CAPSTEAD MORTGAGE CORP Form DEF 14A March 16, 2012

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

SCHEDULE 14A INFORMATION

Proxy Statement Pursuant to Section 14(a) of the

Securities Exchange Act of 1934

(Amendment No.)

Filed by the Registrant "Filed by a Party other than the Registrant "

Check the appropriate box:

- " Preliminary Proxy Statement
- " Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))
- b Definitive Proxy Statement
- " Definitive Additional Materials
- " Soliciting Material under §240.14a-12

Capstead Mortgage Corporation

(Name of registrant as specified in its charter)

 $(Name\ of\ person(s)\ filing\ proxy\ statement,\ if\ other\ than\ the\ registrant)$

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(2)	Form, Schedule or Registration Statement No.:
(3)	Filing Party:
(4)	Date Filed:

NOTICE OF ANNUAL MEETING OF STOCKHOLDERS

To Be Held April 25, 2012

To the stockholders of
CAPSTEAD MORTGAGE CORPORATION:
CAPSTEAD MORTGAGE CORPORATION:

The annual meeting of stockholders of Capstead Mortgage Corporation, a Maryland corporation, will be held at 8401 North Central Expressway, Suite 345, Dallas, Texas on Wednesday, April 25, 2012 beginning at 9:00 a.m., Central Time, for the following purposes:

- (1) To elect seven directors to hold office until the next annual meeting of stockholders and until their successors are elected and qualified;
- (2a) To consider advisory approval of our compensation philosophy;

To the stockholders of

- (2b) To consider advisory approval of the compensation granted to our executive officers in 2011;
- (3) To re-approve the Capstead Mortgage Corporation Amended 2004 Flexible Long-Term Incentive Plan; and
- (4) To ratify the appointment of Ernst & Young LLP as our independent registered public accounting firm for the fiscal year ending December 31, 2012.

In the discretion of the proxies, the meeting may include the transacting of any other business that may properly come before the annual meeting of stockholders or any adjournment of the annual meeting.

** PLEASE VOTE NOW ** YOUR VOTE IS IMPORTANT ** PLEASE VOTE NOW **

Stockholders of record at the close of business on February 22, 2012 will be entitled to notice of and to vote at the annual meeting of stockholders. It is important your shares are represented at the annual meeting regardless of the size of your holdings. Whether or not you plan to attend the annual meeting in person, please vote your shares as promptly as possible via the internet, by telephone, or by signing, dating and returning your proxy card. Voting promptly saves us the expense of a second mailing or telephone campaign, and reduces the risk that the annual meeting is adjourned because of the lack of a quorum. Voting via the internet or by telephone helps reduce postage and proxy tabulation costs. See the Voting section of this proxy statement for a description of voting methods.

Stockholders please note that New York Stock Exchange regulations require you to vote this proxy in order for your shares to be counted in proposals (1) through (3). Your broker will not have any discretion to vote your shares on your behalf for these matters without direction from you.

PLEASE DO NOT MAIL YOUR PROXY CARD IF YOU VOTE BY INTERNET OR TELEPHONE.

By order of the board of directors,

Phillip A. Reinsch Secretary

8401 North Central Expressway, Suite 800

Dallas, Texas 75225-4404

March 16, 2012

CAPSTEAD MORTGAGE CORPORATION

8401 North Central Expressway, Suite 800

Dallas, Texas 75225-4404

PROXY STATEMENT

ANNUAL MEETING OF STOCKHOLDERS

To Be Held April 25, 2012

This proxy statement, together with the proxy, is solicited by and on behalf of the board of directors of Capstead Mortgage Corporation, a Maryland corporation, for use at the annual meeting of stockholders to be held on April 25, 2012 at 8401 North Central Expressway, Suite 345, Dallas, Texas beginning at 9:00 a.m., Central time. The board is requesting you to allow your shares to be represented and voted at the annual meeting by the proxies named on the proxy card. We, our, us, and Capstead each refers to Capstead Mortgage Corporation. A notice regarding the internet availability of this proxy statement and our 2011 annual report will first be mailed to stockholders on or about March 16, 2012. This proxy statement will be available on our website at that time. See the Notice of Electronic Availability of Proxy Materials section of this proxy statement for more information.

At the annual meeting, action will be taken to elect seven directors to hold office until the next annual meeting and until their successors are elected and qualified; to hold an advisory vote on executive compensation; to re-approve the Capstead Mortgage Corporation Amended 2004 Flexible Long-Term Incentive Plan; and to ratify the appointment of Ernst & Young LLP as our independent registered public accounting firm for the fiscal year ending December 31, 2012. In the discretion of the proxy holders, proxies may be voted on any other business that may properly come before the annual meeting or any adjournment of the annual meeting.

FORWARD-LOOKING STATEMENTS

This document contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements include, without limitation, any statement that may predict, forecast, indicate or imply future results, performance or achievements, and may contain the words believe, anticipate, expect, estimate, intend, will be, will likely continue, will likely resu phrases of similar meaning. These forward-looking statements are based largely on the expectations of management and are subject to a number of risks and uncertainties including, but not limited to, the following:

changes in general economic conditions;

fluctuations in interest rates and levels of mortgage prepayments;

the effectiveness of risk management strategies;

the impact of differing levels of leverage employed;

liquidity of secondary markets and credit markets;

the availability of financing at reasonable levels and terms to support investing on a leveraged basis;

the availability of new investment capital;

the availability of suitable qualifying investments from both an investment return and regulatory perspective;

changes in legislation or regulation affecting Fannie Mae, Freddie Mac and similar federal government agencies and related guarantees;

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deterioration in credit quality and ratings of existing or future issuances of Fannie Mae, Freddie Mac or Ginnie Mae securities;

changes in legislation or regulation affecting exemptions for mortgage REITs from regulation under the Investment Company Act of 1940; and

increases in costs and other general competitive factors.

In addition to the above considerations, our actual results and liquidity are affected by other risks and uncertainties many of which are set forth in the Risk Factors sections contained in our periodic filings with the SEC, which could cause actual results to be significantly different from those expressed or implied by these forward-looking statements. Any forward-looking statements speak only as of the date the statement is made, and we undertake no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. It is not possible to identify all of the risks, uncertainties and other factors that may affect future results. In light of these risks and uncertainties, the forward-looking events and circumstances discussed herein may not occur and actual results could differ materially from those anticipated or implied in the forward-looking statements. Accordingly, readers of this document are cautioned not to place undue reliance on the forward-looking statements.

GENERAL INFORMATION ABOUT VOTING

Solicitation of Proxies

The enclosed proxy is solicited by and on behalf of our board. We will bear the expense of soliciting proxies for the annual meeting, including the mailing cost. In addition to solicitation by mail, our officers or a company of our designation may solicit proxies from stockholders by telephone, e-mail, facsimile or personal interview. Our officers receive no additional compensation for such services.

We intend to request persons holding common shares in their name or custody, or in the name of a nominee, to send a notice of internet availability of proxy materials to their principals and request authority for the execution of the proxies. We will reimburse such persons for their expense in doing so. We will also use the proxy solicitation services of Georgeson Inc. For such services, we will pay a fee that is not expected to exceed \$6,500 plus out-of-pocket expenses.

Voting Securities

Our common shares are our only equity securities entitled to general voting rights. Each common share entitles the holder to one vote. As of February 22, 2012, there were 90,314,208 common shares outstanding and entitled to vote for each director to be elected and for other matters coming before the annual meeting. Only stockholders of record at the close of business on February 22, 2012 are entitled to vote at the annual meeting of stockholders or any adjournment of the meeting.

Voting

If you hold our common shares in your own name as a holder of record, you may instruct the proxies to vote your shares through any of the following methods:

via the internet by logging on to www.eproxy.com/cmo to gain access to the voting site and to authorize the proxies to vote your shares;

by calling our transfer agent Wells Fargo at 1-800-560-1965 and following the prompts; or

by signing, dating and mailing the proxy card in the postage-paid envelope provided.

Our counsel has advised us these three voting methods are permitted under the corporate law of Maryland, the state in which we are incorporated.

The deadline for internet and telephone voting is 12:00 p.m. (noon), Central Time, on April 24, 2012. If you prefer, you may bring your proxy to the annual meeting to vote your shares in person.

If a broker, bank or other nominee holds our common shares on your behalf, the voting instructions above do not apply to you. You will receive voting instructions from them.

Counting of Votes

A quorum will be present at the annual meeting if the holders of a majority of the outstanding shares entitled to vote are present, in person or by proxy. If you have returned valid voting instructions or if you hold your shares in your own name as a holder of record and attend the annual meeting in person with your proxy, your shares will be counted for the purpose of determining whether there is a quorum. If a quorum is not present, the annual meeting may be postponed or adjourned until a quorum has been obtained.

The affirmative vote of a plurality of the common shares cast at the annual meeting is required to elect each nominee to our board (proposal 1). The affirmative vote of a majority of all the votes cast is required to approve the non-binding resolutions regarding the compensation of our executive officers (proposals 2a and 2b), to re-approve the Capstead Mortgage Corporation Amended 2004 Flexible Long-Term Incentive Plan (proposal 3) and to ratify the appointment of Ernst & Young LLP as our independent registered public accounting firm for the year ending December 31, 2012 (proposal 4). For any other matter, unless otherwise required by Maryland or other applicable law, the affirmative vote of a majority of all the votes cast at the annual meeting is required to approve the matter.

Brokers holding shares beneficially owned by their clients do not have the ability to cast votes with respect to any non-routine matter, including the election of directors (proposal 1), any compensation-related proposal (proposal 2), or adopting, extending or amending compensation plans (proposal 3), unless the brokers have received instructions from the beneficial owner of the shares. It is therefore important that you provide instructions to your broker so that your shares will be counted in these matters.

Brokers may vote at their discretion on all routine matters (i.e. the ratification of our independent registered public accounting firm). Broker non-votes occur when a broker, bank or other nominee holding common shares on your behalf votes the shares on some matters but not others. We will treat broker non-votes as common shares present and voting for quorum purposes and votes not cast in any non-routine matter, including proposals 1, 2 and 3.

Abstentions, broker non-votes and withheld votes will have no effect on the outcome of the votes on proposals 1 through 4, assuming that a quorum is obtained.

If you sign and return your proxy card without giving specific voting instructions, your shares will be voted as recommended by the board.

Right to Revoke Proxy

You must meet the same deadline when revoking your proxy as when voting your proxy. See the Voting section of this proxy statement for more information. If you hold our common shares in your own name as a holder of record, you may revoke your proxy instructions through any of the following methods:

by notifying our secretary in writing of your revocation before your shares have been voted;
by signing, dating and mailing a new proxy card to Wells Fargo;
by calling Wells Fargo at 1-800-560-1965 and following the prompts;
via the internet by logging on to www.eproxy.com/cmo and following the prompts; or

by attending the annual meeting with your proxy and voting your shares in person.

If our common shares are held on your behalf by a broker, bank or other nominee, you must contact them to receive information on revoking your proxy.

Notice of Electronic Availability of Proxy Materials

As permitted by rules adopted by the Securities and Exchange Commission (SEC) in 2007, this proxy statement and our 2011 annual report are being furnished to our stockholders by posting them online. On or about March 16, 2012, we mailed our stockholders a notice with instructions on accessing these materials and voting online. If you received a notice, you will not receive a hard copy of the proxy materials unless you request them. If you would like to receive a hard copy of our proxy materials, follow the instructions on the notice.

Multiple Stockholders Sharing the Same Address

SEC rules and Maryland corporate law allow for householding, which is the delivery of a single copy of an annual report and proxy statement, or notice of electronic availability, to any household at which two or more stockholders reside if it is believed the stockholders are members of the same family. Duplicate mailings are eliminated by allowing stockholders to consent to such elimination or through implied consent if a stockholder does not request continuation of duplicate mailings. Depending upon the practices of your broker, bank or other nominee, you may be required to contact them directly to discontinue duplicate mailings to your household. If you wish to revoke your consent to householding, you must contact your broker, bank or other nominee. If you hold our common shares in your own name as a holder of record, householding will not apply to you.

Extra copies of our annual report and proxy statement may be obtained free of charge by sending a request to Capstead Mortgage Corporation, Attention: Stockholder Relations, 8401 North Central Expressway, Suite 800, Dallas, Texas, 75225-4404. You can also obtain copies on our website at www.capstead.com or by calling us toll-free at (800) 358-2323, extension 2339.

Voting Results

Voting results will be announced at the annual meeting and a detail of the voting results will be published in Form 8-K filed with the SEC within four business days of the annual meeting.

PROPOSAL ONE ELECTION OF DIRECTORS

One of the purposes of the annual meeting is to elect seven directors to hold office until the next annual meeting and until their successors have been elected and qualified. In order to understand each nominee squalifications to serve as a director, it is important to first review our investment strategy:

We operate as a self-managed real estate investment trust (REIT) for federal income tax purposes and earn income from investing in a leveraged portfolio of residential mortgage pass-through securities consisting almost exclusively of adjustable-rate mortgage securities issued and guaranteed by government-sponsored entities, either Fannie Mae or Freddie Mac, or by an agency of the federal government, Ginnie Mae.

Set forth below for each director nominee is the name, age, principal occupation, the date elected to our board, board committee memberships held, the number of common shares beneficially held, directorships held with other public companies and certain other biographical information necessary to provide you with a more complete understanding of the experiences, qualifications, attributes or skills of each director nominee.

Also provided below is a brief discussion of our considerations for recommending each of the nominees for director. For discussion of beneficial ownership, see the Security Ownership of Management and Certain Beneficial Owners section of this proxy statement. If any nominee becomes unable to stand for election as a director, an event we do not presently expect, the proxy will be voted for a replacement nominee if our board designates one.

The board recommends a vote FOR all nominees.

Nominees for Director

JACK BIEGLER*

Private Investments

Chairman of the Board

Chairman: Executive Committee

Member: Audit and Compensation Committees

Director since June 2005

Common shares beneficially owned: 41,500

Age 68

Mr. Biegler has served as our chairman of the board since April 2009. Mr. Biegler served as president of Ellison Management LLC from 1996 until his retirement in 2009. From 1980 until its sale in 1996, Mr. Biegler served as chief financial officer (CFO) of Ray Ellison Industries, which was involved in the development and construction of single-family homes in San Antonio, Texas. Mr. Biegler serves on the community board of Wells Fargo Bank, San Antonio.

<u>Consideration for Recommendation</u>: Mr. Biegler worked as a CFO in the single-family homebuilding business for a significant portion of his career and he continues to be involved in various real estate-related activities on a personal basis. Recognizing the depth of his accounting, financial and real estate-related experience, Mr. Biegler serves as our chairman of the board, chairman of the executive committee and as a member of the audit and compensation committees.

ANDREW F. JACOBS

President and Chief Executive Officer

Member: Executive Committee

Director since July 2003

Common shares beneficially owned: 539,609

Age 52

Mr. Jacobs has served as our president and chief executive officer (CEO) since July 2003. He served as our executive vice president finance from August 1998 to July 2003 and as secretary from April 2000 to July 2003. Mr. Jacobs has served in various other executive positions with us since 1988. In 2009 Mr. Jacobs was elected to serve for a three year term on the board of governors of the National Association of Real Estate Investment Trusts (NAREIT) and was appointed founding chairman of NAREIT s Council of Mortgage REITs. Mr. Jacobs is a member of the executive committee of the Chancellor s Council of the University of Texas System and the executive council of the Real Estate Finance and Investment Center at the University of Texas at Austin. Mr. Jacobs has been licensed as a certified public accountant since 1984 and holds a Certificate of Director Education from the National Association of Corporate Directors (NACD).

<u>Consideration for Recommendation</u>: Mr. Jacobs has served in an executive capacity for us since 1988. Recognizing the depth of his experience in the mortgage REIT industry over an extended period of time, Mr. Jacobs serves as our president and CEO and as a member of the executive committee.

Nominees for Director

GARY KEISER*

Private Investments

Mr. Keiser served as a partner at Ernst & Young LLP from 1980 until his retirement in November 2000. Mr. Keiser began his career with Ernst & Young LLP in 1967.

Chairman: Audit Committee

Member: Compensation Committee

Director since January 2004

Common shares beneficially owned: 49,886

Age 68

<u>Consideration for Recommendation</u>: Mr. Keiser worked in the public accounting profession for his entire career, focusing a significant amount of his time on real estate and real estate finance clients. Recognizing the depth of his accounting, mortgage banking and real estate experience, Mr. Keiser serves as the chairman of our audit committee and as a member of our compensation committee.

PAUL M. LOW*

Private Investments

Chairman Emeritus

Member: Governance & Nomination Committee

Director since October 1990;

and April 1985 to March 1990

Common shares beneficially owned: 79,170

Age 81

Mr. Low has served as chairman emeritus of our board since April 2009. From July 2003 to April 2009 Mr. Low served as our chairman of the board. Mr. Low was CEO of Laureate Inc., a private software company, from March 1997 to his retirement in February 2001. From January 1992 to September 1994, Mr. Low was chairman of the board of New America Financial L.P., a mortgage banking firm he founded. Mr. Low was president of Lomas Mortgage USA, a mortgage banking firm, from July 1987 to December 1990, and served in various other executive positions with Lomas beginning in 1957. Mr. Low served as our senior executive vice president from April 1985 to January 1988.

<u>Consideration for Recommendation</u>: Mr. Low worked in the mortgage banking industry for most of his career and was a founding member of our board of directors in 1985. Recognizing the depth of his mortgage banking experience over an extended period of time, Mr. Low serves as chairman emeritus and as a member of our governance & nomination committee.

Nominees for Director

CHRISTOPHER W. MAHOWALD*

President, RSF Management and RSF Partners

Member: Governance & Nomination Committee

Director since June 2005

Common shares beneficially owned: 111,659

Age 50

Mr. Mahowald is the managing partner of RSF Partners, a series of real estate private equity funds. Prior to forming RSF in 1997, Mr. Mahowald was a partner with the Robert M. Bass Group where he was a founding principal in several real estate-related private equity funds, including the Brazos Fund, the Lone Star Opportunity Fund and Colony Capital, where he played a key role in the acquisition and management of over \$8 billion in real estate-related assets. Prior to joining the Bass Group he was a principal for the Trammell Crow Company where he developed and leased industrial real estate projects. Mr. Mahowald previously served on the boards of two publicly traded real estate finance companies, IMPAC Commercial Holdings and Omega Healthcare (NYSE: OHI).

<u>Consideration for Recommendation</u>: Mr. Mahowald has worked in or managed a number of different real estate mortgage and equity funds over his career. Recognizing the depth of this experience, Mr. Mahowald serves as a member of the governance & nomination committee.

MICHAEL G. O NEIL*

Private Investments

Chairman: Governance & Nomination Committee

Member: Audit and Executive Committees

Director since April 2000

Common shares beneficially owned: 57,327

Age 69

Until retiring in July 2001, Mr. O Neil was a director in the investment banking division of Merrill Lynch, Pierce, Fenner & Smith Incorporated, an investment banking firm, where he had been employed since 1972. In 2009, Mr. O Neil retired from the board of directors at Massively Parallel Technologies, Inc., a private software technology company specializing in high-speed computing, though he continues to serve on their advisory board. He also served as a director for MobilePro Corp. a publicly traded company, from 2004 to 2008.

<u>Consideration for Recommendation</u>: Mr. O Neil worked for a major investment banking firm his entire career, focusing on debt and equity transactions involving U.S. and foreign corporations and U.S. Treasury and mortgage-related securities and various real estate-related

entities. He represented his firm as lead underwriter for our initial public offering in 1985. Recognizing the depth of his capital markets experience, and knowledge of a broad spectrum of security types, Mr. O Neil serves as the chairman of our governance & nomination committee and as a member of the audit and executive committees.

Nominees for Director

MARK S. WHITING*

Managing Partner,

Drawbridge Partners, LLC

Chairman: Compensation Committee

Director since April 2000

Common shares beneficially owned: 46,800

Age 55

Mr. Whiting has been the managing partner of Drawbridge Partners, LLC, a real estate investment firm, since September 1998. Mr. Whiting served as CEO and director of TriNet Corporate Realty Trust, Inc., a NYSE listed commercial property REIT, from May 1996 through September 1998 and served as president, chief operating officer and director of TriNet from May 1993 to May 1996. Mr. Whiting currently serves on the board of The Marcus & Millichap Company, a private real estate investment brokerage firm. He has also served as a member of the Stanford University Athletic Board and is on the board of trustees of the Cate School.

<u>Consideration for Recommendation</u>: Mr. Whiting served as the CEO of a publicly traded REIT and continues to be involved in various real estate-related activities on a personal basis. Recognizing the depth of his real estate-related experience and having served as a CEO of a public company, Mr. Whiting serves as the chairman of our compensation committee.

^{*} Indicates an independent director in compliance with Section 303A.02 Independence Tests of the New York Stock Exchange (NYSE) Listed Company Manual and our Board of Directors Guidelines. See the Board Member Independence section of this proxy statement for more information.

BOARD OF DIRECTORS AND COMMITTEE INFORMATION

Our business and affairs are managed under the direction of our board. Members of our board are kept informed of our business through discussions with our chairman, CEO and other executive officers, by reviewing materials provided to them, and by participating in meetings of our board and its committees.

During the year ended December 31, 2011, our board held four regular meetings and five special meetings. In accordance with our Board of Directors Guidelines, directors are expected to attend all meetings of our board and meetings of committees on which they serve. Each director standing for re-election attended more than 75 percent of all meetings of our board and committees on which he served.

Attendance at Annual Meeting

In keeping with our Board of Directors Guidelines, directors are expected to attend in person our annual meeting. All seven of our directors were in attendance at the 2011 annual meeting on May 4, 2011.

Board Member Independence

Section 303A.02 Independence Tests of the NYSE Listed Company Manual outlines the requirements for a director to be deemed independent by the NYSE, including the mandate that our board affirmatively determine that each of our directors has no material relationship with us that would impair independence. To assist in ascertaining the independence of our directors, each director completed a qualification questionnaire in December 2011. Directors were asked to verify biographical information, service on other company boards and committees, and attendance at our board and committee meetings. They were also asked to affirm compliance with all of the independence standards set forth in the NYSE Listed Company Manual and our Board of Directors Guidelines. Further, directors were asked to verify their interest in serving on our board in 2012 and their availability and capability to serve, as well as confirm they meet additional qualifications required for continued service as outlined in our Board of Directors Guidelines.

After receipt of all completed qualification questionnaires, our governance & nomination committee members were given a copy of each questionnaire, along with information regarding each director s ownership in our equity securities. At the conclusion of this process, our board affirmatively determined no director, with the exception of Mr. Jacobs who is our CEO, has a material relationship with us that would impair his independence, and each director meets all of the independence requirements set forth in the NYSE Listed Company Manual and our Board of Directors Guidelines. Therefore, our board is comprised of a majority of independent directors, as required in Section 303A.01 Independent Directors of the NYSE Listed Company Manual.

Our Board of Directors Guidelines are found on our website at www.capstead.com by clicking Investor Relations, Accept and Governance Documents. Any reference to an independent director herein infers compliance with the NYSE independence tests and our Board of Directors Guidelines.

Charitable Contributions

At no time during the preceding three years have we made a contribution to a charitable organization where one of our independent directors served as an executive officer.

Board Member Compensation

Compensation of our independent directors for the fiscal year ended December 31, 2011 is outlined in the following table.

Director Compensation*

Name	Fees Earned or Paid in Cash (\$)	Stock Awards (\$) ^(a)	Option Awards (\$) ^(b)	All Other Compensation (\$) ^(c)	Total (\$)
Jack Biegler	75,000	52,920	-	-	127,920
Gary Keiser	70,000	52,920	-	-	122,920
Paul M. Low	47,000	52,920	-	-	99,920
Christopher W. Mahowald	45,500	52,920	-	-	98,420
Michael G. O Neil	63,000	52,920	-	-	115,920
Mark S. Whiting	60,000	52,920	-	-	112,920

- * Columns for Non-Equity Incentive Plan Compensation and Change in Pension Value and Nonqualified Deferred Compensation Earnings have been omitted because they are not applicable.
- (a) Amount represents the aggregate grant date fair value of stock awards based on the closing market price of our common shares on the date of grant, which is recognized as expense on a straightline basis over the related requisite service period. As of December 31, 2011, each of our directors held 4,000 unvested stock awards.
- (b) As of December 31, 2011, each of our directors held exercisable option awards aggregating: 25,000 shares for Mr. Keiser; and 15,000 shares each for Messrs. Biegler, Low, Mahowald, O Neil and Whiting. No option awards were granted in 2011.
- (c) Dividends paid on unvested stock awards of \$6,220 to each of directors for the 2011 fiscal year were excluded because stock awards are valued for compensation cost purposes based on the closing market price of our stock on the date of grant, which is assumed to factor future dividends into its valuation.

Narrative Disclosure to Director Compensation Table

In May 2011 the board modified its independent director compensation program to eliminate the board meeting attendance fee of \$2,500 per meeting attended. In place of the board meeting fee, each independent director was instead granted an additional 2,000 shares of common stock. This change was made to increase the amount of compensation paid in the form of equity, as discussed further below. After reflecting this change, our independent directors receive base compensation for their representation on our board at an annualized rate of \$40,000 and an annual stock award of 4,000 shares of common stock. The stock award granted on May 4, 2011 will vest in full on April 15, 2012. The chairman of the board receives an additional \$20,000 annually, the chair of our audit committee receives an additional \$15,000 annually, and the chairs of our compensation and governance & nomination committees each receive an additional \$10,000 annually. Committee members receive \$1,000 per committee meeting attended. All of our directors receive reimbursement for travel costs and expenses. Employee directors do not receive compensation for serving on our board.

The board believes a meaningful portion of our independent director s total compensation should be paid in the form of equity awards, as demonstrated by the replacement of the board meeting attendance fees with the grant of additional shares of common stock noted above, in order to better align our independent directors long-term interests to those of our stockholders. Equity awards granted may include (i) stock awards, (ii) option awards or (iii) other incentive-based awards as defined in the Amended and Restated 2004 Flexible Long-Term Incentive Plan.

Stock awards granted to our independent directors provide for vesting in equal annual installments over the requisite service period established by our board, typically one year. Directors are considered owners of the shares and entitled to vote and receive all dividends and any other distributions declared on the shares prior to vesting. Dividends per share or distributions shall not exceed those available to our common stockholders. Unvested shares cannot be sold, transferred or otherwise disposed of for any purpose other than to us. Unvested shares will revert to us in the event a director leaves us for any reason, including termination of directorship by reason of voluntary or involuntary discharge, disability or retirement, except in the event of a change in control, dissolution or liquidation of our company, or death of the grantee, in which case all outstanding unvested shares will automatically vest in full.

Option awards granted to our independent directors provide for vesting in equal annual installments over the requisite service period established by our board, typically one year, and expire at the earliest of (i) ten years after date of grant, (ii) six months, or the remaining term of the option if earlier, after the optionee s termination of directorship by reason of death, resignation, retirement or disability or (iii) on the date of the optionee s termination of directorship for cause. No option awards will vest after the optionee s termination of directorship for any reason, including voluntary or involuntary discharge, disability or retirement, except in the event of a change in control, dissolution or liquidation of our company, or death of the grantee, in which case all outstanding unvested options will automatically vest in full. Outstanding option awards do not receive dividends prior to exercise and are non-voting.

Leadership Structure

Our board currently separates the roles of chairman and CEO, with the chairmanship held by an independent director. Our board believes the separation of roles, while not required, enhances the board s oversight of and independence from management, as well as the ability of the board to carry out its roles and responsibilities on behalf of stockholders. This leadership structure also allows the CEO to focus more of his time and energy on operations while providing him more of an opportunity to learn from the experience and perspectives of our chairman and other independent directors.

Our chairman, together with the CEO and with the input from our other directors, oversees the development of board and board committee calendars and meeting agendas, leads the discussion at board meetings, and acts as the primary liaison between the CEO and the board. Our chairman is also available to speak on behalf of our board under certain circumstances and performs other functions and responsibilities as required under our Board of Directors Guidelines or as directed by the board from time to time.

Our Board s Role in Risk Oversight

Our board recognizes how critical effective risk oversight is in our success and believes that its current leadership structure and operating style, with a board composed of primarily independent directors, its chairmanship separated from our CEO, and experienced executive officers who participate regularly in board and audit committee meetings, enhances risk oversight. Enterprise risks are identified and prioritized by management and reported to the full board on a quarterly basis or as otherwise appropriate, while compliance and financial risks are overseen by the audit committee. The compensation committee considers enterprise risks within the design of our compensation programs to ensure these programs do not encourage excessive risk taking. Our chairman and other independent directors, themselves all experienced business professionals, are active in raising enterprise risk issues for board consideration and challenging management to address their concerns and see their perspective on these issues.

Guidelines

In 2010, the board adopted a standard for ownership of our common stock by our executive officers and directors for purposes of improving the alignment of interests of these individuals and those of our stockholders. Each of our directors is expected to own shares of our common stock equal to three times the annual cash retainer. For a discussion of ownership standards for our executive officers. See Analysis and Setting of Executive Compensation section of the Compensation Discussion and Analysis in this proxy statement.

Hedging Transaction Policy

In 2010 our board adopted a policy which prohibits our employees and directors from entering into transactions to hedge or offset any change in the market value of our common stock.

Board Committees and Meetings

The current standing committees of our board are listed in the table below. Each of these committees has a written charter approved by our board. A copy of the charters can be found on our website at www.capstead.com by clicking Investor Relations, Accept and Committee Charting. The members of the committees and the number of meetings held during 2011 are identified in the table below, and a description of the principal responsibilities of each committee follows.

	Audit	Compensation	Executive	Governance & Nomination
Jack Biegler	X	X	Chair	
Andrew F. Jacobs			X	
Gary Keiser	Chair	X		
Paul M. Low				X
Christopher W. Mahowald				X
Michael G. O Neil	X		X	Chair
Mark S. Whiting		Chair		
Number of Meetings	5	5	0	3

Our *audit committee* is comprised of three independent directors. This committee is responsible for the appointment, compensation, retention and oversight of our independent registered public accounting firm; and it provides assistance to our board in fulfilling their oversight responsibilities to our stockholders, potential stockholders and the investment community relating to:

The integrity of our financial statements and the financial reporting process, including the systems of internal accounting and financial control and disclosure controls and procedures;

Our independent registered public accounting firm s qualifications and independence;

Our compliance with legal and regulatory requirements; and

The performance of our internal audit function (outsourced to a third party service provider) and our independent registered public accounting firm.

Our board has determined that Messrs. Biegler, Keiser and O Neil are audit committee financial experts as defined in the applicable rules and regulations of the Securities Exchange Act of 1934, as amended. All members of our audit committee meet the NYSE listing standards and our Board of Directors Guidelines for independence of audit committee members, have financial management experience and are financially literate as required by the NYSE Corporate Governance Listing Standards. Our audit committee charter limits the number of audit committees on which committee members may serve to no more than two other public companies, unless our board determines such simultaneous service would not impair the ability of such member to effectively serve. No member of our audit committee currently serves on the audit committee of another public company.

Our *compensation committee* is comprised of three independent directors. Our board has determined that Messrs. Biegler, Keiser and Whiting are independent in accordance with NYSE listing standards and Item 407(a) of the SEC Regulation S-K. All of our compensation programs are administered under the direction of this committee. This committee is responsible for overseeing our compensation programs including:

Reviewing and approving corporate goals and objectives relevant to our CEO s compensation;

Evaluating our CEO s performance in light of those goals and approving compensation consistent with such performance;

Approving base salaries, annual incentives and other programs and benefits for our executive officers other than our CEO;

Approving compensation programs and benefits for our other employees and directors;

Reviewing and coordinating succession plans for our CEO and executive officers; and

Reviewing and discussing with the Compensation Discussion and Analysis (CD&A) with our executive officers, legal counsel and its compensation consultant, and recommending to our board its inclusion in our proxy statement and annual report on Form 10-K. Because our CEO determines the responsibilities of each of our executive officers and observes how these responsibilities are carried out throughout the year, he is in the best position to review their performance and make recommendations to the committee regarding all components of compensation for our executive officers, including his own. In its role as the administrator, the committee may exercise its discretion in modifying any of the recommendations and is responsible for ultimately approving all compensation arrangements for our executive officers.

The *executive committee* is comprised of three directors. During the intervals between meetings of our board, this committee has all of the powers and authority of our board in managing our business and affairs, except those powers that by law cannot be delegated by our board.

The governance & nomination committee is comprised of three independent directors. This committee is responsible for:

Recommending nominees to our board for the next annual meeting of stockholders;

Overseeing the evaluation of the performance of our board and executive officers from a corporate governance perspective;

Identifying qualified individuals to serve on our board consistent with criteria approved by our board; and

Developing, recommending to our board, and maintaining our governance policies and guidelines.

Compensation Committee Interlocks and Insider Participation

During the fiscal year ended December 31, 2011, Messrs. Biegler, Keiser and Whiting served on our compensation committee. No member of the compensation committee was at any time during 2011 or at any other time an officer or employee of of ours, and no member had any relationship with us requiring disclosure as a related person transaction in the Related Person Transactions section of this proxy statement. None of our executive officers has served on the board or compensation committee of any other entity that has or had one or more executive officers who served as a member of our board or compensation committee during 2011.

Meetings of Non-Management Directors

Non-management directors regularly meet without management present immediately following our quarterly board meetings. Accordingly, such directors met four times in 2011. At these meetings, the non-management directors reviewed strategic issues for consideration by our board, including future agendas, the flow of information to directors, management progression and succession, and our corporate governance guidelines. The non-management directors have determined that our chairman of the board, Mr. Biegler, will preside at such meetings. The chairman is generally responsible for advising our CEO of decisions reached and suggestions made at these sessions. Stockholders and interested parties may communicate with the presiding director or non-management directors as a group by utilizing the communication process identified in the Interested Party and Stockholder Communication with our Board section of this proxy statement. If non-management directors include a director who is not an independent director, our Board of Director Guidelines require that at least one of the scheduled executive sessions include only independent directors. Presently, all of our non-management directors are independent.

OUR CORPORATE GOVERNANCE PRINCIPLES

Our policies and practices reflect corporate governance initiatives that are compliant with the NYSE listing standards and the corporate governance requirements of the Sarbanes-Oxley Act of 2002. We maintain a corporate governance section on our website which includes key information about our corporate governance initiatives including our Board of Directors Guidelines, charters for the committees of our board, our Code of Business Conduct and Ethics (applicable to all of our employees, officers and directors) and our Financial Code of Professional Conduct. The corporate governance section can be found on our website at www.capstead.com by clicking Investor Relations, Accept and Governance Documents.

Each of our directors should, to the best of his or her ability, perform in good faith the duties of a director and a committee member in a manner he or she believes to be in our best interests with the care an ordinarily prudent person in a like position would use under similar circumstances. This duty of care includes the obligation to make, or cause to be made, an inquiry when the circumstances would alert a reasonable director to the need thereof. Directors are expected to attend, in person or by telephone, all meetings of our board and meetings of the committees on which they serve, as well as attend in person our annual meeting of stockholders.

Considerations for Nomination

Our governance & nomination committee considers and makes recommendations to our board concerning candidates for election and the appropriate size of our board. In considering incumbent directors, the committee reviews the directors—overall service during their terms, including the number of meetings attended, level of participation and quality of performance. Other considerations include the directors—level of ownership in our equity securities and, when applicable, the nature of and time involved in the directors—service on other boards. The committee reviews the completed qualification questionnaires submitted by incumbent directors (as previously described in the Board Member Independence—section of this proxy statement) prior to making its recommendation to the board regarding the slate of directors for election at the following year—s annual meeting of stockholders.

In considering candidates to fill new positions created by expansion and/or vacancies that occur because of resignation, retirement or any other reason, the committee uses its and management s network of contacts to compile a list of potential candidates. The committee may also engage, if it deems appropriate, a professional search firm. Candidates are selected on the basis of talent and experience relevant to our business without regard to race, religion, gender or national origin as described in the Board of Director s Guidelines. Accordingly, the board does not consider diversity in identifying nominees for director in the sense that it is agnostic as to a potential nominee s characteristics in this regard and does not have any diversity goals or guidelines relative to the overall make-up of the board. Candidates should possess fundamental qualities of intelligence, honesty, perceptiveness, good judgment, maturity, high ethics and standards, integrity, fairness and responsibility. Each candidate should also have a genuine interest in our company, recognize that he or she is accountable to our stockholders (not to interest groups) and have a background that demonstrates an understanding of business and financial affairs and the complexities of a large business organization.

No person shall be eligible to serve as a director who has been convicted of a felony criminal offense or any criminal offense involving moral turpitude, dishonesty or a breach of trust. The committee will consider candidates recommended by stockholders provided stockholders follow the procedures set forth in the Stockholder Procedures for Director Candidate Recommendations section of this proxy statement. The committee evaluates a candidate using the criteria set forth above regardless of who nominated the candidate.

Service on Other Boards

Our Board Of Directors Guidelines prohibit our directors from serving on more than four boards of other public companies and recommends its audit committee members serve on the audit committee of no more than two other public companies. In addition, our CEO s service is limited to two other public company boards. Presently, none of our board members, including our CEO, serve on another public company s board.

Mandatory Resignation

Our Board of Directors Guidelines require a director to promptly submit a letter of resignation to our governance & nomination committee if the director (i) changes substantially his or her principal occupation or business association for any reason other than retirement or retirement planning, (ii) declares or is otherwise involved in a personal bankruptcy or bankruptcy of a business in which he or she is a principal or (iii) is named as a party in a material legal proceeding, becomes the target of a material state or federal investigation, or receives a request of a material nature for the production of records or testimony from any state or federal agency. The committee will in turn consider the resignation and make its recommendation to our board on whether to accept or reject the resignation.

Our board, excluding the resigning director, will make a decision regarding the resignation within a reasonable amount of time following receipt of the recommendation by the governance & nomination committee. If a decision is made to accept the resignation, the director s resignation shall be effective immediately. A director who has been convicted of a felony criminal offense or any criminal offense involving moral turpitude, dishonesty or a breach of trust shall resign effective immediately. An employee director must resign from our board, unless a majority of our board determines otherwise, once he or she ceases to be employed by us whether due to retirement or otherwise.

OTHER GOVERNANCE INFORMATION

Stockholder Procedures for Director Candidate Recommendations

Our governance & nomination committee will consider written director candidate recommendations made by stockholders to our secretary at 8401 North Central Expressway, Suite 800, Dallas, Texas 75225-4404. Electronic or facsimile submissions will not be accepted. For the committee to consider a candidate, submissions must include sufficient information concerning the recommended individual including biographical data such as age; employment history; a description of all businesses that employ or employed the candidate, including the name and phone number of the businesses; a list of board memberships the candidate holds, if any; and additional information that would provide a more complete understanding of the experiences, qualifications, attributes or skills of each director nominee in light of our Company s business and structure. In addition, the candidate should affirm he or she can read and understand basic financial statements and consent to stand for election, if nominated by our board, and serve, if elected by our stockholders.

Once a fully complete recommendation is received by the governance & nomination committee, the candidate is sent a questionnaire that requests additional information regarding independence, qualifications and other information to assist the committee in evaluating him or her, as well as certain information that must be disclosed about the candidate in our proxy statement, if nominated. Further, the questionnaire provides that the individual must grant consent to us to conduct a confidential background search of the individual to the extent allowable under federal, state and local legislation. The recommended candidate must return the questionnaire within the time frame as outlined in the following sentence to be considered for nomination by the committee. Recommendations for which we have received completed questionnaires by November 16, 2012 will be considered for candidacy for the 2013 annual meeting of stockholders. Completed questionnaires received after November 16, 2012 will be considered for candidacy for the 2014 annual meeting, if not earlier withdrawn.

Interested Party and Stockholder Communication with our Board

Interested parties and stockholders who wish to contact any of our directors either individually or as a group may do so by calling toll-free (800) 358-2323, by writing to them care of Capstead Mortgage Corporation, 8401 North Central Expressway, Suite 800, Dallas, Texas 75225-4404 or via e-mail at directors@capstead.com. Interested party and stockholder calls, letters and e-mails are screened by company personnel based on criteria established and maintained by our governance & nomination committee, which includes filtering out improper or irrelevant communications such as solicitations, advertisements, spam, surveys, junk mail, mass mailings, resumes and other forms of job inquiries.

Director Orientation and Continuing Education

Our board and executive officers conduct a comprehensive orientation through a review of background material and meetings with our executive officers to familiarize new directors with our vision, strategic direction, core values, ethics, financial matters, corporate governance practices and other key policies and practices. Our board recognizes the importance of continuing education for directors and is committed to providing such education to improve the performance of our board and its committees. Our executive officers assist in identifying and advising our directors about opportunities for continuing education including conferences provided by independent third parties. Mr. O Neil attended KPMG s Spring Audit Committee Roundtable Series in June 2011. Mr. Biegler attended Stanford University s Director College in June 2011. In connection with maintaining his license as a certified public accountant, Mr. Jacobs is required to earn and report to the Texas State Board of Public Accountancy at least 120 continuing education credit hours over each three-year period.

Annual Board Evaluation and Individual Director Self-Evaluations

Section 303A.09 Corporate Governance Guidelines of the NYSE Listed Company Manual requires listed company boards to conduct a self-evaluation at least annually to determine whether it and its committees are functioning effectively. Therefore, approximately 30 days prior to our annual board meeting (generally held immediately following the annual meeting of stockholders) we provide each director a board self-evaluation questionnaire and a self-evaluation questionnaire corresponding to each committee on which he or she serves. All questionnaires are returned to us prior to our annual board meeting. Completed committee questionnaires are given to the committee chair to review and discuss during the next scheduled committee meeting, and the director who presides at the non-management director meetings receives the board self-evaluation questionnaires to review and discuss with directors at our annual board meeting.

EXECUTIVE OFFICERS

The following table shows the names and ages of our current executive officers, and the positions held by each individual. A description of the business experience of each for at least the past five years follows the table.

	Age	Title
Andrew F. Jacobs	52	President and Chief Executive Officer
Phillip A. Reinsch	51	Executive Vice President, Chief Financial Officer and Secretary
Robert R. Spears, Jr.	50	Executive Vice President Director of Residential Mortgage Investments
Michael W. Brown	45	Senior Vice President Asset and Liability Management and Treasurer sexperience, see the Election of Directors section of this proxy statement.

Mr. Reinsch has served as our executive vice president, CFO and secretary since July 2006. He served as our senior vice president, CFO and secretary from July 2003 to July 2006. Mr. Reinsch has served in various other executive positions with us since March 1993. Mr. Reinsch was employed by Ernst & Young LLP from July 1984 to March 1993, last serving as an audit senior manager. Mr. Reinsch has been a licensed certified public accountant since 1988.

Mr. Spears has served as our executive vice president director of residential mortgage investments since July 2006. Prior thereto, Mr. Spears had served as our senior vice president asset and liability management since February 1999. From April 1994 to February 1999, he served as our vice president asset and liability management. Mr. Spears was employed by NationsBanc Mortgage Corporation from April 1990 to April 1994, last serving as vice president secondary marketing manager.

Mr. Brown has served as our senior vice president—asset and liability management and treasurer since July 2006. Prior thereto, Mr. Brown had served as our vice president—asset and liability management and treasurer since June 1999. Mr. Brown has been associated with us since July 1994.

EXECUTIVE COMPENSATION

Compensation Discussion and Analysis

Executive Summary

The compensation committee of our board has responsibility for establishing, implementing and monitoring adherence to our compensation programs and practices and ensuring that the total compensation paid to our executive officers is fair, reasonable, competitive and aligned with the interests of our stockholders.

Our compensation philosophy is to provide competitive, performance-based compensation programs to attract, motivate and retain employees vital to our long-term financial success and creation of stockholder value. We incorporate a pay-for-performance philosophy into the design of our compensation programs by linking each compensation element directly to our operating performance in some manner. The primary elements of our compensation programs are base compensation, annual incentives, long-term equity-based awards and to a lesser extent, other benefits or agreements. In 2011, approximately 34% of our executive officers—current base compensation was linked directly to our payment of common dividends through the use of dividend equivalent rights, which are a form of phantom stock that entitles the holders to quarterly payments mirroring our per share common stock dividend payments. Pursuant to the formula adopted by the committee for establishing an annual bonus pool, the amount available for bonus payments to our executive officers from our annual incentive program is dependent upon our annual operating performance exceeding a minimum performance threshold. Thus, if our operating performance is less than the minimum performance threshold, no bonus pool will be established pursuant to the formula. In addition, the formula caps annual incentive compensation at 1/2 of one percent of our average investment capital. Finally, all of the long-term equity-based stock awarded to our executive officers since 2008 has been performance-based, whereby vesting of the awards is dependent upon cumulative three-year operating performance periods exceeding minimum performance thresholds. Failure to achieve the minimum performance thresholds will result in the deferral and possibly the forfeiture of the related performance shares. In all, over 75% of executive compensation in 2011, as measured for proxy statement purposes, was performance-based.

For the fourth consecutive year, the committee commissioned and reviewed a comprehensive study of our executive compensation programs and practices relative to our peers. The study was prepared by the committee s independent advisor. The study, which was presented to the committee in July 2011, focused on 2010 compensation information presented by our peers in their most recent proxy statements. The study illustrated that Capstead had performed well in 2010 and had significantly outperformed the peer group for the three-year period ended December 31, 2010. In its meetings in July and December 2011, the committee considered the performance of our executive officers, individually and as a group, the results of the 2011 study, and our anticipated operating results for 2011 and took the following actions:

- (i) In July 2011, the committee approved base salary increases and the issuance of additional dividend equivalent rights, together approximating 9% of the overall executive officers base salaries.
- (ii) In December 2011, the committee awarded annual incentive payments to all of our employees in the aggregate amount of approximately \$5.7 million, of which \$4.8 million was paid to our executive officers. As was the case for 2010, the amount paid from the annual incentive pool was capped at 1/2 of one percent of our average investment capital. In addition, the committee again exercised its discretion to pay 50% of the amount awarded to the executive officers in cash and 50% in fully vested shares of company s common stock.
- (iii) In December 2011, the committee awarded 132,490 shares of performance-based stock to all of our employees, of which 99,316 shares valued at approximately \$1.3 million were awarded to executive officers. Vesting provisions on these performance-based stock awards have multi- year minimum performance thresholds similar to prior year awards and will accrue dividends equal to the actual per share dividends declared during the period. The payment of such dividends will not be made until after the performance conditions of the underlying shares have been met.

Compensation Philosophy

Our compensation philosophy is to provide competitive, performance-based compensation programs to attract, motivate and retain employees vital to our long-term financial success and creation of stockholder value. This pay-for-performance philosophy is the cornerstone of all of our compensation programs. The committee believes that a company s executive compensation practices are a window through which the outside world, and most importantly the company s stockholders, sees an organization s priorities and core values. The committee also considers enterprise risks within the design of our compensation programs to ensure these programs do not encourage excessive risk taking. The committee recognizes that the creation of stockholder value ultimately rests with management and the successful execution of our business strategies under changing economic conditions. The committee also recognizes the complexities of managing a large portfolio of residential mortgage securities and has sought to design compensation programs that take into account annual operating performance, portfolio positioning and the overall creation and preservation of stockholder value. Further, the committee recognizes that compensation decisions are complex and can only be made after careful consideration of (i) our performance measured against our stated business objectives, (ii) each executive s individual performance and contribution toward our business objectives, (iii) the amounts and form of prior compensation to such executive, and (iv) the performance and compensation practices of other companies similar to us. Finally, it is the intent of the committee that the types of compensation and benefits described herein that are provided to our executive officers generally be comparable to those provided to our other officers and employees.

In 2010, the committee adopted a series of policies applicable to our executive officers to bolster our pay-for-performance philosophy. These policies, which are ongoing, seek to further link our executive officers interests to our long-term financial success and include (i) establishing minimum standards for appropriate levels of ownership of our common stock, (ii) requiring the forfeiture of certain bonuses and profits by our executive officers if the company is required to prepare an accounting restatement due to material noncompliance as a result of misconduct and (iii) prohibiting our executive officers from entering into transactions to hedge or offset any change in the market value of the company s common stock held by the executive.

Our Recent Performance

Our stockholders and other investors have entrusted us with \$1.4 billion in investment capital, which includes \$1.3 billion of common and preferred stockholders—equity and \$100 million of long-term unsecured borrowings. In making performance comparisons between us and our peers, the committee uses total return on both common book value and average investment capital. The committee uses the average investment capital calculations in an effort to account for differences in capital structures as well as the disparity in size of our peers, making certain comparisons between us and our peers more relevant.

During 2011, we increased our holdings of ARM residential mortgage pass-through securities guaranteed by Fannie Mae, Freddie Mac, or Ginnie Mae, referred to as agency-guaranteed securities, by \$3.75 billion or 44% to \$12.26 billion at December 31, 2011, funded by \$237 million in new common and preferred equity capital raised in 2011, and increased borrowings under repurchase arrangements. With this portfolio growth, portfolio leverage (repurchase arrangements and similar borrowings divided by long-term investment capital) increased to 8.15 to one by December 31, 2011 from 6.91 to one at December 31, 2010. The increase in leverage in 2011 reflects a releveraging of our investment capital from the unusually low levels experienced the prior year as a consequence of high levels of mortgage prepayments associated with Fannie Mae s and Freddie Mac s programs to buyout backlogs of seriously delinquent loans from their guarantee portfolios during 2010. We believe borrowing at current levels represents an appropriate and prudent use of leverage for an agency-guaranteed mortgage securities portfolio in today s market conditions, particularly for a portfolio consisting almost entirely of short-duration ARM securities.

Our net income in 2011 totaled \$160 million or \$1.75 per diluted common share compared to \$127 million or \$1.52 per diluted common share in 2010. The increase in net income can largely be attributed to increases in our average outstanding portfolio. Total financing spreads (the difference between yields on interest-earning assets and rates on interest-bearing liabilities), averaged 156 basis points for the year ended December 31, 2011, compared to 174 basis points during 2010. Lower financing spreads in 2011 reflect the effects on portfolio yields of ARM loan coupon interest rates

underlying the portfolio continuing to reset lower to more current rates, as well as lower yields on acquisitions. The effect on financing spreads of lower portfolio yields was partially offset by lower borrowing rates as higher cost interest rate swap agreements matured and were replaced with new swap agreements at lower rates. Additionally, amortization of investment premiums had less of an impact on yields in 2011 because mortgage prepayment rates were lower compared to the high levels experienced in 2010 as previously discussed. Total general and administrative expenses, including personnel-related costs and other general and administrative expenses, increased slightly to \$16.3 million in 2011, but declined as a percentage of average investment capital to 1.27%, compared to \$16.0 million or 1.43% in 2010, making us one of the lowest cost providers as a percentage of average investment capital in the agency-REIT peer group.

Our book value of \$12.52 per common share at December 31, 2011 increased \$0.50 from our December 31, 2010 book value of \$12.02 per common share. We declared common dividends of \$1.76 per share in 2011 and, together with the increase in our book value per common share, our total return on our beginning book value was 18.8% in 2011 compared to 12.8% in 2010. For the three year period ended December 31, 2011, our annualized total return on common book value averaged 32.4%.

Analysis and Setting of Executive Compensation

In May 2011, the committee commissioned Pay Governance LLC, an independent consulting firm focused on delivering executive compensation advisory services, to perform a comprehensive study of our executive compensation programs and practices, and to advise us on the design, effectiveness and competitiveness of these programs relative to those of our peers. Pay Governance reports directly to the committee and, other than conducting this study and a similar study related to non-employee directors—remuneration, does not provide us with any other services. Therefore Pay Governance meets the advisor independence requirements set forth in Section 952 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the—Dodd-Frank Act—).

In beginning its 2011 study, Pay Governance met with members of the committee and our CEO to discuss our compensation philosophy, our current compensation programs and the appropriate composition of our peer group. It was discussed how in the previous year the committee had expanded its peer review to use additional market reference groups to improve the committee s market perspective on executive compensation. It was noted that the results of the expanded peer review in the prior year concluded that our company outperformed most companies in each of the reference groups identified, and that pay levels of our executive officers appeared to be consistent with or below pay levels relative to our performance when compared to the reference groups. The committee noted while the expanded peer review in 2010 was informative, they did not believe it was necessary to perform such an expanded review every year. As a result, the committee concluded that the 2011 study would compare our pay and performance only to companies primarily investing in agency-guaranteed residential mortgage securities. This comparator group (the Agency-REIT Peer Group) consisted of the following publicly traded companies:

Internally Managed Peers (average investment capital*):

Annaly Capital Management, Inc. (\$10.2 billion); Anworth Mortgage Asset Corporation (\$958 million); Dynex Capital, Inc. (\$212 million); MFA Financial, Inc. (\$2.2 billion); and New York Mortgage Trust, Inc. (\$127 million).

Externally Managed Peers (average investment capital*):

American Capital Agency Corp. (\$859 million);
ARMOUR Residential REIT (\$52 million);
CYS Investments, Inc. (\$391 million);
Hatteras Financial Corp. (\$1.0 billion); and
Two Harbors Investment Corp. (\$220 million).

* Average investment capital is for the year ended December 31, 2010.

In its discussion with the committee regarding the composition of the Agency-REIT Peer Group, Pay Governance noted that our average investment capital in 2010 was \$1.1 billion. While the capital structures and/or amount of capital under management of the peer companies varied considerably, the business model for each was substantially similar to ours, including MFA Financial, Inc. which directs a portion of its capital to non-agency residential mortgage securities. Pay Governance noted that to take into account differences in capital structures and the disparity in size of the peer companies, that they would adjust the reported results for each of the companies as a percentage of each company s average investment capital. After careful consideration, the committee concluded that this group was appropriate for purposes of Pay Governance s 2011 executive compensation study.

In beginning its study of the Agency-REIT Peer Group, Pay Governance reviewed certain information disclosed in each of the peer companies 2011 proxy statements and other filings with the SEC. In addition to a review of similar information for the company, Pay Governance reviewed information provided by our CEO, including (i) multi-year tally sheets for our executive officers setting forth each element of compensation paid during the previous three years, (ii) information regarding vested and unvested option and stock awards, and (iii) the total amount and value of all shares of common stock held by the executive officers. Our CEO also provided Pay Governance an analysis of our operating performance and our general and administrative expenses as a percentage of investment capital in comparison to our peers over the previous three years. Next, Pay Governance prepared an analysis that encompassed both an examination of our operating performance relative to the peer companies and an examination of our compensation levels relative to the peer companies that are internally managed. Specifically, Pay Governance provided the committee with historical performance information for each of the peer companies, including total return on book value, total shareholder return, cost structures utilized, structure of management arrangements, general and administrative expenses, and executive compensation arrangements, noting and adjusting for differences in internally-managed companies as compared to externally-managed companies.

For comparability, Pay Governance classified our general and administrative expenses within the following three categories:

Compensation-related expenses, including, but not limited to, salary, annual incentive compensation and long-term equity based awards;

Management-related expenses, including, but not limited to, rent, utilities, systems, market data services, travel costs and other general office expenses; and

Corporate-related expenses, including, but not limited to, director fees and expenses, legal fees, accounting fees, entity related insurance costs and certain other costs associated with operating a publicly-listed company.

In order to take into account differences in capital structures and the disparity in size of the peer companies and to improve the comparability of the data, Pay Governance adjusted the reported results for each of the companies to a percentage based on each company s average investment capital. In doing so, Pay Governance calculated for each company the percentage of (i) the aggregate of our compensation-related and management-related expenses to the base management fee percentage of the externally managed peer companies, (ii) the aggregate of our general and administrative expenses of both the externally and internally managed peers, and (iii) each component of compensation paid to our executive officers to that of the executive officers of the internally managed peer companies; each divided by each company s average investment capital. The committee agreed that by comparing these costs as a percent of average investment capital, it is able to more accurately make comparisons within the peer group.

In presenting the results of its compensation study to the committee, Pay Governance reported that our total return on beginning book value for the one and three years ended December 31, 2010 was 12.8% and 30.8%, respectively. They noted that when this operating performance is compared to the Agency REIT Peer Group, but only considering those peers operating for the entire performance period, our performance among this peer group ranked us at the 40th and 100th percentile for the one and three year periods, respectively. Pay Governance pointed out to the committee that while our company s longer-term performance continues to rank among the highest of the peer companies in terms of total return on beginning book value, the compensation paid to our executive officers continues to lag the compensation of our peers. To demonstrate this point, Pay Governance calculated for each of the internally managed peer companies the percentage of aggregate executive compensation for the top four

executive officers to their company s average investment capital and multiplied the results by our average investment capital. Pay Governance explained how this calculation adjusted for the size disparity within the peer group. The results showed that the median aggregate executive officer compensation for the internally managed peer companies was \$9.5 million. By comparison, Pay Governance noted that the total compensation paid to our executive officers was \$7.9 million or \$1.6 million less than the median for the peers.

Pay Governance also noted that when compared to a narrower group of peers with investment capital more in line with ours, namely Anworth Mortgage Asset Corporation and MFA Financial, Inc., compensation practices we implemented over the last several years had helped reduce the gap in compensation for our executives. Pay Governance further noted that our overall compensation structure needed to be monitored on an ongoing basis to ensure the committee s compensation objectives are being satisfied. Pay Governance then discussed how the overall structure of our compensation program links certain performance metrics to executive compensation. This direct connection effectively creates a variable component for certain elements of compensation and places a significant portion of the executive officers current and long-term compensation at risk of loss or reduction.

During the year Pay Governance also updated the committee regarding the status of regulations affecting executive compensation included in the Dodd-Frank Act. The committee discussed the various policies adopted in the prior year including (i) the forfeiture of certain bonuses and profits by our executive officers if the company is required to prepare an accounting restatement due to material noncompliance as a result of misconduct, (ii) a prohibition on transactions designed to hedge or offset any change in the market value of the company s common stock held by our executives and (iii) independence requirements for members of the committee and any compensation consultant, legal counsel, or other adviser.

The committee also reviewed the ownership policy of our common stock by our executive officers and directors adopted in the prior year and concluded that such ownership thresholds remained appropriate. The policy states that only shares owned and 60% of unvested service-based stock awards (the approximate after-tax value of the awards) will be considered toward the ownership threshold. Performance-based stock awards are excluded from consideration until the related performance threshold has been achieved. Our executive officers and directors are required to achieve the minimum equity investment, or threshold, within five years from the date he or she first becomes subject to the guidelines. Prior to attaining the minimum ownership threshold and upon vesting of any stock award or exercise of any stock option, an executive officer or director may surrender shares to satisfy applicable taxes and the share equivalent for the aggregate strike price for the option exercise, but shall retain all remaining shares until such time as the ownership threshold has been satisfied. The individual ownership threshold and effective ownership of our common stock by our executive officers as a percent of base salary at December 31, 2011 was as follows:

	Ownership	Effective
Covered Party	<u>Threshold</u>	Ownership*
Chief Executive Officer	500%	508%
Director of Residential Mortgage Investments	400%	426%
Chief Financial Officer	300%	420%
Other Named Executive Officers	300%	420%

^{*} Effective ownership of common stock considered for purposes of measuring an executive officer s ownership threshold adopted by the board in 2010 differs from the amount reported for an executive officer on SEC Form 4 because the threshold calculation adopted by the board includes only owned shares and 60% of the executive officer s unvested service-based stock awards, while excluding all of an executive officer s unvested performance-based.

A discussion of how our compensation practices operate within our overall risk management policies is set forth more fully below under Discussion of Components of Executive Compensation section of this Compensation Discussion and Analysis.

Role of CEO in Compensation Decisions

As in prior years, our CEO reviews the performance of each of our executive officers, researches and analyzes compensation programs and practices of our peers and makes recommendations to the committee regarding all elements of compensation to the executives, including his own. Although our CEO typically attends each of the committee meetings, the committee will request that he leave the meetings after he presents his findings and recommendations. In mid-2011 he provided Pay Governance and the committee information about our compensation programs and practices, and he participated in the committee discussions regarding the analysis and findings from the Pay Governance compensation study. In December following the announcement of our fourth quarter 2011 dividend, he provided the committee our anticipated operating results for 2011, including certain performance-related schedules, and again participated in the committee discussions.

The committee recognizes that as administrator of our compensation programs it is responsible for any and all decisions regarding compensation for our executive officers. Only after careful deliberation and consideration of factors deemed relevant by the committee, including information and recommendations provided by our CEO and the advice of Pay Governance, will the committee make its independent decisions regarding compensation for our executive officers.

Discussion of Components of Executive Compensation

Base Compensation. Base compensation for our executive officers currently consists of a combination of base salaries and dividend equivalent rights. Base salary adjustments and the grant of additional dividend equivalent rights, if any, for each of our executive officers (including our CEO) is recommended by our CEO and considered by the committee annually. The committee believes the CEO is in the best position to determine the responsibilities of each executive officer and observe how well each executive performs his responsibilities. All base compensation determinations are ultimately approved based on the considerations discussed in the Compensation Philosophy and Objectives section of this Compensation Discussion and Analysis.

As previously discussed, the committee sought independent advice from Pay Governance in determining the competitiveness of our executive compensation program. In comparing our executive officers compensation to the internally managed Agency-REIT Peer Group, Pay Governance observed that base compensation paid to our executive officers in the prior years appeared low on an absolute basis and as a percent of average investment capital and suggested increasing the base salaries of the executive officers. The proposed increase would increase the base compensation of our executive officers from \$2.5 million to \$2.8 million. Pay Governance then discussed how dividend equivalent rights granted in previous years had provided a variable performance element to the current compensation of our executive officers and had helped to reduce the shortfall relative to market observations in prior years. Each dividend equivalent right represents a notional phantom share of our common stock, which entitles the holder to a cash payment equal to the per share dividend amounts declared on a single share of our common stock for a specified period of time. Dividend equivalent rights represent the right to receive cash payments if, and only to the extent, our common stockholders receive cash dividends during the period the dividend equivalent rights are outstanding. In this manner, such cash payments to our executive officers are directly tied to our payment of common dividends, and thus are tied directly to our performance.

In arriving at its decisions to make adjustments, the committee considered our company s continued outstanding performance and our performance compared to our peers, also recognizing that the base salaries of our executive officers had historically lagged those of our peers. The committee discussed how dividend equivalent rights provide an appropriate linkage of our executive officers base compensation to the actual dividends paid to our common stockholders. Based on these factors and advice from Pay Governance, the committee determined that the shortfall in base compensation relative to the market observations should be addressed through an increase in the executives base salaries and the grant of additional dividend equivalent rights. After careful deliberation and consideration, the committee approved base salary increases for our executive officers averaging 4% and the grant of an aggregate of 72,000 additional dividend equivalent rights, which were intended to approximate 5% of the executive officers base salaries based on the then current dividend. The amounts of dividend equivalent rights granted to the executive officers were as follows: 27,000 for Mr. Jacobs, 16,000 for Mr. Reinsch, 19,000 for Mr. Spears and 10,000 for Mr. Brown. The expiration date for the newly granted dividend equivalent rights was set at July 1, 2014 and the expiration dates for dividend equivalent rights previously

granted were extended one year to also expire July 1, 2014. After considering the base salary adjustments effective July 1, 2011 and the grant of additional dividend equivalent rights, the annualized base salary and number of dividend equivalent rights outstanding for each of our executive officers and all other officers and employees were as follows:

	Annualized	Number of Dividend	
<u>Name</u>	Base Salary	Equivalent Rights	
Andrew F. Jacobs	\$ 720,000	200,000	
Phillip A. Reinsch	400,000	129,000	
Robert R. Spears, Jr.	505,000	185,000	
Michael W. Brown	270,000	68,000	
All other officers and employees	1,002,000		

Annual Incentives. Our committee believes that our executive officers, as well as our other officers and employees, should have an opportunity to participate in an annual incentive pool tied to a performance threshold determined by the committee. The committee has historically utilized a performance-based formula to establish an annual incentive guideline to determine the amount available for payment to all employees, including our executive officers. The amount available for annual incentive payments is sometimes referred to as the bonus pool.

Pay Governance noted that in 2009 the committee had established a maximum amount, or cap, available to be paid in any one year of 50 basis points multiplied by our average investment capital, as defined below. This cap helps manage the aggregate size of the bonus pool, while continuing to provide an appropriate incentive opportunity for our executive officers. Pay Governance also noted that in early 2011 the committee modified the formula for calculating the incentive pool to raise the performance bar. As more fully discussed below, the minimum performance threshold for 2011 was amended to be the greater of (i) 10% or (ii) the average 10-year U.S. Treasury rate plus 200 basis points (the greater number being the minimum performance threshold). In consideration for the change, the committee felt the elevated target would be appropriate for the 2011 incentive bonus pool given the then-expected regulatory and economic environment, including continued low U.S. Treasury rates. The committee also believed the increased minimum performance threshold would adequately reward our executives for a higher shareholder return while preventing the bonus pool cap from becoming the de facto bonus pool. The committee also determined that the best practice will be to continue to review the annual incentive bonus formula each year in light of that year s expected regulatory and economic environment.

The annual incentive formula approved by the committee for 2011 provides that unless our annual earnings expressed as a percentage of average investment capital exceeds the minimum performance threshold (as these terms are defined below), no bonus pool will be established pursuant to the formula. Notwithstanding the use of a formula to calculate the amount available for the bonus pool, the committee retains complete discretion to (i) determine the amount actually awarded; (ii) allocate any such amount among our executive officers and other employees, and (iii) determine the form of any such awards (e.g. cash versus equity awards). The committee excludes certain items from the definitions of annual earnings and average investment capital in an effort to minimize the impact on annual performance of timing considerations for transactions and to direct the focus of our executive officers to our ongoing business. The committee believes this approach should promote a longer-term performance focus among the executives. Accordingly, for purposes of the calculation, annual earnings and average investment capital are defined as follows:

annual earnings is defined as net income excluding (i) incentive compensation expense, (ii) any gain or loss from asset sales or write downs, including impairment charges, and (iii) interest on unsecured borrowings, net of equity in the earnings of related statutory trusts; and

average investment capital is defined as average stockholders equity and unsecured borrowings, net of related investments in statutory trusts, excluding (i) accumulated other comprehensive income (loss), (ii) incentive compensation accruals, (iii) any gain or loss from asset sales or write downs incurred since 2006, including impairment charges, and (iv) interest accrued on unsecured borrowings.

The first step in determining the amount of the bonus pool is to ascertain if our performance exceeded the minimum performance threshold. To make this determination, annual earnings is divided by average investment capital. The resulting earnings ratio, expressed as a percentage, is then

compared to the performance threshold set by the compensation committee. As noted above, the minimum performance threshold for 2011 was set as the greater of (i) 10% or (ii) the average 10-year U.S. Treasury rate plus 200 basis points. If the resulting earnings ratio is less than the minimum performance threshold, no bonus pool will be established pursuant to the formula. If the earnings ratio exceeds the minimum performance threshold, the following formula is utilized to determine the bonus pool:

First, the excess of the earnings ratio over the minimum performance threshold is multiplied by average invested capital to determine the excess earnings amount.

Next, the excess earnings amount is multiplied by a participation rate established at the beginning of the year, currently 10%, to establish the bonus pool amount.

Recognizing that the formula is intended to serve as a guideline for the creation of a bonus pool, the committee retains the power to act in the best interests of stockholders in compensating our executive officers, while still providing a mechanism to closely align incentive compensation with that of our peers in an effort to retain key employees and ultimately enhance stockholder value. As a result, the committee is not limited to the amount, if any, established by the formula in determining the actual amount to be distributed and similarly, may not pay out the full amount established by the formula.

After the announcement in December of our fourth quarter 2011 common stock dividend, our CEO reported to the committee an estimate of the bonus pool expected for 2011. He noted that our annual earnings and our average investment capital for purposes of the incentive formula was expected to total \$175 million and \$1.14 billion, respectively, representing an earnings ratio of 15.4%, which exceeded the minimum performance threshold of 10%. He then reported that the excess earnings amount per the formula was expected to be over \$61 million, and that while the formula itself would have provided for a bonus pool of \$6.1 million, the annual cap established by the committee limited the amount of the bonus pool to \$5.7 million. He then made his recommended allocation of the bonus pool among our executive officers and employees. After careful deliberation and consideration of factors deemed relevant by the committee, including minimum share ownership guidelines, the committee awarded our executive officers and all other officers and employees incentive compensation as follows:

2011 Annual Incentive Compensation	2011 Annua	l Incentive	Compensation
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	Paid	Paid	Total
Name	in Cash	in Stock	Paid
Andrew F. Jacobs	\$870,000	\$870,000	\$1,740,000
Phillip A. Reinsch	500,000	500,000	1,000,000
Robert R. Spears, Jr.	690,000	690,000	1,380,000
Michael W. Brown	325,000	325,000	650,000
All other officers and employees	927,000		927,000

Our committee exercised its discretion regarding the form of payment under the annual incentive compensation program determining that it would be appropriate to pay one-half of the 2011 bonus amounts to our executive officers in fully vested common stock. The committee believes that the common stock grants made as part of this year s annual incentive compensation, when considered together with the annual grant of longer-term performance-based equity awards and the share ownership guidelines, provides an appropriate alignment of our executive officers interests with those of our stockholders. The amount paid in stock represents the gross amount distributable from the 2011 annual bonus pool to be paid in shares of common stock; however, the actual grant date fair value of shares received by our executive officers was less than the amount reported in the above table because of shares surrendered for the payment for applicable taxes. The grant date fair value of the shares received and shares surrendered for the payment of applicable taxes was determined based on the closing common stock price on January 3, 2012 of \$12.60. After the surrender of shares for the payment of applicable taxes, the grant date fair value of shares awarded to each of the executive officers was: \$571,448 for Mr. Jacobs, \$367,756 for Mr. Reinsch, \$472,765 for Mr. Spears and \$239,035 for Mr. Brown.

Long-Term Equity-Based Awards. Our committee believes all of our employees should have an ongoing stake in the long-term success of our business, and that our executive officers should have a meaningful portion of their total compensation paid in the form of equity awards. This element of the

compensation program is intended to align our executives long-term interests with those of our stockholders, while providing incentives to our executives to remain with the company, through the granting of (i) restricted stock awards, (ii) option awards or (iii) other incentive-based equity awards as defined in our Amended and Restated 2004 Flexible Long-Term Incentive Plan, each of which are designed to create value for our stockholders and promote our long-term growth and success. This plan is currently on the ballot for re-approval by our stockholders as Proposal Four at this annual meeting. The plan is administered by the committee and was designed to promote the interests of our stockholders by enabling us to attract, motivate, reward and retain our executive officers, employees and directors and to encourage the holding of proprietary interests in the company by our key employees.

As previously discussed, in making its 2011 compensation decisions, the committee sought independent advice from Pay Governance to determine the competitiveness of our executive compensation programs. Pay Governance discussed with the committee how the use of longer-term equity-based stock awards had augmented the annual incentive compensation program for our executive officers, and how our overall risk management policies impact our earnings, dividends and book value over time. Pay Governance also noted that long-term performance-based stock awards in prior years had represented approximately 66% of the executive officers base salaries. Pay Governance recommended to the committee that long-term performance-based stock awards continue to be made as they are necessary to maintain the competitiveness of our compensation programs and to provide a long-term horizon for aligning our executive officers compensation with the interests of our shareholders.

Based on guidance from Pay Governance and other factors, including share ownership guidelines, the committee concluded that it was appropriate to evaluate the granting of long-term performance-based stock awards independent of the annual incentive program even though a portion of the 2011 incentive compensation would be paid in the form of equity. The committee also decided that long-term performance-based stock awards should continue to be considered annually as they represent a material part of our overall compensation program. The committee then discussed the performance metrics used for the prior year performance-based stock awards and concluded that the same performance metrics should be used for the current year awards. The committee also discussed how the deferral of dividends on the performance-based stock awards being considered would impact the value of the shares. After careful deliberation and consideration of factors deemed relevant by the committee, including the deferral of dividends on such shares and the share ownership guidelines, the committee approved granting the following performance-based stock awards to our executive officers and our other officers and employees:

Name	Number of Performance-Based Stock Awards	Grant Date Fair Value of Performance-Based Stock Awards
Andrew F. Jacobs	37,735	\$480,000
Phillip A. Reinsch	20,964	266,667
Robert R. Spears, Jr.	26,467	336,667
Michael W. Brown	14,150	180,000
All other officers and employees	33,174	422,056

Consistent with prior year grants, the specific dollar amount of stock awards granted to each of our executives was based on a targeted grant of 66% of each executive officer s base salaries.

The performance-based stock awards were valued at \$12.72 per share, the closing price of our common stock on the December 15, 2011 grant date, and vest 50% at the end of the third year following the year of grant, provided the company meets the related performance criteria over the three-year period, and 50% at the end of year four, provided the company meets the performance criteria over that three-year period. The basic definitions used for measuring the performance criteria for purposes of vesting are similar to the annual incentive formula, but measured over two, three-year performance periods using a minimum performance target representative of our long-term financial success and the creation of stockholder value. The performance criteria will be met if the company s three-year annualized return on average investment capital exceeds a performance threshold equal to the greater of (i) 8% or (ii) the average 10-year U.S. Treasury rate plus 200 basis points. The committee believed that the amount of the grant was significant enough to incentivize our executives to strive for above-average stockholder returns, and the three-year performance period for vesting purposes will help to focus our executive officers—attention on long-term performance. The performance-based stock awards granted will be entitled to dividends equal to the actual per share dividend declared during the period, but the

payment of such dividends will not be made until after the performance conditions of the underlying shares have been met. If the company fails to exceed the performance threshold at any vesting date, vesting will be deferred and re-measured the following year. All unvested shares and the right to receive deferred dividends will expire if the performance criteria for the final three-year measurement period ending December 31, 2018 are not met.

Consistent with prior year grants, the committee concluded that the 2011 performance-based stock awards would contain certain non-routine vesting provisions in the event an executive officer—s employment ceases for any reason. Such reasons include termination by reason of voluntary or involuntary discharge, disability or retirement, the executive officer reduces his scheduled work hours per week (subject to management—s discretion), or in the event of a dissolution or liquidation of the company, in which case all unvested stock awards and related deferred dividends will revert to the company, except as noted below. Exceptions are limited to forfeitures in the event of a change-in-control or death of the executive officer. In the event of a change in control, all unvested stock awards and related deferred dividends will automatically vest in full and in the event of the death of the executive officer, a pro rata portion of the unvested stock awards and related deferred dividends may vest in full after the performance criteria established for the award are met. Additionally, as is the case with all previous equity awards, we do not provide our executive officers with tax gross-ups for any reason.

The initial three-year performance period for the 2008 performance-based stock awards was completed on December 31, 2011. During this initial performance period the average three-year annualized return on average investment capital for purposes of determining vesting was 16.2%. On February 1, 2012 the committee reviewed the performance criteria calculations and accepted a statement prepared by our CFO certifying that the minimum performance threshold for the requisite service period had been met. As a result, the initial 50% of the 2008 performance-based stock awards vested on February 1, 2012. Based on the closing common stock price of \$13.10 on that date, the fair value of shares vested to each of our executive officers was: \$268,550 for Mr. Jacobs, \$149,995 for Mr. Reinsch, \$180,125 for Mr. Spears and \$96,285 for Mr. Brown.

Other Benefits or Agreements. Our executive officers participate in our other benefit programs including basic life insurance, accidental death and dismemberment insurance, long-term disability insurance, long-term care insurance, and a qualified defined contribution retirement plan, or 401(k) plan, each on the same terms offered to other employees. In addition, we offer the following benefits to our executive officers:

A nonqualified deferred compensation plan for our executive officers and any other employees whose eligible compensation exceeds the maximum amount of compensation which may be considered for purposes of determining contributions to our tax-qualified plan pursuant to Internal Revenue Code Section 401(a)(17) (\$245,000 in 2011). The purpose of the plan is to allow employees, regardless of their respective levels of compensation, to retire with the same retirement income as a percentage of final pay as is available to all employees having the same tenure. Accordingly, the deferred compensation plan extends the general matching provisions of the 401(k) plan on compensation amounts that exceed the maximum amount. The aggregate cost to us of this benefit to our executive officers was \$337,000 in 2011.

Defined severance payment guarantees determined pursuant to severance agreements, as amended, with our executive officers and our other officers and employees who were employed with us in December 1999. Pursuant to these agreements, in the event a covered employee is terminated for any reason, including death or disability, other than those reasons described in the Potential Payments Upon Termination or Change-in-Control table of this proxy statement, that employee will receive a severance payment, which is not entitled for any tax gross-up. Any payment under any of these agreements will be limited as follows: three times base salary for Mr. Jacobs, two times base salary for Messrs. Reinsch and Spears and one and one-half times base salary for Mr. Brown.

Tax Considerations. Section 162(m) of the Internal Revenue Code of 1986, as amended, generally precludes a publicly-held corporation from a federal income tax deduction for a taxable year for compensation in excess of \$1 million paid individually to the principal executive officer or any of the three other most highly compensated executive officers who do not hold the title of principal executive officer or principal financial officer. Exceptions are made for, among other things, qualified performance-based

compensation. Qualified performance-based compensation means compensation paid solely upon attaining objective performance goals for each individual, provided that (i) performance goals are determined by a committee consisting solely of two or more outside directors, (ii) material terms of the performance-based compensation programs and performance goals are disclosed to and approved by stockholders at least every five years, and (iii) the committee certifies that the performance goals were attained and other material terms were satisfied prior to any payment. While the compensation committee designs certain components of executive compensation to preserve income tax deductibility, it believes that it is not in the stockholders interest to restrict the committee s discretion and flexibility in developing appropriate compensation programs and establishing compensation levels. Consequently, the committee may approve compensation in some instances that is not fully deductible.

Compensation Committee Report

The committee has reviewed and discussed the above disclosure with our executive officers, and based on this review and discussion recommended to our board that the above Compensation Discussion and Analysis be included in this proxy statement.

COMPENSATION COMMITTEE Mark S. Whiting, Chairman Jack Biegler Gary Keiser

Summary Compensation Table*

Compensation for our executive officers is administered under the direction of our compensation committee and is implemented by our CEO. The Summary Compensation Table below shows certain compensation information for our CEO, CFO and two other most highly compensated executive officers for services rendered in all capacities during the years ended December 31, 2011, 2010 and 2009.

				Stock	Option	All Other	
Name and Principal Position	Year	Salary (\$) ^(a)	Bonus (\$)	Awards (\$)	Awards (\$)	Compensation (\$)	Total (\$)
Andrew F. Jacobs President and Chief Executive Officer	2011 2010 2009	1,032,970 931,450 908,000	870,000 ^(b) 760,000 ^(b) 1,450,000	1,350,000 ^(c) 1,220,000 460,000		153,229 ^(d) 138,379 131,630	3,406,199 3,049,829 2,949,630
Phillip A. Reinsch Executive Vice President, Chief Financial Officer and Secretary	2011 2010 2009	602,800 539,450 532,000	500,000 ^(b) 445,000 ^(b) 840,000	766,667 ^(c) 698,333 ^(c) 253,333		87,262 ^(d) 80,362 75,867	1,956,729 1,763,145 1,701,200
Robert R. Spears, Jr. Executive Vice President-Director of Residential Mortgage Investments	2011	796,190					