

Invesco Mortgage Capital Inc.
Form 10-K/A
August 17, 2015

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K/A

Amendment No. 1

(Mark One)

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

For the fiscal year ended December 31, 2014

or

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

For the Transition Period from _____ to _____

Commission file number 001-34385

(Exact name of registrant as specified in its charter)

Maryland 26-2749336
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

1555 Peachtree Street, N.E., Suite 1800 30309
Atlanta, Georgia (Zip Code)
(Address of principal executive offices)

(404) 892-0896
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Securities Exchange Act of 1934:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, par value \$0.01 per share	New York Stock Exchange
7.75% Series A Cumulative Redeemable Preferred Stock	New York Stock Exchange
7.75% Fixed-to-Floating Series B Cumulative Redeemable Preferred Stock	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Securities Exchange Act of 1934: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes No

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy

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or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

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

The aggregate market value of the registrant's common stock held by non-affiliates was \$2,135,614,631 based on the closing sales price on the New York Stock Exchange on June 30, 2014. As of February 18, 2015, there were 123,112,345 outstanding shares of common stock of Invesco Mortgage Capital Inc.

Documents Incorporated by Reference

Part III of this Form 10-K incorporates by reference certain information (solely to the extent explicitly indicated) from the registrant's proxy statement for the 2015 Annual Meeting of Stockholders to be filed pursuant to Regulation 14A.

Invesco Mortgage Capital Inc.
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Explanatory Note

Invesco Mortgage Capital Inc. (referred to herein as "we," "our," or the "Company") is filing this Amendment No. 1 on Form 10-K (this "Form 10-K/A") to its Annual Report on Form 10-K for the period ended December 31, 2014, which was originally filed with the Securities and Exchange Commission (the "SEC") on February 27, 2015 (the "Original Filing"), for the purpose of restating previously filed financial statements, including notes thereto, and amending portions of the related disclosures contained in the Original Filing (the "Restatement"). This Form 10-K/A includes (i) restated consolidated balance sheets as of December 31, 2014 and 2013, (ii) restated consolidated statements of operations, consolidated statements of comprehensive income (loss), consolidated statements of equity and consolidated statements of cash flows for the years ended December 31, 2014 and 2013 and (iii) restated quarterly financial information for the quarters ended March 31, 2013 through December 31, 2014. We will not file amended periodic reports for any of the affected quarterly periods.

Restatement Background

In late June 2015 after the filing of our Form 10-Q for the quarter ended March 31, 2015, we undertook a thorough review of our generally accepted accounting principles ("GAAP") accounting treatment our securities, including our credit risk transfer securities issued by government-sponsored enterprises ("GSE CRT") and interest-only strips of residential mortgage-backed securities that are guaranteed by a U.S. government agency ("Agency MBS IOs"). We determined that the GSE CRTs are hybrid financial instruments consisting of (i) a debt host contract (the unsecured GSE debenture) and (ii) an embedded derivative related to the credit protection feature of the GSE CRTs that should have been accounted for applying the guidance of Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 815 - Derivatives and Hedging ("ASC 815"). Under ASC 815, changes in fair value of the embedded derivative are required to be recorded in the Company's consolidated statement of operations, instead of in other comprehensive income on the Company's consolidated balance sheet while changes in fair value of the debt host contract remain within other comprehensive income. Additionally, we determined that the Agency MBS IOs are also hybrid financial instruments, which consist of (i) a debt host contract (the mortgage-backed security) and (ii) an embedded interest derivative related to prepayment risk. We have determined that Agency MBS IOs should have been accounted for under ASC 815 by recording changes in fair value of the embedded derivative in the consolidated statement of operations instead of in other comprehensive income on the Company's consolidated balance sheet. Management determined that the Agency MBS IOs embedded derivative cannot be reliably valued as a stand-alone instrument and therefore recorded the entire Agency MBS IOs change in fair value in the consolidated statement of operations in accordance with ASC 815.

On August 9, 2015, the Audit Committee of the Board of Directors of the Company concluded, based on the recommendation of management, that each of the Company's previously issued (i) consolidated financial statements as of and for the years ended December 31, 2013 and 2014, which were included in its Annual Report on Form 10-K for the year ended December 31, 2014, and (ii) interim consolidated financial statements as of and for the quarter ended March 31, 2013 and for all subsequent quarters through the quarter ended March 31, 2015 need to be restated and should no longer be relied upon. Additionally, it was determined that the Company should, as soon as practicable, file with the SEC (i) an amendment to the Original Filing, inclusive of restated financial data pertaining to each applicable quarterly period in 2013 and 2014 and (ii) an amendment to the Quarterly Report on Form 10-Q for the period ended March 31, 2015 in order to restate such financial statements.

Concurrently with the filing of this Form 10-K/A, the Company is filing an amendment to its Quarterly Report on Form 10-Q for the fiscal period ended March 31, 2015 to restate its previously-issued unaudited condensed consolidated financial statements and amend related financial information.

The following sections of this Form 10-K/A contain information that has been amended where necessary to reflect the restatement:

Part I, Item 1A. Risk Factors

Part II, Item 6. Selected Financial Data

Part II, Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations (Certain Sections As Restated)

Part II, Item 8. Financial Statements and Supplementary Data

Part II, Item 9A. Controls and Procedures

Part IV, Item 15. Exhibits, Financial Statement Schedules

Except as described in this Explanatory Note, the information contained in the Original Filing has not been updated to reflect any events, conditions or other developments that have occurred or existed since February 27, 2015, the date of the Original Filing with the SEC.

In accordance with applicable SEC rules, this Form 10-K/A includes new certifications required by Sections 302 and 906 of the Sarbanes-Oxley Act of 2002, as amended, from our Chief Executive Officer and Chief Financial Officer dated as of the filing date of this Form 10-K/A.

Forward-Looking Statements

We make forward-looking statements in this Report and other filings we make with the SEC within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and such statements are intended to be covered by the safe harbor provided by the same.

Forward-looking statements are subject to substantial risks and uncertainties, many of which are difficult to predict and are generally beyond our control. These forward-looking statements include information about possible or assumed future results of our business, investment strategies, financial condition, liquidity, results of operations, plans and objectives. When we use the words "believe," "expect," "anticipate," "estimate," "plan," "continue," "intend," "should," "may," "will," "could," "would," and any other similar expressions and future or conditional verbs such as "will," "may," "could," "should," and "would," and any other statement that necessarily depends on future events, we intend to identify forward-looking statements. Factors that could cause actual results to differ from those expressed in our forward-looking statements include, but are not limited to:

- our business and investment strategy;
- our investment portfolio;
- our projected operating results;
- general volatility of financial markets and effects of governmental responses, including actions and initiatives of the U.S. governmental agencies and changes to U.S. government policies, including the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), mortgage loan modification programs, actions and initiatives of foreign governmental agencies and central banks, and the completion of the Federal Reserve long-term asset purchases (quantitative easing or "QE"), and our ability to respond to and comply with such actions, initiatives and changes;
- the availability of financing sources, including our ability to obtain additional financing arrangements and the terms of such arrangements;
- financing and advance rates for our target assets;
- changes to our expected leverage;
- our expected investments;
- our expected book value per share of common stock;
- interest rate mismatches between our target assets and our borrowings used to fund such investments;
- the adequacy of our cash flow from operations and borrowings to meet our short-term liquidity needs;
- our ability to maintain sufficient liquidity to meet any margin calls;
- changes in the credit rating of the U.S. government;
- changes in interest rates and interest rate spreads and the market value of our target assets;
- changes in prepayment rates on our target assets;
- the impact of any deficiencies in foreclosure practices of third parties and related uncertainty in the timing of collateral disposition;
- our reliance on third parties in connection with services related to our target assets;
- effects of hedging instruments on our target assets;
- rates of default or decreased recovery rates on our target assets;
- modifications to whole loans or loans underlying securities;
- the degree to which our hedging strategies may or may not protect us from interest rate volatility;
- the degree to which derivative contracts expose us to contingent liabilities;
- counterparty defaults;
- compliance with financial covenants in our financing arrangements;
- changes in governmental regulations, tax law and rates, and similar matters and our ability to respond to such changes;

our ability to maintain our qualification as a real estate investment trust for U.S. federal income tax purposes;

our ability to maintain our exception from the definition of “investment company” under the Investment Company Act of 1940, as amended (the “1940 Act”);

availability of investment opportunities in mortgage-related, real estate-related and other securities;

availability of U.S. Government Agency guarantees with regard to payments of principal and interest on securities;

the market price and trading volume of our capital stock;

availability of qualified personnel of our Manager;

the relationship with our Manager;

estimates relating to taxable income and our ability to continue to make distributions to our stockholders in the future;

estimates relating to fair value of our target assets and loan loss reserves;

our understanding of our competition;

changes to generally accepted accounting principles in the United States of America (“U.S. GAAP”);

the impact of the Restatement and the adequacy of our disclosure controls and procedures and internal controls over financial reporting; and

market trends in our industry, interest rates, real estate values, the debt securities markets or the general economy.

The forward-looking statements are based on our beliefs, assumptions and expectations of our future performance, taking into account all information currently available to us. You should not place undue reliance on these forward-looking statements. These beliefs, assumptions and expectations can change as a result of many possible events or factors, not all of which are known to us. Some of these factors are described under the headings “Risk Factors,” “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and “Business.” If a change occurs, our business, financial condition, liquidity and results of operations may vary materially from those expressed in our forward-looking statements. Any forward-looking statement speaks only as of the date on which it is made. New risks and uncertainties arise over time, and it is not possible for us to predict those events or how they may affect us. Except as required by law, we are not obligated to, and do not intend to, update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

PART I

Item 1. Business.

Our Company

We are a Maryland corporation primarily focused on investing in, financing and managing residential and commercial mortgage-backed securities ("MBS") and mortgage loans. We are externally managed and advised by Invesco Advisers, Inc., our Manager, which is an indirect, wholly-owned subsidiary of Invesco Ltd. We elected to be taxed as a real estate investment trust ("REIT") for U.S. federal income tax purposes under the provisions of the Internal Revenue Code of 1986, as amended ("Code"), commencing with our taxable year ended December 31, 2009. To maintain our REIT qualification, we are generally required to distribute at least 90% of our REIT taxable income to our stockholders annually. We operate our business in a manner that permits our exclusion from the definition of "Investment Company" under the 1940 Act.

Our objective is to provide attractive risk-adjusted returns to our investors, primarily through dividends and secondarily through capital appreciation. To achieve this objective, we primarily invest in the following:

Residential mortgage-backed securities ("RMBS") that are guaranteed by a U.S. government agency such as the Government National Mortgage Association ("Ginnie Mae") or a federally chartered corporation such as the Federal National Mortgage Association ("Fannie Mae") or the Federal Home Loan Mortgage Corporation ("Freddie Mac") (collectively "Agency RMBS");

RMBS that are not guaranteed by a U.S. government agency ("non-Agency RMBS");

Credit risk transfer securities that are unsecured obligations issued by government-sponsored enterprises ("GSE CRT");

Commercial mortgage-backed securities ("CMBS");

Residential and commercial mortgage loans; and

Other real estate-related financing arrangements.

We generally finance our investments through short- and long-term borrowings structured as repurchase agreements and secured loans. We finance our residential loans held-for-investment through asset-backed securities ("ABS") issued by consolidated securitization trusts. We have also financed investments through the issuances of debt and equity and may utilize other forms of financing in the future.

Capital Activities

In September 2014, the Company completed a public offering of 6,200,000 shares of 7.75% Fixed-to-Floating Series B Cumulative Redeemable Preferred Stock (the "Series B Preferred Stock") at the price of \$25.00 per share. Total proceeds were \$149.9 million, net of issuance costs of \$5.1 million.

During the three months ended December 31, 2014, we did not repurchase any shares of our common stock. During the year ended December 31, 2014, we repurchased 1,438,213 shares of our common stock at an average repurchase price of \$14.69 per share for a net cost of \$21.1 million, including acquisition expenses.

Our Manager

We are externally managed and advised by Invesco Advisers, Inc. (our "Manager"), a wholly owned subsidiary of Invesco Ltd. ("Invesco"). Under the terms of the management agreement, the Manager and its affiliates provide us with our management team, including its officers, along with appropriate support personnel. Each of our officers is an employee of the Manager or one of its affiliates. We do not have any employees. The Manager is not obligated to dedicate any of its employees exclusively to us, nor are the Manager or its employees obligated to dedicate any specific portion of its or their time to our business. The Manager is at all times subject to the supervision and oversight of our Board of Directors and has only such functions and authority as we delegate to it.

Our Competitive Advantages

We believe that our competitive advantages include the following:

Significant Experience of Our Manager and Our Senior Management

Our senior management team has a long track record and broad experience in managing residential and commercial mortgage-related assets through a variety of credit and interest rate environments and has demonstrated the ability to generate

attractive risk-adjusted returns under different market conditions and cycles. In addition, through our Manager, we benefit from the insight and capabilities of WL Ross & Co. LLC (“WL Ross”) and Invesco’s real estate team. Through WL Ross and Invesco’s real estate team, we have access to broad and deep teams of experienced investment professionals in real estate and distressed investing. Through these teams, we have real time access to research and data on the mortgage and real estate industries. We believe having in-house access to these resources and expertise provides us with a competitive advantage over other companies investing in our target assets who have less internal resources and expertise.

Extensive Strategic Relationships and Experience of our Manager and its Affiliates

Our Manager maintains extensive long-term relationships with other financial intermediaries, including primary dealers, leading investment banks, brokerage firms, leading mortgage originators and commercial banks. We believe these relationships enhance our ability to source, finance and hedge investment opportunities and, thus, will enable us to grow in various credit and interest rate environments.

Disciplined Investment Approach

We seek to maximize our risk-adjusted returns through our disciplined investment approach, which relies on rigorous quantitative and qualitative analysis. Our Manager monitors our overall portfolio risk and evaluates the characteristics of our investments in our target assets including, but not limited to, asset type, interest rate, interest rate type, loan balance distribution, geographic concentration, property type, occupancy, loan-to-value ratio and credit score. In addition, with respect to any particular target asset, our Manager’s investment team evaluates, among other things, relative valuation, supply and demand trends, shape of yield curves, prepayment rates, loan delinquencies, default rates and loss severity rates. We believe this strategy and our commitment to capital preservation provide us with a competitive advantage when operating in a variety of market conditions.

Access to Our Manager’s Sophisticated Analytical Tools, Infrastructure and Expertise

Our Manager has created and maintains analytical and portfolio management capabilities to aid in asset selection and risk management. We capitalize on the market knowledge and ready access to data across our target markets that our Manager and its affiliates obtain through their established platform. We focus on in-depth analysis of the numerous factors that influence our target assets, including: (1) fundamental market and sector review; (2) rigorous cash flow analysis; (3) disciplined asset selection; (4) controlled risk exposure; and (5) prudent balance sheet management. Through the use of these tools, we analyze factors that affect the rate at which mortgage prepayments occur, including changes in the level of interest rates, trends in residential and commercial real estate prices, general economic conditions, the locations of the properties securing the mortgage loans and other social and demographic conditions in order to acquire our target assets.

We also benefit from our Manager’s and its affiliates’ comprehensive financial and administrative infrastructure, including its risk management and financial reporting operations, as well as its business development, legal and compliance teams.

Investment Strategy

We invest in a diversified pool of mortgage assets that generate attractive risk-adjusted returns. Our target assets generally include Agency RMBS, non-Agency RMBS, CMBS, residential and commercial mortgage loans and other real estate-related financing arrangements. In addition to direct purchases of our target assets, we also invest in equity investments (partnerships managed by an affiliate of the Company’s Manager), which, in turn, invest in our target assets.

Agency RMBS

Agency RMBS are residential mortgage-backed securities for which a U.S. government agency such as Ginnie Mae, or a federally chartered corporation such as Fannie Mae or Freddie Mac guarantees payments of principal and interest on the securities. Payments of principal and interest on Agency RMBS, not the market value of the securities themselves, are guaranteed. Agency RMBS differ from other forms of traditional debt securities, which normally provide for periodic payments of interest in fixed amounts with principal payments at maturity or on specified call dates. Instead, Agency RMBS provide for monthly payments, which consist of both principal and interest. In effect, these payments are a “pass-through” of scheduled and prepaid principal payments and the monthly interest payments made by the individual borrowers on the mortgage loans, net of any fees paid to the servicers, guarantors or other related parties of the securities.

The principal may be prepaid at any time due to prepayments on the underlying mortgage loans. These differences can result in significantly greater price and yield volatility than is the case with other fixed-income securities.

Various factors affect the rate at which mortgage prepayments occur, including changes in the level and directional trends in housing prices, interest rates, general economic conditions, the age of the mortgage loan, the location of the property, social and demographic conditions, government initiated refinance programs, legislative regulations, and industry capacity. Generally, prepayments on Agency RMBS increase during periods of falling mortgage interest rates and decrease during periods of rising mortgage interest rates. However, this may not always be the case. We may reinvest principal repayments at a yield that is higher or lower than the yield on the repaid investment, thus affecting our net interest income by altering the average yield on our assets.

However, when interest rates are declining, the value of Agency RMBS with prepayment options may not increase as much as other fixed income securities. The rate of prepayments on underlying mortgages will affect the price and volatility of Agency RMBS and may have the effect of shortening or extending the duration of the security beyond what was anticipated at the time of purchase. When interest rates rise, our holdings of Agency RMBS may experience reduced returns if the owners of the underlying mortgages pay off their mortgages slower than anticipated. This is generally referred to as extension risk.

Mortgage pass-through certificates, CMOs, Freddie Mac Gold Certificates, Fannie Mae Certificates and Ginnie Mae Certificates are types of Agency RMBS that are collateralized by either fixed-rate mortgage loans (“FRMs”), adjustable-rate mortgage loans (“ARMs”), or hybrid ARMs. FRMs have an interest rate that is fixed for the term of the loan and do not adjust. The interest rates on ARMs generally adjust annually (although some may adjust more frequently) to an increment over a specified interest rate index. Hybrid ARMs have interest rates that are fixed for a specified period of time (typically three, five, seven or ten years) and, thereafter, adjust to an increment over a specified interest rate index. ARMs and hybrid ARMs generally have periodic and lifetime constraints on how much the loan interest rate can change on any predetermined interest rate reset date. Our allocation of our Agency RMBS collateralized by FRMs, ARMs or hybrid ARMs will depend on various factors including, but not limited to, relative value, expected future prepayment trends, supply and demand, costs of hedging, costs of financing, expected future interest rate volatility and the overall shape of the U.S. Treasury and interest rate swap yield curves. We take these factors into account when we make investments.

Non-Agency RMBS

Non-Agency RMBS are residential mortgage-backed securities that are not issued or guaranteed by a U.S. government agency. Like Agency RMBS, non-Agency RMBS represent interests in “pools” of mortgage loans secured by residential real property. The mortgage loan collateral for non-Agency RMBS generally consists of residential mortgage loans that do not conform to the U.S. government agency underwriting guidelines due to certain factors including mortgage balance in excess of such guidelines, borrower characteristics, loan characteristics and level of documentation.

A re-securitization of a real estate mortgage investment conduit (“Re-REMIC”) is a transaction in which an existing security or securities is transferred to a special purpose entity that has formed a securitization vehicle that will issue multiple classes of securities secured by and payable from cash flows on the underlying securities. A number of our non-Agency RMBS are structured as Re-REMICs.

Government-Sponsored Enterprises Credit Risk Transfer Securities

GSE CRTs are unsecured general obligations of Fannie Mae and Freddie Mac that are structured to provide credit protection to the issuer with respect to defaults and other credit events within pools of residential mortgage loans that collateralize MBS issued and guaranteed by the GSEs. This credit protection is achieved by allowing the GSEs to reduce the outstanding class principal balance of the securities as designated credit events on the loans arise. The GSEs make monthly payments of accrued interest and periodic payments of principal to the holders of the securities. To date, all GSE CRTs have paid a floating interest rate benchmarked to one-month LIBOR.

CMBS

CMBS are securities backed by obligations (including certificates of participation in obligations) that are principally secured by commercial mortgages on real property or interests therein having a multifamily or commercial use, such as regional malls, retail space, office buildings, industrial or warehouse properties, hotels, apartments, nursing homes and senior living facilities.

CMBS are typically issued in multiple tranches whereby the more senior classes are entitled to priority distributions to make specified interest and principal payments on such tranches. Losses and other shortfalls from expected amounts to be received on the mortgage pool are borne by the most subordinate classes, which receive payments only after the

more senior classes have received all principal and/or interest to which they are entitled. The credit quality of CMBS depends on the credit quality of the underlying mortgage loans, which is a function of factors such as the principal amount of loans relative to the value of the related properties, the mortgage loan terms, such as amortization, market assessment and geographic location, construction quality of the property, and the creditworthiness of the borrowers.

Residential Mortgage Loans

Residential mortgage loans are loans secured by residential real properties. We generally focus our residential mortgage loan acquisition efforts on the purchase of loan portfolios that are first lien, single-family FRMs, ARMs and Hybrid ARMs with original terms to maturity of not more than 30 years and that are either fully amortizing or are interest-only for up to ten years, and fully amortizing thereafter.

Prime and Jumbo Prime Mortgage Loans

Prime mortgage loans are mortgage loans that generally require borrower credit histories, debt-to-income ratios and loan-to-value ratios similar to those dictated by GSE underwriting guidelines, though in certain cases they may not meet the same income documentation or other requirements. Jumbo prime mortgage loans are mortgage loans with requirements similar to prime mortgage loans except that the mortgage balance exceeds the maximum amount permitted by GSE underwriting guidelines.

Alt-A Mortgage Loans

Alt-A mortgage loans are mortgage loans made to borrowers whose qualifying mortgage characteristics do not conform to GSE underwriting guidelines, but whose borrower characteristics may. Generally, Alt-A mortgage loans allow homeowners to qualify for a mortgage loan with reduced or alternative forms of documentation. The credit quality of Alt-A borrowers generally exceeds the credit quality of subprime borrowers.

Subprime Mortgage Loans

Subprime mortgage loans are loans that do not conform to U.S. government agency underwriting guidelines. Subprime borrowers generally have imperfect or impaired credit histories and low credit scores.

Reperforming Mortgage Loans

Reperforming mortgage loans are residential mortgage loans that have a history of delinquency and generally have been restructured since origination. Repperforming mortgage loans may or may not have originally conformed to GSE underwriting guidelines. Due to past delinquencies, borrowers generally have impaired credit histories and low credit scores, and may have a greater than normal risk of future delinquencies and defaults.

Commercial Mortgage Loans

Commercial mortgage loans are mortgage loans secured by first or second liens on commercial properties such as regional malls, retail space, office buildings, industrial or warehouse properties, hotels, apartments, nursing homes and senior living facilities. These loans, which tend to range in term from two to ten years, can carry either fixed or floating interest rates. They generally permit pre-payments before final maturity but may require the payment to the lender of yield maintenance pre-payment penalties. First lien loans represent the senior lien on a property while second lien loans or second mortgages represent a subordinate or second lien on a property.

Mezzanine Loans

Mezzanine loans are generally structured to represent a senior position in the borrower's equity in, and subordinate to a first mortgage loan, on a property. These loans are generally secured by pledges of ownership interests, in whole or in part, in entities that directly or indirectly own the real property. At times, mezzanine loans may be secured by additional collateral, including letters of credit, personal guarantees, or collateral unrelated to the property. Mezzanine loans may be structured to carry either fixed or floating interest rates as well as carry a right to participate in a percentage of gross revenues and a percentage of the increase in the fair market value of the property securing the loan. Mezzanine loans may also contain prepayment lockouts, penalties, minimum profit hurdles and other mechanisms to protect and enhance returns to the lender. Mezzanine loans usually have maturities that match the maturity of the related mortgage loan but may have shorter or longer terms.

Equity Investments

The Company has investments in unconsolidated ventures. In circumstances where the Company has a non-controlling interest but is deemed to be able to exert significant influence over the affairs of the enterprise, the Company utilizes the equity method of accounting. Under the equity method of accounting, the initial investment is increased each period for additional capital contributions and a proportionate share of the entity's earnings and decreased for cash distributions and a proportionate share of the entity's losses.

Financing Strategy

We generally finance our investments through short- and long-term borrowings structured as repurchase agreements and secured loans. We finance our residential loans held-for-investment through asset-backed securities issued by consolidated securitization trusts. We have also financed investments through the issuances of debt and equity.

Repurchase Agreements

Repurchase agreements are financings pursuant to which we sell our target assets to the repurchase agreement counterparty, the buyer, for an agreed upon price with the obligation to repurchase these assets from the buyer at a future date and at a price higher than the original purchase price. The amount of financing we receive under a repurchase agreement is limited to a specified percentage of the estimated market value of the assets we sell to the buyer. The difference between the sale price and repurchase price is the cost, or interest expense, of financing under a repurchase agreement. Under repurchase agreement financing arrangements, certain buyers require us to provide additional cash collateral in the event the market value of the asset declines to maintain the ratio of value of the collateral to the amount of borrowing.

Secured Loans

In March 2014, our wholly-owned subsidiary, IAS Services LLC, became a member of the Federal Home Loan Bank of Indianapolis ("FHLBI"). As a member of the FHLBI, IAS Services LLC may borrow funds from the FHLBI in the form of secured advances. FHLBI advances are treated as secured financing transactions and are carried at their contractual amounts.

Leverage

We use leverage on our target assets to achieve our return objectives, which are adjusted as our investment and financing opportunities change. The amount of leverage we apply to a given asset depends primarily on the expected price volatility and liquidity of the asset we use as collateral, the type of financing, the advance rate against our collateral, and the cost of financing. Shorter duration and higher quality liquid assets generally merit higher leverage due to lower price volatility, higher advance rates, and more attractive financing rates. Assets that are less liquid or exhibit higher price volatility tend to be held unlevered or with lower leverage applied.

We include a table that shows the allocation of our equity to our target assets in Item 7, "Management's Discussion and Analysis of Operations" of this Report. In addition, we present a non-GAAP financial measure of leverage, our repurchase agreement debt-to-equity ratio. Since we began using other longer-term means of financing our investments, such as our exchangeable senior notes, asset-backed securities issued by securitization trusts, and secured loans, we have reduced our reliance on repurchase agreements. We believe presenting our repurchase agreement debt-to-equity ratio when considered with U.S. GAAP financial measures, provides information that is useful to investors in understanding the Company's refinancing risks, and gives investors a comparable statistic to other mortgage REITS who almost exclusively borrow using repurchase agreements which are short-term and subject to refinancing risk.

Risk Management Strategy

Market Risk Management

Risk management is an integral component of our strategy to deliver returns to our stockholders. Because we invest in MBS, investment losses from prepayment, interest rate volatility or other risks can meaningfully impact our earnings and our distributions to stockholders. In addition, because we employ financial leverage in funding our investment portfolio, mismatches in the maturities of our assets and liabilities can create the need to continually renew or otherwise refinance our liabilities. Our results are dependent upon a positive spread between the returns on our asset portfolio and our overall cost of funding. To minimize the risks to our portfolio, we actively employ portfolio-wide and security-specific risk measurement and management processes in our daily operations. Our Manager's risk management tools include software and services licensed or purchased from third parties, in addition to proprietary software and analytical methods developed by Invesco.

Interest Rate Risk

We engage in a variety of interest rate management techniques that seek to mitigate the influence of interest rate changes on the costs of liabilities and help us achieve our risk management objective. Specifically, we seek to hedge our exposure to potential interest rate mismatches between the interest we earn on our investments and our borrowing costs caused by fluctuations in short-term interest rates. In utilizing leverage and interest rate hedges, we seek to

improve risk-adjusted returns and, where possible, to lock in, on a long-term basis, a favorable spread between the yield on our assets and the cost of our financing. We may utilize various derivative financial instruments including puts and calls on securities or indices of securities, futures, interest rate swaps and swaptions, interest rate caps, exchange-traded derivatives, U.S. Treasury securities and options on U.S. Treasury securities and interest rate floors to hedge all or a portion of the interest rate risk associated with the financing of our investment portfolio.

Credit Risk

We believe that our investment strategy will generally keep our credit losses and financing costs low. However, we retain the risk of potential credit losses on all of our residential and commercial mortgage investments. We seek to manage this risk in part through our pre-acquisition due diligence process. In addition, we re-evaluate the credit risk inherent in our investments on a regular basis pursuant to fundamental considerations such as gross domestic product ("GDP"), unemployment, interest rates, retail sales, store closings/openings, corporate earnings, housing inventory, affordability and regional home price trends. We also review key loan credit metrics including, but not limited to, payment status, current loan-to-value ratios, current borrower credit scores and debt yields. These characteristics assist in determining the likelihood and severity of loan loss as well as prepayment and extension expectations. We then perform structural analysis under multiple scenarios to establish likely cash flow profiles and credit enhancement levels relative to collateral performance projections. This analysis allows us to quantify our opinions of credit quality and fundamental value, which are key drivers of portfolio management decisions.

Foreign Exchange Rate Risk

We have an investment in a commercial loan denominated in a foreign currency. We are exposed to foreign exchange risk on the balance of the loan and contractual payments of interest on the loan. We have hedged our foreign currency exposure on the loan by purchasing currency forward contracts.

Investment Guidelines

Our board of directors has adopted the following investment guidelines:

- no investment shall be made that would cause us to fail to qualify as a REIT for federal income tax purposes;
 - no investment shall be made that would cause us to be regulated as an investment company under the 1940 Act;
 - our assets will be invested within our target assets; and
- until appropriate investments can be identified, our Manager may pay off short-term debt or invest the proceeds of any offering in interest-bearing, short-term investments, including funds that are consistent with maintaining our REIT qualification.

These investment guidelines may be changed from time to time by our board of directors without the approval of our stockholders.

Investment Committee

Our investment committee is comprised of certain of our officers and certain of our Manager's investment professionals. The investment committee periodically reviews our investment portfolio for risk characteristics, investment performance, liquidity, portfolio composition, leverage and other applicable items. It also reviews its compliance with our investment policies and procedures, including our investment guidelines, and our Manager provides our board of directors an investment report at the end of each quarter in conjunction with its review of our quarterly results.

Investment Process

Our Manager's investment team has a strong focus on asset selection and on the relative value of various sectors within the mortgage market. Our Manager utilizes this expertise to build a diversified portfolio. Our Manager incorporates its views on the economic environment and the outlook for the mortgage market, including relative valuation, supply and demand trends, the level of interest rates, the shape of the yield curve, prepayment rates, financing and liquidity, housing prices, delinquencies, default rates and loss severity rates of various collateral types.

Our investment process includes sourcing and screening investment opportunities, assessing investment suitability, conducting interest rate and prepayment analysis, evaluating cash flow and collateral performance, reviewing legal structure and servicer and originator information and investment structuring, as appropriate, to ensure an attractive return commensurate with the risk we are bearing. Upon identification of an investment opportunity, the investment will be screened and monitored by our Manager to determine its impact on maintaining our REIT qualification and our exemption from registration under the 1940 Act. We make investments in sectors where our Manager has strong core competencies and where we believe market risk and expected performance can be reasonably quantified.

Our Manager evaluates each of our investment opportunities based on its expected risk-adjusted return relative to the returns available from other, comparable investments. In addition, we evaluate new opportunities based on their relative expected returns compared to assets held in our portfolio. The terms of any leverage available to us for use in funding an investment purchase are also taken into consideration, as are any risks posed by illiquidity or correlations

with other assets in

the portfolio. Our Manager also develops a macro outlook with respect to each target asset class by examining factors in the broader economy such as gross domestic product, interest rates, unemployment rates and availability of credit, among other factors. Our Manager analyzes fundamental trends in the relevant target asset class sector to adjust or maintain its outlook for that particular target asset class. These macro decisions guide our Manager's assumptions regarding model inputs and portfolio allocations among target assets. Additionally, our Manager conducts extensive diligence with respect to each target asset class by, among other things, examining and monitoring the capabilities and financial wherewithal of the parties responsible for the origination, administration and servicing of relevant target assets.

Competition

Our net income depends, in large part, on our ability to acquire assets at favorable spreads over our borrowing costs. In acquiring our investments, we compete with other REITs, specialty finance companies, mortgage bankers, insurance companies, mutual funds, institutional investors, investment banking firms, financial institutions, governmental bodies and other entities. Refer to "Management's Discussion and Analysis of Financial Condition and Results of Operations — Market Conditions." In addition, there are numerous REITs with similar asset acquisition objectives. These other REITs increase competition for the available supply of mortgage assets suitable for purchase. Many of our competitors are significantly larger than we are, have access to greater capital and other resources and may have other advantages over us. In addition, some of our competitors may have higher risk tolerances or different risk assessments, which could allow them to consider a wider variety of investments and establish more relationships than we can. Market conditions may attract more competitors, which may increase the competition for sources of financing. An increase in the competition for sources of financing could adversely affect the availability and cost of financing.

We have access to our Manager's professionals and their industry expertise, which we believe provides us with a competitive advantage. These professionals help us assess investment risks and determine appropriate pricing for certain potential investments. These relationships enable us to compete more effectively for attractive investment opportunities. Despite certain competitive advantages, we may not be able to achieve our business goals or expectations due to the competitive risks that we face. For additional information concerning these competitive risks, refer to "Risk Factors — Risks Related to Our Investments — We operate in a highly competitive market for investment opportunities and competition may limit our ability to acquire desirable investments in our target assets and could also affect the pricing of these securities."

Staffing

We are managed by our Manager pursuant to the management agreement between our Manager and us. Refer to "Certain Relationships, Related Transactions, and Director Independence" for a discussion of the management fee and our relationship with our Manager. All of our officers are employees of Invesco. We do not have any employees.

Our Corporate Information

Our principal executive offices are located at 1555 Peachtree Street, N.E., Suite 1800, Atlanta, Georgia 30309. Our telephone number is (404) 892-0896. Our website is www.invescomortgagecapital.com. We make available free of charge, through our corporate website, our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. The information on our website is not intended to form a part of or be incorporated by reference into this Report.

Item 1A. Risk Factors.

Set forth below are the material risks and uncertainties that, if they were to occur, could materially and adversely affect our business, financial condition, results of operations and the trading price of our securities. Additional risks not presently known, or that we currently deem immaterial, also may have a material adverse effect on our business, financial condition and results of operation.

Risks Related to Our Investments

Difficult conditions in the mortgage, residential and commercial real estate markets may cause us to experience market losses related to our investments.

Our results of operations are materially affected by conditions in the mortgage market, the residential and commercial real estate markets, the financial markets and the economy generally. Ongoing concerns about the mortgage market and real estate market, as well as inflation, energy costs, geopolitical issues and the availability and cost of credit, continue to contribute to market volatility. The mortgage market has been severely affected by changes in the lending landscape and there is no

assurance that these conditions have stabilized or that they will not worsen. The disruption in the mortgage market contributed to a decline in demand for homes, which compressed the homeownership rate and weighed heavily on home prices. There is a strong correlation between home price growth rates and mortgage loan delinquencies. Any deterioration of the real estate market may cause us to experience losses related to our assets and to sell assets at a loss.

Declines in the market values of our investments may adversely affect our results of operations and credit availability, which may reduce earnings and, in turn, cash available for distribution to our stockholders. In addition, a substantial portion of our investments are classified for accounting purposes as “available-for-sale.” Changes in the market values of those assets will be directly charged or credited to stockholders' equity. As a result, a decline in values may reduce our book value.

Because assets we acquire may experience periods of illiquidity, we may lose profits or be prevented from earning capital gains if we cannot sell mortgage-related assets at an opportune time.

We bear the risk of being unable to dispose of our target assets at advantageous times or in a timely manner because mortgage-related assets generally experience periods of illiquidity. The lack of liquidity may result from the absence of a willing buyer or an established market for these assets, as well as legal or contractual restrictions on resale or the unavailability of financing for these assets. As a result, our ability to vary our portfolio in response to changes in economic and other conditions may be relatively limited, which may cause us to incur losses.

In addition, some of the assets that comprise our investment portfolio and that we acquire are not publicly traded. These securities may be less liquid than publicly-traded securities. The illiquidity of our investments may make it difficult for us to sell such investments if the need or desire arises. In addition, if we are required to liquidate all or a portion of our portfolio quickly, we may realize significantly less than the value at which we have previously recorded our investments. As a result, our ability to vary our portfolio in response to changes in economic and other conditions may be relatively limited, which could adversely affect our results of operations and financial condition.

Our investments may be concentrated and will be subject to risk of default.

While we diversify and intend to continue to diversify our portfolio of investments, we are not required to observe specific diversification criteria, except as may be set forth in the investment guidelines adopted by our board of directors. Therefore, our investments in our target assets may at times be concentrated in certain property types that are subject to higher risk of foreclosure, or secured by properties concentrated in a limited number of geographic locations. For example, as of December 31, 2014, a significant percentage of our non-Agency RMBS, GSE CRTs and CMBS was secured by property located in California, as well as New York with respect to our CMBS. Refer to “Management’s Discussion and Analysis of Financial Results - Investment Activities - Portfolio Characteristics” for additional information. To the extent that our portfolio is concentrated in any one region or type of security, downturns relating generally to such region or type of security may result in defaults on a number of our investments within a short time period, which may reduce our net income and the value of our capital stock and accordingly reduce our ability to pay dividends to our stockholders.

We operate in a highly competitive market for investment opportunities and competition may limit our ability to acquire desirable investments in our target assets and could also affect the pricing of these securities.

We operate in a highly competitive market for investment opportunities. Our profitability depends, in large part, on our ability to acquire our target assets at attractive prices. In acquiring our target assets, we compete with a variety of institutional investors, including other REITs, specialty finance companies, public and private funds (including other funds managed by Invesco), commercial and investment banks, commercial finance and insurance companies and other financial institutions. Many of our competitors are substantially larger and have considerably greater financial, technical, marketing and other resources than we do. Some competitors may have a lower cost of funds and access to funding sources that may not be available to us, such as funding from the U.S. government, if we are not eligible to participate in programs established by the U.S. government. Many of our competitors are not subject to the operating constraints associated with REIT tax compliance or maintenance of an exemption from the 1940 Act. In addition, some of our competitors may have higher risk tolerances or different risk assessments, which could allow them to consider a wider variety of investments and establish more relationships. Furthermore, competition for investments in our target assets may lead to the price of such assets increasing, which may further limit our ability to generate desired returns. We cannot assure you that the competitive pressures we face will not have a material adverse effect on our

business, financial condition and results of operations. Also, as a result of this competition, desirable investments in our target assets may be limited in the future and we may not be able to take advantage of attractive investment opportunities from time to time, as we can provide no assurance that we will be able to identify and make investments that are consistent with our investment objectives.

We may invest in investments with which our stockholders may not agree.

Our stockholders will be unable to evaluate the manner in which we invest or the economic merit of our expected investments and, as a result, we may invest in investments with which our stockholders may not agree. The failure of our

management to find investments that meet our investment criteria could cause a material adverse effect on our business, financial condition, liquidity, results of operations and ability to make distributions to our stockholders, and could cause the value of our capital stock to decline.

We acquire mortgage-backed securities and loans that are subject to defaults, foreclosure timeline extension, fraud and residential and commercial price depreciation, and unfavorable modification of loan principal amount, interest rate and amortization of principal, which could result in losses to us.

Mortgage-backed securities are secured by mortgage loans (primarily single family residential properties for RMBS and single commercial mortgage loans or a pool of commercial mortgage loans for CMBS). Accordingly, the MBS we invest in are subject to all the risks of the respective underlying mortgage loans, including risks of defaults, foreclosure timeline extension, fraud and price depreciation and unfavorable modification of loan principal amount, interest rate and amortization of principal, accompanying the underlying mortgage loans.

The ability of a borrower to repay a mortgage loan secured by a residential property is dependent in part upon the income and assets of the borrower. A number of factors over which we have no control may impair a borrower's ability to repay their loans.

Commercial mortgage loans are secured by multifamily or commercial property and are subject to risks of delinquency and foreclosure, and risks of loss that may be greater than similar risks associated with loans made on the security of single-family residential property. The ability of a borrower to repay a loan secured by an income-producing property typically is dependent primarily upon the successful operation of such property rather than upon the existence of independent income or assets of the borrower. If the net operating income of the property is reduced, the borrower's ability to repay the loan may be impaired. Net operating income of an income-producing property can be affected by a number of factors over which we have no control.

In the event of any default under a mortgage loan held directly by us, we bear a risk of loss of principal to the extent of any deficiency between the value of the collateral and the principal and accrued interest of the mortgage loan, which could have a material adverse effect on our cash flow from operations. In the event of defaults on the mortgage loans that underlie our investments and the exhaustion of any underlying or any additional credit support, we may not realize our anticipated return on our investments and we may incur a loss on these investments.

Our investments include non-Agency RMBS collateralized by Alt-A and subprime mortgage loans, which are subject to increased risks.

Our investments include non-Agency RMBS backed by collateral pools of mortgage loans known as "Alt-A mortgage loans," or "subprime mortgage loans." These loans have been originated using underwriting standards that are less restrictive than those used in underwriting "prime mortgage loans." These lower standards include mortgage loans made to borrowers having imperfect or impaired credit histories, mortgage loans where the amount of the loan at origination is 80% or more of the value of the mortgage property, mortgage loans made to borrowers who have other debt that represents a large portion of their income and mortgage loans made to borrowers whose income is not required to be disclosed or verified. Due to economic conditions, a decline in home prices, and aggressive lending practices, many Alt-A and subprime mortgage loans have experienced increased rates of delinquency, foreclosure, bankruptcy and loss, and they are likely to continue to experience delinquency, foreclosure, bankruptcy and loss rates that are higher, and that may be substantially higher, than those experienced by mortgage loans underwritten in a more traditional manner. Thus, because of the higher delinquency rates and losses associated with many Alt-A and subprime mortgage loans, the performance of non-Agency RMBS backed by Alt-A and subprime mortgage loans that we may acquire could be correspondingly adversely affected, which could adversely impact our results of operations, financial condition and business.

Our subordinated MBS assets may be in the "first loss" position, subjecting us to greater risks of loss.

We invest in certain tranches of MBS that are only entitled to a portion of the principal and interest payments made on mortgage loans underlying the securities issued by the trust. In general, losses on a mortgage loan included in a RMBS trust will be borne first by the equity holder of the issuing trust if any, and then by the "first loss" subordinated security holder and then by the "second loss" subordinate holder and so on. For CMBS assets, losses on a mortgaged property securing a mortgage loan included in a securitization will be borne first by the equity holder of the property, then by a cash reserve fund or letter of credit, if any, then by the holder of a mezzanine loan or B-Note, if any, then by the "first loss" subordinated security holder (generally, the "B-Piece" buyer) and then by the holder of a higher-rated security.

We may acquire securities at every level of such a trust, from the equity position to the most senior tranche. In the event of default and the exhaustion of any classes of securities junior to those which we acquire, our securities will suffer losses as well. In addition, if we overvalue the underlying mortgage portfolio, or if the values subsequently decline and, as a result, less collateral is available to satisfy interest and principal payments due on the related MBS, the securities which we acquire may

effectively become the “first loss” position ahead of the more senior securities, which may result in significant losses. The prices of lower credit quality securities are generally less sensitive to interest rate changes than more highly rated securities, but more sensitive to adverse economic downturns or individual issuer developments. A projection of an economic downturn could cause a decline in the value of lower credit quality securities because the ability of obligors of mortgages underlying MBS to make principal and interest payments may be impaired. In such event, existing credit support in the securitization structure may be insufficient to protect us against loss of our principal on these securities. Fluctuations in interest rates could adversely affect the value of our investments and cause our interest expense to increase, which could result in reduced earnings, affect our profitability and dividends as well as the cash available for distribution to our stockholders.

Interest rates are highly sensitive to many factors, including governmental monetary and tax policies, domestic and international economic and political considerations and other factors beyond our control. Interest rate fluctuations present a variety of risks, including the risk of a narrowing of the difference between asset yields and borrowing rates, flattening or inversion of the yield curve and fluctuating prepayment rates, and may adversely affect our income and the value of our assets and capital stock.

We invest in Agency RMBS, non-Agency RMBS, CMBS and mortgage loans that are subject to risks related to interest rate fluctuations. In a normal yield curve environment, short-term interest rates are lower than long-term interest rates. Fluctuations in short- or long-term interest rates could have adverse effects on our operations and financial condition, which may negatively affect cash available for distribution to our stockholders. Fluctuations in interest rates could impact us as follows:

If long-term rates increased significantly, the market value of investments in our target assets would decline, and the duration and weighted average life of the investments may increase. We could realize a loss if the securities were sold. Further, declines in market value may reduce book value and ultimately reduce earnings or result in losses to us.

An increase in short-term interest rates would increase the amount of interest owed on the repurchase agreements we enter into to finance the purchase of our investments.

If short-term interest rates rise disproportionately relative to longer-term interest rates (a flattening of the yield curve), our borrowing costs may increase more rapidly than the interest income earned on our assets.

- Because we expect our investments, on average, generally will bear interest based on longer-term rates than our borrowings, a flattening of the yield curve would tend to decrease our net income. Additionally, to the extent cash flows from investments that return scheduled and unscheduled principal are reinvested, the spread between the yields on the new investments and available borrowing rates may decline, which would likely decrease our net income.

If short-term interest rates exceed longer-term interest rates (a yield curve inversion), our borrowing costs may exceed our interest income and we could incur operating losses.

If interest rates fall, we may recognize losses on our swap positions that are not offset by gains on our assets, which may adversely affect our liquidity and financial position.

In a period of rising interest rates, our operating results will depend in large part on the difference between the income from our assets and financing costs. We anticipate that, in most cases, the income from such assets will respond more slowly to interest rate fluctuations than the cost of our borrowings. Consequently, changes in interest rates, particularly short-term interest rates, may significantly influence our net income. Increases in these rates will tend to decrease our net income and the market value of our assets and may negatively affect cash available for distribution to our stockholders.

In addition, market values of our investments may decline without any general increase in interest rates for a number of reasons, such as increases or expected increases in defaults, or increases or expected increases in voluntary prepayments for those investments that are subject to prepayment risk or widening of credit spreads, which may negatively affect cash available for distribution to our stockholders.

We may not control the special servicing of the mortgage loans included in the MBS in which we invest and, in such cases, the special servicer may take actions that could adversely affect our interests.

With respect to each series of MBS in which we invest, overall control over the special servicing of the related underlying mortgage loans is held by a “directing certificate holder” or a “controlling class representative,” which is appointed by the holders of the most subordinate class of MBS in such series. Depending on the class of MBS in

which we invest, we may not have the right to appoint the directing certificate holder. In connection with the servicing of the specially serviced mortgage loans, the related special servicer may, at the direction of the directing certificate holder, take actions with respect to the specially serviced mortgage loans that could adversely affect our interests.

If our Manager underestimates the collateral loss on our investments, we may experience losses.

Our Manager values our potential investments based on loss-adjusted yields, taking into account estimated future losses on the mortgage loans that collateralize the investments, and the estimated impact of these losses on expected future cash flows. Our Manager's loss estimates may not prove accurate, as actual results may vary from estimates. In the event that our Manager underestimates the pool level losses relative to the price we pay for a particular investment, we may experience losses with respect to such investment.

We and our third party loan originators and servicers' due diligence of potential assets may not reveal all of the liabilities associated with such assets and may not reveal other weaknesses in such assets, which could lead to losses. Before making an asset acquisition, we will assess the strengths and weaknesses of the originator or issuer of the asset as well as other factors and characteristics that are material to the performance of the asset. In making the assessment and otherwise conducting customary due diligence, we will rely on resources available to us, including our third party loan originators and servicers. This process is particularly important with respect to newly formed originators or issuers because there may be little or no information publicly available about these entities and assets. There can be no assurance that our due diligence process will uncover all relevant facts or that any asset acquisition will be successful, which could lead to losses in the value of our portfolio.

We depend on third-party service providers, including mortgage servicers, for a variety of services related to our RMBS. We are, therefore, subject to the risks associated with third-party service providers.

We depend on a variety of services provided by third-party service providers related to our RMBS. We rely on the mortgage servicers who service the mortgage loans backing our RMBS to, among other things, collect principal and interest payments on the underlying mortgages and perform loss mitigation services. Mortgage servicers and other service providers to our RMBS, such as trustees, bond insurance providers and custodians, may not perform in a manner that promotes our interests.

For example, recent legislation intended to reduce or prevent foreclosures through, among other things, loan modifications may reduce the value of mortgage loans underlying our RMBS. Mortgage servicers may be incentivized to pursue such loan modifications, as well as forbearance plans and other actions intended to prevent foreclosure, even if such loan modifications and other actions are not in the best interests of the beneficial owners of the mortgage loans. Similarly, legislation delaying the initiation or completion of foreclosure proceedings on specified types of residential mortgage loans or otherwise limiting the ability of mortgage servicers to take actions that may be essential to preserve the value of the mortgage loans may also reduce the value of mortgage loans underlying our RMBS. Any such limitations are likely to cause delayed or reduced collections from mortgagors and generally increase servicing costs. As a consequence of the foregoing matters, our business, financial condition and results of operations may be adversely affected.

In addition, federal and state governmental and regulatory bodies have pursued settlement agreements with a number of mortgage servicers to address alleged servicing and foreclosure abuses related to deficiencies in foreclosure documentation. These agreements may result in the temporary delay of foreclosure proceedings while servicers modify their foreclosure practices. The extension of foreclosure timelines may increase the inventory backlog of distressed homes on the market and create greater uncertainty about housing prices. Prior to making investments in non-Agency RMBS, we carefully consider many factors, including housing prices and foreclosure timelines, and formulate loss assumptions. The concerns about deficiencies in foreclosure practices of servicers may impact our loss assumptions and affect the values of, and our returns on, our investments in non-Agency RMBS.

Our commercial loans held-for investment include investments that involve greater risks of loss than senior loan assets secured by income-producing properties.

We may acquire mezzanine loans, which take the form of subordinated loans secured by second mortgages on the underlying property or loans secured by a pledge of the ownership interests of either the entity owning the property or the entity that owns the interest in the entity owning the property. These types of assets involve a higher degree of risk than long-term senior mortgage lending secured by income-producing real property, because the loan may become unsecured as a result of foreclosure by the senior lender. In the event of a bankruptcy of the entity providing the pledge of its ownership interests as security, we may not have full recourse to the assets of such entity, or the assets of the entity may not be sufficient to satisfy our mezzanine loan. If a borrower defaults on our mezzanine loan or debt senior to our loan, or in the event of a borrower bankruptcy, our mezzanine loan will be satisfied only after the senior

debt. As a result, we may not recover some or all of our initial expenditure. In addition, mezzanine loans may have higher loan-to-value ratios than conventional mortgage loans, resulting in less equity in the property and increasing the risk of loss of principal.

In addition, we make commercial loans structured as preferred equity investments. These investments involve a higher degree of risk than conventional debt financing due to a variety of factors, including their non-collateralized nature and subordinated ranking to other loans and liabilities of the entity in which such preferred equity is held.

Accordingly, if the issuer

defaults on our investment, we would only be able to proceed against such entity in accordance with the terms of the preferred security, and not against any property owned by such entity. Furthermore, in the event of bankruptcy or foreclosure, we would only be able to recoup our investment after all lenders to, and other creditors of, such entity are paid in full. As a result, we may lose all or a significant part of our investment, which could result in significant losses.

We may acquire B-Notes, mortgage loans typically (i) secured by a first mortgage on a single large commercial property or group of related properties, and (ii) subordinated to an A-Note secured by the same first mortgage on the same collateral. As a result, if a borrower defaults, there may not be sufficient funds remaining for B-Note holders after payment to the A-Note holders. However, because each transaction is privately negotiated, B-Notes can vary in their structural characteristics and risks. For example, the rights of holders of B-Notes to control the process following a borrower default may vary from transaction to transaction. Further, B-Notes typically are secured by a single property and reflect the risks associated with significant concentration.

Significant losses related to our commercial loans held for investment would result in operating losses for us and may limit our ability to make distributions to our stockholders.

When we foreclose on an asset, we may come to own and operate the property securing the loan, which would expose us to the risks inherent in that activity.

When we foreclose on an asset, we may take title to the property securing that asset, and if we do not or cannot sell the property, we would then come to own and operate it as “real estate owned.” Owning and operating real property involves risks that are different (and in many ways more significant) than the risks faced in owning an asset secured by that property. In addition, we may end up owning a property that we would not otherwise have decided to acquire directly at the price of our original investment or at all. We may not manage these properties as well as they might be managed by another owner, and our returns to investors could suffer. If we foreclose on and come to own property, our financial performance and returns to stockholders could suffer.

Liability relating to environmental matters may impact the value of properties that we may acquire or foreclose on. If we acquire or foreclose on properties with respect to which we have extended mortgage loans, we may be subject to environmental liabilities arising from such foreclosed properties. Under various U.S. federal, state and local laws, an owner or operator of real property may become liable for the costs of removal of certain hazardous substances released on its property. These laws often impose liability without regard to whether the owner or operator knew of, or was responsible for, the release of such hazardous substances.

The presence of hazardous substances may adversely affect an owner’s ability to sell real estate or borrow using real estate as collateral. To the extent that an owner of a property underlying one of our debt investments becomes liable for removal costs, the ability of the owner to make payments to us may be reduced, which in turn may adversely affect the value of the relevant mortgage asset held by us and our ability to make distributions to our stockholders. If we acquire any properties, the presence of hazardous substances on a property may adversely affect our ability to sell the property and we may incur substantial remediation costs, thus harming our financial condition. The discovery of material environmental liabilities attached to such properties could have a material adverse effect on our results of operations and financial condition and our ability to make distributions to our stockholders.

An increase in interest rates may cause a decrease in the volume of certain of our target assets which could adversely affect our ability to acquire target assets that satisfy our investment objectives and to generate income and pay dividends.

Rising interest rates generally reduce the demand for mortgage loans due to the higher cost of borrowing. A reduction in the volume of mortgage loans originated may affect the volume of target assets available to us, which could adversely affect our ability to acquire assets that satisfy our investment objectives. Rising interest rates may also cause our target assets that were issued prior to an interest rate increase to provide yields that are below prevailing market interest rates. If rising interest rates cause us to be unable to acquire a sufficient volume of our target assets with a yield that is above our borrowing cost, our ability to satisfy our investment objectives and to generate income and pay dividends may be materially and adversely affected.

We may experience a decline in the market value of our mortgage-backed securities.

A decline in the market value of our mortgage-backed securities may require us to recognize an “other-than-temporary” impairment against such assets under U.S. GAAP if we were to determine that, with respect to any assets in unrealized

loss positions, we do not have the ability and intent to hold such assets to maturity or for a period of time sufficient to allow for recovery to the amortized cost of such assets. If such a determination were to be made, we would recognize unrealized losses through earnings and write down the amortized cost of such assets to a new cost basis, based on the fair market value of such assets on the date they are considered to be other-than-temporarily impaired. Such impairment charges reflect non-cash losses

at the time of recognition; subsequent disposition or sale of such assets could further affect our future losses or gains, as they are based on the difference between the sale price received and adjusted amortized cost of such assets at the time of sale.

Our mortgage-backed securities are recorded at estimated fair value and, as a result, there is uncertainty as to the value of these investments.

Some of our mortgage-backed securities are in the form of securities that are not publicly or actively traded. The fair value of mortgage-backed securities that are not publicly or actively traded may not be readily determinable. We value these investments quarterly at fair value, which may include unobservable inputs. Because such valuations are subjective, the fair value of certain of our assets may fluctuate over short periods of time and our determinations of fair value may differ materially from the values that would have been used if a ready market for these securities existed. The value of our capital stock could be adversely affected if our determinations regarding the fair value of these investments were materially higher than the values that we ultimately realize upon their disposal.

Prepayment rates may adversely affect the value of our investment portfolio.

Pools of residential mortgage loans underlie the RMBS that we acquire. In the case of residential mortgage loans, there are seldom any restrictions on borrowers' abilities to prepay their loans. We generally receive prepayments of principal that are made on these underlying mortgage loans. When borrowers prepay their mortgage loans faster than expected, the prepayments on the RMBS are also faster than expected. Faster than expected prepayments could adversely affect our profitability, including in the following ways:

We may purchase RMBS that have a higher interest rate than the market interest rate at the time. In exchange for this higher interest rate, we may pay a premium over the par value to acquire the security. In accordance with U.S. GAAP, we may amortize this premium over the estimated term of the RMBS. If the RMBS is prepaid in whole or in part prior to its maturity date, however, we may be required to expense the premium that was prepaid at the time of the prepayment.

A substantial portion of our adjustable-rate RMBS may bear interest rates that are lower than their fully indexed rates, which are equivalent to the applicable index rate plus a margin. If an adjustable-rate RMBS is prepaid prior to or soon after the time of adjustment to a fully-indexed rate, we will have held that RMBS while it was least profitable and lost the opportunity to receive interest at the fully indexed rate over the remainder of its expected life.

If we are unable to acquire new RMBS similar to the prepaid RMBS, our financial condition, results of operation and cash flow would suffer. Prepayment rates generally increase when interest rates fall and decrease when interest rates rise, but changes in prepayment rates are difficult to predict. Prepayment rates also may be affected by conditions in the housing and financial markets, general economic conditions and the relative interest rates on FRMs and ARMs. While we seek to minimize prepayment risk to the extent practical, in selecting investments we must balance prepayment risk against other risks and the potential returns of each investment. No strategy can completely insulate us from prepayment risk.

Ongoing market conditions may upset the historical relationship between interest rate changes and prepayment trends, which would make it more difficult for us to analyze our investment portfolio.

Our success depends on our ability to analyze the relationship of changing interest rates on prepayments of the mortgage loans that underlie our RMBS and mortgage loans we acquire. Changes in interest rates and prepayments affect the market price of the target assets. As part of our overall portfolio risk management, we analyze interest rate changes and prepayment trends separately and collectively to assess their effects on our investment portfolio. In conducting our analysis, we depend on certain assumptions based upon historical trends with respect to the relationship between interest rates and prepayments under normal market conditions. If dislocations in the mortgage market or other developments change the way that prepayment trends have historically responded to interest rate changes, our ability to (1) assess the market value of our investment portfolio, (2) implement our hedging strategies, and (3) implement techniques to reduce our prepayment rate volatility would be significantly affected, which could materially adversely affect our financial position and results of operations.

Risks Related to Financing and Hedging

We use leverage in executing our business strategy, which may adversely affect the return on our assets and may reduce cash available for distribution to our stockholders, as well as increase losses when economic conditions are unfavorable.

We use leverage to finance our assets through borrowings from repurchase agreements and other secured and unsecured forms of borrowing (including Federal Home Loan Bank advances), and we contribute capital to equity investments. Although we are not required to maintain any particular debt-to-equity leverage ratio, the amount of leverage we may deploy for particular assets will depend upon our Manager's assessment of the credit and other risks of those assets.

Our access to financing depends upon a number of factors over which we have little or no control, including:

- general market conditions;
- the lender's view of the quality of our assets, valuation of our assets and our liquidity;
- the lender's perception of our growth potential;
- regulatory requirements of the Federal Housing Finance Authority or Federal Home Loan Bank;
- our current and potential future earnings and cash distributions; and
- the market price of the shares of our capital stock.

Any weakness or volatility in the financial markets, the residential and commercial mortgage markets or the economy generally could adversely affect the factors listed above. In addition, such weakness or volatility could adversely affect one or more of our potential lenders and could cause one or more of our potential lenders to be unwilling or unable to provide us with financing or to increase the costs of that financing. Some of our target assets may be more difficult to finance than others and the market for such financing can change based on many factors over which we have little or no control.

The return on our assets and cash available for distribution to our stockholders may be reduced to the extent that market conditions prevent us from leveraging our assets or cause the cost of our financing to increase relative to the income that can be derived from the assets acquired. Our financing costs will reduce cash available for distributions to stockholders. We may not be able to meet our financing obligations and, to the extent that we cannot, we risk the loss of some or all of our assets to liquidation or sale to satisfy the obligations.

As a result of ongoing market conditions, including the contraction among and failure of certain lenders, it may be more difficult for us to secure financing.

Our results of operations are materially affected by conditions in the financial markets and the economy generally. Continuing concerns over inflation, energy price volatility, geopolitical issues, unemployment, the availability and cost of credit, the mortgage market and the real estate market contribute to market volatility.

In recent years, dramatic declines in the residential and commercial real estate markets, decreased home prices and increased foreclosures and unemployment resulted in significant asset writedowns by financial institutions, which caused many financial institutions to seek additional capital, to merge with other institutions and, in some cases, to fail. We rely significantly on the availability of repurchase agreement financing to acquire many of our target assets. Institutions from which we seek to obtain financing may have owned or financed residential or commercial mortgage loans, real estate-related securities and real estate loans which have declined in value and caused losses. Many lenders and institutional investors have reduced and, in some cases, ceased to provide funding to borrowers, including other financial institutions. As a result of ongoing market conditions and regulatory actions, it may be more difficult for us to secure financing as there are fewer institutional lenders and those remaining lenders have tightened their lending standards. Our profitability may be adversely affected if we are unable to secure financing for our assets.

We depend on repurchase agreement financing to acquire our target assets and our inability to access this funding on acceptable terms could have a material adverse effect on our results of operations, financial condition and business.

We use repurchase agreement financing as a strategy to increase the return on our assets. However, we may not be able to achieve our desired leverage ratio for a number of reasons, including if the following events occur:

- our lenders do not make repurchase agreement financing available to us at acceptable rates;
- certain of our lenders exit the repurchase market;
- our lenders require that we pledge additional collateral to cover our borrowings, which we may be unable to do; or
- we determine that the leverage would expose us to excessive risk.

Our ability to fund our target assets may be impacted by our ability to secure repurchase agreement financing on acceptable terms. We can provide no assurance that lenders will be willing or able to provide us with sufficient financing. In addition, because repurchase agreements are short-term commitments of capital, lenders may respond to market conditions making it more difficult for us to secure continued financing. During certain periods of the credit cycle, lenders may curtail their willingness to provide financing. For example, in response to market conditions lenders have in the past and may in the future increase financing rates and decrease advance rates. Repurchase agreement counterparties have taken these steps in order to compensate themselves for a perceived increased risk due to the illiquidity of the underlying collateral. In some cases, margin calls have forced borrowers to liquidate collateral in order to meet the capital requirements of these margin calls, resulting in losses. In addition, if major market

participants were to exit the repurchase agreement financing business, the value of our portfolio could be negatively impacted, thus reducing net stockholder equity, or book value. Furthermore, if many of our current or potential lenders are unwilling or unable to provide us with repurchase agreement financing, we could be forced to sell our assets at an inopportune time when prices are depressed. In addition, if the regulatory capital requirements imposed on

our lenders change, they may be required to significantly increase the cost of the financing that they provide to us. Our lenders also may revise their eligibility requirements for the types of assets they are willing to finance or the terms of such financings, based on, among other factors, the regulatory environment and their management of perceived risk, particularly with respect to assignee liability.

If a counterparty to our repurchase transactions defaults on its obligation to resell the underlying security back to us at the end of the transaction term, if the value of the underlying security has declined as of the end of that term, or if we default on our obligations under the repurchase agreement, we may incur a loss on our repurchase transactions.

When we engage in repurchase transactions, we generally sell securities to lenders (repurchase agreement counterparties) and receive cash from these lenders. The lenders are obligated to resell the same or similar securities back to us at the end of the term of the transaction. Because the cash we receive from the lender when we initially sell the securities to the lender is less than the value of those securities (this difference is the haircut), if the lender defaults on its obligation to resell the same securities back to us we may incur a loss on the transaction equal to the amount of the haircut (assuming there was no change in the value of the securities). As of December 31, 2014, three counterparties held collateral that exceeded the amounts borrowed under the related repurchase agreements by more than \$131.9 million, or 5% of our stockholders' equity. Refer to Note 7 - "Borrowings" of our consolidated financial statements for additional detail. We may incur a loss on a repurchase transaction if the value of the underlying securities has declined as of the end of the transaction term, as we would have to repurchase the securities for their initial value but would receive securities worth less than that amount. Further, if we default on one of our obligations under a repurchase transaction, the lender can terminate the transaction and cease entering into any other repurchase transactions with us. Some of our repurchase agreements contain cross-default provisions, so that if a default occurs under any one agreement, the lenders under our other agreements could also declare a default. Any losses we incur on our repurchase transactions could adversely affect our earnings and thus our cash available for distribution to our stockholders.

The repurchase agreements that we use to finance our investments may require us to provide additional collateral and may restrict us from leveraging our assets as fully as desired.

The amount of financing we receive, or may in the future receive, under our repurchase agreements and secured loans, is directly related to the lenders' valuation of the assets that secure the outstanding borrowings. Lenders under our repurchase agreements and secured loans typically have the absolute right to reevaluate the market value of the assets that secure outstanding borrowings at any time. If a lender determines in its sole discretion that the value of the assets has decreased, it has the right to initiate a margin call or increase collateral requirements. A margin call or increased collateral requirements would require us to transfer additional assets to such lender without any advance of funds from the lender for such transfer or to repay a portion of the outstanding borrowings. Any such margin call or increased collateral requirements could have a material adverse effect on our results of operations, financial condition, business, liquidity and ability to make distributions to our stockholders, and could cause the value of our capital stock to decline. We may be forced to sell assets at significantly depressed prices to meet such margin calls and to maintain adequate liquidity, which could cause us to incur losses. Moreover, to the extent we are forced to sell assets at such time, given market conditions, we may be selling at the same time as others facing similar pressures, which could exacerbate a difficult market environment and which could result in our incurring significantly greater losses on our sale of such assets. In an extreme case of market duress, a market may not even be present for certain of our assets at any price. Such a situation would likely result in a rapid deterioration of our financial condition and possibly necessitate a filing for bankruptcy protection.

Further, financial institutions providing the repurchase facilities may require us to maintain a certain amount of cash uninvested or to set aside non-levered assets sufficient to maintain a specified liquidity position which would allow us to satisfy our collateral obligations. In addition, the FHLBI could increase our collateral requirements. As a result, we may not be able to leverage our assets as fully as desired, which could reduce our return on equity. If we are unable to meet these collateral obligations, our financial condition could deteriorate rapidly.

A failure to comply with covenants in our repurchase agreements and other financing arrangements would have a material adverse effect on us, and any future financings may require us to provide additional collateral or pay down debt.

We are subject to various covenants contained in our existing financing arrangements and may become subject to additional covenants in connection with future financings. Many of our master repurchase agreements, as well as our FHLB financing arrangements and swap agreements, require us to maintain compliance with various financial covenants, including a minimum tangible net worth, specified financial ratios, such as total debt to total assets and financial information delivery obligations. These covenants may limit our flexibility to pursue certain investments or incur additional debt. If we fail to meet or satisfy any of these covenants, we would be in default under these agreements, and our lenders could elect to declare outstanding amounts due and payable, terminate their commitments, require the posting of additional collateral and/or enforce their interests against existing collateral. We may also be subject to cross-default and acceleration rights and, with respect to collateralized debt, the posting of

additional collateral and foreclosure rights upon default. Further, this could also make it difficult for us to satisfy the distribution requirements necessary to maintain our status as a REIT for U.S. federal income tax purposes.

Our use or future use of repurchase agreements to finance our target assets may give our lenders greater rights in the event that either we or a lender files for bankruptcy.

Our borrowings or future borrowings under repurchase agreements for our target assets may qualify for special treatment under the U.S. Bankruptcy Code, giving our lenders the ability to avoid the automatic stay provisions of the U.S. Bankruptcy Code and to take possession of and liquidate the assets that we have pledged under their repurchase agreements without delay in the event that we file for bankruptcy. Furthermore, the special treatment of repurchase agreements under the U.S. Bankruptcy Code may make it difficult for us to recover our pledged assets in the event that a lender party to such agreement files for bankruptcy. Therefore, our use of repurchase agreements to finance our investments exposes our pledged assets to risk in the event of a bankruptcy filing by either a lender or us.

We enter into hedging transactions that could expose us to contingent liabilities in the future.

Part of our investment strategy involves entering into hedging transactions that could require us to fund cash payments in certain circumstances (such as the early termination of the hedging instrument caused by an event of default or other early termination event, or the decision by a counterparty to request margin securities it is contractually owed under the terms of the hedging instrument). The amount due would be equal to the unrealized loss of the open swap positions with the respective counterparty and could also include other fees and charges. Such economic losses would be reflected in our results of operations, and our ability to fund these obligations would depend on the liquidity of our assets and access to capital at the time, and the need to fund these obligations could adversely impact our financial condition.

Hedging may adversely affect our earnings, which could reduce our cash available for distribution to our stockholders.

We pursue various hedging strategies to seek to reduce our exposure to adverse changes in interest rates and currency exchange rates. Our hedging activity varies in scope based on the level and volatility of interest rates, currency exchange rates, the type of assets held and other changing market conditions. Hedging may fail to protect or could adversely affect us because, among other things:

- interest rate and/or currency hedging can be expensive, particularly during periods of rising and volatile interest rates;
- available interest rate hedges may not correspond directly with the interest rate risk for which protection is sought;
- due to a credit loss, the duration of the hedge may not match the duration of the related liability;
- the amount of income that a REIT may earn from hedging transactions (other than hedging transactions that satisfy certain requirements of the Internal Revenue Code or that are done through a taxable REIT subsidiary (“TRS”)) to offset interest rate losses is limited by U.S. federal tax provisions governing REITs;
- the credit quality of the hedging counterparty owing money on the hedge may be downgraded to such an extent that it impairs our ability to sell or assign our side of the hedging transaction; and
- the hedging counterparty owing money in the hedging transaction may default on its obligation to pay.

Our hedging transactions, which are intended to limit losses, may actually adversely affect our earnings, which could reduce our cash available for distribution to our stockholders.

In addition, the enforceability of agreements underlying hedging transactions may depend on compliance with applicable statutory and commodity and other regulatory requirements and, depending on the identity of the counterparty, applicable international requirements. Any actions taken by regulators could constrain our investment strategy and could increase our costs, either of which could materially and adversely impact our results of operations. The business failure of a hedging counterparty with whom we enter into a hedging transaction will most likely result in its default. Default by a party with whom we enter into a hedging transaction may result in the loss of unrealized profits and force us to cover our commitments, if any, at the then current market price. Although generally we seek to reserve the right to terminate our hedging positions, it may not always be possible to dispose of or close out a hedging position without the consent of the hedging counterparty and we may not be able to enter into an offsetting contract in order to cover our risk. We cannot assure you that a liquid secondary market will exist for hedging instruments purchased or sold, and we may be required to maintain a position until exercise or expiration, which could result in losses.

We may enter into derivative contracts that expose us to contingent liabilities and those contingent liabilities may not appear on our balance sheet. We may invest in synthetic securities, credit default swaps, and other credit derivatives, which expose us to additional risks.

We have entered and may again in the future enter into derivative contracts that could require us to make cash payments in certain circumstances. Potential payment obligations would be contingent liabilities and may not appear on our balance sheet. Our ability to satisfy these contingent liabilities depends on the liquidity of our assets and our access to capital and cash. The need to fund these contingent liabilities could adversely impact our financial condition. We may directly or through our equity investments, invest in synthetic securities, credit default swaps, and other credit derivatives that reference other real estate securities or indices. These investments may present risks in excess of those resulting from the referenced security or index. These investments are typically a contractual relationship with counterparties and not an acquisition of a referenced security or other asset. In these types of investments, we have no right to directly enforce compliance with the terms of the referenced security or other assets and we have no voting or other consensual rights of ownership with respect to the referenced security or other assets. In the event of insolvency of a counterparty, we will be treated as a general creditor of the counterparty and will have no claim of title with respect to the referenced security.

The markets for these types of investments have, in some cases, only existed for a few years and may not be liquid. Many of these investments incorporate “pay as you go” credit events which have been introduced into the market fairly recently. For example, the terms of credit default swaps are still evolving and may change significantly, which could make it more difficult to assign such an instrument or determine the “loss” pursuant to the underlying agreement. In a credit default swap, the party wishing to “buy” protection will pay a premium. When interest rates change, the spreads change, or the prevailing credit premiums on credit default swaps change, the amount of the termination payment due could change by a substantial amount. In an illiquid market, the determination of this change could be difficult to ascertain and, as a result, we may not achieve the desired benefit of entering into this contractual relationship. To date, we have entered into a limited number of these agreements. We may over time increase our exposure to these types of investments as the market for them grows and during times when acquiring other real estate loans and securities may be difficult. We may find credit default swaps and other forms of synthetic securities to be a more efficient method of providing credit-enhancement on specific pools of real estate loans. Our efforts to manage the risk associated with these investments, including counterparty risks may prove to be insufficient in enabling us to generate the returns anticipated.

Risks Related to Our Company

Maintaining 1940 Act exclusions for our subsidiaries imposes limits on our operations. Failure to maintain an exclusion could have a material negative impact on our operations.

We conduct our operations so that neither we, nor our operating partnership, IAS Operating Partnership LP (the “Operating Partnership”) nor the subsidiaries of the Operating Partnership are required to register as an investment company under the 1940 Act.

Section 3(a)(1)(A) of the 1940 Act defines an investment company as any issuer that is or holds itself out as being engaged primarily in the business of investing, reinvesting or trading in securities. We believe neither we nor our Operating Partnership will be considered an investment company under Section 3(a)(1)(A) of the 1940 Act because neither we nor our Operating Partnership will engage primarily or hold ourselves out as being engaged primarily in the business of investing, reinvesting or trading in securities. Rather, through our Operating Partnership’s wholly-owned or majority-owned subsidiaries, we and our Operating Partnership will be primarily engaged in the non-investment company businesses of these subsidiaries, namely the business of purchasing or otherwise acquiring real property, mortgages and other interests in real estate.

Section 3(a)(1)(C) of the 1940 Act defines an investment company as any issuer that is engaged or proposes to engage in the business of investing, reinvesting, owning, holding or trading in securities and owns or proposes to acquire investment securities having a value exceeding 40% of the value of the issuer’s total assets (exclusive of U.S. government securities and cash items) on an unconsolidated basis, which we refer to as the 40% test. Excluded from the term “investment securities,” among other things, are U.S. government securities and securities issued by majority-owned subsidiaries that are not themselves investment companies and are not relying on the exception from

the definition of investment company set forth in Section 3(c)(1) or Section 3(c)(7) of the 1940 Act. We are a holding company that conducts its businesses through the Operating Partnership and the Operating Partnership's wholly-owned or majority-owned subsidiaries. Both we and the Operating Partnership conduct our operations so that we comply with the 40% test. Accordingly, the securities issued by these subsidiaries that are excepted from the definition of "investment company" under Section 3(c)(1) or Section 3(c)(7) of the 1940 Act, together with any other investment securities the Operating Partnership may own, may not have a value in excess of 40% of the value of the Operating Partnership's total assets (exclusive of U.S. government securities and cash items) on an unconsolidated basis. Compliance with the 40% test

limits the types of businesses in which we are permitted to engage through our subsidiaries. Furthermore, IAS Asset I LLC and certain of the Operating Partnership's other subsidiaries that we may form in the future intend to rely upon an exception from the definition of investment company under Section 3(c)(5)(C) of the 1940 Act, which is available for entities "primarily engaged in the business of purchasing or otherwise acquiring mortgages and other liens on and interests in real estate." This exception generally requires that at least 55% of a subsidiary's portfolio must be comprised of qualifying assets and at least 80% of its portfolio must be comprised of qualifying assets and real estate-related assets (and no more than 20% comprised of miscellaneous assets). In analyzing a subsidiary's compliance with Section 3(c)(5)(C) of the 1940 Act, we classify investments based in large measure on SEC staff guidance, including no-action letters, and, in the absence of SEC guidance, on our view of what constitutes a qualifying real estate asset and a real estate-related asset.

Qualification for exception from the definition of investment company under the 1940 Act will limit our ability to make certain investments, such as investments in agency partial pool certificates, which are considered real estate-related assets. Therefore, IAS Asset I LLC and the Operating Partnership's other subsidiaries may need to adjust their respective assets and strategy from time-to-time in order to continue to rely on the exception from the definition of investment company under Section 3(c)(5)(C) of the 1940 Act. Any such adjustment in assets or strategy is not expected to have a material adverse effect on our business or strategy. There can be no assurance that we will be able to maintain this exception from the definition of investment company for IAS Asset I LLC and the Operating Partnership's other subsidiaries intending to rely on Section 3(c)(5)(C) of the 1940 Act.

We may in the future organize one or more subsidiaries that seek to rely on other exceptions from being deemed an investment company under the 1940 Act, such as the exception provided to certain structured financing vehicles by Rule 3a-7. Any such subsidiary would need to be structured to comply with any guidance that may be issued by the SEC staff on the restrictions contained in Rule 3a-7 or any other exception on which we seek to rely.

There can be no assurance that the laws and regulations governing the 1940 Act status of REITs, including the SEC staff providing more specific or different guidance regarding these exemptions, will not change in a manner that adversely affects our operations or inhibits our ability to pursue our strategies. If we, the Operating Partnership or its subsidiaries fail to maintain an exception or exemption from the 1940 Act, we could, among other things, be required to (a) change the investments that we hold or the manner in which we conduct our operations to avoid being required to register as an investment company, (b) effect sales of our assets in a manner that, or at a time when, we would not otherwise choose to do so, or (c) register as an investment company, any of which could negatively affect the value of our capital stock, the sustainability of our business model, and our ability to make distributions which could have an adverse effect on our business and the market price for our shares of capital stock. In addition, if it were established that we were an unregistered investment company, there would be a risk that we would be subject to monetary penalties or injunctive relief imposed by the SEC.

We may be adversely affected by the current and future economic, regulatory and other actions of government bodies and their agencies.

In response to the financial crisis of 2008, the U.S. government, Federal Reserve, U.S. Treasury, Securities and Exchange Commission and other governmental and regulatory bodies have taken a number of economic actions and regulatory initiatives designed to stabilize and stimulate the economy and the financial markets, and additional actions and initiatives may occur in the future. These actions may include the development and implementation of programs that could result in a flattening in the yield curve and lower long-term interest rates, among other potential impacts. Lower long-term interest rates could result in increased prepayment rates and a narrowing of our net interest margin. In addition, foreign financial markets have experienced significant volatility related to events such as the European debt crisis, declining currencies in certain emerging markets and governments' and central banks' responses. Such responses have included the implementation of various financial reforms including but not limited to development of the Basel III standards by the Basel Committee on Banking Supervision.

There can be no assurance that, in the long term, actions the government and regulatory bodies or central banks have taken in the past or may take in the future will improve the efficiency and stability of mortgage or financial markets. To the extent the financial markets do not respond favorably to any of these actions or such actions do not function as intended, our business may be harmed. In addition, because the programs are designed, in part, to improve the markets for certain of our target assets, the establishment of these programs may result in increased competition for attractive

opportunities in our target assets or, in the case of government-backed refinancing and modification programs, may have the effect of reducing the revenues associated with certain of our target assets. We cannot predict whether or when additional actions or initiatives to stabilize and stimulate the economy and the financial markets may occur, and such actions could have an adverse effect on our business, results of operations and financial condition.

We may change any of our strategies, policies or procedures without stockholder consent.

We may change any of our strategies, policies or procedures with respect to investments, acquisitions, growth, operations, indebtedness, capitalization and distributions at any time without the consent of our stockholders, which could result in an investment portfolio with a different risk profile. A change in our investment strategy may increase our exposure to interest rate risk, default risk and real estate market fluctuations. Furthermore, a change in our asset allocation could result in our making investments in asset categories different from those described in this Report. These changes could adversely affect our business, financial condition, results of operations, the market price of our capital stock and our ability to make distributions to our stockholders.

We are highly dependent on information systems and systems failures could significantly disrupt our business, which may, in turn, negatively affect the market price of our capital stock and our ability to pay dividends.

Our business is highly dependent on third parties' information systems, including our Manager and other service providers. Any failure or interruption of such systems or cyber-attacks or security breaches could cause delays or other problems in our securities trading activities and financial, accounting and other data processing activities, which could have a material adverse effect on our operating results and negatively affect the market price of our capital stock and our ability to pay dividends to our stockholders. In addition, we also face the risk of operational failure, termination or capacity constraints of any of the third parties with which we do business or that facilitate our business activities, including clearing agents or other financial intermediaries we use to facilitate our securities transactions.

Computer malware, viruses and computer hacking and phishing attacks have become more prevalent in our industry and may occur on our Manager's and other service providers' systems in the future. We rely heavily on our and our third party providers' financial, accounting and other data processing systems. It is difficult to determine what, if any, negative impact may directly result from any specific interruption or cyber-attacks or security breaches of such networks or systems or any failure to maintain the performance, reliability and security of our technical infrastructure. As a result, any computer malware, viruses and computer hacking and phishing attacks may negatively affect our operations.

Risks Related to Accounting

Reclassification of mortgage-backed securities financed with repurchase agreements may adversely affect our operations and our reported profitability.

The Financial Accounting Standards Board's ("FASB") guidance regarding transactions that involve the acquisition of securities from a counterparty and the subsequent financing of these securities through repurchase agreements with the same counterparty allows for financial statement presentation on a gross basis, if certain criteria are met. If we fail to meet the criteria under guidance to account for the transactions on a gross basis, our accounting treatment would not affect the economics of these transactions, but would affect how these transactions are reported on our financial statements. Although we would not expect this change in presentation to have a material impact on our net income, it could have an adverse impact on our operations. It could have an impact on our ability to include certain securities purchased and simultaneously financed from the same counterparty as qualifying real estate interests or real estate-related assets used to qualify under the exemption to not have to register as an investment company under the 1940 Act. It could also limit our investment opportunities as we may need to limit our purchases of securities that are simultaneously financed with the same counterparty.

We have discontinued hedge accounting for interest rate swap agreements which may result in volatility in our U.S. GAAP earnings.

We enter into derivative transactions to reduce the impact that changes in interest rates will have on our net interest margin. Effective December 31, 2013, we discontinued hedge accounting for our interest rate swap agreements by de-designating the interest rate swaps as cash flow hedges. All of our interest rate swaps had previously been accounted for as cash flow hedges. As a result of discontinuing hedge accounting, beginning January 1, 2014, changes in the fair value of interest rate swap agreements are now recorded in the Company's consolidated statement of operations as "gain (loss) on derivative instruments, net" and may result in volatility in our U.S. GAAP earnings. The total changes in fair value may exceed our consolidated net income in any period or for a full year. Volatility in our net income may adversely affect the price of our capital stock.

The preparation of our financial statements involves use of estimates, judgments and assumptions, and our financial statements may be materially affected if our estimates prove to be inaccurate.

Financial statements prepared in accordance with U.S. GAAP require the use of estimates, judgments and assumptions that affect the reported amounts. Different estimates, judgments and assumptions reasonably could be used that would have a material effect on the financial statements, and changes in these estimates, judgments and assumptions are likely to occur from period to period in the future. Significant areas of accounting requiring the application of management's judgment include, but

are not limited to, determining the fair value of investment securities and reserves for loan losses. These estimates, judgments and assumptions are inherently uncertain, and, if they prove to be wrong, then we face the risk that charges to income will be required. Any such charges could significantly harm our business, financial condition, results of operations and the price of our securities. Refer to “Management’s Discussion and Analysis of Financial Condition and Results of Operations - Critical Accounting Policies” for a discussion of the accounting estimates, judgments and assumptions that we believe are the most critical to an understanding of our business, financial condition and results of operations.

Our reported U.S. GAAP financial results differ from our REIT taxable income that impact our dividend distribution requirements and, therefore, our U.S. GAAP results may not be an accurate indicator of future taxable income and dividend distributions.

Generally, the cumulative net income we report over the life of an asset will be the same for U.S. GAAP and tax purposes, although the timing of this income recognition over the life of the asset could be materially different. Differences exist in the accounting for U.S. GAAP net income and REIT taxable income which can lead to significant variances in the amount and timing of when income and losses are recognized under these two measures. Due to these differences, our reported U.S. GAAP financial results could materially differ from our determination of taxable income, which impacts our dividend distribution requirements. Therefore, our U.S. GAAP results may not be an accurate indicator of future REIT taxable income and dividend distributions. Capital gains and losses in a period may impact REIT taxable income and impact the dividend paid in future periods.

We have restated our prior consolidated financial statements, which may lead to additional risks and uncertainties, including loss of investor confidence and negative impacts on our stock price.

As discussed in the Explanatory Note and Note 16 to our consolidated financial statements included in Item 8 of this Form 10-K/A, we have restated our audited consolidated financial statements as of and for the years ended December 31, 2013 and 2014 and our unaudited consolidated financial statements for all interim periods commencing with the quarter ended March 31, 2013 through the quarter ended March 31, 2015 (the “Restated Periods”). The determination to restate the financial statements for the Restated Periods was made by our Audit Committee upon management’s recommendation following the identification of errors related to the accounting treatment of our investment in GSE CRTs and Agency MBS IOs. Due to the errors, our Audit Committee concluded that our previously issued financial statements for the Restated Periods should no longer be relied upon. Our Annual Report on Form 10-K for the year ended December 31, 2014 and our Quarterly Report on Form 10-Q for the quarter ended March 31, 2015 has been and will be, respectively, amended to, among other things, reflect the restatement of our financial statements for the Restated Periods (the “Restatement”).

As a result of these events, we have become subject to a number of additional costs and risks, including unanticipated costs for accounting and legal fees in connection with or related to the Restatement and the remediation of our ineffective disclosure controls and procedures and material weakness in internal control over financial reporting. In addition, the attention of our management team has been diverted by these efforts. We could be subject to additional stockholder, governmental, or other actions in connection with the Restatement or other matters. Any such proceedings will, regardless of the outcome, consume a significant amount of management’s time and attention and may result in additional legal, accounting, insurance and other costs. If we do not prevail in any such proceedings, we could be required to pay substantial damages or settlement costs. In addition, the Restatement and related matters could impair our reputation or could cause our counterparties to lose confidence in us. Each of these occurrences could have a material adverse effect on our business, results of operations, financial condition and stock price which could, among other items, result in a default under the Company’s financing agreements.

We have identified a material weakness in our internal control over financial reporting and determined that our disclosure controls and procedures were not effective which could, if not remediated, result in additional material misstatements in our financial statements.

Our management is responsible for establishing and maintaining adequate disclosure controls and procedures and internal control over our financial reporting, as defined in Rules 13a- 15(e) and 13a-15(f), respectively, under the Securities Exchange Act of 1934, as amended. As disclosed in Item 9A of this Form 10-K/A, management identified a material weakness in our internal control over financial reporting and determined our disclosure controls and procedures were not effective based upon our identification of certain errors related to the accounting treatment of our investment in GSE CRTs and Agency MBS IOs. A material weakness is defined as a deficiency, or combination of significant deficiencies, in internal control over financial reporting, such that there is a more than a remote likelihood that a material misstatement of our annual or interim financial statements will not be prevented or detected on a timely basis. As a result of this material weakness, our management concluded that the Company did not maintain effective disclosure controls and procedures and internal control over financial reporting as of December 31, 2014. Our Annual Report on Form 10-K for the year ended December 31, 2014 and our Quarterly Report on Form 10-Q for the quarter ended March 31, 2015 has been and will be, respectively, amended to, among other things, reflect the change in management's

conclusion regarding the effectiveness of our disclosure controls and procedures and internal control over financial reporting as of December 31, 2014, as discussed in Item 9A of this Form 10-K/A.

We are actively engaged in developing a remediation plan designed to address this material weakness in internal control over financial reporting and ineffective disclosure controls and procedures. If our remedial measures are insufficient, or if additional material weaknesses or significant deficiencies in our internal controls are discovered or occur in the future, our consolidated financial statements may contain material misstatements and we could be required to restate our financial results, which could materially and adversely affect our business and results of operations or financial condition, restrict our ability to access the capital markets, require us to expend significant resources to correct the weaknesses or deficiencies, subject us to fines, penalties or judgments, harm our reputation or otherwise cause a decline in investor confidence.

Risks Related to Our Relationship with Our Manager

We are dependent on our Manager and its key personnel for our success.

We have no separate facilities and are completely reliant on our Manager. We do not have any employees. Our executive officers are employees of our Manager or one of its affiliates. Our Manager has significant discretion as to the implementation of our investment and operating policies and strategies. Accordingly, we believe that our success depends to a significant extent upon the efforts, experience, diligence, skill and network of business contacts of the executive officers and key personnel of our Manager. The executive officers and key personnel of our Manager evaluate, negotiate, close and monitor our investments; therefore, our success depends on their continued service. The departure of any of the executive officers or key personnel of our Manager who provide management services to us could have a material adverse effect on our performance. In addition, we offer no assurance that our Manager will remain our investment manager or that we will continue to have access to our Manager's principals and professionals. The initial term of our management agreement with our Manager expired on July 1, 2011. The agreement automatically renews for successive one-year terms, and the management agreement is currently in a renewal term. If the management agreement is terminated and no suitable replacement is found to manage us, we may not be able to execute our business plan. Moreover, our Manager is not obligated to dedicate certain of its personnel exclusively to us nor is it obligated to dedicate any specific portion of its time to our business.

There are conflicts of interest in our relationship with our Manager and Invesco, which could result in decisions that are not in the best interests of our stockholders.

We are subject to conflicts of interest arising out of our relationship with Invesco and our Manager. Specifically, each of our officers and certain members of our board of directors are employees of our Manager or one of its affiliates. Our Manager and our executive officers may have conflicts between their duties to us and their duties to, and interests in, Invesco. We compete for investment opportunities directly with other clients of our Manager or Invesco and its subsidiaries. A substantial number of separate accounts managed by our Manager have limited exposure to our target assets. In addition, in the future our Manager may have additional clients that compete directly with us for investment opportunities. Our Manager has investment allocation policies in place intended to enable us to share equitably with the other clients of our Manager or Invesco and its subsidiaries. There is no assurance that our Manager's allocation policies that address some of the conflicts relating to our access to investment and financing sources will be adequate to address all of the conflicts that may arise. Therefore, we may compete for investment or financing opportunities sourced by our Manager and, as a result, we may either not be presented with the opportunity or have to compete with other clients of our Manager or clients of Invesco and its subsidiaries to acquire these investments or have access to these sources of financing. Our Manager and our executive officers may choose to allocate favorable investments to other clients of Invesco instead of to us. Further, when there are turbulent conditions in the mortgage markets, distress in the credit markets or other times when we will need focused support and assistance from our Manager, Invesco or entities for which our Manager also acts as an investment manager will likewise require greater focus and attention, placing our Manager's resources in high demand. In such situations, we may not receive the level of support and assistance that we may receive if we were internally managed or if our Manager did not act as a manager for other entities.

We pay our Manager substantial management fees regardless of the performance of our portfolio. Our Manager's entitlement to a management fee, which is not based upon performance metrics or goals, might reduce its incentive to

devote its time and effort to seeking investments that provide attractive risk-adjusted returns for our portfolio. This in turn could hurt both our ability to make distributions to our stockholders and the market price of our capital stock. Our Manager would have a conflict in recommending our participation in any equity investment it manages. Our Manager has a conflict of interest in recommending our participation in any equity investment it manages because the fees payable to it may be greater than the fees payable by us under the management agreement. With respect to equity investments we have made in partnerships managed by an affiliate of our Manager, our Manager has agreed to waive fees at the equity investment level to avoid duplication. To address any potential conflict of interest, we require the terms of any equity

investment managed by our Manager to be approved by our audit committee consisting of our independent directors. However, there can be no assurance that all conflicts of interest will be eliminated.

The management agreement with our Manager was not negotiated on an arm's-length basis and may not be as favorable to us as if it had been negotiated with an unaffiliated third party and may be costly and difficult to terminate. Our executive officers and certain members of our board of directors are employees of our Manager or one of its affiliates. Our management agreement with our Manager was negotiated between related parties and its terms, including fees payable, may not be as favorable to us as if it had been negotiated with an unaffiliated third party. Termination of the management agreement with our Manager without cause is difficult and costly. Our independent directors review our Manager's performance and the management fees annually and the management agreement may be terminated annually upon the affirmative vote of at least two-thirds of our independent directors based upon: (1) our Manager's unsatisfactory performance that is materially detrimental to us, or (2) a determination that the management fees payable to our Manager are not fair, subject to our Manager's right to prevent termination based on unfair fees by accepting a reduction of management fees agreed to by at least two-thirds of our independent directors. Our Manager will be provided 180 days prior notice of any such termination. Additionally, upon such a termination, the management agreement provides that we will pay our Manager a termination fee equal to three times the sum of the average annual management fee received by our Manager during the prior 24-month period before such termination, calculated as of the end of the most recently completed fiscal quarter. These provisions may increase the cost of terminating the management agreement and adversely affect our ability to terminate our Manager without cause. If the management agreement is terminated and no suitable replacement is found to manage us, we may not be able to execute our business plan.

Pursuant to the management agreement, our Manager does not assume any responsibility other than to render the services called for thereunder and is not responsible for any action of our board of directors in following or declining to follow its advice or recommendations. Our Manager maintains a contractual, as opposed to a fiduciary, relationship with us. Under the terms of the management agreement, our Manager, its officers, stockholders, members, managers, partners, directors and personnel, any person controlling or controlled by our Manager and any person providing sub-advisory services to our Manager will not be liable to us, any subsidiary of ours, our directors, our stockholders or any subsidiary's stockholders or partners for acts or omissions performed in accordance with and pursuant to the management agreement, except because of acts constituting bad faith, willful misconduct, gross negligence, or reckless disregard of their duties under the management agreement, as determined by a final non-appealable order of a court of competent jurisdiction. We have agreed to indemnify our Manager, its officers, stockholders, members, managers, directors and personnel, any person controlling or controlled by our Manager and any person providing sub-advisory services to our Manager with respect to all expenses, losses, damages, liabilities, demands, charges and claims arising from acts of our Manager not constituting bad faith, willful misconduct, gross negligence, or reckless disregard of duties, performed in good faith in accordance with and pursuant to the management agreement.

Our board of directors approved very broad investment guidelines for our Manager and does not approve each investment and financing decision made by our Manager.

Our Manager is authorized to follow very broad investment guidelines. Our board of directors will periodically review our investment guidelines and our investment portfolio but does not, and is not required to, review all of our proposed investments, except that an investment in a security structured or issued by an entity managed by Invesco must be approved by a majority of our independent directors prior to such investment. In addition, in conducting periodic reviews, our board of directors may rely primarily on information provided to them by our Manager. Furthermore, our Manager may use complex strategies, and transactions entered into by our Manager may be costly, difficult or impossible to unwind by the time they are reviewed by our board of directors. Our Manager has great latitude within the broad parameters of our investment guidelines in determining the types and amounts of Agency RMBS, non-Agency RMBS, CMBS, mortgage loans and mortgage and real-estate financing arrangements (including mezzanine debt and private equity interests) it may decide are attractive investments for us, which could result in investment returns that are substantially below expectations or that result in losses, which would materially and adversely affect our business operations and results.

Risks Related to Our Capital Stock

The market price and trading volume of our capital stock may be volatile.

The market price of our capital stock may be highly volatile and be subject to wide fluctuations. In addition, the trading volume in our capital stock may fluctuate and cause significant price variations to occur. If the market price of our capital stock declines significantly, our stockholders may be unable to resell their shares at or above the price our stockholders paid for their shares. We cannot assure you that the market price of our capital stock will not fluctuate or decline significantly in the future. Some of the factors that could negatively affect our share price or result in fluctuations in the price or trading volume of our capital stock include:

- actual or anticipated variations in our quarterly operating results or distributions;
- changes in our earnings estimates or publication of research reports about us or the real estate or specialty finance industry;
- decreases in the market valuations of our target assets;
- increased difficulty in maintaining or obtaining financing on attractive terms, or at all;
- increases in market interest rates that lead our stockholders to demand a higher yield;
- changes in market valuations of similar companies;
- adverse market reaction to any increased indebtedness we incur in the future;
- additions or departures of key management personnel;
- actions by institutional stockholders;
- speculation in the press or investment community;
- general market and economic conditions; and
- changes to U.S. federal income tax laws or regulations governing REITS or the administrative interpretation of those laws.

Common stock eligible for future sale may have adverse effects on our share price.

We cannot predict the effect, if any, of future sales of our common stock, or the availability of shares for future sales, on the market price of our common stock. Sales of substantial amounts of common stock or the perception that such sales could occur may adversely affect the prevailing market price for our common stock. Also, we may issue additional shares in public offerings or private placements to make new investments or for other purposes. We are not required to offer any such shares to existing stockholders on a preemptive basis. Therefore, it may not be possible for existing stockholders to participate in such future share issuances, which may dilute existing stockholders' interests in us.

We have not established a minimum distribution payment level, and we cannot assure our stockholders of our ability to pay distributions in the future.

We pay quarterly distributions and make other distributions to our stockholders in an amount such that we distribute all or substantially all of our REIT taxable income in each year, subject to certain adjustments. We have not established a minimum distribution payment level and our ability to pay distributions may be adversely affected by a number of factors, including the risk factors described in this Report. All distributions will be made at the discretion of our board of directors and will depend on our earnings, our financial condition, debt covenants, maintenance of our REIT qualification, applicable provisions of Maryland law and other factors as our board of directors may deem relevant from time to time. We believe that a change in any one of the following factors could adversely affect our results of operations and impair our ability to pay distributions to our stockholders:

- our ability to make profitable investments;
 - margin calls or other expenses that reduce our cash flow;
 - defaults in our asset portfolio or decreases in the value of our portfolio; and
 - the fact that anticipated operating expense levels may not prove accurate, as actual results may vary from estimates.
- We cannot assure our stockholders that we will achieve investment results that will allow us to make a specified level of cash distributions or year-to-year increases in cash distributions in the future. In addition, some of our distributions may include a return in capital.

Investing in our capital stock may involve a high degree of risk.

The investments we make in accordance with our investment objectives may result in a high amount of risk when compared to alternative investment options and volatility or loss of principal. Our investments may be highly speculative and aggressive, and therefore an investment in our capital stock may not be suitable for someone with lower risk tolerance.

A change in market interest rates may cause a material decrease in the market price of our capital stock.

One of the factors that investors may consider in deciding whether to buy or sell shares of our capital stock is our distribution rate as a percentage of our share price relative to market interest rates. If the market price of our capital stock is based primarily on the earnings and return that we derive from our investments and income with respect to our investments and our related distributions to stockholders, and not from the market value of the investments themselves, then interest rate fluctuations and capital market conditions are likely to adversely affect the market price

of our capital stock. For instance, if

market rates rise without an increase in our distribution rate, the market price of our capital stock could decrease as potential investors may require a higher distribution yield or seek other securities paying higher distributions or interest.

Future offerings of debt or equity securities, which would rank senior to our common stock, may adversely affect the market price of our common stock.

We have issued Series A Preferred Stock, Series B Preferred Stock and 5.00% Exchangeable Senior Notes due 2018. If we decide to issue debt or equity securities in the future, which would rank senior to our common stock, it is likely that they will be governed by an indenture or other instrument containing covenants restricting our operating flexibility. Any convertible or exchangeable securities that we issue in the future may have rights, preferences and privileges more favorable than those of our common stock and may result in dilution to owners of our common stock. For example, preferred shares and debt have a preference on liquidating distributions or a preference on dividend or interest payments that could limit our ability to make a distribution to the holders of our common stock. We and, indirectly, our stockholders, will bear the cost of issuing and servicing such securities. Because our decision to issue debt or equity securities in any future offering will depend on market conditions and other factors beyond our control, we cannot predict or estimate the amount, timing or nature of our future offerings.

Holders of our common stock are not entitled to preemptive rights or other protections against dilution. Thus holders of our common stock will bear the risk of our future offerings reducing the market price of our common stock and diluting the value of their stock holdings in us. Holders of our common stock also bear the risk of holders of our exchangeable notes making an election to exchange their notes for common stock, which could result in significant dilution to our existing stockholders. In addition, future issuances and sales of preferred stock on parity to our Series A Preferred Stock or the Series B Preferred Stock, or the perception that such issuances and sales could occur, may also cause prevailing market prices for the Series A Preferred Stock, Series B Preferred Stock and our common stock to decline and may adversely affect our ability to raise additional capital in the financial markets at times and prices favorable to us.

Risks Related to Our Organization and Structure

Certain provisions of Maryland law could inhibit changes in control.

Certain provisions of the Maryland General Corporation Law (the “MGCL”), may have the effect of deterring a third party from making a proposal to acquire us or of impeding a change in control under circumstances that otherwise could provide the holders of our common stock with the opportunity to realize a premium over the then-prevailing market price of our common stock. Under the MGCL, certain “business combinations” (including a merger, consolidation, share exchange, or, in circumstances specified in the statute, an asset transfer or issuance or reclassification of equity securities) between us and an “interested stockholder” (defined generally as any person who beneficially owns 10% or more of our then outstanding voting capital stock or an affiliate or associate of ours who, at any time within the two-year period prior to the date in question, was the beneficial owner of 10% or more of our then outstanding voting capital stock) or an affiliate thereof are prohibited for five years after the most recent date on which the stockholder becomes an interested stockholder. After the five-year prohibition, any business combination between us and an interested stockholder generally must be recommended by our board of directors and approved by the affirmative vote of at least (1) 80% of the votes entitled to be cast by holders of outstanding shares of our voting capital stock; and (2) two-thirds of the votes entitled to be cast by holders of voting capital stock of the corporation other than shares held by the interested stockholder with whom or with whose affiliate the business combination is to be effected or held by an affiliate or associate of the interested stockholder. These super-majority vote requirements do not apply if our common stockholders receive a minimum price, as defined under Maryland law, for their shares in the form of cash or other consideration in the same form as previously paid by the interested stockholder for its shares. These provisions of the MGCL also do not apply to business combinations that are approved or exempted by a board of directors prior to the time that the interested stockholder becomes an interested stockholder. Pursuant to the statute, our board of directors has by resolution exempted business combinations between us and any other person, provided that such business combination is first approved by our board of directors (including a majority of our directors who are not affiliates or associates of such person).

The “control share” provisions of the MGCL provide that “control shares” of a Maryland corporation (defined as shares which, when aggregated with other shares controlled by the stockholder (except solely by virtue of a revocable proxy),

entitle the stockholder to exercise one of three increasing ranges of voting power in electing directors) acquired in a “control share acquisition” (defined as the direct or indirect acquisition of ownership or control of “control shares”) have no voting rights except to the extent approved by our stockholders by the affirmative vote of at least two-thirds of all the votes entitled to be cast on the matter, excluding votes entitled to be cast by the acquiror of control shares, our officers and our employees who are also our directors. Our bylaws contain a provision exempting from the control share acquisition statute any and all acquisitions by any person of shares of our stock. There can be no assurance that this provision will not be amended or eliminated at any time in the future.

The “unsolicited takeover” provisions of the MGCL permit our board of directors, without stockholder approval and regardless of what is currently provided in our charter or bylaws, to implement takeover defenses, some of which (for example,

a classified board) we do not yet have. These provisions may have the effect of inhibiting a third party from making an acquisition proposal for us or of delaying, deferring or preventing a change in control of us under circumstances that otherwise could provide the holders of shares of common stock with the opportunity to realize a premium over the then current market price. Our charter contains a provision whereby we have elected to be subject to the provisions of Title 3, Subtitle 8 of the MGCL relating to the filling of vacancies on our board of directors.

Ownership limitations may restrict change of control of business combination opportunities in which our stockholders might receive a premium for their shares.

In order for us to qualify as a REIT, no more than 50% in value of our outstanding capital stock may be owned, directly or indirectly, by five or fewer individuals during the last half of any calendar year. "Individuals" for this purpose include natural persons, private foundations, some employee benefit plans and trusts, and some charitable trusts. To preserve our REIT qualification, among other purposes, our charter generally prohibits any person from directly or indirectly owning more than 9.8% in value or in number of shares, whichever is more restrictive, of the outstanding shares of our capital stock or more than 9.8% in value or in number of shares, whichever is more restrictive, of the outstanding shares of our common stock. This ownership limitation could have the effect of discouraging a takeover or other transaction in which holders of our common stock might receive a premium for their shares over the then prevailing market price or which holders might believe to be otherwise in their best interests.

Our authorized but unissued shares of capital stock may prevent a change in our control.

Our charter authorizes us to issue additional authorized but unissued shares of common or preferred stock. In addition, our board of directors may, without stockholder approval, amend our charter to increase the aggregate number of our shares of stock or the number of shares of stock of any class or series that we have authority to issue and classify or reclassify any unissued shares of common or preferred stock and set the preferences, rights and other terms of the classified or reclassified shares. As a result, our board of directors may establish a series of shares of common or preferred stock that could delay or prevent a transaction or a change in control that might involve a premium price for our shares of common stock or otherwise be in the best interest of our stockholders.

The change of control conversion feature of our Series A Preferred Stock, Series B Preferred Stock and our Exchangeable Senior Notes may make it more difficult for a party to acquire us or discourage a party from acquiring us.

The change of control conversion feature of our Series A Preferred Stock, Series B Preferred Stock and our Exchangeable Senior Notes may have the effect of discouraging a third party from making an acquisition proposal for us or of delaying, deferring or preventing certain of our change of control transactions under circumstances that otherwise could provide the holders of our common stock, Series A Preferred Stock and Series B Preferred Stock with the opportunity to realize a premium over the then-current market price of such stock or that stockholders may otherwise believe is in their best interests.

We are the sole general partner of our Operating Partnership and could become liable for the debts and other obligations of our Operating Partnership beyond the amount of our initial expenditure.

We are the sole general partner of our Operating Partnership and directly or indirectly conduct all of our business activities through the Operating Partnership and its subsidiaries. As the sole general partner, we are liable for our Operating Partnership's debts and other obligations. Therefore, if our Operating Partnership is unable to pay its debts and other obligations, we will be liable for such debts and other obligations beyond the amount of our expenditure for ownership interests in our Operating Partnership. These obligations could include unforeseen contingent liabilities and could materially adversely affect our financial condition, operating results and ability to make distributions to our stockholders.

Our Exchangeable Senior Notes are recourse obligations to us.

In 2013, our Operating Partnership issued \$400,000,000 in aggregate principal amount of 5.00% Exchangeable Senior Notes due 2018 (the "Notes"). Because the Company is the sole general partner of the Operating Partnership, these amounts are full recourse obligations of the Company. If we are not able to extend, refinance or repurchase the Notes, we may not have the ability to repay these amounts when they come due. Our inability to repay the Notes could cause the acceleration of our other borrowings, which would have a material adverse effect on our business.

The indenture governing the Notes contains cross-default provisions whereby a default or acceleration of borrowings under other agreements could result in a default under the indenture. If a cross-default occurred, we may not be able to

pay our liabilities or access capital from external sources in order to refinance our borrowings. If some or all of our borrowings default and it causes a default under other borrowings, our business, financial condition and results of operations could be materially and adversely affected.

Tax Risks

Investment in our capital stock has various U.S. federal income tax risks.

This summary of certain tax risks is limited to the U.S. federal tax risks addressed below. Additional risks or issues may exist that are not addressed in this Report and that could affect the U.S. federal income tax treatment of us or our stockholders.

We strongly urge you to seek advice based on your particular circumstances from an independent tax advisor concerning the effects of U.S. federal, state and local income tax law on an investment in our capital stock and on your individual tax situation.

Our failure to qualify as a REIT would subject us to U.S. federal income tax and potentially increased state and local taxes, which would reduce the amount of cash available for distribution to our stockholders.

We believe that we have been organized and operated and we intend to continue to operate in a manner that enables us to qualify as a REIT for U.S. federal income tax purposes. However, qualification as a REIT involves the application of highly technical and complex Internal Revenue Code provisions for which only a limited number of judicial and administrative interpretations exist. Even an inadvertent or technical mistake could jeopardize our REIT status. Our continued qualification as a REIT will depend on our satisfaction of certain asset, income, organizational, distribution, stockholder ownership and other requirements on a continuing basis.

Moreover, new legislation, court decisions or administrative guidance, in each case possibly with retroactive effect, may make it more difficult or impossible for us to qualify as a REIT. Thus, while we intend to operate so that we will qualify as a REIT, given the highly complex nature of the rules governing REITs, the ongoing importance of factual determinations, and the possibility of future changes in our circumstances, no assurance can be given that we will so qualify for any particular year.

If we fail to qualify as a REIT in any taxable year, and we do not qualify for certain statutory relief provisions, we would be required to pay U.S. federal income tax on our taxable income, and distributions to our stockholders would not be deductible by us in determining our taxable income. In such a case, we might need to borrow money or sell assets in order to pay our taxes. Our payment of income tax would decrease the amount of our income available for distribution to our stockholders. Furthermore, if we fail to maintain our qualification as a REIT, we no longer would be required to distribute substantially all of our taxable income to our stockholders. In addition, unless we were eligible for certain statutory relief provisions, we could not re-elect to qualify as a REIT until the fifth calendar year following the year in which we failed to qualify.

Complying with REIT requirements may cause us to forego otherwise attractive investment opportunities or financing or hedging strategies.

To qualify as a REIT for U.S. federal income tax purposes, we must continually satisfy various tests regarding the sources of our income, the nature and diversification of our assets, and the amounts we distribute to our stockholders. To meet these tests, we may be required to forego investments we might otherwise make or financing or hedging strategies we might otherwise employ. We may be required to make distributions to stockholders at disadvantageous times or when we do not have funds readily available for distribution. Thus, compliance with the REIT requirements may hinder our investment performance.

Complying with REIT requirements may force us to liquidate otherwise attractive investments.

To qualify as a REIT, we generally must ensure that at the end of each calendar quarter at least 75% of the value of our total assets consists of cash, cash items, government securities and qualifying real estate assets, including certain mortgage loans and MBS. The remainder of our investment in securities (other than government securities, securities of our TRSs and qualifying real estate assets) generally cannot include more than 10% of the outstanding voting securities of any one issuer or more than 10% of the total value of the outstanding securities of any one issuer. In addition, in general, no more than 5% of the value of our assets can consist of the securities of any one issuer (other than government securities, securities of our TRSs and qualifying real estate assets), and no more than 25% of the value of our total securities can be represented by securities of one or more TRSs. If we fail to comply with these requirements at the end of any quarter, we must correct the failure within 30 days after the end of such calendar quarter or qualify for certain statutory relief provisions to avoid losing our REIT qualification and suffering adverse tax consequences. As a result, we may be required to liquidate from our portfolio otherwise attractive investments. These actions could have the effect of reducing our income and amounts available for distribution to our stockholders.

REIT distribution requirements could adversely affect our ability to execute our business plan and may require us to incur debt, sell assets or take other actions to make such distributions.

To qualify as a REIT, we must distribute to our stockholders each calendar year at least 90% of our REIT taxable income (including certain items of non-cash income), determined without regard to the deduction for dividends paid and excluding net capital gain. To the extent that we satisfy the 90% distribution requirement, but distribute less than 100% of our taxable

income, we will be subject to U.S. federal corporate income tax on our undistributed taxable income. In addition, we will incur a 4% nondeductible excise tax on the amount, if any, by which our distributions in any calendar year are less than a minimum amount specified under U.S. federal income tax laws. We intend to make sufficient distributions to our stockholders to satisfy the 90% distribution requirement and to avoid both corporate income tax and the 4% nondeductible excise tax.

Our taxable income may be substantially different from our net income as determined by U.S. GAAP, because, for example, realized capital losses will be deducted in determining our U.S. GAAP net income, but may not be deductible in computing our taxable income. In addition, differences in timing between the recognition of taxable income and the actual receipt of cash may occur. For example, we may invest in debt instruments requiring us to accrue original issue discount (“OID”) or recognize market discount income that generate taxable income in excess of economic income or in advance of the corresponding cash flow referred to as “phantom income.” We may also acquire distressed debt investments that are subsequently modified by agreement with the borrower. If amendments to the outstanding debt are “significant modifications” under applicable Treasury Regulations, the modified debt may be considered to have been reissued to us in a debt-for-debt exchange with the borrower, with gain recognized by us to the extent that the principal amount of the modified debt exceeds our cost of purchasing it prior to modification. Finally, we may be required under the terms of the indebtedness that we incur, whether to private lenders or pursuant to government programs, to use cash received from interest payments to make principal payment on that indebtedness, with the effect that we will recognize income but will not have a corresponding amount of cash available for distribution to our stockholders.

As a result of the foregoing, we may find it difficult or impossible to meet the REIT distribution requirements in certain circumstances. In such circumstances, we may be required to (1) sell assets in adverse market conditions, (2) borrow on unfavorable terms, (3) distribute amounts that would otherwise be invested in future acquisitions, capital expenditures or repayment of debt, or (4) make a taxable distribution of our shares of common stock as part of a distribution in which stockholders may elect to receive shares of common stock or (subject to a limit measured as a percentage of the total distribution) cash, in order to comply with the REIT distribution requirements. Thus, compliance with the REIT distribution requirements may hinder our ability to grow, which could adversely affect the value of our common stock.

We may choose to pay dividends in our own stock, in which case our stockholders may be required to pay income taxes in excess of the cash dividends received.

We may distribute taxable dividends that are payable in cash and in shares of our common stock at the election of each stockholder. Taxable stockholders receiving such dividends will be required to include the full amount of the dividend in income to the extent of our current and accumulated earnings and profits for federal income tax purposes. As a result, a U.S. stockholder may be required to pay income taxes with respect to such dividends in excess of the cash dividends received. If a U.S. stockholder sells the stock it receives as a dividend in order to pay this tax, the sales proceeds may be less than the amount included in income with respect to the dividend, depending on the market price of our stock at the time of the sale. Furthermore, with respect to non-U.S. stockholders, we may be required to withhold U.S. tax with respect to such dividends, including in respect of all or a portion of such dividend that is payable in stock. In addition, if a significant number of our stockholders determine to sell shares of our common stock in order to pay taxes owed on dividends, it may put downward pressure on the trading price of our common stock. Our ownership of and relationship with any TRS that we may form or acquire is subject to limitations, and a failure to comply with the limits would jeopardize our REIT qualification and may result in the application of a 100% excise tax.

A REIT may own up to 100% of the stock of one or more TRSs. A TRS may earn income that would not be qualifying income if earned directly by the parent REIT. Both the subsidiary and the REIT must jointly elect to treat the subsidiary as a TRS. Overall, no more than 25% of the value of a REIT’s assets may consist of stock or securities of one or more TRSs at the end of any calendar quarter. A TRS will pay federal, state and local income tax at regular corporate rates on any income that it earns. In addition, the TRS rules impose a 100% excise tax on certain transactions between a TRS and its parent REIT that are not conducted on an arm’s length basis. There can be no assurance that we will be able to comply with the TRS limitations or to avoid application of the 100% excise tax discussed above.

Our domestic TRSs would pay U.S. federal, state and local income tax on its taxable income, and its after-tax net income would be available for distribution to us but would not be required to be distributed to us. If we were to organize a TRS as a non-U.S. corporation (or entity treated as a corporation for U.S. federal income tax purposes), we may generate income inclusions relating to the earnings of the non-U.S. TRS, the treatment of which under the REIT gross income tests is not clear.

Liquidation of our assets to repay obligations to our lenders may jeopardize our REIT qualification.

To qualify as a REIT, we must comply with requirements regarding our assets and our sources of income. If we are compelled to liquidate our investments to repay obligations to our lenders, we may be unable to comply with these requirements, ultimately jeopardizing our qualification as a REIT.

Characterization of the repurchase agreements we enter into to finance our investments as sales for tax purposes rather than as secured borrowing transactions, or the failure of a mezzanine loan to qualify as a real estate asset, could adversely affect our ability to qualify as a REIT.

We may enter into repurchase agreements with a variety of counterparties to finance assets in which we invest. When we enter into a repurchase agreement, we generally sell assets to our counterparty to the agreement and receive cash from the counterparty. The counterparty is obligated to resell the assets back to us at the end of the term of the transaction. We believe that, for U.S. federal income tax purposes, we will be treated as the owner of the assets that are the subject of repurchase agreements and that the repurchase agreements will be treated as secured borrowing transactions notwithstanding that such agreements may transfer record ownership of the assets to the counterparty during the term of the agreement. It is possible, however, that the IRS could successfully assert that we did not own these assets during the term of the repurchase agreements, in which case we could fail to qualify as a REIT.

In addition, we may acquire mezzanine loans, which are loans secured by equity interests in a partnership or limited liability company that directly or indirectly owns real property. In Revenue Procedure 2003-65, the IRS provided a safe harbor pursuant to which a mezzanine loan, if it meets each of the requirements contained in the Revenue Procedure, will be treated by the IRS as a real estate asset for purposes of the REIT asset tests, and interest derived from the mezzanine loan will be treated as qualifying mortgage interest for purposes of the 75% gross income test. Although the Revenue Procedure provides a safe harbor on which taxpayers may rely, it does not prescribe rules of substantive tax law. We acquire or originate mezzanine loans that do not meet all of the requirements for reliance on this safe harbor. The IRS could challenge such loan's treatment as a real estate asset for purposes of the REIT asset and income tests, and if such a challenge were sustained, we could fail to qualify as a REIT.

The "taxable mortgage pool" rules may limit our financing options.

Certain securitizations and other financing structures could result in the creation of taxable mortgage pools for federal income tax purposes. A taxable mortgage pool owned by our Operating Partnership would be treated as a corporation for U.S. federal income tax purposes and may cause us to fail the REIT asset tests. Accordingly, if we were to consider a securitization that would create a taxable mortgage pool, we would have to undertake such securitization through a TRS or a subsidiary that qualified as a REIT. These rules may limit our financing options.

The tax on prohibited transactions will limit our ability to engage in transactions, including certain methods of securitizing mortgage loans, which would be treated as sales for federal income tax purposes.

A REIT's net income from prohibited transactions is subject to a 100% tax. In general, prohibited transactions are sales or other dispositions of property, other than foreclosure property, but including mortgage loans, held primarily for sale to customers in the ordinary course of business. We might be subject to this tax if we were to dispose of or securitize loans in a manner that was treated as a sale of the loans for federal income tax purposes. Therefore, in order to avoid the prohibited transactions tax, we may choose not to engage in certain sales of loans at the REIT level and may limit the structures we utilize for our securitization transactions, even though the sales or such structures might otherwise be beneficial to us.

Complying with REIT requirements may limit our ability to hedge effectively.

The REIT provisions of the Internal Revenue Code limit our ability to enter into hedging transactions. In order to qualify as a REIT, we must satisfy two gross income tests annually. For these purposes, income with respect to certain hedges of our liabilities or foreign currency risks will be disregarded. Income from other hedges will be non-qualifying income for purposes of both gross income tests. As a result, we might have to limit our use of advantageous hedging techniques or implement those hedges through a TRS. This could increase the cost of our hedging activities or expose us to greater risks associated with changes in interest rates than we would otherwise want to bear.

Purchases of mortgages at a discount may affect our ability to satisfy the REIT asset and gross income tests.

Whether our loan holdings are treated as real estate assets and interest income thereon is treated as qualifying income for purposes of the 75% gross income test depends on whether the loans are adequately secured by real property. Treasury regulations, as interpreted in Revenue Procedure 2014-51, provide that if a mortgage loan is secured by both real property and personal property and the value of the real property at the time the REIT commits to make or acquire the loan is less than the highest principal amount (i.e., the face amount) of the loan during the year, interest on the loan will be treated as qualifying income only in proportion to the ratio of the value of the real property at the time the

REIT commits to make or acquire the loan to the highest principal amount of the loan during the year. Similarly, the IRS issued guidance for determining the extent to which an interest in an “eligible REMIC” (relating to the HARP program) is treated as a real estate asset and generates qualifying income for purposes of the 75% gross income test. Failure to accurately apply these rules and manage our income and assets could cause us to fail to qualify as a REIT.

Our qualification as a REIT could be jeopardized as a result of our interest in joint ventures or investment funds. We currently own, and may continue to acquire, interests in partnerships or limited liability companies that are joint ventures or investment funds. We may not have timely access to information from such partnerships and limited liability companies related to monitoring and managing our REIT qualification. If a partnership or limited liability company in which we own an interest but do not control takes or expects to take actions that could jeopardize our REIT qualification or require us to pay tax, we may be forced to dispose of our interest in such entity. It is possible that a partnership or limited liability company could take an action which could cause us to fail a REIT gross income or asset test and that we would not become aware of such action in time to dispose of our interest in the partnership or limited liability company or take other corrective action on a timely basis. In that case, we could fail to qualify as a REIT unless we are able to qualify for a statutory REIT "savings" provision, which may require us to pay a significant penalty tax to maintain our REIT qualification.

We may be required to report taxable income for certain investments in excess of the economic income we ultimately realize from them.

We acquire debt instruments in the secondary market for less than their face amount. The discount at which such debt instruments are acquired may reflect doubts about their ultimate collectibility rather than current market interest rates. The amount of such discount will nevertheless generally be treated as "market discount" for federal income tax purposes. Accrued market discount is reported as income when, and to the extent that, any payment of principal of the debt instrument is made. If we collect less on the debt instrument than our purchase price plus the market discount we had previously reported as income, we may not be able to benefit from any offsetting loss deductions.

Some of the debt instruments that we acquire may have been issued with original issue discount. We will be required to report such original issue discount based on a constant yield method and will be taxed based on the assumption that all future projected payments due on such debt instruments will be made. If such debt instruments or MBS turn out not to be fully collectible, an offsetting loss deduction will become available only in the later year that uncollectibility is provable.

In addition, we may acquire debt instruments that are subsequently modified by agreement with the borrower. If the amendments to the outstanding instrument are "significant modifications" under the applicable Treasury regulations, the modified instrument will be considered to have been reissued to us in a debt-for-debt exchange with the borrower. In that event, we may be required to recognize taxable gain to the extent the principal amount of the modified instrument exceeds our adjusted tax basis in the unmodified instrument, even if the value of the instrument or the payment expectations have not changed. Following such a taxable modification, we would hold the modified loan with a cost basis equal to its principal amount for federal tax purposes.

Finally, in the event that any debt instruments acquired by us are delinquent as to mandatory principal and interest payments, or in the event payments with respect to a particular instrument are not made when due, we may nonetheless be required to continue to recognize the unpaid interest as taxable income as it accrues, despite doubt as to its ultimate collectibility. Similarly, we may be required to accrue interest income with respect to debt instruments at its stated rate regardless of whether corresponding cash payments are received or are ultimately collectible. In each case, while we would in general ultimately have an offsetting loss deduction available to us when such interest was determined to be uncollectible, the utility of that deduction could depend on our having taxable income in that later year or thereafter.

Even if we qualify as a REIT, we may face tax liabilities that reduce our cash flow.

Even if we qualify as a REIT, we may be subject to certain U.S. federal, state and local taxes on our income and assets, including taxes on any undistributed income, tax on income from some activities conducted as a result of a foreclosure, and state or local income, franchise, property and transfer taxes, including mortgage-related taxes.

We may be subject to adverse legislative or regulatory tax changes that could reduce the market price of our capital stock.

At any time, the U.S. federal income tax laws or regulations governing REITs or the administrative interpretations of those laws or regulations may be amended. We cannot predict when or if any new U.S. federal income tax law, regulation or administrative interpretation, or any amendment to any existing federal income tax law, regulation or administrative interpretation, will be adopted, promulgated or become effective. Any such law, regulation or interpretation may take effect retroactively. We and our stockholders could be adversely affected by any such change

in, or any new, federal income tax law, regulation or administrative interpretation.

Dividends paid by REITs do not qualify for the reduced tax rates that apply to other corporate dividends.

The maximum tax rate for “qualified dividends” paid by corporations to individuals is currently 20%. Dividends paid by REITs, however, generally are not “qualified dividends” and generally are taxed at the normal ordinary income rates, currently subject to a maximum rate of 39.6% in the case of non-corporate taxpayers. The more favorable rates applicable to qualified dividends could cause potential investors who are individuals to perceive investments in REITs to be relatively less attractive

than investments in the stocks of non-REIT corporations that pay qualified dividends, which could adversely affect the value of the stock of REITs, including our capital stock.

Dividends paid by REITs may be subject to Unearned Income Medicare tax.

High-income U.S. individuals, estates, and trusts will be subject to an additional 3.8% tax on net investment income. For these purposes, net investment income includes dividends and gains from sales of stock. In the case of an individual, the tax will be 3.8% of the lesser of the individuals' net investment income or the excess of the individuals' modified adjusted gross income over \$250,000 in the case of a married individual filing a joint return or a surviving spouse, \$125,000 in the case of a married individual filing a separate return, or \$200,000 in the case of a single individual.

Tax-exempt stockholders may realize unrelated business taxable income if we generate excess inclusion income. If we acquire REMIC residual interests or equity interests in taxable mortgage pools (in a manner consistent with our REIT qualification) and generate "excess inclusion income," a portion of our dividends received by a tax-exempt stockholder will be treated as unrelated business taxable income.

Changing the nature of our assets may complicate our ability to satisfy the REIT gross income and asset tests.

We have large holdings of RMBS that are qualifying assets for purposes of the REIT asset tests and generate interest income that is qualifying income for purposes of the REIT gross income tests. The REIT asset tests do not require that all assets be qualifying assets, nor do the REIT gross income tests require that all income be qualifying income. Our substantial RMBS holdings have given us room to make investments that may not qualify, all or in part, as real estate assets or that may generate income that may not qualify, all or in part, under one or both of the gross income tests.

Reductions in our RMBS holdings would reduce our room for non-qualifying assets and income. In addition, we may make investments in which the proper application of the REIT gross income and assets tests may not be clear.

Mistakes in classifying assets or income for REIT purposes or in projecting the amount of qualifying and non-qualifying income could cause us to fail to qualify as a REIT.

Our qualification as a REIT may depend upon the accuracy of legal opinions or advice rendered or given or statements by the issuers of assets we acquire.

When purchasing securities, we may rely on opinions or advice of counsel for the issuer of such securities, or statements made in related offering documents, for purposes of determining, among other things, whether such securities represent debt or equity securities for U.S. federal income tax purposes, the value of such securities, and also to what extent those securities constitute qualified real estate assets for purposes of the REIT asset tests and produce qualified income for purposes of the 75% gross income test. The inaccuracy of any such opinions, advice or statements may adversely affect our ability to qualify as a REIT and result in significant corporate-level tax.

Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

Our principal executive office is located at 1555 Peachtree Street, NE, Suite 1800, Atlanta, Georgia 30309. As part of our management agreement, our Manager is responsible for providing office space and office services required in rendering services to us.

Item 3. Legal Proceedings.

From time to time, we may be involved in various claims and legal actions arising in the ordinary course of business. As of December 31, 2014, we were not involved in any such legal proceedings.

Item 4. Mine and Safety Disclosures

Not applicable.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Market Information

Our common stock is traded on the NYSE under the symbol "IVR." The following table sets forth, for the periods indicated, the high and low sale price of our common stock as reported on the NYSE.

	High	Low
2014		
Fourth quarter	\$16.66	\$15.19
Third quarter	\$17.64	\$15.72
Second quarter	\$18.00	\$16.36
First quarter	\$17.46	\$14.64
2013		
Fourth quarter	\$16.60	\$14.41
Third quarter	\$17.08	\$14.40
Second quarter	\$21.60	\$16.38
First quarter	\$22.26	\$20.06

Holders

As of February 18, 2015, there were 114 stockholders of record.

Dividends

U.S. federal income tax law generally requires that a REIT distribute annually at least 90% of its REIT taxable income, determined without regard to the deduction for dividends paid and excluding net capital gains, and that it pay tax at regular corporate rates on its undistributed taxable income. We intend to continue to pay regular quarterly dividends to our stockholders. Before we pay any dividend, whether for U.S. federal income tax purposes or otherwise, we must first meet both our operating requirements and debt service obligations. If our cash available for distribution is less than our taxable income, we could be required to sell assets or borrow funds to make cash distributions, or we may make a portion of the required distribution in the form of a taxable stock distribution or distribution of debt securities.

The following table sets forth the dividends declared per share of our common stock for the periods indicated.

Date Declared	Dividends Declared Per Share	
	Amount	Date Paid
2014		
December 16, 2014	\$0.45	January 27, 2015
September 15, 2014	\$0.50	October 28, 2014
June 16, 2014	\$0.50	July 28, 2014
March 18, 2014	\$0.50	April 28, 2014
2013		
December 17, 2013	\$0.50	January 28, 2014
September 16, 2013	\$0.50	October 28, 2013
June 17, 2013	\$0.65	July 26, 2013
March 19, 2013	\$0.65	April 26, 2013

The following table sets forth the dividends declared per share of our common stock and the related tax characterization for the fiscal tax years ended December 31, 2014 and 2013.

Fiscal Tax Year	Dividends Declared	Tax Characterization of Dividends		
		Ordinary Dividends	Capital Gain Distribution	Carry Forward
Common Stock Dividends				
Fiscal tax year 2014	1.950000	1.776691	—	0.173309
Fiscal tax year 2013	2.300000	2.300000	—	—

Performance Graph

The following graph matches the cumulative 5-year total return of holders of Invesco Mortgage Capital Inc.'s common stock with the cumulative total returns of the S&P 500 index and the FTSE NAREIT Mortgage REITs index. The graph assumes that the value of the investment in our common stock and in each of the indices (including reinvestment of dividends) was \$100 on December 31, 2009 and tracks it through December 31, 2014.

Index	12/31/2009	12/31/2010	12/31/2011	12/31/2012	12/31/2013	12/31/2014
Invesco Mortgage Capital Inc.	100.00	112.38	86.68	139.10	118.34	140.26
S&P 500	100.00	115.06	117.49	136.30	180.44	205.14
FTSE NAREIT Mortgage REITs	100.00	122.60	119.63	143.43	140.62	165.76

The stock price performance included in this graph is not necessarily indicative of future stock price performance.

Use of Proceeds

We used all of the net proceeds from our common and preferred stock offerings to acquire our target assets in accordance with our objectives and strategies described in Item 1, Business - Investment Strategy. We focus on purchasing our target assets, subject to our investment guidelines and to the extent consistent with maintaining our REIT qualification. Our Manager determines the percentage of our equity that will be invested in each of our target assets.

Repurchases of Equity Securities

In December 2011, our board of directors approved a share repurchase program of up to 7,000,000 of our common shares with no stated expiration date. In December 2013, our board of directors approved an additional share repurchase of up to 20,000,000 of our common shares with no stated expiration date. As of December 31, 2014, there were 14,841,784 common shares available for repurchase. No shares of common stock were purchased during the quarter ended December 31, 2014. The shares may be repurchased from time to time through privately negotiated transactions or open market transactions, including pursuant to a trading plan in accordance with Rules 10b5-1 and 10b-18 under Exchange Act or by any combination of such methods. The manner, price, number and timing of share repurchases will be subject to a variety of factors, including market conditions and applicable SEC rules.

Item 6. Selected Financial Data. (As Restated)

The selected historical financial information as of and for the years ended December 31, 2014, 2013, 2012, 2011 and 2010 presented in the tables below have been derived from our audited financial statements. The information presented below is not necessarily indicative of the trends in our performance.

The information presented below is only a summary and does not provide all of the information contained in our historical financial statements, including the related notes. You should read the information below in conjunction with “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and our historical financial statements, including the related notes, included elsewhere in this Report.

The Company has restated its consolidated balance sheets as of December 31, 2014 and 2013 and its consolidated statement of operations, consolidated statement of comprehensive income (loss), consolidated statement of equity and consolidated statement of cash flows for the years ended December 31, 2014 and 2013, along with certain related notes.

Balance Sheet Data

\$ in thousands	As of December 31,				
	2014 (As Restated)	2013 (As Restated)	2012	2011	2010
Mortgage-backed and credit risk transfer securities, at fair value	17,248,895	17,348,657	18,470,563	14,214,149	5,578,333
Residential loans, held-for-investment	3,365,003	(1) 1,810,262	(1) —	—	—
Commercial loans, held-for-investment	145,756	64,599	—	—	—
Total assets	21,231,017	(1) 20,350,979	(1) 18,914,760	14,772,167	5,862,399
Repurchase agreements	13,622,677	15,451,675	15,720,460	12,253,038	4,344,659
Secured loans	1,250,000	—	—	—	—
Asset-backed securities issued by securitization trusts	2,929,820	(1) 1,643,741	(1) —	—	—
Exchangeable senior notes	400,000	400,000	—	—	—
Total stockholders’ equity	2,610,315	2,376,115	2,558,098	1,892,338	1,019,150
Non-controlling interest	28,535	27,120	31,422	25,075	31,664
Total equity	2,638,850	2,403,235	2,589,520	1,917,413	1,050,814

(1) Our consolidated balance sheets include assets of consolidated variable interest entities (“VIEs”) that can only be used to settle obligations and liabilities of the VIEs for which creditors do not have recourse to us. As of December 31, 2014 and December 31, 2013, total assets of the consolidated VIEs were \$3,380,597 and

\$1,819,295, respectively, and total liabilities of the consolidated VIEs were \$2,938,512 and \$1,648,400, respectively. Refer to Note 3 - "Variable Interest Entities" of our consolidated financial statements for further discussion.

Statements of Operations Data

\$ in thousands, except share amounts	For the Years ended December 31,				
	2014 (As Restated)	2013 (As Restated)	2012 ⁽¹⁾	2011 ⁽¹⁾	2010 ⁽¹⁾
Interest income	676,643	682,360	566,830	453,352	134,229
Interest expense	281,895	332,252	237,405	155,241	29,556
Net interest income	394,748	350,108	329,425	298,111	104,673
(Reduction in) provision for loan losses	(142)	884	—	—	—
Net interest income after provision for loan losses	394,890	349,224	329,425	298,111	104,673
Other income (loss)	(572,762)	(136,258)	53,041	11,044	12,127
Expenses	52,866	53,144	39,684	30,118	12,093
Net income (loss)	(230,738)	159,822	342,782	279,037	104,707
Net income (loss) attributable to non-controlling interest	(2,632)	1,667	4,108	4,788	5,338
Net income (loss) attributable to Invesco Mortgage Capital Inc.	(228,106)	158,155	338,674	274,249	99,369
Dividends to preferred stockholders	17,378	10,851	5,395	—	—
Net income (loss) attributable to common stockholders	(245,484)	147,304	333,279	274,249	99,369
Earnings per share:					
Net income (loss) attributable to common stockholders					
Basic	(1.99)	1.11	2.88	3.18	3.82
Diluted	(1.99)	1.11	2.88	3.18	3.81
Dividends declared per common share	1.95	2.30	2.60	3.42	3.49
Weighted average number of shares of common stock:					
Basic	123,104,934	132,714,012	115,558,668	86,364,506	26,038,628
Diluted	124,529,934	134,173,691	117,012,500	87,804,292	27,468,177

The Company identified, individually and in the aggregate, immaterial out of period errors for the years ended December 31, 2012, 2011 and 2010 related to its accounting for Agency MBS IOs. The impact of the error for the (1) year ended December 31, 2012 was a \$1.2 million decrease to net income (2011: \$7.8 million decrease; 2010: \$1.0 million increase). For discussion of the restatement adjustments, see Note 16 - "Restatement of Previously Issued Financial Statements" of our consolidated financial statements.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations. (Certain Sections Restated)

The following discussion should be read in conjunction with our consolidated financial statements and the accompanying notes to our consolidated financial statements, which are included in the Part IV, Item 15 of this Report.

Restatement Background

As discussed in the Explanatory Note to this Form 10-K/A and Note 16 - "Restatement of Previously Issued Financial Statements", we are restating our consolidated financial statements for the years ended December 31, 2014 and 2013 and restating quarterly financial information for the quarter ended March 31, 2013 and for all subsequent quarters through December 31, 2014 due to errors related to the accounting treatment of GSE CRTs and Agency MBS IOs. Specifically, we determined that the GSE CRTs are hybrid financial instruments consisting of (i) a debt host contract (the unsecured GSE debenture) and (ii) an embedded derivative related to the credit protection feature of the GSE CRTs that should have been accounted for applying the guidance of Financial Accounting Standards Board ("FASB")

Accounting Standards Codification (“ASC”) 815 - Derivatives and Hedging (“ASC 815”). Under ASC 815, changes in fair value of the embedded derivative are required to be recorded in the Company’s consolidated statement of operations, instead of in other comprehensive income on the Company’s consolidated balance sheet while changes in fair value of the debt host contract remain within other comprehensive income. Additionally, we determined that the Agency MBS IOs are also hybrid financial instruments, which consist of (i) a debt host contract (the mortgage-backed security) and (ii) an embedded interest derivative related to prepayment

risk. We have determined that Agency MBS IOs should have been accounted for under ASC 815 by recording changes in fair value of the embedded derivative in the consolidated statement of operations instead of in other comprehensive income on the Company's consolidated balance sheet. Management determined that the Agency MBS IOs embedded derivative cannot be reliably valued as a stand-alone instrument and therefore recorded the entire Agency MBS IOs change in fair value in the consolidated statement of operations in accordance with ASC 815. The below table illustrates the quarterly impact of the Restatement to the consolidated statement of operations for the years ended 2014 and 2013:

In thousands	2014					
	As Reported	Adjustments			As Restated	
	Twelve Months Ended December 31,	Three Months Ended March 31,	Three Months Ended June 30,	Three Months Ended September 30,	Three Months Ended December 31,	Twelve Months Ended December 31,
Interest Income:						
Mortgage-backed and credit risk transfer securities	596,357	(3,334)	(3,725)	(4,624)	(5,612)	579,062
Other income (loss):						
Gain (loss) on investments, net	(79,430)	(6,054)	569	(412)	(1,841)	(87,168)
Realized and unrealized credit derivative income (loss), net	1,093	17,158	31,763	(28,860)	(24,020)	(2,866)
Net income (loss)	(201,746)	7,770	28,607	(33,896)	(31,473)	(230,738)
Net income (loss) attributable to non-controlling interest	(2,301)	89	328	(388)	(360)	(2,632)
Net income (loss) attributable to Invesco Mortgage Capital, Inc.	(199,445)	7,681	28,279	(33,508)	(31,113)	(228,106)
Net income (loss) attributable to common stockholders	(216,823)	7,681	28,279	(33,508)	(31,113)	(245,484)
Earnings per share:						
Basic	(1.76)	0.06	0.23	(0.27)	(0.25)	(1.99)
Diluted	(1.76)	0.06	0.23	(0.27)	(0.25)	(1.99)
2013						
In thousands	As Reported	Adjustments			As Restated	
	Twelve Months Ended December 31,	Three Months Ended March 31,	Three Months Ended June 30,	Three Months Ended September 30,	Three Months Ended December 31,	Twelve Months Ended December 31,
Interest Income:						
Mortgage-backed and credit risk transfer securities	646,787	—	—	—	—	646,787
Other income (loss):						
Gain (loss) on investments, net	(199,449)	(137)	11,194	(4,282)	9,941	(182,733)
Realized and unrealized credit derivative income (loss), net	1,127	—	—	—	—	1,127
Net income (loss)	143,106	(137)	11,194	(4,282)	9,941	159,822

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Net income (loss) attributable to non-controlling interest	1,486	(1) 117	(45) 110	1,667
Net income (loss) attributable to Invesco Mortgage Capital, Inc.	141,620	(136	) 11,077	(4,237	) 9,831	158,155
Net income (loss) attributable to common stockholders	130,769	(136	) 11,077	(4,237	) 9,831	147,304
Earnings per share:						
Basic	0.99	—	0.08	(0.04	) 0.07	1.11
Diluted	0.99	—	0.07	(0.04	) 0.07	1.11

Overview

We are a Maryland corporation primarily focused on investing in, financing and managing residential and commercial mortgage-backed securities ("MBS") and mortgage loans. We are externally managed and advised by Invesco Advisers, Inc., our Manager, which is an indirect, wholly-owned subsidiary of Invesco Ltd. We elected to be taxed as a real estate investment trust ("REIT") for U.S. federal income tax purposes under the provisions of the Internal Revenue Code of 1986, as amended ("Code"), commencing with our taxable year ended December 31, 2009. To maintain our REIT qualification, we are generally required to distribute at least 90% of our REIT taxable income to our stockholders annually. We operate our business in a manner that permits our exclusion from the definition of "Investment Company" under the 1940 Act.

Our objective is to provide attractive risk-adjusted returns to our investors, primarily through dividends and secondarily through capital appreciation. To achieve this objective, we primarily invest in the following:

Residential mortgage-backed securities ("RMBS") that are guaranteed by a U.S. government agency such as the Government National Mortgage Association or a federally chartered corporation such as the Federal National Mortgage Association ("Fannie Mae") or the Federal Home Loan Mortgage Corporation ("Freddie Mac") (collectively "Agency RMBS");

RMBS that are not guaranteed by a U.S. government agency ("non-Agency RMBS");

Credit risk transfer securities that are unsecured obligations issued by government-sponsored enterprises ("GSE CRT");

Commercial mortgage-backed securities ("CMBS");

Residential and commercial mortgage loans; and

Other real estate-related financing arrangements.

We generally finance our investments through short- and long-term borrowings structured as repurchase agreements and secured loans. We finance our residential loans held-for-investment through asset-backed securities ("ABS") issued by consolidated securitization trusts. We have also financed investments through the issuance of debt and equity and may utilize other forms of financing in the future.

Capital Activities

In September 2014, we completed a public offering of 6,200,000 shares of 7.75% Fixed-to-Floating Series B Cumulative Redeemable Preferred Stock (the "Series B Preferred Stock") at the price of \$25.00 per share. Total proceeds were \$149.9 million, net of issuance costs of \$5.1 million.

On November 4, 2014, we declared a dividend of \$0.5705 per share of Series B Preferred Stock. The dividend was paid on December 29, 2014 to stockholders of record as of the close of business on December 5, 2014.

On December 16, 2014, we declared the following dividends:

a dividend of \$0.45 per share of common stock to be paid on January 27, 2015 to stockholders of record as of the close of business on December 29, 2014;

a dividend of \$0.4844 per share of Series A Preferred Stock to be paid on January 26, 2015 to stockholders of record as of the close of business on January 1, 2015; and

a dividend of \$0.4844 per share of Series B Preferred Stock to be paid on March 27, 2015 to stockholders of record as of the close of business on March 5, 2015.

During the three months ended December 31, 2014, we did not repurchase any shares of our common stock. During the year ended December 31, 2014, we repurchased 1,438,213 shares of our common stock at an average repurchase price of \$14.69 per share for a net cost of \$21.1 million, including acquisition expenses.

Factors Impacting Our Operating Results

Our operating results can be affected by a number of factors and primarily depend on the level of our net interest income and the market value of our assets. The market value of our assets can be impacted by asset spreads and the supply of, and demand for, target assets in which we invest. Our net interest income, which includes the amortization of purchase premiums and accretion of purchase discounts, varies primarily as a result of changes in market interest rates and prepayment speeds, as measured by the constant prepayment rate ("CPR") on our target assets. Interest rates and prepayment speeds vary according to the type of investment, conditions in the financial markets, competition and other factors, none of which can be predicted with any certainty.

Market Conditions

Macroeconomic factors that affect our business include credit spread premiums, market interest rates, Federal Reserve policy initiatives, residential and commercial real estate prices, employment conditions and inflation. After a modest increase in implied interest rate volatility early in the fourth quarter, volatility declined to end the quarter approximately unchanged and significantly lower than at the end of 2013. The yield curve continued to flatten as short maturity interest rates moved modestly higher and long-term rates moved meaningfully lower for both the fourth quarter and for the year.

Domestic economic conditions continue to improve. The November 2014 payroll report released in early December 2014 saw an increase of 321,000 jobs which is the highest of 2014, and the unemployment rate was 5.8% versus 6.7% at the end of 2013. The low interest rate environment, coupled with declining energy prices, should be supportive for U.S. economic growth as policy rates are much lower than that which would be historically indicated by unemployment and inflation indicators alone. Households are once again increasing their debt levels, albeit at a modest rate, which increases their ability to consume goods and services. Inflation data continues to indicate smaller increases than the Federal Reserve's 2% inflation target, with core personal consumption expenditures prices having increased 1.4% year-over-year through November 2014.

Despite apparent improvement in the domestic economy as described above, longer term U.S. Treasury interest rates fell in the fourth quarter of 2014. Global concerns seem to lead the list of factors that can explain the drop in market yields quarter- and year-to-date; namely weaker growth prospects and growing deflationary risks in Europe, declining growth in China, and growing concern over the economies of countries reliant on commodity exports and tensions in the Middle East. Five year government bond yields in some European countries are now negative, which should support the U.S. bond market, keeping yields low. The 10-year U.S. Treasury note yield generally fell throughout 2014 having started slightly above 3% and ending under 2.2%. The interest rate environment has been supportive for the Agency RMBS market despite lower interest rates as the prepayment option embedded in MBS is less onerous given low interest rate volatility. Further, MBS investors are much less concerned over the market impact from Federal Reserve tapering of MBS purchases since that program ended with little noticeable impact. There has been adequate demand from investors and limited supply of new MBS to offset the decline in demand from the Federal Reserve. Agency RMBS outperformed similar term U.S. Treasury notes during 2014 and performed in line for the fourth quarter. With respect to credit assets, CMBS and non-Agency RMBS spreads over comparable term interest rate swaps narrowed over the year but were little changed in the fourth quarter of 2014. Spreads in GSE CRTs issued by Fannie Mae and Freddie Mac widened over the second half of the year after tightening markedly during the first half of 2014. This spread widening had a negative impact on the value of our holdings in that sector but had only a modestly negative impact on our book value because they represent a small fraction of our assets. Wider spreads offered us the opportunity to reinvest portfolio cash flows at attractive levels.

We have reduced the interest rate sensitivity of our investment portfolio, resulting in greater book value stability, but we remain subject to volatility from credit spreads. It is possible that we may realize losses on the sale of assets in future periods and these losses may cause our GAAP earnings to be negative. In addition, as of December 31, 2013 we elected to discontinue hedge accounting for our portfolio of interest rate swaps. As a result of discontinuing hedge accounting, beginning January 1, 2014, changes in the fair value of the interest rate swap agreements are recorded in gain (loss) on derivative instruments, net in our consolidated statements of operations, rather than in accumulated other comprehensive income (loss) ("AOCI"). This change will cause our net income to be more volatile in future periods and could contribute to us recording a net loss in future periods. Refer to Note 8 - "Derivatives and Hedging Activities" of our consolidated financial statements for further information.

The impact of regulatory initiatives on the economy may also affect our business and our financial results. The Dodd-Frank Act, enacted in July 2010, contains numerous provisions affecting the financial and mortgage industries, many of which may have an impact on our operating environment and the target assets in which we invest. Consequently, the Dodd-Frank Act may affect our cost of doing business, may limit our investment opportunities and may affect the competitive balance within our industry and market areas. Under the Dodd-Frank Act, new underwriting requirements for residential mortgage loans have been adopted. The Ability-to-Repay (“ATR”) rule requires lenders to make a reasonable, good-faith determination that the borrower has a reasonable ability to repay the loan, upon its terms. In addition to the ATR rule, the Consumer Financial Protection Bureau adopted a Qualified Mortgage (“QM”) framework that provides certain legal protections to lenders related to residential mortgage loans that meet the QM criteria, which include restrictions on loan features, points and fees and borrower

debt-to-income ratios. While we are not directly subject to compliance with the implementation of rules regarding the origination of residential mortgage loans, the impact of these regulations and others could affect our ability to securitize or invest in newly originated loans in the future.

There have been a number of pending legislative proposals related to the potential wind down or phaseout of the GSEs. In the second quarter of 2014 there was a bi-partisan effort in the U.S. Senate to bring about mortgage finance reform via the Johnson-Crapo bill. The bill did not receive enough votes in Committee to get to the floor for a vote. At this point it seems unlikely there will be material mortgage finance reform legislation in the near term. Moreover, meaningful resurrection of a fully functioning primary market for private label securitizations is unlikely to occur in the near term. We have been successful in participating in securitizations despite the environment, having consolidated in our financial statements five additional prime jumbo securitizations in 2014. We expect to close one additional prime jumbo securitization in the first quarter of 2015. The high credit quality of the loans underlying these securitizations is apparent via strong performance to date.

In addition, the regulatory landscape for our repurchase agreement counterparties continues to evolve following the adoption of new capital rules which generally affects the manner in which banks lend. Regulators are also focused on liquidity requirements which will likely impact how banks fund themselves. While we are not directly subject to compliance with the implementation of rules regarding financial institutions, the effect of these regulations and others could affect our ability to finance our assets in the future.

On September 2, 2014, the Federal Housing Finance Agency ("FHFA"), proposed to revise its regulations governing Federal Home Loan Bank membership to, among other things, exclude captive insurance companies. However, the proposed rules would permit existing captive insurers, such as our captive insurance company subsidiary IAS Services LLC, to remain members for a period of five years following the effective date of the final rules. In addition, the Federal Home Loan Bank of Indianapolis ("FHLBI") would be permitted to allow outstanding advances to IAS Services LLC that were made prior to the effective date of the final rules to honor contractual terms to maturity. Therefore, under the proposed rules, we do not expect there would be any impact to our existing FHLBI borrowings. The rules are subject to change prior to their final adoption. However, if the FHFA's rules are adopted substantially as proposed, we do not expect that the rules would have a material effect on our sources or costs of funding or our results of operations.

Investment Activities

In 2014, we continued to position our investment portfolio to take advantage of compelling opportunities in both mortgage-backed and credit risk transfer securities and newly originated loans against a backdrop of improving housing and commercial real estate markets. During 2013 and 2014, we purchased subordinate interests in ten residential loan securitizations that are consolidated in our financial statements. We continue to invest in GSE CRT transactions issued by both Fannie Mae and Freddie Mac and hold securities with a fair value of \$625.4 million as of December 31, 2014. In addition, we committed to purchase securities in one additional residential loan securitizations and anticipate this securitization will close in the first quarter of 2015. Since the inception of our commercial real estate lending program in 2013, we have invested in a first mortgage loan and six subordinated interests.

To provide economic stimulus, the Federal Reserve had been purchasing Agency RMBS through its QE program, which had the effect of holding mortgage interest rates at low levels. In 2014, the Federal Reserve ended new purchases under their QE program of U.S. Treasuries and Agency RMBS, but due to reinvestment of paydowns, they have continued buying a large percentage of issuance, which has also declined. The interest rate and credit spread premium environment and our views on how they will change have a significant impact on our portfolio decisions. We have continued to reduce our lower coupon 30 year Agency RMBS positions by nearly 29% from \$6.7 billion at December 31, 2013 to \$4.8 billion at December 31, 2014. We reinvested proceeds of sales and prepayments in part into agency hybrid ARM assets. We have also reduced our repurchase agreement debt from 5.8 times equity at December 31, 2013 to 5.4 times equity at December 31, 2014. In addition, we decreased the notional amount of our interest rate swaps from \$12.8 billion at December 31, 2013 to \$10.6 billion at December 31, 2014, or by 17.6%. As a result of all of these actions, we believe we have repositioned us to benefit from an improved residential and commercial real estate market and reduced our overall sensitivity to interest rates.

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The table below shows the allocation of our equity as of December 31, 2014 and 2013:

	As of December 31,		
	2014	2013	
Agency RMBS	36.4	% 49.2	%
Non-Agency RMBS	32.3	% 35.6	%
GSE CRT	6.7	% 2.4	%
CMBS	32.1	% 24.4	%
Residential Loans, Held-for-Investment	0.3	% 0.3	%
Commercial Loans, Held-for-Investment	5.6	% 2.7	%
Other	(13.4	)% (14.6)%
Total	100.0	% 100.0	%

We have reduced our overall sensitivity to interest rates by reducing the size of our Agency MBS portfolio. Within the remaining Agency MBS portfolio we have continued to hold certain 30 year fixed-rate Agency RMBS securities that offer higher coupons and which we expect to prepay relatively slowly based on their seasoning and collateral attributes. Our sales of 30 year fixed-rate Agency RMBS were primarily in 3% and 3.5% coupons or relatively newer vintage that have not experienced a high prepayment environment. Therefore, the average coupon of our 30 year fixed-rate Agency RMBS continued to increase to 4.29% at December 31, 2014, compared to 4.11% at December 31, 2013. In addition, we hold 15 year fixed-rate Agency RMBS securities, Agency Hybrid ARM RMBS and Agency ARM RMBS that we believe have lower durations and better cash flow certainty relative to current 30 year fixed-rate Agency RMBS. Further, we own Agency collateralized mortgage obligations ("CMOs"), some of which are interest-only securities.

The table below shows the breakdown of our investment portfolio as of December 31, 2014 and 2013:

\$ in thousands	As of December 31,	
	2014	2013
Agency RMBS:		
30 year fixed-rate, at fair value	4,790,293	6,702,153
15 year fixed-rate, at fair value	1,327,101	1,744,281
Hybrid ARM, at fair value	2,976,918	1,770,558
ARM, at fair value	546,782	253,282
Agency CMO, at fair value	450,895	474,514
Non-Agency RMBS, at fair value	3,061,647	3,607,328
GSE CRT, at fair value	625,424	167,981
CMBS, at fair value	3,469,835	2,628,560
Residential loans, at amortized cost	3,365,003	1,810,262
Commercial loans, at amortized cost	145,756	64,599
Total Investment portfolio	20,759,654	19,223,518

Our portfolio of investments that have credit exposure include non-Agency RMBS, GSE CRTs, CMBS and residential and commercial real estate loans. We use our proprietary models to perform a detailed review of each investment which often includes loan level analysis of expected performance. We do not place any reliance on ratings by various agencies as we believe our models more accurately evaluate the performance based on our assumptions about market conditions and are updated more frequently than agency ratings. As shown in the table above, we have increased our exposure to credit assets as we believe the improving economy will provide better risk-adjusted returns for this asset class while having lower interest rate exposure relative to Agency MBS.

With respect to our non-Agency RMBS portfolio, we primarily invest in RMBS collateralized by prime and Alt-A loans. In addition, we have invested in re-securitizations of real estate mortgage investment conduit ("Re-REMIC") RMBS and reperforming mortgage loans that we believe provide attractive risk adjusted returns. We also invest in GSE CRTs. Based on our view of the improving housing market and relative value opportunities, we increased holdings in GSE CRTs as paydowns from principal repayments and limited dispositions reduced our non-Agency RMBS holdings during 2014.

Our CMBS portfolio generally consists of assets originated before 2007, assets originated after 2010 (“CMBS 2.0”) and multi-family CMBS issued by Freddie Mac under their “K” program. Over the past twelve months we have primarily invested in CMBS 2.0. Since December 31, 2013, we grew our CMBS portfolio \$841.3 million and grew the allocation of our CMBS holdings in our MBS and GSE CRT portfolio to approximately 20.1% as of December 31, 2014 from approximately 15.2% as of December 31, 2013.

During 2013 and 2014, we expanded our portfolio of credit assets by adding subordinate securities backed by residential loans. The residential loans collateralizing these securities consist of prime jumbo mortgages that were generally originated in 2011 or later. We believe these loans have high credit quality based on their risk characteristics, including but not limited to high credit scores and low loan-to-value ratios based on current home values. For further details on the loan portfolio, refer to Note 3 - "Variable Interest Entities" of our consolidated financial statements.

We also added commercial real estate loans during 2013 and 2014. Our commercial real estate loan portfolio includes a first mortgage loan and subordinate interests we purchased or originated. For further details on the loan portfolio, refer to Note 5 - "Commercial Loans Held-for-Investment" of our consolidated financial statements.

Portfolio Characteristics

The table below represents the vintage of our MBS and GSE CRT credit assets as of December 31, 2014 as a percentage of the fair value:

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Total
Re-REMIC ⁽¹⁾	— %	— %	— %	— %	0.3 %	— %	0.6 %	3.7 %	18.0 %	8.0 %	0.5 %	1.6 %	32.7 %
Prime	0.4 %	1.3 %	4.9 %	3.7 %	9.7 %	2.1 %	— %	— %	0.2 %	— %	6.9 %	2.5 %	31.7 %
Alt-A	— %	0.5 %	8.6 %	6.0 %	7.6 %	— %	— %	— %	— %	— %	— %	— %	22.7 %
Subprime/reperforming	— %	— %	— %	0.1 %	0.5 %	— %	— %	— %	— %	— %	1.6 %	10.7 %	12.9 %
Total Non-Agency	0.4 %	1.8 %	13.5 %	9.8 %	18.1 %	2.1 %	0.6 %	3.7 %	18.2 %	8.0 %	9.0 %	14.8 %	100.0 %
GSE CRT	— %	— %	— %	— %	— %	— %	— %	— %	— %	— %	41.5 %	58.5 %	100.0 %
CMBS	— %	— %	8.8 %	9.8 %	0.6 %	— %	— %	7.5 %	21.6 %	11.8 %	13.3 %	26.6 %	100.0 %

For Re-REMICs, the table reflects the year in which the resecuritizations were issued. The vintage distribution of (1) the securities that collateralize our Re-REMIC investments is 11.0% for 2005, 34.2% for 2006 and 54.3% for 2007, 0.2% for 2009 and 0.3% for 2010.

The tables below represent the geographic concentration of the underlying collateral for our MBS and GSE CRT portfolio as of December 31, 2014:

Non-Agency RMBS State	Percentage	GSE CRT State	Percentage	CMBS State	Percentage
California	42.7	California	23.1	California	15.9
Florida	7.1	Texas	5.4	New York	13.1
New York	6.7	Virginia	4.5	Texas	9.2
Virginia	3.8	Illinois	4.1	Florida	5.8
Maryland	3.6	New York	3.9	Illinois	4.8
New Jersey	3.6	Massachusetts	3.8	Pennsylvania	4.1
Washington	2.8	Colorado	3.4	New Jersey	3.3
Illinois	2.7	Florida	3.3	Ohio	3.0
Arizona	2.1	Washington	3.3	Virginia	2.7
Massachusetts	2.1	New Jersey	3.2	Maryland	2.5
Other	22.8	Other	42.0	Other	35.6
Total	100.0		100.0	Total	100.0

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The following table summarizes residential loans held-for-investment at December 31, 2014 by year of origination.

\$ in thousands	2014	2013	2012	2011	2010	2009	2008	2007	Total
Portfolio Characteristics:									
Number of Loans	622	2,746	716	99	27	7	18	18	4,253
Current Principal Balance	465,218	2,092,439	613,351	100,761	25,910	3,006	17,632	13,875	3,332,192
Net Weighted Average Coupon Rate	3.73	% 3.53	% 3.32	% 3.40	% 3.77	% 3.71	% 5.03	% 4.74	% 3.53
Weighted Average Maturity (years)	29.32	28.47	27.96	26.42	25.90	24.41	23.58	22.51	28.36
Current Performance:									
Current	463,704	2,089,570	612,369	100,761	25,910	3,006	17,632	13,875	3,326,827
30 Days Delinquent	1,514	2,869	982	—	—	—	—	—	5,365
60 Days Delinquent	—	—	—	—	—	—	—	—	—
90+ Days Delinquent	—	—	—	—	—	—	—	—	—
Bankruptcy/Foreclosure	—	—	—	—	—	—	—	—	—
Total	465,218	2,092,439	613,351	100,761	25,910	3,006	17,632	13,875	3,332,192

The following table summarizes the geographic concentrations of residential loans held-for-investment at December 31, 2014 based on principal balance outstanding.

State	Percent
California	53.2 %
New York	6.0 %
Massachusetts	4.9 %
Illinois	4.3 %
Maryland	3.0 %
Other states (none greater than 4%)	28.6 %
Total	100.0 %

Financing and Other Liabilities.

We enter into repurchase agreements to finance the majority of our target assets. These agreements are secured by our Agency RMBS, non-Agency RMBS, GSE CRTs and CMBS. In addition, these agreements are generally settled on a short-term basis, usually ranging from one to twelve months, and bear interest at rates that have historically moved in close relationship to the London Interbank Offer Rate (“LIBOR”). At each settlement date, we refinance each repurchase agreement at the market interest rate at that time. As of December 31, 2014, we had entered into repurchase agreements totaling \$13.6 billion (2013: \$15.5 billion). The decrease in our repurchase agreement balance was due to a reallocation of our investment portfolio and replacing some of our repurchase borrowings with secured loans, as discussed below.

In March 2014, our wholly-owned subsidiary, IAS Services LLC, became a member of the FHLBI. As a member of the FHLBI, IAS Services LLC has borrowed funds from the FHLBI in the form of secured advances. As of December 31, 2014, IAS Services LLC had \$1.25 billion in outstanding long-term secured advances and is approved for additional available uncommitted credit for borrowing of an amount up to \$2.5 billion. Available uncommitted credit may be adjusted at the sole discretion of the FHLBI. For the year ended December 31, 2014, IAS Services LLC had average borrowings of \$707.8 million with a weighted average borrowing rate of 0.36%.

We have also committed to invest up to \$124.2 million in unconsolidated ventures that are sponsored by an affiliate of our Manager. As of December 31, 2014, \$93.3 million of our commitment to these unconsolidated ventures has been called. We are committed to fund an additional \$31.0 million in capital to cover future expenses should they occur. We record a liability for mortgage-backed and credit risk transfer securities purchased, for which settlement has not taken place, as an investment related payable. As of December 31, 2014 and 2013, we had investment related payables of \$17.0 million, and \$28.8 million, respectively, of which no items were outstanding greater than thirty days. The change in balance was due to a decrease in unsettled MBS purchases and unsettled repurchase borrowings as of

December 31, 2014. We record a receivable for mortgage-backed and credit risk transfer securities sold for which settlement has not taken place as an investment related receivable. As of December 31, 2014 and 2013, we had investment related receivables of \$38.7 million and \$515.4 million, respectively, of which no items were outstanding greater than thirty days. The change in balance was due to a decrease in unsettled sold MBS as of December 31, 2014.

Hedging Instruments. We generally hedge as much of our interest rate and foreign exchange risk as we deem prudent in light of market conditions. No assurance can be given that our hedging activities will have the desired beneficial impact on our results of operations or financial condition. Our investment policies do not contain specific requirements as to the percentages or amount of risk that we are required to hedge.

Hedging may fail to protect or could adversely affect us because, among other things:

- available interest rate hedging may not correspond directly with the interest rate risk for which protection is sought;
- the duration of the hedge may not match the duration of the related liability;
- the party owing money in the hedging transaction may default on its obligation to pay;
- the credit quality of the party owing money on the hedge may be downgraded to such an extent that it impairs our ability to sell or assign our side of the hedging transaction; and
- the value of derivatives used for hedging may be adjusted from time-to-time in accordance with accounting rules to reflect changes in fair value. Downward adjustments or mark-to-market losses would reduce our stockholders' equity.

On December 31, 2013, we discontinued hedge accounting for our interest rate swap agreements by de-designating the interest rate swaps as cash flow hedges. No interest rate swaps were terminated in conjunction with this action, and our risk management and hedging practices are not impacted. However, our accounting for these transactions changed prospectively. All of our interest rate swaps had previously been accounted for as cash flow hedges under the applicable guidance. As a result of discontinuing hedge accounting, beginning January 1, 2014, changes in the fair value of the interest rate swap agreements are recorded in gain (loss) on derivative instruments, net in our consolidated statements of operations, rather than in AOCI. Also, net interest paid or received under the interest rate swaps, which up through December 31, 2013 was recognized in interest expense, repurchase agreements is recognized in gain (loss) on derivatives, net in our consolidated statements of operations. Refer to Note 8 - "Derivatives and Hedging Activities" of our consolidated financial statements for further information.

As of December 31, 2014, we have entered into interest rate swap agreements designed to mitigate the effects of increases in interest rates under a portion of our borrowings. These swap agreements provide for fixed interest rates indexed off of one-month LIBOR and effectively fix the floating interest rates on \$10.6 billion (2013: \$12.8 billion) of borrowings. As of December 31, 2014, included in this amount we had forward starting swaps with a total notional amount of \$1.2 billion, with starting dates ranging from February 24, 2015 to February 5, 2016. The increase in the amount of interest rate swaps was due to our view of interest rate risk and the expected duration of our investment portfolio and liabilities.

As of December 31, 2014, we held \$1.1 billion (2013: \$1.2 billion) in interest rate swaptions as an asset with a fair value of \$322,000 (2013: \$2.4 million). During the year ended December 31, 2014, interest rate swaptions expired unexercised with a notional amount of approximately \$1.2 billion (2013: \$4.2 billion sold) and realized loss of \$23.3 million (2013: \$56.3 million gain). We purchase interest rate swaptions to reduce the impact that interest rate volatility has on our portfolio. The change in the notional amount of swaptions held was due to our views on the potential for change in volatility.

As of December 31, 2014, we held \$127.4 million (2013: \$100.0 million) in notional amount of short U.S. Treasury futures as an asset with fair value of \$89,000 (2013: \$2.6 million). During the year ended December 31, 2014, we sold U.S. Treasury futures contracts of \$1.3 billion (2013: \$100.0 million) in notional amount and realized a net loss of \$11.5 million (2013: \$2.4 million). We invest in U.S. Treasury futures to help mitigate the potential impact of changes in interest rates on the performance of our portfolio.

As of December 31, 2014, we held \$198.0 million (2013: \$0) in notional amount of to-be-announced securities ("TBA") as a liability with a fair value of \$558,000 (2013: \$0). During the year ended December 31, 2014, \$3.1 billion (2013: \$0) notional TBA were settled with realized net loss of \$10.8 million (2013: \$0). TBAs are contracts for which we agree to purchase or deliver in the future Agency RMBS with certain principal and interest terms. We purchase or sell certain TBAs to help mitigate the potential impact of changes in interest rates on the performance of our portfolio.

As of December 31, 2014, we held \$35.7 million (2013: \$0) in notional amount of currency forward contracts as an asset with a fair value of \$599,000 (2013: \$0). During the year ended December 31, 2014, we settled currency forward contracts of \$67.7 million (2013: \$0) in notional amount and realized a net gain of \$2.2 million (2013: \$0). We use currency forward contracts to help mitigate the potential impact of changes in foreign currency exchange rates on our

investments denominated in foreign currencies.

Book Value per Share

Our book value per common share was \$18.82, \$17.97 and \$20.83 as of December 31, 2014, 2013 and 2012, respectively, on a fully diluted basis, after giving effect to our units of limited partnership interest in our Operating Partnership, which may be converted to common shares at our sole election. The change in our book value in 2014 was primarily due to the change in valuation of our investment portfolio and our interest rate hedges that through December 31, 2013 were recorded in Other Comprehensive Income (Loss) on our consolidated balance sheets and subsequently in gain (loss) on derivative instruments, net on our consolidated statements of operations. Refer to Note 4 – “Mortgage-Backed and Credit Risk Transfer Securities” of our consolidated financial statements for the impact of changes in accumulated other comprehensive income on our investment portfolio. The values of our assets and liabilities change daily based on market conditions. Refer to Item 7A. “Quantitative and Qualitative Disclosures About Market Risk” for interest rate risk and its impact on fair value.

Critical Accounting Policies (As Restated)

Our consolidated financial statements are prepared in accordance with U.S. GAAP, which requires the use of estimates and assumptions that involve the exercise of judgment and use of assumptions as to future uncertainties. Accounting estimates and assumptions discussed in this section are those that we consider to be the most critical to an understanding of our financial statements because they involve significant judgments and uncertainties. All of these estimates reflect our best judgment about current, and for some estimates, future economic and market conditions and their effects based on information available as of the date of these financial statements. If conditions change from those expected, it is possible that the judgments and estimates described below could change, which may result in a change in valuation of our investment portfolio, future impairments of our MBS and GSE CRTs, change in our interest income recognition, allowance for loan losses, inclusion of the change in derivative values in our income rather than other comprehensive income and a change in our tax liability among other effects.

Mortgage-Backed and Credit Risk Transfer Securities. We record our MBS except Agency MBS IOs as available-for-sale and report them at fair value. Agency MBS IOs and GSE CRTs are hybrid financial instruments reported at fair value. Fair value is determined by obtaining valuations from an independent source. If the fair value of a security is not available from a third-party pricing service, we may estimate the fair value of the security using a variety of methods including other pricing services, discounted cash flow analysis, matrix pricing, option adjusted spread models and other fundamental analysis of observable market factors. It is possible that changes in these inputs could change the valuation estimate and lead to impairment of our MBS and GSE CRT portfolio. Further information is provided in Note 2 - "Summary of Significant Accounting Policies" and Note 4 - "Mortgage-Backed and Credit Risk Transfer Securities."

Other-than-temporary Impairment. We regularly review our available-for-sale portfolio for other-than-temporary impairment. This determination involves both qualitative and quantitative data. It is possible that estimates may be incorrect, economic conditions may change or we may be forced to sell the investment before recovery of our amortized cost. Further information is provided in Note 2 - "Summary of Significant Accounting Policies" and Note 4 - "Mortgage-Backed and Credit Risk Transfer Securities."

Residential and Commercial Loans. Residential loans held-for-investment are carried at unpaid principal balance net of any allowance for loan losses. Commercial loans held-for-investment are carried at cost net of any allowance for loan losses. An allowance for loan losses is established based on credit losses inherent in the portfolio. These estimates require consideration of various observable inputs including, but not limited to, historical loss experience, delinquency status, borrower credit scores, geographic concentrations and loan-to-value ratios, and are adjusted for current economic conditions as deemed necessary by management. In addition, since we have not incurred any direct losses on our portfolio, we use national historical credit performance information from a third party vendor to assist in our analysis. Changes in our estimates can significantly impact the allowance for loan losses and provision expense. It is also possible that we will experience credit losses that are different from our current estimates or that the timing of those losses may differ from our estimates. Further information on the allowance for loan losses is provided in Note 2 - "Summary of Significant Accounting Policies."

Interest Income Recognition. Interest income on MBS is accrued based on the outstanding principal balance of the securities and their contractual terms. Premiums or discounts are amortized or accreted into interest income over the life of the investment using the effective interest method. Interest income on our non-Agency RMBS (and other

prepayable mortgage-backed securities where we may not recover substantially all of our initial investment) is based on estimated cash flows. Management estimates, at the time of purchase, the future expected cash flows and determines the effective interest rate based on these estimated cash flows and our purchase price. Over the life of the investments, these estimated cash flows are updated and a revised yield is computed based on the current amortized cost of the investment. In estimating these cash flows, there are a number of assumptions that are subject to uncertainties and contingencies, including the rate and timing of principal payments (prepayments, repurchases, defaults and liquidations), the pass through or coupon rate and interest rate fluctuations. These uncertainties and contingencies are difficult to predict and are subject to future events that may impact management's estimates and interest income. Interest income recognition on our Agency RMBS that cannot be prepaid in such a way that we would not recover substantially all of our initial investment is based on contractual cash flows. We do not estimate prepayments in

applying the effective interest method. Interest income from our residential loans is recognized on an accrual basis with the related premiums being amortized into interest income using the effective interest method over the weighted average life of these loans. As needed, these estimated cash flows are updated and a revised yield is computed based on the current amortized cost of the investment. Interest income from our commercial loans is recognized when earned and deemed collectible or until a loan becomes past due based on the terms of the loan agreement.

Accounting for Derivative Financial Instruments. We use derivatives to manage interest rate and currency exchange risk. The Company records all derivatives on its consolidated balance sheets at fair value. Effective December 31, 2013, the Company voluntarily discontinued hedge accounting for its interest rate swap agreements by de-designating the interest rate swaps as cash flow hedges. As a result of discontinuing hedge accounting, changes in the fair value of the interest rate swaps are recorded in gain (loss) on derivative instruments, net in the Company's consolidated statement of operations, rather than in accumulated other comprehensive income (loss). Further information including information on our discontinued use of hedge accounting effective on December 31, 2013 is provided in Note 8 - "Derivatives and Hedging Activities."

Income Taxes. We have elected to be taxed as a REIT. Accordingly, we generally will not be subject to U.S. federal and applicable state and local corporate income tax to the extent that we make qualifying distributions and provided we satisfy on a continuing basis, through actual investment and operating results, the REIT requirements including certain asset, income, distribution and stock ownership tests. The REIT qualifications rules are complex and failure to apply them correctly could subject us to U.S. federal, state and local income taxes.

Expected Impact of New Authoritative Guidance on Future Financial Information

In April 2014, the Financial Accounting Standards Board ("FASB") issued updated guidance that changes the requirements for reporting discontinued operations. Under the new guidance, a discontinued operation is defined as a disposal of a component of an entity or group of components of an entity that is disposed of or is classified as held for sale and represents a strategic shift that has (or will have) a major effect on an entity's operations and financial results. The guidance is effective prospectively as of the first quarter of 2015, with early adoption permitted for new disposals or new classifications as held-for-sale. The guidance is effective for annual periods beginning on or after December 15, 2014 and interim periods within annual periods beginning on or after December 15, 2015. Early adoption is permitted but only for disposals (or classifications as held for sale) that have not been reported in financial statements previously issued or available for issue. The new guidance is not expected to have a material impact on our consolidated financial statements.

In June 2014, the FASB issued guidance that changes the accounting for repurchase-to-maturity transactions and repurchase financing arrangements. The new guidance aligns the accounting for repurchase-to-maturity transactions and repurchase agreements executed as a repurchase financing with the accounting for other typical repurchase agreements. These transactions would all be accounted for as secured borrowings. The guidance eliminates sale accounting for repurchase-to-maturity transactions and supersedes the guidance under which a transfer of a financial asset and a contemporaneous repurchase financing could be accounted for on a combined basis as a forward agreement, which has resulted in outcomes referred to as off-balance-sheet accounting. In addition, the guidance requires additional disclosures. The guidance is effective for the first interim or annual period beginning after December 15, 2014. Earlier application for a public company is prohibited. Certain disclosures under this guidance do not take effect until the first period beginning after March 15, 2015. The new guidance is not expected to have a material impact on our consolidated financial statements.

In August 2014, the FASB issued guidance that provides a measurement alternative for an entity that consolidates a collateralized financing entity ("CFE") and has elected the fair value option for the financial assets and financial liabilities of such CFE. If the CFE has elected the fair value option, the reporting entity would measure both the financial assets and the financial liabilities of the CFE by using the more observable of the fair value of the financial assets or the fair value of the financial liabilities. The guidance will require certain recurring disclosures and is effective for annual periods beginning on or after December 15, 2015, with early adoption permitted. We have not elected the fair value option for reporting the financial assets and financial liabilities of the CFEs that we consolidate as of December 31, 2014. Accordingly, the new guidance is not expected to have an impact on our consolidated financial statements.

In January 2015, the FASB issued guidance to simplify income statement presentation by eliminating the concept of extraordinary items. U.S. GAAP currently requires that a company separately classify, disclose and present extraordinary events and transactions. The guidance eliminates the concept of extraordinary items from U.S. GAAP. The existing requirement to separately present items that are of an unusual nature or occur infrequently on a pre-tax basis within income from continuing operations has been retained. The new guidance also requires similar separate presentation of items that are both unusual and infrequent. The standard is effective for periods beginning after December 15, 2015. Early adoption is permitted, but only as of the beginning of the fiscal year of adoption. Upon adoption, a reporting entity may elect prospective or retrospective application. If adopted prospectively, both the nature and amount of any subsequent adjustments to previously reported extraordinary items must be disclosed. The new guidance is not expected to have a material impact on our consolidated financial statements.

Results of Operations (As Restated)

The table below presents certain information from our consolidated statements of operations for the years ended December 31, 2014, 2013 and 2012.

In thousands except share amounts	Years Ended December 31,		
	2014 (As Restated)	2013 (As Restated)	2012
Interest Income			
Mortgage-backed and credit risk transfer securities	579,062	646,787	566,830
Residential loans	88,073	34,122	—
Commercial loans	9,508	1,451	—
Total interest income	676,643	682,360	566,830
Interest Expense			
Repurchase agreements	188,699	287,547	237,405
Secured loans	2,576	—	—
Exchangeable senior notes	22,461	18,023	—
Asset-backed securities	68,159	26,682	—
Total interest expense	281,895	332,252	237,405
Net interest income	394,748	350,108	329,425
(Reduction in) provision for loan losses	(142	) 884	—
Net interest income after provision for loan losses	394,890	349,224	329,425
Other income (loss)			
Gain (loss) on investments, net	(87,168	) (182,733	) 46,989
Equity in earnings of unconsolidated ventures	6,786	5,345	7,169
Gain (loss) on derivative instruments, net	(487,469	) 40,003	(4,232
Realized and unrealized credit derivative income (loss), net	(2,866	) 1,127	3,115
Other investment income (loss), net	(2,045) —	—
Total other income (loss)	(572,762	) (136,258	) 53,041
Expenses			
Management fee — related party	37,599	42,639	35,658
General and administrative	15,267	10,505	4,026
Total expenses	52,866	53,144	39,684
Net income (loss)	(230,738	) 159,822	342,782
Net income (loss) attributable to non-controlling interest	(2,632	) 1,667	4,108
Net income (loss) attributable to Invesco Mortgage Capital Inc.	(228,106	) 158,155	338,674
Dividends to preferred stockholders	17,378	10,851	5,395
Net income (loss) attributable to common stockholders	(245,484	) 147,304	333,279
Earnings per share:			
Net income (loss) attributable to common stockholders			
Basic	(1.99	) 1.11	2.88
Diluted	(1.99	) 1.11	2.88
Weighted average number of shares of common stock:			
Basic	123,104,934	132,714,012	115,558,668
Diluted	124,529,934	134,173,691	117,012,500

Net Income Summary (As Restated)

For the year ended December 31, 2014, our net loss attributable to common stockholders was \$245.5 million (2013: \$147.3 million income; 2012: \$333.3 million income), or \$1.99 (2013: \$1.11 income; 2012: \$2.88 income) basic and diluted net loss per average share available to common stockholders.

The change in net loss attributable to common stockholders for the year ended December 31, 2014 versus net income attributable to common stockholders for the year ended December 31, 2013 is primarily attributable to the de-designation of interest rate swaps and realized and unrealized losses on derivative contracts.

As a result of discontinuing hedge accounting, beginning January 1, 2014, changes in the fair value of the interest rate swap agreements are recorded in gain (loss) on derivative instruments, net in our consolidated statements of operations, rather than in AOCI. For the year ended December 31, 2014, we recognized unrealized losses for the change in fair value of our interest rates swaps of \$223.9 million. In addition, during the year ended December 31, 2014, we recognized amortization of deferred swap losses from de-designation previously recognized in other comprehensive income of \$85.2 million.

The decrease to net income attributable to common stockholders for the year ended December 31, 2013 versus 2012 is primarily attributable to the sale of MBS at a loss during 2013. During 2013, interest rates on mortgage loans increased resulting in a decline in the value of certain MBS we owned. In response to the changing interest rate environment, we sold certain MBS realizing a net loss of \$79.4 million and invested the proceeds in other target assets.

Non-GAAP Financial Measures (As Restated)

We are presenting the following non-GAAP financial measures: core earnings (and by calculation, core earnings per share), effective interest income (and by calculation, effective yield), effective interest expense (and by calculation, effective cost of funds), effective net interest income (and by calculation, effective interest rate margin) and repurchase agreement debt-to-equity ratio. Our management uses these non-GAAP financial measures in our internal analysis of results and believes these measures are useful to investors for the reasons explained below. The most directly comparable U.S. GAAP measures are net income attributable to common stockholders (and by calculation, basic earnings (loss) per common share), total interest income (and by calculation, yield), total interest expense (and by calculation, cost of funds), net interest income (and by calculation, net interest rate margin) and total debt-to-equity ratio.

These non-GAAP financial measures should not be considered as substitutes for any measures derived in accordance with U.S. GAAP and may not be comparable to other similarly titled measures of other companies. An analysis of any non-GAAP financial measure should be made in conjunction with results presented in accordance with U.S. GAAP. Additional reconciling items may be added in the future to these non-GAAP measures if deemed appropriate.

Core Earnings

We calculate core earnings as U.S. GAAP net income (loss) attributable to common stockholders adjusted for (gain) loss on investments, net; realized (gain) loss on derivative instruments, net (excluding contractual net interest on interest rate swaps); unrealized (gain) loss on derivative instruments, net; realized and unrealized change in fair value of GSE CRT credit derivative income (loss), net; (gain) loss on foreign currency transactions, net; amortization of net deferred swap losses on de-designation; and an adjustment attributable to non-controlling interest. We record changes in the valuation of our mortgage-backed securities and the valuation assigned to the debt host contract associated with our GSE CRTs in other comprehensive income on our consolidated balance sheets. We believe the presentation of core earnings provides a consistent measure of operating performance by excluding the impact of gains and losses described above from operating results.

We believe that providing transparency into core earnings enables our investors to consistently measure, evaluate and compare our operating performance to that of our peers over multiple reporting periods. However, we caution that core earnings should not be considered as an alternative to net income (determined in accordance with U.S. GAAP), or as an indication of our cash flow from operating activities (determined in accordance with U.S. GAAP), a measure of our liquidity, or as an indication of amounts available to fund our cash needs, including our ability to make cash distributions.

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The table below provides a reconciliation of U.S. GAAP net income (loss) attributable to common stockholders to core earnings for the following periods:

\$ in thousands, except per share data	Years Ended December 31,		
	2014 (As Restated)	2013 (As Restated)	2012
Net income (loss) attributable to common stockholders	(245,484)	147,304	333,279
Adjustments:			
(Gain) loss on investments, net	87,168	182,733	(46,989)
Realized (gain) loss on derivative instruments, net (excluding contractual net interest on interest rate swaps of \$199,783, \$0, and \$0, respectively)	72,187	(53,926)	—
Unrealized (gain) loss on derivative instruments, net	215,499	13,923	4,232
Realized and unrealized change in fair value of GSE CRT credit derivative income (loss), net	21,495	—	—
Loss (gain) on foreign currency transactions, net	2,746	—	—
Amortization of deferred swap losses on de-designation	85,176	—	—
Subtotal	484,271	142,730	(42,757)
Adjustment attributable to non-controlling interest	(5,532)	(1,559)	520
Core earnings	233,255	288,475	291,042
Basic earnings (loss) per common share	(1.99)	1.11	2.88
Core earnings per share attributable to common stockholders	1.89	2.17	2.52

Effective Interest Income / Effective Interest Expense / Effective Cost of Funds / Effective Net Interest Income / Effective Interest Rate Margin

We calculate effective interest income (and by calculation, effective yield) as U.S. GAAP total interest income adjusted for GSE CRT embedded derivative coupon interest that is recorded in realized and unrealized credit derivative income (loss), net. We add back GSE CRT embedded derivative coupon interest to our total interest income because we consider GSE CRT embedded derivative coupon interest a current component of our total interest income. We calculate effective interest expense (and by calculation, effective cost of funds) as U.S. GAAP total interest expense adjusted for net interest paid on our interest rate swaps that is recorded in gain (loss) on derivative instruments and the reclassification of amortization of net deferred swap losses on de-designated interest rate swaps that is being amortized into interest expense over the remaining lives of the swaps. We view our interest rate swaps as an economic hedge against increases in future market interest rates on our floating rate borrowings. We add back the net payments we make on our interest rate swap agreements to our total U.S. GAAP interest expense because we use interest rate swaps to add stability to interest expense. We subtract amortization of net deferred losses on de-designated interest rate swaps because we do not consider the amortization a current component of our borrowing costs.

We calculate effective net interest income (and by calculation, effective interest rate margin) as U.S. GAAP net interest income adjusted for net interest paid on our interest rate swaps that is recorded in gain (loss) on derivative instruments, the reclassification of amortization of net deferred losses on de-designated interest rate swaps that is being amortized into repurchase agreements interest expense over the remaining lives of the swaps and GSE CRT embedded derivative coupon interest that is recorded in realized and unrealized credit derivative income (loss), net. We believe the presentation of effective interest income, effective yield, effective interest expense, effective cost of funds, effective net interest income and effective interest rate margin measures, when considered together with U.S. GAAP financial measures, provide information that is useful to investors in understanding our borrowing costs and operating performance.

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The following table reconciles total interest income to effective interest income and yield to effective yield for the following periods:

\$ in thousands	Years Ended December 31, 2014 (As Restated)			2013			2012		
	Reconciliation	Yield/Effective Yield		Reconciliation	Yield/Effective Yield		Reconciliation	Yield/Effective Yield	
Total interest income	676,643	3.41	%	682,360	3.32	%	566,830	3.47	%
Add: GSE CRT embedded derivative coupon interest recorded as realized and unrealized credit derivative income (loss), net	17,536	0.09	%	—	—	%	—	—	%
Effective interest income	694,179	3.50	%	682,360	3.32	%	566,830	3.47	%

The following table reconciles total interest expense to effective interest expense and cost of funds to effective cost of funds for the following periods:

\$ in thousands	Years Ended December 31, 2014			2013			2012		
	Reconciliation	Cost of Funds / Effective Cost of Funds		Reconciliation	Cost of Funds / Effective Cost of Funds		Reconciliation	Cost of Funds / Effective Cost of Funds	
Total interest expense	281,895	1.61	%	332,252	1.84	%	237,405	1.68	%
Less: Amortization of net deferred swap losses on de-designation	(85,176)	(0.48)	%	—	—	%	—	—	%
Add: Net interest paid - interest rate swaps	199,783	1.14	%	—	—	%	—	—	%
Effective interest expense	396,502	2.27	%	332,252	1.84	%	237,405	1.68	%

The following table reconciles net interest income to effective net interest income and net interest rate margin to effective interest rate margin for the following periods:

\$ in thousands	Years Ended December 31, 2014 (As Restated)			2013			2012		
	Reconciliation	Net Interest Rate Margin / Effective Interest Rate Margin		Reconciliation	Net Interest Rate Margin / Effective Interest Rate Margin		Reconciliation	Net Interest Rate Margin / Effective Interest Rate Margin	
Net interest income	394,748	1.80	%	350,108	1.48	%	329,425	1.79	%
Add: Amortization of deferred swap losses from de-designation	85,176	0.48	%	—	—	%	—	—	%
Add: GSE CRT embedded derivative coupon interest recorded as realized and unrealized credit derivative income (loss), net	17,536	0.09	%	—	—	%	—	—	%

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Less: Net interest paid - interest rate swaps	(199,783)	(1.14)%	—	—	—	—	%	
Effective net interest income	297,677		1.23	%	350,108	1.48	%	329,425	1.79	%

Repurchase Agreement Debt-to-Equity Ratio

The tables below show the allocation of our equity to our targeted assets, our total debt-to-equity ratio, and our repurchase agreement debt-to-equity ratio as of December 31, 2014 and December 31, 2013. The mortgage REIT industry primarily uses repurchase agreements, which typically mature within one year, to finance investments. Improving our balance sheet by diversifying our liabilities away from repurchase agreements has been a focus of management over the past two years. Since

we began using other longer-term means of financing our investments, such as our exchangeable senior notes, asset-backed securities issued by securitization trusts, and secured loans, we have reduced our reliance on repurchase agreements. We believe presenting our repurchase agreement debt-to-equity ratio, a non-GAAP financial measure of leverage, when considered together with U.S. GAAP financial measures, provides information that is useful to investors in understanding the Company's refinancing risks, and gives investors a comparable statistic to other mortgage REITS who almost exclusively borrow using repurchase agreements which are short-term and subject to refinancing risk.

December 31, 2014

\$ in thousands	Agency RMBS	Non-Agency RMBS ⁽⁶⁾	GSE CRT ⁽⁶⁾	CMBS ⁽⁷⁾	Commercial Loans ⁽⁷⁾	Consolidated VIEs ⁽⁴⁾⁽⁶⁾	Other ⁽⁷⁾	Eliminations ⁽⁵⁾	Total
Investments	10,091,989	3,494,181	625,424	3,469,835	145,756	3,365,003	43,998	(432,534)	20,803,652
Cash and cash equivalents ⁽¹⁾	64,603	41,578	10,154	47,809	—	—	—	—	164,144
Derivative assets, at fair value ⁽²⁾	23,183	396	—	—	599	—	—	—	24,178
Other assets	111,817	13,742	15,639	75,209	1,030	15,591	7,888	(1,873)	239,043
Total assets	10,291,592	3,549,897	651,217	3,592,853	147,385	3,380,594	51,886	(434,407)	21,231,017
Repurchase agreements	9,018,818	2,676,626	468,782	1,458,451	—	—	—	—	13,622,677
Secured loans ⁽³⁾	—	—	—	1,250,000	—	—	—	—	1,250,000
Asset-backed securities issued by securitization trusts	—	—	—	—	—	3,362,354	—	(432,534)	2,929,820
Exchangeable senior notes	—	—	—	—	—	—	400,000	—	400,000
Derivative liabilities, at fair value	254,026	—	—	—	—	—	—	—	254,026
Other liabilities	56,894	21,351	5,233	37,589	—	10,563	5,887	(1,873)	135,644
Total liabilities	9,329,738	2,697,977	474,015	2,746,040	—	3,372,917	405,887	(434,407)	18,592,167
Allocated equity	961,854	851,920	177,202	846,813	147,385	7,677	(354,001)	—	2,638,850
Less equity associated with secured loans:									
Collateral pledged	—	—	—	(1,550,270)	—	—	—	—	(1,550,270)
Secured loans	—	—	—	1,250,000	—	—	—	—	1,250,000
Net equity (excluding secured loans)	961,854	851,920	177,202	546,543	NA	NA	NA	—	2,537,519
Total debt-to-equity ratio ⁽⁸⁾	9.4	3.1	2.6	3.2	—	NA	NA	NA	6.9
Repurchase agreement debt-to-equity ratio ⁽⁹⁾	9.4	3.1	2.6	2.7	NA	NA	NA	NA	5.4

(1)

Cash and cash equivalents is allocated based on a percentage of equity for Agency RMBS, Non-Agency RMBS, GSE CRT and CMBS.

- (2) Derivative assets are allocated based on the hedging strategy for each asset class.
- (3) Secured loans are allocated based on amount of collateral pledged.
- (4) Represents VIE assets and liabilities before intercompany eliminations. VIEs are securitized entities with no substantive equity at risk.
- (5) Represents our ownership of asset-backed securities and accrued interest eliminated upon consolidation.
- (6) Non-Agency RMBS, GSE CRT and Consolidated VIEs are considered residential credit.
- (7) CMBS, Commercial Loans and Investments in unconsolidated ventures of \$44.0 million (which are included in Other), are considered commercial credit.
- (8) Debt-to-equity ratio is calculated as the ratio of total debt (sum of repurchase agreements, secured loans, asset-backed securities issued by securitization trusts and exchangeable senior notes) to allocated equity.
- (9) Repurchase agreement debt-to-equity ratio is calculated as the ratio of repurchase agreements to net equity (excluding secured loans).

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December 31, 2013

\$ in thousands	Agency RMBS	Non-Agency RMBS ⁽⁵⁾	GSE CRT ⁽⁵⁾	CMBS ⁽⁶⁾	Commercial Loans ⁽⁶⁾	Consolidated VIEs ⁽³⁾⁽⁵⁾	Other ⁽⁶⁾	Eliminations ⁽⁴⁾	Total
Investments	10,944,787	3,770,130	167,981	2,628,560	64,599	1,810,262	44,403	(162,801)	19,267,921
Cash and cash equivalents ⁽¹⁾	96,957	62,669	4,658	46,328	—	—	—	—	210,612
Derivative assets, at fair value ⁽²⁾	258,814	3,245	—	—	—	—	—	—	262,059
Other assets	556,982	21,533	200	12,922	356	9,033	10,349	(988)	610,387
Total assets	11,857,540	3,857,577	172,839	2,687,810	64,955	1,819,295	54,752	(163,789)	20,350,979
Repurchase agreements	10,281,154	2,974,998	113,066	2,082,457	—	—	—	—	15,451,675
Asset-backed securities issued by securitization trusts	—	—	—	—	—	1,806,542	—	(162,801)	1,643,741
Exchangeable senior notes	—	—	—	—	—	—	400,000	—	400,000
Derivative liabilities, at fair value	263,204	—	—	—	—	—	—	—	263,204
Other liabilities	131,206	26,887	1,745	18,807	—	5,579	5,888	(988)	189,124
Total liabilities	10,675,564	3,001,885	114,811	2,101,264	—	1,812,121	405,888	(163,789)	17,947,744
Allocated equity	1,181,976	855,692	58,028	586,546	64,955	7,174	(351,136)	—	2,403,235
Net equity (excluding secured loans)	1,181,976	855,692	58,028	586,546	NA	NA	NA	—	2,682,242
Total debt-to-equity ratio ⁽⁷⁾	8.7	3.5	1.9	3.6	—	NA	NA	NA	7.3
Repurchase agreement debt-to-equity ratio ⁽⁸⁾	8.7	3.5	1.9	3.6	NA	NA	NA	NA	5.8

(1) Cash and cash equivalents is allocated based on a percentage of equity for Agency RMBS, Non-Agency RMBS, GSE CRT and CMBS.

(2) Derivative assets are allocated based on the hedging strategy for each asset class.

(3) Represents VIE assets and liabilities before intercompany eliminations. VIEs are securitized entities with no substantive equity at risk.

(4) Represents our ownership of asset-backed securities and accrued interest eliminated upon consolidation.

(5) Non-Agency RMBS, GSE CRT and Consolidated VIEs are considered residential credit.

(6) CMBS, Commercial Loans and Investments in unconsolidated ventures of \$44.4 million (which are included in Other), are considered commercial credit.

(7) Debt-to-equity ratio is calculated as the ratio of total debt (sum of repurchase agreements, secured loans, asset-backed securities issued by securitization trusts and exchangeable senior notes) to allocated equity.

(8) Repurchase agreement debt-to-equity ratio is calculated as the ratio of repurchase agreements to net equity.

Interest Income and Average Earning Asset Yield (As Restated)

The table below presents certain information for our portfolio as of and for the years ended December 31, 2014, 2013 and 2012.

\$ in thousands	As of and for the Years Ended			
	December 31, 2014 (As Restated)	2013	2012	
Average Balances*:				
Agency RMBS:				
15 year fixed-rate, at amortized cost	1,450,316	1,897,780	2,302,218	
30 year fixed-rate, at amortized cost	5,723,270	10,217,822	8,395,560	
ARM, at amortized cost	475,401	122,225	150,377	
Hybrid ARM, at amortized cost	2,452,062	758,625	1,028,432	
MBS-CMO, at amortized cost	476,636	496,607	465,469	
Non-Agency RMBS, at amortized cost	3,245,701	3,593,337	2,524,635	
GSE CRT, at amortized cost	478,929	9,435	—	
CMBS, at amortized cost	2,947,733	2,412,694	1,461,359	
Residential loans, at amortized cost	2,473,258	1,006,374	—	
Commercial loans, at amortized cost	109,551	14,858	—	
Average Investment portfolio	19,832,857	20,529,757	16,328,050	
Average Portfolio Yields ⁽¹⁾ :				
Agency RMBS:				
15 year fixed-rate	2.66	% 2.32	% 2.54	%
30 year fixed-rate	3.05	% 2.88	% 3.12	%
ARM	2.30	% 2.35	% 2.51	%
Hybrid ARM	2.28	% 2.18	% 2.60	%
MBS - CMO	3.56	% 2.26	% 2.02	%
Non-Agency RMBS	4.54	% 4.59	% 5.16	%
GSE CRT ⁽²⁾	0.50	% 5.80	% —	%
CMBS	4.47	% 4.64	% 5.22	%
Residential loans	3.57	% 3.30	% n/a	
Commercial loans	8.56	% 9.77	% n/a	
Average Investment portfolio	3.41	% 3.32	% 3.47	%

* Average amounts for each period are based on weighted month-end balances.

(1) Average portfolio yield for the period was calculated by dividing interest income, including amortization of premiums and discounts, by our average of the amortized cost of the investments. All yields are annualized.

(2) GSE CRT average portfolio yield for the year ended December 31, 2014 excludes embedded derivative coupon interest recorded as realized and unrealized credit derivative income (loss), net.

Our primary source of income is interest earned on our investment portfolio. We had average earning assets of approximately \$19.8 billion (2013: \$20.5 billion; 2012: \$16.3 billion) and earned interest income of \$676.6 million (2013: \$682.4 million; 2012: \$566.8 million) during 2014. The yield on our average investment portfolio was 3.41% (2013: 3.32%; 2012: 3.47%).

The change in our average assets and the portfolio yield for 2014 versus 2013 was primarily attributable to the change in our portfolio reallocation to lower leveraged assets. The change in our average assets and the portfolio yield for 2013 versus 2012 was primarily attributable to investing capital from our equity and debt offerings and by changing our portfolio composition. We continue to evaluate our investment portfolio and make adjustments based on our views of the market opportunities.

Our interest income is subject to interest rate risk. Refer to Item 7A. "Quantitative and Qualitative Disclosures about Market Risk" for more information relating to interest rate risk and its impact on our operating results.

The constant prepayment rate ("CPR") of our portfolio impacts the amount of premium and discount on the purchase of securities that is recognized into income. The table below shows the three month CPR for our RMBS and GSE CRT compared to bonds with similar characteristics ("Cohorts"):

	December 31, 2014		September 30, 2014	
	Company	Cohort	Company	Cohort
15 year Agency RMBS	11.9	15.0	12.9	14.8
30 year Agency RMBS	11.8	13.5	12.0	12.8
Agency Hybrid ARM RMBS	14.3	NA	13.0	NA
Non-Agency RMBS	10.7	NA	11.9	NA
GSE CRT	7.7	NA	8.2	NA
Weighted average CPR	12.0	NA	12.1	NA

Interest Expense and the Cost of Funds

The table below presents certain information related to our financing as of and for the years ended December 31, 2014, 2013 and 2012.