MFA FINANCIAL, INC.
Form 10-Q
November 06, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

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FORM 10-Q
(Mark One)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2018

or

o 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: 1-13991

MFA FINANCIAL, INC.
(Exact name of registrant as specified in its charter)

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| Maryland | 13-3974868 |
|---|---|
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |
| 350 Park Avenue, 20th Floor, New York, New York | 10022 |
| (Address of principal executive offices) | (Zip Code) |

(212) 207-6400
(Registrant’s telephone number, including area code)
Not Applicable
(Former name, former address and former fiscal year, if changed since last period)

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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 x No o

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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

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

| | |
|---|---|
| Large accelerated filer x | Accelerated filer o |
| Non-accelerated filer o | Smaller reporting company o |
| | Emerging growth company o |

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o
No x
449,546,435 shares of the registrant’s common stock, $0.01 par value, were outstanding as of October 31, 2018.

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MFA FINANCIAL, INC.

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MFA FINANCIAL, INC.
CONSOLIDATED BALANCE SHEETS

| (In Thousands Except Per Share Amounts) | September 30, 2018 (Unaudited) | December 31, 2017 |
|---|---|---|
| Assets: | | |
| Mortgage-backed securities ("MBS") and credit risk transfer ("CRT") securities: | | |
| Agency MBS, at fair value ($2,795,273 and $2,727,510 pledged as collateral, respectively) | $2,905,490 | $2,824,681 |
| Non-Agency MBS, at fair value ($3,237,108 and $2,379,523 pledged as collateral, respectively) | 3,334,610 | 3,533,966 |
| CRT securities, at fair value ($504,931 and $595,900 pledged as collateral, respectively) | 538,945 | 664,403 |
| Mortgage servicing rights ("MSR") related assets ($565,272 and $482,158 pledged as collateral, respectively) | 565,272 | 492,080 |
| Residential whole loans, at carrying value ($1,149,293 and $448,689 pledged as collateral, respectively) (1) | 2,471,567 | 908,516 |
| Residential whole loans, at fair value ($685,095 and $996,226 pledged as collateral, respectively) (1) | 1,449,365 | 1,325,115 |
| Cash and cash equivalents | 104,186 | 449,757 |
| Restricted cash | 6,489 | 13,307 |
| Other assets | 406,069 | 742,909 |
| Total Assets | $11,781,993 | $10,954,734 |
| | | |
| Liabilities: | | |
| Repurchase agreements | $7,278,270 | $6,614,701 |
| Other liabilities | 951,483 | 1,078,397 |
| Total Liabilities | $8,229,753 | $7,693,098 |
| | | |
| Commitments and contingencies (See Note 10) | | |
| | | |
| Stockholders' Equity: | | |
| Preferred stock, $.01 par value; 7.50% Series B cumulative redeemable; 8,050 shares authorized; 8,000 shares issued and outstanding ($200,000 aggregate liquidation preference) | $80 | $80 |
| Common stock, $.01 par value; 886,950 shares authorized; 449,472 and 397,831 shares issued and outstanding, respectively | 4,495 | 3,978 |
| Additional paid-in capital, in excess of par | 3,620,268 | 3,227,304 |
| Accumulated deficit | (598,971) | (578,950) |
| Accumulated other comprehensive income | 526,368 | 609,224 |
| Total Stockholders' Equity | $3,552,240 | $3,261,636 |
| Total Liabilities and Stockholders' Equity | $11,781,993 | $10,954,734 |

(1) Includes approximately $215.1 million and $183.2 million of Residential whole loans, at carrying value and $723.8 million and $289.3 million of Residential whole loans, at fair value transferred to consolidated variable interest entities (“VIEs”) at September 30, 2018 and December 31, 2017, respectively. Such assets can be used only to settle the obligations of the VIEs.

The accompanying notes are an integral part of the consolidated financial statements.

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MFA FINANCIAL, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (In Thousands, Except Per Share Amounts) | 2018 | 2017 | 2018 | 2017 |
| Interest Income: | | | | |
| Agency MBS | $14,332 | $15,533 | $42,795 | $50,014 |
| Non-Agency MBS | 58,667 | 63,252 | 169,812 | 212,728 |
| CRT securities | 7,748 | 8,676 | 25,939 | 22,898 |
| MSR related assets | 6,407 | 7,194 | 20,249 | 17,833 |
| Residential whole loans held at carrying value | 29,524 | 9,026 | 61,788 | 26,219 |
| Cash and cash equivalent investments | 754 | 1,452 | 2,348 | 2,854 |
| Interest Income | $117,432 | $105,133 | $322,931 | $332,546 |
| | | | | |
| Interest Expense: | | | | |
| Repurchase agreements and other advances | $50,881 | $46,303 | $142,832 | $141,444 |
| Other interest expense | 7,997 | 2,972 | 18,410 | 7,202 |
| Interest Expense | $58,878 | $49,275 | $161,242 | $148,646 |
| | | | | |
| Net Interest Income | $58,554 | $55,858 | $161,689 | $183,900 |
| | | | | |
| Other Income, net: | | | | |
| Net gain on residential whole loans held at fair value | $34,942 | $18,679 | $105,883 | $48,660 |
| Net gain on sales of investment securities | 16,415 | 14,933 | 32,661 | 30,530 |
| Other, net | (2,998) | (4,515) | (1,519) | 13,812 |
| Other Income, net | $48,359 | $29,097 | $137,025 | $93,002 |
| | | | | |
| Operating and Other Expense: | | | | |
| Compensation and benefits | $6,868 | $10,892 | $20,654 | $26,258 |
| Other general and administrative expense | 4,155 | 4,081 | 13,569 | 14,060 |
| Loan servicing and other related operating expenses | 8,758 | 6,177 | 23,569 | 14,785 |
| Operating and Other Expense | $19,781 | $21,150 | $57,792 | $55,103 |
| | | | | |
| Net Income | $87,132 | $63,805 | $240,922 | $221,799 |
| Less Preferred Stock Dividends | 3,750 | 3,750 | 11,250 | 11,250 |
| Net Income Available to Common Stock and Participating Securities | $83,382 | $60,055 | $229,672 | $210,549 |
| | | | | |
| Earnings per Common Share - Basic and Diluted | $0.19 | $0.15 | $0.56 | $0.54 |
| | | | | |
| Dividends Declared per Share of Common Stock | $0.20 | $0.20 | $0.60 | $0.60 |

The accompanying notes are an integral part of the consolidated financial statements.

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MFA FINANCIAL, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME/(LOSS)
(UNAUDITED)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (In Thousands) | 2018 | 2017 | 2018 | 2017 |
| Net income | $87,132 | $63,805 | $240,922 | $221,799 |
| Other Comprehensive Income/(Loss): | | | | |
| Unrealized loss on Agency MBS, net | (9,177) | (3,032) | (27,507) | (22,241) |
| Unrealized (loss)/gain on Non-Agency MBS, net | (25,101) | 10,020 | (62,743) | 93,429 |
| Reclassification adjustment for MBS sales included in net income | (9,455) | (14,935) | (25,580) | (30,283) |
| Reclassification adjustment for other-than-temporary impairments included in net income | — | — | — | (1,032) |
| Derivative hedging instrument fair value changes, net | 5,390 | 5,791 | 32,974 | 16,671 |
| Other Comprehensive (Loss)/Income | (38,343) | (2,156) | (82,856) | 56,544 |
| Comprehensive income before preferred stock dividends | $48,789 | $61,649 | $158,066 | $278,343 |
| Dividends declared on preferred stock | (3,750) | (3,750) | (11,250) | (11,250) |
| Comprehensive Income Available to Common Stock and Participating Securities | $45,039 | $57,899 | $146,816 | $267,093 |

The accompanying notes are an integral part of the consolidated financial statements.

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MFA FINANCIAL, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
(UNAUDITED)

| (In Thousands, Except Per Share Amounts) | Nine Months Ended September 30, 2018 Preferred Stock 7.50% Series B Cumulative Redeemable - Liquidation Preference $25.00 per Share | | Common Stock | | Additional Paid-in Capital | Accumulated Deficit | Accumulated Other Comprehensive Income | Total |
|---|---|---|---|---|---|---|---|---|
| | Shares | Amount | Shares | Amount | | | | |
| Balance at December 31, 2017 | 8,000 | $ 80 | 397,831 | $ 3,978 | $ 3,227,304 | $ (578,950) | $ 609,224 | $ 3,261,636 |
| Cumulative effect adjustment on adoption of new accounting standard for revenue recognition | — | — | — | — | — | 295 | — | 295 |
| Net income | — | — | — | — | — | 240,922 | — | 240,922 |
| Issuance of common stock, net of expenses (1) | — | — | 51,892 | 517 | 391,065 | — | — | 391,582 |
| Repurchase of shares of common stock (1) | — | — | (251) | — | (1,957) | — | — | (1,957) |
| Equity based compensation expense | — | — | — | — | 3,887 | — | — | 3,887 |
| Accrued dividends attributable to stock-based awards | — | — | — | — | (31) | — | — | (31) |
| Dividends declared on common stock | — | — | — | — | — | (249,287) | — | (249,287) |
| Dividends declared on preferred stock | — | — | — | — | — | (11,250) | — | (11,250) |
| Dividends attributable to dividend equivalents | — | — | — | — | — | (701) | — | (701) |
| Change in unrealized gains on MBS, net | — | — | — | — | — | — | (115,830) | (115,830) |
| Derivative hedging instrument fair value changes, net | — | — | — | — | — | — | 32,974 | 32,974 |
| Balance at September 30, 2018 | 8,000 | $ 80 | 449,472 | $ 4,495 | $ 3,620,268 | $ (598,971) | $ 526,368 | $ 3,552,240 |

| (In Thousands, Except Per Share Amounts) | Nine Months Ended September 30, 2017 Preferred Stock 7.50% Series B Cumulative | Common Stock | Additional Paid-in Capital | Accumulated Deficit | Accumulated Other Comprehensive Income | Total |
|---|---|---|---|---|---|---|

| | Redeemable - Liquidation Preference $25.00 per Share | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Shares | Amount | Shares | Amount | | | | |
| Balance at December 31, 2016 | 8,000 | $ 80 | 371,854 | $ 3,719 | $ 3,029,062 | $ (572,641 ) | $ 573,682 | $ 3,033,902 |
| Net income | — | — | — | — | — | 221,799 | — | 221,799 |
| Issuance of common stock, net of expenses (1) | — | — | 25,726 | 250 | 190,265 | — | — | 190,515 |
| Repurchase of shares of common stock (1) | — | — | (641 ) | — | (5,158 ) | — | — | (5,158 ) |
| Equity based compensation expense | — | — | — | — | 5,209 | — | — | 5,209 |
| Accrued dividends attributable to stock-based awards | — | — | — | — | 20 | — | — | 20 |
| Dividends declared on common stock | — | — | — | — | — | (233,244 ) | — | (233,244 ) |
| Dividends declared on preferred stock | — | — | — | — | — | (11,250 ) | — | (11,250 ) |
| Dividends attributable to dividend equivalents | — | — | — | — | — | (686 ) | — | (686 ) |
| Change in unrealized gains on MBS, net | — | — | — | — | — | — | 39,873 | 39,873 |
| Derivative hedging instruments fair value changes, net | — | — | — | — | — | — | 16,671 | 16,671 |
| Balance at September 30, 2017 | 8,000 | $ 80 | 396,939 | $ 3,969 | $ 3,219,398 | $ (596,022 ) | $ 630,226 | $ 3,257,651 |

(1) For the nine months ended September 30, 2018 and 2017, includes approximately $2.0 million (250,946 shares) and $5.2 million (640,748 shares), respectively surrendered for tax purposes related to equity-based compensation awards.

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MFA FINANCIAL, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

| | Nine Months Ended September 30, | |
|---|---|---|
| (In Thousands) | 2018 | 2017 |
| Cash Flows From Operating Activities: | | |
| Net income | $240,922 | $221,799 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Gain on sales of MBS, CRT securities and U.S. Treasury securities | (32,661) | (30,530) |
| Gain on sales of real estate owned | (6,582) | (2,844) |
| Gain on liquidation of residential whole loans | (18,598) | (7,178) |
| Other-than-temporary impairment charges | — | 1,032 |
| Accretion of purchase discounts on MBS and CRT securities, residential whole loans and MSR related assets | (64,211) | (67,065) |
| Amortization of purchase premiums on MBS, CRT securities, and residential whole loans | 21,141 | 23,766 |
| Depreciation and amortization on real estate, fixed assets and other assets | 1,354 | 1,199 |
| Equity-based compensation expense | 3,891 | 5,369 |
| Unrealized gain on residential whole loans at fair value | (26,788) | (12,499) |
| Unrealized losses/(gains) on MBS, CRT securities and Swaps | 2,767 | (11,932) |
| (Increase)/decrease in other assets and other | (31,018) | 10,538 |
| Increase/(decrease) in other liabilities | 33 | (10,248) |
| Net cash provided by operating activities | $90,250 | $121,407 |
| | | |
| Cash Flows From Investing Activities: | | |
| Principal payments on MBS, CRT securities and MSR related assets | $1,797,012 | $3,387,673 |
| Proceeds from sales of MBS, CRT securities and U.S. Treasury securities | 341,589 | 222,143 |
| Purchases of MBS, CRT securities, MSR related assets and U.S. Treasury securities | (2,021,914) | (1,425,717) |
| Purchases of residential whole loans and capitalized advances | (2,158,105) | (391,613) |
| Principal payments on residential whole loans | 345,917 | 105,549 |
| Proceeds from sales of real estate owned | 93,635 | 51,834 |
| Purchases of real estate owned and capital improvements | (10,179) | (17,224) |
| Redemption of Federal Home Loan Bank stock | — | 10,422 |
| Additions to leasehold improvements, furniture and fixtures | (1,009) | (596) |
| Net cash (used in)/provided by investing activities | $(1,613,054) | $1,942,471 |
| | | |
| Cash Flows From Financing Activities: | | |
| Principal payments on repurchase agreements and other advances | $(48,988,034) | $(57,118,263) |
| Proceeds from borrowings under repurchase agreements | 49,651,416 | 55,302,002 |
| Proceeds from issuance of securitized debt | 419,970 | 147,847 |
| Principal payments on securitized debt | (67,945) | (9,140) |
| Payments made for securitization related costs | (2,472) | (1,520) |
| Payments made for settlements on interest rate swap agreements (“Swaps”) | (40,885) | (30,050) |
| Proceeds from settlements on Swaps | 57,656 | — |
| Proceeds from issuances of common stock | 391,932 | 190,928 |
| Payments made for costs related to common stock issuances | (350) | (412) |
| Dividends paid on preferred stock | (11,250) | (11,250) |
| Dividends paid on common stock and dividend equivalents | (239,623) | (228,982) |

| | | |
|---|---|---|
| Net cash provided by/(used in) financing activities | $1,170,415 | $(1,758,840) |
| Net (decrease)/increase in cash, cash equivalents and restricted cash | $(352,389) | $305,038 |
| Cash, cash equivalents and restricted cash at beginning of period | $463,064 | $318,575 |
| Cash, cash equivalents and restricted cash at end of period | $110,675 | $623,613 |
| | | |
| Non-cash Investing and Financing Activities: | | |
| Net (decrease)/increase in securities obtained as collateral/obligation to return securities obtained as collateral | $(505,850) | $131,930 |
| Transfer from residential whole loans to real estate owned | $161,572 | $97,388 |
| Dividends and dividend equivalents declared and unpaid | $90,136 | $79,605 |
| Payable for unsettled MBS and residential whole loans purchases | $10,888 | $124,006 |

The accompanying notes are an integral part of the consolidated financial statements.

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## 1. Organization

MFA Financial, Inc. (the “Company”) was incorporated in Maryland on July 24, 1997 and began operations on April 10, 1998. The Company has elected to be treated as a real estate investment trust (“REIT”) for U.S. federal income tax purposes. In order to maintain its qualification as a REIT, the Company must comply with a number of requirements under federal tax law, including that it must distribute at least 90% of its annual REIT taxable income to its stockholders. The Company has elected to treat certain of its subsidiaries as a taxable REIT subsidiary (“TRS”). In general, a TRS may hold assets and engage in activities that the Company cannot hold or engage in directly and generally may engage in any real estate or non-real estate related business. (See Note 2(o))

## 2. Summary of Significant Accounting Policies

### (a) Basis of Presentation and Consolidation

The interim unaudited consolidated financial statements of the Company have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission (the “SEC”). Certain information and note disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) have been condensed or omitted according to these SEC rules and regulations. Management believes that the disclosures included in these interim unaudited consolidated financial statements are adequate to make the information presented not misleading. The accompanying unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017. In the opinion of management, all normal and recurring adjustments necessary to present fairly the financial condition of the Company at September 30, 2018 and results of operations for all periods presented have been made. The results of operations for the three and nine months ended September 30, 2018 should not be construed as indicative of the results to be expected for the full year.

The accompanying consolidated financial statements of the Company have been prepared on the accrual basis of accounting in accordance with GAAP. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although the Company’s estimates contemplate current conditions and how it expects them to change in the future, it is reasonably possible that actual conditions could differ from those estimates, which could materially impact the Company’s results of operations and its financial condition. Management has made significant estimates in several areas, including other-than-temporary impairment (“OTTI”) on MBS (See Note 3), valuation of MBS, CRT securities and MSR related assets (See Notes 3 and 14), income recognition and valuation of residential whole loans (See Notes 4 and 14), valuation of derivative instruments (See Notes 5(c) and 14) and income recognition on certain Non-Agency MBS (defined below) purchased at a discount. (See Note 3) In addition, estimates are used in the determination of taxable income used in the assessment of REIT compliance and contingent liabilities for related taxes, penalties and interest. (See Note 2(o)) Actual results could differ from those estimates.

The Company has one reportable segment as it manages its business and analyzes and reports its results of operations on the basis of one operating segment; investing, on a leveraged basis, in residential mortgage assets.

The consolidated financial statements of the Company include the accounts of all subsidiaries; all intercompany accounts and transactions have been eliminated. In addition, the Company consolidates entities established to facilitate transactions related to the acquisition and securitization of residential whole loans as well as MBS resecuritization transactions completed in prior years. Certain prior period amounts have been reclassified to conform to the current period presentation.



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(b) MBS and CRT Securities

The Company has investments in residential MBS that are issued or guaranteed as to principal and/or interest by a federally chartered corporation, such as the Federal National Mortgage Association ("Fannie Mae") or the Federal Home Loan Mortgage Corporation ("Freddie Mac"), or an agency of the U.S. Government, such as the Government National Mortgage Association ("Ginnie Mae") (collectively, "Agency MBS"), and residential MBS that are not guaranteed by any agency of the U.S. Government or any federally chartered corporation ("Non-Agency MBS"). In addition, the Company has investments in CRT securities that are issued by Fannie Mae and Freddie Mac. The coupon payments on CRT securities are paid by Fannie Mae and Freddie Mac and the principal payments received are based on the performance of loans in a reference pool of previously securitized MBS. As the loans in the underlying reference pool are paid, the principal balance of the CRT securities is paid. As an investor in a CRT security, the Company may incur a loss if certain defined credit events occur, including, for certain CRT securities, if the loans in the reference pool experience delinquencies exceeding specified thresholds.

Designation

MBS that the Company generally intends to hold until maturity, but that it may sell from time to time as part of the overall management of its business, are designated as "available-for-sale" ("AFS"). Such MBS are carried at their fair value with unrealized gains and losses excluded from earnings (except when an OTTI is recognized, as discussed below) and reported in Accumulated other comprehensive income/(loss) ("AOCI"), a component of Stockholders' Equity.

Upon the sale of an AFS security, any unrealized gain or loss is reclassified out of AOCI to earnings as a realized gain or loss using the specific identification method.

The Company has elected the fair value option for certain of its Agency MBS that it does not intend to hold to maturity. These securities are carried at their fair value with changes in fair value included in earnings for the period and reported in Other Income, net on the Company's consolidated statements of operations.

The Company has elected the fair value option for its CRT securities as it considers this method of accounting to more appropriately reflect the risk sharing structure of these securities. Such securities are carried at their fair value with changes in fair value included in earnings for the period and reported in Other Income, net on the Company's consolidated statements of operations.

Revenue Recognition, Premium Amortization and Discount Accretion

Interest income on securities is accrued based on the outstanding principal balance and their contractual terms. Premiums and discounts associated with Agency MBS and Non-Agency MBS assessed as high credit quality at the time of purchase are amortized into interest income over the life of such securities using the effective yield method. Adjustments to premium amortization are made for actual prepayment activity.

Interest income on the Non-Agency MBS that were purchased at a discount to par value and/or are considered to be of less than high credit quality is recognized based on the security's effective interest rate which is the security's internal rate of return ("IRR"). The IRR is determined using management's estimate of the projected cash flows for each security, which are based on the Company's observation of current information and events and include assumptions related to fluctuations in interest rates, prepayment speeds and the timing and amount of credit losses. On at least a quarterly

basis, the Company reviews and, if appropriate, makes adjustments to its cash flow projections based on input and analysis received from external sources, internal models, and its judgment about interest rates, prepayment rates, the timing and amount of credit losses, and other factors. Changes in cash flows from those originally projected, or from those estimated at the last evaluation, may result in a prospective change in the IRR/ interest income recognized on these securities or in the recognition of OTTIs. (See Note 3)

Based on the projected cash flows from the Company's Non-Agency MBS purchased at a discount to par value, a portion of the purchase discount may be designated as non-accretable purchase discount ("Credit Reserve"), which effectively mitigates the Company's risk of loss on the mortgages collateralizing such MBS and is not expected to be accreted into interest income. The amount designated as Credit Reserve may be adjusted over time, based on the actual performance of the security, its underlying collateral, actual and projected cash flow from such collateral, economic conditions and other factors. If the performance of a security with a Credit Reserve is more favorable than forecasted, a portion of the amount designated as Credit Reserve may be reallocated to accretable discount and recognized into interest income over time. Conversely, if the performance of a security with

a Credit Reserve is less favorable than forecasted, the amount designated as Credit Reserve may be increased, or impairment charges and write-downs of such securities to a new cost basis could result.

Determination of Fair Value for MBS and CRT Securities

In determining the fair value of the Company's MBS and CRT securities, management considers a number of observable market data points, including prices obtained from pricing services, brokers and repurchase agreement counterparties, dialogue with market participants, as well as management's observations of market activity. (See Note 14)

Impairments/OTTI

When the fair value of an AFS security is less than its amortized cost at the balance sheet date, the security is considered impaired. The Company assesses its impaired securities on at least a quarterly basis and designates such impairments as either "temporary" or "other-than-temporary." If the Company intends to sell an impaired security, or it is more likely than not that it will be required to sell the impaired security before its anticipated recovery, then the Company must recognize an OTTI through charges to earnings equal to the entire difference between the investment's amortized cost and its fair value at the balance sheet date. If the Company does not expect to sell an other-than-temporarily impaired security, only the portion of the impairment related to credit losses is recognized through charges to earnings with the remainder recognized through AOCI on the consolidated balance sheets. Impairments recognized through other comprehensive income/(loss) ("OCI") do not impact earnings. Following the recognition of an OTTI through earnings, a new cost basis is established for the security and may not be adjusted for subsequent recoveries in fair value through earnings. However, OTTIs recognized through charges to earnings may be accreted back to the amortized cost basis of the security on a prospective basis through interest income. The determination as to whether an OTTI exists and, if so, the amount of credit impairment recognized in earnings is subjective, as such determinations are based on factual information available at the time of assessment as well as the Company's estimates of the future performance and cash flow projections. As a result, the timing and amount of OTTIs constitute material estimates that are susceptible to significant change. (See Note 3)

Non-Agency MBS that are assessed to be of less than high credit quality and on which impairments are recognized have experienced, or are expected to experience, credit-related adverse cash flow changes. The Company's estimate of cash flows for its Non-Agency MBS is based on its review of the underlying mortgage loans securing the MBS. The Company considers information available about the past and expected future performance of underlying mortgage loans, including timing of expected future cash flows, prepayment rates, default rates, loss severities, delinquency rates, percentage of non-performing loans, year of origination, loan-to-value ratios ("LTVs"), geographic concentrations and dialogue with market participants. As a result, significant judgment is used in the Company's analysis to determine the expected cash flows for its Non-Agency MBS. In determining the OTTI related to credit losses for securities that were purchased at significant discounts to par and/or are considered to be of less than high credit quality, the Company compares the present value of the remaining cash flows expected to be collected at the purchase date (or last date previously revised) against the present value of the cash flows expected to be collected at the current financial reporting date. The discount rate used to calculate the present value of expected future cash flows is the current yield used for income recognition purposes. Impairment assessment for Non-Agency MBS that were purchased at prices close to par and/or are otherwise considered to be of high credit quality involves comparing the present value of the remaining cash flows expected to be collected against the amortized cost of the security at the assessment date. The discount rate used to calculate the present value of the expected future cash flows is based on the instrument's IRR.

Balance Sheet Presentation

The Company’s MBS and CRT Securities pledged as collateral against repurchase agreements and Swaps are included on the consolidated balance sheets with the fair value of the securities pledged disclosed parenthetically.  Purchases and sales of securities are recorded on the trade date.

(c) MSR Related Assets

The Company has investments in financial instruments whose cash flows are considered to be largely dependent on underlying MSRs that either directly or indirectly act as collateral for the investment. These financial instruments, which are referred to as MSR related assets, are discussed in more detail below. The Company’s MSR related assets pledged as collateral against repurchase agreements are included in the consolidated balance sheets with the amounts pledged disclosed parenthetically. Purchases and sales of MSR related assets are recorded on the trade date. (See Notes 3, 6, 7 and 14)

Term Notes Backed by MSR Related Collateral

The Company has invested in term notes that are issued by special purpose vehicles ("SPV") that have acquired rights to receive cash flows representing the servicing fees and/or excess servicing spread associated with certain MSRs. The Company considers payment of principal and interest on these term notes to be largely dependent on the cash flows generated by the underlying MSRs as this impacts the cash flows available to the SPV that issued the term notes. Credit risk borne by the holders of the term notes is also mitigated by structural credit support in the form of over-collateralization. Credit support is also provided by a corporate guarantee from the ultimate parent or sponsor of the SPV that is intended to provide for payment of interest and principal to the holders of the term notes should cash flows generated by the underlying MSRs be insufficient.

The Company's term notes backed by MSR related collateral are reported at fair value on the Company's consolidated balance sheets with unrealized gains and losses excluded from earnings and reported in AOCI. Interest income is recognized on an accrual basis on the Company's consolidated statements of operations. The Company's valuation process for such notes considers a number of factors, including a comparable bond analysis performed by a third-party pricing service which involves determining a pricing spread at issuance of the term note. The pricing spread is used at each subsequent valuation date to determine an implied yield to maturity of the term note, which is then used to derive an indicative market value for the security. This indicative market value is further reviewed by the Company and may be adjusted to ensure it reflects a realistic exit price at the valuation date given the structural features of these securities. Other factors taken into consideration include indicative values provided by repurchase agreement counterparties, estimated changes in fair value of the related underlying MSR collateral and the financial performance of the ultimate parent or sponsoring entity of the issuer, which has provided a guarantee that is intended to provide for payment of interest and principal to the holders of the term notes should cash flows generated by the related underlying MSR collateral be insufficient.

Corporate Loans

The Company has made or participated in loans to provide financing to entities that originate residential mortgage loans and own the related MSRs. These corporate loans are generally secured by certain MSRs, as well as certain other unencumbered assets owned by the borrower.

Corporate loans are recorded on the Company's consolidated balance sheets at the drawn amount, on which interest income is recognized on an accrual basis on the Company's consolidated statements of operations. Commitment fees received on the undrawn amount are deferred and recognized as interest income over the remaining loan term at the time of draw. At the end of the commitment period, any remaining deferred commitment fees are recorded as Other Income on the Company's consolidated statements of operations. The Company evaluates the recoverability of its corporate loans on a quarterly basis considering various factors, including the current status of the loan, changes in the fair value of the MSRs that secure the loan and the recent financial performance of the borrower.

(d) Residential Whole Loans (including Residential Whole Loans transferred to consolidated VIEs)

Residential whole loans included in the Company's consolidated balance sheets are primarily comprised of pools of fixed and adjustable rate residential mortgage loans acquired through consolidated trusts in secondary market transactions, with the majority at discounted purchase prices. The accounting model utilized by the Company is determined at the time each loan package is initially acquired and is generally based on the delinquency status of the

majority of the underlying borrowers in the package at acquisition. The accounting model described below for purchased credit impaired loans that are held at carrying value is typically utilized by the Company for purchased credit impaired loans where the underlying borrower has a delinquency status of less than 60 days at the acquisition date. The Company may also purchase newly or recently originated loans that are performing as of the purchase date. Such loans are typically held at carrying value, but the accounting methods for income recognition and determination and measurement of any required loan loss reserves differ to those used for purchased credit impaired loans held at carrying value. The accounting model described below for residential whole loans held at fair value is typically utilized by the Company for loans where the underlying borrower has a delinquency status of 60 days or more at the acquisition date. The accounting model initially applied is not subsequently changed.

The Company's residential whole loans pledged as collateral against repurchase agreements are included in the consolidated balance sheets with amounts pledged disclosed parenthetically.  Purchases and sales of residential whole loans are recorded on the trade date, with amounts recorded reflecting management's current estimate of assets that will be acquired or disposed at the closing

of the transaction. This estimate is subject to revision at the closing of the transaction, pending the outcome of due diligence performed prior to closing. Recorded amounts of residential whole loans for which the closing of the purchase transaction is yet to occur are not eligible to be pledged as collateral against any repurchase agreement financing until the closing of the purchase transaction. (See Notes 4, 6, 7, 14 and 15)

Residential Whole Loans at Carrying Value

Purchased Credit Impaired Loans

The Company has elected to account for these loans as credit impaired as they were acquired at discounted prices that reflect, in part, the impaired credit history of the borrower. Substantially all of these loans have previously experienced payment delinquencies and the amount owed may exceed the value of the property pledged as collateral. Consequently, these loans generally have a higher likelihood of default than newly originated mortgage loans with LTVs of 80% or less to creditworthy borrowers. The Company believes that amounts paid to acquire these loans represent fair market value at the date of acquisition. Loans considered credit impaired are initially recorded at the purchase price with no allowance for loan losses. Subsequent to acquisition, the recorded amount for these loans reflects the original investment amount, plus accretion of interest income, less principal and interest cash flows received. These loans are presented on the Company’s consolidated balance sheets at carrying value, which reflects the recorded amount reduced by any allowance for loan losses established subsequent to acquisition.

Under the application of the accounting model for purchased credit impaired loans, the Company may aggregate into pools loans acquired in the same fiscal quarter that are assessed as having similar risk characteristics. For each pool established, or on an individual loans basis for loans not aggregated into pools, the Company estimates at acquisition, and periodically on at least a quarterly basis, the principal and interest cash flows expected to be collected. The difference between the cash flows expected to be collected and the carrying amount of the loans is referred to as the “accretable yield.” This amount is accreted as interest income over the life of the loans using an effective interest rate (level yield) methodology. Interest income recorded each period reflects the amount of accretable yield recognized and not the coupon interest payments received on the underlying loans. The difference between contractually required principal and interest payments and the cash flows expected to be collected is referred to as the “non-accretable difference,” and includes estimates of both the effect of prepayments and expected credit losses over the life of the underlying loans.

A decrease in expected cash flows in subsequent periods may indicate impairment at the pool and/or individual loan level, thus requiring the establishment of an allowance for loan losses by a charge to the provision for loan losses. The allowance for loan losses generally represents the present value of cash flows expected at acquisition, adjusted for any increases due to changes in estimated cash flows, that are subsequently no longer expected to be received at the relevant measurement date. Under the accounting model applied to credit impaired loans, a significant increase in expected cash flows in subsequent periods first reduces any previously recognized allowance for loan losses and then will result in a recalculation in the amount of accretable yield. The adjustment of accretable yield due to a significant increase in expected cash flows is accounted for prospectively as a change in estimate and results in reclassification from nonaccretable difference to accretable yield.

Other Loans at Carrying Value

The Company also has investments in loans that are not considered to be credit impaired at purchase. To date such loans have included newly or previously originated performing loans that are primarily comprised of: (i) loans to

finance (or refinance) one-to-four family residential properties and are not considered to meet the definition of a "Qualified Mortgage" in accordance with guidelines adopted by the Consumer Financial Protection Bureau ("Non-QM loans"), (ii) short-term business purpose loans collateralized by residential properties made to non-occupant borrowers who intend to rehabilitate and sell the property for a profit ("Rehabilitation loans" or "Fix and Flip loans"), (iii) loans to finance (or refinance) non-owner occupied one-to-four family residential properties that are rented to one or more tenants ("Single-family rental loans"), and (iv) previously originated loans secured by residential real estate that is generally owner occupied ("Seasoned performing loans"), (collectively "Other Loans at Carrying Value"). The Company's Other Loans at Carrying Value are initially recorded at their purchase price. Interest income on Other Loans at Carrying Value purchased at par is accrued based on each loan's current interest bearing balance and current interest rate, net of related servicing costs. Interest income on such loans purchased at a premium/discount to par is recorded each period based on the contractual coupon net of any premium or discount and related servicing costs, and adjusted for actual prepayment activity.

An allowance for loan losses is recorded when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the existing contractual terms of the loan agreement. Any required loan loss allowance would typically be measured based on fair value of the collateral securing the loan and would reduce the carrying value of the loan with a corresponding charge to earnings. Significant judgments are required in determining any allowance for loan loss, including assumptions regarding the loan cash flows expected to be collected, the value of the underlying collateral and the ability of the Company to collect on any other forms of security, such as a personal guaranty provided either by the borrower or an affiliate of the borrower. Income recognition is suspended for loans at the earlier of the date at which payments become 90 days past due or when, in the opinion of management, a full recovery of income and principal becomes doubtful. When the ultimate collectability of the principal of an impaired loan is in doubt, all payments are applied to principal under the cost recovery method. When the ultimate collectability of the principal of an impaired loan is not in doubt, interest income is recorded under the cash basis method as interest payments are received. Interest accruals are resumed when the loan becomes contractually current and performance is demonstrated to be resumed. A loan is written off when it is no longer realizable and/or it is legally discharged.

Residential Whole Loans at Fair Value

Certain of the Company’s residential whole loans are presented at fair value on its consolidated balance sheets as a result of a fair value election made at time of acquisition. For the majority of these loans, there is significant uncertainty associated with estimating the timing of and amount of cash flows that will be collected. Further, the cash flows ultimately collected may be dependent on the value of the property securing the loan. Consequently, the Company considers that accounting for these loans at fair value should result in a better reflection over time of the economic returns for the majority of these loans. The Company determines the fair value of its residential whole loans held at fair value after considering portfolio valuations obtained from a third-party who specializes in providing valuations of residential mortgage loans and trading activity observed in the market place. Subsequent changes in fair value are reported in current period earnings and presented in Net gain on residential whole loans held at fair value on the Company’s consolidated statements of operations.

Cash received reflecting coupon payments on residential whole loans held at fair value is not included in Interest Income, but rather is presented in Net gain on residential whole loans held at fair value on the Company’s consolidated statements of operations. Cash outflows associated with loan-related advances made by the Company on behalf of the borrower are included in the basis of the loan and are reflected in Net gain on residential whole loans held at fair value.

(e) Cash and Cash Equivalents

Cash and cash equivalents include cash on deposit with financial institutions and investments in money market funds, all of which have original maturities of three months or less. Cash and cash equivalents may also include cash pledged as collateral to the Company by its repurchase agreement counterparties as a result of reverse margin calls (i.e., margin calls made by the Company). At September 30, 2018 and December 31, 2017, the Company had cash and cash equivalents of $104.2 million and $449.8 million, respectively. The Company’s investments in overnight money market funds, which are not bank deposits and are not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency, were $71.1 million and $354.0 million at September 30, 2018 and December 31, 2017, respectively. (See Notes 7 and 14)

(f) Restricted Cash

Restricted cash represents the Company’s cash held by its counterparties in connection with certain of the Company’s repurchase agreements that is not available to the Company for general corporate purposes. Restricted cash may be applied against amounts due to repurchase agreement counterparties, or may be returned to the Company when the related collateral requirements are exceeded or at the maturity of the repurchase agreement. The Company had aggregate restricted cash held as collateral or otherwise in connection with its repurchase agreements of $6.5 million and $13.3 million at September 30, 2018 and December 31, 2017, respectively. (See Notes 5(c), 6, 7 and 14)

(g) Goodwill

At September 30, 2018 and December 31, 2017, the Company had goodwill of $7.2 million, which represents the unamortized portion of the excess of the fair value of its common stock issued over the fair value of net assets acquired in connection with its formation in 1998. Goodwill is tested for impairment at least annually, or more frequently under certain circumstances, at the entity level. Through September 30, 2018, the Company had not recognized any impairment against its goodwill. Goodwill is included in Other assets on the Company’s consolidated balance sheets.



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(h) Real Estate Owned ("REO")

REO represents real estate acquired by the Company, including through foreclosure, deed in lieu of foreclosure, or purchased in connection with the acquisition of residential whole loans. REO acquired through foreclosure or deed in lieu of foreclosure is initially recorded at fair value less estimated selling costs. REO acquired in connection with the acquisition of residential whole loans is initially recorded at its purchase price. Subsequent to acquisition, REO is reported, at each reporting date, at the lower of the current carrying amount or fair value less estimated selling costs and for presentation purposes is included in Other assets on the Company's consolidated balance sheets. Changes in fair value that result in an adjustment to the reported amount of an REO property that has a fair value at or below its carrying amount are reported in Other Income, net on the Company's consolidated statements of operations. (See Note 5(b))

(i) Depreciation

Leasehold Improvements and Other Depreciable Assets

Depreciation is computed on the straight-line method over the estimated useful life of the related assets or, in the case of leasehold improvements, over the shorter of the useful life or the lease term. Furniture, fixtures, computers and related hardware have estimated useful lives ranging from five to eight years at the time of purchase.

(j) Loan Securitization and Other Debt Issuance Costs

Loan securitization related costs are costs associated with the issuance of beneficial interests by consolidated VIEs and incurred by the Company in connection with various financing transactions completed by the Company. Other debt issuance and related costs include costs incurred by the Company in connection with issuing 8% Senior Notes due 2042 ("Senior Notes") and certain other repurchase agreement financings. These costs may include underwriting, rating agency, legal, accounting and other fees. Such costs, which reflect deferred charges, are included on the Company's consolidated balance sheets as a direct deduction from the corresponding debt liability. These deferred charges are amortized as an adjustment to interest expense using the effective interest method. For Senior Notes and other repurchase agreement financings, such costs are amortized over the shorter of the period to the expected or stated legal maturity of the debt instruments. The Company periodically reviews the recoverability of these deferred costs and in the event an impairment charge is required, such amount will be included in Operating and Other Expense on the Company's consolidated statements of operations.

(k) Repurchase Agreements

The Company finances the holdings of a significant portion of its residential mortgage assets with repurchase agreements. Under repurchase agreements, the Company sells securities to a lender and agrees to repurchase the same securities in the future for a price that is higher than the original sale price. The difference between the sale price that the Company receives and the repurchase price that the Company pays represents interest paid to the lender. Although legally structured as sale and repurchase transactions, the Company accounts for repurchase agreements as secured borrowings. Under its repurchase agreements, the Company pledges its securities as collateral to secure the borrowing, which is equal in value to a specified percentage of the fair value of the pledged collateral, while the Company retains beneficial ownership of the pledged collateral. At the maturity of a repurchase financing, unless the repurchase financing is renewed with the same counterparty, the Company is required to repay the loan including any

accrued interest and concurrently receives back its pledged collateral from the lender. With the consent of the lender, the Company may renew a repurchase financing at the then prevailing financing terms. Margin calls, whereby a lender requires that the Company pledge additional securities or cash as collateral to secure borrowings under its repurchase financing with such lender, are routinely experienced by the Company when the value of the MBS pledged as collateral declines as a result of principal amortization and prepayments or due to changes in market interest rates, spreads or other market conditions. The Company also may make margin calls on counterparties when collateral values increase.

The Company's repurchase financings typically have terms ranging from one month to six months at inception, but may also have longer or shorter terms. Should a counterparty decide not to renew a repurchase financing at maturity, the Company must either refinance elsewhere or be in a position to satisfy the obligation. If, during the term of a repurchase financing, a lender should default on its obligation, the Company might experience difficulty recovering its pledged assets which could result in an unsecured claim against the lender for the difference between the amount loaned to the Company plus interest due to the counterparty and

the fair value of the collateral pledged by the Company to such lender, including accrued interest receivable or such collateral. (See Notes 6, 7 and 14)

In addition to the repurchase agreement financing arrangements discussed above, as part of its financing strategy for Non-Agency MBS, the Company in prior periods entered into contemporaneous repurchase and reverse repurchase agreements with a single counterparty. Under a typical reverse repurchase agreement, the Company buys securities from a borrower for cash and agrees to sell the same securities in the future for a price that is higher than the original purchase price. The difference between the purchase price the Company originally paid and the sale price represents interest received from the borrower. In contrast, the contemporaneous repurchase and reverse repurchase transactions effectively resulted in the Company pledging Non-Agency MBS as collateral to the counterparty in connection with the repurchase agreement financing and obtaining U.S. Treasury securities as collateral from the same counterparty in connection with the reverse repurchase agreement. No net cash was exchanged between the Company and counterparty at the inception of the transactions. Securities obtained and pledged as collateral are recorded in Other assets on the Company's consolidated balance sheets. Interest income is recorded on the reverse repurchase agreement and interest expense is recorded on the repurchase agreement on an accrual basis. The Company's liability to the counterparty in prior periods in connection with this financing arrangement is recorded in Other liabilities on the Company's consolidated balance sheets and disclosed as "Obligation to return securities obtained as collateral, at fair value." (See Note 5(a))

(l) Equity-Based Compensation

Compensation expense for equity-based awards that are subject to vesting conditions, is recognized ratably over the vesting period of such awards, based upon the fair value of such awards at the grant date. For certain awards granted prior to January 1, 2017, compensation expense recognized included the impact of estimated forfeitures, with any changes in estimated forfeiture rates accounted for as a change in estimate. Upon adoption of new accounting guidance that was effective for the Company on January 1, 2017, the Company made a policy election to account for forfeitures as they occur.

Beginning in 2014, the Company has made annual grants of restricted stock units ("RSUs") certain of which cliff vest after a three-year period and others of which cliff vest after a three-year period, subject to the achievement of certain performance criteria based on a formula tied to the Company's achievement of average total stockholder return during that three-year period, as well as the total shareholder return ("TSR") of the Company relative to the TSR of a group of peer companies (over the three-year period) selected by the Compensation Committee of the Company's Board of Directors (the "Compensation Committee") at the date of grant. The features in these awards related to the attainment of total stockholder return over a specified period constitute a "market condition" which impacts the amount of compensation expense recognized for these awards. Specifically, the uncertainty regarding the achievement of the market condition was reflected in the grant date fair valuation of the RSUs, which is recognized as compensation expense over the relevant vesting period. The amount of compensation expense recognized is not dependent on whether the market condition was or will be achieved.

The Company makes dividend equivalent payments in connection with certain of its equity-based awards. A dividend equivalent is a right to receive a distribution equal to the dividend distributions that would be paid on a share of the Company's common stock. Dividend equivalents may be granted as a separate instrument or may be a right associated with the grant of another award (e.g., an RSU) under the Company's Equity Compensation Plan (the "Equity Plan"), and they are paid in cash or other consideration at such times and in accordance with such rules, terms and conditions, as the Compensation Committee may determine in its discretion. Payments pursuant to dividend

equivalents are generally charged to Stockholders' Equity to the extent that the attached equity awards are expected to vest. Compensation expense is recognized for payments made for dividend equivalents to the extent that the attached equity awards (i) do not or are not expected to vest and (ii) grantees are not required to return payments of dividends or dividend equivalents to the Company. (See Notes 2(m) and 13)

(m) Earnings per Common Share ("EPS")

Basic EPS is computed using the two-class method, which includes the weighted-average number of shares of common stock outstanding during the period and an estimate of other securities that participate in dividends, such as the Company's unvested restricted stock and RSUs that have non-forfeitable rights to dividends and dividend equivalents attached to/associated with RSUs and vested stock options to arrive at total common equivalent shares. In applying the two-class method, earnings are allocated to both shares of common stock and estimated securities that participate in dividends based on their respective weighted-average shares outstanding for the period. For the diluted EPS calculation, common equivalent shares are further adjusted for the effect of dilutive unexercised stock options and RSUs outstanding that are unvested and have dividends that are subject to forfeiture using the treasury stock method. Under the treasury stock method, common equivalent shares are calculated assuming that all

dilutive common stock equivalents are exercised and the proceeds, along with future compensation expenses associated with such instruments, are used to repurchase shares of the Company's outstanding common stock at the average market price during the reported period. (See Note 12)

(n) Comprehensive Income/(Loss)

The Company's comprehensive income/(loss) available to common stock and participating securities includes net income, the change in net unrealized gains/(losses) on its AFS securities and derivative hedging instruments, (to the extent that such changes are not recorded in earnings), adjusted by realized net gains/(losses) reclassified out of AOCI for sold AFS securities and is reduced by dividends declared on the Company's preferred stock and issuance costs of redeemed preferred stock.

(o) U.S. Federal Income Taxes

The Company has elected to be taxed as a REIT under the provisions of the Internal Revenue Code of 1986, as amended, (the "Code") and the corresponding provisions of state law. The Company expects to operate in a manner that will enable it to satisfy the various requirements to maintain its status as a REIT for federal income tax purposes. In order to maintain its status as a REIT, the Company must, among other things, distribute at least 90% of its REIT taxable income (excluding net long-term capital gains) to stockholders in the timeframe permitted by the Code. As long as the Company maintains its status as a REIT, the Company will not be subject to regular federal income tax to the extent that it distributes 100% of its REIT taxable income (including net long-term capital gains) to its stockholders within the permitted timeframe. Should this not occur, the Company would be subject to federal taxes at prevailing corporate tax rates on the difference between its REIT taxable income and the amounts deemed to be distributed for that tax year. As the Company's objective is to distribute 100% of its REIT taxable income to its stockholders within the permitted timeframe, no provision for current or deferred income taxes has been made in the accompanying consolidated financial statements. Should the Company incur a liability for corporate income tax, such amounts would be recorded as REIT income tax expense on the Company's consolidated statements of operations. Furthermore, if the Company fails to distribute during each calendar year, or by the end of January following the calendar year in the case of distributions with declaration and record dates falling in the last three months of the calendar year, at least the sum of (i) 85% its REIT ordinary income for such year, (ii) 95% of its REIT capital gain income for such year, and (iii) any undistributed taxable income from prior periods, the Company would be subject to a 4% nondeductible excise tax on the excess of the required distribution over the amounts actually distributed. To the extent that the Company incurs interest, penalties or related excise taxes in connection with its tax obligations, including as a result of its assessment of uncertain tax positions, such amounts will be included in Operating and Other Expense on the Company's consolidated statements of operations.

In addition, the Company has elected to treat certain of its subsidiaries as a TRS. In general, a TRS may hold assets and engage in activities that the Company cannot hold or engage in directly and generally may engage in any real estate or non-real estate-related business. Generally, a domestic TRS is subject to U.S. federal, state and local corporate income taxes. Since a portion of the Company's business may be conducted through one or more TRS, its income earned by TRS may be subject to corporate income taxation. To maintain the Company's REIT election, no more than 20% of the value of a REIT's assets at the end of each calendar quarter may consist of stock or securities in TRS. For purposes of the determination of U.S. federal and state income taxes, the Company's subsidiaries that elected to be treated as a TRS record current or deferred income taxes based on differences (both permanent and timing) between the determination of their taxable income and net income under GAAP. No deferred tax benefit was recorded by the Company for the nine months ended September 30, 2018 and 2017, as a valuation allowance for the full

amount of the associated deferred tax asset was recognized as its recovery is not considered more likely than not.

Based on its analysis of any potential uncertain tax positions, the Company concluded that it does not have any material uncertain tax positions that meet the relevant recognition or measurement criteria as of September 30, 2018, December 31, 2017, or September 30, 2017. The Company filed its 2017 tax return prior to October 15, 2018. The Company's tax returns for tax years 2015 through 2017 are open to examination.

(p) Derivative Financial Instruments

The Company may use a variety of derivative instruments to economically hedge a portion of its exposure to market risks, including interest rate risk and prepayment risk. The objective of the Company's risk management strategy is to reduce fluctuations in net book value over a range of interest rate scenarios. In particular, the Company attempts to mitigate the risk of the cost of its variable rate liabilities increasing during a period of rising interest rates. The Company's derivative instruments are currently comprised of Swaps, the majority of which are designated as cash flow hedges against the interest rate risk associated with its borrowings.

Swaps

The Company documents its risk-management policies, including objectives and strategies, as they relate to its hedging activities and the relationship between the hedging instrument and the hedged liability for all Swaps designated as hedging transactions. The Company assesses, both at inception of a hedge and on a quarterly basis thereafter, whether or not the hedge is "highly effective."

Swaps are carried on the Company's consolidated balance sheets at fair value, in Other assets, if their fair value is positive, or in Other liabilities, if their fair value is negative. Beginning in January 2017, variation margin payments on the Company's Swaps that have been novated to a clearing house are treated as a legal settlement of the exposure under the Swap contract. Previously such payments were treated as collateral pledged against the exposure under the Swap contract. The effect of this change is to reduce what would have otherwise been reported as fair value of the Swap. All of the Company's Swaps have been novated to a central clearing house. Changes in the fair value of the Company's Swaps designated in hedging transactions are recorded in OCI provided that the hedge remains effective. Changes in fair value for any ineffective amount of a Swap are recognized in earnings. The Company has not recognized any change in the value of its existing Swaps designated as hedges through earnings as a result of hedge ineffectiveness. Periodic payments accrued in connection with Swaps designated as hedges are included in interest expense, and are treated as an operating cash flow.

The Company discontinues hedge accounting on a prospective basis and recognizes changes in fair value through earnings when: (i) it is determined that the derivative is no longer effective in offsetting cash flows of a hedged item (including forecasted transactions); (ii) it is no longer probable that the forecasted transaction will occur; or (iii) it is determined that designating the derivative as a hedge is no longer appropriate. (See Notes 5(c), 7 and 14)

Changes in the fair value of the Company's Swaps not designated in hedging transactions are recorded in Other income, net on the Company's consolidated statement of operations.

(q) Fair Value Measurements and the Fair Value Option for Financial Assets and Financial Liabilities

The Company's presentation of fair value for its financial assets and liabilities is determined within a framework that stipulates that the fair value of a financial asset or liability is an exchange price in an orderly transaction between market participants to sell the asset or transfer the liability in the market in which the reporting entity would transact for the asset or liability, that is, the principal or most advantageous market for the asset or liability. The transaction to sell the asset or transfer the liability is a hypothetical transaction at the measurement date, considered from the perspective of a market participant that holds the asset or owes the liability. This definition of fair value focuses on exit price and prioritizes the use of market-based inputs over entity-specific inputs when determining fair value. In addition, the framework for measuring fair value establishes a three-level hierarchy for fair value measurements based

upon the observability of inputs to the valuation of an asset or liability as of the measurement date.

In addition to the financial instruments that it is required to report at fair value, the Company has elected the fair value option for certain of its residential whole loans, Agency MBS and CRT securities at time of acquisition. Subsequent changes in the fair value of these financial instruments are reported in Other income, net, in the Company's consolidated statements of operations. A decision to elect the fair value option for an eligible financial instrument, which may be made on an instrument by instrument basis, is irrevocable. (See Notes 2(b), 2(d), 3, 4 and 14)

(r) Variable Interest Entities

An entity is referred to as a VIE if it meets at least one of the following criteria: (i) the entity has equity that is insufficient to permit the entity to finance its activities without additional subordinated financial support of other parties; or (ii) as a group, the holders of the equity investment at risk lack (a) the power to direct the activities of an entity that most significantly impact the entity's economic performance; (b) the obligation to absorb the expected losses; or (c) the right to receive the expected residual returns; or (iii) have disproportional voting rights and the entity's activities are conducted on behalf of the investor that has disproportionately few voting rights.

The Company consolidates a VIE when it has both the power to direct the activities that most significantly impact the economic performance of the VIE and a right to receive benefits or absorb losses of the entity that could be potentially significant to the VIE. The Company is required to reconsider its evaluation of whether to consolidate a VIE each reporting period, based upon changes in the facts and circumstances pertaining to the VIE.

The Company has entered into several financing transactions which resulted in the Company consolidating the VIEs that were created to facilitate these transactions. In determining the accounting treatment to be applied to these transactions, the Company concluded that the entities used to facilitate these transactions were VIEs and that they should be consolidated. If the Company had determined that consolidation was not required, it would have then assessed whether the transfers of the underlying assets would qualify as sale or should be accounted for as secured financings under GAAP. (See Note 15)

The Company also includes on its consolidated balance sheets certain financial assets and liabilities that are acquired/issued by trusts and/or other special purpose entities that have been evaluated as being required to be consolidated by the Company under the applicable accounting guidance.

(s) Offering Costs Related to Issuance and Redemption of Preferred Stock

Offering costs related to issuance of preferred stock are recorded as a reduction in Additional paid-in capital, a component of Stockholders' Equity, at the time such preferred stock is issued. On redemption of preferred stock, any excess of the fair value of the consideration transferred to the holders of the preferred stock over the carrying amount of the preferred stock in the Company's consolidated balance sheets is included in the determination of Net Income Available to Common Stock and Participating Securities in the calculation of EPS.

(t) New Accounting Standards and Interpretations

Accounting Standards Adopted in 2018

Compensation - Stock Compensation - Scope of Modification Accounting

In May 2017, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2017-09, Scope of Modification Accounting ("ASU 2017-09"). The amendments in ASU 2017-09 provide guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting. Pursuant to this ASU, an entity should account for the effects of a modification unless all of the following are met: (1) the fair value (or calculated value or intrinsic value, if such an alternative measurement method is used) of the modified award is the same as the fair value (or calculated value or intrinsic value, if such an alternative measurement method is used) of the original award immediately before the original award is modified; (2)

the vesting conditions of the modified award are the same as the vesting conditions of the original award immediately before the original award is modified; and (3) the classification of the modified award as an equity instrument or a liability instrument is the same as the classification of the original award immediately before the original award date is modified. The Company adopted ASU 2017-09 on January 1, 2018 and its adoption did not have an impact on its financial position or financial statement disclosures.

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Statement of Cash Flows - Restricted Cash

In November 2016, the FASB issued ASU 2016-18, Restricted Cash ("ASU 2016-18"). ASU 2016-18 clarifies how entities should present restricted cash and restricted cash equivalents in the statement of cash flows with the objective of reducing the existing diversity in practice. The amendments in ASU 2016-18 require restricted cash and restricted cash equivalents to be included with cash and cash equivalents when reconciling the beginning-of-period and end-of period total amounts shown on the statement of cash flows. The Company adopted ASU 2016-18 on January 1, 2018 and its adoption did not have a significant impact on its financial position or financial statement disclosures.

Statement of Cash Flows - Classification of Certain Cash Receipts and Cash Payments

In August 2016, the FASB issued ASU 2016-15, Classification of Certain Cash Receipts and Cash Payments ("ASU 2016-15"). The amendments in ASU 2016-15 provide guidance for eight specific cash flow classification issues, certain cash receipts and cash payments on the statement of cash flows with the objective of reducing the existing diversity in practice. The Company adopted ASU 2016-15 on January 1, 2018 and its adoption did not have a significant impact on its financial position or financial statement disclosures.

Financial Instruments - Overall - Recognition and Measurement of Financial Assets and Financial Liabilities

In January 2016, the FASB issued ASU 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities ("ASU 2016-01"). The amendments in this ASU affect all entities that hold financial assets or owe financial liabilities, and address certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. The classification and measurement guidance of investments in debt securities and loans are not affected by the amendments in this ASU. ASU 2016-01 was effective for the Company for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. The Company's adoption of this ASU on January 1, 2018 did not have a significant impact on the Company's financial position or financial statement disclosures as the classification and measurement of its investments in debt securities and loans were not affected by the amendments in this ASU.

Revenue from Contracts with Customers

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers ("ASU 2014-09"). The ASU requires an entity to recognize revenue in an amount that reflects the consideration to which it expects to be entitled for the transfer of promised goods or services to customers. ASU 2014-09 replaced most existing revenue recognition guidance in GAAP when it became effective. The Company adopted this ASU on January 1, 2018 and its adoption did not have a material impact on the Company's financial position or financial statement disclosures as the majority of the Company's revenues are generated by financial instruments that are explicitly scoped out of this ASU. On adoption of the new standard on January 1, 2018, the Company recorded a transition adjustment, under the modified retrospective approach, of approximately $295,000 to the opening balance of retained earnings in order to reflect the recognition of a gain on sale of REO that was previously deferred under the prior accounting guidance.

## 3. MBS, CRT Securities and MSR Related Assets

### Agency and Non-Agency MBS

The Company's MBS are comprised of Agency MBS and Non-Agency MBS which include MBS issued prior to 2008 ("Legacy Non-Agency MBS"). These MBS are secured by: (i) hybrid mortgages ("Hybrids"), which have interest rates that are fixed for a specified period of time and, thereafter, generally adjust annually to an increment over a specified interest rate index; (ii) adjustable-rate mortgages ("ARMs"), which have interest rates that reset annually or more frequently (collectively, "ARM-MBS"); and (iii) 15 and 30 year fixed-rate mortgages for Agency MBS and, for Non-Agency MBS, 30-year and longer-term fixed rate mortgages. In addition, the Company's MBS are also comprised of MBS backed by securitized re-performing/non-performing loans ("RPL/NPL MBS"), where the cash flows of the bond may not reflect the contractual cash flows of the underlying collateral. The Company's RPL/NPL MBS are primarily structured with a contractual coupon step-up feature where the coupon increases from 300 - 400 basis points at 36 - 48 months from issuance or sooner. The Company pledges a significant portion of its MBS as collateral against its borrowings under repurchase agreements and Swaps. (See Note 7)

Agency MBS: Agency MBS are guaranteed as to principal and/or interest by a federally chartered corporation, such as Fannie Mae or Freddie Mac, or an agency of the U.S. Government, such as Ginnie Mae. The payment of principal and/or interest on Ginnie Mae MBS is explicitly backed by the full faith and credit of the U.S. Government. Since the third quarter of 2008, Fannie Mae and Freddie Mac have been under the conservatorship of the Federal Housing Finance Agency, which significantly strengthened the backing for these government-sponsored entities.

Non-Agency MBS: The Company's Non-Agency MBS are primarily secured by pools of residential mortgages, which are not guaranteed by an agency of the U.S. Government or any federally chartered corporation. Credit risk associated with Non-Agency MBS is regularly assessed as new information regarding the underlying collateral becomes available and based on updated estimates of cash flows generated by the underlying collateral.

### CRT Securities

CRT securities are debt obligations issued by Fannie Mae and Freddie Mac. The payments of principal and interest on the CRT securities are paid by Fannie Mae or Freddie Mac, as the case may be, on a monthly basis, and are dependent on the performance of loans in a reference pool of Agency MBS securitized by the issuing entity. As an investor in a CRT security, the Company may incur a loss if losses on the mortgage loans in the reference pool exceed the credit enhancement on the underlying CRT security owned by the Company. The Company assesses the credit risk associated with CRT securities by assessing the current and expected future performance of the associated reference pool. The Company pledges a portion of its CRT securities as collateral against its borrowings under repurchase agreements. (See Note 7)

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The following tables present certain information about the Company's MBS and CRT securities at September 30, 2018 and December 31, 2017:

September 30, 2018

| (In Thousands) | Principal/ Current Face | Purchase Premiums | Accretable Purchase Discounts | Discount Designated as Credit Reserve and OTTI (1) | Amortized Cost (2) | Fair Value | Gross Unrealized Gains | Gross Unrealized Losses | Net Unrealized Gain/(Loss) |
|---|---|---|---|---|---|---|---|---|---|
| Agency MBS: (3) | | | | | | | | | |
| Fannie Mae | $1,851,447 | $70,882 | $(29) | $— | $1,922,300 | $1,896,739 | $14,650 | $(40,211) | $(25,561) |
| Freddie Mac | 987,833 | 40,183 | — | — | 1,028,453 | 1,003,583 | 1,027 | (25,897) | (24,870) |
| Ginnie Mae | 5,028 | 92 | — | — | 5,120 | 5,168 | 48 | — | 48 |
| Total Agency MBS | 2,844,308 | 111,157 | (29) | — | 2,955,873 | 2,905,490 | 15,725 | (66,108) | (50,383) |
| Non-Agency MBS: | | | | | | | | | |
| Expected to Recover Par (4)(5) | 1,343,835 | 41 | (23,835) | — | 1,320,041 | 1,343,272 | 25,146 | (1,915) | 23,231 |
| Expected to Recover Less than Par (4) | 2,165,454 | — | (167,910) | (531,757) | 1,465,787 | 1,991,338 | 525,770 | (219) | 525,551 |
| Total Non-Agency MBS (6) | 3,509,289 | 41 | (191,745) | (531,757) | 2,785,828 | 3,334,610 | 550,916 | (2,134) | 548,782 |
| Total MBS | 6,353,597 | 111,198 | (191,774) | (531,757) | 5,741,701 | 6,240,100 | 566,641 | (68,242) | 498,399 |
| CRT securities (7) | 495,018 | 9,936 | (178) | — | 504,776 | 538,945 | 34,173 | (4) | 34,169 |
| Total MBS and CRT securities | $6,848,615 | $121,134 | $(191,952) | $(531,757) | $6,246,477 | $6,779,045 | $600,814 | $(68,246) | $532,568 |

December 31, 2017

| (In Thousands) | Principal/ Current Face | Purchase Premiums | Accretable Purchase Discounts | Discount Designated as Credit Reserve and OTTI (1) | Amortized Cost (2) | Fair Value | Gross Unrealized Gains | Gross Unrealized Losses | Net Unrealized Gain/(Loss) |
|---|---|---|---|---|---|---|---|---|---|
| Agency MBS: (3) | | | | | | | | | |
| Fannie Mae | $2,170,974 | $82,271 | $(40) | $— | $2,253,205 | $2,246,600 | $21,736 | $(28,341) | $(6,605) |
| Freddie Mac | 561,346 | 21,683 | — | — | 584,920 | 571,748 | 1,624 | (14,796) | (13,172) |
| Ginnie Mae | 6,142 | 112 | — | — | 6,254 | 6,333 | 79 | — | 79 |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Total Agency MBS | 2,738,462 | 104,066 | (40) | — | 2,844,379 | 2,824,681 | 23,439 | (43,137) | (19,698) |
| Non-Agency MBS: | | | | | | | | | |
| Expected to Recover Par (4)(5) | 1,128,808 | 50 | (22,737) | — | 1,106,121 | 1,132,205 | 26,518 | (434) | 26,084 |
| Expected to Recover Less than Par (4) | 2,589,935 | — | (192,588) | (593,227) | 1,804,120 | 2,401,761 | 597,660 | (19) | 597,641 |
| Total Non-Agency MBS (6) | 3,718,743 | 50 | (215,325) | (593,227) | 2,910,241 | 3,533,966 | 624,178 | (453) | 623,725 |
| Total MBS | 6,457,205 | 104,116 | (215,365) | (593,227) | 5,754,620 | 6,358,647 | 647,617 | (43,590) | 604,027 |
| CRT securities (7) | 602,799 | 8,887 | (3,550) | — | 608,136 | 664,403 | 56,290 | (23) | 56,267 |
| Total MBS and CRT securities | $7,060,004 | $113,003 | $(218,915) | $(593,227) | $6,362,756 | $7,023,050 | $703,907 | $(43,613) | $660,294 |

(1) Discount designated as Credit Reserve and amounts related to OTTI are generally not expected to be accreted into interest income.  Amounts disclosed at September 30, 2018 reflect Credit Reserve of $519.6 million and OTTI of $12.2 million.  Amounts disclosed at December 31, 2017 reflect Credit Reserve of $579.0 million and OTTI of $14.2 million.

(2) Includes principal payments receivable of $438,000 and $1.9 million at September 30, 2018 and December 31, 2017, respectively, which are not included in the Principal/Current Face.

(3) Amounts disclosed at September 30, 2018 include Agency MBS with a fair value of $746.7 million for which the fair value option has been elected. Such securities had no unrealized gains and gross unrealized losses of approximately $5.5 million at September 30, 2018. The Company did not have any Agency MBS for which the fair value option had been elected at December 31, 2017.

(4) Based on management's current estimates of future principal cash flows expected to be received.

(5) Includes RPL/NPL MBS, which at September 30, 2018 had a $1.2 billion Principal/Current face, $1.2 billion amortized cost and $1.2 billion fair value. At December 31, 2017, RPL/NPL MBS had a $922.0 million Principal/Current face, $920.1 million amortized cost and $923.1 million fair value.

(6) At September 30, 2018 and December 31, 2017, the Company expected to recover approximately 85% and 84% of the then-current face amount of Non-Agency MBS, respectively.

(7) Amounts disclosed at September 30, 2018 includes CRT securities with a fair value of $538.9 million for which the fair value option has been elected. Such securities had gross unrealized gains of approximately $34.2 million and gross unrealized losses of approximately $4,000 at September 30, 2018. Amounts disclosed at December 31, 2017 includes CRT securities with a fair value of $528.9 million for which the fair value option has been elected. Such securities had gross unrealized gains of approximately $40.5 million and gross unrealized losses of approximately $23,000 at December 31, 2017.

Sales of MBS and CRT Securities

During the nine months ended September 30, 2018, the Company sold certain Agency MBS for $75.3 million realizing losses of $3.8 million. The Company also sold certain CRT securities during the three and nine months ended September 30, 2018 for $118.9 million and $222.9 million, realizing gains of $13.0 million and $24.2 million, respectively. In addition, during the three and nine months ended September 30, 2018, the Company sold certain Non-Agency MBS for $24.3 million and $43.7 million, realizing gains of $3.4 million and $12.2 million, respectively. During the three and nine months ended September 30, 2017, the Company sold certain Non-Agency MBS for $44.5 million and $83.1 million, realizing gains of $14.9 million and $30.8 million, respectively. The Company has no continuing involvement with any of the sold MBS.

Unrealized Losses on MBS and CRT Securities

The following table presents information about the Company's MBS and CRT securities that were in an unrealized loss position at September 30, 2018:

| Unrealized Loss Position For: | Less than 12 Months | | | 12 Months or more | | | Total | |
|---|---|---|---|---|---|---|---|---|
| (Dollars in Thousands) | Fair Value | Unrealized Losses | Number of Securities | Fair Value | Unrealized Losses | Number of Securities | Fair Value | Unrealized Losses |
| Agency MBS: (1) | | | | | | | | |
| Fannie Mae | $438,980 | $4,293 | 105 | $838,566 | $35,918 | 251 | $1,277,546 | $40,211 |
| Freddie Mac | 668,566 | 6,020 | 37 | 298,083 | 19,877 | 103 | 966,649 | 25,897 |
| Total Agency MBS | 1,107,546 | 10,313 | 142 | 1,136,649 | 55,795 | 354 | 2,244,195 | 66,108 |
| Non-Agency MBS: | | | | | | | | |
| Expected to Recover Par (2) | 435,011 | 1,849 | 15 | 3,877 | 66 | 7 | 438,888 | 1,915 |
| Expected to Recover Less than Par (2) | 44,630 | 219 | 6 | — | — | — | 44,630 | 219 |
| Total Non-Agency MBS | 479,641 | 2,068 | 21 | 3,877 | 66 | 7 | 483,518 | 2,134 |
| Total MBS | 1,587,187 | 12,381 | 163 | 1,140,526 | 55,861 | 361 | 2,727,713 | 68,242 |
| CRT securities (3) | 15,754 | 4 | 4 | — | — | — | 15,754 | 4 |
| Total MBS and CRT securities | $1,602,941 | $12,385 | 167 | $1,140,526 | $55,861 | 361 | $2,743,467 | $68,246 |

(1) Amounts disclosed at September 30, 2018 include Agency MBS with a fair value of $746.7 million on which the fair value option has been elected. Such securities had unrealized losses of $5.5 million at September 30, 2018.
(2) Based on management's current estimates of future principal cash flows expected to be received.
(3) Amounts disclosed at September 30, 2018 represent CRT securities on which the fair value option has been elected.

At September 30, 2018, the Company did not intend to sell any of its investments that were in an unrealized loss position, and it is "more likely than not" that the Company will not be required to sell these securities before recovery of their amortized cost basis, which may be at their maturity.

Gross unrealized losses on the Company’s Agency MBS were $66.1 million at September 30, 2018. Agency MBS are issued by Government Sponsored Entities (“GSEs”) and enjoy either the implicit or explicit backing of the full faith and credit of the U.S. Government. While the Company’s Agency MBS are not rated by any rating agency, they are currently perceived by market participants to be of high credit quality, with risk of default limited to the unlikely event that the U.S. Government would not continue to support the GSEs. Given the credit quality inherent in Agency MBS, the Company does not consider any of the current impairments on its Agency MBS to be credit related. In assessing whether it is more likely than not that it will be required to sell any impaired security before its anticipated recovery, which may be at its maturity, the Company considers for each impaired security, the significance of each investment, the amount of impairment, the projected future performance of such impaired securities, as well as the Company’s current and anticipated leverage capacity and liquidity position. Based on these analyses, the Company determined that at September 30, 2018 any unrealized losses on its Agency MBS were temporary.

Gross unrealized losses on the Company’s Non-Agency MBS were $2.1 million at September 30, 2018. Based upon the most recent evaluation, the Company does not consider these unrealized losses to be indicative of OTTI and does not believe that

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these unrealized losses are credit related, but are rather a reflection of current market yields and/or marketplace bid-ask spreads. The Company has reviewed its Non-Agency MBS that are in an unrealized loss position to identify those securities with losses that are other-than-temporary based on an assessment of changes in expected cash flows for such securities, which considers recent bond performance and, where possible, expected future performance of the underlying collateral.

The Company did not recognize any credit-related OTTI losses through earnings related to its Non-Agency MBS during the three and nine months ended September 30, 2018 and three months ended September 30, 2017. The Company recognized credit-related OTTI losses through earnings related to its Non-Agency MBS of $1.0 million during the nine months ended September 30, 2017.

Non-Agency MBS on which OTTI is recognized have experienced, or are expected to experience, credit-related adverse cash flow changes. The Company's estimate of cash flows for these Non-Agency MBS is based on its review of the underlying mortgage loans securing these MBS. The Company considers information available about the structure of the securitization, including structural credit enhancement, if any, and the past and expected future performance of underlying mortgage loans, including timing of expected future cash flows, prepayment rates, default rates, loss severities, delinquency rates, percentage of non-performing loans, year of origination, LTVs, geographic concentrations, as well as Rating Agency reports, general market assessments, and dialogue with market participants. Changes in the Company's evaluation of each of these factors impacts the cash flows expected to be collected at the OTTI assessment date. For Non-Agency MBS purchased at a discount to par that were assessed for and had no OTTI recorded this period, such cash flow estimates indicated that the amount of expected losses decreased compared to the previous OTTI assessment date. These positive cash flow changes are primarily driven by recent improvements in LTVs due to loan amortization and home price appreciation, which, in turn, positively impacts the Company's estimates of default rates and loss severities for the underlying collateral. In addition, voluntary prepayments (i.e., loans that prepay in full with no loss) have generally trended higher relative to the Company's assumptions for these MBS which also positively impacts the Company's estimate of expected loss. Overall, the combination of higher voluntary prepayments and lower LTVs supports the Company's assessment that such MBS are not other-than-temporarily impaired.

The following table presents the composition of OTTI charges recorded by the Company for the three and nine months ended September 30, 2018 and 2017:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (In Thousands) | 2018 | 2017 | 2018 | 2017 |
| Total OTTI losses | $ — | $ — | $ — | $ (63) |
| OTTI reclassified from OCI | — | — | — | (969) |
| OTTI recognized in earnings | $ — | $ — | $ — | $ (1,032) |

The following table presents a roll-forward of the credit loss component of OTTI on the Company's Non-Agency MBS for which a non-credit component of OTTI was previously recognized in OCI. Changes in the credit loss component of OTTI are presented based upon whether the current period is the first time OTTI was recorded on a security or a subsequent OTTI charge was recorded.

| (In Thousands) | Three Months Ended September 30, 2018 | Nine Months Ended September 30, 2018 |
|---|---|---|
| Credit loss component of OTTI at beginning of period | $ 38,337 | $ 38,337 |
| Additions for credit related OTTI not previously recognized | — | — |
| Subsequent additional credit related OTTI recorded | — | — |
| Credit loss component of OTTI at end of period | $ 38,337 | $ 38,337 |

Purchase Discounts on Non-Agency MBS

The following tables present the changes in the components of the Company's purchase discount on its Non-Agency MBS between purchase discount designated as Credit Reserve and OTTI and accretable purchase discount for the three and nine months ended September 30, 2018 and 2017:

| | Three Months Ended September 30, 2018 | | Three Months Ended September 30, 2017 | |
|---|---|---|---|---|
| (In Thousands) | Discount Designated as Credit Reserve and OTTI | Accretable Discount (1) | Discount Designated as Credit Reserve and OTTI | Accretable Discount (1) |
| Balance at beginning of period | $(553,596) | $(202,248) | $(626,498) | $(257,967) |
| Impact of RMBS Issuer Settlement (2) | — | (2,734) | — | — |
| Accretion of discount | — | 20,115 | — | 18,621 |
| Realized credit losses | 12,042 | — | 13,982 | — |
| Purchases | (1,975) | 1,368 | — | (1,929) |
| Sales | 1,552 | 1,974 | 4,620 | 11,244 |
| Transfers/release of credit reserve | 10,220 | (10,220) | 14,762 | (14,762) |
| Balance at end of period | $(531,757) | $(191,745) | $(593,134) | $(244,793) |

| | Nine Months Ended September 30, 2018 | | Nine Months Ended September 30, 2017 | |
|---|---|---|---|---|
| (In Thousands) | Discount Designated as Credit Reserve and OTTI | Accretable Discount (1) | Discount Designated as Credit Reserve and OTTI | Accretable Discount (1) |
| Balance at beginning of period | $(593,227) | $(215,325) | $(694,241) | $(278,191) |
| Impact of RMBS Issuer Settlement (2)(3) | — | (14,822) | — | — |
| Accretion of discount | — | 54,860 | — | 60,461 |
| Realized credit losses | 31,443 | — | 39,445 | — |
| Purchases | (2,510) | 1,856 | (484) | (3,449) |
| Sales | 7,144 | 7,079 | 29,398 | 10,166 |
| Net impairment losses recognized in earnings | — | — | (1,032) | — |
| Transfers/release of credit reserve | 25,393 | (25,393) | 33,780 | (33,780) |
| Balance at end of period | $(531,757) | $(191,745) | $(593,134) | $(244,793) |

(1) Together with coupon interest, accretable purchase discount is recognized as interest income over the life of the security.

(2) Includes the impact of approximately $2.7 million of cash proceeds (a one-time payment) received by the Company during the three and nine months ended September 30, 2018 in connection with the settlement of litigation related to certain residential mortgage backed securitization trusts that were sponsored by Lehman

Brothers Holdings Inc.

(3) Includes the impact of approximately $12.1 million of cash proceeds (a one-time payment) received by the Company during the nine months ended September 30, 2018 in connection with the settlement of litigation related to certain residential mortgage backed securitization trusts that were sponsored by JP Morgan Chase & Co. and affiliated entities.

MSR Related Assets

(a) Term Notes Backed by MSR Related Collateral

At September 30, 2018 and December 31, 2017, the Company had $505.2 million and $381.8 million, respectively, of term notes issued by SPVs that have acquired rights to receive cash flows representing the servicing fees and/or excess servicing spread associated with certain MSRs. Payment of principal and interest on these term notes is considered to be largely dependent on cash flows generated by the underlying MSRs, as this impacts the cash flows available to the SPV that issued the term notes.

At September 30, 2018, these term notes had an amortized cost of $504.3 million, gross unrealized gains of approximately $922,000, a weighted average yield of 5.15% and a weighted average term to maturity of 4.5 years. At December 31, 2017, the term notes had an amortized cost of $381.0 million, unrealized gains of $804,000, a weighted average yield of 5.80% and a weighted average term to maturity of 3.4 years.

(b) Corporate Loans

The Company has made or participated in loans to provide financing to entities that originate residential mortgage loans and own the related MSRs. These corporate loans are secured by MSRs, as well as certain other unencumbered assets owned by the borrower.

During the three months ended September 30, 2018, the Company participated in a loan where the Company committed to lend $100.0 million of which approximately $60.1 million was drawn at September 30, 2018. At September 30, 2018, the coupon paid by the borrower on the drawn amount is 5.64%, the remaining term associated with the loan is 1.9 years and the remaining commitment period on any undrawn amount is 1.9 years. During the remaining commitment period, the Company receives a commitment fee between 0.25% and 1.0% based on the undrawn amount of the loan.

In December 2016, the Company entered into a loan agreement under the terms of which it had committed to lend $130.0 million, of which approximately $124.2 million was drawn at March 31, 2018. This loan was paid in full during the three months ended June 30, 2018, at which time any remaining commitment was extinguished.

For the three and nine months ended September 30, 2018, the Company recognized interest income on its corporate loans of $138,000 and $3.8 million including discount accretion and commitment fee income of $19,000 and $1.3 million, respectively. In addition, the Company recorded $136,000 of Other Income consisting of deferred commitment fees recognized upon repayment of a corporate loan during the nine months ended September 30, 2018. For the three and nine months ended September 30, 2017, the Company recognized interest income on its corporate loans of approximately $2.1 million and $5.7 million including discount accretion and commitment fee income of approximately $76,000 and $212,000, respectively.

Impact of AFS Securities on AOCI

The following table presents the impact of the Company's AFS securities on its AOCI for the three and nine months ended September 30, 2018 and 2017:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (In Thousands) | 2018 | 2017 | 2018 | 2017 |
| AOCI from AFS securities: | | | | |
| Unrealized gain on AFS securities at beginning of period | $548,551 | $668,223 | $620,648 | $620,403 |
| Unrealized loss on Agency MBS, net | (9,177) | (3,032) | (27,507) | (22,241) |
| Unrealized (loss)/gain on Non-Agency MBS, net | (25,101) | 10,020 | (62,743) | 93,429 |
| Reclassification adjustment for MBS sales included in net income | (9,455) | (14,935) | (25,580) | (30,283) |
| Reclassification adjustment for OTTI included in net income | — | — | — | (1,032) |
| Change in AOCI from AFS securities | (43,733) | (7,947) | (115,830) | 39,873 |
| Balance at end of period | $504,818 | $660,276 | $504,818 | $660,276 |

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NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2018

Interest Income on MBS, CRT Securities and MSR Related Assets

The following table presents the components of interest income on the Company’s MBS, CRT securities and MSR related assets for the three and nine months ended September 30, 2018 and 2017:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (In Thousands) | 2018 | 2017 | 2018 | 2017 |
| Agency MBS | | | | |
| Coupon interest | $21,549 | $23,473 | $62,546 | $74,589 |
| Effective yield adjustment (1) | (7,217) | (7,940) | (19,751) | (24,575) |
| Interest income | $14,332 | $15,533 | $42,795 | $50,014 |
| | | | | |
| Legacy Non-Agency MBS | | | | |
| Coupon interest | $27,026 | $30,688 | $83,791 | $97,796 |
| Effective yield adjustment (2)(3) | 18,984 | 18,005 | 53,648 | 59,033 |
| Interest income | $46,010 | $48,693 | $137,439 | $156,829 |
| | | | | |
| RPL/NPL MBS | | | | |
| Coupon interest | $11,526 | $13,947 | $31,167 | $54,475 |
| Effective yield adjustment (1)(4) | 1,131 | 612 | 1,206 | 1,424 |
| Interest income | $12,657 | $14,559 | $32,373 | $55,899 |
| | | | | |
| CRT securities | | | | |
| Coupon interest | $7,257 | $7,868 | $23,484 | $19,712 |
| Effective yield adjustment (2) | 491 | 808 | 2,455 | 3,186 |
| Interest income | $7,748 | $8,676 | $25,939 | $22,898 |
| | | | | |
| MSR related assets | | | | |
| Coupon interest | $6,407 | $7,117 | $19,005 | $17,621 |
| Effective yield adjustment (1) | — | 77 | 1,244 | 212 |
| Interest income | $6,407 | $7,194 | $20,249 | $17,833 |

(1) Includes amortization of premium paid net of accretion of purchase discount. For Agency MBS, RPL/NPL MBS and the corporate loan secured by MSRs, interest income is recorded at an effective yield, which reflects net premium amortization/accretion based on actual prepayment activity.
(2) The effective yield adjustment is the difference between the net income calculated using the net yield, which is based on management’s estimates of the amount and timing of future cash flows, less the current coupon yield.
(3) Includes accretion income recognized due to the impact of redemptions of certain securities that had been previously been purchased at a discount of $2.3 million during the three months ended September 30, 2018 and $2.3 million and $1.7 million during the nine months ended September 30, 2018 and 2017, respectively.
(4) Includes accretion income recognized due to the impact of redemptions of certain securities that had been previously been purchased at a discount of $1.1 million and $575,000 during the three months ended September 30, 2018 and 2017, respectively and $1.2 million during each of the nine months ended September 30, 2018 and 2017, respectively.

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4. Residential Whole Loans

Included on the Company's consolidated balance sheets at September 30, 2018 and December 31, 2017 are approximately $3.9 billion and $2.2 billion, respectively, of residential whole loans arising from the Company's interests in certain trusts established to acquire the loans and certain entities established in connection with its loan securitization transactions. The Company has assessed that these entities are required to be consolidated for financial reporting purposes.

Residential Whole Loans, at Carrying Value

The following table presents the components of the Company's Residential whole loans, at carrying value at September 30, 2018 and December 31, 2017:

| (Dollars In Thousands) | September 30, 2018 | December 31, 2017 |
|---|---|---|
| Purchased credit impaired loans | $825,614 | $790,879 |
| Other loans at carrying value: | | |
| Non-QM loans | 989,818 | 55,612 |
| Rehabilitation loans | 329,301 | 56,706 |
| Single-family rental loans | 79,699 | 5,319 |
| Seasoned performing loans | 247,135 | — |
| Total other loans at carrying value | $1,645,953 | $117,637 |
| Total Residential whole loans, at carrying value | $2,471,567 | $908,516 |
| | | |
| Number of loans | 9,900 | 4,800 |

The following table presents additional information regarding the Company's Residential whole loans, at carrying value at September 30, 2018:

September 30, 2018

| (Dollars In Thousands) | Carrying Value | Unpaid Principal Balance ("UPB") | Weighted Average Coupon (1) | Weighted Average Term to Maturity (Months) | Weighted Average LTV Ratio (2) | Aging by UPB | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | Past Due Days | | |
| | | | | | | Current | 30-59 | 60-89 | 90+ |
| Purchased credit impaired loans | $825,614 | $1,034,890 | 4.36 % | 304 | 87 % | N/A | N/A | N/A | N/A |
| Other loans at carrying value:(3) | | | | | | | | | |
| Non-QM loans | 989,818 | 956,162 | 6.18 | 358 | 66 | $944,564 | $8,564 | $1,865 | $1,169 |
| Rehabilitation loans | 329,301 | 329,301 | 7.51 | 9 | 65 | 309,951 | 12,836 | 3,620 | 2,894 |
| Single-family rental loans | 79,699 | 79,563 | 5.84 | 355 | 68 | 78,172 | 870 | — | 521 |
| Seasoned performing loans | 240,362 | 260,770 | 4.05 | 194 | 49 | 239,025 | 20,373 | 635 | 737 |
| Residential whole loans, at carrying | $2,464,794 | $2,660,686 | 5.46 % | 278 | | | | | |

value, total or
weighted average

(1) Weighted average is calculated based on the interest bearing principal balance of each loan within the related category. For loans acquired with servicing rights released by the seller, interest rates included in the calculation do not reflect loan servicing fees. For loans acquired with servicing rights retained by the seller, interest rates included in the calculation are net of servicing fees.
(2) LTV represents the ratio of the total unpaid principal balance of the loan, to the estimated value of the collateral securing the related loan. For Rehabilitation loans, the LTV generally represents the ratio of the maximum unpaid principal balance of the loan, including unfunded commitments, to the estimated after repaired value of the collateral securing the related loan. For certain Rehabilitation loans, an after repaired valuation is not obtained during loan underwriting. For these loans, the LTV represents the ratio of the current unpaid principal balance of the loan, to the "as is" estimated value of the collateral securing the related loan.
(3) Excluded from the table above are approximately $6.8 million of other loans held at carrying value for which the closing of the purchase transaction had not occurred as of September 30, 2018.

Purchased Credit Impaired Loans

As of September 30, 2018, the Company had established an allowance for loan losses of approximately $461,000 on its purchased credit impaired loans held at carrying value. For the three and nine months ended September 30, 2018, a provision for loan losses of approximately $164,000 and $131,000 was recorded, respectively, which is included in Operating and Other expense on the Company’s consolidated statements of operations. For the three and nine months ended September 30, 2017, a net reversal of provision for loan losses of approximately $57,000 and $672,000 was recorded, respectively.

The following table presents the activity in the Company’s allowance for loan losses on its purchased credit impaired loans held at carrying value for the three and nine months ended September 30, 2018 and 2017:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (In Thousands) | 2018 | 2017 | 2018 | 2017 |
| Balance at the beginning of period | $297 | $375 | $330 | $990 |
| Provisions/(reversal of provisions) for loan losses | 164 | (57) | 131 | (672) |
| Balance at the end of period | $461 | $318 | $461 | $318 |

The following table presents information regarding the estimates of the contractually required payments, the cash flows expected to be collected, and the estimated fair value of the purchased credit impaired loans held at carrying value acquired by the Company for the three and nine months ended September 30, 2018 and 2017:

| | Three Months Ended September 30, (1) | | Nine Months Ended September 30, (1) | |
|---|---|---|---|---|
| (In Thousands) | 2018 | 2017 | 2018 | 2017 |
| Contractually required principal and interest | $154,911 | $185,234 | $154,911 | $185,234 |
| Contractual cash flows not expected to be collected (non-accretable yield) | (15,378) | (33,448) | (15,378) | (33,448) |
| Expected cash flows to be collected | 139,533 | 151,786 | 139,533 | 151,786 |
| Interest component of expected cash flows (accretable yield) | (41,947) | (53,916) | (41,947) | (53,916) |
| Fair value at the date of acquisition | $97,586 | $97,870 | $97,586 | $97,870 |

(1) Included in the activity presented for the three and nine months ended September 30, 2018 and 2017 are approximately $54.9 million and $97.9 million of purchase credit impaired loans held at carrying value the Company committed to purchase during the three months ended June 30, 2018 and 2017, but for which the closing of the purchase transaction occurred during the three months ended September 30, 2018 and 2017, respectively.

The following table presents accretable yield activity for the Company's purchased credit impaired loans held at carrying value for the three and nine months ended September 30, 2018 and 2017:

| | Three Months Ended September 30, (1) | | Nine Months Ended September 30, (1) | |
|---|---|---|---|---|
| (In Thousands) | 2018 | 2017 | 2018 | 2017 |
| Balance at beginning of period | $401,075 | $318,125 | $421,872 | $334,379 |
| Additions | 41,947 | 53,916 | 41,947 | 53,916 |
| Accretion | (11,198) | (9,026) | (33,139) | (26,219) |
| Liquidations and other | (8,378) | — | (23,388) | — |
| Reclassifications (to)/from non-accretable difference, net | 9,694 | 303 | 25,848 | 1,242 |
| Balance at end of period | $433,140 | $363,318 | $433,140 | $363,318 |

(1) Included in the activity presented for the three and nine months ended September 30, 2018 and 2017 are approximately $54.9 million and $97.9 million of purchase credit impaired loans held at carrying value the Company committed to purchase during the three months ended June 30, 2018 and 2017, but for which the closing of the purchase transaction occurred during the three months ended September 30, 2018 and 2017, respectively.

Accretable yield for purchased credit impaired residential whole loans is the excess of loan cash flows expected to be collected over the purchase price. The cash flows expected to be collected represent the Company's estimate of the amount and timing of undiscounted principal and interest cash flows. Additions include accretable yield estimates for purchases made during the period and reclassification to accretable yield from non-accretable yield. Accretable yield is reduced by accretion during the period. The reclassifications between accretable and non-accretable yield and the accretion of interest income are based on changes in estimates regarding loan performance and the value of the underlying real estate securing the loans. In future periods, as the Company updates estimates of cash flows expected to be collected from the loans and the underlying collateral, the accretable yield may change. Therefore, the amount of accretable income recorded during the three and nine months ended September 30, 2018 is not necessarily indicative of future results.

Other Loans at Carrying Value

As of September 30, 2018, there were ten loans held at carrying value, that have been placed on non-accrual status as they are more than 90 days delinquent and had not yet become current with respect to the contractually required payments under the loan. Such loans have an unpaid balance of approximately $5.3 million. These non-performing loans represent approximately 0.3% of the total outstanding principal balance of all of the Company's Other Loans at Carrying Value. Management has assessed the recoverability of these loans and based on estimates of the value of the underlying collateral, no allowance for loan loss reserves has been recorded as of September 30, 2018.

In connection with purchased Rehabilitation loans, the Company has unfunded commitments of $43.9 million.

Residential Whole Loans, at Fair Value

Certain of the Company's residential whole loans are presented at fair value on its consolidated balance sheets as a result of a fair value election made at time of acquisition. Subsequent changes in fair value are reported in current period earnings and presented in Net gain on residential whole loans held at fair value on the Company's consolidated statements of operations.

The following table presents information regarding the Company's residential whole loans held at fair value at September 30, 2018 and December 31, 2017:

| (Dollars in Thousands) | September 30, 2018 (1) | December 31, 2017 |
|---|---|---|
| Less than 60 Days Past Due: | | |
| Outstanding principal balance | $585,024 | $488,600 |
| Aggregate fair value | $544,890 | $446,616 |
| Weighted Average LTV Ratio (2) | 76.17 % | 74.98 % |
| Number of loans | 2,775 | 2,323 |
| | | |
| 60 Days to 89 Days Past Due: | | |
| Outstanding principal balance | $70,018 | $45,955 |
| Aggregate fair value | $62,043 | $37,927 |
| Weighted Average LTV Ratio (2) | 77.62 % | 89.25 % |
| Number of loans | 319 | 207 |
| | | |
| 90 Days or More Past Due: | | |
| Outstanding principal balance | $972,488 | $1,027,818 |
| Aggregate fair value | $840,634 | $840,572 |
| Weighted Average LTV Ratio (2) | 89.48 % | 94.50 % |
| Number of loans | 3,416 | 3,984 |
| Total Residential whole loans, at fair value | $1,447,567 | $1,325,115 |

(1) Excluded from the table above are approximately $1.8 million of residential whole loans held at fair value for which the closing of the purchase transaction had not occurred as of September 30, 2018.

(2) LTV represents the ratio of the total unpaid principal balance of the loan, to the estimated value of the collateral securing the related loan. Excluded from the calculation of weighted average LTV are certain low value loans secured by vacant lots, for which the LTV ratio is not meaningful.

The following table presents the components of Net gain on residential whole loans held at fair value for the three and nine months ended September 30, 2018 and 2017:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (In Thousands) | 2018 | 2017 | 2018 | 2017 |
| Coupon payments and other income received (1) | $17,634 | $9,824 | $52,034 | $27,971 |
| Net unrealized gains | 8,442 | 5,289 | 26,788 | 12,499 |

| | | | | |
|---|---|---|---|---|
| Net gain on payoff/liquidation of loans | 3,251 | 1,456 | 10,203 | 3,076 |
| Net gain on transfers to REO | 5,615 | 2,110 | 16,858 | 5,114 |
| Total | $34,942 | $18,679 | $105,883 | $48,660 |

(1) Primarily includes coupon interest payments received upon the liquidation of previously delinquent mortgage loans, recurring coupon interest payments received on mortgage loans that are contractually current, and cash payments received from private mortgage insurance on liquidated loans.

5. Other Assets

The following table presents the components of the Company's Other assets at September 30, 2018 and December 31, 2017:

| (In Thousands) | September 30, 2018 | December 31, 2017 |
|---|---|---|
| Securities obtained and pledged as collateral, at fair value | $ — | $ 504,062 |
| REO | 223,105 | 152,356 |
| MBS and loan related receivables | 101,578 | 54,640 |
| Swaps, at fair value | 22,311 | 679 |
| Goodwill | 7,189 | 7,189 |
| Other | 51,886 | 23,983 |
| Total Other Assets | $ 406,069 | $ 742,909 |

(a) Securities Obtained and Pledged as Collateral/Obligation to Return Securities Obtained as Collateral

In connection with its financing strategy for Non-Agency MBS, in prior periods the Company obtained securities as collateral under collateralized financing arrangements. Securities obtained as collateral in connection with these transactions are recorded at fair value, with a liability, representing the obligation to return the collateral obtained, recorded in Other liabilities. While beneficial ownership of securities obtained remains with the counterparty, the Company had the right to transfer the collateral obtained or to pledge it as part of a subsequent collateralized financing transaction. During the three months ended September 30, 2018, these financing arrangements were unwound and the related securities obtained as collateral were returned to the counterparty.

(b) Real Estate Owned

At September 30, 2018, the Company had 979 REO properties with an aggregate carrying value of $223.1 million. At December 31, 2017, the Company had 709 REO properties with an aggregate carrying value of $152.4 million.

During the three and nine months ended September 30, 2018, the Company reclassified to REO 240 and 795 mortgage loans, respectively at an aggregate estimated fair value less estimated selling costs of $58.1 million and $161.6 million, respectively, at the time of transfer. During the three and nine months ended September 30, 2017, the Company reclassified to REO 174 and 521 mortgage loans, respectively at an aggregate estimated fair value less estimated selling cost of $38.9 million and $97.4 million, respectively, at the time of transfer. Such transfers occur when the Company takes possession of the property by foreclosing on the borrower or completes a "deed-in-lieu of foreclosure" transaction. From time to time, the Company also acquires REO in connection with transactions to acquire residential whole loans.

At September 30, 2018, $214.4 million of residential real estate property was held by the Company that was acquired either through a completed foreclosure proceeding or from completion of a deed-in-lieu of foreclosure or similar legal agreement. In addition, formal foreclosure proceedings were in process with respect to $48.7 million of residential whole loans held at carrying value and $720.1 million of residential whole loans held at fair value at September 30,

2018.

During the three and nine months ended September 30, 2018, the Company sold 157 and 537 REO properties for consideration of $29.9 million and $96.0 million, realizing net gains of approximately $2.0 million and $6.6 million, respectively. During the three and nine months ended September 30, 2017, the Company sold 139 and 368 REO properties for consideration of $18.4 million and $53.0 million, realizing net gain of approximately $805,000 and $2.8 million, respectively. These amounts are included in Other Income, net on the Company's consolidated statements of operations. In addition, following an updated assessment of liquidation amounts expected to be realized that was performed on all REO held at the end of the third quarters of 2018 and 2017, downward adjustments of approximately $4.1 million and $3.1 million were recorded to reflect certain REO properties at the lower of cost or estimated fair value as of September 30, 2018 and 2017, respectively.

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The following table presents the activity in the Company's REO for the three and nine months ended September 30, 2018 and 2017:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (In Thousands) | 2018 | 2017 | 2018 | 2017 |
| Balance at beginning of period | $192,162 | $104,443 | $152,356 | $80,503 |
| Adjustments to record at lower of cost or fair value | (4,056) | (3,129) | (11,592) | (7,306) |
| Transfer from residential whole loans (1) | 58,051 | 38,944 | 161,572 | 97,388 |
| Purchases and capital improvements | 4,897 | 15,342 | 10,179 | 17,224 |
| Disposals | (27,949) | (17,621) | (89,410) | (49,830) |
| Balance at end of period | $223,105 | $137,979 | $223,105 | $137,979 |

(1) Includes net gain recorded on transfer of approximately $5.8 million and $2.8 million, for the three months ended September 30, 2018 and 2017, respectively; and approximately $17.0 million and $5.3 million for the nine months ended September 30, 2018 and 2017, respectively.

(c) Derivative Instruments

The Company's derivative instruments are currently comprised of Swaps, the majority of which are designated as cash flow hedges against the interest rate risk associated with its borrowings. In addition, in connection with managing risks associated with purchases of longer duration Agency MBS, the Company has also entered into Swaps that are not designated as hedges for accounting purposes. The following table presents the fair value of the Company's derivative instruments and their balance sheet location at September 30, 2018 and December 31, 2017:

| | | | September 30, 2018 | | December 31, 2017 | |
|---|---|---|---|---|---|---|
| Derivative Instrument (1) | Designation | Balance Sheet Location | Notional Amount | Fair Value | Notional Amount | Fair Value |
| (In Thousands) | | | | | | |
| Swaps | Hedging | Other assets | $2,122,000 | $18,650 | $750,000 | $ 679 |
| Swaps | Hedging | Other liabilities | $— | $— | $1,800,000 | $ — |
| Swaps | Non-Hedging | Other assets | $515,000 | $3,661 | $— | $ — |

(1) Represents Swaps executed bilaterally with a counterparty in the over-the-counter market but then novated to a central clearing house, whereby the central clearing house becomes the counterparty to both of the original counterparties.

Swaps

The following table presents the assets pledged as collateral against the Company's Swap contracts at September 30, 2018 and December 31, 2017:

| (In Thousands) | September 30, 2018 | December 31, 2017 |
|---|---|---|
| Agency MBS, at fair value | $ 2,877 | $ 21,756 |

| | | |
|---|---|---|
| Restricted cash | — | 6,405 |
| Total assets pledged against Swaps | $ 2,877 | $ 28,161 |

Swaps designated as hedges, or a portion thereof, could become ineffective in the future if the associated repurchase agreements that such derivatives hedge fail to exist or fail to have terms that match those of the derivatives that hedge such borrowings. At September 30, 2018, all of the Company's derivatives that were designated in a hedging relationship were deemed effective for hedging purposes.

The Company's Swaps designated as hedging transactions have the effect of modifying the repricing characteristics of the Company's repurchase agreements and cash flows for such liabilities. To date, no cost has been incurred at the inception of a

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Swap (except for certain transaction fees related to entering into Swaps cleared though a central clearing house), pursuant to which the Company agrees to pay a fixed rate of interest and receive a variable interest rate, generally based on one-month or three-month London Interbank Offered Rate ("LIBOR"), on the notional amount of the Swap. The Company did not recognize any change in the value of its existing Swaps designated as hedges through earnings as a result of hedge ineffectiveness during the three and nine months ended September 30, 2018 and 2017.

At September 30, 2018, the Company had Swaps with an aggregate notional amount of $2.6 billion and extended 32 months on average with a maximum term of approximately 121 months.

The following table presents information about the Company's Swaps at September 30, 2018 and December 31, 2017:

| | September 30, 2018 | | | December 31, 2017 | | |
|---|---|---|---|---|---|---|
| Maturity (1) | Notional Amount | Weighted Average Fixed-Pay Interest Rate | Weighted Average Variable Interest Rate (2) | Notional Amount | Weighted Average Fixed-Pay Interest Rate | Weighted Average Variable Interest Rate (2) |
| (Dollars in Thousands) | | | | | | |
| Within 30 days | $— | — % | — % | $— | — % | — % |
| Over 30 days to 3 months | — | — | — | — | — | — |
| Over 3 months to 6 months | 100,000 | 1.71 | 2.21 | 50,000 | 1.45 | 1.56 |
| Over 6 months to 12 months | 100,000 | 1.71 | 2.21 | 500,000 | 1.50 | 1.46 |
| Over 12 months to 24 months | 1,630,000 | 2.27 | 2.20 | 200,000 | 1.71 | 1.54 |
| Over 24 months to 36 months | 322,000 | 2.34 | 2.17 | 1,500,000 | 2.22 | 1.51 |
| Over 36 months to 48 months | — | — | — | 200,000 | 2.20 | 1.53 |
| Over 48 months to 60 months | 355,000 | 2.85 | 2.28 | — | — | — |
| Over 60 months to 72 months | — | — | — | 100,000 | 2.75 | 1.50 |
| Over 72 months to 84 months | — | — | — | — | — | — |
| Over 84 months | 130,000 | 2.94 | 2.32 | — | — | — |
| Total Swaps | $2,637,000 | 2.35 % | 2.21 % | $2,550,000 | 2.04 % | 1.50 % |

(1) Each maturity category reflects contractual amortization and/or maturity of notional amounts.
(2) Reflects the benchmark variable rate due from the counterparty at the date presented, which rate adjusts monthly or quarterly based on one-month or three-month LIBOR, respectively.

The following table presents the net impact of the Company's derivative hedging instruments on its interest expense and the weighted average interest rate paid and received for such Swaps for the three and nine months ended September 30, 2018 and 2017:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (Dollars in Thousands) | 2018 | 2017 | 2018 | 2017 |
| Interest expense attributable to Swaps | $547 | $5,310 | $4,187 | $19,606 |
| Weighted average Swap rate paid | 2.19 % | 2.04 % | 2.09 % | 1.96 % |

| Weighted average Swap rate received | 2.09 % | 1.23 % | 1.86 % | 1.00 % |
|---|---|---|---|---|

During the three and nine months ended September 30, 2018, the Company recorded net gains on Swaps not designated in hedging relationships of $4.0 million and $4.4 million, respectively. These amounts are included in Other income, net on the Company’s consolidated statements of operations. All of the Company’s Swaps were designated in hedging relationships during the three and nine months ended September 30, 2017.

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Impact of Derivative Hedging Instruments on AOCI

The following table presents the impact of the Company's derivative hedging instruments on its AOCI for the three and nine months ended September 30, 2018 and 2017:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (In Thousands) | 2018 | 2017 | 2018 | 2017 |
| AOCI from derivative hedging instruments: | | | | |
| Balance at beginning of period | $16,160 | $(35,841) | $(11,424) | $(46,721) |
| Net gain on Swaps | 5,390 | 5,791 | 32,974 | 16,671 |
| Balance at end of period | $21,550 | $(30,050) | $21,550 | $(30,050) |

6. Repurchase Agreements

The Company's repurchase agreements are accounted for as secured borrowings and bear interest that is generally LIBOR-based. (See Notes 2(k) and 7) At September 30, 2018, the Company's borrowings under repurchase agreements had a weighted average remaining term-to-interest rate reset of 25 days and an effective repricing period of 11 months, including the impact of related Swaps. At December 31, 2017, the Company's borrowings under repurchase agreements had a weighted average remaining term-to-interest rate reset of 16 days and an effective repricing period of 11 months, including the impact of related Swaps.

The following table presents information with respect to the Company's borrowings under repurchase agreements and associated assets pledged as collateral at September 30, 2018 and December 31, 2017:

| (Dollars in Thousands) | September 30, 2018 | | December 31, 2017 | |
|---|---|---|---|---|
| Repurchase agreement borrowings secured by Agency MBS | $2,584,097 | | $2,501,340 | |
| Fair value of Agency MBS pledged as collateral under repurchase agreements | $2,792,396 | | $2,705,754 | |
| Weighted average haircut on Agency MBS (1) | 4.48 | % | 4.65 | % |
| Repurchase agreement borrowings secured by Legacy Non-Agency MBS | $1,592,067 | | $1,256,033 | |
| Fair value of Legacy Non-Agency MBS pledged as collateral under repurchase agreements | $2,075,540 | | $1,652,983 | |
| Weighted average haircut on Legacy Non-Agency MBS (1) | 21.70 | % | 21.87 | % |
| Repurchase agreement borrowings secured by RPL/NPL MBS | $913,249 | | $567,140 | |
| Fair value of RPL/NPL MBS pledged as collateral under repurchase agreements | $1,161,568 | | $726,540 | |
| Weighted average haircut on RPL/NPL MBS (1) | 21.22 | % | 22.05 | % |
| Repurchase agreements secured by U.S. Treasuries | $— | | $470,334 | |
| Fair value of U.S. Treasuries pledged as collateral under repurchase agreements | $— | | $472,095 | |
| Weighted average haircut on U.S. Treasuries (1) | — | % | 1.47 | % |
| Repurchase agreements secured by CRT securities | $405,168 | | $459,058 | |
| Fair value of CRT securities pledged as collateral under repurchase agreements | $504,931 | | $595,900 | |
| Weighted average haircut on CRT securities (1) | 19.73 | % | 22.16 | % |
| Repurchase agreements secured by MSR related assets | $435,762 | | $317,255 | |
| Fair value of MSR related assets pledged as collateral under repurchase agreements | $565,272 | | $482,158 | |
| Weighted average haircut on MSR related assets (1) | 22.56 | % | 33.19 | % |
| Repurchase agreements secured by residential whole loans (2) | $1,347,946 | | $1,043,747 | |
| Fair value of residential whole loans pledged as collateral under repurchase agreements (3) | $1,888,445 | | $1,474,704 | |
| Weighted average haircut on residential whole loans (1) | 21.93 | % | 26.10 | % |

(1) Haircut represents the percentage amount by which the collateral value is contractually required to exceed the loan amount.
(2) Excludes $19,000 and $206,000 of unamortized debt issuance costs at September 30, 2018 and December 31, 2017, respectively.
(3) At September 30, 2018 includes Non-Agency MBS with an aggregate fair value of $27.0 million obtained in connection with the Company's loan securitization transactions that are eliminated in consolidation.

The following table presents repricing information about the Company's borrowings under repurchase agreements, which does not reflect the impact of associated derivative hedging instruments, at September 30, 2018 and December 31, 2017:

| | September 30, 2018 | | December 31, 2017 | |
|---|---|---|---|---|
| Time Until Interest Rate Reset | Balance | Weighted Average Interest Rate | Balance | Weighted Average Interest Rate |

| (Dollars in Thousands) | | | | | | |
|---|---|---|---|---|---|---|
| Within 30 days | $6,985,487 | 3.01 | % | $6,161,008 | 2.39 | % |
| Over 30 days to 3 months | 29,501 | 2.48 | | 453,899 | 2.76 | |
| Over 3 months to 12 months | 263,301 | 3.09 | | — | — | |
| Total repurchase agreements | 7,278,289 | 3.01 | % | 6,614,907 | 2.42 | % |
| Less debt issuance costs | 19 | | | 206 | | |
| Total repurchase agreements less debt issuance costs | $7,278,270 | | | $6,614,701 | | |

The following table presents contractual maturity information about the Company's borrowings under repurchase agreements, all of which are accounted for as secured borrowings, at September 30, 2018, and does not reflect the impact of derivative contracts that hedge such repurchase agreements:

| | September 30, 2018 | | | | | |
|---|---|---|---|---|---|---|
| Contractual Maturity | Overnight | Within 30 Days | Over 30 Days to 3 Months | Over 3 Months to 12 Months | Over 12 months | Total |
| (Dollars in Thousands) | | | | | | |
| Agency MBS | $— | $2,570,990 | $13,107 | $— | $ — | $2,584,097 |
| Legacy Non-Agency MBS | — | 1,544,995 | 47,072 | — | — | 1,592,067 |
| RPL/NPL MBS | — | 887,087 | 26,162 | — | — | 913,249 |
| CRT securities | — | 399,064 | 6,104 | — | — | 405,168 |
| MSR related assets | — | 342,704 | 93,058 | — | — | 435,762 |
| Residential whole loans | — | 267,129 | 376,936 | 703,881 | — | 1,347,946 |
| Total (1) | $— | $6,011,969 | $562,439 | $703,881 | $ — | $7,278,289 |
| Weighted Average Interest Rate | —% | 2.85 % | 3.73 % | 3.80 % | — % | 3.01 % |