our operating expenses and dividends on our common and preferred stock. We also use our liquidity to post initial and variation margins on our repurchase agreements and derivative transactions, including TBA contracts, when required under the terms of the related agreements. We may also use liquidity to repurchase shares of our stock periodically.

Our liquid assets fluctuate based on our investment activities, our financing and capital raising activities, and changes in the fair value of our investments and derivative instruments. We seek to maintain sufficient liquidity to support our operations and to meet our anticipated liquidity demands, including potential margin calls from lenders (as discussed further below). We measure, manage, and forecast our liquidity on a daily basis. Our most liquid assets include

unrestricted cash and cash equivalents, U.S. Treasuries and unencumbered Agency RMBS, CMBS, and CMBS IO. As of December 31, 2017, our most liquid assets were $283.9 million compared to $138.1 million as of December 31, 2016.

We perform sensitivity analysis on our liquidity based on changes in the fair value of our investments due to changes in interest rates, credit spreads, lender haircuts, and prepayment speeds as well as changes in the fair value of our derivative instruments due to changes in interest rates. In performing this analysis we will also consider the current state of the fixed income markets and

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the repurchase agreement markets in order to determine if market forces such as supply-demand imbalances or structural changes to these markets could change the liquidity of MBS or the availability of financing. The objective of our analysis is to assess the adequacy of our liquidity to withstand potential adverse events. We may change our leverage targets based on market conditions and our perceptions of the liquidity of our investments.

We closely monitor our debt-to-invested equity ratio (which is the ratio of debt financing to invested equity for any investment) as part of our liquidity management process as well as our overall enterprise level debt-to-equity ratio. We also monitor the ratio of our available liquidity to outstanding repurchase agreement borrowings, which fluctuates due to changes in the fair value of collateral we have pledged to our lenders. On an enterprise level basis, our current operating policies limit our total liabilities-to-shareholders' equity to 8 times our shareholders' equity. Including our TBA dollar roll positions at cost (if settled), which was $829.4 million as of December 31, 2017, our leverage was 6.4 times shareholders’ equity. It is possible under certain market conditions that it may be uneconomical for us to roll our TBA dollar roll positions into future months, which may result in us having to take physical delivery of the underlying securities. Because under those circumstances we would have to fund our total purchase commitment with cash or other financing sources, which may impact our liquidity position, management includes our TBA dollar roll positions at cost (if settled) in evaluating the Company’s leverage.

The following table presents information regarding the balances of our repurchase agreement borrowings and our TBA dollar roll positions for the periods indicated:

	Repurchase Agreements			TBA Dollar Roll Positions [1]	
($ in thousands)	Balance Outstanding As of Quarter End	Average Balance Outstanding For the Quarter Ended	Maximum Balance Outstanding During the Quarter Ended	Balance Outstanding As of Quarter End	Average Balance Outstanding For the Quarter Ended
December 31, 2017	$2,565,902	$2,557,573	$2,677,894	$829,425	$ 928,329
September 30, 2017	2,519,230	2,616,250	2,801,418	683,813	745,270
June 30, 2017	2,540,759	2,753,019	2,826,005	416,312	305,720
March 31, 2017	2,825,945	2,843,733	2,913,617	—	—
December 31, 2016	2,898,952	2,768,769	2,938,745	—	—
September 30, 2016	2,478,278	2,536,562	2,599,491	—	—

(1) Balance outstanding as of quarter end and average balance outstanding for the quarter ended includes TBA dollar roll positions as reported at cost (as if settled). Does not include short TBA positions used to hedge interest rate risk exposure from fixed-rate Agency RMBS.

We have historically had ample sources of liquidity to fund our activities and operations. The ability to fund our operations in the future depends in large measure on the availability of credit through repurchase agreement financing and the liquidity of our investments. Credit markets have historically experienced brief periods of extreme volatility such as what occurred in 2008 and 2009. Such events are typically marked by concerns regarding counterparty credit, severe market illiquidity, and steep declines in asset prices. In recent periods U.S. financial regulatory agencies (such as the Office of Financial Research in the U.S. Treasury and the Federal Reserve) have expressed some concern about the stability of repurchase agreement financing for mortgage REITs in a sharply rising interest rate environment, and regulatory reform in the form of certain provisions of the Basel III capital framework (and supplemental bank capital rules) and the Dodd-Frank Wall Street Reform and Consumer Protection Act could impact the overall availability of credit by restricting the number of repurchase agreement lenders and the credit made available by such lenders. In times of severe market stress, repurchase agreement availability could be rapidly reduced and the terms on which we can borrow could be materially altered, particularly given the focus on these markets by the federal financial and banking regulators. Competition from other REITs, banks, hedge funds, and the federal government for capacity with

our repurchase agreement lenders could also reduce our repurchase agreement availability.

Depending on our liquidity levels, investment opportunities, the condition of the credit markets, and other factors, we may from time to time consider the issuance of debt, equity, or other securities. We may also sell investments in order to provide additional liquidity for our operations. While we will attempt to avoid dilutive or otherwise costly issuances, depending on market conditions and in order to manage our liquidity, we could be forced to issue equity or debt securities which are dilutive to our capital base or our profitability.

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Repurchase Agreements

Our repurchase agreement borrowings are generally renewable at the discretion of our lenders without guaranteed roll-over terms. Given the short-term and uncommitted nature of most of our repurchase agreement financing, we attempt to maintain unused capacity under our existing repurchase agreement credit lines with multiple counterparties which helps protect us in the event of a counterparty's failure to renew existing repurchase agreements either with favorable terms or at all. As of December 31, 2017, we had repurchase agreement borrowings outstanding with 16 of our 34 available repurchase agreement counterparties at a weighted average borrowing rate of 1.67% compared to 1.03% as of December 31, 2016. Our repurchase agreement borrowings generally carry a rate of interest based on a spread to an index such as LIBOR.

For our repurchase agreement borrowings, we are required to post and maintain margin to the lender (i.e., collateral in excess of the repurchase agreement financing) in order to support the amount of the financing. This excess collateral is often referred to as a "haircut" (and which we also refer to as equity at risk) and is intended to provide the lender some protection against fluctuations in fair value of the collateral and/or the failure by us to repay the borrowing at maturity. If we fail to meet any margin call, our lenders also have the right to terminate the repurchase agreement and sell any collateral pledged. Therefore, we attempt to maintain cash and other liquid securities in sufficient amounts to manage our exposure to margin calls by lenders. The lender also has the right to change the required haircut at maturity of the repurchase agreement (if the term is renewed) which would require us to post additional collateral to the lender.

As the collateral pledged is generally MBS, the fair value of the collateral can fluctuate with changes in market conditions. If the fair value of the collateral falls below the haircut required by the lender, the lender has the right to demand additional margin, or collateral, to increase the haircut back to the initial amount. These demands are typically referred to as "margin calls". Declines in the value of investments occur for any number of reasons including but not limited to changes in interest rates, changes in ratings on an investment, changes in actual or perceived liquidity of the investment, or changes in overall market risk perceptions. Additionally, values in Agency RMBS will also decline from the payment delay feature of those securities. Agency RMBS have a payment delay feature whereby Fannie Mae and Freddie Mac announce principal payments on Agency RMBS but do not remit the actual principal payments and interest for 20 days in the case of Fannie Mae and 40 days in the case of Freddie Mac. Because these securities are financed with repurchase agreements, the repurchase agreement lender generally makes a margin call for an amount equal to the product of their advance rate on the repurchase agreement and the announced principal payments on the Agency RMBS. This causes a temporary use of our liquidity to meet the margin call until we receive the principal payments and interest 20 to 40 days later.

The following table presents the weighted average minimum haircut contractually required by our counterparties for MBS pledged as collateral for our repurchase agreement borrowings as of the dates indicated:

	December 31, 2017	September 30, 2017	June 30, 2017	March 31, 2017	December 31, 2016
Agency CMBS and RMBS	4.9 %	5.0 %	5.0 %	5.0 %	5.0 %
Non-Agency CMBS and RMBS	15.0 %	15.0 %	18.0 %	15.8 %	16.3 %
CMBS IO	14.6 %	15.0 %	15.0 %	15.3 %	15.4 %

The counterparties with whom we have the greatest amounts of equity at risk may vary significantly during any given period due to the short-term and generally uncommitted nature of the repurchase agreement borrowings. Equity at risk is defined as the amount pledged as collateral to the counterparty in excess of the borrowed amount outstanding. This equity at risk represents the potential loss to the Company if the counterparty is unable or unwilling to return collateral securing the repurchase agreement borrowing at its maturity. The following tables present the counterparties with whom we had greater than 5% of our equity at risk as of December 31, 2017 and December 31, 2016:

($ in thousands)	December 31, 2017 Amount Outstanding	Equity at Risk
Well Fargo Bank, N.A. and affiliates	$311,351	$56,383
	$311,351	$56,383

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($ in thousands)	December 31, 2016 Amount Outstanding	Equity at Risk
Well Fargo Bank, N.A. and affiliates	$342,160	$62,041
South Street Financial Corporation	597,394	38,770
JP Morgan Securities, LLC	212,921	35,658
	$1,152,475	$136,469

The following table discloses our repurchase agreement amounts outstanding and the value of the related collateral pledged by geographic region of our counterparties as of December 31, 2017 and December 31, 2016:

($ in thousands)	December 31, 2017		December 31, 2016	
	Amount Outstanding	Market Value of Collateral Pledged	Amount Outstanding	Market Value of Collateral Pledged
North America	$1,551,758	$1,700,582	$2,105,337	$2,309,391
Asia	489,376	515,593	421,991	443,098
Europe	524,768	548,924	371,624	397,351
	$2,565,902	$2,765,099	$2,898,952	$3,149,840

Certain of our repurchase agreement counterparties require us to comply with various operating and financial covenants. The financial covenants include, among other things, requirements that we maintain minimum shareholders' equity (usually a set minimum, or a percentage of the highest amount of shareholders' equity since the date of the agreement), maximum decline in shareholders' equity (expressed as a percentage decline in any given period), and limits on maximum leverage (as a multiple of shareholders' equity). Operating requirements include, among other things, requirements to maintain our status as a REIT and to maintain our listing on the NYSE. Violations of one or more of these covenants could result in the lender declaring an event of default which would result in the termination of the repurchase agreement and immediate acceleration of amounts due thereunder. In addition, some of the agreements contain cross default features, whereby default with one lender simultaneously causes default under agreements with other lenders. Violations could also restrict us from paying dividends or engaging in other transactions that are necessary for us to maintain our REIT status.

We monitor and evaluate on an ongoing basis the impact these customary financial covenants may have on our operating and financing flexibility. Currently, we do not believe we are subject to any covenants that materially restrict our financing flexibility.

Derivative Instruments

We are party to certain types of financial instruments that are accounted for as derivative instruments including interest rate swaps, Eurodollar futures and long and short positions in TBA securities. Certain of these derivative instruments may require us to post initial margin at inception and daily variation margin based on subsequent changes in their fair value. The collateral posted as margin by us is typically in the form of cash or Agency MBS. Generally, as interest rates decline, we will be required to post collateral with counterparties on our interest rate derivatives, and vice versa as interest rates increase. As of December 31, 2017, we had cash of $46.3 million posted as initial margin under these agreements.

As of December 31, 2017, approximately $160 million of the Company’s interest rate swaps were entered into under bilateral agreements which contain cross-default provisions with other agreements between the parties. In addition, these bilateral agreements contain financial and operational covenants similar to those contained in our repurchase agreements, as described above. Currently, we do not believe we are subject to any covenants that materially restrict

our hedging flexibility.

Our TBA contracts are subject to master securities forward transaction agreements published by the Securities Industry and Financial Markets Association as well as supplemental terms and conditions with each counterparty. Under the terms of these agreements, we may be required to pledge collateral to, or have the right to receive collateral from, our counterparties when initiated or in the event the fair value of our TBA contracts declines. Declines in the fair value of TBA contracts are generally related to such factors as rising interest rates, increases in expected prepayment speeds, or widening spreads. Our TBA contracts generally provide that valuations for our TBA contracts and any pledged collateral are to be obtained from a generally recognized source agreed to by both parties. However, in certain circumstances, our counterparties have the sole discretion to determine the value of the TBA contract and any pledged collateral. In such instances, our counterparties are required to act in good faith in making determinations of value. In the event of a margin call, we must generally provide additional collateral on the same business day.

Dividends

As a REIT, we are required to distribute to our shareholders amounts equal to at least 90% of our REIT taxable income for each taxable year after consideration of our tax NOL carryforwards. We generally fund our dividend distributions through our cash flows from operations. If we make dividend distributions in excess of our operating cash flows during the period, whether for purposes of meeting our REIT distribution requirements or other strategic reasons, those distributions are generally funded either through our existing cash balances or through the return of principal from our investments (either through repayment or sale).

We have a net operating tax loss ("NOL") carryforward that we could use to offset our REIT taxable income distribution requirement. This NOL carryforward had an estimated balance of $89.8 million as of December 31, 2017. We also have deferred tax hedge losses on terminated derivative instruments, which will be recognized over the original periods being hedged by those terminated derivatives. These losses have already been recognized in our GAAP earnings but will reduce taxable income over the next ten years as noted in the following table:

($ in thousands)	Tax Hedge Loss Deduction
2018	$ 21,644
2019	17,109
2020	8,015
2021 - 2026	4,782
	$ 51,550

If any of the deferred tax hedge losses for the years noted in the table above result in dividend distributions to our shareholders in excess of REIT taxable income, the excess dividends distributed will be considered a return of capital to the shareholder. Approximately 70% of our common stock dividends declared during the year ended December 31, 2017 will represent a return of capital to shareholders and not a distribution of REIT taxable income, principally as a result of the amount of the tax hedge loss deduction.

Contractual Obligations

The following table summarizes our contractual obligations by payment due date as of December 31, 2017:

($ in thousands)	Payments due by period				
Contractual Obligations:	Total	< 1 year	1-3 years	3-5 years	> 5 years
Repurchase agreements [1]	$2,608,774	$2,608,774	$—	$—	$—
Non-recourse collateralized financing [2]	5,596	1,602	2,167	1,183	644
Operating lease obligations	491	160	331	—	—
Total	$2,614,861	$2,610,536	$2,498	$1,183	$ 644

(1) Includes estimated interest payments calculated using interest rates in effect as of December 31, 2017.
(2) Amounts shown are for principal only and exclude interest obligations as those amounts are not significant. Non-recourse collateralized financing represents securitization financing that is payable solely from loans and securities pledged as collateral. Payments due by period were estimated based on the principal repayments forecasted for the underlying loans and securities, substantially all of which is used to repay the associated financing outstanding.

Other Matters

As of December 31, 2017, we do not believe that any off-balance sheet arrangements exist that are reasonably likely to have a material effect on our current or future financial condition, results of operations, or liquidity other than as

discussed above. In addition, we do not have any material commitments for capital expenditures and have not obtained any commitments for funds to fulfill any capital obligations.

RECENT ACCOUNTING PRONOUNCEMENTS

Please refer to Note 1 to the Notes to the Consolidated Financial Statements contained in this Annual Report on Form 10-K for information regarding recently issued accounting pronouncements.

FORWARD-LOOKING STATEMENTS

Certain written statements in this Annual Report on Form 10-K that are not historical facts constitute “forward-looking statements” within the meaning of Section 27A of the 1933 Act and Section 21E of the Exchange Act. Statements in this report addressing expectations, assumptions, beliefs, projections, future plans and strategies, future events, developments that we expect or anticipate will occur in the future, and future operating results are forward-looking statements. Forward-looking statements are based upon management’s beliefs, assumptions, and expectations as of the date of this report regarding future events and operating performance, taking into account all information currently available to us, and are applicable only as of the date of this report. Forward-looking statements generally can be identified by use of words such as “believe”, “expect”, “anticipate”, “estimate”, “plan” “may”, “will”, “intend”, “should”, “cou expressions. We caution readers not to place undue reliance on our forward-looking statements, which are not historical facts and may be based on projections, assumptions, expectations, and anticipated events that do not materialize. Except as required by law, we are not obligated to, and do not intend to, update or revise any forward-looking statement whether as a result of new information, future events, or otherwise.

Forward-looking statements in this Annual Report on Form 10-K may include, but are not limited to statements about:

- Our business and investment strategy including our ability to generate acceptable risk-adjusted returns and our target investment allocations;
- Our views on conditions in the investment and credit markets;
- Our views on the effect of actual or proposed actions of the U.S. Federal Reserve and the FOMC with respect to monetary policy (including the targeted Federal Funds Rate), and the potential impact of these actions on interest rates, inflation or unemployment;
- The effect of regulatory initiatives of the Federal Reserve (including the FOMC), other financial regulators, and other central banks;
- Our financing strategy including our target leverage ratios, our use of TBA dollar roll transactions, and anticipated trends in financing costs, and our hedging strategy including changes to the derivative instruments to which we are a party, and changes to government regulation of hedging instruments and our use of these instruments;
- Our investment portfolio composition and target investments;
- Our investment portfolio performance, including the fair value, yields, and forecasted prepayment speeds of our investments;
- Our liquidity and ability to access financing, and the anticipated availability and cost of financing;
- Our stock repurchase activity and the impact of stock repurchases;
- Our use of and restrictions on using our tax NOL carryforward;
- The status of pending litigation;
- The competitive environment in the future, including competition for investments and the availability of financing;
- Estimates of future interest expenses, including related to the Company’s repurchase agreements and derivative instruments;
- The status and effect of legislative reforms and regulatory rule-making or review processes, and the status of reform efforts and other business developments in the repurchase agreement financing market;
- Market, industry and economic trends, how these trends and related economic data may impact the behavior of market participants and financial regulators; and
- Market interest rates and market spreads.

Forward-looking statements are inherently subject to risks, uncertainties and other factors that could cause our actual results to differ materially from historical results or from any results expressed or implied by such forward-looking statements. Not all of these risks and other factors are known to us. New risks and uncertainties arise over time, and it is not possible to predict those events or how they may affect us. The projections, assumptions, expectations or beliefs upon which the forward-looking statements are based can also change as a result of these risks or other factors. If such a risk or other factor materializes in future periods, our business, financial condition, liquidity and results of operations may vary materially from those expressed or implied in our forward-looking statements.

While it is not possible to identify all factors that may cause actual results to differ from historical results or from any results expressed or implied by forward-looking statements, or that may cause our projections, assumptions, expectations or beliefs to change, some of those factors include the following:

- the risks and uncertainties referenced in this Annual Report on Form 10-K, particularly those set forth under and incorporated by reference into Part II, Item 1A, "Risk Factors";
- our ability to find suitable reinvestment opportunities;
- changes in domestic economic conditions;
- changes in interest rates and interest rate spreads, including the repricing of interest-earning assets and interest-bearing liabilities;
- our investment portfolio performance particularly as it relates to cash flow, prepayment rates and credit performance;
- the impact on markets and asset prices from the Federal Reserve's balance sheet normalization process through the reduction in its holdings of Agency RMBS and U.S. Treasuries;
- actual or anticipated changes in Federal Reserve monetary policy or the monetary policy of other central banks;
- adverse reactions in U.S. financial markets related to actions of foreign central banks or the economic performance of foreign economies including in particular China, Japan, the European Union, and the United Kingdom;
- uncertainty concerning the long-term fiscal health and stability of the United States;
- the cost and availability of financing, including the future availability of financing due to changes to regulation of, and capital requirements imposed upon, financial institutions;
- the cost and availability of new equity capital;
- changes in our use of leverage;
- changes to our investment strategy, operating policies, dividend policy or asset allocations;
- the quality of performance of third-party servicer providers of our loans and loans underlying our securities;
- the level of defaults by borrowers on loans we have securitized;
- changes in our industry;
- increased competition;
- changes in government regulations affecting our business;
- changes or volatility in the repurchase agreement financing markets and other credit markets;
- changes to the market for interest rate swaps and other derivative instruments, including changes to margin requirements on derivative instruments;
- uncertainty regarding continued government support of the U.S financial system and U.S. housing and real estate markets; or to reform the U.S. housing finance system including the resolution of the conservatorship of Fannie Mae and Freddie Mac;
- the composition of the Board of Governors of the Federal Reserve System;
- ownership shifts under Section 382 that further limit the use of our tax NOL carryforward; and
- exposure to current and future claims and litigation.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk is the exposure to losses resulting from changes in market factors. Our business strategy exposes us to a variety of market risks, including interest rate, spread, prepayment, reinvestment, credit, and liquidity risks. These risks can and do cause fluctuations in our comprehensive income and book value as discussed below.

Interest Rate Risk

Investing in interest-rate sensitive investments such as MBS and TBA securities subjects us to interest rate risk. Interest rate risk results from investing in securities that have a fixed coupon or when the coupon may not immediately adjust for changes in interest rates. Interest rate risk also results form the mismatch between the duration of our assets versus the duration of our liabilities and hedges.

The measures of an instrument’s price sensitivity to interest rate fluctuations are its duration and convexity. Duration measures the percentage change in projected market value of our investments and derivative instruments given a change in interest rates. The duration of RMBS and TBA securities tend to increase when interest rates rise and decrease when interest rates fall, which is commonly referred to as negative convexity. This occurs because prepayments of the mortgage loans underlying the RMBS tend to decline when interest rates rise (which extends the life of the security) and increase when interest rates fall (which shortens the life of the security). The fair value of TBA securities react similarly to RMBS to changes in interest rates as they are based on an underlying non-specified pool of fixed-rate RMBS securities. CMBS and CMBS IO, however, generally have little convexity because the mortgage loans underlying the securities contain some form of prepayment protection provision (such as prepayment lock-outs) or prepayment compensation provisions (such as yield maintenance or prepayment penalties) which create an economic disincentive for the loans to prepay.

We attempt to manage our exposure to changes in interest rates that results from the duration mismatch between our assets and liabilities by entering into interest rate swaps and other instruments to hedge this risk. We manage interest rate risk within tolerances set by our Board of Directors. Our portfolio duration changes based on the composition of our investment portfolio and our hedge positions as well as market factors. We calculate our portfolio duration based on model projected cash flows, and such calculated duration can be an imprecise measure of actual interest rate risk. In the case of Agency RMBS and TBA securities, the primary input to the calculated duration is the anticipated prepayment speed of the underlying mortgage loans, which is sensitive to future interest rates and borrowers’ behavior. Estimates of prepayment speeds can vary significantly by investor for the same security and therefore estimates of security and portfolio duration can vary significantly.

During a period of rising interest rates (particularly short term rates in a flattening yield curve environment), normally our borrowing costs will increase faster than our asset yields, negatively impacting our net interest income. The amount of the impact will depend on the composition of our portfolio, our hedging strategy, the effectiveness of our hedging instruments as well as the magnitude and the duration of the increase in interest rates. In addition, our adjustable-rate Agency RMBS reset based on one-year LIBOR and have limits or caps on the initial, aggregate, or periodic amount that an interest rate may reset while our liabilities do not have interest rate reset caps.

As of December 31, 2017, we had a positive net duration gap in our investment portfolio, which means our liabilities mature or reset sooner than our investments, and we had not fully hedged this difference. Therefore, increases in interest rates, particularly rapid increases, will negatively impact the market value of our investments, thereby reducing our book value. The table below shows the projected sensitivity of our net interest income and net periodic interest costs on our interest rate swaps; the projected sensitivity of the market value of our investments and derivative instruments (including TBA securities); and the percentage change in shareholders’ equity as they existed as of the periods indicated based on an instantaneous parallel shift in market interest rates as set forth in the table below. In light of the low interest rate environment at December 31, 2017, the only declining rate scenario that we present is a

downward shift of 50 basis points.

Changes in types of our investments, the returns earned on these investments, future interest rates, credit spreads, the shape of the yield curve, the availability of financing, and/or the mix of our investments and financings including derivative instruments may cause actual results to differ significantly from the modeled results. There can be no assurance that assumed events used for the model below will occur, or that other events will not occur, that will affect the outcomes; therefore, the tables below and all related disclosures constitute forward-looking statements.

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Parallel Shift in Interest Rates	December 31, 2017 Percentage Change in			December 31, 2016 Percentage Change in		
	Market Value of Investments [(1)]	Shareholders' Equity	Net Interest Income and Net Periodic Interest Costs [(2)]	Market Value of Investments [(1)]	Shareholders' Equity	Net Interest Income and Net Periodic Interest Costs [(2)]
+100	(1.7)%	(10.0)%	(8.1)%	(0.6)%	(4.4)%	(42.4)%
+50	(0.7)%	(4.0)%	(3.2)%	(0.3)%	(1.9)%	(20.7)%
-50	0.3%	1.8%	0.7%	0.2%	1.2%	18.7%

(1) Includes changes in market value of our investments and derivative instruments, including TBA securities, but excludes changes in market value of our financings because they are not carried at fair value on our balance sheet. The projections for market value do not assume any change in credit spreads.

(2) Includes changes in net interest income as well as net periodic interest costs on our interest rate swaps recorded in "gain (loss) on derivatives instruments, net".

During 2017, we made adjustments to our hedges primarily to reduce our exposure to the impact of higher interest rates on net interest income and net periodic interest costs as noted in the table above. Our exposure to declines in market value of investments and shareholders' equity from higher interest rates increased since December 31, 2016 as we added fixed-rate Agency RMBS and TBA securities.

Management also considers changes in the shape of the interest rate curves in assessing and managing portfolio interest rate risk. Often interest rates do not move in a parallel fashion from quarter to quarter. The table below shows the percentage change in projected market value of our investment portfolio net of derivative instruments for instantaneous changes in the shape of the U.S. Treasury ("UST") curve (with similar changes to the interest rate swap curves) as of the periods indicated:

Basis Point Change in		December 31, 2017 Percentage Change in		December 31, 2016	
2-year UST	10-year UST	Market Value of Investments [(1)]	Shareholders' Equity	Market Value of Investments [(1)]	Shareholders' Equity
+25	+50	(0.5)%	(3.0)%	0.1%	0.5%
+25	+0	(0.2)%	(0.9)%	(0.4)%	(2.5)%
+50	+25	(0.5)%	(2.8)%	(0.5)%	(3.2)%
+50	+100	(1.3)%	(7.7)%	0.1%	0.4%
-10	-50	0.1%	0.8%	(0.3)%	(2.3)%

(1) Includes changes in market value of our investments and derivative instruments, including TBA securities, but excludes changes in market value of our financings because they are not carried at fair value on our balance sheet. The projections for market value do not assume any change in credit spreads.

Spread Risk

Spread risk is the risk of loss from an increase in the market spread between the yield on an investment versus its benchmark index. Changes in market spreads represent the market's valuation of the perceived riskiness of an asset relative to risk-free rates, and widening spreads reduce the market value of our investments as market participants require additional yield to hold riskier assets. Market spreads could change based on macroeconomic or systemic factors as well as the factors specific to a particular security such as prepayment performance or credit performance. Other factors that could impact credit spreads include technical issues such as supply and demand for a particular type of security or FOMC monetary policy. Likewise, most of our investments are fixed-rate or reset in rate over a period of time, and as interest rates rise, we would expect the market value of these investments to decrease.

Fluctuations in spreads typically vary based on the type of investment. Sensitivity to changes in market spreads is derived from models that are dependent on various assumptions, and actual changes in market value in response to changes in market spreads could differ materially from the projected sensitivity if actual conditions differ from these assumptions.

The table below is an estimate of the percentage change in projected market value of our investments (including TBA securities) given the indicated change in market spreads as of the periods indicated:

Basis Point Change in Market Spreads	Percentage Change in Projected Market Value of Investments	
	December 31, 2017	December 31, 2016
+50	(3.1)%	(2.2)%
+25	(1.1)%	(1.1)%
-25	1.6%	1.1%
-50	3.2%	2.3%

Prepayment and Reinvestment Risk

Prepayment risk is the risk of an early, unscheduled return of principal on an investment. We are subject to prepayment risk from premiums paid on investments, which are amortized as a reduction in interest income using the effective yield method under GAAP. Principal prepayments on our investments are influenced by changes in market interest rates and a variety of economic, geographic, government policy, and other factors beyond our control.

Loans underlying our CMBS and CMBS IO securities typically have some form of prepayment protection provisions (such as prepayment lock-outs) or prepayment compensation provisions (such as yield maintenance or prepayment penalties). Yield maintenance and prepayment penalty requirements are intended to create an economic disincentive for the loans to prepay; however, the amount of the prepayment penalty required to be paid may decline over time, and as loans age, interest rates decline, or market values of collateral supporting the loans increase, prepayment penalties may lessen as an economic disincentive to the borrower. Generally, our experience has been that prepayment lock-out and yield maintenance provisions result in stable prepayment performance from period to period. There are no prepayment protections, however, if the loan defaults and is partially or wholly repaid earlier as a result of loss mitigation actions taken by the underlying loan servicer. Historically, we have experienced low default rates on loans underlying CMBS and CMBS IO.

Because CMBS IO consist of rights to interest on the underlying commercial mortgage loan pools and do not have rights to principal payments on the underlying loans, prepayment risk on these securities would be particularly acute without these prepayment protection provisions. CMBS IO prepayment protection and compensation provisions vary by issuer of the security (i.e. Freddie Mac, Fannie Mae, Ginnie Mae, or non-Agency). The majority of our Agency CMBS IO are issued by Freddie Mac and these securities generally have initial prepayment lock-outs followed by a defeasance period which on average extends to within six months of the stated maturities of the underlying loans.

Non-Agency CMBS IO generally have prepayment protection in the form of prepayment lock-outs and defeasance provisions. The following table details the fair value of our CMBS IO portfolio by issuer as of the end of the periods indicated:

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($ in thousands)	December 31, 2017	December 31, 2016
Fannie Mae	$ 10,419	$18,957
Freddie Mac	369,886	392,941
Non-Agency CMBS IO	312,216	342,648
	$ 692,521	$754,546

Prepayments on the loans underlying our RMBS generally accelerate in a declining interest rate environment, as the loans age, and, with respect to ARMS, as the loans near their respective interest rate reset dates, particularly the initial reset date, or if expectations are that interest rates will rise in the future. Our prepayment models anticipate an acceleration of prepayments in these events. To the extent the actual prepayments exceed our modeled prepayments, or, with respect to adjustable-rate RMBS, if we change our future prepayment expectations, we will record adjustments to our premium amortization which may negatively impact our net interest income. In addition, changes in market expectations of prepayments could impact the fair value of our RMBS.

As an indication of our prepayment risk on our RMBS portfolio, the following table summarizes information for our Agency RMBS portfolio regarding the net premium and weighted average coupon by months to reset ("MTR") or until maturity in the case of fixed-rate securities as of the end of the past four quarters:

	December 31, 2017		September 30, 2017		June 30, 2017		March 31, 2017	
($ in thousands)	Net Premium	WAC	Net Premium	WAC	Net Premium	WAC	Net Premium	WAC
0-12 MTR	$1,231	3.50%	$1,313	3.44%	$7,637	3.36%	$17,671	3.24%
13-36 MTR	301	4.53%	182	4.52%	3,278	3.14%	7,307	3.07%
37-60 MTR	8,114	3.11%	6,928	3.16%	11,074	3.07%	11,651	3.38%
> 60 MTR	772	2.54%	2,588	2.58%	7,085	2.57%	11,744	2.68%
30-year fixed-rate(1)	35,602	3.72%	19,163	3.52%	—	—%	—	—%
Total	$46,020	3.56%	$30,174	3.35%	$29,074	2.98%	$48,373	3.04%
Par balance	$1,146,553		$816,353		$715,015		$1,033,735	
Premium, net as a % of par value	4.0 %		3.7 %		4.1 %		4.7 %	

(1) Excludes TBA securities which do not have prepayment risk.

We seek to manage our prepayment risk on our MBS by diversifying our investments, seeking investments which we believe will have superior prepayment performance, and investing in securities which have some sort of prepayment prohibition or yield maintenance (as is the case with CMBS and CMBS IO). With respect to RMBS, when we invest in RMBS at a premium to the security's par value, we tend to favor securities in which we believe the underlying borrowers have some disincentive to refinance as a result of the size of each loan's principal balance, credit characteristics of the borrower, or geographic location of the property, among other factors.

We are also subject to reinvestment risk as a result of the prepayment, repayment and sales of our investments. In order to maintain our investment portfolio size and our earnings, we need to reinvest capital received from these events into new interest-earning assets or TBA securities. If we are unable to find suitable reinvestment opportunities or if yields on assets in which we reinvest are lower than yields on existing assets, our results and cash flows could be negatively impacted. In addition, based on market conditions, our leverage, and our liquidity profile, we may decide to not reinvest the cash flows we receive from our investment portfolio even when attractive reinvestment opportunities are available, or we may decide to reinvest in assets with lower yield but greater liquidity. If we retain rather than reinvest capital or if we invest it in lower yielding assets for liquidity reasons, the size of our investment portfolio and the amount of income generated by our investment portfolio will likely decline.

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Credit Risk

Credit risk is the risk that we will not receive all contractual amounts due on investments that we own due to default by the borrower or due to a deficiency in proceeds from the liquidation of the collateral securing the obligation. Agency RMBS and Agency CMBS have credit risk to the extent that Fannie Mae or Freddie Mac fails to remit payments on the MBS for which they have issued a guaranty of payment. Given the improved financial performance and conservatorship of these entities and the continued support of the U.S. government, we believe this risk is low. Since Agency CMBS IO represent the right to excess interest and not principal on the underlying loans, these securities are exposed to the loss of investment basis in the event a loan collateralizing the security liquidates without paying yield maintenance or prepayment penalty, which typically occurs when an involuntarily liquidating loan repays all or a portion of its related principal balance.

We are exposed to credit risk on our non-Agency securities and we attempt to mitigate our credit risk through asset selection and by purchasing higher quality non-Agency MBS. Our non-Agency MBS are typically investment grade rated securities which we believe will have strong credit performance. We do not currently seek to purchase heavily discounted, credit sensitive MBS. The majority of our non-Agency securities are CMBS and CMBS IO and the return we earn on these securities is dependent on the credit performance of the underlying commercial loans. In particular, since investments in CMBS IO pay interest from the underlying commercial mortgage loan pools, returns generally are more negatively impacted by liquidations of loans in the underlying loan pool. Please refer to “Financial Condition-Repurchase Agreements” within Part II, Item 7 of this Annual Report on Form 10-K for information regarding the credit ratings on our non-Agency MBS.

Liquidity Risk

We have liquidity risk principally from the use of recourse repurchase agreements to finance our ownership of securities. In general, our repurchase agreements provide a source of uncommitted short-term financing for longer-term assets, thereby creating a mismatch between the maturities of the asset and the associated financing. Our repurchase agreements are renewable at the discretion of our lenders and do not contain guaranteed roll-over terms. If we fail to repay the lender at maturity, the lender has the right to immediately sell the collateral and pursue us for any shortfall if the sales proceeds are inadequate to cover the repurchase agreement financing. In addition, declines in the market value of our investments pledged as collateral for repurchase agreement borrowings may result in counterparties initiating margin calls for additional collateral.

Our use of TBA long positions as a means of investing in and financing Agency RMBS also exposes us to liquidity risk in the event that we are unable to roll or terminate our TBA contracts prior to their settlement date. If we are unable to roll or terminate our TBA long positions, we could be required to take physical delivery of the underlying securities and settle our obligations for cash, which could negatively impact our liquidity position or force us to sell assets under adverse conditions if financing is not available to us on acceptable terms.

For further information, including how we attempt to mitigate liquidity risk and monitor our liquidity position, please refer to “Liquidity and Capital Resources” in Part II, Item 7 of this Annual Report on Form 10-K.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Our consolidated financial statements and the related notes, together with the Reports of the Independent Registered Public Accounting Firm thereon, are set forth beginning on page F-1 of this Annual Report on Form 10-K.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

Our management evaluated, with the participation of our Principal Executive Officer and Principal Financial Officer, the effectiveness of our disclosure controls and procedures, as defined in Exchange Act Rule 13a-15(e), as of the end of the period covered by this report. Based on that evaluation, our Principal Executive Officer and Principal Financial Officer concluded that our disclosure controls and procedures were effective as of December 31, 2017 to ensure that information required to be disclosed in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Principal Executive Officer and Principal Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting during the three months ended December 31, 2017 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Management's Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) of the Exchange Act. Because of inherent limitations, a system of internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate due to a change in conditions, or that the degree of compliance with policies or procedures may deteriorate.

Our management evaluated, with the participation of our principal executive officer and principal financial officer, the effectiveness of our internal control over financial reporting using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") (2013) in "Internal Control-Integrated Framework." Based on that evaluation, our principal executive officer and principal financial officer concluded that our internal control over financial reporting was effective as of the end of the period covered by this report.

The Company's internal control over financial reporting as of December 31, 2017 has been audited by BDO USA, LLP, the independent registered public accounting firm that also audited the Company's consolidated financial statements included in this Annual Report on Form 10-K. The attestation report of BDO USA, LLP on the effectiveness of the Company's internal control over financial reporting appears on page F-4 herein.

ITEM 9B. OTHER INFORMATION

None.

PART III.

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information about our executive officers required by this item is included in Part I, Item I of this Annual Report on Form 10-K under the caption “Executive Officers of the Company”. The remaining information required by Item 10 will be included in our definitive proxy statement for use in connection with our 2018 Annual Meeting of Shareholders (“2018 Proxy Statement”) under the captions “Election of Directors,” “Committees of the Board,” “Code of Ethics” and “Section 16(a) Beneficial Ownership Reporting Compliance,” and is incorporated herein by reference.

ITEM 11. EXECUTIVE COMPENSATION

The information required by Item 11 will be included in the 2018 Proxy Statement under the captions “Executive Compensation” and “Directors’ Compensation” and is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The following table sets forth information as of December 31, 2017 with respect to our equity compensation plans under which shares of our common stock are authorized for issuance.

	Number of Securities to Be Issued upon Exercise of Outstanding Options, Warrants and Rights	Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans [(1)]
Equity Compensation Plans Approved by Shareholders:			
2009 Stock and Incentive Plan	—	—	785,962
Equity Compensation Plans Not Approved by Shareholders [(2)]	—	—	—
Total	—	$ —	785,962

(1) Reflects shares available to be granted under the 2009 Stock and Incentive Plan in the form of stock options, stock appreciation rights, stock awards, dividend equivalent rights, performance share awards, stock units and incentive awards.

(2) The Company does not have any equity compensation plans that have not been approved by shareholders.

The remaining information required by Item 12 will be included in the 2018 Proxy Statement under the caption “Ownership of Stock” and is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by Item 13 will be included in the 2018 Proxy Statement under the captions “Related Person Transactions” and “Director Independence,” and is incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNANT FEES AND SERVICES

The information required by Item 14 will be included in the 2018 Proxy Statement under the caption “Audit Information,” and is incorporated herein by reference.

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PART IV.

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a)(1) and (a)(2) Financial Statements and Schedules:

1. and 2. Financial Statements and Schedules:The information required by this section of Item 15 is set forth in the Consolidated Financial Statements and Reports of Independent Registered Public Accounting Firm beginning at page F-1 of this Annual Report on Form 10-K. The index to the Financial Statements is set forth at page F-2 of this Annual Report on Form 10-K.

(a)(3) Documents filed as part of this report:

Exhibit No.	Description
3.1	Restated Articles of Incorporation, effective June 2, 2014 (incorporated herein by reference to Exhibit 3.1 to Dynex's Registration Statement on Form S-8 filed September 17, 2014).
3.2	Amended and Restated Bylaws, effective as of May 16, 2017 (incorporated herein by reference to Exhibit 3.2 to Dynex’s Quarterly Report on Form 10-Q for the quarter ended June 30, 2017).
10.11*	Dynex Capital, Inc. 2009 Stock and Incentive Plan, effective as of May 13, 2009 (incorporated herein by reference to Appendix A to Dynex’s Proxy Statement filed April 3, 2009).
10.14	Equity Distribution Agreement between Dynex Capital, Inc. and JMP Securities LLC, dated June 24, 2010 (incorporated herein by reference to Exhibit 10.14 to Dynex’s Current Report on Form 8-K filed June 24, 2010).
10.14.1	Amendment No. 1 to Equity Distribution Agreement between Dynex Capital, Inc. and JMP Securities LLC, dated December 23, 2011 (incorporated herein by reference to Exhibit 10.14.1 to Dynex’s Current Report on Form 8-K filed December 23, 2011).
10.16*	Form of Restricted Stock Agreement for Executive Officers under the Dynex Capital, Inc. 2009 Stock and Incentive Plan (incorporated herein by reference to Exhibit 10.16 to Dynex’s Annual Report on Form 10-K for the year ended December 31, 2010).
10.18*	Non-employee directors’ annual compensation for Dynex Capital, Inc. (filed herewith).
10.23	Master Repurchase and Securities Contract dated as of August 6, 2012 between Issued Holdings Capital Corporation, Dynex Capital, Inc. (as guarantor) and Wells Fargo Bank, National Association (incorporated herein by reference to Exhibit 10.23 to Dynex’s Current Report on Form 8-K filed August 8, 2012).
10.23.1	Amendment No. 1 to Master Repurchase and Securities Contract dated as of October 1, 2013 between Issued Holdings Capital Corporation, Dynex Capital, Inc. (as guarantor) and Wells Fargo Bank, N.A. (incorporated herein by reference to Exhibit 10.23.1 to Dynex’s Current Report on Form 8-K filed October 7, 2013).
10.23.2	Amendment No. 2 to Master Repurchase and Securities Contract dated as of February 5, 2015 between Issued Holdings Capital Corporation, Dynex Capital, Inc. (as guarantor) and Wells Fargo Bank, N.A. (incorporated herein by reference to Exhibit 10.23.2 to Dynex’s Current Report on Form 8-K filed February 11, 2015).
10.23.3	Amendment No. 3 to Master Repurchase and Securities Contract dated as of April 29, 2016 between Issued Holdings Capital Corporation, Dynex Capital, Inc. (as guarantor) and Wells Fargo Bank, N.A. (incorporated herein by reference to Exhibit 10.23.3 to Dynex’s Current Report on Form 8-K filed May 3, 2016).
10.23.4	Amendment No. 4 to Master Repurchase and Securities Contract dated as of May 12, 2017 between Issued Holdings Capital Corporation, Dynex Capital, Inc. (as guarantor) and Wells Fargo Bank, N.A. (incorporated herein by reference to Exhibit 10.23.4 to Dynex’s Current Report on Form 8-K filed May 17, 2017).
10.24	

Guarantee Agreement dated as of August 6, 2012 by Dynex Capital, Inc. in favor of Wells Fargo Bank, National Association (incorporated herein by reference to Exhibit 10.24 to Dynex's Current Report on Form 8-K filed August 8, 2012).

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Exhibit No.	Description
10.25*	Form of Restricted Stock Agreement for Non-Employee Directors under the Dynex Capital, Inc. 2009 Stock and Incentive Plan (incorporated herein by reference to Exhibit 10.25 to Dynex's Quarterly Report on Form 10-Q for the quarter ended June 30, 2016).
10.28*	Dynex Capital, Inc. Executive Incentive Plan (as amended February 22, 2018) (filed herewith).
10.29	Equity Distribution Agreement among Dynex Capital, Inc., Ladenburg Thalmann & Co. Inc. and JonesTrading Institutional Services LLC, dated November 21, 2016 (incorporated herein by reference to Exhibit 10.29 to Dynex's Current Report on Form 8-K filed November 22, 2016).
10.30*	Employment Agreement, dated as of December 8, 2016, between Dynex Capital, Inc. and Byron L. Boston (incorporated herein by reference to Exhibit 10.30 to Dynex's Current Report on Form 8-K filed December 9, 2016).
10.31*	Form of Restricted Stock Agreement for Executive Officers under the Dynex Capital, Inc. 2009 Stock and Incentive Plan (incorporated herein by reference to Exhibit 10.31 to Dynex's Current Report on Form 8-K filed February 13, 2017).
10.32*	Employment Agreement, dated as of March 3, 2017, between Dynex Capital, Inc. and Stephen J. Benedetti (incorporated herein by reference to Exhibit 10.32 to Dynex's Current Report on Form 8-K filed March 8, 2017).
10.33*	Employment Agreement, dated as of March 3, 2017, between Dynex Capital, Inc. and Smriti L. Popenoe (incorporated herein by reference to Exhibit 10.33 to Dynex's Current Report on Form 8-K filed March 8, 2017).
10.34	Amended and Restated Equity Distribution Agreement between Dynex Capital, Inc. and JMP Securities LLC, dated March 31, 2017 (incorporated herein by reference to Exhibit 10.34 to Dynex's Current Report on Form 8-K filed April 3, 2017).
10.34.1	Amendment No. 1, dated December 27, 2017, to Amended and Restated Equity Distribution Agreement between Dynex Capital, Inc. and JMP Securities LLC, dated March 31, 2017 (incorporated herein by reference to Exhibit 10.34.1 to Dynex's Current Report on Form 8-K filed December 27, 2017).
12.1	Statement Regarding Computation of Ratio of Earnings to Fixed Charges and Ratio of Earnings to Combined Fixed Charges and Preferred Stock Dividends (filed herewith).
21.1	List of consolidated entities of Dynex Capital, Inc. (filed herewith).
23.1	Consent of BDO USA, LLP (filed herewith).
31.1	Certification of principal executive officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
31.2	Certification of principal financial officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
32.1	Certification of principal executive officer and principal financial officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith).
101	The following materials from Dynex Capital, Inc.'s Annual Report on Form 10-K for the year ended December 31, 2017, formatted in XBRL (Extensible Business Reporting Language), filed herewith: (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Comprehensive Income (Loss), (iii) Consolidated Statements of Shareholders' Equity, (iv) Consolidated Statements of Cash Flows, and (v) Notes to Consolidated Financial Statements.

* Denotes management contract.

(b) Exhibits: See Item 15(a)(3) above.

(c) Financial Statement Schedules: None.

ITEM 16. FORM 10-K SUMMARY

None.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.
(Registrant)

March 5, 2018 /s/ Stephen J. Benedetti
Stephen J. Benedetti, Executive Vice President, Chief Financial Officer and Chief Operating Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ Byron L. Boston Byron L. Boston	Chief Executive Officer, President, Co-Chief Investment Officer, and Director (Principal Executive Officer)	March 5, 2018
/s/ Stephen J. Benedetti Stephen J. Benedetti	Executive Vice President, Chief Financial Officer and Chief Operating Officer (Principal Financial Officer)	March 5, 2018
/s/ Jeffrey L. Childress Jeffrey L. Childress	Vice President and Controller (Principal Accounting Officer)	March 5, 2018
/s/ Michael R. Hughes Michael R. Hughes	Director	March 5, 2018
/s/ Barry A. Igdaloff Barry A. Igdaloff	Director	March 5, 2018
/s/ Valerie A. Mosley Valerie A. Mosley	Director	March 5, 2018
/s/ Robert A. Salcetti Robert A. Salcetti	Director	March 5, 2018

DYNEX CAPITAL, INC.

CONSOLIDATED FINANCIAL STATEMENTS AND

REPORTS OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

For Inclusion in Annual Report on Form 10-K

Filed with Securities and Exchange Commission

December 31, 2017

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DYNEX CAPITAL, INC.
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Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders
Dynex Capital, Inc.
Glen Allen, Virginia
Opinion on the Consolidated Financial Statements
We have audited the accompanying consolidated balance sheets of Dynex Capital, Inc. (the “Company”) and subsidiaries as of December 31, 2017 and 2016, the related consolidated statements of comprehensive income (loss), shareholders’ equity, and cash flows for each of the three years in the period ended December 31, 2017, and the related notes (collectively referred to as the “consolidated financial statements”). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company at December 31, 2017 and 2016, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2017, in conformity with accounting principles generally accepted in the United States of America.
We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (“PCAOB”), the Company's internal control over financial reporting as of December 31, 2017, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”) and our report dated March 5, 2018 expressed an unqualified opinion thereon.
Basis for Opinion
These consolidated financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on the Company’s consolidated financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.
We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud.
Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ BDO USA, LLP
We have served as the Company's auditor since 2005.
Richmond, Virginia
March 5, 2018

BDO USA, LLP, a Delaware limited liability partnership, is the U.S. member of BDO International Limited, a UK company limited by guarantee, and forms part of the international BDO network of independent member firms.

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Report of Independent Registered Public Accounting Firm
Board of Directors and Shareholders
Dynex Capital, Inc.
Glen Allen, Virginia
Opinion on Internal Control over Financial Reporting
We have audited Dynex Capital, Inc.'s (the "Company's") internal control over financial reporting as of December 31, 2017, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (the "COSO criteria"). In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2017, based on the COSO criteria.
We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) ("PCAOB"), the consolidated balance sheets of the Company and subsidiaries as of December 31, 2017 and 2016, the related consolidated statements of comprehensive income (loss), shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2017, and the related notes and our report dated March 5, 2018 expressed an unqualified opinion thereon.
Basis for Opinion
The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Item 9A, Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.
We conducted our audit of internal control over financial reporting in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.
Definition and Limitations of Internal Control over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

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Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ BDO USA, LLP
Richmond, Virginia
March 5, 2018

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

	December 31, 2017	December 31, 2016
ASSETS		
Investments in securities, at fair value:		
Mortgage-backed securities (including pledged of $2,640,884 and $3,150,610, respectively)	$ 3,026,989	$ 3,212,084
U.S. Treasuries (including pledged of $124,215 and $0, respectively)	146,530	—
Mortgage loans held for investment, net	15,738	19,036
Cash and cash equivalents	40,867	74,120
Restricted cash	46,333	24,769
Derivative assets	2,940	28,534
Principal receivable on investments	165	11,978
Accrued interest receivable	19,819	20,396
Other assets, net	6,397	6,814
Total assets	$ 3,305,778	$ 3,397,731
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities:		
Repurchase agreements	$ 2,565,902	$ 2,898,952
Payable for unsettled securities	156,899	—
Non-recourse collateralized financing	5,520	6,440
Derivative liabilities	269	6,922
Accrued interest payable	3,734	3,156
Accrued dividends payable	12,526	12,268
Other liabilities	3,870	2,809
Total liabilities	2,748,720	2,930,547
Shareholders' equity:		
Preferred stock, par value $.01 per share; 50,000,000 shares authorized; 5,888,680 and 4,571,937 shares issued and outstanding, respectively ($147,217 and $114,298 aggregate liquidation preference, respectively)	$ 141,294	$ 110,005
Common stock, par value $.01 per share, 200,000,000 shares authorized; 55,831,549 and 49,153,463 shares issued and outstanding, respectively	558	492
Additional paid-in capital	775,873	727,369
Accumulated other comprehensive loss	(8,697)	(32,609)
Accumulated deficit	(351,970)	(338,073)
Total shareholders' equity	557,058	467,184
Total liabilities and shareholders' equity	$ 3,305,778	$ 3,397,731

See notes to the consolidated financial statements.

DYNEX CAPITAL, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(amounts in thousands except per share data)

	Year Ended December 31,		
	2017	2016	2015
Interest income	$94,502	$91,898	$100,244
Interest expense	36,178	25,231	22,605
Net interest income	58,324	66,667	77,639
Gain (loss) on derivative instruments, net	3,044	(5,606)	(43,128)
Loss on sale of investments, net	(11,530)	(4,238)	(978)
Fair value adjustments, net	75	103	69
Other (loss) income, net	(201)	880	610
General and administrative expenses:			
Compensation and benefits	(8,509)	(7,550)	(9,103)
Other general and administrative	(7,310)	(7,157)	(8,565)
Net income	33,893	43,099	16,544
Preferred stock dividends	(10,794)	(9,185)	(9,176)
Net income to common shareholders	$23,099	$33,914	$7,368
Other comprehensive income:			
Unrealized gain (loss) on available-for-sale investments, net	$12,650	$(23,828)	$(38,561)
Reclassification adjustment for loss on sale of investments, net	11,530	4,238	978
Reclassification adjustment for de-designated cash flow hedges	(268)	(251)	3,499
Total other comprehensive income (loss)	23,912	(19,841)	(34,084)
Comprehensive income (loss) to common shareholders	$47,011	$14,073	$(26,716)
Net income per common share-basic and diluted	$0.46	$0.69	$0.14
Weighted average common shares-basic and diluted	50,417	49,114	52,847

See notes to the consolidated financial statements.

DYNEX CAPITAL, INC.
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
($ in thousands)

	Preferred Stock		Common Stock					
	Shares	Amount	Shares	Amount	Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Total Shareholders' Equity
Balance as of December 31, 2014	4,550,000	$ 109,658	54,739,111	$ 547	$ 763,935	$ 21,316	$ (288,154)	$ 607,302
Stock issuance	—	—	22,607	—	166	—	—	166
Restricted stock granted, net of amortization	—	—	263,829	3	2,962	—	—	2,965
Adjustments for tax withholding on share-based compensation	—	—	(67,296)	(1)	(556)	—	—	(557)
Stock issuance costs	—	—	—	—	(37)	—	—	(37)
Common stock repurchased	—	—	(5,910,916)	(59)	(41,112)	—	—	(41,171)
Net income	—	—	—	—	—	—	16,544	16,544
Dividends on preferred stock	—	—	—	—	—	—	(9,176)	(9,176)
Dividends on common stock	—	—	—	—	—	—	(49,927)	(49,927)
Other comprehensive loss	—	—	—	—	—	(34,084)	—	(34,084)
Balance as of December 31, 2015	4,550,000	$ 109,658	49,047,335	$ 490	$ 725,358	$ (12,768)	$ (330,713)	$ 492,025
Stock issuance	21,937	548	20,582	1	136	—	—	685
Restricted stock granted, net of amortization	—	—	214,878	2	2,707	—	—	2,709
Adjustments for tax withholding on share-based compensation	—	—	(80,888)	(1)	(484)	—	—	(485)
Stock issuance costs	—	(201)	—	—	(38)	—	—	(239)
Common stock repurchased	—	—	(48,444)	—	(310)	—	—	(310)
Net income	—	—	—	—	—	—	43,099	43,099
Dividends on preferred stock	—	—	—	—	—	—	(9,185)	(9,185)
Dividends on common stock	—	—	—	—	—	—	(41,274)	(41,274)
Other comprehensive loss	—	—	—	—	—	(19,841)	—	(19,841)
Balance as of December 31, 2016	4,571,937	$ 110,005	49,153,463	$ 492	$ 727,369	$ (32,609)	$ (338,073)	$ 467,184

Stock issuance	1,316,743	31,350	6,617,487	66	47,116	—	—	78,532
Restricted stock granted, net of amortization	—	—	138,166	1	1,953	—	—	1,954
Adjustments for tax withholding on share-based compensation	—	—	(77,567)	(1)	(520)	—	—	(521)
Stock issuance costs	—	(61)	—	—	(45)	—	—	(106)
Net income	—	—	—	—	—	—	33,893	33,893
Dividends on preferred stock	—	—	—	—	—	—	(10,794)	(10,794)
Dividends on common stock	—	—	—	—	—	—	(36,996)	(36,996)
Other comprehensive income	—	—	—	—	—	23,912	—	23,912
Balance as of December 31, 2017	5,888,680	$ 141,294	55,831,549	$ 558	$ 775,873	$ (8,697)	$ (351,970)	$ 557,058

See notes to the consolidated financial statements.

DYNEX CAPITAL, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
($ in thousands)

	Year Ended December 31,		
	2017	2016	2015
Operating activities:			
Net income	$33,893	$ 43,099	$ 16,544
Adjustments to reconcile net income to cash provided by operating activities:			
Decrease (increase) in accrued interest receivable	577	2,368	(1,607)
Increase (decrease) in accrued interest payable	578	1,413	(204)
(Gain) loss on derivative instruments, net	(3,044)	5,606	43,128
Loss on sale of investments, net	11,530	4,238	978
Fair value adjustments, net	(75)	(103)	(69)
Amortization of investment premiums, net	157,706	150,729	152,308
Other amortization and depreciation, net	1,287	1,502	5,338
Stock-based compensation expense	1,954	2,709	2,965
Increase (decrease) in other assets and liabilities, net	42	(1,047)	(2,430)
Net cash and cash equivalents provided by operating activities	204,448	210,514	216,951
Investing activities:			
Purchase of investments	(1,317,959)	(435,046)	(1,122,970)
Principal payments received on investments	307,133	448,567	494,275
Proceeds from sales of investments	1,073,101	99,284	449,921
Principal payments received on mortgage loans held for investment, net	3,386	4,953	15,570
Payment to acquire interest in limited partnership	—	—	(6,000)
Distributions received from limited partnership	—	10,835	—
Net receipts (payments) on derivatives, including terminations	21,986	(60,588)	(39,929)
Other investing activities	(214)	(37)	(237)
Net cash and cash equivalents provided by (used in) investing activities	87,433	67,968	(209,370)
Financing activities:			
Borrowings under repurchase agreements and FHLB advances	84,876,542	40,594,639	23,555,007
Repayments of repurchase agreement borrowings and FHLB advances	(85,209,592)	(40,805,107)	(23,458,697)
Principal payments on non-recourse collateralized financing	(938)	(2,039)	(2,395)
Proceeds from issuance of preferred stock	31,350	548	—
Proceeds from issuance of common stock	47,182	137	166
Cash paid for stock issuance costs	(61)	(201)	—
Cash paid for repurchases of common stock	—	(310)	(41,171)
Payments related to tax withholding for stock-based compensation	(521)	(485)	(557)
Dividends paid	(47,532)	(51,900)	(61,016)
Net cash and cash equivalents used in financing activities	(303,570)	(264,718)	(8,663)
Net (decrease) increase in cash, cash equivalents, and restricted cash	(11,689)	13,764	(1,082)
Cash, cash equivalents, and restricted cash at beginning of period	98,889	85,125	86,207
Cash, cash equivalents, and restricted cash at end of period	$87,200	$ 98,889	$ 85,125
Supplemental Disclosure of Cash Activity:			
Cash paid for interest	$35,851	$ 24,033	$ 19,260

See notes to the consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DYNEX CAPITAL, INC.
(amounts in thousands except share data)

NOTE 1 – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

Dynex Capital, Inc., ("Company") was incorporated in the Commonwealth of Virginia on December 18, 1987 and commenced operations in February 1988. The Company primarily earns income from investing on a leveraged basis in debt securities, the majority of which are specified pools of Agency and non-Agency mortgage-backed securities ("MBS") consisting of residential MBS ("RMBS"), commercial MBS ("CMBS") and CMBS interest-only ("IO") securities that are issued or guaranteed by the U.S. Government or U.S. Government sponsored agencies ("Agency MBS") and MBS issued by others ("non-Agency MBS"). The Company also invests in other types of mortgage-related securities, such as to-be-announced securities ("TBAs" or "TBA securities"), and in other debt securities, such as U.S. Treasury securities, which are not collateralized but are backed by the full faith and credit of the U.S. government.

Basis of Presentation

The accompanying consolidated financial statements of Dynex Capital, Inc. and its subsidiaries (together, "Dynex" or, as appropriate, the "Company") have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP") the instructions to the Annual Report on Form 10-K and Article 3 of Regulation S-X promulgated by the Securities and Exchange Commission (the "SEC").

Consolidation

The consolidated financial statements include the accounts of the Company and the accounts of its majority owned subsidiaries and variable interest entities ("VIE") for which it is the primary beneficiary. As a primary beneficiary, the Company has both the power to direct the activities that most significantly impact the economic performance of the VIE and a right to receive benefits or absorb losses of the entity that could be potentially significant to the VIE. The Company is required to reconsider its evaluation of whether to consolidate a VIE each reporting period, based upon changes in the facts and circumstances pertaining to the VIE. The Company consolidates certain trusts through which it has securitized mortgage loans as a result of not meeting the sale criteria under GAAP at the time the financial assets were transferred to the trust. All intercompany accounts and transactions have been eliminated in consolidation.

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 the disclosure of contingent assets and liabilities at the date of the financial statements as well as the reported amounts of revenue and expenses during the reported period. Actual results could differ from those estimates. The most significant estimates used by management include, but are not limited to, amortization of premiums and discounts, fair value measurements of its investments, and other-than-temporary impairments. These items are discussed further below within this note to the consolidated financial statements.

Income Taxes

The Company has elected to be taxed as a real estate investment trust ("REIT") under the Internal Revenue Code of 1986 and the corresponding provisions of state law. To qualify as a REIT, the Company must meet certain tests

including investing in primarily real estate-related assets and the required distribution of at least 90% of its annual REIT taxable income to stockholders after consideration of its net operating loss ("NOL") carryforward and not including taxable income retained in its taxable subsidiaries. As a REIT, the Company generally will not be subject to federal income tax on the amount of its income or capital gains that is distributed as dividends to shareholders.

The Company assesses its tax positions for all open tax years and determines whether the Company has any material unrecognized liabilities in accordance with Accounting Standards Codification ("ASC") Topic 740. The Company records these liabilities, if any, to the extent they are deemed more likely than not to have been incurred.

Net Income Per Common Share

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DYNEX CAPITAL, INC.
(amounts in thousands except share data)

The Company calculates basic net income per common share by dividing net income to common shareholders for the period by weighted-average shares of common stock outstanding for that period. The Company did not have any potentially dilutive securities outstanding during the three-year period ended December 31, 2017.

Holders of unvested shares of the Company’s issued and outstanding restricted common stock are eligible to receive non-forfeitable dividends. As such, these unvested shares are considered participating securities as per ASC Topic 260-10 and therefore are included in the computation of basic net income per common share using the two-class method. Upon vesting, restrictions on transfer expire on each share of restricted stock, and each such share of restricted stock represents one unrestricted share of common stock.

Because the Company’s 8.50% Series A Cumulative Redeemable Preferred Stock (the “Series A Preferred Stock”) and 7.625% Series B Cumulative Redeemable Preferred Stock (the “Series B Preferred Stock”) are redeemable at the Company’s option for cash only and may convert into shares of common stock only upon a change of control of the Company, the effect of those shares and their related dividends is excluded from the calculation of diluted net income per common share.

Cash and Cash Equivalents

Cash and cash equivalents include cash on hand and highly liquid investments with original maturities of three months or less.

Restricted Cash

Restricted cash consists of cash the Company has pledged to cover initial and variation margin with its financing and derivative counterparties.

The Company early adopted Accounting Standards Update ("ASU") No. 2016-18, Statement of Cash Flows (Topic 230) - Restricted Cash, which requires amounts generally described as restricted cash or restricted cash equivalents to be included with cash and cash equivalents when reconciling the beginning of period and end of period total amounts shown on the statement of cash flows. Because this ASU is to be applied retrospectively to each period presented, “net cash and cash equivalents used in financing activities” on the Company’s consolidated statement of cash flows for the years ended December 31, 2016 and December 31, 2015 now omits the change in restricted cash as reported in prior periods, and that change is now included within “net increase in cash, cash equivalents, and restricted cash” for those periods in order to conform to the current period’s presentation.

The following table provides a reconciliation of cash, cash equivalents, and restricted cash reported on the Company's consolidated balance sheet as of December 31, 2017 that sum to the total of the same such amounts shown on the Company’s consolidated statement of cash flows for the year ended December 31, 2017:

	December 31, 2017
Cash and cash equivalents	$ 40,867
Restricted cash	46,333
Total cash, cash equivalents, and restricted cash shown on consolidated statement of cash flows	$ 87,200

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DYNEX CAPITAL, INC.
(amounts in thousands except share data)

Investments in Debt Securities

The Company's investments in debt securities are designated as available-for-sale ("AFS") and are recorded at fair value on the Company's consolidated balance sheet. Changes in unrealized gain (loss) on the Company's debt securities are reported in other comprehensive income ("OCI") until the investment is sold, matures, or is determined to be other than temporarily impaired. Although the Company generally intends to hold its AFS securities until maturity, it may sell any of these securities as part of the overall management of its business. Upon the sale of an AFS security, any unrealized gain or loss is reclassified out of accumulated other comprehensive income ("AOCI") into net income as a realized "gain (loss) on sale of investments, net" using the specific identification method.

The fair value of the Company's debt securities pledged as collateral against repurchase agreements and derivative instruments is disclosed parenthetically on the Company's consolidated balance sheets.

Interest Income, Premium Amortization, and Discount Accretion. Interest income on debt securities is accrued based on the outstanding principal balance (or notional balance in the case of interest-only, or "IO", securities) and their contractual terms. Premiums or discounts associated with the purchase of Agency MBS as well as any non-Agency MBS rated 'AA' and higher are amortized or accreted into interest income over the expected life of such securities using the effective yield method, and adjustments to premium amortization and discount accretion are made for actual cash payments. The Company may also adjust premium amortization and discount accretion for changes in projected future cash payments. The Company's projections of future cash payments are based on input and analysis received from external sources and internal models, and include assumptions about the amount and timing of loan prepayment rates, fluctuations in interest rates, credit losses, and other factors. On at least a quarterly basis, the Company reviews and makes any necessary adjustments to its cash flow projections and updates the yield recognized on these assets. The Company does not estimate future prepayments on its fixed-rate Agency RMBS.

The Company holds certain non-Agency MBS that had credit ratings of less than 'AA' at the time of purchase or were not rated by any of the nationally recognized credit rating agencies. A portion of these non-Agency MBS were purchased at discounts to their par value, which management does not believe to be substantial. The discount is accreted into income over the security's expected life based on management's estimate of the security's projected cash flows. Future changes in the timing of projected cash flows or differences arising between projected cash flows and actual cash flows received may result in a prospective change in the effective yield on those securities.

Determination of MBS Fair Value. The Company estimates the fair value of the majority of its MBS based upon prices obtained from third-party pricing services and broker quotes. The remainder of the Company's MBS are valued by discounting the estimated future cash flows derived from cash flow models that utilize information such as the security's coupon rate, estimated prepayment speeds, expected weighted average life, collateral composition, estimated future interest rates, expected losses, and credit enhancements as well as certain other relevant information. Refer to Note 5 for further discussion of MBS fair value measurements.

Other-than-Temporary Impairment. An MBS is considered impaired when its fair value is less than its amortized cost. The Company evaluates all of its impaired MBS for other-than-temporary impairments ("OTTI") on at least a quarterly basis. An impairment is considered other-than-temporary if: (1) the Company intends to sell the MBS; (2) it is more likely than not that the Company will be required to sell the MBS before its fair value recovers; or (3) the Company does not expect to recover the full amortized cost basis of the MBS. If either of the first two conditions is met, the entire amount of the impairment is recognized in earnings. If the impairment is solely due to the inability to fully

recover the amortized cost basis, the security is further analyzed to quantify any credit loss, which is the difference between the present value of cash flows expected to be collected on the MBS and its amortized cost. The credit loss, if any, is then recognized in earnings, while the balance of impairment related to other factors is recognized in other comprehensive income.

Following the recognition of an OTTI through earnings, a new cost basis is established for the security. Any subsequent recoveries in fair value may be accreted back into the amortized cost basis of the MBS on a prospective basis through interest income. Please see Note 2 for additional information related to the Company’s evaluation for OTTI.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DYNEX CAPITAL, INC.
(amounts in thousands except share data)

Repurchase Agreements

The Company’s repurchase agreements, which are used to finance its purchases of debt securities, are accounted for as secured borrowings 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 of a decline in the fair value of the collateral pledged. Repurchase agreement financing is recourse to the Company and the assets pledged. Most of the Company’s repurchase agreements are based on the September 1996 version of the Bond Market Association Master Repurchase Agreement, which generally provides that the lender, as buyer, is responsible for obtaining collateral valuations from a generally recognized source agreed to by both the Company and the lender, or, in an instance when such source is not available, the value determination is made by the lender.

Derivative Instruments

The Company’s derivative instruments include interest rate swaps, Eurodollar futures, and forward contracts for the purchase or sale of non-specified Agency RMBS, commonly referred to as “TBA securities” or “TBA contracts”. Derivative instruments are accounted for at the fair value of their unit of account. Derivative instruments in a gain position are reported as derivative assets and derivative instruments in a loss position are reported as derivative liabilities on the Company’s consolidated balance sheet. All periodic interest costs and changes in fair value of derivative instruments, including gains and losses realized upon termination, maturity, or settlement are recorded in “gain (loss) on derivative instruments, net” on the Company’s consolidated statement of comprehensive income. Cash receipts and payments related to derivative instruments are classified in the investing activities section of the consolidated statements of cash flows in accordance with the underlying nature or purpose of the derivative transactions.

The Company’s interest rate swap agreements are privately negotiated in the over-the-counter (“OTC”) market and the majority of these agreements are centrally cleared through the Chicago Mercantile Exchange (“CME”) with the rest being subject to bilateral agreements between the Company and the swap counterparty. The Company’s CME cleared swaps require that the Company post initial margin as determined by the CME, and in addition, variation margin is exchanged, typically in cash, for changes in the fair value of the CME cleared swaps. Beginning in January 2017, as a result of a change in the CME’s rulebook, the exchange of variation margin for CME cleared swaps is legally considered to be the settlement of the derivative itself as opposed to a pledge of collateral. Accordingly, beginning in 2017, the Company accounts for the daily exchange of variation margin associated with its CME cleared interest rate swaps as a direct increase or decrease to the carrying value of the related derivative asset or liability. The carrying value of CME cleared interest rate swaps on the Company’s consolidated balance sheets is the unsettled fair value of those instruments.

A TBA security is a forward contract (“TBA contract”) for the purchase (“long position”) or sale (“short position”) of a non-specified Agency MBS at a predetermined price with certain principal and interest terms and certain types of collateral, but the particular Agency securities to be delivered are not identified until shortly before the settlement date. The Company accounts for long and short positions in TBAs as derivative instruments because the Company cannot assert that it is probable at inception and throughout the term of an individual TBA transaction that its

settlement will result in physical delivery of the underlying Agency RMBS, or the individual TBA transaction will not settle in the shortest time period possible.

Please refer to Note 4 for additional information regarding the Company's derivative instruments as well as Note 5 for information on how the fair value of these instruments are calculated.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DYNEX CAPITAL, INC.
(amounts in thousands except share data)

Share-Based Compensation

Pursuant to the Company’s 2009 Stock and Incentive Plan, the Company may grant share-based compensation to eligible employees, directors or consultants or advisers to the Company, including stock awards, stock options, stock appreciation rights, dividend equivalent rights, performance shares, and restricted stock units. The Company’s restricted stock currently issued and outstanding under this plan may be settled only in shares of its common stock, and therefore are treated as equity awards with their fair value measured at the grant date and recognized as compensation cost over the requisite service period with a corresponding credit to shareholders’ equity. The requisite service period is the period during which an employee is required to provide service in exchange for an award, which is equivalent to the vesting period specified in the terms of the time-based restricted stock award. None of the Company’s restricted stock awards have performance based conditions. The Company does not currently have any share-based compensation issued or outstanding other than restricted stock issued to its employees, officers, and directors.

Contingencies

In the normal course of business, there may be various lawsuits, claims, and other contingencies pending against the Company. On a quarterly basis, the Company evaluates whether to establish provisions for estimated losses from those matters. The Company recognizes a liability for a contingent loss when: (a) the underlying causal event has occurred prior to the balance sheet date; (b) it is probable that a loss has been incurred; and (c) there is a reasonable basis for estimating that loss. A liability is not recognized for a contingent loss when it is only possible or remotely possible that a loss has been incurred, however, possible contingent losses shall be disclosed. If the contingent loss (or an additional loss in excess of any accrual) is at least a reasonable possibility and material, then the Company discloses a reasonable estimate of the possible loss or range of loss, if such reasonable estimate can be made. If the Company cannot make a reasonable estimate of the possible material loss, or range of loss, then that fact is disclosed.

Recent Accounting Pronouncements

The Financial Accounting Standards Board ("FASB") issued ASU No. 2017-08, Receivables-Nonrefundable Fees and Other Costs, which shortens the amortization period for certain callable debt securities held at a premium, requiring the premium to be amortized to the earliest call date. The amendments in this ASU are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018 and early adoption is permitted. The amendments in this Update should be applied using the modified-retrospective transition approach and will require disclosures for the change in accounting principle. The Company does not expect this ASU to have a material impact on the Company’s consolidated financial statements.

FASB issued ASU No. 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities, which contains significant amendments to hedge accounting with the main objective of better aligning an entity’s risk management activities and financial reporting for hedging relationships through changes to both the designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results. To meet that objective, the amendments expand and refine hedge accounting for both non-financial and financial risk components and align the recognition and presentation of the effects of the hedging instrument and the hedged item in the financial statements. This ASU also includes certain targeted improvements to ease the application of current guidance related to the assessment of hedge effectiveness as well as changes to current disclosure requirements. The amendments in this ASU are effective for public business entities for fiscal years beginning after

December 15, 2018, and interim periods within those fiscal years, and early adoption is permitted. All transition requirements and elections will be applied to hedging relationships existing on the date of adoption. The effect of adoption will be reflected as of the beginning of the fiscal year of adoption, and the amended presentation and disclosure guidance is required only prospectively. The Company does not currently apply hedge accounting, but is evaluating the impact this ASU would have on its consolidated financial statements if the Company elects to adopt hedge accounting in the future.

FASB issued ASU No. 2014-09, Revenue from Contracts with Customers, which is a comprehensive revenue recognition standard that supersedes virtually all existing revenue guidance under U.S. GAAP and is effective on January 1, 2018. The standard’s core principle is that an entity will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DYNEX CAPITAL, INC.
(amounts in thousands except share data)

Revenue recognition with respect to financial instruments is excluded from the scope of ASU 2014-09. Therefore, ASU 2014-09 will not have an impact on the Company's consolidated financial statements.

NOTE 2 – INVESTMENTS IN DEBT SECURITIES

The majority of the Company's debt securities are pledged as collateral for the Company's repurchase agreements. The following tables present the Company's debt securities by investment type as of the dates indicated:

	December 31, 2017						
	Par	Net Premium (Discount)	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value	WAC (1)
RMBS:							
Agency (2)	$1,146,553	$46,021	$1,192,574	$ 1,626	$(9,939)	$1,184,261	3.56%
Non-Agency	1,070	—	1,070	41	(20)	1,091	6.75%
	1,147,623	46,021	1,193,644	1,667	(9,959)	1,185,352	
CMBS:							
Agency	1,123,967	10,442	1,134,409	3,514	(13,572)	1,124,351	3.03%
Non-Agency	26,501	(4,035)	22,466	2,298	—	24,764	5.47%
	1,150,468	6,407	1,156,875	5,812	(13,572)	1,149,115	
CMBS IO (3):							
Agency	—	375,361	375,361	5,238	(293)	380,306	0.62%
Non-Agency	—	308,472	308,472	4,468	(724)	312,216	0.61%
	—	683,833	683,833	9,706	(1,017)	692,522	
U.S. Treasuries:	148,400	(133)	148,267	—	(1,737)	146,530	2.13%
Total AFS securities:	$2,446,491	$736,128	$3,182,619	$ 17,185	$(26,285)	$3,173,519	

(1) The weighted average coupon ("WAC") is the gross interest rate of the security weighted by the outstanding principal balance (or by notional balance in the case of an IO security).
(2) Includes purchased securities pending settlement.
(3) The notional balance for Agency CMBS IO and non-Agency CMBS IO was $14,196,122 and $11,006,463, respectively, as of December 31, 2017.

	December 31, 2016						
	Par	Net Premium (Discount)	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value	WAC (1)
RMBS:							
Agency	$1,157,258	$57,066	$1,214,324	$ 2,832	$(15,951)	$1,201,205	3.05%
Non-Agency	33,572	(24)	33,548	64	(50)	33,562	3.58%
	1,190,830	57,042	1,247,872	2,896	(16,001)	1,234,767	
CMBS:							
Agency	1,152,586	13,868	1,166,454	6,209	(28,108)	1,144,555	3.12%
Non-Agency	79,467	(6,718)	72,749	5,467	—	78,216	4.72%
	1,232,053	7,150	1,239,203	11,676	(28,108)	1,222,771	
CMBS IO (2):							
Agency	—	411,737	411,737	3,523	(3,362)	411,898	0.67%
Non-Agency	—	346,155	346,155	1,548	(5,055)	342,648	0.61%
	—	757,892	757,892	5,071	(8,417)	754,546	
Total AFS securities:	$2,422,883	$822,084	$3,244,967	$ 19,643	$(52,526)	$3,212,084	

(1) The WAC is the gross interest rate of the security weighted by the outstanding principal balance (or by notional balance in the case of an IO security).

(2) The notional balance for the Agency CMBS IO and non-Agency CMBS IO was $13,106,912 and $10,884,964, respectively, as of December 31, 2016.

Actual maturities of MBS are affected by the contractual lives of the underlying mortgage collateral, periodic payments of principal, prepayments of principal, and the payment priority structure of the security; therefore, actual maturities are generally shorter than the securities' stated contractual maturities. The following table categorizes the Company's debt securities according to their stated maturity as of the periods indicated:

	December 31, 2017		December 31, 2016	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Less than 1 year	$4,480	$4,542	$12,375	$12,189
>1 and <5 years	208,046	210,727	228,443	235,059
>5 and <10 years	1,334,795	1,326,178	1,060,273	1,040,609
> 10 years	1,635,298	1,632,072	1,943,876	1,924,227
	$3,182,619	$3,173,519	$3,244,967	$3,212,084

The Company reallocated capital during the year ended December 31, 2017 from adjustable rate investments with shorter duration into fixed rate investments with longer duration.

The following table presents information regarding the sales included in "loss on sale of investments, net" on the Company's consolidated statements of comprehensive income for the periods indicated:

	Year Ended December 31, 2017		2016		2015	
	Proceeds Received	Realized Gain (Loss)	Proceeds Received	Realized Gain (Loss)	Proceeds Received	Realized Gain (Loss)
Agency RMBS	$716,560	$(12,392)	$54,178	$(3,010)	$174,565	$(2,865)
Agency CMBS	252,624	(135)	—	—	149,360	(604)
Non-Agency CMBS	35,705	1,199	33,640	(1,228)	30,775	(566)
Non-Agency RMBS	16,407	42	—	—	—	—
Agency CMBS IO	—	—	—	—	45,096	1,698
Non-Agency CMBS IO	—	—	—	—	50,125	1,359
U.S. Treasuries	51,797	(244)	—	—	—	—
	$1,073,093	$(11,530)	$87,818	$(4,238)	$449,921	$(978)

The following table presents certain information for those MBS in an unrealized loss position as of the dates indicated:

	December 31, 2017			December 31, 2016		
	Fair Value	Gross Unrealized Losses	# of Securities	Fair Value	Gross Unrealized Losses	# of Securities
Continuous unrealized loss position for less than 12 months:						
Agency MBS	$1,293,798	$(9,769)	71	$1,738,094	$(38,469)	133
Non-Agency MBS	51,406	(421)	11	205,484	(2,773)	48
Continuous unrealized loss position for 12 months or longer:						
Agency MBS	$423,698	$(14,035)	30	$427,405	$(8,952)	72
Non-Agency MBS	20,414	(323)	12	81,660	(2,332)	26

Because the principal related to Agency MBS is guaranteed by the government-sponsored entities Fannie Mae and Freddie Mac which have the implicit guarantee of the U.S. government, the Company does not consider any of the unrealized losses on its Agency MBS to be credit related. Although the unrealized losses are not credit related, the Company assesses its ability and intent to hold any Agency MBS with an unrealized loss until the recovery in its value in accordance with GAAP. This assessment is based on the amount of the unrealized loss and significance of the related investment as well as the Company’s leverage and liquidity position. Based on this analysis, the Company has determined that the unrealized losses on its Agency MBS as of December 31, 2017 and December 31, 2016 were temporary.

The Company reviews any non-Agency MBS in an unrealized loss position to evaluate whether any decline in fair value represents an OTTI. The evaluation includes a review of the credit ratings of the non-Agency MBS, the credit characteristics of the mortgage loans collateralizing these securities, and the estimated future cash flows including projected collateral losses. The Company performed this evaluation for its non-Agency MBS in an unrealized loss position and has determined that there have not been any adverse changes in the timing or amount of estimated future cash flows that necessitate a recognition of OTTI amounts as of December 31, 2017 or December 31, 2016.

NOTE 3 – REPURCHASE AGREEMENTS

The Company’s repurchase agreements outstanding as of December 31, 2017 and December 31, 2016 are summarized in the following tables:

	December 31, 2017				December 31, 2016			
Collateral Type	Balance	Weighted Average Rate		Fair Value of Collateral Pledged	Balance	Weighted Average Rate		Fair Value of Collateral Pledged
Agency RMBS	$836,281	1.47	%	$867,120	$1,157,302	0.82	%	$1,191,147
Non-Agency RMBS	—	—	%	—	26,149	1.98	%	31,952
Agency CMBS	1,003,146	1.44	%	1,071,904	1,005,726	0.82	%	1,095,002
Non-Agency CMBS	15,508	2.47	%	18,212	66,881	1.63	%	77,840
Agency CMBS IO	324,163	2.17	%	372,077	346,892	1.57	%	407,481
Non-Agency CMBS IO	263,694	2.43	%	311,571	291,199	1.67	%	341,139
U.S. Treasuries	123,110	1.85	%	124,215	—	—	%	—
Securitization financing bond	—	—	%	—	4,803	2.00	%	5,278
Total repurchase agreements	$2,565,902	1.67	%	$2,765,099	$2,898,952	1.03	%	$3,149,839

The Company also had $156,899 due to counterparties for purchases of $156,551 fixed-rate Agency RMBS which were pending settlement as of December 31, 2017.

The following table provides information on the remaining term to maturity and original term to maturity for the Company’s repurchase agreements as of the periods indicated:

	December 31, 2017		December 31, 2016	
Remaining Term to Maturity	Balance	WAVG Original Term to Maturity	Balance	WAVG Original Term to Maturity
Less than 30 days	$2,240,791	49	$2,480,213	58
30 to 90 days	274,231	90	418,739	87
91 to 180 days	50,880	121	—	—
Total	$2,565,902	54	$2,898,952	63

The following table lists the counterparties with whom the Company had over 10% of its shareholders’ equity at risk (defined as the excess of collateral pledged over the borrowings outstanding):

	December 31, 2017			
Counterparty Name	Balance	Weighted Average Rate		Equity at Risk
Wells Fargo Bank, N. A. and affiliates	$311,351	2.43	%	$56,383

Of the amount outstanding with Wells Fargo Bank, N.A. and affiliates, $304,005 is under a committed repurchase facility which has an aggregate maximum borrowing capacity of $400,000 and is scheduled to mature on May 12, 2019, subject to early termination provisions contained in the master repurchase agreement. The facility is collateralized primarily by CMBS IO, and its weighted average borrowing rate as of December 31, 2017 was 2.43%.

As of December 31, 2017, the Company had repurchase agreement amounts outstanding with 16 of its 34 available repurchase agreement counterparties. The Company’s counterparties, as set forth in the master repurchase agreement with the

counterparty, require the Company to comply with various customary operating and financial covenants, including, but not limited to, minimum net worth and earnings, maximum declines in net worth in a given period, and maximum leverage requirements as well as maintaining the Company's REIT status. In addition, some of the agreements contain cross default features, whereby default under an agreement with one lender simultaneously causes default under agreements with other lenders. To the extent that the Company fails to comply with the covenants contained in these financing agreements or is otherwise found to be in default under the terms of such agreements, the counterparty has the right to accelerate amounts due under the master repurchase agreement. The Company was in full compliance with all covenants as of December 31, 2017.

The Company's repurchase agreements are subject to underlying agreements with master netting or similar arrangements, which provide for the right of offset in the event of default or in the event of bankruptcy of either party to the transactions. The Company reports its repurchase agreements to these arrangements on a gross basis. The following tables present information regarding the Company's repurchase agreements as if the Company had presented them on a net basis as of December 31, 2017 and December 31, 2016:

	Gross Amount of Recognized Liabilities	Gross Amount Offset in the Balance Sheet	Net Amount of Liabilities Presented in the Balance Sheet	Gross Amount Not Offset in the Balance Sheet [(1)]		Net Amount
				Financial Instruments Posted as Collateral	Cash Posted as Collateral	
December 31, 2017						
Repurchase agreements	$ 2,565,902	$ —	$ 2,565,902	$ (2,565,902)	$ —	$ —
December 31, 2016:						
Repurchase agreements	$ 2,898,952	$ —	$ 2,898,952	$ (2,898,952)	$ —	$ —

(1) Amounts disclosed for collateral received by or posted to the same counterparty include cash and the fair value of debt securities up to and not exceeding the net amount of the asset or liability presented in the balance sheet. The fair value of the total collateral received by or posted to the same counterparty may exceed the amounts presented.

Please see Note 4 for information related to the Company's derivatives which are also subject to underlying agreements with master netting or similar arrangements.

NOTE 4 – DERIVATIVES

The Company is a party to certain types of financial instruments that are accounted for as derivative instruments. Please refer to Note 1 for information related to the Company's accounting policy for its derivative instruments.

Types and Uses of Derivatives Instruments

Interest Rate Derivatives

Changing interest rates impact the fair value of the Company's investments as well as the interest rates on the Company's repurchase agreement borrowings used to finance its investments. The Company primarily uses interest rate swaps and Eurodollar futures as economic hedges to mitigate declines in book value and to protect some portion of the Company's earnings from rising interest rates.

TBA Transactions

The Company also holds long positions in TBA securities by executing a series of transactions which effectively delay the settlement of a forward purchase of a non-specified Agency RMBS by entering into an offsetting TBA short position, net settling the paired-off positions in cash, and simultaneously entering into an identical TBA long position with a later settlement date. These long positions in TBA securities ("dollar roll positions") are viewed by management as economically equivalent to investing in and financing non-specified fixed-rate Agency RMBS. TBA securities

purchased for a forward settlement month are generally priced at a discount relative to TBA securities sold for settlement in the current month. This discount, often referred

to as “drop income” represents the economic equivalent of net interest income (interest income less implied financing cost) on the underlying Agency security from trade date to settlement date.
Periodically, the Company may also hold short positions in TBA securities for the purpose of economically hedging a portion of the impact of changing interest rates on the fair value of the Company’s fixed-rate Agency RMBS.
The table below summarizes information about the fair value by type of derivative instrument on the Company’s consolidated balance sheets as of the dates indicated:

Type of Derivative Instrument	Balance Sheet Location	Purpose	December 31, 2017 Fair Value	December 31, 2016 Fair Value (1)
Interest rate swaps	Derivative assets	Economic hedging	$ 791	$ 28,534
Eurodollar futures(2)	Derivative assets	Economic hedging	666	—
TBA securities	Derivative assets	Investing	1,483	—
			$ 2,940	$ 28,534
Interest rate swaps	Derivative liabilities	Economic hedging	$ —	$ (6,922)
TBA securities	Derivative liabilities	Economic hedging	(269)	—
			$ (269)	$ (6,922)

(1) Refer to Note 1 regarding information on a change in the CME rulebook. Amounts reported on the consolidated balance sheet as of December 31, 2017 for its interest rate swaps reflect the netting of the derivative asset or liability with the related collateral received or posted, respectively. The net amounts comparable to December 31, 2017 for the derivative asset and derivative liabilities as of December 31, 2016 were $104 and $(576), respectively.

(2) The Eurodollar futures aggregate notional amount represents the total notional of the 3-month contracts with expiration dates from 2017 to 2018. The maximum notional outstanding for any future 3-month period did not exceed $650,000 as of December 31, 2017.

The following tables present information about the Company’s interest rate swaps as of the dates indicated:

	December 31, 2017			
		Weighted-Average:		
Years to Maturity:	Net Notional Amount [1]	Pay Rate [2]	Life Remaining (in Years)	Fair Value
< 3 years	$3,320,000	1.35%	0.7	$791
>3 and < 6 years	1,210,000	2.00%	4.6	—
>6 and < 10 years	1,025,000	2.49%	8.0	—
>10 years	120,000	2.75%	17.3	—
Total	$5,675,000	1.71%	3.1	$791

	December 31, 2016			
		Weighted-Average:		
Years to Maturity:	Net Notional Amount [1]	Pay Rate [2]	Life Remaining (in Years)	Fair Value
< 3 years	$595,000	0.73%	2.3	$4,348
>3 and < 6 years	1,185,000	1.47%	4.3	8,631
>6 and < 10 years	1,250,000	2.42%	8.9	8,633
Total	$3,030,000	1.58%	5.3	$21,612

(1) The net notional amounts included in the tables above represent pay-fixed interest rate swaps, net of receive-fixed interest rate swaps and include $2,525,000 and $2,725,000 of pay-fixed forward starting interest rate swaps as of December 31, 2017 and December 31, 2016, respectively.

(2) Excluding forward starting pay-fixed interest rate swaps, the weighted average pay rate was 1.36% and 0.73% as of December 31, 2017 and December 31, 2016, respectively.

The following table summarizes information about the Company's TBA securities as of December 31, 2017:

	December 31, 2017			
	Notional Amount [1]	Implied Cost Basis [2]	Implied Market Value [3]	Net Carrying Value [4]
Dollar roll positions:				
30-year 4.0% TBA securities	$795,000	$829,425	$830,908	$1,483
Economic hedges:				
30-year 3.5% TBA securities	$150,000	$(153,797)	$(154,066)	$(269)

(1) Notional amount represents the par value (or principal balance) of the underlying Agency MBS as if settled as of the end of the period.

(2) Implied cost basis represents the forward price to be paid for the underlying Agency MBS as if settled as of end of the period.

(3) Implied market value represents the estimated fair value of the underlying Agency MBS as if settled as of the end of the period.

(4) Net carrying value represents the difference between the implied market value and the implied cost basis of the TBA security as of the end of the period and is included on the consolidated balance sheets within “derivative assets (liabilities)”.

The tables below summarize changes in the Company’s derivative instruments for the periods indicated:

Type of Derivative Instrument	Notional Amount as of December 31, 2016	Additions	Settlements, Terminations, or Pair-Offs	Notional Amount as of December 31, 2017
Receive-fixed interest rate swaps	$ 425,000	$ —	$ (325,000)	$ 100,000
Pay-fixed interest rate swaps	3,455,000	3,890,000	(1,570,000)	5,775,000
Eurodollar futures	—	2,600,000	(650,000)	1,950,000
TBA dollar roll positions	—	6,729,000	(5,934,000)	795,000
TBA economic hedges	—	(250,000)	100,000	(150,000)

The table below provides detail of the Company's "gain (loss) on derivative instruments, net" by type of derivative for the periods indicated:

	Year Ended December 31,		
Type of Derivative Instrument	2017	2016	2015
Receive-fixed interest rate swaps	$ 23	$ 2,515	$ 6,522
Pay-fixed interest rate swaps	(2,655)	(3,306)	(28,687)
Eurodollar futures	821	(4,815)	(20,963)
TBA dollar roll positions	5,757	—	—
TBA economic hedges	(902)	—	—
Gain (loss) on derivative instruments, net	$ 3,044	$ (5,606)	$ (43,128)

There is a net unrealized gain of $402 remaining in AOCI on the Company's consolidated balance sheet as of December 31, 2017 which represents the activity related to interest rate swap agreements while they were previously designated as cash flow hedges, and this amount will be recognized in the Company's net income as an adjustment to "interest expense" over the remaining contractual life of the agreements. The Company estimates a credit of $237 will be reclassified to net income as a reduction of "interest expense" within the next 12 months.

A portion of the Company's interest rate swaps were entered into under bilateral agreements which contain cross-default provisions with other agreements between the parties. In addition, these bilateral agreements contain financial and operational covenants similar to those contained in the repurchase agreements as described in Note 3. The Company was in compliance with all covenants with respect to bilateral agreements under which interest rate swaps were entered into as of December 31, 2017.

The Company's derivatives are subject to underlying agreements with master netting or similar arrangements, which provide for the right of offset in the event of default or in the event of bankruptcy of either party to the transactions. The Company reports its derivative assets and liabilities subject to these arrangements on a gross basis. The following tables present information regarding those derivative assets and liabilities subject to such arrangements as if the Company had presented them on a net basis as of December 31, 2017 and December 31, 2016:

Offsetting of Assets

	Gross Amount of Recognized Assets	Gross Amount Offset in the Balance Sheet	Net Amount of Assets Presented in the Balance Sheet	Gross Amount Not Offset in the Balance Sheet (1) Financial Instruments Received as Collateral	Cash Received as Collateral	Net Amount
December 31, 2017						
Interest rate swaps	$791	$ —	$ 791	$—	$—	$ 791
Eurodollar Futures	666	—	666	—	(666)	—
TBA securities	1,483	—	1,483	(180)	—	1,303
Derivative assets	$2,940	$ —	$ 2,940	$(180)	$(666)	$ 2,094
December 31, 2016:						
Interest rate swaps	$28,534	$ —	$ 28,534	$(6,449)	$(22,085)	$ —
TBA securities	—	—	—	—	—	—
Derivative assets	$28,534	$ —	$ 28,534	$(6,449)	$(22,085)	$ —

Offsetting of Liabilities

	Gross Amount of Recognized Liabilities	Gross Amount Offset in the Balance Sheet	Net Amount of Liabilities Presented in the Balance Sheet	Gross Amount Not Offset in the Balance Sheet (1) Financial Instruments Posted as Collateral	Cash Posted as Collateral	Net Amount
December 31, 2017						
Interest rate swaps	$—	$ —	$ —	$—	$ —	$ —
TBA securities	269	—	269	(180)	—	89
Derivative liabilities	$269	$ —	$ 269	$(180)	$ —	$ 89
December 31, 2016:						
Interest rate swaps	$6,922	$ —	$ 6,922	$(6,913)	$ —	$ 9
TBA securities	—	—	—	—	—	—
Derivative liabilities	$6,922	$ —	$ 6,922	$(6,913)	$ —	$ 9

(1) Amounts disclosed for collateral received by or posted to the same counterparty include cash and the fair value of MBS up to and not exceeding the net amount of the asset or liability presented in the balance sheet. The fair value of the total collateral received by or posted to the same counterparty may exceed the amounts presented.

Please see Note 3 for information related to the Company's repurchase agreements which are also subject to underlying agreements with master netting or similar arrangements.

NOTE 5 – FAIR VALUE OF FINANCIAL INSTRUMENTS

ASC Topic 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC Topic 820 clarifies that fair value should be based on the assumptions market participants would use when pricing an asset or liability and also requires an entity to consider all aspects of nonperformance risk, including the entity's own credit standing, when measuring fair value of a liability. ASC Topic 820 established a valuation hierarchy of three levels as follows:

- Level 1 – Inputs are unadjusted, quoted prices in active markets for identical assets or liabilities as of the measurement date.

- Level 2 – Inputs include quoted prices in active markets for similar assets or liabilities; quoted prices in inactive markets for identical or similar assets or liabilities; or inputs either directly observable or indirectly observable through correlation with market data at the measurement date and for the duration of the instrument's anticipated life.
- Level 3 – Unobservable inputs are supported by little or no market activity. The unobservable inputs represent management's best estimate of how market participants would price 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.

The Company reviews the classification of its financial instruments within the fair value hierarchy on a quarterly basis, and management may conclude that its financial instruments should be reclassified to a different level in the future if a change in type of inputs occurs.

The following table presents the fair value of the Company's financial instruments segregated by the hierarchy level of the fair value estimate that are measured at fair value on a recurring basis as of the dates indicated:

	December 31, 2017			
	Fair Value	Level 1 - Unadjusted Quoted Prices in Active Markets	Level 2 - Observable Inputs	Level 3 - Unobservable Inputs
Assets carried at fair value:				
Investments in securities:				
Mortgage-backed securities	$3,026,989	$ —	$3,019,746	$ 7,243
U.S. Treasuries	146,530	146,530	—	—
Derivative assets:				
Interest rate swaps	791	—	791	—
Eurodollar futures	666	666	—	—
TBA securities	1,483	—	1,483	—
Total assets carried at fair value	$3,176,459	$ 147,196	$3,022,020	$ 7,243
Liabilities carried at fair value:				
TBA securities	269	—	269	—
Total liabilities carried at fair value	$269	$ —	$269	$ —

	December 31, 2016			
	Fair Value	Level 1 - Unadjusted Quoted Prices in Active Markets	Level 2 - Observable Inputs	Level 3 - Unobservable Inputs
Assets carried at fair value:				
Mortgage-backed securities	$3,212,084	$ —	$3,201,157	$ 10,927
Interest rate swaps	28,534	—	28,534	—
Total assets carried at fair value	$3,240,618	$ —	$3,229,691	$ 10,927
Liabilities carried at fair value:				
Interest rate swaps	$6,922	$ —	$6,922	$ —
Total liabilities carried at fair value	$6,922	$ —	$6,922	$ —

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The Company's derivative assets and liabilities include interest rate swaps, Eurodollar futures, and TBA securities. The fair value of interest rate swaps are measured using the income approach with the primary input being the forward interest rate swap curve, which is considered an observable input, and thus their fair values are considered Level 2 measurements. Eurodollar futures are valued based on closing exchange prices on these contracts and are classified accordingly as Level 1 measurements. The fair value of TBA securities are estimated using methods similar those used to fair value the Company's Level 2 MBS.

The fair value measurements for a majority of the Company's MBS are considered Level 2 because these securities are substantially similar to securities that either are actively traded or have been recently traded in their respective markets. The Company determines the fair value of its Level 2 securities based on prices received from the Company's primary pricing service as well as other pricing services and brokers. The Company evaluates the third party prices it receives to assess their reasonableness. Although the Company does not adjust third party prices, they may be excluded from use in the determination of a security's fair value if they are significantly different from other observable market data. In valuing a security, the primary pricing service uses either a market approach, which uses observable prices and other relevant information that is generated by market transactions of identical or similar securities, or an income approach, which uses valuation techniques to convert future amounts to a single, discounted present value amount. The Company also reviews the assumptions and inputs utilized in the valuation techniques of its primary pricing service. Examples of these observable inputs and assumptions include market interest rates, credit spreads, and projected prepayment speeds, among other things.

The Company owns certain non-Agency MBS for which there are not sufficiently recent trades of substantially similar securities, and their fair value measurements are thus considered Level 3. The Company determines the fair value of its Level 3 securities by discounting the estimated future cash flows derived from cash flow models using significant inputs which are determined by the Company when market observable inputs are not available. Information utilized in those pricing models include the security's credit rating, coupon rate, estimated prepayment speeds, expected weighted average life, collateral composition, estimated future interest rates, expected credit losses, and credit enhancement as well as certain other relevant information. Significant changes in any of these inputs in isolation may result in a significantly different fair value measurement. Level 3 assets are generally most sensitive to the default rate and severity assumptions.

The activity of the Company's non-Agency MBS measured at fair value on a recurring basis using Level 3 inputs is presented in the following table for the periods indicated:

	Year Ended December 31,		
	2017	2016	2015
Balance as of beginning of period	$10,927	$16,435	$43,957
Unrealized (loss) gain included in OCI [1]	(1,733)	(1,057)	2,608
Principal payments	(4,351)	(6,019)	(30,602)
Accretion	2,400	1,568	472
Balance as of end of period	$7,243	$10,927	$16,435

(1) Amount included in "unrealized gain (loss) on available-for-sale investments, net" on consolidated statements of comprehensive income (loss).

The following table presents a summary of the carrying value and estimated fair values of the Company's financial instruments as of the dates indicated:

	December 31, 2017		December 31, 2016	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Assets:				
Mortgage-backed securities	$3,026,989	$3,026,989	$3,212,084	$3,212,084
U.S. Treasuries	146,530	146,530	—	—
Mortgage loans held for investment, net [(1)]	15,738	12,973	19,036	15,971
Derivative assets	2,940	2,940	28,534	28,534
Liabilities:				
Repurchase agreements [(2)]	$2,565,902	$2,565,902	$2,898,952	$2,898,952
Non-recourse collateralized financing [(1)]	5,520	5,554	6,440	6,357
Derivative liabilities	269	269	6,922	6,922

(1) The Company determines the fair value of its mortgage loans held for investment, net and its non-recourse collateralized financing using internally developed cash flow models with inputs similar to those used to estimate the fair value of the Company's Level 3 non-Agency MBS.

(2) The carrying value of repurchase agreements generally approximates fair value due to their short term maturities.

NOTE 6 – SHAREHOLDERS' EQUITY AND SHARE-BASED COMPENSATION

Preferred Stock

The Company's articles of incorporation authorize the issuance of up to 50,000,000 shares of preferred stock, par value $0.01 per share, of which the Company's Board of Directors has designated 8,000,000 shares of 8.50% Series A Preferred Stock and 7,000,000 shares of 7.625% Series B Preferred Stock, (the Series A Preferred Stock and the Series B Preferred Stock collectively, the "Preferred Stock"). The Company had 2,300,000 shares of its Series A Preferred Stock and 3,588,680 shares of its Series B Preferred Stock issued and outstanding as of December 31, 2017 compared to 2,300,000 shares of Series A Preferred Stock and 2,271,937 shares of Series B Preferred Stock as of December 31, 2016.

The Preferred Stock has no maturity and will remain outstanding indefinitely unless redeemed or otherwise repurchased or converted into common stock pursuant to the terms of the Preferred Stock. The Company's Series A Preferred Stock may be redeemed in whole, or in part, at any time and from time to time at the Company's option at a cash redemption price of $25.00 per share plus any accumulated and unpaid dividends. Except under certain limited circumstances, the Company may not redeem the Series B Preferred Stock prior to April 30, 2018. On or after April 30, 2018, the Company's Series B Preferred Stock may be redeemed in whole, or in part, at any time and from time to time at the Company's option at a cash redemption price of $25.00 per share plus any accumulated and unpaid dividends. Because the Preferred Stock is redeemable only at the option of the issuer, it is classified as equity on the Company's consolidated balance sheet. The Series A Preferred Stock pays a cumulative cash dividend equivalent to 8.50% of the $25.00 liquidation preference per share each year and the Series B Preferred Stock pays a cumulative cash dividend equivalent to 7.625% of the $25.00 liquidation preference per share each year. The Company paid its regular quarterly dividends on its Preferred Stock for the fourth quarter on January 15, 2018 to shareholders of record as of January 1, 2018.

Common Stock

The Company declared a fourth quarter common stock dividend of $0.18 per share that was paid on January 31, 2018 to shareholders of record as of December 29, 2017.

2009 Stock and Incentive Plan. Of the 2,500,000 shares of common stock authorized for issuance under its 2009 Stock and Incentive Plan, the Company had 785,962 available for issuance as of December 31, 2017. Total stock-based compensation

expense recognized by the Company for the year ended December 31, 2017 was $1,954 compared to $2,709 and $2,965 for the years ended December 31, 2016 and December 31, 2015, respectively.

The following table presents a rollforward of the restricted stock activity for the periods indicated:

	Year Ended December 31, 2017		2016		2015	
	Shares	Weighted Average Grant Date Fair Value Per Share	Shares	Weighted Average Grant Date Fair Value Per Share	Shares	Weighted Average Grant Date Fair Value Per Share
Restricted stock outstanding as of beginning of period	553,396	$ 7.55	696,597	$ 8.54	731,809	$ 8.89
Restricted stock granted	138,166	6.76	214,878	6.28	263,829	8.21
Restricted stock vested	(338,459)	7.80	(358,079)	8.71	(299,041)	9.12
Restricted stock outstanding as of end of period	353,103	$ 7.01	553,396	$ 7.55	696,597	$ 8.54

As of December 31, 2017, the grant date fair value of the Company’s remaining nonvested restricted stock is $1,117 which will be amortized into compensation expense over a weighted average period of 1.4 years.

NOTE 7 – MORTGAGE LOANS HELD FOR INVESTMENT, NET AND RELATED NON-RECOURSE COLLATERALIZED FINANCING

The Company's mortgage loans held for investment, net are single-family mortgage loans which were originated or purchased by the Company from 1992 through 1998. These loans have an amortized cost of $15,885 as of December 31, 2017 compared to $19,317 as of December 31, 2016. The unpaid principal balance of the Company's single-family mortgage loans identified as seriously delinquent as of December 31, 2017 was $1,307 compared to $1,094 as of December 31, 2016. The Company continues to accrue interest on its seriously delinquent securitized single-family mortgage loans because the primary servicer continues to advance the interest and/or principal due on the loan.

An allowance has been established for currently existing and probable losses on the Company's mortgage loans held for investment, which was $147 as of December 31, 2017 compared to $281 as of December 31, 2016. The Company's single-family mortgage loans are considered homogeneous and are evaluated on a pool basis for a general allowance. The Company considers various factors in determining its general allowance requirement, including whether a loan is delinquent, the Company’s historical experience with similar types of loans, historical cure rates of delinquent loans, and historical and anticipated loss severity of the mortgage 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. The Company recorded $80, $130, and $180 as provision for loan losses for the years ended December 31, 2017, 2016, and 2015, respectively, which is included within "other income, net" on the Company's consolidated statements of comprehensive income (loss).

The majority of the Company's mortgage loans held for investment, net is pledged as collateral for the one remaining class of the Company's single-family securitization financing bond, which is recorded on the Company's balance sheet as "non-recourse collateralized financing". The interest rate on this bond is based on 1-month LIBOR plus 0.30% and is expected to mature by January 31, 2025 based on scheduled principal payments projected as of December 31, 2017. As of December 31, 2017, $6,233 of the principal balance of the single-family mortgage loans held for investment was pledged as collateral for the Company's non-recourse collateralized financing which had a remaining principal

balance of $5,596. As of December 31, 2016, $7,200 of the principal balance of the Company's mortgage loans held for investment was pledged as collateral for the remaining principal balance of the outstanding bonds of $6,533.

NOTE 8 – INCOME TAXES

The Company's estimated REIT taxable income before consideration of its NOL carryforward was $21,332 for the year ended December 31, 2017, $21,702 for the year ended December 31, 2016, and $52,964 for the year ended December 31, 2015. After common and preferred dividend distributions during those years as well as utilization of the Company's NOL carryforward to offset taxable earnings, the Company does not expect to incur any income tax liability for the year ended December 31, 2017 and did not incur any material income tax liability for the years ending December 31, 2016 or December 31, 2015.

The Company's estimated NOL carryforward as of December 31, 2017 is $89,775. Because the Company incurred an "ownership change" under Section 382 of the Internal Revenue Code ("Section 382"), the Company's ability to utilize its NOL carryforward to offset its taxable income after any required dividend distributions is limited to approximately $13,451 per year with any unused amounts being accumulated and carried forward for use in subsequent years. As of December 31, 2017, the Company had $52,092 of NOL that is not subject to the existing Section 382 limitations available to offset any future taxable income. The NOL will expire beginning in 2020 to the extent it is not used.

After reviewing for any potentially uncertain income tax positions, the Company has concluded that it does not have any uncertain tax positions that meet the recognition or measurement criteria of ASC 740 as of December 31, 2017, December 31, 2016, or December 31, 2015, although its tax returns for those tax years are open to examination by the IRS. In the event that the Company incurs income tax related interest and penalties, its policy is to classify them as a component of provision for income taxes.

NOTE 9 – RELATED PARTY TRANSACTIONS

As noted in previous filings, DCI Commercial, Inc. ("DCI"), a former affiliate of the Company and formerly known as Dynex Commercial, Inc., was named a party to several lawsuits in 1999 and 2000 regarding the activities of DCI while it was an operating subsidiary of an affiliate of the Company. The Company was named a party to several of the lawsuits (the "DCI Litigation") due to its affiliation with DCI. In December 2000, the Company and DCI entered into a Litigation Cost Sharing Agreement whereby the Company agreed to advance DCI's portion of the costs of defending against the DCI Litigation. The DCI Litigation concluded in 2004 and, after various appeals by the plaintiffs in the DCI Litigation (the "DCI Plaintiffs"), no judgment or damages were entered against the Company, but final judgment was entered in the DCI Litigation against DCI (the "DCI Judgment"). The DCI Plaintiffs have attempted to enforce the DCI Judgment against the Company through a separate action which is discussed in Item 3 of Part I of this Annual Report on Form 10-K.

The Litigation Cost Sharing Agreement remained in effect as of December 31, 2017. DCI costs advanced by the Company are loans and bear simple interest at the rate of Prime plus 8.0% per annum. The Company's advances to cover DCI's costs during the years ended December 31, 2017, 2016, and 2015 were $30, $173, and $228, respectively. The total amount due to the Company under the Litigation Cost Sharing Agreement including interest was $10,615 as of December 31, 2017 compared to $10,240 as of December 31, 2016. Because DCI does not currently have any assets, the amount due as of December 31, 2017 has been fully reserved for collectibility by the Company. DCI is currently wholly owned by a company unaffiliated with the Company. An executive of the Company is the sole shareholder of this unaffiliated company.

NOTE 10 - SELECTED QUARTERLY INFORMATION (UNAUDITED)

	Year Ended December 31, 2017			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Operating results:				
Interest income	$22,419	$24,856	$23,103	$24,124
Interest expense	7,519	8,714	9,889	10,056
Net interest income	14,900	16,142	13,214	14,068
Gain (loss) on derivatives instruments, net	175	(15,802)	5,993	12,678
Loss on sale of investments, net	(1,708)	(3,709)	(5,211)	(902)
Fair value adjustments and other income (expense) amounts, net	(36)	34	(86)	(38)
General and administrative expenses	(4,280)	(4,097)	(3,599)	(3,843)
Preferred stock dividends	(2,435)	(2,641)	(2,808)	(2,910)
Net income (loss) to common shareholders	6,616	(10,073)	7,503	19,053
Other comprehensive income (loss)	19,977	12,375	6,144	(14,584)
Comprehensive income (loss) to common shareholders	$26,593	$2,302	$13,647	$4,469
Net income (loss) per common share	$0.13	$(0.20)	$0.15	$0.36
Dividends declared per common share	$0.18	$0.18	$0.18	$0.18

	Year Ended December 31, 2016			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Operating results:				
Interest income	$25,089	$22,816	$21,135	$22,858
Interest expense	6,310	6,100	6,068	6,753
Net interest income	18,779	16,716	15,067	16,105
(Loss) gain on derivatives instruments, net	(48,264)	(16,297)	2,409	56,546
Loss on sale of investments, net	(3,941)	(297)	—	—
Fair value adjustments and other income (expense) amounts, net	87	318	579	(1)
General and administrative expenses	(4,092)	(3,671)	(3,355)	(3,589)
Preferred stock dividends	(2,294)	(2,294)	(2,294)	(2,303)
Net (loss) income to common shareholders	(39,725)	(5,525)	12,406	66,758
Other comprehensive income (loss)	41,728	22,947	670	(85,186)
Comprehensive income (loss) to common shareholders	$2,003	$17,422	$13,076	$(18,428)
Net (loss) income per common share	$(0.81)	$(0.11)	$0.25	$1.36
Dividends declared per common share	$0.21	$0.21	$0.21	$0.21

NOTE 11 – SUBSEQUENT EVENTS

Management has evaluated events and circumstances occurring as of and through the date this Annual Report on Form 10-K was filed with the SEC and has determined that there have been no significant events or circumstances that qualify as a "recognized" or "nonrecognized" subsequent event as defined by ASC Topic 855.