

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended June 30, 2019  
OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 001-34385

 **Invesco Mortgage Capital Inc.**

**Invesco Mortgage Capital Inc.**

(Exact Name of Registrant as Specified in Its Charter)

Maryland

(State or Other Jurisdiction of  
Incorporation or Organization)

26-2749336

(I.R.S. Employer  
Identification No.)

1555 Peachtree Street, N.E., Suite 1800,

Atlanta, Georgia

(Address of Principal Executive Offices)

30309

(Zip Code)

(404) 892-0896

(Registrant's Telephone Number, Including Area Code)

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

| Title of Each Class                                                    | Trading Symbol | Name of Each Exchange on Which Registered |
|------------------------------------------------------------------------|----------------|-------------------------------------------|
| Common Stock, par value \$0.01 per share                               | IVR            | New York Stock Exchange                   |
| 7.75% Series A Cumulative Redeemable Preferred Stock                   | IVRpA          | New York Stock Exchange                   |
| 7.75% Fixed-to-Floating Series B Cumulative Redeemable Preferred Stock | IVRpB          | New York Stock Exchange                   |
| 7.50% Fixed-to-Floating Series C Cumulative Redeemable Preferred Stock | IVRpC          | New York Stock Exchange                   |

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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 | <input checked="" type="checkbox"/> | Accelerated filer         | <input type="checkbox"/> |
| Non-Accelerated filer   | <input type="checkbox"/>            | Smaller reporting company | <input type="checkbox"/> |
|                         |                                     | Emerging growth company   | <input type="checkbox"/> |

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. ☐

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

As of July 31, 2019, there were 128,795,528 outstanding shares of common stock of Invesco Mortgage Capital Inc.

**INVESCO MORTGAGE CAPITAL INC.  
TABLE OF CONTENTS**

|                                                                                                                                                     | <b><u>Page</u></b> |
|-----------------------------------------------------------------------------------------------------------------------------------------------------|--------------------|
| <b><u>PART I FINANCIAL INFORMATION</u></b>                                                                                                          | <b><u>1</u></b>    |
| Item 1. <a href="#">Financial Statements</a>                                                                                                        | <a href="#">1</a>  |
| <a href="#">Unaudited Condensed Consolidated Balance Sheets as of June 30, 2019 and December 31, 2018</a>                                           | <a href="#">1</a>  |
| <a href="#">Unaudited Condensed Consolidated Statements of Operations for the three and six months ended June 30, 2019 and 2018</a>                 | <a href="#">2</a>  |
| <a href="#">Unaudited Condensed Consolidated Statements of Comprehensive Income for the three and six months ended June 30, 2019 and 2018</a>       | <a href="#">3</a>  |
| <a href="#">Unaudited Condensed Consolidated Statements of Equity for the three months ended March 31, 2019 and 2018 and June 30, 2019 and 2018</a> | <a href="#">4</a>  |
| <a href="#">Unaudited Condensed Consolidated Statements of Cash Flows for the six months ended June, 2019 and 2018</a>                              | <a href="#">6</a>  |
| <a href="#">Notes to Condensed Consolidated Financial Statements</a>                                                                                | <a href="#">7</a>  |
| Item 2. <a href="#">Management’s Discussion and Analysis of Financial Condition and Results of Operations</a>                                       | <a href="#">36</a> |
| Item 3. <a href="#">Quantitative and Qualitative Disclosures About Market Risk</a>                                                                  | <a href="#">69</a> |
| Item 4. <a href="#">Controls and Procedures</a>                                                                                                     | <a href="#">72</a> |
| <b><u>PART II OTHER INFORMATION</u></b>                                                                                                             | <b><u>73</u></b>   |
| Item 1. <a href="#">Legal Proceedings</a>                                                                                                           | <a href="#">73</a> |
| Item 1A. <a href="#">Risk Factors</a>                                                                                                               | <a href="#">73</a> |
| Item 2. <a href="#">Unregistered Sales of Equity Securities and Use of Proceeds</a>                                                                 | <a href="#">73</a> |
| Item 3. <a href="#">Defaults Upon Senior Securities</a>                                                                                             | <a href="#">73</a> |
| Item 4. <a href="#">Mine Safety Disclosures</a>                                                                                                     | <a href="#">73</a> |
| Item 5. <a href="#">Other Information</a>                                                                                                           | <a href="#">73</a> |
| Item 6. <a href="#">Exhibits</a>                                                                                                                    | <a href="#">75</a> |

---

# PART I

## ITEM 1. FINANCIAL STATEMENTS

### INVESCO MORTGAGE CAPITAL INC. AND SUBSIDIARIES CONDENSED CONSOLIDATED BALANCE SHEETS (Unaudited)

| \$ in thousands except share amounts                                                                                                                          | As of         |                   |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------|-------------------|
|                                                                                                                                                               | June 30, 2019 | December 31, 2018 |
| <b>ASSETS</b>                                                                                                                                                 |               |                   |
| Mortgage-backed and credit risk transfer securities, at fair value (including pledged securities of \$20,848,269 and \$17,082,825, respectively)              | 21,536,047    | 17,396,642        |
| Cash and cash equivalents                                                                                                                                     | 99,620        | 135,617           |
| Restricted cash                                                                                                                                               | 55,271        | —                 |
| Due from counterparties                                                                                                                                       | 21,041        | 13,500            |
| Investment related receivable                                                                                                                                 | 141,989       | 66,598            |
| Derivative assets, at fair value                                                                                                                              | 10,067        | 15,089            |
| Other assets                                                                                                                                                  | 174,043       | 186,059           |
| Total assets                                                                                                                                                  | 22,038,078    | 17,813,505        |
| <b>LIABILITIES AND EQUITY</b>                                                                                                                                 |               |                   |
| <b>Liabilities:</b>                                                                                                                                           |               |                   |
| Repurchase agreements                                                                                                                                         | 17,075,065    | 13,602,484        |
| Secured loans                                                                                                                                                 | 1,650,000     | 1,650,000         |
| Derivative liabilities, at fair value                                                                                                                         | 36,969        | 23,390            |
| Dividends and distributions payable                                                                                                                           | 60,671        | 49,578            |
| Investment related payable                                                                                                                                    | 462,060       | 132,096           |
| Accrued interest payable                                                                                                                                      | 55,002        | 37,620            |
| Collateral held payable                                                                                                                                       | 14,939        | 18,083            |
| Accounts payable and accrued expenses                                                                                                                         | 3,144         | 1,694             |
| Due to affiliate                                                                                                                                              | 10,127        | 11,863            |
| Total liabilities                                                                                                                                             | 19,367,977    | 15,526,808        |
| <b>Commitments and contingencies (See Note 14):</b>                                                                                                           |               |                   |
| <b>Equity:</b>                                                                                                                                                |               |                   |
| Preferred Stock, par value \$0.01 per share; 50,000,000 shares authorized:                                                                                    |               |                   |
| 7.75% Series A Cumulative Redeemable Preferred Stock: 5,600,000 shares issued and outstanding (\$140,000 aggregate liquidation preference)                    | 135,356       | 135,356           |
| 7.75% Fixed-to-Floating Series B Cumulative Redeemable Preferred Stock: 6,200,000 shares issued and outstanding (\$155,000 aggregate liquidation preference)  | 149,860       | 149,860           |
| 7.50% Fixed-to-Floating Series C Cumulative Redeemable Preferred Stock: 11,500,000 shares issued and outstanding (\$287,500 aggregate liquidation preference) | 278,108       | 278,108           |
| Common Stock, par value \$0.01 per share; 450,000,000 shares authorized; 128,795,528 and 111,584,996 shares issued and outstanding, respectively              | 1,287         | 1,115             |
| Additional paid in capital                                                                                                                                    | 2,650,329     | 2,383,532         |
| Accumulated other comprehensive income                                                                                                                        | 318,013       | 220,813           |
| Retained earnings (distributions in excess of earnings)                                                                                                       | (862,852)     | (882,087)         |
| Total stockholders' equity                                                                                                                                    | 2,670,101     | 2,286,697         |
| Total liabilities and stockholders' equity                                                                                                                    | 22,038,078    | 17,813,505        |

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

**INVESCO MORTGAGE CAPITAL INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
(Unaudited)

| \$ in thousands, except share amounts                        | Three Months Ended June 30, |          | Six Months Ended June 30, |           |
|--------------------------------------------------------------|-----------------------------|----------|---------------------------|-----------|
|                                                              | 2019                        | 2018     | 2019                      | 2018      |
| <b>Interest Income</b>                                       |                             |          |                           |           |
| Mortgage-backed and credit risk transfer securities          | 200,737                     | 147,548  | 386,229                   | 296,551   |
| Commercial and other loans                                   | 1,484                       | 4,051    | 3,066                     | 8,273     |
| Total interest income                                        | 202,221                     | 151,599  | 389,295                   | 304,824   |
| <b>Interest Expense</b>                                      |                             |          |                           |           |
| Repurchase agreements                                        | 117,978                     | 69,389   | 219,853                   | 128,974   |
| Secured loans                                                | 11,258                      | 8,471    | 22,402                    | 15,398    |
| Exchangeable senior notes                                    | —                           | —        | —                         | 1,621     |
| Total interest expense                                       | 129,236                     | 77,860   | 242,255                   | 145,993   |
| <b>Net interest income</b>                                   | 72,985                      | 73,739   | 147,040                   | 158,831   |
| <b>Other Income (loss)</b>                                   |                             |          |                           |           |
| Gain (loss) on investments, net                              | 302,182                     | (36,377) | 570,564                   | (196,747) |
| Equity in earnings (losses) of unconsolidated ventures       | 702                         | 798      | 1,394                     | 1,694     |
| Gain (loss) on derivative instruments, net                   | (344,733)                   | 67,169   | (546,193)                 | 200,536   |
| Realized and unrealized credit derivative income (loss), net | (2,438)                     | 735      | 5,446                     | 3,900     |
| Net loss on extinguishment of debt                           | —                           | —        | —                         | (26)      |
| Other investment income (loss), net                          | 1,007                       | (2,160)  | 2,036                     | 942       |
| <b>Total other income (loss)</b>                             | (43,280)                    | 30,165   | 33,247                    | 10,299    |
| <b>Expenses</b>                                              |                             |          |                           |           |
| Management fee – related party                               | 9,370                       | 10,102   | 18,904                    | 20,323    |
| General and administrative                                   | 1,999                       | 1,525    | 4,257                     | 3,281     |
| <b>Total expenses</b>                                        | 11,369                      | 11,627   | 23,161                    | 23,604    |
| <b>Net income</b>                                            | 18,336                      | 92,277   | 157,126                   | 145,526   |
| Net income attributable to non-controlling interest          | —                           | 1,163    | —                         | 1,834     |
| Net income attributable to Invesco Mortgage Capital Inc.     | 18,336                      | 91,114   | 157,126                   | 143,692   |
| Dividends to preferred stockholders                          | 11,106                      | 11,106   | 22,213                    | 22,213    |
| Net income attributable to common stockholders               | 7,230                       | 80,008   | 134,913                   | 121,479   |
| Earnings per share:                                          |                             |          |                           |           |
| Net income attributable to common stockholders               |                             |          |                           |           |
| Basic                                                        | 0.06                        | 0.72     | 1.08                      | 1.09      |
| Diluted                                                      | 0.06                        | 0.72     | 1.08                      | 1.08      |

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

**INVESCO MORTGAGE CAPITAL INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**  
(Unaudited)

| \$ in thousands                                                                                                                              | Three Months Ended June 30, |          | Six Months Ended June 30, |           |
|----------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------|----------|---------------------------|-----------|
|                                                                                                                                              | 2019                        | 2018     | 2019                      | 2018      |
| Net income                                                                                                                                   | 18,336                      | 92,277   | 157,126                   | 145,526   |
| <b>Other comprehensive income (loss):</b>                                                                                                    |                             |          |                           |           |
| Unrealized gain (loss) on mortgage-backed and credit risk transfer securities, net                                                           | 47,188                      | (47,929) | 99,537                    | (180,246) |
| Reclassification of unrealized (gain) loss on sale of mortgage-backed and credit risk transfer securities to gain (loss) on investments, net | (121)                       | 9,889    | 10,026                    | 19,126    |
| Reclassification of amortization of net deferred (gain) loss on de-designated interest rate swaps to repurchase agreements interest expense  | (5,916)                     | (6,898)  | (11,767)                  | (13,437)  |
| Currency translation adjustments on investment in unconsolidated venture                                                                     | (320)                       | 486      | (596)                     | 798       |
| Total other comprehensive income (loss)                                                                                                      | 40,831                      | (44,452) | 97,200                    | (173,759) |
| Comprehensive income (loss)                                                                                                                  | 59,167                      | 47,825   | 254,326                   | (28,233)  |
| Less: Comprehensive (income) loss attributable to non-controlling interest                                                                   | —                           | (602)    | —                         | 357       |
| Less: Dividends to preferred stockholders                                                                                                    | (11,106)                    | (11,106) | (22,213)                  | (22,213)  |
| Comprehensive income (loss) attributable to common stockholders                                                                              | 48,061                      | 36,117   | 232,113                   | (50,089)  |

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

**INVESCO MORTGAGE CAPITAL INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF EQUITY**  
For the three months ended March 31, 2019 and June 30, 2019  
(Unaudited)

| \$<br>in thousands except<br>share amounts                             | Series A<br>Preferred Stock |         | Series B<br>Preferred Stock |         | Series C<br>Preferred Stock |         | Common Stock |        | Additional<br>Paid in<br>Capital | Accumulated<br>Other<br>Comprehensive<br>Income (Loss) | Retained<br>Earnings<br>(Distributions<br>in excess of<br>earnings) | Total<br>Stockholders'<br>Equity |
|------------------------------------------------------------------------|-----------------------------|---------|-----------------------------|---------|-----------------------------|---------|--------------|--------|----------------------------------|--------------------------------------------------------|---------------------------------------------------------------------|----------------------------------|
|                                                                        | Shares                      | Amount  | Shares                      | Amount  | Shares                      | Amount  | Shares       | Amount |                                  |                                                        |                                                                     |                                  |
| <b>Balance at<br/>December 31, 2018</b>                                | 5,600,000                   | 135,356 | 6,200,000                   | 149,860 | 11,500,000                  | 278,108 | 111,584,996  | 1,115  | 2,383,532                        | 220,813                                                | (882,087)                                                           | 2,286,697                        |
| Net income                                                             | —                           | —       | —                           | —       | —                           | —       | —            | —      | —                                | —                                                      | 138,790                                                             | 138,790                          |
| Other comprehensive<br>income                                          | —                           | —       | —                           | —       | —                           | —       | —            | —      | —                                | 56,369                                                 | —                                                                   | 56,369                           |
| Proceeds from<br>issuance of common<br>stock, net of offering<br>costs | —                           | —       | —                           | —       | —                           | —       | 16,672,000   | 167    | 258,386                          | —                                                      | —                                                                   | 258,553                          |
| Stock awards                                                           | —                           | —       | —                           | —       | —                           | —       | 10,501       | —      | —                                | —                                                      | —                                                                   | —                                |
| Common stock<br>dividends                                              | —                           | —       | —                           | —       | —                           | —       | —            | —      | —                                | —                                                      | (57,720)                                                            | (57,720)                         |
| Preferred stock<br>dividends                                           | —                           | —       | —                           | —       | —                           | —       | —            | —      | —                                | —                                                      | (11,107)                                                            | (11,107)                         |
| Amortization of<br>equity-based<br>compensation                        | —                           | —       | —                           | —       | —                           | —       | —            | —      | 132                              | —                                                      | —                                                                   | 132                              |
| <b>Balance at March<br/>31, 2019</b>                                   | 5,600,000                   | 135,356 | 6,200,000                   | 149,860 | 11,500,000                  | 278,108 | 128,267,497  | 1,282  | 2,642,050                        | 277,182                                                | (812,124)                                                           | 2,671,714                        |
| Net income                                                             | —                           | —       | —                           | —       | —                           | —       | —            | —      | —                                | —                                                      | 18,336                                                              | 18,336                           |
| Other comprehensive<br>income                                          | —                           | —       | —                           | —       | —                           | —       | —            | —      | —                                | 40,831                                                 | —                                                                   | 40,831                           |
| Proceeds from<br>issuance of common<br>stock, net of offering<br>costs | —                           | —       | —                           | —       | —                           | —       | 521,136      | 5      | 8,149                            | —                                                      | —                                                                   | 8,154                            |
| Stock awards                                                           | —                           | —       | —                           | —       | —                           | —       | 6,895        | —      | —                                | —                                                      | —                                                                   | —                                |
| Common stock<br>dividends                                              | —                           | —       | —                           | —       | —                           | —       | —            | —      | —                                | —                                                      | (57,958)                                                            | (57,958)                         |
| Preferred stock<br>dividends                                           | —                           | —       | —                           | —       | —                           | —       | —            | —      | —                                | —                                                      | (11,106)                                                            | (11,106)                         |
| Amortization of<br>equity-based<br>compensation                        | —                           | —       | —                           | —       | —                           | —       | —            | —      | 130                              | —                                                      | —                                                                   | 130                              |
| <b>Balance at June 30,<br/>2019</b>                                    | 5,600,000                   | 135,356 | 6,200,000                   | 149,860 | 11,500,000                  | 278,108 | 128,795,528  | 1,287  | 2,650,329                        | 318,013                                                | (862,852)                                                           | 2,670,101                        |

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

**INVESCO MORTGAGE CAPITAL INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF EQUITY (Continued)**  
**For the three months ended March 31, 2018 and June 30, 2018**  
**(Unaudited)**

| \$<br>in thousands except<br>share amounts                      | Attributable to Common Stockholders |                |                             |                |                             |                |                    |              |                                  |                                                        |                                                                     |                                  |                                 |                  |
|-----------------------------------------------------------------|-------------------------------------|----------------|-----------------------------|----------------|-----------------------------|----------------|--------------------|--------------|----------------------------------|--------------------------------------------------------|---------------------------------------------------------------------|----------------------------------|---------------------------------|------------------|
|                                                                 | Series A<br>Preferred Stock         |                | Series B<br>Preferred Stock |                | Series C<br>Preferred Stock |                | Common Stock       |              | Additional<br>Paid in<br>Capital | Accumulated<br>Other<br>Comprehensive<br>Income (Loss) | Retained<br>Earnings<br>(Distributions<br>in excess of<br>earnings) | Total<br>Stockholders'<br>Equity | Non-<br>Controlling<br>Interest | Total<br>Equity  |
|                                                                 | Shares                              | Amount         | Shares                      | Amount         | Shares                      | Amount         | Shares             | Amount       |                                  |                                                        |                                                                     |                                  |                                 |                  |
| <b>Balance at December 31, 2017</b>                             | <u>5,600,000</u>                    | <u>135,356</u> | <u>6,200,000</u>            | <u>149,860</u> | <u>11,500,000</u>           | <u>278,108</u> | <u>111,624,159</u> | <u>1,116</u> | <u>2,384,356</u>                 | <u>261,029</u>                                         | <u>(579,334)</u>                                                    | <u>2,630,491</u>                 | <u>26,387</u>                   | <u>2,656,878</u> |
| Net income                                                      | —                                   | —              | —                           | —              | —                           | —              | —                  | —            | —                                | —                                                      | 52,578                                                              | 52,578                           | 671                             | 53,249           |
| Other comprehensive loss                                        | —                                   | —              | —                           | —              | —                           | —              | —                  | —            | —                                | (127,677)                                              | —                                                                   | (127,677)                        | (1,630)                         | (129,307)        |
| Stock awards                                                    | —                                   | —              | —                           | —              | —                           | —              | 12,564             | —            | —                                | —                                                      | —                                                                   | —                                | —                               | —                |
| Common stock dividends                                          | —                                   | —              | —                           | —              | —                           | —              | —                  | —            | —                                | —                                                      | (46,887)                                                            | (46,887)                         | —                               | (46,887)         |
| Common unit dividends                                           | —                                   | —              | —                           | —              | —                           | —              | —                  | —            | —                                | —                                                      | —                                                                   | —                                | (599)                           | (599)            |
| Preferred stock dividends                                       | —                                   | —              | —                           | —              | —                           | —              | —                  | —            | —                                | —                                                      | (11,107)                                                            | (11,107)                         | —                               | (11,107)         |
| Amortization of equity-based compensation                       | —                                   | —              | —                           | —              | —                           | —              | —                  | —            | 127                              | —                                                      | —                                                                   | 127                              | 2                               | 129              |
| Rebalancing of ownership percentage of non-controlling interest | —                                   | —              | —                           | —              | —                           | —              | —                  | —            | 143                              | —                                                      | —                                                                   | 143                              | (143)                           | —                |
| <b>Balance at March 31, 2018</b>                                | <u>5,600,000</u>                    | <u>135,356</u> | <u>6,200,000</u>            | <u>149,860</u> | <u>11,500,000</u>           | <u>278,108</u> | <u>111,636,723</u> | <u>1,116</u> | <u>2,384,626</u>                 | <u>133,352</u>                                         | <u>(584,750)</u>                                                    | <u>2,497,668</u>                 | <u>24,688</u>                   | <u>2,522,356</u> |
| Net income                                                      | —                                   | —              | —                           | —              | —                           | —              | —                  | —            | —                                | —                                                      | 91,114                                                              | 91,114                           | 1,163                           | 92,277           |
| Other comprehensive loss                                        | —                                   | —              | —                           | —              | —                           | —              | —                  | —            | —                                | (43,891)                                               | —                                                                   | (43,891)                         | (561)                           | (44,452)         |
| Stock awards                                                    | —                                   | —              | —                           | —              | —                           | —              | 6,465              | —            | —                                | —                                                      | —                                                                   | —                                | —                               | —                |
| Common stock dividends                                          | —                                   | —              | —                           | —              | —                           | —              | —                  | —            | —                                | —                                                      | (46,890)                                                            | (46,890)                         | —                               | (46,890)         |
| Common unit dividends                                           | —                                   | —              | —                           | —              | —                           | —              | —                  | —            | —                                | —                                                      | —                                                                   | —                                | (598)                           | (598)            |
| Preferred stock dividends                                       | —                                   | —              | —                           | —              | —                           | —              | —                  | —            | —                                | —                                                      | (11,106)                                                            | (11,106)                         | —                               | (11,106)         |
| Amortization of equity-based compensation                       | —                                   | —              | —                           | —              | —                           | —              | —                  | —            | 135                              | —                                                      | —                                                                   | 135                              | 1                               | 136              |
| Rebalancing of ownership percentage of non-controlling interest | —                                   | —              | —                           | —              | —                           | —              | —                  | —            | 141                              | —                                                      | —                                                                   | 141                              | (141)                           | —                |
| <b>Balance at June 30, 2018</b>                                 | <u>5,600,000</u>                    | <u>135,356</u> | <u>6,200,000</u>            | <u>149,860</u> | <u>11,500,000</u>           | <u>278,108</u> | <u>111,643,188</u> | <u>1,116</u> | <u>2,384,902</u>                 | <u>89,461</u>                                          | <u>(551,632)</u>                                                    | <u>2,487,171</u>                 | <u>24,552</u>                   | <u>2,511,723</u> |

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

[Table of Contents](#)

**INVESCO MORTGAGE CAPITAL INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(Unaudited)

| \$ in thousands                                                                                   | Six Months Ended June 30, |              |
|---------------------------------------------------------------------------------------------------|---------------------------|--------------|
|                                                                                                   | 2019                      | 2018         |
| <b>Cash Flows from Operating Activities</b>                                                       |                           |              |
| Net income                                                                                        | 157,126                   | 145,526      |
| Adjustments to reconcile net income to net cash provided by operating activities:                 |                           |              |
| Amortization of mortgage-backed and credit risk transfer securities premiums and (discounts), net | 13,800                    | 25,657       |
| Realized and unrealized (gain) loss on derivative instruments, net                                | 558,227                   | (217,159)    |
| Realized and unrealized (gain) loss on credit derivatives, net                                    | 5,204                     | 7,371        |
| (Gain) loss on investments, net                                                                   | (570,564)                 | 196,747      |
| (Gain) loss from investments in unconsolidated ventures in excess of distributions received       | (1,394)                   | (1,150)      |
| Other amortization                                                                                | (11,505)                  | (13,052)     |
| Net loss on extinguishment of debt                                                                | —                         | 26           |
| (Gain) loss on foreign currency transactions, net                                                 | —                         | 1,099        |
| Changes in operating assets and liabilities:                                                      |                           |              |
| (Increase) decrease in operating assets                                                           | (10,769)                  | 2,267        |
| Increase in operating liabilities                                                                 | 16,877                    | 435          |
| Net cash provided by operating activities                                                         | 157,002                   | 147,767      |
| <b>Cash Flows from Investing Activities</b>                                                       |                           |              |
| Purchase of mortgage-backed and credit risk transfer securities                                   | (5,644,867)               | (1,213,558)  |
| (Contributions to) distributions from investments in unconsolidated ventures, net                 | (865)                     | (1,077)      |
| Change in other assets                                                                            | 7,096                     | —            |
| Principal payments from mortgage-backed and credit risk transfer securities                       | 760,639                   | 1,061,392    |
| Proceeds from sale of mortgage-backed and credit risk transfer securities                         | 1,670,394                 | 387,726      |
| Settlement (termination) of futures, currency forwards and interest rate swaps, net               | (539,626)                 | 149,852      |
| Net change in due from counterparties and collateral held payable                                 | (9,435)                   | 25,165       |
| Principal payments from commercial loans held-for-investment                                      | 7,261                     | 64,814       |
| Origination and advances of commercial loans, net of origination fees                             | —                         | (1,677)      |
| Net cash (used in) provided by investing activities                                               | (3,749,403)               | 472,637      |
| <b>Cash Flows from Financing Activities</b>                                                       |                           |              |
| Proceeds from issuance of common stock                                                            | 266,878                   | —            |
| Proceeds from repurchase agreements                                                               | 54,344,320                | 72,281,324   |
| Principal repayments of repurchase agreements                                                     | (50,872,638)              | (72,659,696) |
| Extinguishment of exchangeable senior notes                                                       | —                         | (143,433)    |
| Payments of deferred costs                                                                        | (87)                      | (167)        |
| Payments of dividends and distributions                                                           | (126,798)                 | (117,179)    |
| Net cash provided by (used in) financing activities                                               | 3,611,675                 | (639,151)    |
| Net change in cash, cash equivalents and restricted cash                                          | 19,274                    | (18,747)     |
| Cash, cash equivalents and restricted cash, beginning of period                                   | 135,617                   | 89,001       |
| Cash, cash equivalents and restricted cash, end of period                                         | 154,891                   | 70,254       |
| <b>Supplement Disclosure of Cash Flow Information</b>                                             |                           |              |
| Interest paid                                                                                     | 236,649                   | 158,027      |
| <b>Non-cash Investing and Financing Activities Information</b>                                    |                           |              |
| Net change in unrealized gain (loss) on mortgage-backed and credit risk transfer securities       | 109,563                   | (161,120)    |
| Dividends and distributions declared not paid                                                     | 60,671                    | 50,201       |
| Net change in investment related payable (receivable)                                             | (264,449)                 | (18,871)     |
| Offering costs not paid                                                                           | (171)                     | —            |
| Net change in repurchase agreements, not settled                                                  | 899                       | (108)        |

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



**INVESCO MORTGAGE CAPITAL INC. AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(Unaudited)**

**Note 1 – Organization and Business Operations**

Invesco Mortgage Capital Inc. (the "Company", "we") is a Maryland corporation primarily focused on investing in, financing and managing residential and commercial mortgage-backed securities and other mortgage-related assets. We are externally managed and advised by Invesco Advisers, Inc. (our "Manager"), a registered investment adviser and an indirect, wholly-owned subsidiary of Invesco Ltd. ("Invesco"), a leading independent global investment management firm. We conduct our business through IAS Operating Partnership LP (the "Operating Partnership") and have one operating segment. Prior to November 30, 2018, a wholly-owned subsidiary of Invesco owned 1.3% of the Operating Partnership. See Note 15 - "Non-Controlling Interest - Operating Partnership" of our Annual Report on Form 10-K for the year ended December 31, 2018 for information regarding redemption of Operating Partnership Units ("OP Units") previously held by Invesco.

We primarily invest in:

- Residential mortgage-backed securities ("RMBS") that are guaranteed by a U.S. government agency such as the Government National Mortgage Association ("Ginnie Mae"), or a federally chartered corporation such as the Federal National Mortgage Association ("Fannie Mae") or the Federal Home Loan Mortgage Corporation ("Freddie Mac") (collectively "Agency RMBS");
- Commercial mortgage-backed securities ("CMBS") that are guaranteed by a U.S. government agency such as Ginnie Mae or a federally chartered corporation such as Fannie Mae or Freddie Mac (collectively "Agency CMBS");
- RMBS that are not guaranteed by a U.S. government agency or a federally chartered corporation ("non-Agency RMBS");
- CMBS that are not guaranteed by a U.S. government agency or a federally chartered corporation ("non-Agency CMBS");
- Credit risk transfer securities that are unsecured obligations issued by government-sponsored enterprises ("GSE CRT");
- Residential and commercial mortgage loans; and
- Other real estate-related financing agreements.

We elected to be taxed as a real estate investment trust ("REIT") for U.S. federal income tax purposes under the provisions of the Internal Revenue Code of 1986 commencing with our taxable year ended December 31, 2009. To maintain our REIT qualification, we are generally required to distribute at least 90% of our REIT taxable income to our stockholders annually. We operate our business in a manner that permits exclusion from the "Investment Company" definition under the Investment Company Act of 1940.

**Note 2 – Summary of Significant Accounting Policies**

**Basis of Presentation and Consolidation**

Certain disclosures included in our Annual Report on Form 10-K are not required to be included on an interim basis in our quarterly reports on Form 10-Q. We have condensed or omitted these disclosures. Therefore, this Form 10-Q should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2018.

Our condensed consolidated financial statements have been prepared in accordance with U.S. GAAP and consolidate the financial statements of the Company and our controlled subsidiaries. All significant intercompany transactions, balances, revenues and expenses are eliminated upon consolidation. In the opinion of management, the condensed consolidated financial statements reflect all adjustments, consisting of normal recurring accruals, which are necessary for a fair statement of our financial condition and results of operations for the periods presented.

**Reclassifications**

Our condensed consolidated balance sheet for the year ended December 31, 2018 presented in this Form 10-Q includes a reclassification of Commercial Loans, held-for-investment to Other assets to conform to our current period presentation. See Note 5 - "Other Assets" for further information.

**Use of Estimates**

## [Table of Contents](#)

The preparation of condensed consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. Examples of estimates include, but are not limited to, estimates of the fair values of financial instruments, interest income on mortgage-backed and credit risk transfer securities, provision for loan losses and other-than-temporary impairment charges. Actual results may differ from those estimates.

### Significant Accounting Policies

There have been no changes to our accounting policies included in Note 2 to the consolidated financial statements of our Annual Report on Form 10-K for the year ended December 31, 2018 except for the implementation of new accounting guidance for stock-based payments to non-employees discussed below.

### Accounting Pronouncements Recently Adopted

Effective January 1, 2019, we adopted the accounting guidance that aligns the measurement and classification for stock-based payments to non-employees with the guidance for stock-based payments to employees. Under the new guidance, the measurement of equity-classified non-employee awards is fixed at the grant date. The implementation of the guidance did not have a material impact on our financial statements.

### Pending Accounting Pronouncements

In June 2016, new accounting guidance was issued for reporting credit losses for assets measured at amortized cost and available-for-sale securities. The new guidance significantly changes how entities will measure credit losses for most financial assets, including loans, that are not measured at fair value through net income. The guidance replaces the existing "incurred loss" model with an "expected loss" model for instruments measured at amortized cost and requires entities to record credit allowances for available-for-sale debt securities rather than reduce the carrying amount, as they do today under the other-than-temporary impairment model. The new guidance also simplifies the accounting model for purchased credit-impaired debt securities and loans. We are required to adopt the new guidance as of January 1, 2020.

We are currently evaluating the potential impacts of the new guidance and proposed amendments to the new guidance on our consolidated financial statements. The new guidance specifically excludes available-for-sale securities measured at fair value through net income. The Company elected the fair value option for all MBS purchased on or after September 1, 2016 and GSE CRTs purchased on or after August 24, 2015. Accordingly, the impact of the new guidance on accounting for our debt securities will be limited to those securities purchased prior to election of the fair value option that the Company continues to hold on January 1, 2020. As of June 30, 2019, we hold approximately \$4.8 billion of MBS and GSE CRT securities that were purchased prior to election of the fair value option that will be assessed for impairment under the new guidance. The new guidance for available-for-sale securities will be implemented prospectively.

We have one commercial loan as of June 30, 2019 that is measured at amortized cost. We intend to implement the new guidance for this loan by electing the fair value option. The new guidance for this loan will be implemented on a modified retrospective basis by recording a cumulative effect adjustment to retained earnings on January 1, 2020. The loan is due in February 2021, and we do not expect the new guidance to have a material impact on our accounting for this loan.

### Note 3 – Variable Interest Entities ("VIEs")

Our maximum risk of loss in VIEs in which we are not the primary beneficiary at June 30, 2019 is presented in the table below.

| \$ in thousands                        | Carrying Amount | Company's Maximum Risk of Loss |
|----------------------------------------|-----------------|--------------------------------|
| Non-Agency CMBS                        | 3,651,587       | 3,651,587                      |
| Non-Agency RMBS                        | 1,118,073       | 1,118,073                      |
| Investments in unconsolidated ventures | 25,675          | 25,675                         |
| Total                                  | 4,795,335       | 4,795,335                      |

Refer to Note 4 - "Mortgage-Backed and Credit Risk Transfer Securities" and Note 5 - "Other Assets" for additional details regarding these investments.

**Note 4 – Mortgage-Backed and Credit Risk Transfer Securities**

The following tables summarize our mortgage-backed securities ("MBS") and GSE CRT portfolio by asset type as of June 30, 2019 and December 31, 2018.

**June 30, 2019**

| <b>\$ in thousands</b>               | <b>Principal/<br/>Notional<br/>Balance</b> | <b>Unamortized<br/>Premium<br/>(Discount)</b> | <b>Amortized<br/>Cost</b> | <b>Unrealized<br/>Gain/<br/>(Loss), net</b> | <b>Fair<br/>Value</b> | <b>Period-<br/>end<br/>Weighted<br/>Average<br/>Yield <sup>(1)</sup></b> |
|--------------------------------------|--------------------------------------------|-----------------------------------------------|---------------------------|---------------------------------------------|-----------------------|--------------------------------------------------------------------------|
| Agency RMBS:                         |                                            |                                               |                           |                                             |                       |                                                                          |
| 15 year fixed-rate                   | 325,735                                    | 2,318                                         | 328,053                   | 9,867                                       | 337,920               | 3.35%                                                                    |
| 30 year fixed-rate                   | 11,496,479                                 | 366,826                                       | 11,863,305                | 213,786                                     | 12,077,091            | 3.70%                                                                    |
| ARM*                                 | 6,104                                      | 178                                           | 6,282                     | 55                                          | 6,337                 | 3.68%                                                                    |
| Hybrid ARM*                          | 97,925                                     | 1,694                                         | 99,619                    | 1,169                                       | 100,788               | 3.21%                                                                    |
| Total Agency RMBS pass-through       | 11,926,243                                 | 371,016                                       | 12,297,259                | 224,877                                     | 12,522,136            | 3.69%                                                                    |
| Agency-CMO <sup>(2)</sup>            | 945,125                                    | (543,338)                                     | 401,787                   | 11,377                                      | 413,164               | 3.41%                                                                    |
| Agency CMBS                          | 2,705,117                                  | 46,874                                        | 2,751,991                 | 174,252                                     | 2,926,243             | 3.39%                                                                    |
| Non-Agency CMBS <sup>(3)</sup>       | 4,279,103                                  | (768,252)                                     | 3,510,851                 | 140,736                                     | 3,651,587             | 5.21%                                                                    |
| Non-Agency RMBS <sup>(4)(5)(6)</sup> | 2,646,663                                  | (1,648,005)                                   | 998,658                   | 119,415                                     | 1,118,073             | 6.70%                                                                    |
| GSE CRT <sup>(7)</sup>               | 835,392                                    | 18,319                                        | 853,711                   | 51,133                                      | 904,844               | 3.11%                                                                    |
| Total                                | 23,337,643                                 | (2,523,386)                                   | 20,814,257                | 721,790                                     | 21,536,047            | 4.02%                                                                    |

\* Adjustable-rate mortgage ("ARM")

- (1) Period-end weighted average yield is based on amortized cost as of June 30, 2019 and incorporates future prepayment and loss assumptions.
- (2) Agency collateralized mortgage obligation ("Agency-CMO") includes interest-only securities ("Agency IO"), which represent 60.9% of principal/notional balance, 7.8% of amortized cost and 7.6% of fair value.
- (3) Non-Agency CMBS includes interest-only securities which represent 14.0% of principal/notional balance, 0.4% of amortized cost and 0.4% of fair value.
- (4) Non-Agency RMBS is 55.7% fixed rate, 39.2% variable rate, and 5.1% floating rate based on fair value. Coupon payments on variable rate investments are based upon changes in the underlying ARM and Hybrid ARM loan coupons, while coupon payments on floating rate investments are based upon a spread to a reference index.
- (5) Of the total discount in non-Agency RMBS, \$134.7 million is non-accretable (calculated using the principal/notional balance) based on estimated future cash flows of the securities.
- (6) Non-Agency RMBS includes interest-only securities ("non-Agency IO") which represent 55.5% of principal/notional balance, 2.3% of amortized cost and 2.0% of fair value.
- (7) GSE CRT weighted average yield excludes coupon interest associated with embedded derivatives not accounted for under the fair value option that is recorded as realized and unrealized credit derivative income (loss), net.

December 31, 2018

| \$ in thousands                      | Principal/Notional Balance | Unamortized Premium (Discount) | Amortized Cost | Unrealized Gain/(Loss), net | Fair Value | Period-end Weighted Average Yield <sup>(1)</sup> |
|--------------------------------------|----------------------------|--------------------------------|----------------|-----------------------------|------------|--------------------------------------------------|
| Agency RMBS:                         |                            |                                |                |                             |            |                                                  |
| 15 year fixed-rate                   | 417,233                    | 5,077                          | 422,310        | 1,944                       | 424,254    | 3.27%                                            |
| 30 year fixed-rate                   | 9,599,301                  | 298,693                        | 9,897,994      | (125,225)                   | 9,772,769  | 3.55%                                            |
| ARM                                  | 105,453                    | 350                            | 105,803        | (56)                        | 105,747    | 2.74%                                            |
| Hybrid ARM                           | 548,133                    | 13,425                         | 561,558        | (7,357)                     | 554,201    | 2.80%                                            |
| Total Agency RMBS pass-through       | 10,670,120                 | 317,545                        | 10,987,665     | (130,694)                   | 10,856,971 | 3.49%                                            |
| Agency-CMO <sup>(2)</sup>            | 907,862                    | (631,180)                      | 276,682        | (8,991)                     | 267,691    | 3.61%                                            |
| Agency CMBS                          | 973,122                    | 15,058                         | 988,180        | 14,330                      | 1,002,510  | 3.54%                                            |
| Non-Agency CMBS <sup>(3)</sup>       | 4,024,715                  | (727,307)                      | 3,297,408      | (10,949)                    | 3,286,459  | 5.05%                                            |
| Non-Agency RMBS <sup>(4)(5)(6)</sup> | 2,800,335                  | (1,748,223)                    | 1,052,112      | 111,570                     | 1,163,682  | 7.24%                                            |
| GSE CRT <sup>(7)</sup>               | 738,529                    | 21,259                         | 759,788        | 59,541                      | 819,329    | 3.10%                                            |
| Total                                | 20,114,683                 | (2,752,848)                    | 17,361,835     | 34,807                      | 17,396,642 | 4.00%                                            |

(1) Period-end weighted average yield is based on amortized cost as of December 31, 2018 and incorporates future prepayment and loss assumptions.

(2) Agency collateralized mortgage obligation ("Agency-CMO") includes interest-only securities ("Agency IO"), which represent 73.6% of principal (notional) balance, 13.5% of amortized cost and 12.4% of fair value.

(3) Non-Agency CMBS includes interest-only securities which represent 15.0% of principal/notional balance, 0.4% of amortized cost and 0.5% of fair value.

(4) Non-Agency RMBS is 43.5% variable rate, 50.7% fixed rate, and 5.8% floating rate based on fair value. Coupon payments on variable rate investments are based upon changes in the underlying ARM and Hybrid ARM loan coupons, while coupon payments on floating rate investments are based upon a spread to a reference index.

(5) Of the total discount in non-Agency RMBS, \$145.6 million is non-accretable (calculated using the principal/notional balance) based on estimated future cash flows of the securities.

(6) Non-Agency RMBS includes interest-only securities, which represent 55.4% of principal/notional balance, 2.3% of amortized cost and 2.4% of fair value.

(7) GSE CRT weighted average yield excludes coupon interest associated with embedded derivatives not accounted for under the fair value option that is recorded as realized and unrealized credit derivative income (loss), net.

The following table presents the fair value of our available-for-sale securities and securities accounted for under the fair value option by asset type as of June 30, 2019 and December 31, 2018. We have elected the fair value option for all of our RMBS IOs, our MBS purchased on or after September 1, 2016 and our GSE CRTs purchased on or after August 24, 2015. As of June 30, 2019 and December 31, 2018, approximately 78% and 67%, respectively, of our MBS and GSE CRTs are accounted for under the fair value option.

| \$ in thousands                | June 30, 2019                 |                                    |                  | December 31, 2018             |                                    |                  |
|--------------------------------|-------------------------------|------------------------------------|------------------|-------------------------------|------------------------------------|------------------|
|                                | Available-for-sale Securities | Securities under Fair Value Option | Total Fair Value | Available-for-sale Securities | Securities under Fair Value Option | Total Fair Value |
| Agency RMBS:                   |                               |                                    |                  |                               |                                    |                  |
| 15 year fixed-rate             | 126,708                       | 211,212                            | 337,920          | 204,347                       | 219,907                            | 424,254          |
| 30 year fixed-rate             | 869,612                       | 11,207,479                         | 12,077,091       | 1,093,070                     | 8,679,699                          | 9,772,769        |
| ARM                            | 6,337                         | —                                  | 6,337            | 105,747                       | —                                  | 105,747          |
| Hybrid ARM                     | 69,770                        | 31,018                             | 100,788          | 521,199                       | 33,002                             | 554,201          |
| Total RMBS Agency pass-through | 1,072,427                     | 11,449,709                         | 12,522,136       | 1,924,363                     | 8,932,608                          | 10,856,971       |
| Agency-CMO                     | 163,025                       | 250,139                            | 413,164          | 168,385                       | 99,306                             | 267,691          |
| Agency CMBS                    | —                             | 2,926,243                          | 2,926,243        | —                             | 1,002,510                          | 1,002,510        |
| Non-Agency CMBS                | 2,168,868                     | 1,482,719                          | 3,651,587        | 2,153,403                     | 1,133,056                          | 3,286,459        |
| Non-Agency RMBS                | 862,660                       | 255,413                            | 1,118,073        | 961,445                       | 202,237                            | 1,163,682        |
| GSE CRT                        | 555,134                       | 349,710                            | 904,844          | 586,231                       | 233,098                            | 819,329          |
| Total                          | 4,822,114                     | 16,713,933                         | 21,536,047       | 5,793,827                     | 11,602,815                         | 17,396,642       |

[Table of Contents](#)

The components of the carrying value of our MBS and GSE CRT portfolio at June 30, 2019 and December 31, 2018 are presented below.

| \$ in thousands                        | June 30, 2019              |                          |             |
|----------------------------------------|----------------------------|--------------------------|-------------|
|                                        | MBS and GSE CRT Securities | Interest-Only Securities | Total       |
| Principal/notional balance             | 20,839,637                 | 2,498,006                | 23,337,643  |
| Unamortized premium                    | 471,995                    | —                        | 471,995     |
| Unamortized discount                   | (561,979)                  | (2,433,402)              | (2,995,381) |
| Gross unrealized gains <sup>(1)</sup>  | 731,892                    | 5,783                    | 737,675     |
| Gross unrealized losses <sup>(1)</sup> | (11,668)                   | (4,217)                  | (15,885)    |
| Fair value                             | 21,469,877                 | 66,170                   | 21,536,047  |

  

| \$ in thousands                        | December 31, 2018          |                          |             |
|----------------------------------------|----------------------------|--------------------------|-------------|
|                                        | MBS and GSE CRT Securities | Interest-Only Securities | Total       |
| Principal/notional balance             | 17,442,367                 | 2,672,316                | 20,114,683  |
| Unamortized premium                    | 395,907                    | —                        | 395,907     |
| Unamortized discount                   | (549,988)                  | (2,598,767)              | (3,148,755) |
| Gross unrealized gains <sup>(1)</sup>  | 238,579                    | 7,448                    | 246,027     |
| Gross unrealized losses <sup>(1)</sup> | (204,664)                  | (6,556)                  | (211,220)   |
| Fair value                             | 17,322,201                 | 74,441                   | 17,396,642  |

- (1) Gross unrealized gains and losses includes gains (losses) recognized in net income for securities accounted for as derivatives or under the fair value option as well as gains (losses) for available-for-sale securities which are recognized as adjustments to other comprehensive income. Realization occurs upon sale or settlement of such securities. Further detail on the components of our total gains (losses) on investments, net for the three and six months ended June 30, 2019 and 2018 is provided below within this Note 4.

The following table summarizes our MBS and GSE CRT portfolio according to estimated weighted average life classifications as of June 30, 2019 and December 31, 2018.

| \$ in thousands                                | June 30, 2019 | December 31, 2018 |
|------------------------------------------------|---------------|-------------------|
| Less than one year                             | 55,567        | 110,020           |
| Greater than one year and less than five years | 9,122,993     | 3,508,100         |
| Greater than or equal to five years            | 12,357,487    | 13,778,522        |
| Total                                          | 21,536,047    | 17,396,642        |

[Table of Contents](#)

The following tables present the estimated fair value and gross unrealized losses of our MBS and GSE CRTs by length of time that such securities have been in a continuous unrealized loss position at June 30, 2019 and December 31, 2018.

**June 30, 2019**

| \$ in thousands                               | Less than 12 Months |                   |                      | 12 Months or More |                   |                      | Total      |                   |                      |
|-----------------------------------------------|---------------------|-------------------|----------------------|-------------------|-------------------|----------------------|------------|-------------------|----------------------|
|                                               | Fair Value          | Unrealized Losses | Number of Securities | Fair Value        | Unrealized Losses | Number of Securities | Fair Value | Unrealized Losses | Number of Securities |
| Agency RMBS:                                  |                     |                   |                      |                   |                   |                      |            |                   |                      |
| 15 year fixed-rate                            | 2,853               | (7)               | 14                   | 3,833             | (22)              | 14                   | 6,686      | (29)              | 28                   |
| 30 year fixed-rate                            | 958                 | (2)               | 2                    | 903,747           | (3,390)           | 31                   | 904,705    | (3,392)           | 33                   |
| ARM                                           | —                   | —                 | —                    | 2,764             | (32)              | 2                    | 2,764      | (32)              | 2                    |
| Hybrid ARM                                    | 2,757               | (1)               | 1                    | 32,705            | (396)             | 10                   | 35,462     | (397)             | 11                   |
| Total Agency RMBS pass-through <sup>(1)</sup> | 6,568               | (10)              | 17                   | 943,049           | (3,840)           | 57                   | 949,617    | (3,850)           | 74                   |
| Agency-CMO <sup>(2)</sup>                     | 7,302               | (2,392)           | 13                   | 46,468            | (1,400)           | 13                   | 53,770     | (3,792)           | 26                   |
| Non-Agency CMBS <sup>(3)</sup>                | 15,899              | (29)              | 3                    | 127,707           | (6,586)           | 9                    | 143,606    | (6,615)           | 12                   |
| Non-Agency RMBS <sup>(4)</sup>                | 11,399              | (1,027)           | 10                   | 84,033            | (601)             | 11                   | 95,432     | (1,628)           | 21                   |
| Total                                         | 41,168              | (3,458)           | 43                   | 1,201,257         | (12,427)          | 90                   | 1,242,425  | (15,885)          | 133                  |

(1) Includes Agency RMBS with a fair value of \$786.5 million for which the fair value option has been elected. These securities have unrealized losses of \$2.6 million.

(2) Includes Agency IO with fair value of \$12.2 million for which the fair value option has been elected. These Agency IO have unrealized losses of \$3.3 million.

(3) Includes non-Agency CMBS with a fair value of \$15.9 million for which the fair value option has been elected. These securities have unrealized losses of \$29,000.

(4) Includes non-Agency RMBS and non-Agency IO with a fair value of \$6.1 million and \$4.4 million, respectively for which the fair value option has been elected. These securities have unrealized losses of \$120,000 and \$907,000, respectively.

December 31, 2018

| \$ in thousands                               | Less than 12 Months |                   |                      | 12 Months or More |                   |                      | Total      |                   |                      |
|-----------------------------------------------|---------------------|-------------------|----------------------|-------------------|-------------------|----------------------|------------|-------------------|----------------------|
|                                               | Fair Value          | Unrealized Losses | Number of Securities | Fair Value        | Unrealized Losses | Number of Securities | Fair Value | Unrealized Losses | Number of Securities |
| Agency RMBS:                                  |                     |                   |                      |                   |                   |                      |            |                   |                      |
| 15 year fixed-rate                            | 86,241              | (814)             | 50                   | 16,660            | (189)             | 22                   | 102,901    | (1,003)           | 72                   |
| 30 year fixed-rate                            | 3,966,347           | (49,182)          | 158                  | 2,846,090         | (94,716)          | 95                   | 6,812,437  | (143,898)         | 253                  |
| ARM                                           | 2,632               | (28)              | 1                    | 49,954            | (785)             | 10                   | 52,586     | (813)             | 11                   |
| Hybrid ARM                                    | 6,758               | (59)              | 2                    | 453,463           | (8,390)           | 71                   | 460,221    | (8,449)           | 73                   |
| Total Agency RMBS pass-through <sup>(1)</sup> | 4,061,978           | (50,083)          | 211                  | 3,366,167         | (104,080)         | 198                  | 7,428,145  | (154,163)         | 409                  |
| Agency-CMO <sup>(2)</sup>                     | 152,962             | (6,315)           | 34                   | 101,705           | (5,100)           | 19                   | 254,667    | (11,415)          | 53                   |
| Non-Agency CMBS <sup>(3)</sup>                | 1,214,691           | (17,778)          | 94                   | 659,298           | (25,381)          | 52                   | 1,873,989  | (43,159)          | 146                  |
| Non-Agency RMBS <sup>(4)</sup>                | 87,850              | (1,152)           | 19                   | 89,265            | (1,138)           | 16                   | 177,115    | (2,290)           | 35                   |
| GSE CRT <sup>(5)</sup>                        | 9,639               | (193)             | 1                    | —                 | —                 | —                    | 9,639      | (193)             | 1                    |
| Total                                         | 5,527,120           | (75,521)          | 359                  | 4,216,435         | (135,699)         | 285                  | 9,743,555  | (211,220)         | 644                  |

- (1) Includes Agency RMBS with a fair value of \$6.1 billion for which the fair value option has been elected. These securities have unrealized losses of \$130.2 million.
- (2) Includes Agency IO and Agency-CMO with fair value of \$21.8 million and \$66.0 million, respectively, for which the fair value option has been elected. These Agency IO and Agency-CMO securities have unrealized losses of \$6.3 million and \$845,000, respectively.
- (3) Includes non-Agency CMBS with a fair value of \$831.3 million for which the fair value option has been elected. These securities have unrealized losses of \$26.3 million.
- (4) Includes non-Agency RMBS and non-Agency IO with a fair value of \$6.2 million and \$3.7 million for which the fair value option has been elected. These securities have unrealized losses of \$79,000 and \$269,000, respectively.
- (5) Fair value option has been elected for all GSE CRT that are in an unrealized loss position.

Gross unrealized losses on our Agency RMBS, Agency CMBS and CMO were \$4.3 million at June 30, 2019. Gross unrealized losses on our Agency RMBS, GSE CRT and CMO were \$159.3 million at December 31, 2018. Due to the inherent credit quality of Agency RMBS, Agency CMBS and Agency-CMO, we determined that at June 30, 2019 and December 31, 2018, any unrealized losses on these securities are not other than temporary.

Gross unrealized losses on our Agency IO, non-Agency RMBS and non-Agency CMBS were \$11.6 million at June 30, 2019 (December 31, 2018: \$51.9 million). We did not consider these unrealized losses to be credit related, but rather due to non-credit related factors such as interest rates, prepayment speeds, and market fluctuations. These investment securities are included in our assessment for other-than-temporary impairment ("OTTI").

We assess our investment securities for OTTI on a quarterly basis. When the fair value of an investment is less than its amortized cost at the balance sheet date of the reporting period for which impairment is assessed, the impairment is designated as either "temporary" or "other-than-temporary." This analysis includes a determination of estimated future cash flows through an evaluation of the characteristics of the underlying loans and the structural features of the investment. Underlying loan characteristics reviewed include, but are not limited to, delinquency status, loan-to-value ratios, borrower credit scores, occupancy status and geographic concentration.

The following table summarizes OTTI included in earnings for the three and six months ended June 30, 2019 and 2018:

| \$ in thousands                | Three Months Ended June 30, |       | Six Months Ended June 30, |       |
|--------------------------------|-----------------------------|-------|---------------------------|-------|
|                                | 2019                        | 2018  | 2019                      | 2018  |
| RMBS interest-only securities  | 489                         | 2,089 | 1,952                     | 6,398 |
| Non-Agency RMBS <sup>(1)</sup> | 711                         | —     | 1,024                     | 50    |
| Total                          | 1,200                       | 2,089 | 2,976                     | 6,448 |

- (1) Amounts disclosed relate to credit losses on debt securities for which a portion of an other-than-temporary impairment was recognized in other comprehensive income.

[Table of Contents](#)

OTTI on RMBS interest-only securities was recorded as a reclassification from an unrealized to realized loss within gain (loss) on investments, net on the condensed consolidated statements of operations because we account for these securities under the fair value option. As of June 30, 2019, we did not intend to sell the securities and determined that it was not more likely than not that we will be required to sell the securities.

The following table summarizes the components of our total gain (loss) on investments, net for the three and six months ended June 30, 2019 and 2018.

| \$ in thousands                                                                      | Three Months Ended June 30, |          | Six Months Ended June 30, |           |
|--------------------------------------------------------------------------------------|-----------------------------|----------|---------------------------|-----------|
|                                                                                      | 2019                        | 2018     | 2019                      | 2018      |
| Gross realized gains on sale of investments                                          | 3,957                       | 35       | 5,159                     | 35        |
| Gross realized losses on sale of investments                                         | (1,928)                     | (11,560) | (14,245)                  | (20,797)  |
| Other-than-temporary impairment losses                                               | (1,200)                     | (2,089)  | (2,976)                   | (6,448)   |
| Net unrealized gains and losses on MBS accounted for under the fair value option     | 304,692                     | (22,941) | 584,731                   | (170,136) |
| Net unrealized gains and losses on GSE CRT accounted for under the fair value option | (3,339)                     | 182      | (2,105)                   | 616       |
| Net unrealized gains and losses on trading securities                                | —                           | (4)      | —                         | (17)      |
| Total gain (loss) on investments, net                                                | 302,182                     | (36,377) | 570,564                   | (196,747) |

The following tables present components of interest income recognized on our MBS and GSE CRT portfolio for the three and six months ended June 30, 2019 and 2018. GSE CRT interest income excludes coupon interest associated with embedded derivatives not accounted for under the fair value option that is recorded as realized and unrealized credit derivative income (loss), net.

**For the three months ended June 30, 2019**

| \$ in thousands | Coupon Interest | Net (Premium Amortization)/Discount Accretion | Interest Income |
|-----------------|-----------------|-----------------------------------------------|-----------------|
| Agency RMBS     | 131,757         | (17,153)                                      | 114,604         |
| Agency CMBS     | 17,862          | (909)                                         | 16,953          |
| Non-Agency CMBS | 40,615          | 3,350                                         | 43,965          |
| Non-Agency RMBS | 13,877          | 2,800                                         | 16,677          |
| GSE CRT         | 9,426           | (1,852)                                       | 7,574           |
| Other           | 964             | —                                             | 964             |
| Total           | 214,501         | (13,764)                                      | 200,737         |

**For the three months ended June 30, 2018**

| \$ in thousands | Coupon Interest | Net (Premium Amortization)/Discount Accretion | Interest Income |
|-----------------|-----------------|-----------------------------------------------|-----------------|
| Agency RMBS     | 105,389         | (22,274)                                      | 83,115          |
| Agency CMBS     | 41              | (1)                                           | 40              |
| Non-Agency CMBS | 38,101          | 1,195                                         | 39,296          |
| Non-Agency RMBS | 13,195          | 5,159                                         | 18,354          |
| GSE CRT         | 7,180           | (696)                                         | 6,484           |
| Other           | 259             | —                                             | 259             |
| Total           | 164,165         | (16,617)                                      | 147,548         |

[Table of Contents](#)
**For the six months ended June 30, 2019**

| \$ in thousands | Coupon Interest | Net (Premium Amortization)/Discount Accretion | Interest Income |
|-----------------|-----------------|-----------------------------------------------|-----------------|
| Agency RMBS     | 251,483         | (29,347)                                      | 222,136         |
| Agency CMBS     | 28,333          | (1,440)                                       | 26,893          |
| Non-Agency CMBS | 79,445          | 6,381                                         | 85,826          |
| Non-Agency RMBS | 28,144          | 6,722                                         | 34,866          |
| GSE CRT         | 18,022          | (3,030)                                       | 14,992          |
| Other           | 1,516           | —                                             | 1,516           |
| Total           | 406,943         | (20,714)                                      | 386,229         |

**For the six months ended June 30, 2018**

| \$ in thousands | Coupon Interest | Net (Premium Amortization)/Discount Accretion | Interest Income |
|-----------------|-----------------|-----------------------------------------------|-----------------|
| Agency RMBS     | 213,706         | (45,496)                                      | 168,210         |
| Agency CMBS     | 41              | (1)                                           | 40              |
| Non-Agency CMBS | 75,394          | 2,621                                         | 78,015          |
| Non-Agency RMBS | 27,207          | 10,336                                        | 37,543          |
| GSE CRT         | 13,705          | (1,393)                                       | 12,312          |
| Other           | 431             | —                                             | 431             |
| Total           | 330,484         | (33,933)                                      | 296,551         |

**Note 5 – Other Assets**

The following table summarizes our other assets as of June 30, 2019 and December 31, 2018.

| \$ in thousands                        | June 30, 2019 | December 31, 2018 |
|----------------------------------------|---------------|-------------------|
| FHLBI stock                            | 74,250        | 74,250            |
| Loan participation interest            | 47,885        | 54,981            |
| Commercial loans, held-for-investment  | 24,321        | 31,582            |
| Investments in unconsolidated ventures | 25,675        | 24,012            |
| Prepaid expenses and other assets      | 1,912         | 1,234             |
| Total                                  | 174,043       | 186,059           |

IAS Services LLC, our wholly-owned captive insurance subsidiary, is required to purchase and hold Federal Home Loan Bank of Indianapolis ("FHLBI") stock as a condition of membership in the FHLBI. The stock is recorded at cost.

In August 2018, we acquired a participation interest in a secured loan collateralized by mortgage servicing rights. The secured loan has a two year term subject to a one year extension at the borrower's option. The participation interest bears interest at a floating rate based on LIBOR plus a spread. The weighted average asset yield for the participation interest was 6.06% as of June 30, 2019 and 6.06% as of December 31, 2018. We elected to account for the investment using the fair value option. Refer to Note 14 - "Commitments and Contingencies" for additional details regarding our unfunded commitment on this loan participation interest.

As of June 30, 2019, our commercial loan portfolio consisted of one commercial loan with a maturity of 1.7 years (December 31, 2018: two commercial loans with a weighted average maturity of 1.7 years). The loans had a weighted average coupon rate of 10.94% as of June 30, 2019 and 10.69% as of December 31, 2018. The loans were not impaired, and we have not recorded an allowance for loan losses as of June 30, 2019 and December 31, 2018 based on our analysis of credit quality factors as described in Note 2 - "Summary of Significant Accounting Policies" included in the consolidated financial statements of our Annual Report on Form 10-K for the year ended December 31, 2018.

We have invested in unconsolidated ventures that are managed by an affiliate of our Manager. The unconsolidated ventures invest in our target assets. Refer to Note 14 - "Commitments and Contingencies" for additional details regarding our commitments to these unconsolidated ventures.

## Note 6 – Borrowings

We finance the majority of our investment portfolio through repurchase agreements and secured loans. The following tables summarize certain characteristics of our borrowings at June 30, 2019 and December 31, 2018. Refer to Note 7 - "Collateral Positions" for collateral pledged and held under our repurchase agreements and secured loans.

| \$ in thousands             | June 30, 2019         |                                         |                                                        |
|-----------------------------|-----------------------|-----------------------------------------|--------------------------------------------------------|
|                             | Amount<br>Outstanding | Weighted<br>Average<br>Interest<br>Rate | Weighted<br>Average<br>Remaining<br>Maturity<br>(days) |
|                             |                       |                                         |                                                        |
| Repurchase Agreements:      |                       |                                         |                                                        |
| Agency RMBS                 | 11,234,043            | 2.62%                                   | 45                                                     |
| Agency CMBS                 | 2,299,766             | 2.61%                                   | 50                                                     |
| Non-Agency CMBS             | 1,849,544             | 3.44%                                   | 17                                                     |
| Non-Agency RMBS             | 904,432               | 3.34%                                   | 23                                                     |
| GSE CRT                     | 751,367               | 3.37%                                   | 14                                                     |
| Loan participation interest | 35,913                | 4.04%                                   | 424                                                    |
| Total Repurchase Agreements | 17,075,065            | 2.78%                                   | 41                                                     |
| Secured Loans               | 1,650,000             | 2.66%                                   | 1771                                                   |
| Total Borrowings            | 18,725,065            | 2.77%                                   | 193                                                    |

| \$ in thousands             | December 31, 2018     |                                         |                                                        |
|-----------------------------|-----------------------|-----------------------------------------|--------------------------------------------------------|
|                             | Amount<br>Outstanding | Weighted<br>Average<br>Interest<br>Rate | Weighted<br>Average<br>Remaining<br>Maturity<br>(days) |
|                             |                       |                                         |                                                        |
| Repurchase Agreements:      |                       |                                         |                                                        |
| Agency RMBS                 | 9,529,352             | 2.56%                                   | 36                                                     |
| Agency CMBS                 | 810,450               | 2.53%                                   | 31                                                     |
| Non-Agency CMBS             | 1,616,473             | 3.56%                                   | 19                                                     |
| Non-Agency RMBS             | 923,959               | 3.60%                                   | 26                                                     |
| GSE CRT                     | 681,014               | 3.48%                                   | 21                                                     |
| Loan participation interest | 41,236                | 4.09%                                   | 605                                                    |
| Total Repurchase Agreements | 13,602,484            | 2.80%                                   | 34                                                     |
| Secured Loans               | 1,650,000             | 2.68%                                   | 1952                                                   |
| Total Borrowings            | 15,252,484            | 2.79%                                   | 242                                                    |

[Table of Contents](#)

The following table shows the aggregate amount of maturities of our outstanding borrowings:

| <b>\$ in thousands</b>             | <b>As of</b>         |
|------------------------------------|----------------------|
| <b>Borrowings maturing within:</b> | <b>June 30, 2019</b> |
| 7/1/2019 - 6/30/2020               | 17,339,152           |
| 7/1/2020 - 6/30/2021               | 135,913              |
| 7/1/2021 - 6/30/2022               | —                    |
| 7/1/2022 - 6/30/2023               | —                    |
| 7/1/2023 - 6/30/2024               | —                    |
| Thereafter                         | 1,250,000            |
| <b>Total</b>                       | <b>18,725,065</b>    |

### Repurchase Agreements

Our repurchase agreements generally bear interest at a contractually agreed upon rate and have maturities ranging from one month to six months. Our repurchase agreement that is collateralized by a loan participation interest bears interest at a floating rate based on LIBOR plus a spread and matures on August 27, 2020. Repurchase agreements are accounted for as secured borrowings since we maintain effective control of the financed assets. Repurchase agreements are subject to certain financial covenants. We were in compliance with these covenants at June 30, 2019.

Our repurchase agreement collateral pledged ratio (MBS, GSE CRTs and a loan participation interest pledged as collateral/amount outstanding) was 110% as of June 30, 2019 (December 31, 2018: 111%).

### Secured Loans

Our wholly-owned captive insurance subsidiary, IAS Services LLC, is a member of the FHLBI. As a member of the FHLBI, IAS Services LLC has borrowed funds from the FHLBI in the form of secured loans.

As of June 30, 2019, IAS Services LLC had \$1.65 billion in outstanding secured loans from the FHLBI. These secured loans have floating rates that are based on the three-month FHLB swap rate plus a spread. For the six months ended June 30, 2019, IAS Services LLC had weighted average borrowings of \$1.65 billion with a weighted average borrowing rate of 2.72% and a weighted average maturity of 4.9 years.

The Federal Housing Finance Agency's ("FHFA") final rule governing Federal Home Loan Bank membership (the "FHFA Rule") became effective on February 19, 2016. The FHFA Rule permits existing captive insurance companies, such as IAS Services LLC, to remain members until February 2021. New advances or renewals that mature after February 2021 are prohibited. The FHLBI has indicated it will honor the contractual maturity dates of existing advances to IAS Services LLC that were made prior to February 19, 2016 and extend beyond February 2021. We do not expect there to be any impact to our existing FHLBI borrowings under the FHFA rule. The ability to borrow from the FHLBI is subject to our continued creditworthiness, pledging of sufficient eligible collateral to secure advances, and compliance with certain agreements with FHLBI and FHFA rules.

As discussed in Note 5 - "Other Assets," IAS Services LLC is required to purchase and hold a certain amount of FHLBI stock, which is based, in part, upon the outstanding principal balance of secured loans from the FHLBI.

**Note 7 - Collateral Positions**

The following table summarizes the fair value of collateral that we have pledged and held under our repurchase agreements, secured loans, interest rate swaps, futures contracts and currency forward contracts as of June 30, 2019 and December 31, 2018. Refer to Note 2 - "Summary of Significant Accounting Policies - Fair Value Measurements" of our consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2018 for a description of how we determine fair value. RMBS, CMBS and GSE CRT collateral pledged is included in mortgage-backed and credit risk transfer securities on our condensed consolidated balance sheets. Loan participation interest collateral pledged is included in other assets on our condensed consolidated balance sheets. Cash collateral pledged on secured loans, centrally cleared swaps, bilateral interest rate swaps and currency forward contracts is classified as restricted cash on our condensed consolidated balance sheets. Cash collateral pledged on futures contracts and To Be Announced Securities ("TBAs") is classified as due from counterparties on our condensed consolidated balance sheets.

Cash collateral held on bilateral swaps and repurchase agreements that is not restricted for use is included in cash and cash equivalents on our condensed consolidated balance sheets and the liability to return the collateral is included in collateral held payable. Non-cash collateral held is only recognized if the counterparty defaults or if we sell the pledged collateral. As of June 30, 2019 and December 31, 2018, we did not recognize any non-cash collateral held on the condensed consolidated balance sheets.

[Table of Contents](#)

\$ in thousands

| Collateral Pledged                                                                             | As of         |                   |
|------------------------------------------------------------------------------------------------|---------------|-------------------|
|                                                                                                | June 30, 2019 | December 31, 2018 |
| Repurchase Agreements:                                                                         |               |                   |
| Agency RMBS                                                                                    | 11,868,055    | 10,158,404        |
| Agency CMBS                                                                                    | 2,474,292     | 870,702           |
| Non-Agency CMBS                                                                                | 2,341,069     | 2,016,202         |
| Non-Agency RMBS                                                                                | 1,097,426     | 1,127,911         |
| GSE CRT                                                                                        | 904,843       | 819,328           |
| Loan participation interest                                                                    | 47,885        | 54,981            |
| Cash                                                                                           | 15,613        | —                 |
| Total repurchase agreements collateral pledged                                                 | 18,749,183    | 15,047,528        |
| Secured Loans:                                                                                 |               |                   |
| Agency RMBS                                                                                    | 688,520       | 702,952           |
| Non-Agency CMBS                                                                                | 1,267,117     | 1,227,412         |
| Total secured loans collateral pledged                                                         | 1,955,637     | 1,930,364         |
| Interest Rate Swaps, Futures Contracts and Currency Forward Contracts:                         |               |                   |
| Agency RMBS                                                                                    | 206,947       | 159,914           |
| Cash                                                                                           | 5,428         | 13,500            |
| Restricted cash                                                                                | 55,271        | —                 |
| Total interest rate swaps, futures contracts and currency forward contracts collateral pledged | 267,646       | 173,414           |
| Total collateral pledged:                                                                      |               |                   |
| Mortgage-backed and credit risk transfer securities                                            | 20,848,269    | 17,082,825        |
| Loan participation interest                                                                    | 47,885        | 54,981            |
| Cash <sup>(1)</sup>                                                                            | 21,041        | 13,500            |
| Restricted cash                                                                                | 55,271        | —                 |
| Total collateral pledged                                                                       | 20,972,466    | 17,151,306        |
|                                                                                                |               |                   |
| Collateral Held                                                                                | As of         |                   |
|                                                                                                | June 30, 2019 | December 31, 2018 |
| Repurchase Agreements:                                                                         |               |                   |
| Cash                                                                                           | 14,780        | —                 |
| Non-cash collateral                                                                            | 26,423        | —                 |
| Total repurchase agreements collateral held                                                    | 41,203        | —                 |
| Interest Rate Swaps:                                                                           |               |                   |
| Cash                                                                                           | 159           | 18,083            |
| Non-cash collateral                                                                            | —             | —                 |
| Total interest rate swap collateral held                                                       | 159           | 18,083            |
| Total collateral held:                                                                         |               |                   |
| Cash                                                                                           | 14,939        | 18,083            |
| Non-cash collateral                                                                            | 26,423        | —                 |
| Total collateral held                                                                          | 41,362        | 18,083            |

(1) Includes cash pledged as collateral on repurchase agreements, futures contracts and TBAs that is recorded as due from counterparties. Cash collateral pledged on TBAs relates to TBAs that are accounted for as regular-way security trades.

## **Repurchase Agreements**

Collateral pledged with our repurchase agreement counterparties is segregated in our books and records. The repurchase agreement counterparties have the right to resell and repledge the collateral posted but have the obligation to return the pledged collateral, or substantially the same collateral if agreed to by us, upon maturity of the repurchase agreement. Under the repurchase agreements, the respective lender retains the contractual right to mark the underlying collateral to fair value as determined by a pricing service agreed to by the respective lender and us. We would be required to provide additional collateral or fund margin calls if the value of pledged assets declined. We intend to maintain a level of liquidity that will enable us to meet margin calls.

## **Secured Loans**

The ability to borrow from the FHLBI is subject to our continued creditworthiness, pledging of sufficient eligible collateral to secure advances, and compliance with FHLBI and FHFA rules. Collateral pledged with the FHLBI is held in trust for the benefit of the FHLBI and is not commingled with our other assets. The FHLBI does not have the right to resell or repledge collateral posted unless an event of default occurs. The FHLBI retains the right to mark the underlying collateral for FHLBI advances to fair value as determined by the FHLBI in its sole discretion. IAS Services LLC would be required to provide additional collateral or fund margin calls if the value of pledged assets declines.

## **Interest Rate Swaps**

Collateral pledged with our interest rate swap counterparties is segregated in our books and records. We have two types of interest rate swap agreements: bilateral interest rate swaps that are governed by an International Swaps and Derivatives Association ("ISDA") agreement and interest rate swaps that are centrally cleared by a registered clearing organization such as the Chicago Mercantile Exchange ("CME") and LCH Limited ("LCH") through a Futures Commission Merchant ("FCM"). Interest rate swaps that are governed by an ISDA agreement provide for bilateral collateral pledging based on the counterparties' market value. The counterparties have the right to repledge the collateral posted, but have the obligation to return the pledged collateral, or substantially the same collateral, if agreed to by us, as the market value of the interest rate swaps change.

We are required to pledge initial margin and daily variation margin for our interest rate swaps that are centrally cleared. The FCM determines the fair value of our centrally cleared swaps, including daily variation margin. The daily variation margin payment for centrally cleared interest rate swaps is characterized as settlement of the derivative itself rather than collateral and is recorded as gain (loss) on derivative instruments, net in our condensed consolidated statement of operations.

## **Futures Contracts**

We are required to pledge initial margin and daily variation margin for our futures contracts that is based on the fair value of our contracts as determined by our FCM. The daily variation margin payment for our futures contracts is characterized as settlement of the futures contract itself rather than collateral and is recorded as gain (loss) on derivative instruments, net in our condensed consolidated statement of operations.

## **Currency Forward Contracts**

Collateral pledged with our currency forward counterparty is segregated in our books and records. Our currency forward contract provides for bilateral collateral pledging based on market value as determined by the counterparty and can be in the form of cash or securities. Our counterparty has the right to repledge the collateral posted, but has the obligation to return the pledged collateral, or substantially the same collateral, if agreed to by us, as the market value of the currency forward contract changes.

## Note 8 – Derivatives and Hedging Activities

The following table summarizes changes in the notional amount of our derivative instruments during 2019:

| \$ in thousands            | Notional Amount as<br>of December 31, 2018 | Additions  | Settlement,<br>Termination,<br>Expiration<br>or Exercise | Notional Amount as<br>of June 30, 2019 |
|----------------------------|--------------------------------------------|------------|----------------------------------------------------------|----------------------------------------|
| Interest Rate Swaps        | 12,370,000                                 | 10,475,000 | (10,375,000)                                             | 12,470,000                             |
| Futures Contracts          | 1,689,900                                  | 3,131,500  | (4,327,100)                                              | 494,300                                |
| Currency Forward Contracts | 23,149                                     | 52,119     | (48,684)                                                 | 26,584                                 |
| Credit Derivatives         | 526,912                                    | —          | (22,598)                                                 | 504,314                                |
| Total                      | 14,609,961                                 | 13,658,619 | (14,773,382)                                             | 13,495,198                             |

Refer to Note 7 - "Collateral Positions" for further information regarding our collateral pledged to and received from our interest rate swap counterparties.

### Interest Rate Swaps

Our repurchase agreements are usually settled on a short-term basis ranging from one to twelve months. At each settlement date, we typically refinance each repurchase agreement at the market interest rate at that time. In addition, our secured loans have floating interest rates. As such, we are exposed to changing interest rates. Our objectives in using interest rate derivatives are to add stability to interest expense and to manage our exposures to interest rate movements. To accomplish these objectives, we primarily use interest rate swaps as part of our interest rate risk management strategy. Interest rate swaps involve making fixed-rate payments to a counterparty in exchange for the receipt of variable-rate amounts over the life of the agreements without exchange of the underlying notional amount.

Amounts recorded in accumulated other comprehensive income ("AOCI") before we discontinued cash flow hedge accounting for our interest rate swaps are reclassified to interest expense on repurchase agreements on the condensed consolidated statements of operations as interest is accrued and paid on the related repurchase agreements over the remaining life of the interest rate swap agreements. We reclassified \$5.9 million as a decrease (June 30, 2018: \$6.9 million as a decrease) and \$11.8 million as a decrease (June 30, 2018: \$13.4 million as a decrease) to interest expense for the three and six months ended June 30, 2019, respectively. During the next 12 months, we estimate that \$23.8 million will be reclassified as a decrease to interest expense, repurchase agreements. As of June 30, 2019, \$87.9 million (December 31, 2018: \$99.6 million) of unrealized gains on discontinued cash flow hedges, net are still included in accumulated other comprehensive income and will be reclassified as a decrease to interest expense, repurchase agreements over a period of time through December 15, 2023.

[Table of Contents](#)

As of June 30, 2019 and December 31, 2018, we had interest rate swaps with the following maturities outstanding:

| \$ in thousands | Maturities | As of June 30, 2019            |                                 |                                    |
|-----------------|------------|--------------------------------|---------------------------------|------------------------------------|
|                 |            | Notional Amount <sup>(1)</sup> | Weighted Average Fixed Pay Rate | Weighted Average Receive Rate      |
|                 |            |                                |                                 | Weighted Average Years to Maturity |
|                 | 2021       | 1,700,000                      | 2.24%                           | 2.43%                              |
|                 | 2022       | 4,650,000                      | 2.09%                           | 2.48%                              |
|                 | 2023       | 1,000,000                      | 2.09%                           | 2.39%                              |
|                 | 2024       | 1,900,000                      | 2.08%                           | 2.49%                              |
|                 | Thereafter | 3,220,000                      | 2.24%                           | 2.44%                              |
|                 | Total      | 12,470,000                     | 2.15%                           | 2.46%                              |

| \$ in thousands | Maturities | As of December 31, 2018        |                                 |                                    |
|-----------------|------------|--------------------------------|---------------------------------|------------------------------------|
|                 |            | Notional Amount <sup>(2)</sup> | Weighted Average Fixed Pay Rate | Weighted Average Receive Rate      |
|                 |            |                                |                                 | Weighted Average Years to Maturity |
|                 | 2019       | 1,500,000                      | 2.70%                           | 2.47%                              |
|                 | 2020       | 1,500,000                      | 2.78%                           | 2.51%                              |
|                 | 2021       | 2,300,000                      | 2.51%                           | 2.58%                              |
|                 | 2022       | 2,550,000                      | 2.13%                           | 2.65%                              |
|                 | 2023       | 1,600,000                      | 2.39%                           | 2.47%                              |
|                 | Thereafter | 2,920,000                      | 2.47%                           | 2.55%                              |
|                 | Total      | 12,370,000                     | 2.46%                           | 2.55%                              |

(1) Notional amount includes \$7.2 billion of interest rate swaps that receive variable payments based on 1-month LIBOR and \$5.3 billion of interest rate swaps that receive variable payments based on 3-month LIBOR as of June 30, 2019.

(2) Notional amount includes \$6.7 billion of interest rate swaps that receive variable payments based on 1-month LIBOR and \$5.7 billion of interest rate swaps that receive variable payments based on 3-month LIBOR as of December 31, 2018.

### TBAs, Futures and Currency Forward Contracts

We purchase or sell certain TBAs and U.S. Treasury futures contracts to help mitigate the potential impact of changes in interest rates on the performance of our investment portfolio. We recognize realized and unrealized gains and losses associated with the purchases or sales of TBAs and U.S. Treasury futures contracts in gain (loss) on derivative instruments, net in our condensed consolidated statements of operations.

We use currency forward contracts to help mitigate the potential impact of changes in foreign currency exchange rates on our investments denominated in foreign currencies. We recognize realized and unrealized gains and losses associated with the purchases or sales of currency forward contracts in gain (loss) on derivative instruments, net in our condensed consolidated statements of operations. As of June 30, 2019, we had \$26.6 million (December 31, 2018: \$23.1 million) of notional amount of currency forward contracts related to an investment in an unconsolidated venture denominated in Euro.

### Credit Derivatives

Our GSE CRTs purchased prior to August 24, 2015 are accounted for as hybrid financial instruments consisting of a debt host contract and an embedded credit derivative. Embedded derivatives associated with GSE CRTs are recorded within mortgage-backed and credit risk transfer securities, at fair value, on the condensed consolidated balance sheets. At June 30, 2019 and December 31, 2018, terms of the GSE CRT embedded derivatives are:

| \$ in thousands                                          | June 30, 2019 | December 31, 2018 |
|----------------------------------------------------------|---------------|-------------------|
| Fair value amount                                        | 17,567        | 22,771            |
| Notional amount                                          | 504,314       | 526,912           |
| Maximum potential amount of future undiscounted payments | 504,314       | 526,912           |

**Tabular Disclosure of the Effect of Derivative Instruments on the Balance Sheet**

The table below presents the fair value of our derivative financial instruments, as well as their classification on the condensed consolidated balance sheets as of June 30, 2019 and December 31, 2018.

\$ in thousands

| Derivative Assets          |                     |                         | Derivative Liabilities        |                     |                         |
|----------------------------|---------------------|-------------------------|-------------------------------|---------------------|-------------------------|
|                            | As of June 30, 2019 | As of December 31, 2018 |                               | As of June 30, 2019 | As of December 31, 2018 |
| Balance Sheet              | Fair Value          | Fair Value              | Balance Sheet                 | Fair Value          | Fair Value              |
| Interest Rate Swaps Asset  | 9,446               | 15,089                  | Interest Rate Swaps Liability | 36,669              | 15,382                  |
| Currency Forward Contracts | 3                   | —                       | Currency Forward Contracts    | 300                 | 172                     |
| Futures Contracts          | 618                 | —                       | Futures Contracts             | —                   | 7,836                   |

**Tabular Disclosure of the Effect of Derivative Instruments on the Income Statement**

The tables below present the effect of our credit derivatives on the condensed consolidated statements of operations for the three and six months ended June 30, 2019 and 2018.

\$ in thousands

| Derivative not designated as hedging instrument | Three months ended June 30, 2019 |                                             |                             |                                                              |
|-------------------------------------------------|----------------------------------|---------------------------------------------|-----------------------------|--------------------------------------------------------------|
|                                                 | Realized gain (loss), net        | GSE CRT embedded derivative coupon interest | Unrealized gain (loss), net | Realized and unrealized credit derivative income (loss), net |
| GSE CRT Embedded Derivatives                    | —                                | 5,300                                       | (7,738)                     | (2,438)                                                      |

\$ in thousands

| Derivative not designated as hedging instrument | Three months ended June 30, 2018 |                                             |                             |                                                              |
|-------------------------------------------------|----------------------------------|---------------------------------------------|-----------------------------|--------------------------------------------------------------|
|                                                 | Realized gain (loss), net        | GSE CRT embedded derivative coupon interest | Unrealized gain (loss), net | Realized and unrealized credit derivative income (loss), net |
| GSE CRT Embedded Derivatives                    | —                                | 5,638                                       | (4,903)                     | 735                                                          |

\$ in thousands

| Derivative not designated as hedging instrument | Six months ended June 30, 2019 |                                             |                             |                                                              |
|-------------------------------------------------|--------------------------------|---------------------------------------------|-----------------------------|--------------------------------------------------------------|
|                                                 | Realized gain (loss), net      | GSE CRT embedded derivative coupon interest | Unrealized gain (loss), net | Realized and unrealized credit derivative income (loss), net |
| GSE CRT Embedded Derivatives                    | —                              | 10,650                                      | (5,204)                     | 5,446                                                        |

\$ in thousands

| Derivative not designated as hedging instrument | Six months ended June 30, 2018 |                                             |                             |                                                              |
|-------------------------------------------------|--------------------------------|---------------------------------------------|-----------------------------|--------------------------------------------------------------|
|                                                 | Realized gain (loss), net      | GSE CRT embedded derivative coupon interest | Unrealized gain (loss), net | Realized and unrealized credit derivative income (loss), net |
| GSE CRT Embedded Derivatives                    | —                              | 11,271                                      | (7,371)                     | 3,900                                                        |

## [Table of Contents](#)

The following table summarizes the effect of interest rate swaps, futures contracts and currency forward contracts reported in gain (loss) on derivative instruments, net on the condensed consolidated statements of operations for the three and six months ended June 30, 2019 and 2018:

| \$ in thousands            | Derivative<br>not designated as<br>hedging instrument | Three Months Ended June 30, 2019                          |                                              |                                |                                               |
|----------------------------|-------------------------------------------------------|-----------------------------------------------------------|----------------------------------------------|--------------------------------|-----------------------------------------------|
|                            |                                                       | Realized gain (loss) on<br>derivative instruments,<br>net | Contractual net interest<br>income (expense) | Unrealized gain (loss),<br>net | Gain (loss) on derivative<br>instruments, net |
| Interest Rate Swaps        |                                                       | (241,839)                                                 | 7,525                                        | (39,922)                       | (274,236)                                     |
| Futures Contracts          |                                                       | (65,953)                                                  | —                                            | (4,490)                        | (70,443)                                      |
| Currency Forward Contracts |                                                       | 553                                                       | —                                            | (607)                          | (54)                                          |
| Total                      |                                                       | (307,239)                                                 | 7,525                                        | (45,019)                       | (344,733)                                     |

| \$ in thousands            | Derivative<br>not designated as<br>hedging instrument | Three Months Ended June 30, 2018                          |                                              |                                |                                               |
|----------------------------|-------------------------------------------------------|-----------------------------------------------------------|----------------------------------------------|--------------------------------|-----------------------------------------------|
|                            |                                                       | Realized gain (loss) on<br>derivative instruments,<br>net | Contractual net interest<br>income (expense) | Unrealized gain (loss),<br>net | Gain (loss) on derivative<br>instruments, net |
| Interest Rate Swaps        |                                                       | 34,273                                                    | (4,511)                                      | 32,985                         | 62,747                                        |
| Futures Contracts          |                                                       | 640                                                       | —                                            | (1,044)                        | (404)                                         |
| Currency Forward Contracts |                                                       | 1,361                                                     | —                                            | 3,465                          | 4,826                                         |
| Total                      |                                                       | 36,274                                                    | (4,511)                                      | 35,406                         | 67,169                                        |

| \$ in thousands            | Derivative<br>not designated as<br>hedging instrument | Six Months Ended June 30, 2019                            |                                       |                                |                                               |
|----------------------------|-------------------------------------------------------|-----------------------------------------------------------|---------------------------------------|--------------------------------|-----------------------------------------------|
|                            |                                                       | Realized gain (loss) on<br>derivative instruments,<br>net | Contractual net interest<br>(expense) | Unrealized gain (loss),<br>net | Gain (loss) on derivative<br>instruments, net |
| Interest Rate Swaps        |                                                       | (407,723)                                                 | 12,034                                | (26,931)                       | (422,620)                                     |
| Futures Contracts          |                                                       | (132,641)                                                 | —                                     | 8,454                          | (124,187)                                     |
| Currency Forward Contracts |                                                       | 738                                                       | —                                     | (124)                          | 614                                           |
| Total                      |                                                       | (539,626)                                                 | 12,034                                | (18,601)                       | (546,193)                                     |

| \$ in thousands            | Derivative<br>not designated as<br>hedging instrument | Six Months Ended June 30, 2018                            |                                       |                                |                                               |
|----------------------------|-------------------------------------------------------|-----------------------------------------------------------|---------------------------------------|--------------------------------|-----------------------------------------------|
|                            |                                                       | Realized gain (loss) on<br>derivative instruments,<br>net | Contractual net<br>interest (expense) | Unrealized gain (loss),<br>net | Gain (loss) on derivative<br>instruments, net |
| Interest Rate Swaps        |                                                       | 156,546                                                   | (16,623)                              | 65,359                         | 205,282                                       |
| Futures Contracts          |                                                       | (4,637)                                                   | —                                     | (2,656)                        | (7,293)                                       |
| Currency Forward Contracts |                                                       | (2,057)                                                   | —                                     | 4,604                          | 2,547                                         |
| Total                      |                                                       | 149,852                                                   | (16,623)                              | 67,307                         | 200,536                                       |

### Credit-risk-related Contingent Features

We have agreements with each of our bilateral derivative counterparties. Some of those agreements contain a provision whereby if we default on any of our indebtedness, including default whereby repayment of the indebtedness has not been accelerated by the lender, we could be declared in default on our derivative obligations.

At June 30, 2019, the fair value of derivatives in a net liability position, which includes accrued interest but excludes any adjustment for non-performance risk related to bilateral interest rate swap agreements, was \$36.6 million. We have minimum collateral posting thresholds with certain of our bilateral derivative counterparties and pledged securities with a fair value of \$15.6 million and restricted cash of \$23.3 million with these counterparties as of June 30, 2019. If we had breached any of these

[Table of Contents](#)

provisions at June 30, 2019, we could have been required to settle our obligations under these agreements at their termination value.

We also have an agreement with a clearing counterparty for our interest rate swaps that includes cross default provisions. The fair value of our centrally cleared interest rate derivative contracts, which includes accrued interest and variation margin but excludes any adjustment for non-performance risk, was a net asset of \$9.4 million as of June 30, 2019.

We were in compliance with all of the financial provisions of these counterparty agreements as of June 30, 2019.

**Note 9 – Offsetting Assets and Liabilities**

Certain of our repurchase agreements and derivative transactions are governed by underlying agreements that generally provide for a right of offset under master netting arrangements (or similar agreements) in the event of default or in the event of bankruptcy of either party to the transactions. Assets and liabilities subject to such arrangements are presented on a gross basis in the condensed consolidated balance sheets.

The following tables present information about the assets and liabilities that are subject to master netting agreements (or similar agreements) and can potentially be offset on our condensed consolidated balance sheets at June 30, 2019 and December 31, 2018. The daily variation margin payment for centrally cleared interest rate swaps is characterized as settlement of the derivative itself rather than collateral. As of June 30, 2019, our derivative asset of \$9.4 million (December 31, 2018: derivative liability of \$13.2 million) related to centrally cleared interest rate swaps is not included in the table below as a result of this characterization of daily variation margin.

**Offsetting of Derivative Assets**

**As of June 30, 2019**

| \$ in thousands<br>Description | Gross<br>Amounts of<br>Recognized<br>Assets | Gross<br>Amounts<br>Offset in the<br>Condensed<br>Consolidated<br>Balance<br>Sheets | Net Amounts<br>of Assets<br>presented in<br>the Condensed<br>Consolidated<br>Balance Sheets | Gross Amounts Not Offset in the<br>Condensed Consolidated Balance Sheets |                             | Net Amount |
|--------------------------------|---------------------------------------------|-------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------|--------------------------------------------------------------------------|-----------------------------|------------|
|                                |                                             |                                                                                     |                                                                                             | Financial<br>Instruments                                                 | Cash Collateral<br>Received |            |
| Derivatives <sup>(1) (3)</sup> | 622                                         | —                                                                                   | 622                                                                                         | (3)                                                                      | —                           | 619        |

**Offsetting of Derivative Liabilities, Repurchase Agreements and Secured Loans**

**As of June 30, 2019**

| \$ in thousands<br>Description       | Gross<br>Amounts of<br>Recognized<br>Liabilities | Gross<br>Amounts<br>Offset in the<br>Condensed<br>Consolidated<br>Balance<br>Sheets | Net Amounts<br>of Liabilities<br>presented in<br>the Condensed<br>Consolidated<br>Balance Sheets | Gross Amounts Not Offset in the<br>Condensed Consolidated Balance Sheets |                            | Net Amount |
|--------------------------------------|--------------------------------------------------|-------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------|----------------------------|------------|
|                                      |                                                  |                                                                                     |                                                                                                  | Financial<br>Instruments <sup>(2)</sup>                                  | Cash Collateral<br>Pledged |            |
| Derivatives <sup>(3)</sup>           | 36,969                                           | —                                                                                   | 36,969                                                                                           | (15,114)                                                                 | (21,661)                   | 194        |
| Repurchase Agreements <sup>(4)</sup> | 17,075,065                                       | —                                                                                   | 17,075,065                                                                                       | (17,075,065)                                                             | —                          | —          |
| Secured Loans <sup>(5)</sup>         | 1,650,000                                        | —                                                                                   | 1,650,000                                                                                        | (1,650,000)                                                              | —                          | —          |
| Total                                | 18,762,034                                       | —                                                                                   | 18,762,034                                                                                       | (18,740,179)                                                             | (21,661)                   | 194        |

**Offsetting of Derivative Assets**  
**As of December 31, 2018**

| \$ in thousands<br>Description | Gross<br>Amounts of<br>Recognized<br>Assets | Gross<br>Amounts<br>Offset in the<br>Condensed<br>Consolidated<br>Balance<br>Sheets | Net Amounts<br>of Assets<br>presented in<br>the Condensed<br>Consolidated<br>Balance Sheets | Gross Amounts Not Offset in the<br>Condensed Consolidated Balance Sheets |                             |            |
|--------------------------------|---------------------------------------------|-------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------|--------------------------------------------------------------------------|-----------------------------|------------|
|                                |                                             |                                                                                     |                                                                                             | Financial<br>Instruments                                                 | Cash Collateral<br>Received | Net Amount |
| Derivatives <sup>(1) (3)</sup> | 15,089                                      | —                                                                                   | 15,089                                                                                      | (433)                                                                    | (14,656)                    | —          |

**Offsetting of Derivative Liabilities and Repurchase Agreements**  
**As of December 31, 2018**

| \$ in thousands<br>Description       | Gross<br>Amounts of<br>Recognized<br>Liabilities | Gross<br>Amounts<br>Offset in the<br>Condensed<br>Consolidated<br>Balance<br>Sheets | Net Amounts<br>of Liabilities<br>presented in<br>the Condensed<br>Consolidated<br>Balance Sheets | Gross Amounts Not Offset in the<br>Condensed Consolidated Balance Sheets |                            |            |
|--------------------------------------|--------------------------------------------------|-------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------|----------------------------|------------|
|                                      |                                                  |                                                                                     |                                                                                                  | Financial<br>Instruments <sup>(2)</sup>                                  | Cash Collateral<br>Pledged | Net Amount |
| Derivatives <sup>(3)</sup>           | 10,239                                           | —                                                                                   | 10,239                                                                                           | (2,058)                                                                  | (7,836)                    | 345        |
| Repurchase Agreements <sup>(4)</sup> | 13,602,484                                       | —                                                                                   | 13,602,484                                                                                       | (13,602,484)                                                             | —                          | —          |
| Secured Loans <sup>(5)</sup>         | 1,650,000                                        | —                                                                                   | 1,650,000                                                                                        | (1,650,000)                                                              | —                          | —          |
| Total                                | 15,262,723                                       | —                                                                                   | 15,262,723                                                                                       | (15,254,542)                                                             | (7,836)                    | 345        |

- (1) Amounts represent derivatives in an asset position which could potentially be offset against derivatives in a liability position at June 30, 2019 and December 31, 2018, subject to a netting arrangement.
- (2) Amounts represent collateral pledged that is available to be offset against liability balances associated with repurchase agreements, secured loans and derivatives.
- (3) The fair value of securities pledged against our derivatives was \$206.9 million (December 31, 2018: \$159.9 million) at June 30, 2019, of which \$182.4 million (December 31, 2018: \$158.3 million) relates to initial margin pledged on centrally cleared interest rate swaps. Centrally cleared interest rate swaps are excluded from the tables above. Cash collateral received on our derivatives was \$159,000 and \$18.1 million at June 30, 2019 and December 31, 2018, respectively. Cash collateral pledged by us on our futures contracts and interest rate swaps were \$60.0 million and \$13.5 million at June 30, 2019 and December 31, 2018, respectively. Cash collateral pledged on our centrally cleared interest rate swaps is settled against the fair value of these swaps and therefore excluded from the tables above at June 30, 2019 and December 31, 2018, respectively.
- (4) The fair value of securities pledged against our borrowing under repurchase agreements was \$18.7 billion and \$15.0 billion at June 30, 2019 and December 31, 2018, respectively. We pledged cash collateral of \$15.6 million and held cash collateral of \$14.8 million under repurchase agreements as of June 30, 2019.
- (5) The fair value of securities pledged against IAS Services LLC's borrowings under secured loans was \$1.9 billion at June 30, 2019 and December 31, 2018, respectively.

**Note 10 – Fair Value of Financial Instruments**

A three-level valuation hierarchy exists for disclosure of fair value measurements based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. Observable inputs reflect readily obtainable data from independent sources, while unobservable inputs reflect our market assumptions. The three levels are defined as follows:

- *Level 1 Inputs* – Quoted prices for identical instruments in active markets.
- *Level 2 Inputs* – Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose inputs are observable or whose significant value drivers are observable.
- *Level 3 Inputs* – Instruments with primarily unobservable value drivers.

[Table of Contents](#)

The following tables present our assets and liabilities measured at fair value on a recurring basis.

| \$ in thousands                                                       | June 30, 2019                  |                   |               |                                             |                     |
|-----------------------------------------------------------------------|--------------------------------|-------------------|---------------|---------------------------------------------|---------------------|
|                                                                       | Fair Value Measurements Using: |                   |               |                                             | Total at Fair Value |
|                                                                       | Level 1                        | Level 2           | Level 3       | NAV as a practical expedient <sup>(3)</sup> |                     |
| <b>Assets:</b>                                                        |                                |                   |               |                                             |                     |
| Mortgage-backed and credit risk transfer securities <sup>(1)(2)</sup> | —                              | 21,518,480        | 17,567        | —                                           | 21,536,047          |
| Derivative assets                                                     | 618                            | 9,449             | —             | —                                           | 10,067              |
| Other assets <sup>(4)</sup>                                           | —                              | —                 | 47,885        | 25,675                                      | 73,560              |
| <b>Total assets</b>                                                   | <b>618</b>                     | <b>21,527,929</b> | <b>65,452</b> | <b>25,675</b>                               | <b>21,619,674</b>   |
| <b>Liabilities:</b>                                                   |                                |                   |               |                                             |                     |
| Derivative liabilities                                                | —                              | 36,969            | —             | —                                           | 36,969              |
| <b>Total liabilities</b>                                              | <b>—</b>                       | <b>36,969</b>     | <b>—</b>      | <b>—</b>                                    | <b>36,969</b>       |

| \$ in thousands                                                       | December 31, 2018              |                   |               |                                             |                     |
|-----------------------------------------------------------------------|--------------------------------|-------------------|---------------|---------------------------------------------|---------------------|
|                                                                       | Fair Value Measurements Using: |                   |               |                                             | Total at Fair Value |
|                                                                       | Level 1                        | Level 2           | Level 3       | NAV as a practical expedient <sup>(3)</sup> |                     |
| <b>Assets:</b>                                                        |                                |                   |               |                                             |                     |
| Mortgage-backed and credit risk transfer securities <sup>(1)(2)</sup> | —                              | 17,373,871        | 22,771        | —                                           | 17,396,642          |
| Derivative assets                                                     | —                              | 15,089            | —             | —                                           | 15,089              |
| Other assets <sup>(4)</sup>                                           | —                              | —                 | 54,981        | 24,012                                      | 78,993              |
| <b>Total assets</b>                                                   | <b>—</b>                       | <b>17,388,960</b> | <b>77,752</b> | <b>24,012</b>                               | <b>17,490,724</b>   |
| <b>Liabilities:</b>                                                   |                                |                   |               |                                             |                     |
| Derivative liabilities                                                | 7,836                          | 15,554            | —             | —                                           | 23,390              |
| <b>Total liabilities</b>                                              | <b>7,836</b>                   | <b>15,554</b>     | <b>—</b>      | <b>—</b>                                    | <b>23,390</b>       |

(1) For more detail about the fair value of our MBS and GSE CRTs, refer to Note 4 - "Mortgage-Backed and Credit Risk Transfer Securities."

(2) Our GSE CRTs purchased prior to August 24, 2015 are accounted for as hybrid financial instruments with an embedded derivative. The hybrid financial instruments consist of debt host contracts classified as Level 2 and embedded derivatives classified as Level 3. As of June 30, 2019, the net embedded derivative asset position of \$17.6 million includes \$24.2 million of embedded derivatives in an asset position and \$6.6 million of embedded derivatives in a liability position. As of December 31, 2018, the net embedded derivative asset position of \$22.8 million includes \$28.8 million of embedded derivatives in an asset position and \$6.0 million of embedded derivatives in a liability position.

(3) Investments in unconsolidated ventures are valued using the net asset value ("NAV") as a practical expedient and are not subject to redemption, although investors may sell or transfer their interest at the approval of the general partner of the underlying funds. As of June 30, 2019 and December 31, 2018, the weighted average remaining term of our investments in unconsolidated ventures is 2.8 and 2.6 years, respectively.

(4) Includes \$47.9 million and \$55.0 million of a loan participation interest as of June 30, 2019 and December 31, 2018, respectively. The loan participation interest is transferable and bears interest at a variable rate based on LIBOR plus a spread and resets daily. As a result, the cost of the loan participation interest approximates its fair value.

[Table of Contents](#)

The following table shows a reconciliation of the beginning and ending fair value measurements of our GSE CRT embedded derivatives, which we have valued utilizing Level 3 inputs:

| \$ in thousands                                  | Three Months Ended June 30, |         | Six Months Ended June 30, |         |
|--------------------------------------------------|-----------------------------|---------|---------------------------|---------|
|                                                  | 2019                        | 2018    | 2019                      | 2018    |
| Beginning balance                                | 25,305                      | 42,932  | 22,771                    | 45,400  |
| Unrealized credit derivative gains (losses), net | (7,738)                     | (4,903) | (5,204)                   | (7,371) |
| Ending balance                                   | 17,567                      | 38,029  | 17,567                    | 38,029  |

The following table shows a reconciliation of the beginning and ending fair value measurements of our loan participation interest, which we have valued utilizing Level 3 inputs:

| \$ in thousands   | Three Months Ended June 30, | Six Months Ended June 30, |
|-------------------|-----------------------------|---------------------------|
|                   | 2019                        | 2019                      |
| Beginning balance | 53,827                      | 54,981                    |
| Advances          | —                           | 577                       |
| Repayments        | (5,942)                     | (7,673)                   |
| Ending balance    | 47,885                      | 47,885                    |

The following tables summarize significant unobservable inputs used in the fair value measurement of our GSE CRT embedded derivatives:

| \$ in thousands              | Fair Value at June 30, 2019 | Valuation Technique                | Unobservable Input    | Range           | Weighted Average |
|------------------------------|-----------------------------|------------------------------------|-----------------------|-----------------|------------------|
| GSE CRT Embedded Derivatives | 17,567                      | Market Comparables, Vendor Pricing | Weighted average life | 2.0 - 5.2 years | 3.6 years        |

| \$ in thousands              | Fair Value at December 31, 2018 | Valuation Technique                | Unobservable Input    | Range           | Weighted Average |
|------------------------------|---------------------------------|------------------------------------|-----------------------|-----------------|------------------|
| GSE CRT Embedded Derivatives | 22,771                          | Market Comparables, Vendor Pricing | Weighted average life | 2.9 - 5.9 years | 4.3 years        |

These significant unobservable inputs change according to market conditions and security performance. We estimate the weighted average life of GSE CRTs in order to identify GSE corporate debt with a similar maturity. We obtain our weighted average life estimates from a third party provider. Although weighted average life is a significant input, changes in weighted average life may not have an explicit directional impact on the fair value measurement.

## [Table of Contents](#)

The following table presents the carrying value and estimated fair value of our financial instruments that are not carried at fair value on the condensed consolidated balance sheets at June 30, 2019 and December 31, 2018:

| \$ in thousands                       | June 30, 2019  |                      | December 31, 2018 |                      |
|---------------------------------------|----------------|----------------------|-------------------|----------------------|
|                                       | Carrying Value | Estimated Fair Value | Carrying Value    | Estimated Fair Value |
| <b>Financial Assets</b>               |                |                      |                   |                      |
| Commercial loans, held-for-investment | 24,321         | 24,605               | 31,582            | 31,826               |
| FHLBI stock                           | 74,250         | 74,250               | 74,250            | 74,250               |
| Total                                 | 98,571         | 98,855               | 105,832           | 106,076              |
| <b>Financial Liabilities</b>          |                |                      |                   |                      |
| Repurchase agreements                 | 17,075,065     | 17,077,175           | 13,602,484        | 13,602,050           |
| Secured loans                         | 1,650,000      | 1,650,000            | 1,650,000         | 1,650,000            |
| Total                                 | 18,725,065     | 18,727,175           | 15,252,484        | 15,252,050           |

The following describes our methods for estimating the fair value for financial instruments not carried at fair value on the condensed consolidated balance sheets.

- The estimated fair value of commercial loans held-for-investment, included in "Other assets" on our condensed consolidated balance sheets, is a Level 3 fair value measurement. Subsequent to the origination or purchase, commercial loan investments are valued on a monthly basis by an independent third party valuation agent using a discounted cash flow technique.
- The estimated fair value of FHLBI stock, included in "Other assets" on our condensed consolidated balance sheets, is a Level 3 fair value measurement. FHLBI stock may only be sold back to the FHLBI at its discretion at par. As a result, the cost of the FHLBI stock approximates its fair value.
- The estimated fair value of repurchase agreements is a Level 3 fair value measurement based on an expected present value technique. This method discounts future estimated cash flows using rates we determined best reflect current market interest rates that would be offered for repurchase agreements with similar characteristics and credit quality.
- The estimated fair value of secured loans is a Level 3 fair value measurement. The secured loans have floating rates based on an index plus a spread and the spread is typically consistent with those demanded in the market. Accordingly, the interest rates on these secured loans are at market, and thus the carrying amount approximates fair value.

### Note 11 – Related Party Transactions

Under the terms of our management agreement, our Manager and its affiliates provide us with our management team, including our officers and appropriate support personnel. Each of our officers is an employee of our Manager or one of its affiliates. We do not have any employees. Our Manager is not obligated to dedicate any of its employees exclusively to us, nor is our Manager obligated to dedicate any specific portion of time to our business. During the three and six months ended June 30, 2019, we reimbursed our Manager \$213,000 (June 30, 2018: \$217,000) and \$396,000 (June 30, 2018: \$431,000), respectively, for costs of support personnel that are fully dedicated to our business.

We have invested \$32.4 million as of June 30, 2019 (December 31, 2018: \$131.9 million) in money market or mutual funds managed by affiliates of our Manager. The investments are reported as cash and cash equivalents on our condensed consolidated balance sheets as they are highly liquid and have original or remaining maturities of three months or less when purchased.

### Management Fee Expense

We pay our Manager a management fee equal to 1.50% of our stockholders' equity per annum. The fee is calculated and payable quarterly in arrears. For purposes of calculating the management fee, stockholders' equity is equal to the sum of the net proceeds from all issuances of equity securities since inception including proceeds from the issuance of operating partnership units to an affiliate of our Manager, plus retained earnings at the end of the most recently completed calendar quarter (without taking into account any non-cash equity compensation expense incurred in current or prior periods), less any amount paid to repurchase common stock since inception. Stockholders equity excludes (i) any unrealized gains, losses or other items that do not affect realized net income (regardless of whether such items are included in other comprehensive income or loss, or in net income); (ii) cumulative net realized losses that are not attributable to permanently impaired investments and that relate to the investments for which market movement is accounted for in other comprehensive income; provided, however, that such

## [Table of Contents](#)

adjustment shall not exceed cumulative unrealized net gains in other comprehensive income; (iii) one-time events pursuant to changes in U.S. GAAP; and (iv) certain non-cash items after discussions between our Manager and our independent directors and approval by a majority of our independent directors.

We do not pay any management fees on our investments in unconsolidated ventures that are managed by an affiliate of our Manager.

### Expense Reimbursement

We are required to reimburse our Manager for our operating expenses incurred on our behalf, including directors and officers insurance, accounting services, auditing and tax services, filing fees, and miscellaneous general and administrative costs. Our reimbursement obligation is not subject to any dollar limitation.

The following table summarizes the costs incurred on our behalf by our Manager for the three and six months ended June 30, 2019 and 2018.

| \$ in thousands                                                     | Three Months Ended June 30, |       | Six Months Ended June 30, |       |
|---------------------------------------------------------------------|-----------------------------|-------|---------------------------|-------|
|                                                                     | 2019                        | 2018  | 2019                      | 2018  |
| Incurred costs, prepaid or expensed                                 | 1,609                       | 1,300 | 3,213                     | 2,792 |
| Incurred costs, charged against equity as a cost of raising capital | 124                         | 2     | 444                       | 167   |
| Total incurred costs, originally paid by our Manager                | 1,733                       | 1,302 | 3,657                     | 2,959 |

### Termination Fee

If we terminate our management agreement, we owe our Manager a termination fee equal to three times the sum of our average annual management fee during the 24-month period before termination, calculated as of the end of the most recently completed fiscal quarter.

## Note 12 – Stockholders’ Equity

### Preferred Stock

Holders of our Series A Preferred Stock are entitled to receive dividends at an annual rate of 7.75% of the liquidation preference of \$25.00 per share or \$1.9375 per share per annum. Dividends are cumulative and payable quarterly in arrears.

Holders of our Series B Preferred Stock are entitled to receive dividends at an annual rate of 7.75% of the liquidation preference of \$25.00 per share or \$1.9375 per share per annum until December 27, 2024. After December 27, 2024, holders are entitled to receive dividends at a floating rate equal to three-month LIBOR plus a spread of 5.18% of the \$25.00 liquidation preference per annum. Dividends are cumulative and payable quarterly in arrears.

Holders of our Series C Preferred Stock are entitled to receive dividends at an annual rate of 7.50% of the liquidation preference of \$25.00 per share or \$1.875 per share per annum until September 27, 2027. After September 27, 2027, holders are entitled to receive dividends at a floating rate equal to three-month LIBOR plus a spread of 5.289% of the \$25.00 liquidation preference per annum. Dividends are cumulative and payable quarterly in arrears.

As of July 27, 2017, we had the option to redeem shares of Series A Preferred Stock for \$25.00 per share, plus any accumulated and unpaid dividends through the date of redemption. We have the option to redeem shares of Series B Preferred Stock after December 27, 2024 and shares of Series C Preferred Stock after September 27, 2027 for \$25.00 per share, plus any accumulated and unpaid dividends through the date of the redemption. Shares of Series B and Series C Preferred Stock are not redeemable, convertible into or exchangeable for any other property or any other securities of the Company prior to those times, except under circumstances intended to preserve our qualification as a REIT or upon the occurrence of a change in control.

In March 2019, we entered into an equity distribution agreement with a placement agent under which we may sell up to 7,000,000 shares of our preferred stock from time to time in at-the-market or privately negotiated transactions. These shares are registered with the SEC under our automatic shelf registration statement (as amended and/or supplemented). As of June 30, 2019, we have not sold any shares of preferred stock under the equity distribution agreement.

## Common Stock

On February 7, 2019, we completed a public offering of 16,100,000 shares of common stock at the price of \$15.73 per share. Total net proceeds were approximately \$249.5 million after deducting estimated offering costs.

In March 2019, we amended our equity distribution agreement, dated December 18, 2017, with a placement agent under which we may sell up to 17,000,000 shares of our common stock from time to time in at-the-market or privately negotiated transactions. These shares are registered with the SEC under our automatic shelf registration statement (as amended and/or supplemented). During the three and six months ended June 30, 2019 ended June 30, 2019, we issued 521,136 and 1,093,136 shares, respectively, of common stock under the equity distribution agreement for proceeds of \$8.2 million and \$17.2 million, net of approximately \$170,000 and \$363,000 in commissions and fees, respectively.

## Share Repurchase Program

During the three and six months ended June 30, 2019 and 2018, we did not repurchase any shares of our common stock. As of June 30, 2019, we had authority to purchase 18,163,982 shares of our common stock through our share repurchase program.

## Share-Based Compensation

We established the 2009 Equity Incentive Plan for grants of common stock and other equity based awards to our independent directors and officers and employees of our Manager and its affiliates (the "Incentive Plan"). The Incentive Plan was amended and restated as of May 3, 2019 to extend the term of the plan until 2029 and to reduce the number of shares of common stock available for issuance under the Incentive Plan to 200,000.

We recognized compensation expense of approximately \$112,000 (June 30, 2018: \$106,000) and \$225,000 (June 30, 2018: \$199,000) for shares issued to our independent directors under our 2009 Equity Incentive Plan (the "Incentive Plan") for the three and six months ended June 30, 2019, respectively. During the three months ended June 30, 2019 and 2018, we issued 6,895 shares and 6,465 shares of common stock, respectively, to our independent directors. During the six months ended June 30, 2019 and 2018, we issued 13,960 and 13,642 shares of common stock, respectively, to our independent directors. The fair market value of the shares granted was determined by the closing stock market price on the date of the grant. The grants vested immediately.

We recognized compensation expense of approximately \$18,000 (June 30, 2018: \$30,000) and \$37,000 (June 30, 2018: \$44,000) for the three and six months ended June 30, 2019, respectively for restricted stock units awarded to employees of our Manager and its affiliates under the Incentive Plan. Our Manager reimburses us for the cost of these restricted stock awards under the terms of our management agreement. At June 30, 2019, there was approximately \$167,000 of total unrecognized compensation cost related to restricted stock unit awards that is expected to be recognized over a period of up to 45 months, with a weighted-average remaining vesting period of 21 months.

The following table summarizes the activity related to restricted stock units awarded to employees of our Manager and its affiliates for the three and six months ended June 30, 2019.

|                                         | Three Months Ended June 30, |                                                       | Six Months Ended June 30, |                                                       |
|-----------------------------------------|-----------------------------|-------------------------------------------------------|---------------------------|-------------------------------------------------------|
|                                         | 2019                        |                                                       | 2019                      |                                                       |
|                                         | Restricted Stock Units      | Weighted Average Grant Date Fair Value <sup>(1)</sup> | Restricted Stock Units    | Weighted Average Grant Date Fair Value <sup>(1)</sup> |
| Unvested at the beginning of the period | 12,520                      | \$ 15.25                                              | 11,051                    | \$ 14.55                                              |
| Shares granted during the period        | —                           | —                                                     | 6,189                     | 15.92                                                 |
| Shares vested during the period         | —                           | —                                                     | (4,720)                   | 14.48                                                 |
| Unvested at the end of the period       | 12,520                      | \$ 15.25                                              | 12,520                    | \$ 15.25                                              |

(1) The grant date fair value of restricted stock awards is based on the closing market price of our common stock at the grant date.

### Accumulated Other Comprehensive Income

The following tables present the components of total other comprehensive income (loss), net and accumulated other comprehensive income ("AOCI") for the three and six months ended June 30, 2019 and 2018. The tables exclude gains and losses on MBS and GSE CRTs that are accounted for under the fair value option.

| \$ in thousands                                                                                                                              | Three Months Ended June 30, 2019 |                               |                         |         |
|----------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------|-------------------------------|-------------------------|---------|
|                                                                                                                                              | Equity method investments        | Available-for-sale securities | Derivatives and hedging | Total   |
| Total other comprehensive income (loss)                                                                                                      |                                  |                               |                         |         |
| Unrealized gain (loss) on mortgage-backed and credit risk transfer securities, net                                                           | —                                | 47,188                        | —                       | 47,188  |
| Reclassification of unrealized (gain) loss on sale of mortgage-backed and credit risk transfer securities to gain (loss) on investments, net | —                                | (121)                         | —                       | (121)   |
| Reclassification of amortization of net deferred (gain) loss on de-designated interest rate swaps to repurchase agreements interest expense  | —                                | —                             | (5,916)                 | (5,916) |
| Currency translation adjustments on investment in unconsolidated venture                                                                     | (320)                            | —                             | —                       | (320)   |
| Total other comprehensive income (loss)                                                                                                      | (320)                            | 47,067                        | (5,916)                 | 40,831  |
| AOCI balance at beginning of period                                                                                                          | 237                              | 183,160                       | 93,785                  | 277,182 |
| Total other comprehensive income (loss)                                                                                                      | (320)                            | 47,067                        | (5,916)                 | 40,831  |
| AOCI balance at end of period                                                                                                                | (83)                             | 230,227                       | 87,869                  | 318,013 |

  

| \$ in thousands                                                                                                                              | Three Months Ended June 30, 2018 |                               |                         |          |
|----------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------|-------------------------------|-------------------------|----------|
|                                                                                                                                              | Equity method investments        | Available-for-sale securities | Derivatives and hedging | Total    |
| Total other comprehensive income (loss)                                                                                                      |                                  |                               |                         |          |
| Unrealized gain (loss) on mortgage-backed and credit risk transfer securities, net                                                           | —                                | (47,929)                      | —                       | (47,929) |
| Reclassification of unrealized (gain) loss on sale of mortgage-backed and credit risk transfer securities to gain (loss) on investments, net | —                                | 9,889                         | —                       | 9,889    |
| Reclassification of amortization of net deferred (gain) loss on de-designated interest rate swaps to repurchase agreements interest expense  | —                                | —                             | (6,898)                 | (6,898)  |
| Currency translation adjustments on investment in unconsolidated venture                                                                     | 486                              | —                             | —                       | 486      |
| Total other comprehensive income (loss)                                                                                                      | 486                              | (38,040)                      | (6,898)                 | (44,452) |
| AOCI balance at beginning of period                                                                                                          | 1,255                            | 14,660                        | 117,437                 | 133,352  |
| Total other comprehensive income (loss)                                                                                                      | 486                              | (38,040)                      | (6,898)                 | (44,452) |
| Other comprehensive income/(loss) attributable to non-controlling interest                                                                   | (5)                              | 479                           | 87                      | 561      |
| AOCI balance at end of period                                                                                                                | 1,736                            | (22,901)                      | 110,626                 | 89,461   |

[Table of Contents](#)

| \$ in thousands                                                                                                                              | Six Months Ended June 30, 2019 |                               |                         |           |
|----------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------|-------------------------------|-------------------------|-----------|
|                                                                                                                                              | Equity method investments      | Available-for-sale securities | Derivatives and hedging | Total     |
| Total other comprehensive income/(loss)                                                                                                      |                                |                               |                         |           |
| Unrealized gain (loss) on mortgage-backed and credit risk transfer securities, net                                                           | —                              | 99,537                        | —                       | 99,537    |
| Reclassification of unrealized (gain) loss on sale of mortgage-backed and credit risk transfer securities to gain (loss) on investments, net | —                              | 10,026                        | —                       | 10,026    |
| Reclassification of amortization of net deferred (gain) loss on de-designated interest rate swaps to repurchase agreements interest expense  | —                              | —                             | (11,767)                | (11,767)  |
| Currency translation adjustments on investment in unconsolidated venture                                                                     | (596)                          | —                             | —                       | (596)     |
| Total other comprehensive income/(loss)                                                                                                      | (596)                          | 109,563                       | (11,767)                | 97,200    |
| AOCI balance at beginning of period                                                                                                          | 513                            | 120,664                       | 99,636                  | 220,813   |
| Total other comprehensive income/(loss)                                                                                                      | (596)                          | 109,563                       | (11,767)                | 97,200    |
| AOCI balance at end of period                                                                                                                | (83)                           | 230,227                       | 87,869                  | 318,013   |
|                                                                                                                                              |                                |                               |                         |           |
| \$ in thousands                                                                                                                              | Six Months Ended June 30, 2018 |                               |                         |           |
|                                                                                                                                              | Equity method investments      | Available-for-sale securities | Derivatives and hedging | Total     |
| Total other comprehensive income/(loss)                                                                                                      |                                |                               |                         |           |
| Unrealized gain (loss) on mortgage-backed and credit risk transfer securities, net                                                           | —                              | (180,246)                     | —                       | (180,246) |
| Reclassification of unrealized (gain) loss on sale of mortgage-backed and credit risk transfer securities to gain (loss) on investments, net | —                              | 19,126                        | —                       | 19,126    |
| Reclassification of amortization of net deferred (gain) loss on de-designated interest rate swaps to repurchase agreements interest expense  | —                              | —                             | (13,437)                | (13,437)  |
| Currency translation adjustments on investment in unconsolidated venture                                                                     | 798                            | —                             | —                       | 798       |
| Total other comprehensive income/(loss)                                                                                                      | 798                            | (161,120)                     | (13,437)                | (173,759) |
| AOCI balance at beginning of period                                                                                                          | 947                            | 136,188                       | 123,894                 | 261,029   |
| Total other comprehensive income/(loss)                                                                                                      | 798                            | (161,120)                     | (13,437)                | (173,759) |
| Other comprehensive income/(loss) attributable to non-controlling interest                                                                   | (9)                            | 2,031                         | 169                     | 2,191     |
| AOCI balance at end of period                                                                                                                | 1,736                          | (22,901)                      | 110,626                 | 89,461    |

Amounts recorded in AOCI before we discontinued cash flow hedge accounting for our interest rate swaps are reclassified to interest expense on repurchase agreements on the condensed consolidated statements of operations as interest is accrued and paid on the related repurchase agreements over the remaining original life of the interest rate swap agreements.

## Dividends

We declared the following dividends during the three months ended June 30, 2019 and 2018:

| \$ in thousands, except per share amounts |  | Dividends Declared |              |                 |
|-------------------------------------------|--|--------------------|--------------|-----------------|
| <u>Series A Preferred Stock</u>           |  | Per Share          | In Aggregate | Date of Payment |
| <b>2019</b>                               |  |                    |              |                 |
| June 17, 2019                             |  | 0.4844             | 2,712        | July 25, 2019   |
| March 18, 2019                            |  | 0.4844             | 2,713        | April 25, 2019  |
| <b>2018</b>                               |  |                    |              |                 |
| June 15, 2018                             |  | 0.4844             | 2,712        | July 25, 2018   |
| March 15, 2018                            |  | 0.4844             | 2,713        | April 25, 2018  |
| \$ in thousands, except per share amounts |  | Dividends Declared |              |                 |
| <u>Series B Preferred Stock</u>           |  | Per Share          | In Aggregate | Date of Payment |
| <b>2019</b>                               |  |                    |              |                 |
| May 3, 2019                               |  | 0.4844             | 3,004        | June 27, 2019   |
| February 14, 2019                         |  | 0.4844             | 3,003        | March 27, 2019  |
| <b>2018</b>                               |  |                    |              |                 |
| May 2, 2018                               |  | 0.4844             | 3,004        | June 27, 2018   |
| February 15, 2018                         |  | 0.4844             | 3,003        | March 27, 2018  |
| \$ in thousands, except per share amounts |  | Dividends Declared |              |                 |
| <u>Series C Preferred Stock</u>           |  | Per Share          | In Aggregate | Date of Payment |
| <b>2019</b>                               |  |                    |              |                 |
| May 3, 2019                               |  | 0.46875            | 5,390        | June 27, 2019   |
| February 14, 2019                         |  | 0.46875            | 5,391        | March 27, 2019  |
| <b>2018</b>                               |  |                    |              |                 |
| May 2, 2018                               |  | 0.46875            | 5,390        | June 27, 2018   |
| February 15, 2018                         |  | 0.46875            | 5,391        | March 27, 2018  |
| \$ in thousands, except per share amounts |  | Dividends Declared |              |                 |
| <u>Common Stock</u>                       |  | Per Share          | In Aggregate | Date of Payment |
| <b>2019</b>                               |  |                    |              |                 |
| June 17, 2019                             |  | 0.45               | 57,958       | July 26, 2019   |
| March 18, 2019                            |  | 0.45               | 57,720       | April 26, 2019  |
| <b>2018</b>                               |  |                    |              |                 |
| June 15, 2018                             |  | 0.42               | 46,890       | July 26, 2018   |
| March 15, 2018                            |  | 0.42               | 46,887       | April 26, 2018  |

### Note 13 – Earnings per Common Share

Earnings per share for the three and six months ended June 30, 2019 and 2018 is computed as follows:

| In thousands except per share amounts          | Three Months Ended June 30, |         | Six Months Ended June 30, |         |
|------------------------------------------------|-----------------------------|---------|---------------------------|---------|
|                                                | 2019                        | 2018    | 2019                      | 2018    |
| <b>Numerator (Income)</b>                      |                             |         |                           |         |
| Basic Earnings:                                |                             |         |                           |         |
| Net income available to common stockholders    | 7,230                       | 80,008  | 134,913                   | 121,479 |
| Effect of dilutive securities:                 |                             |         |                           |         |
| Income allocated to exchangeable senior notes  | —                           | —       | —                         | 1,621   |
| Income allocated to non-controlling interest   | —                           | 1,163   | —                         | 1,834   |
| Dilutive net income available to stockholders  | 7,230                       | 81,171  | 134,913                   | 124,934 |
| <b>Denominator (Weighted Average Shares)</b>   |                             |         |                           |         |
| Basic Earnings:                                |                             |         |                           |         |
| Shares available to common stockholders        | 128,659                     | 111,641 | 124,900                   | 111,635 |
| Effect of dilutive securities:                 |                             |         |                           |         |
| Restricted stock awards                        | 13                          | 19      | 12                        | 19      |
| Non-controlling interest OP units              | —                           | 1,425   | —                         | 1,425   |
| Exchangeable senior notes                      | —                           | —       | —                         | 2,389   |
| Dilutive Shares                                | 128,672                     | 113,085 | 124,912                   | 115,468 |
| Earnings per share:                            |                             |         |                           |         |
| Net income attributable to common stockholders |                             |         |                           |         |
| Basic                                          | 0.06                        | 0.72    | 1.08                      | 1.09    |
| Diluted                                        | 0.06                        | 0.72    | 1.08                      | 1.08    |

### Note 14 – Commitments and Contingencies

#### Commitments and Contingencies

Commitments and contingencies may arise in the ordinary course of business. Our material off-balance sheet commitments as of June 30, 2019 are discussed below.

As discussed in Note 5 - "Other Assets", we have invested in unconsolidated ventures that are sponsored by an affiliate of our Manager. The unconsolidated ventures are structured as partnerships, and we invest in the partnerships as a limited partner. The entities are structured such that capital commitments are to be drawn down over the life of the partnership as investment opportunities are identified. As of June 30, 2019 and December 31, 2018, our undrawn capital and purchase commitments were \$6.5 million and \$10.0 million, respectively.

As discussed in Note 5 - "Other Assets", we have funded our portion of a commitment in a loan participation. The remainder of our commitment will be funded over the two year term of the loan based upon the financing needs of the borrower. As of June 30, 2019, we have an unfunded commitment of \$27.1 million.

We have entered into agreements with financial institutions to guarantee certain obligations of our subsidiaries. We would be required to perform under these guarantees in the event of certain defaults. We have not had prior claims or losses pursuant to these contracts and expect the risk of loss to be remote.

### Note 15 – Subsequent Events

We have reviewed subsequent events occurring through the date that these condensed consolidated financial statements were issued and determined that no subsequent events occurred that would require accrual or additional disclosure.

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

*In this quarterly report on Form 10-Q, or this "Report," we refer to Invesco Mortgage Capital Inc. and its consolidated subsidiaries as "we," "us," "our Company," or "our," unless we specifically state otherwise or the context indicates otherwise. We refer to our external manager, Invesco Advisers, Inc., as our "Manager," and we refer to the indirect parent company of our Manager, Invesco Ltd. together with its consolidated subsidiaries (which does not include us), as "Invesco."*

The following discussion should be read in conjunction with our condensed consolidated financial statements and the accompanying notes to our condensed consolidated financial statements, which are included in Item 1 of this Report, as well as the information contained in our most recent Form 10-K filed with the Securities and Exchange Commission (the "SEC").

### Forward-Looking Statements

We make forward-looking statements in this Report and other filings we make with the SEC within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and such statements are intended to be covered by the safe harbor provided by the same. Forward-looking statements are subject to substantial risks and uncertainties, many of which are difficult to predict and are generally beyond our control. These forward-looking statements include information about possible or assumed future results of our business, investment strategies, financial condition, liquidity, results of operations, plans and objectives. When we use the words "believe," "expect," "anticipate," "estimate," "plan," "intend," "project," "forecast" or similar expressions and future or conditional verbs such as "will," "may," "could," "should," and "would," and any other statement that necessarily depends on future events, we intend to identify forward-looking statements. Factors that could cause actual results to differ from those expressed in our forward-looking statements include, but are not limited to:

- our business and investment strategy;
- our investment portfolio;
- our projected operating results;
- general volatility of financial markets and effects of governmental responses, including actions and initiatives of the U.S. governmental agencies and changes to U.S. government policies, mortgage loan modification programs, actions and initiatives of foreign governmental agencies and central banks, monetary policy actions of the Federal Reserve, including actions relating to its agency mortgage-backed securities portfolio and the continuation of re-investment of principal payments, and our ability to respond to and comply with such actions, initiatives and changes;
- the availability of financing sources, including our ability to obtain additional financing arrangements and the terms of such arrangements;
- financing and advance rates for our target assets;
- changes to our expected leverage;
- our expected investments;
- our expected book value per common share;
- interest rate mismatches between our target assets and our borrowings used to fund such investments;
- the adequacy of our cash flow from operations and borrowings to meet our short-term liquidity needs;
- our ability to maintain sufficient liquidity to meet any margin calls;
- changes in the credit rating of the U.S. government;
- changes in interest rates and interest rate spreads and the market value of our target assets;
- changes in prepayment rates on our target assets;
- the impact of any deficiencies in foreclosure practices of third parties and related uncertainty in the timing of collateral disposition;
- our reliance on third parties in connection with services related to our target assets;
- effects of hedging instruments on our target assets;
- rates of default or decreased recovery rates on our target assets;

## [Table of Contents](#)

- modifications to whole loans or loans underlying securities;
- the degree to which our hedging strategies may or may not protect us from interest rate volatility;
- the degree to which derivative contracts expose us to contingent liabilities;
- counterparty defaults;
- compliance with financial covenants in our financing arrangements;
- changes in governmental regulations, zoning, insurance, eminent domain and tax law and rates, and similar matters and our ability to respond to such changes;
- our ability to maintain our qualification as a real estate investment trust for U.S. federal income tax purposes;
- our ability to maintain our exception from the definition of “investment company” under the Investment Company Act of 1940, as amended (the “1940 Act”);
- availability of investment opportunities in mortgage-related, real estate-related and other securities;
- availability of U.S. Government Agency guarantees with regard to payments of principal and interest on securities;
- the market price and trading volume of our capital stock;
- availability of qualified personnel of our Manager;
- the relationship with our Manager;
- estimates relating to taxable income and our ability to continue to make distributions to our stockholders in the future;
- estimates relating to fair value of our target assets and loan loss reserves;
- our understanding of our competition;
- changes to generally accepted accounting principles in the United States of America (“U.S. GAAP”);
- the adequacy of our disclosure controls and procedures and internal controls over financial reporting; and
- market trends in our industry, interest rates, real estate values, the debt securities markets or the general economy.

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

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

## **Overview**

We are a Maryland corporation primarily focused on investing in, financing and managing residential and commercial mortgage-backed securities (“MBS”) and mortgage loans. Our objective is to provide attractive risk-adjusted returns to our investors, primarily through dividends and secondarily through capital appreciation. To achieve this objective, we primarily invest in the following:

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

## [Table of Contents](#)

- RMBS that are not guaranteed by a U.S. government agency or a federally chartered corporation (“non-Agency RMBS”);
- CMBS that are not guaranteed by a U.S. government agency or a federally chartered corporation (“non-Agency CMBS”);
- Credit risk transfer securities that are unsecured obligations issued by government-sponsored enterprises (“GSE CRT”);
- Residential and commercial mortgage loans; and
- Other real estate-related financing arrangements.

We elected to be taxed as a real estate investment trust (“REIT”) for U.S. federal income tax purposes under the provisions of the Internal Revenue Code of 1986. To maintain our REIT qualification, we are generally required to distribute at least 90% of our REIT taxable income to our stockholders annually. We operate our business in a manner that permits our exclusion from the definition of “Investment Company” under the 1940 Act. We are externally managed and advised by Invesco Advisers, Inc., our Manager, which is an indirect, wholly-owned subsidiary of Invesco Ltd.

### **Capital Activities**

On February 7, 2019, we completed a public offering of 16,100,000 shares of common stock at the price of \$15.73 per share. Total net proceeds were approximately \$249.5 million after deducting offering expenses.

We may sell up to 17,000,000 shares of our common stock from time to time in at-the-market or privately negotiated transactions under our equity distribution agreement. These shares are registered with the SEC under our automatic shelf registration statement (as amended and/or supplemented). During the three and six months ended June 30, 2019, we issued 521,136 and 1,093,136 shares, respectively, of common stock under our equity distribution agreement for proceeds of \$8.2 million and \$17.2 million, net of commissions and fees, respectively.

On June 17, 2019, we declared the following dividends:

- a dividend of \$0.45 per share of common stock paid on July 26, 2019 to stockholders of record as of the close of business on June 28, 2019; and
- a dividend of \$0.4844 per share of Series A Preferred Stock paid on July 25, 2019 to stockholders of record as of the close of business on July 1, 2019.

On May 3, 2019, we declared the following dividends:

- a dividend of \$0.4844 per share of Series B Preferred Stock paid on June 27, 2019 to stockholders of record as of the close of business on June 5, 2019; and
- a dividend of \$0.46875 per share of Series C Preferred Stock paid on June 27, 2019 to stockholders of record as of the close of business on June 5, 2019.

During the six months ended June 30, 2019, we did not repurchase any shares of our common stock.

### **Factors Impacting Our Operating Results**

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

### **Market Conditions**

Macroeconomic factors that affect our business include interest rate spread premiums, governmental policy initiatives, residential and commercial real estate prices, credit availability, consumer personal income and spending, corporate earnings, employment conditions, financial conditions and inflation.

Financial conditions were generally stable during the second quarter of 2019 as equity markets rallied, volatility increased, and credit spreads continued to tighten. Volatility increased across the fixed income and equity markets as

uncertainty concerning future Federal Reserve policy actions increased. Equity markets continued their strong start to 2019, with both the S&P 500 Index and the NASDAQ returning over 3% during the second quarter. Investor sentiment was bolstered as the Federal Open Market Committee ("FOMC") signaled that they likely would lower the Federal Funds rate in the coming quarters. Commodity prices declined modestly, as the CRB Commodity Price Index decreased by 1.5% during the second quarter and WTI Crude decreased by 3.3%.

The US economy appears to be growing at a moderate pace, and the labor market remains positive. Monthly gains in non-farm payrolls averaged 171,000 for the second quarter, in line with the 174,000 average of the first quarter. The unemployment rate remained close to multi-year lows at 3.7%. The consensus forecast for GDP growth in 2019 is 2.5%, with the consensus estimates for both 2020 and 2021 at 1.8%.

Inflation remained subdued during the second quarter, with the U.S. Personal Consumption Expenditure Core Price Index remaining below the Federal Reserve's inflation target of 2% in January. Implied breakeven rates on Treasury Inflation Protected securities, which reflect the markets expectation of future inflation rates, fell sharply during the second quarter, with the implied 2 and 5 year inflation rates ending the second quarter at 1.16% and 1.54%, respectively. The FOMC did not take any action during their May or June meetings, and communication out of the central bank caused market expectations for further FOMC policy action to readjust once again. Over the course of the second quarter, the pricing of federal funds futures contracts went from implying one cut in each of 2019 and 2020 to implying between two and three cuts this year and another cut next year. This caused Treasury rates to fall across the maturity spectrum, with the 2 year Treasury rate falling 51 basis points during the second quarter to 1.75% and the 10 year Treasury rate falling 40 basis points to 2.01% as of June 30, 2019.

The performance of structured securities was mixed during the second quarter of 2019. Agency mortgages underperformed similar duration Treasuries during the quarter, but agency pools backed by collateral that offered protection against prepayment risk performed extremely well. The outlook for Agency RMBS is mixed, as the tapering of reinvestment activity by the Federal Reserve and increased prepayment risk is offset by wider spreads and attractive funding costs. Prepayment activity is expected to increase in the coming quarters, as rate incentives are now large enough to allow a greater percentage of homeowners to refinance.

During the second quarter, spreads (defined as the yield in excess of risk-free rates) on CMBS and GSE CRT securities were also mixed. Premium priced CRT bonds widened due to prepayment concerns, while spreads on CMBS were tighter in lower-rated bonds and wider in higher-quality classes. Fundamentals in both commercial and residential housing remain on solid footing, lending support to asset prices.

We expect the U.S. will continue to experience moderate, albeit slowing, economic growth, and that core inflation will remain close to the Federal Reserve's policy objective of 2%. Other concerns include the actions of central banks, and their impact on the global economy, the potential impact of trade tensions, and the potential impact of the Brexit process and resulting stress in the European banking system.

In addition, the regulatory landscape for our repurchase agreement counterparties continues to evolve, which may affect their funding methods and lending practices. While we are not directly subject to compliance with the implementation of rules regarding financial institutions, the effect of these regulations and others could impact our ability to finance our assets in the future.

#### ***Proposed Changes to LIBOR***

On July 27, 2017, the Chief Executive of the U.K. Financial Conduct Authority (the "FCA"), which regulates LIBOR, announced that the FCA will no longer persuade or compel banks to submit rates for the calculation of the LIBOR benchmark after 2021. This announcement indicates that the continuation of LIBOR on the current basis cannot and will not be guaranteed after 2021, and it appears likely that LIBOR will be phased out or the methodology for determining LIBOR will be modified by 2021. The Alternative Reference Rates Committee ("ARRC") has proposed that the Secured Overnight Financing Rate ("SOFR") is the rate that represents best practice as the alternative to USD-LIBOR for use in derivatives and other financial contracts that are currently indexed to USD-LIBOR. ARRC has proposed a paced market transition plan to SOFR from USD-LIBOR, and organizations are currently working on industry wide and company specific transition plans as it relates to derivatives and cash markets exposed to USD-LIBOR.

We have material contracts that are indexed to USD-LIBOR and are monitoring this activity and evaluating the related risks. However, it is not possible to predict the effect of any of these developments, and any future initiatives to regulate, reform or change the manner of administration of LIBOR could result in adverse consequences to the rate of interest payable and receivable on, market value of and market liquidity for LIBOR-based financial instruments.

Centrally cleared swaps are among our LIBOR-based material contracts that may be impacted. On July 15, 2019, the CME announced a high-level proposal for transitioning price alignment interest (used to determine interest paid on cash collateral) and the discount rate for USD centrally cleared swaps from the daily effective federal funds rate (EFFR) to SOFR.

## [Table of Contents](#)

Their goal in publishing the proposal is to facilitate discussion on how this transition will be implemented. They propose that after the close of business on July 17, 2020, the CME would conduct a standard end-of-day valuation cycle using EFFR discounting to determine variation margin and price alignment interest. Upon completion of this initial cycle, CME would then conduct a special cycle in which positions will be valued using SOFR as the discount rate. In an effort to neutralize the value transfer attributed to the change in the discounting rate, CME proposes making a cash adjustment that is equal to the change in each cleared swap's net present value. To mitigate hedging costs associated with this transition and sensitivity to closing curve markets on July 17, 2020, CME would book a series of EFFR/SOFR basis swaps to participants' accounts. They propose that this will restore participants back to their original risk profiles and be booked at the July 17, 2020 closing curve levels.

On July 26, 2019, LCH also proposed plans to switch from using EFFR to SOFR as both the discount rate used to value USD centrally cleared swaps and the rate used to determine price alignment interest. The LCH is targeting the conversion to take place on or around October 17, 2020. Similar to the CME, they propose compensation for valuation and risk adjustment will be provided in the form of cash and compensating basis swaps. However, they also propose providing clients with the ability to elect a cash-only option. Under this method, they propose using an auction to facilitate the cash-only election and determine the cash compensating accounts.

It is important to note that these proposals are preliminary and may be revised going forward. Further the ARCC may seek to synchronize the proposed methodologies of the CME and LCH.

## Investment Activities

The table below shows the allocation of our equity as of June 30, 2019, December 31, 2018 and June 30, 2018:

| \$ in thousands                   | As of         |                   |               |
|-----------------------------------|---------------|-------------------|---------------|
|                                   | June 30, 2019 | December 31, 2018 | June 30, 2018 |
| Agency RMBS                       | 45%           | 46%               | 48%           |
| Agency CMBS                       | 10%           | 3%                | —%            |
| Commercial Credit <sup>(1)</sup>  | 31%           | 33%               | 33%           |
| Residential Credit <sup>(2)</sup> | 14%           | 18%               | 19%           |
| Total                             | 100%          | 100%              | 100%          |

(1) Commercial credit includes non-Agency CMBS, commercial loans and investments in unconsolidated ventures.

(2) Residential credit includes non-Agency RMBS, GSE CRTs and a loan participation interest.

The table below shows the breakdown of our investment portfolio as of June 30, 2019, December 31, 2018 and June 30, 2018:

| \$ in thousands                            | As of         |                   |               |
|--------------------------------------------|---------------|-------------------|---------------|
|                                            | June 30, 2019 | December 31, 2018 | June 30, 2018 |
| Agency RMBS:                               |               |                   |               |
| 30 year fixed-rate, at fair value          | 12,077,091    | 9,772,769         | 7,665,139     |
| 15 year fixed-rate, at fair value          | 337,920       | 424,254           | 2,523,184     |
| Hybrid ARM, at fair value                  | 100,788       | 554,201           | 1,567,051     |
| ARM, at fair value                         | 6,337         | 105,747           | 214,801       |
| Agency CMO, at fair value                  | 413,164       | 267,691           | 238,816       |
| Agency CMBS, at fair value                 | 2,926,243     | 1,002,510         | 152,227       |
| Non-Agency CMBS, at fair value             | 3,651,587     | 3,286,459         | 3,151,237     |
| Non-Agency RMBS, at fair value             | 1,118,073     | 1,163,682         | 1,220,076     |
| GSE CRT, at fair value                     | 904,844       | 819,329           | 850,656       |
| Loan participation interest, at fair value | 47,885        | 54,981            | —             |
| Commercial loans, at amortized cost        | 24,321        | 31,582            | 127,607       |
| Investments in unconsolidated ventures     | 25,675        | 24,012            | 28,997        |
| Total investment portfolio                 | 21,633,928    | 17,507,217        | 17,739,791    |

During the six months ended June 30, 2019, we purchased \$3.7 billion of newly issued fixed rate Agency RMBS, \$1.8 billion of Agency CMBS, \$263.8 million of non-Agency CMBS, \$75.6 million of non-Agency RMBS and \$120.8 million of GSE CRT. We funded these purchases with proceeds from our common stock issuances and paydowns and sales of securities. During the six months ended June 30, 2019, we sold most of our ARM and Hybrid ARM securities.

As of June 30, 2019 our holdings of 30 year fixed-rate Agency RMBS represent approximately 56% of our total investment portfolio versus 56% as of December 31, 2018 and 43% as of June 30, 2018. We increased our holdings of 30 year fixed-rate Agency RMBS over the past 12 months as the return on equity profile for these securities was accretive due to lower funding costs given changes in the outlook for short-term interest rates. We have focused our purchases on 30 year specified pools priced at modest pay-ups to generic Agency RMBS because those securities have characteristics that reduce prepayment risk.

As of June 30, 2019 our holdings of Agency CMBS represent approximately 14% of our total investment portfolio versus 6% as of December 31, 2018. We began investing in Agency CMBS issued by Freddie Mac and Fannie Mae late in the second quarter of 2018 and have increased our holdings of these securities in 2019 because they benefit from prepayment protection characteristics and have an attractive return on equity profile. These securities offer targeted exposure to multi-family loans and benefit from a guarantee of principal and interest payments from governmental agencies and federally chartered corporations. Further, the hedging costs are economical as they are less sensitive to interest rate risk given limited extension beyond initial expected maturity dates and underlying loan prepayment protection.

Our portfolio of investments that have credit exposure includes non-Agency CMBS, non-Agency RMBS, GSE CRTs, a commercial real estate loan, and a loan participation interest. Rather than relying on the rating agencies, we utilize proprietary models as well as third party applications to quantify and monitor the credit risk associated with our portfolio holdings. Our analysis generally begins at the underlying asset level, where we gather detailed information on loan, borrower, and property characteristics that inform our expectations for future performance. In addition to base case cash flow projections, we perform a range of scenario stresses to gauge the sensitivity of returns to potential deviations in underlying asset behavior. We perform this detailed credit analysis at the time of initial purchase and regularly throughout the holding period of each investment.

As of June 30, 2019 our holdings of non-Agency CMBS represent approximately 17% of our total investment portfolio versus 19% as of December 31, 2018 and 18% as of June 30, 2018. Our non-Agency CMBS portfolio is collateralized by loans secured by various property types located across the United States. Property types include but are not limited to office, retail, multi-family, industrial warehouse and hotel. The largest property geographic locations include New York, California, Texas, Florida and Illinois. The majority of our non-Agency CMBS portfolio is comprised of fixed rate credits that are rated investment grade or higher by a nationally recognized statistical rating organization. Over 80% of our non-Agency CMBS portfolio is collateralized by loans originated after 2009 and before 2017. These seasoned investments generally benefit from property price appreciation, growing credit enhancement and, in some instances, rating agency upgrades. The remainder of our

## [Table of Contents](#)

assets were originated during and after 2017. We continue to identify attractive opportunities in this sector given our expectation for commercial real estate property rent growth, further property price appreciation and strong loan performance.

As of June 30, 2019 our holdings of non-Agency RMBS represent approximately 5% of our total investment portfolio versus 7% as of December 31, 2018 and June 30, 2018. We primarily invest in non-Agency RMBS securities collateralized by prime and Alt-A loans. In addition, we have invested in re-securitizations of real estate mortgage investment conduit ("Re-REMIC") RMBS and securitizations of reperforming mortgage loans that we expect to provide attractive risk adjusted returns. We also invest in GSE CRTs which have the added benefit of paying a floating rate coupon and reduce our need to hedge interest rate risk. The majority of our GSE CRT holdings are concentrated in 2013 and 2014 vintages, where reference loans have significant embedded home price appreciation. From a fundamental perspective, we continue to view GSE CRT as an attractive asset class based on the strength of the U.S. housing market and the strong performance of reference mortgage loans to date.

During the third quarter of 2018, we acquired a participation interest in a secured loan collateralized by mortgage servicing rights associated with Fannie Mae, Freddie Mac, and Ginnie Mae loans. The secured loan has a two year term subject to a one year extension at the borrower's option. We funded \$47.9 million of the loan as of June 30, 2019 and have committed to fund up to an additional \$27.1 million.

As of June 30, 2019, we have invested in one commercial real estate mezzanine loan that matures in 2021 and has a loan-to-value ratio of approximately 73.8%. The commercial real estate loan had a yield of 11.13% during the three months ended June 30, 2019 and continued to benefit from favorable fundamentals. One commercial loan was repaid during the six months ended June 30, 2019.

We have also invested in two joint ventures that invest in our target assets.

### *Portfolio Characteristics*

The table below illustrates the vintage distribution of our non-Agency RMBS, GSE CRT and non-Agency CMBS portfolio as of June 30, 2019 as a percentage of the fair value:

|                         | 2003-2007 | 2008-2010 | 2011  | 2012  | 2013  | 2014  | 2015 | 2016  | 2017 | 2018  | 2019 | Total  |
|-------------------------|-----------|-----------|-------|-------|-------|-------|------|-------|------|-------|------|--------|
| Prime                   | 17.0%     | 0.6%      | —%    | —%    | 13.0% | 10.3% | 2.5% | 0.3%  | —%   | 15.6% | 5.8% | 65.1%  |
| Alt-A                   | 26.5%     | —%        | —%    | —%    | —%    | —%    | —%   | —%    | —%   | —%    | —%   | 26.5%  |
| Re-REMIC <sup>(1)</sup> | 0.6%      | 4.0%      | 1.7%  | 1.4%  | 0.6%  | —%    | —%   | —%    | —%   | —%    | —%   | 8.3%   |
| Subprime/RPL            | 0.1%      | —%        | —%    | —%    | —%    | —%    | —%   | —%    | —%   | —%    | —%   | 0.1%   |
| Total Non-Agency RMBS   | 44.2%     | 4.6%      | 1.7%  | 1.4%  | 13.6% | 10.3% | 2.5% | 0.3%  | —%   | 15.6% | 5.8% | 100.0% |
| GSE CRT                 | —%        | —%        | —%    | —%    | 26.1% | 30.9% | 5.3% | 19.7% | 3.3% | 7.0%  | 7.7% | 100.0% |
| Non-Agency CMBS         | —%        | 2.3%      | 15.5% | 10.5% | 11.8% | 30.9% | 7.5% | 4.0%  | 8.8% | 4.8%  | 3.9% | 100.0% |

(1) Reflects the year in which the re-securitizations were issued. The vintage distribution of the securities that collateralize our Re-REMIC investments is 4.4% for 2005, 1.3% for 2006, and 94.3% for 2007.

## [Table of Contents](#)

The following table summarizes the credit enhancement provided to our non-Agency RMBS Re-REMIC holdings as of June 30, 2019 and December 31, 2018.

| Re-REMIC Subordination <sup>(1)</sup> | Percentage of Re-REMIC Holdings at Fair Value |                   |
|---------------------------------------|-----------------------------------------------|-------------------|
|                                       | June 30, 2019                                 | December 31, 2018 |
| 0% - 10%                              | 55.1%                                         | 49.8%             |
| 10% - 20%                             | 3.4%                                          | 3.4%              |
| 20% - 30%                             | 18.2%                                         | 16.9%             |
| 30% - 40%                             | 11.7%                                         | 14.9%             |
| 40% - 50%                             | 1.1%                                          | 1.8%              |
| 50% - 60%                             | 10.5%                                         | 12.5%             |
| 60% - 70%                             | —%                                            | 0.7%              |
| Total                                 | 100.0%                                        | 100.0%            |

- (1) Subordination refers to the credit enhancement provided to the Re-REMIC tranche held by us by any junior Re-REMIC tranche or tranches in a resecuritization. This figure reflects the percentage of the balance of the underlying securities represented by any junior tranche or tranches at the time of resecuritization. Generally, principal losses on the underlying securities in excess of the subordination amount would result in principal losses on the Re-REMIC tranche held by us. As of June 30, 2019, 72.3% of our Re-REMIC holdings are not senior tranches.

The tables below represent the geographic concentration of the underlying collateral for our non-Agency RMBS, GSE CRT and non-Agency CMBS portfolio as of June 30, 2019:

| Non-Agency RMBS State | Percentage | GSE CRT State | Percentage | Non-Agency CMBS State | Percentage |
|-----------------------|------------|---------------|------------|-----------------------|------------|
| California            | 46.1%      | California    | 18.3%      | New York              | 15.2%      |
| New York              | 8.7%       | Texas         | 6.3%       | California            | 15.0%      |
| Florida               | 5.9%       | Florida       | 4.7%       | Texas                 | 8.8%       |
| New Jersey            | 3.7%       | New York      | 4.5%       | Florida               | 6.1%       |
| Massachusetts         | 3.4%       | Virginia      | 4.1%       | Illinois              | 4.4%       |
| Virginia              | 2.9%       | Illinois      | 3.8%       | Pennsylvania          | 3.9%       |
| Washington            | 2.8%       | Washington    | 3.4%       | New Jersey            | 3.5%       |
| Maryland              | 2.6%       | Massachusetts | 3.3%       | Ohio                  | 3.1%       |
| Colorado              | 2.5%       | New Jersey    | 3.3%       | Michigan              | 3.0%       |
| Illinois              | 2.4%       | Pennsylvania  | 3.1%       | Virginia              | 2.9%       |
| Other                 | 19.0%      | Other         | 45.2%      | Other                 | 34.1%      |
| Total                 | 100.0%     | Total         | 100.0%     | Total                 | 100.0%     |

### *Financing and Other Liabilities*

We enter into repurchase agreements to finance the majority of our target assets. These agreements are secured by our mortgage-backed and credit risk transfer securities and an investment in a loan participation interest. Repurchase agreements are generally settled on a short-term basis, usually from one to twelve months, and bear interest at rates that have historically moved in close relationship to LIBOR. At each settlement date, we refinance each repurchase agreement at the market interest rate at that time. As of June 30, 2019, we had entered into repurchase agreements totaling \$17.1 billion (December 31, 2018: \$13.6 billion).

Our wholly-owned captive insurance subsidiary, IAS Services, is a member of the Federal Home Loan Bank of Indianapolis ("FHLBI"). As a member of the FHLBI, IAS Services has borrowed funds from the FHLBI in the form of secured loans. As of June 30, 2019, IAS Services had \$1.65 billion in outstanding secured loans. For the six months ended June 30, 2019, IAS Services had weighted average borrowings of \$1.65 billion with a weighted average borrowing rate of 2.72% and a weighted average maturity of 4.9 years.

## [Table of Contents](#)

The following table presents the amount of collateralized borrowings outstanding under repurchase agreements and secured loans as of the end of each quarter, the average amount outstanding during the quarter and the maximum balance outstanding during the quarter:

| \$ in thousands    | Collateralized borrowings under repurchase agreements and secured loans |                           |                 |
|--------------------|-------------------------------------------------------------------------|---------------------------|-----------------|
|                    | Quarter-end balance                                                     | Average quarterly balance | Maximum balance |
| Quarter Ended      |                                                                         |                           |                 |
| June 30, 2018      | 15,352,321                                                              | 15,275,972                | 15,352,321      |
| September 30, 2018 | 16,028,518                                                              | 15,973,428                | 16,078,388      |
| December 31, 2018  | 15,252,484                                                              | 15,836,597                | 16,144,062      |
| March 31, 2019     | 18,474,387                                                              | 17,229,809                | 18,474,387      |
| June 30, 2019      | 18,725,065                                                              | 19,019,503                | 19,365,413      |

We have invested in and partially funded our portion of a commitment in a loan participation. The remainder of our commitment under the agreement will be funded over the two year term of the loan based upon the financing needs of the borrower. As of June 30, 2019, we have unfunded commitments of \$27.1 million.

We have also committed to invest up to \$122.6 million in unconsolidated ventures that are sponsored by an affiliate of our Manager. As of June 30, 2019, \$116.1 million of our commitment to these unconsolidated ventures has been called. We are committed to fund \$6.5 million in additional capital to fund future investments and cover future expenses should they occur.

### *Hedging Instruments.*

As of June 30, 2019, we have entered into interest rate swap agreements designed to mitigate the effects of increases in interest rates for a portion of our borrowings. Under these swap agreements, we pay fixed interest rates and receive floating interest rates indexed off of one- or three-month LIBOR, effectively fixing the floating interest rates on \$12.5 billion (December 31, 2018: \$12.4 billion) of borrowings. As of June 30, 2019, we received interest based on one-month LIBOR on \$7.2 billion of our swaps and interest based on three-month LIBOR on \$5.3 billion of our swaps.

During the six months ended June 30, 2019, we terminated existing swaps with a notional amount of \$10.4 billion and entered into new swaps with a notional amount of \$10.5 billion to hedge repurchase agreement debt associated with purchases of Agency RMBS and Agency CMBS securities. As of June 30, 2019, our interest rate swap portfolio had a weighted average fixed pay rate of 2.15% (December 31, 2018: 2.46%) and a weighted average years to maturity of 4.7 years (December 31, 2018: 3.7 years). Daily variation margin payment for interest rate swaps is characterized as settlement of the derivative itself rather than collateral and is recorded as a realized gain or loss in our condensed consolidated statement of operations. We realized a net loss of \$407.7 million on interest rate swaps during the six months ended June 30, 2019 primarily due to falling interest rates in the first half of 2019.

As of June 30, 2019 we held \$494.3 million (December 31, 2018: \$1.7 billion) in notional amount of futures contracts. During the six months ended June 30, 2019, we settled futures contracts with a notional amount of \$4.3 billion and realized a net loss of \$132.6 million due to falling interest rates in the first half of 2019. Daily variation margin payment for futures is characterized as settlement of the derivative itself rather than collateral and is recorded as a realized gain or loss in our condensed consolidated statement of operations.

We enter into currency forward contracts to help mitigate the potential impact of changes in foreign currency exchange rates on investments denominated in foreign currencies. During the six months ended June 30, 2019, we settled currency forward contracts of \$48.7 million (June 30, 2018: \$156.2 million) in notional amount and realized a net gain of \$738,000 (June 30, 2018: \$2.1 million net loss). As of June 30, 2019, we had \$26.6 million (December 31, 2018: \$23.1 million) of notional amount of forward contracts denominated in Euro related to our investment in an unconsolidated venture.

**Book Value per Common Share**

We calculate book value per common share as follows:

| In thousands except per share amounts                    | As of         |                   |
|----------------------------------------------------------|---------------|-------------------|
|                                                          | June 30, 2019 | December 31, 2018 |
| <b>Numerator (adjusted equity):</b>                      |               |                   |
| Total equity                                             | 2,670,101     | 2,286,697         |
| Less: Liquidation preference of Series A Preferred Stock | (140,000)     | (140,000)         |
| Less: Liquidation preference of Series B Preferred Stock | (155,000)     | (155,000)         |
| Less: Liquidation preference of Series C Preferred Stock | (287,500)     | (287,500)         |
| Total adjusted equity                                    | 2,087,601     | 1,704,197         |
| <b>Denominator (number of shares):</b>                   |               |                   |
| Common stock outstanding                                 | 128,796       | 111,585           |
| Book value per common share                              | 16.21         | 15.27             |

Our book value per common share increased 6.2% as of June 30, 2019 compared to December 31, 2018 primarily due to interest rate spread tightening in both Agency and credit assets. Refer to Item 3. "Quantitative and Qualitative Disclosures About Market Risk" for interest rate risk and its impact on fair value.

### **Critical Accounting Policies**

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

There have been no significant changes to our critical accounting policies that are disclosed in our most recent Form 10-K for the year ended December 31, 2018.

### **Recent Accounting Standards**

See Part I, Item 1, Financial Statements Note 2 - "Accounting Pronouncements Recently Adopted" and "Pending Accounting Pronouncements".

## Results of Operations

The table below presents certain information from our condensed consolidated statements of operations for the three and six months ended June 30, 2019 and 2018.

| \$ in thousands, except share data                           | Three Months Ended June 30, |             | Six Months Ended June 30, |             |
|--------------------------------------------------------------|-----------------------------|-------------|---------------------------|-------------|
|                                                              | 2019                        | 2018        | 2019                      | 2018        |
| <b>Interest Income</b>                                       |                             |             |                           |             |
| Mortgage-backed and credit risk transfer securities          | 200,737                     | 147,548     | 386,229                   | 296,551     |
| Commercial and other loans                                   | 1,484                       | 4,051       | 3,066                     | 8,273       |
| Total interest income                                        | 202,221                     | 151,599     | 389,295                   | 304,824     |
| <b>Interest Expense</b>                                      |                             |             |                           |             |
| Repurchase agreements                                        | 117,978                     | 69,389      | 219,853                   | 128,974     |
| Secured loans                                                | 11,258                      | 8,471       | 22,402                    | 15,398      |
| Exchangeable senior notes                                    | —                           | —           | —                         | 1,621       |
| Total interest expense                                       | 129,236                     | 77,860      | 242,255                   | 145,993     |
| <b>Net interest income</b>                                   | 72,985                      | 73,739      | 147,040                   | 158,831     |
| <b>Other Income (loss)</b>                                   |                             |             |                           |             |
| Gain (loss) on investments, net                              | 302,182                     | (36,377)    | 570,564                   | (196,747)   |
| Equity in earnings (losses) of unconsolidated ventures       | 702                         | 798         | 1,394                     | 1,694       |
| Gain (loss) on derivative instruments, net                   | (344,733)                   | 67,169      | (546,193)                 | 200,536     |
| Realized and unrealized credit derivative income (loss), net | (2,438)                     | 735         | 5,446                     | 3,900       |
| Net loss on extinguishment of debt                           | —                           | —           | —                         | (26)        |
| Other investment income (loss), net                          | 1,007                       | (2,160)     | 2,036                     | 942         |
| <b>Total other income (loss)</b>                             | (43,280)                    | 30,165      | 33,247                    | 10,299      |
| <b>Expenses</b>                                              |                             |             |                           |             |
| Management fee – related party                               | 9,370                       | 10,102      | 18,904                    | 20,323      |
| General and administrative                                   | 1,999                       | 1,525       | 4,257                     | 3,281       |
| <b>Total expenses</b>                                        | 11,369                      | 11,627      | 23,161                    | 23,604      |
| <b>Net income</b>                                            | 18,336                      | 92,277      | 157,126                   | 145,526     |
| Net income attributable to non-controlling interest          | —                           | 1,163       | —                         | 1,834       |
| Net income attributable to Invesco Mortgage Capital Inc.     | 18,336                      | 91,114      | 157,126                   | 143,692     |
| Dividends to preferred stockholders                          | 11,106                      | 11,106      | 22,213                    | 22,213      |
| Net income attributable to common stockholders               | 7,230                       | 80,008      | 134,913                   | 121,479     |
| Earnings per share:                                          |                             |             |                           |             |
| Net income (loss) attributable to common stockholders        |                             |             |                           |             |
| Basic                                                        | 0.06                        | 0.72        | 1.08                      | 1.09        |
| Diluted                                                      | 0.06                        | 0.72        | 1.08                      | 1.08        |
| Weighted average number of shares of common stock:           |                             |             |                           |             |
| Basic                                                        | 128,658,546                 | 111,640,630 | 124,900,484               | 111,634,900 |
| Diluted                                                      | 128,671,066                 | 113,084,816 | 124,912,532               | 115,467,670 |

## Interest Income and Average Earning Asset Yields

The table below presents information related to our average earning assets and earning asset yields for the three and six months ended June 30, 2019 and 2018.

| \$ in thousands                                     | Three Months Ended June 30, |            | Six Months Ended June 30, |            |
|-----------------------------------------------------|-----------------------------|------------|---------------------------|------------|
|                                                     | 2019                        | 2018       | 2019                      | 2018       |
| <b>Average Balances <sup>(1)</sup>:</b>             |                             |            |                           |            |
| Agency RMBS:                                        |                             |            |                           |            |
| 15 year fixed-rate, at amortized cost               | 342,822                     | 2,648,396  | 356,946                   | 2,763,406  |
| 30 year fixed-rate, at amortized cost               | 12,569,625                  | 7,805,977  | 12,176,996                | 7,818,321  |
| ARM, at amortized cost                              | 6,326                       | 220,960    | 12,805                    | 226,103    |
| Hybrid ARM, at amortized cost                       | 146,331                     | 1,595,131  | 185,179                   | 1,630,813  |
| Agency - CMO, at amortized cost                     | 377,794                     | 254,642    | 335,091                   | 264,210    |
| Agency CMBS, at amortized cost                      | 1,940,906                   | 50,179     | 1,537,309                 | 25,228     |
| Non-Agency CMBS, at amortized cost                  | 3,470,708                   | 3,177,398  | 3,416,222                 | 3,185,442  |
| Non-Agency RMBS, at amortized cost                  | 1,020,856                   | 1,030,949  | 1,052,612                 | 1,057,619  |
| GSE CRT, at amortized cost                          | 852,083                     | 769,821    | 830,310                   | 773,263    |
| Loan participation interest                         | 51,377                      | —          | 53,061                    | —          |
| Commercial loans, at amortized cost                 | 24,365                      | 178,080    | 25,862                    | 185,767    |
| Average earning assets                              | 20,803,193                  | 17,731,533 | 19,982,393                | 17,930,172 |
| <b>Average Earning Asset Yields <sup>(2)</sup>:</b> |                             |            |                           |            |
| Agency RMBS:                                        |                             |            |                           |            |
| 15 year fixed-rate                                  | 3.21%                       | 1.99%      | 3.36%                     | 2.02%      |
| 30 year fixed-rate                                  | 3.43%                       | 2.95%      | 3.40%                     | 2.96%      |
| ARM                                                 | 3.60%                       | 2.43%      | 3.67%                     | 2.37%      |
| Hybrid ARM                                          | 2.85%                       | 2.28%      | 3.23%                     | 2.26%      |
| Agency - CMO                                        | 3.24%                       | 3.04%      | 3.38%                     | 2.76%      |
| Agency CMBS                                         | 3.49%                       | 3.63%      | 3.50%                     | 3.63%      |
| Non-Agency CMBS                                     | 5.07%                       | 4.95%      | 5.02%                     | 4.90%      |
| Non-Agency RMBS                                     | 6.53%                       | 7.12%      | 6.62%                     | 7.10%      |
| GSE CRT <sup>(3)</sup>                              | 3.56%                       | 3.37%      | 3.61%                     | 3.18%      |
| Loan participation interest                         | 6.12%                       | —%         | 6.13%                     | —%         |
| Commercial loans                                    | 11.13%                      | 9.12%      | 11.10%                    | 8.98%      |
| Average earning asset yields                        | 3.89%                       | 3.42%      | 3.90%                     | 3.40%      |

(1) Average balances for each period are based on weighted month-end average earning assets.

(2) Average earning asset yields for the period were calculated by dividing interest income, including amortization of premiums and discounts, by the average month-end earning assets based on the amortized cost of the investments. All yields are annualized.

(3) GSE CRT average earning asset yields exclude coupon interest associated with embedded derivatives on securities not accounted for under the fair value option that is recorded as realized and unrealized credit derivative income (loss), net under U.S. GAAP.

Our primary source of income is interest earned on our investment portfolio. We had average earning assets of approximately \$20.8 billion for the three months ended June 30, 2019 (June 30, 2018: \$17.7 billion) and \$20.0 billion for the six months ended June 30, 2019 (June 30, 2018: \$17.9 billion). Average earning assets increased for the three and six months ended June 30, 2019 primarily because we invested and leveraged \$266.7 million in net proceeds from 2019 common stock issuances and \$168.2 million in proceeds from commercial loan repayments over the last eighteen months primarily into newly issued 30 year fixed-rate Agency RMBS and Agency CMBS securities.

## [Table of Contents](#)

We earned total interest income of \$202.2 million (June 30, 2018: \$151.6 million) and \$389.3 million (June 30, 2018: \$304.8 million) for the three and six months ended June 30, 2019. Our interest income includes coupon interest and net premium amortization on MBS and GSE CRTs as well as interest income on commercial and other loans as shown in the table below.

| \$ in thousands                            | Three Months Ended June 30, |          | Six Months Ended June 30, |          |
|--------------------------------------------|-----------------------------|----------|---------------------------|----------|
|                                            | 2019                        | 2018     | 2019                      | 2018     |
| <b>Interest Income</b>                     |                             |          |                           |          |
| MBS and GSE CRT - coupon interest          | 214,501                     | 164,165  | 406,943                   | 330,484  |
| MBS and GSE CRT - net premium amortization | (13,764)                    | (16,617) | (20,714)                  | (33,933) |
| MBS and GSE CRT - interest income          | 200,737                     | 147,548  | 386,229                   | 296,551  |
| Commercial and other loans                 | 1,484                       | 4,051    | 3,066                     | 8,273    |
| Total interest income                      | 202,221                     | 151,599  | 389,295                   | 304,824  |

MBS and GSE CRT interest income increased \$53.2 million and \$89.7 million, respectively, for the three and six months ended June 30, 2019 compared to 2018 primarily due to higher average earnings assets. Net premium amortization decreased \$2.9 million and \$13.2 million, respectively, for the three and six months ended June 30, 2019 compared to 2018 primarily due to changes in the composition of our Agency RMBS portfolio and purchases of non-Agency CMBS securities at a discount over the last twelve months.

Interest income on our commercial and other loans decreased \$2.6 million and \$5.2 million, respectively, during the three and six months ended June 30, 2019 primarily due to commercial loan repayments over the past twelve months. The balance of our commercial loans held-for-investment decreased to \$24.3 million as of June 30, 2019 compared to \$127.6 million as of June 30, 2018.

Our average earning asset yields increased 47 and 50 basis points, respectively, during the three and six months ended June 30, 2019 compared to 2018 primarily due to purchases of new securities at higher yields and higher index rates on floating and adjustable assets.

### *Prepayment Speeds*

Our RMBS and GSE CRT portfolio is subject to inherent prepayment risk primarily driven by changes in interest rates, which impacts the amount of premium and discount on the purchase of these securities that is recognized into interest income. Expected future prepayment speeds on our RMBS and GSE CRT portfolio are estimated on a quarterly basis. Generally, in an environment of falling interest rates, prepayment speeds will increase as homeowners are more likely to prepay their existing mortgage and refinance into a lower borrowing rate. If the actual prepayment speed during the period is faster than estimated, the amortization on securities purchased at a premium to par value will be accelerated, resulting in lower interest income recognized. Conversely, for securities purchased at a discount to par value, interest income will be reduced in periods where prepayment speeds were slower than expected. The standard measure of prepayment speeds is the constant prepayment rate, also known as the conditional prepayment rate or "CPR". CPR measures prepayments as a percentage of the current outstanding loan balance and is expressed as a compound annual rate. The table below provides the three month constant prepayment rate for our RMBS and GSE CRTs as of June 30, 2019, March 31, 2019, June 30, 2018 and March 31, 2018.

|                                | As of         |                |               |                |
|--------------------------------|---------------|----------------|---------------|----------------|
|                                | June 30, 2019 | March 31, 2019 | June 30, 2018 | March 31, 2018 |
| 15 year fixed-rate Agency RMBS | 11.1          | 7.1            | 10.6          | 9.2            |
| 30 year fixed-rate Agency RMBS | 8.5           | 4.9            | 8.2           | 7.1            |
| ARM/ Hybrid ARM Agency RMBS    | 18.2          | 15.7           | 15.7          | 14.4           |
| Non-Agency RMBS                | 11.4          | 8.3            | 12.0          | 11.6           |
| GSE CRT                        | 9.8           | 6.6            | 9.8           | 9.5            |
| Weighted average CPR           | 9.0           | 5.7            | 10.2          | 9.2            |

## [Table of Contents](#)

The following table presents net premium amortization recognized on our MBS and GSE CRT portfolio for the three and six months ended June 30, 2019 and 2018.

| \$ in thousands, except share data            | Three Months Ended June 30, |          | Six Months Ended June 30, |          |
|-----------------------------------------------|-----------------------------|----------|---------------------------|----------|
|                                               | 2019                        | 2018     | 2019                      | 2018     |
| Agency RMBS                                   | (17,153)                    | (22,274) | (29,347)                  | (45,496) |
| Agency CMBS                                   | (909)                       | (1)      | (1,440)                   | (1)      |
| Non-Agency CMBS                               | 3,350                       | 1,195    | 6,381                     | 2,621    |
| Non-Agency RMBS                               | 2,800                       | 5,159    | 6,722                     | 10,336   |
| GSE CRT                                       | (1,852)                     | (696)    | (3,030)                   | (1,393)  |
| Net (premium amortization) discount accretion | (13,764)                    | (16,617) | (20,714)                  | (33,933) |

Net premium amortization decreased compared to the same periods in 2018 primarily due to changes in the composition of our Agency RMBS portfolio in the three and six months ended June 30, 2019 and purchases of non-Agency CMBS securities at a discount over the last twelve months.

Our interest income is subject to interest rate risk. Refer to Item 3. "Quantitative and Qualitative Disclosures about Market Risk" for more information relating to interest rate risk and its impact on our operating results.

### Interest Expense and the Cost of Funds

The table below presents the components of interest expense for the three and six months ended June 30, 2019 and 2018:

| \$ in thousands                                                               | Three Months Ended June 30, |         | Six Months Ended June 30, |          |
|-------------------------------------------------------------------------------|-----------------------------|---------|---------------------------|----------|
|                                                                               | 2019                        | 2018    | 2019                      | 2018     |
| <b>Interest Expense</b>                                                       |                             |         |                           |          |
| Interest expense on repurchase agreement borrowings                           | 123,894                     | 76,287  | 231,620                   | 142,411  |
| Amortization of net deferred (gain) loss on de-designated interest rate swaps | (5,916)                     | (6,898) | (11,767)                  | (13,437) |
| Repurchase agreements interest expense                                        | 117,978                     | 69,389  | 219,853                   | 128,974  |
| Secured loans                                                                 | 11,258                      | 8,471   | 22,402                    | 15,398   |
| Exchangeable senior notes                                                     | —                           | —       | —                         | 1,621    |
| Total interest expense                                                        | 129,236                     | 77,860  | 242,255                   | 145,993  |

We enter into repurchase agreements to finance the majority of our target assets. These agreements are secured by our mortgage-backed and credit risk transfer securities. These agreements are generally settled on a short-term basis, usually from one to twelve months, and bear interest at rates that have historically moved in close relationship to LIBOR. At each settlement date, we typically refinance each repurchase agreement at the market interest rate at that time.

Our interest expense on repurchase agreement borrowings rose \$47.6 million and \$89.2 million for the three and six months ended June 30, 2019, respectively, compared to 2018 due to higher average borrowings and increases in the federal funds rate over the past twelve months. We increased our average borrowings in 2019 after investing and leveraging \$266.7 million in net proceeds from 2019 common stock issuances and \$168.2 million in proceeds from commercial loan repayments over the last eighteen months into newly issued 30 year fixed-rate Agency RMBS and Agency CMBS securities.

Our repurchase agreement interest expense as reported in our condensed consolidated statement of operations includes amortization of net deferred gains and losses on de-designated interest rate swaps as summarized in the table above. Amortization of net deferred gains on de-designated interest rate swaps decreased our total interest expense by \$5.9 million and \$11.8 million, respectively, during the three and six months ended June 30, 2019 and \$6.9 million and \$13.4 million, respectively, during the three and six months ended June 30, 2018. Amounts recorded in AOCI before we discontinued cash flow hedge accounting for our interest rate swaps are reclassified to interest expense on repurchase agreements on the condensed consolidated statements of operations as interest is accrued and paid on the related repurchase agreements over the remaining life of the interest rate swap agreements. During the next twelve months, we estimate that \$23.8 million of net deferred gains on de-designated interest rate swaps will be reclassified from other comprehensive income and recorded as a decrease to interest expense.

## [Table of Contents](#)

During the three and six months ended June 30, 2019, interest expense for our secured loans increased \$2.8 million and \$7.0 million, respectively, compared to the same period in 2018 due to higher borrowing rates. Borrowing rates on our secured loans are based on the three-month FHLB swap rate plus a spread. For the six months ended June 30, 2019, the weighted average borrowing rate on our secured loans was 2.72% as compared to 1.87% for the six months ended June 30, 2018.

During the six months ended June 30, 2019, interest expense on exchangeable senior notes (the "Notes") decreased \$1.6 million compared to the same period in 2018 because the Notes were retired on March 15, 2018.

Our total interest expense during the three months ended June 30, 2019 increased \$51.4 million from the same period in 2018 primarily due to the \$50.4 million increase in interest expense on repurchase agreements borrowings and secured loans in the 2019.

Our total interest expense during the six months ended June 30, 2019 increased \$96.3 million from the same period in 2018 primarily due to the \$96.2 million increase in interest expense on repurchase agreements borrowings and secured loans in the 2019 period offset by a \$1.6 million decrease in interest expense on the Notes as discussed above.

The table below presents information related to our borrowings and cost of funds for the three and six months ended June 30, 2019 and 2018:

| \$ in thousands                                           | Three Months Ended June 30, |            | Six Months Ended June 30, |            |
|-----------------------------------------------------------|-----------------------------|------------|---------------------------|------------|
|                                                           | 2019                        | 2018       | 2019                      | 2018       |
| <b>Average Borrowings<sup>(1)</sup>:</b>                  |                             |            |                           |            |
| Agency RMBS <sup>(2)</sup>                                | 12,516,268                  | 11,146,252 | 12,092,572                | 11,286,117 |
| Agency CMBS                                               | 1,881,685                   | 43,984     | 1,480,530                 | 22,114     |
| Non-Agency CMBS <sup>(2)</sup>                            | 2,819,109                   | 2,556,166  | 2,741,948                 | 2,549,519  |
| Non-Agency RMBS                                           | 901,451                     | 861,598    | 894,044                   | 876,318    |
| GSE CRT                                                   | 751,882                     | 667,972    | 734,777                   | 671,245    |
| Exchangeable senior notes                                 | —                           | —          | —                         | 57,767     |
| Loan participation interest                               | 38,532                      | —          | 39,795                    | —          |
| Total average borrowings                                  | 18,908,927                  | 15,275,972 | 17,983,666                | 15,463,080 |
| Maximum borrowings during the period <sup>(3)</sup>       | 19,365,413                  | 15,352,321 | 19,365,413                | 15,674,202 |
| <b>Average Cost of Funds <sup>(4)</sup>:</b>              |                             |            |                           |            |
| Agency RMBS <sup>(2)</sup>                                | 2.73%                       | 1.98%      | 2.66%                     | 1.82%      |
| Agency CMBS                                               | 2.68%                       | 2.38%      | 2.66%                     | 2.38%      |
| Non-Agency CMBS <sup>(2)</sup>                            | 3.19%                       | 2.68%      | 3.22%                     | 2.48%      |
| Non-Agency RMBS                                           | 3.46%                       | 3.19%      | 3.50%                     | 3.05%      |
| GSE CRT                                                   | 3.47%                       | 3.16%      | 3.48%                     | 3.02%      |
| Exchangeable senior notes                                 | —%                          | —%         | —%                        | 5.58%      |
| Loan participation interest                               | 4.11%                       | —%         | 4.13%                     | —%         |
| Cost of funds                                             | 2.73%                       | 2.04%      | 2.69%                     | 1.89%      |
| Effective cost of funds (non-GAAP measure) <sup>(5)</sup> | 2.70%                       | 2.34%      | 2.69%                     | 2.28%      |

(1) Average borrowings for each period are based on weighted month-end balances.

(2) Agency RMBS and non-Agency CMBS average borrowings and average cost of funds include borrowings under repurchase agreements and secured loans.

(3) Amount represents the maximum borrowings at month-end during each of the respective periods.

(4) Average cost of funds is calculated by dividing annualized interest expense excluding amortization of net deferred gain (loss) on de-designated interest rate swaps by our average borrowings.

(5) For a reconciliation of cost of funds to effective cost of funds, see "Non-GAAP Financial Measures."

Total average borrowings rose \$3.6 billion and \$2.5 billion, respectively, in the three and six months ended June 30, 2019 compared to 2018 primarily because we entered into repurchase agreements to finance our increased holdings of 30 year fixed-rate Agency RMBS, Agency CMBS and non-Agency CMBS. The increase in our average cost of funds for three and six months ended June 30, 2019 versus 2018 was primarily due to increases in the federal funds rate over the past twelve months.

## Net Interest Income

The table below presents the components of net interest income for the three and six months ended June 30, 2019 and 2018:

| \$ in thousands                                                               | Three Months Ended June 30, |         | Six Months Ended June 30, |          |
|-------------------------------------------------------------------------------|-----------------------------|---------|---------------------------|----------|
|                                                                               | 2019                        | 2018    | 2019                      | 2018     |
| <b>Interest Income</b>                                                        |                             |         |                           |          |
| Mortgage-backed and credit risk transfer securities                           | 200,737                     | 147,548 | 386,229                   | 296,551  |
| Commercial and other loans                                                    | 1,484                       | 4,051   | 3,066                     | 8,273    |
| Total interest income                                                         | 202,221                     | 151,599 | 389,295                   | 304,824  |
| <b>Interest Expense</b>                                                       |                             |         |                           |          |
| Interest expense on repurchase agreement borrowings                           | 123,894                     | 76,287  | 231,620                   | 142,411  |
| Amortization of net deferred (gain) loss on de-designated interest rate swaps | (5,916)                     | (6,898) | (11,767)                  | (13,437) |
| Repurchase agreements interest expense                                        | 117,978                     | 69,389  | 219,853                   | 128,974  |
| Secured loans                                                                 | 11,258                      | 8,471   | 22,402                    | 15,398   |
| Exchangeable senior notes                                                     | —                           | —       | —                         | 1,621    |
| Total interest expense                                                        | 129,236                     | 77,860  | 242,255                   | 145,993  |
| <b>Net interest income</b>                                                    | 72,985                      | 73,739  | 147,040                   | 158,831  |
| <b>Net interest rate margin</b>                                               | 1.16%                       | 1.38%   | 1.21%                     | 1.51%    |

Our net interest income, which equals interest income less interest expense, totaled \$73.0 million (June 30, 2018: \$73.7 million) and \$147.0 million (June 30, 2018: \$158.8 million) for the three and six months ended June 30, 2019, respectively. The decrease in net interest income for the three and six months ended June 30, 2019 was primarily due to an increase in interest expense driven by higher average borrowings and borrowing rates exceeding the increase in interest income on higher average earning assets.

Our net interest rate margin, which equals the yield on our average assets for the period less the average cost of funds for the period, was 1.16% (June 30, 2018: 1.38%) and 1.21% (June 30, 2018: 1.51%) for the three and six months ended June 30, 2019. The decrease in net interest rate margin for the three and six months ended June 30, 2019 compared to the same periods in 2018 was primarily due to increases in the federal funds rate over the last twelve months that had a greater impact on our average cost of funds than on our average earning asset yields. Our cost of funds on all of our borrowings is influenced by changes in short term interest rates, whereas approximately 91% of the Company's investments were fixed rate assets as of June 30, 2019.

## Gain (Loss) on Investments, net

The table below summarizes the components of gain (loss) on investments, net for the three and six months ended June 30, 2019 and 2018:

| \$ in thousands                                                                    | Three Months Ended June 30, |          | Six Months Ended June 30, |           |
|------------------------------------------------------------------------------------|-----------------------------|----------|---------------------------|-----------|
|                                                                                    | 2019                        | 2018     | 2019                      | 2018      |
| Net realized gains (losses) on sale of investments                                 | 2,029                       | (11,525) | (9,086)                   | (20,762)  |
| Other-than-temporary impairment losses                                             | (1,200)                     | (2,089)  | (2,976)                   | (6,448)   |
| Net unrealized gains (losses) on MBS accounted for under the fair value option     | 304,692                     | (22,941) | 584,731                   | (170,136) |
| Net unrealized gains (losses) on GSE CRT accounted for under the fair value option | (3,339)                     | 182      | (2,105)                   | 616       |
| Net unrealized gains (losses) on trading securities                                | —                           | (4)      | —                         | (17)      |
| Gain (loss) on investments, net                                                    | 302,182                     | (36,377) | 570,564                   | (196,747) |

As part of our investment process, our mortgage-backed and credit risk transfer securities are continuously reviewed to determine if they continue to meet our risk and return targets. This process involves looking at changing market assumptions

and the impact those assumptions will have on the individual securities. During the six months ended June 30, 2019, we continued to actively manage our investment portfolio and sold most of our 15 year fixed-rate Agency, ARM and Hybrid ARM securities. During the three months ended June 30, 2019, we sold \$933.5 million of mortgage-backed securities (June 30, 2018: \$210.0 million) and realized net gains of \$2.0 million (June 30, 2018: net losses of \$11.5 million). During the six months ended June 30, 2019, we sold \$1.7 billion of mortgage-backed securities (June 30, 2018: \$408.5 million) and realized net losses of \$9.1 million (June 30, 2018: net losses of \$20.8 million).

We assess our investment securities for other-than-temporary impairment on a quarterly basis. Our determination of whether a security is other-than-temporarily impaired involves judgment and assumptions based on subjective and objective factors. We consider (i) whether we intend to sell the security and whether it is more likely than not that we will be required to sell the security before recovery of its amortized cost and (ii) the financial condition and near-term prospects of recovery in fair value of the security. This includes a determination of estimated future cash flows through an evaluation of the characteristics of the underlying loans and the structural features of the investment. When the fair value of an investment is less than its amortized cost at the balance sheet date of the reporting period for which impairment is assessed, the impairment is designated as either "temporary" or "other-than-temporary." For additional information regarding our assessment analysis of other-than temporary impairment on our investment securities, refer to Note 4 – "Mortgage-Backed and Credit Risk Transfer Securities" of our condensed consolidated financial statements.

We have elected the fair value option for all of our RMBS IOs, our MBS purchased on or after September 1, 2016 and our GSE CRTs purchased on or after August 24, 2015. Under the fair value option, changes in fair value are recognized in income in the condensed consolidated statements of operations and are reported as a component of gain (loss) on investments, net. As of June 30, 2019, \$16.7 billion (December 31, 2018: \$11.6 billion) or 78% (December 31, 2018: 67%) of our MBS and GSE CRT are accounted for under the fair value option. We recorded net unrealized gains on our MBS portfolio accounted for under the fair value option of \$304.7 million in the three months ended June 30, 2019 compared to net losses of \$22.9 million in the three months ended June 30, 2018. We recorded net unrealized gains on our MBS portfolio accounted for under the fair value option of \$584.7 million in the six months ended June 30, 2019 compared to net losses of \$170.1 million in the six months ended June 30, 2018. Net unrealized gains in the three and six months ended June 30, 2019 reflect tighter interest rate spreads across the Company's credit assets and Agency CMBS, and valuation gains in the Company's specified pool Agency RMBS. Most of our holdings of 30 year fixed-rate Agency RMBS are in specified pools with attractive prepayment characteristics.

#### **Equity in Earnings (Losses) of Unconsolidated Ventures**

For the three months ended June 30, 2019, we recorded equity in earnings of unconsolidated ventures of \$702,000 (June 30, 2018: equity in earnings of \$798,000). For the six months ended June 30, 2019, we recorded equity in earnings of unconsolidated ventures of \$1.4 million (June 30, 2018: equity in earnings of \$1.7 million). We recorded equity in earnings for the three and six months ended June 30, 2019 and 2018 primarily due to realized and unrealized gains on the underlying portfolio investments.

#### **Gain (Loss) on Derivative Instruments, net**

Our objectives in using interest rate derivatives are to add stability to interest expense and to manage our exposure to interest rate movements on our floating rate repurchase agreements and secured loans. To accomplish these objectives, we primarily use interest rate derivative instruments, including interest rate swaps, interest rate swaptions, U.S. Treasury futures contracts and TBAs as part of our interest rate risk management strategy.

We also use currency forward contracts to help mitigate the potential impact of changes in foreign currency exchange rates on our investments denominated in foreign currencies.

[Table of Contents](#)

The tables below summarize our realized and unrealized gain (loss) on derivative instruments, net for the following periods:

| \$ in thousands                                 |                                                     | Three months ended June 30, 2019          |                             |                                            |
|-------------------------------------------------|-----------------------------------------------------|-------------------------------------------|-----------------------------|--------------------------------------------|
| Derivative not designated as hedging instrument | Realized gain (loss) on derivative instruments, net | Contractual net interest income (expense) | Unrealized gain (loss), net | Gain (loss) on derivative instruments, net |
| Interest Rate Swaps                             | (241,839)                                           | 7,525                                     | (39,922)                    | (274,236)                                  |
| Futures Contracts                               | (65,953)                                            | —                                         | (4,490)                     | (70,443)                                   |
| Currency Forward Contracts                      | 553                                                 | —                                         | (607)                       | (54)                                       |
| Total                                           | (307,239)                                           | 7,525                                     | (45,019)                    | (344,733)                                  |

| \$ in thousands                                 |                                                     | Three months ended June 30, 2018          |                             |                                            |
|-------------------------------------------------|-----------------------------------------------------|-------------------------------------------|-----------------------------|--------------------------------------------|
| Derivative not designated as hedging instrument | Realized gain (loss) on derivative instruments, net | Contractual net interest income (expense) | Unrealized gain (loss), net | Gain (loss) on derivative instruments, net |
| Interest Rate Swaps                             | 34,273                                              | (4,511)                                   | 32,985                      | 62,747                                     |
| Futures Contracts                               | 640                                                 | —                                         | (1,044)                     | (404)                                      |
| Currency Forward Contracts                      | 1,361                                               | —                                         | 3,465                       | 4,826                                      |
| Total                                           | 36,274                                              | (4,511)                                   | 35,406                      | 67,169                                     |

| \$ in thousands                                 |                                                     | Six Months Ended June 30, 2019            |                             |                                            |
|-------------------------------------------------|-----------------------------------------------------|-------------------------------------------|-----------------------------|--------------------------------------------|
| Derivative not designated as hedging instrument | Realized gain (loss) on derivative instruments, net | Contractual net interest income (expense) | Unrealized gain (loss), net | Gain (loss) on derivative instruments, net |
| Interest Rate Swaps                             | (407,723)                                           | 12,034                                    | (26,931)                    | (422,620)                                  |
| Futures Contracts                               | (132,641)                                           | —                                         | 8,454                       | (124,187)                                  |
| Currency Forward Contracts                      | 738                                                 | —                                         | (124)                       | 614                                        |
| Total                                           | (539,626)                                           | 12,034                                    | (18,601)                    | (546,193)                                  |

| \$ in thousands                                 |                                                     | Six Months Ended June 30, 2018            |                             |                                            |
|-------------------------------------------------|-----------------------------------------------------|-------------------------------------------|-----------------------------|--------------------------------------------|
| Derivative not designated as hedging instrument | Realized gain (loss) on derivative instruments, net | Contractual net interest income (expense) | Unrealized gain (loss), net | Gain (loss) on derivative instruments, net |
| Interest Rate Swaps                             | 156,546                                             | (16,623)                                  | 65,359                      | 205,282                                    |
| Futures Contracts                               | (4,637)                                             | —                                         | (2,656)                     | (7,293)                                    |
| Currency Forward Contracts                      | (2,057)                                             | —                                         | 4,604                       | 2,547                                      |
| Total                                           | 149,852                                             | (16,623)                                  | 67,307                      | 200,536                                    |

As of June 30, 2019 and December 31, 2018, we held the following interest rate swaps whereby we receive interest at a one-month and three-month LIBOR rate:

| \$ in thousands       |                  | As of June 30, 2019    |                      |                          | As of December 31, 2018 |                        |                      |                          |
|-----------------------|------------------|------------------------|----------------------|--------------------------|-------------------------|------------------------|----------------------|--------------------------|
| Derivative instrument | Notional Amounts | Average Fixed Pay Rate | Average Receive Rate | Average Maturity (Years) | Notional Amounts        | Average Fixed Pay Rate | Average Receive Rate | Average Maturity (Years) |
| Interest Rate Swaps   | 12,470,000       | 2.15%                  | 2.46%                | 4.7                      | 12,370,000              | 2.46%                  | 2.55%                | 3.7                      |

During the six months ended June 30, 2019, we terminated existing swaps with a notional amount of \$10.4 billion and entered into new swaps with a notional amount of \$10.5 billion to hedge repurchase agreement debt associated with purchases of Agency RMBS and Agency CMBS securities. Daily variation margin payment for interest rate swaps is characterized as settlement of the derivative itself rather than collateral and is recorded as a realized gain or loss in our condensed consolidated

statement of operations. We realized a net loss of \$241.8 million and \$407.7 million for the three and six months ended June 30, 2019, respectively, on interest rate swaps primarily due to falling interest rates in the first half of 2019.

As of June 30, 2019 we held \$494.3 million (December 31, 2018: \$1.7 billion) in notional amount of futures contracts. During the six months ended June 30, 2019, we settled futures contracts with a notional amount of \$4.3 billion. We realized a net loss of \$66.0 million and \$132.6 million on the settlement of futures contracts for the three and six months ended June 30, 2019, respectively, due to falling interest rates in the first half of 2019. Daily variation margin payment for futures is characterized as settlement of the derivative itself rather than collateral and is recorded as a realized gain or loss in our condensed consolidated statement of operations.

#### Realized and Unrealized Credit Derivative Income (Loss), net

The table below summarizes the components of realized and unrealized credit derivative income (loss), net for the three and six months ended June 30, 2019 and 2018.

| \$ in thousands                                                    | Three Months Ended June 30, |         | Six Months Ended June 30, |         |
|--------------------------------------------------------------------|-----------------------------|---------|---------------------------|---------|
|                                                                    | 2019                        | 2018    | 2019                      | 2018    |
| GSE CRT embedded derivative coupon interest                        | 5,300                       | 5,638   | 10,650                    | 11,271  |
| Change in fair value of GSE CRT embedded derivatives               | (7,738)                     | (4,903) | (5,204)                   | (7,371) |
| Total realized and unrealized credit derivative income (loss), net | (2,438)                     | 735     | 5,446                     | 3,900   |

In the three months ended June 30, 2019, we recorded a decrease of \$3.2 million in realized and unrealized credit derivative income (loss), net compared to the same periods in 2018 because the decreases in the valuation of the GSE CRT debt host contracts exceeded the decreases in valuation of the hybrid financial instruments.

In the six months ended June 30, 2019, we recorded an increase of \$1.5 million in realized and unrealized credit derivative income (loss), net compared to the same periods in 2018 because the increases in the valuation of the GSE CRT debt host contracts exceeded the increases in valuation of the hybrid financial instruments.

## Net Loss on Extinguishment of Debt

We fully retired our Exchangeable Senior Notes upon their maturity on March 15, 2018 and recognized a net loss on extinguishment of debt of \$26,000.

## Other Investment Income (Loss), net

Our other investment income (loss), net during the three and six months ended June 30, 2019 consists of quarterly dividends from FHLBI stock. Our other investment income (loss), net during the three and six months ended June 30, 2018 consisted of (i) quarterly dividends from FHLBI stock and an investment in an exchange-traded fund, and (ii) foreign exchange rate gains and losses related to a commercial loan investment denominated in a foreign currency. The table below summarizes the components of other investment income (loss), net for the three and six months ended June 30, 2019 and 2018.

| \$ in thousands                                   | Three Months Ended June 30, |         | Six Months Ended June 30, |         |
|---------------------------------------------------|-----------------------------|---------|---------------------------|---------|
|                                                   | 2019                        | 2018    | 2019                      | 2018    |
| Dividend income                                   | 1,007                       | 806     | 2,036                     | 2,094   |
| Gain (loss) on foreign currency transactions, net | —                           | (2,966) | —                         | (1,152) |
| Total                                             | 1,007                       | (2,160) | 2,036                     | 942     |

We are required to purchase and hold a certain amount of FHLBI stock, which is based, in part, upon the outstanding principal balance of secured advances from the FHLBI. We earn dividend income on our investment in FHLBI stock, and the amount of our dividend income varies based upon the number of shares that we are required to own and the dividend declared per share.

We incurred foreign exchange gains on the revaluation of a commercial loan investment (notional amount of £34.5 million) for the three and six months ended June 30, 2018 due to the fluctuation in the Pound Sterling/ U.S. Dollar foreign exchange rate. The loan was repaid in the third quarter of 2018. We enter into currency forward contracts as an economic hedge against our foreign currency exposure. Changes in the fair value of our currency forward contracts are recognized in gain (loss) derivative instruments, net in the condensed consolidated statements of operations. During the three and six months ended June 30, 2018, we recognized net gains of \$4.8 million and \$2.5 million, respectively, on our currency forward contracts.

## Expenses

We incurred management fees of \$9.4 million (June 30, 2018: \$10.1 million) for the three months ended June 30, 2019 and \$18.9 million (June 30, 2018: \$20.3 million) for the six months ended June 30, 2019. Management fees decreased for the three and six months ended June 30, 2019 compared to the same period in 2018 due to a lower shareholders' equity management fee base in 2019. Refer to Note 11 – "Related Party Transactions" of our condensed consolidated financial statements for a discussion of our relationship with our Manager and a description of how our fees are calculated.

Our general and administrative expenses not covered under our management agreement amounted to \$2.0 million (June 30, 2018: \$1.5 million) for the three months ended June 30, 2019 and \$4.3 million (June 30, 2018: \$3.3 million) for the six months ended June 30, 2019. General and administrative expenses not covered under our management agreement primarily consist of directors and officers insurance, legal costs, accounting, auditing and tax services, filing fees, and miscellaneous general and administrative costs. General and administrative costs were higher for the three and six months ended June 30, 2019 compared to the same period in 2018 primarily due to higher fees for derivative transactions in 2019 and the write-off of previously deferred costs associated with the Company's at-the-market program in the first quarter of 2019.

### **Net Income (Loss) attributable to Common Stockholders**

For the three months ended June 30, 2019, our net income attributable to common stockholders was \$7.2 million (June 30, 2018: \$80.0 million net income attributable to common stockholders) or \$0.06 basic and diluted net income per average share available to common stockholders (June 30, 2018: \$0.72 basic and diluted net income per average share available to common stockholders). The change in net income attributable to common stockholders was primarily due to (i) a net gain on investments of \$302.2 million in the 2019 period compared to a net loss on investments of \$36.4 million in the 2018 period, (ii) a net loss on derivative instruments of \$344.7 million in the 2019 period compared to a net gain on derivative instruments of \$67.2 million in the 2018 period, (iii) credit derivative net loss of \$2.4 million in the 2019 period compared to credit derivative net income of \$735,000 in the 2018 period and (iv) a \$754,000 decrease in net interest income.

For the six months ended June 30, 2019 our net income attributable to common stockholders was \$134.9 million (June 30, 2018: \$121.5 million net income) or \$1.08 basic and \$1.08 diluted net income per average share available to common stockholders (June 30, 2018: \$1.09 basic and \$1.08 diluted net income per average share available to common stockholders). The change in net income attributable to common stockholders was primarily due to (i) a net gain on investments of \$570.6 million in the 2019 period compared to a net loss on investments of \$196.7 million in the 2018 period, (ii) a net loss on derivative instruments of \$546.2 million in the 2019 period compared to a net gain on derivative instruments of \$200.5 million in the 2018 period, (iii) credit derivative net income of \$5.4 million in the 2019 period compared to credit derivative net income of \$3.9 million in the 2018 period and (iv) a \$11.8 million decrease in net interest income.

For further information on the changes in net gain (loss) on investments, net gains (loss) on derivative instruments, realized and unrealized credit derivative income (loss), net and net interest income, see preceding discussion under "Gain (Loss) on Investments, net," "Gain (Loss) on Derivative Instruments, net," "Realized and Unrealized Credit Derivative Income (Loss), net," and "Net Interest Income."

### **Non-GAAP Financial Measures**

We use the following non-GAAP financial measures to analyze the Company's operating results and believe these financial measures are useful to investors in assessing our performance as further discussed below:

- core earnings (and by calculation, core earnings per common share),
- effective interest income (and by calculation, effective yield),
- effective interest expense (and by calculation, effective cost of funds),
- effective net interest income (and by calculation, effective interest rate margin), and
- repurchase agreement debt-to-equity ratio.

The most directly comparable U.S. GAAP measures are:

- net income (loss) attributable to common stockholders (and by calculation, basic earnings (loss) per common share),
- total interest income (and by calculation, earning asset yields),
- total interest expense (and by calculation, cost of funds),
- net interest income (and by calculation, net interest rate margin), and
- debt-to-equity ratio.

The non-GAAP financial measures used by management should be analyzed in conjunction with U.S. GAAP financial measures and should not be considered substitutes for U.S. GAAP financial measures. In addition, the non-GAAP financial measures may not be comparable to similarly titled non-GAAP financial measures of our peer companies.

### Core Earnings

We calculate core earnings as U.S. GAAP net income (loss) attributable to common stockholders adjusted for (gain) loss on investments, net; realized (gain) loss on derivative instruments, net; unrealized (gain) loss on derivative instruments, net; realized and unrealized (gain) loss on GSE CRT embedded derivatives, net; (gain) loss on foreign currency transactions, net; amortization of net deferred (gain) loss on de-designated interest rate swaps; net loss on extinguishment of debt; and cumulative adjustments attributable to non-controlling interest. We may add and have added additional reconciling items to our core earnings calculation as appropriate.

We believe the presentation of core earnings provides a consistent measure of operating performance by excluding the impact of gains and losses described above from operating results. We exclude the impact of gains and losses because gains and losses are not accounted for consistently under U.S. GAAP. Under U.S. GAAP, certain gains and losses are reflected in net income whereas other gains and losses are reflected in other comprehensive income. For example, a portion of our mortgage-backed securities are classified as available-for-sale securities, and we record changes in the valuation of these securities in other comprehensive income on our condensed consolidated balance sheets. We elected the fair value option for our mortgage-backed securities purchased on or after September 1, 2016, and changes in the valuation of these securities are recorded in other income (loss) in our condensed consolidated statements of operations. In addition, certain gains and losses represent one-time events.

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

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

| \$ in thousands, except per share data                                                       | Three Months Ended June 30, |          | Six Months Ended June 30, |           |
|----------------------------------------------------------------------------------------------|-----------------------------|----------|---------------------------|-----------|
|                                                                                              | 2019                        | 2018     | 2019                      | 2018      |
| Net income attributable to common stockholders                                               | 7,230                       | 80,008   | 134,913                   | 121,479   |
| Adjustments:                                                                                 |                             |          |                           |           |
| (Gain) loss on investments, net                                                              | (302,182)                   | 36,377   | (570,564)                 | 196,747   |
| Realized (gain) loss on derivative instruments, net <sup>(1)</sup>                           | 307,239                     | (36,274) | 539,626                   | (149,852) |
| Unrealized (gain) loss on derivative instruments, net <sup>(1)</sup>                         | 45,019                      | (35,406) | 18,601                    | (67,307)  |
| Realized and unrealized (gain) loss on GSE CRT embedded derivatives, net <sup>(2)</sup>      | 7,738                       | 4,903    | 5,204                     | 7,371     |
| (Gain) loss on foreign currency transactions, net <sup>(3)</sup>                             | —                           | 2,966    | —                         | 1,152     |
| Amortization of net deferred (gain) loss on de-designated interest rate swaps <sup>(4)</sup> | (5,916)                     | (6,898)  | (11,767)                  | (13,437)  |
| Net loss on extinguishment of debt                                                           | —                           | —        | —                         | 26        |
| Subtotal                                                                                     | 51,898                      | (34,332) | (18,900)                  | (25,300)  |
| Cumulative adjustments attributable to non-controlling interest                              | —                           | 432      | —                         | 318       |
| Core earnings attributable to common stockholders                                            | 59,128                      | 46,108   | 116,013                   | 96,497    |
| Basic income per common share                                                                | 0.06                        | 0.72     | 1.08                      | 1.09      |
| Core earnings per share attributable to common stockholders <sup>(5)</sup>                   | 0.46                        | 0.41     | 0.93                      | 0.86      |

- (1) U.S. GAAP gain (loss) on derivative instruments, net on the condensed consolidated statements of operations includes the following components:

| \$ in thousands                                                  | Three Months Ended June 30, |         | Six Months Ended June 30, |          |
|------------------------------------------------------------------|-----------------------------|---------|---------------------------|----------|
|                                                                  | 2019                        | 2018    | 2019                      | 2018     |
| Realized gain (loss) on derivative instruments, net              | (307,239)                   | 36,274  | (539,626)                 | 149,852  |
| Unrealized gain (loss) on derivative instruments, net            | (45,019)                    | 35,406  | (18,601)                  | 67,307   |
| Contractual net interest income (expense) on interest rate swaps | 7,525                       | (4,511) | 12,034                    | (16,623) |
| Gain (loss) on derivative instruments, net                       | (344,733)                   | 67,169  | (546,193)                 | 200,536  |

- (2) U.S. GAAP realized and unrealized credit derivative income (loss), net on the condensed consolidated statements of operations includes the following components:

| \$ in thousands                                                          | Three Months Ended June 30, |         | Six Months Ended June 30, |         |
|--------------------------------------------------------------------------|-----------------------------|---------|---------------------------|---------|
|                                                                          | 2019                        | 2018    | 2019                      | 2018    |
| Realized and unrealized gain (loss) on GSE CRT embedded derivatives, net | (7,738)                     | (4,903) | (5,204)                   | (7,371) |
| GSE CRT embedded derivative coupon interest                              | 5,300                       | 5,638   | 10,650                    | 11,271  |
| Realized and unrealized credit derivative income (loss), net             | (2,438)                     | 735     | 5,446                     | 3,900   |

- (3) U.S. GAAP other investment income (loss) net on the condensed consolidated statements of operations includes the following components:

| \$ in thousands                                   | Three Months Ended June 30, |         | Six Months Ended June 30, |         |
|---------------------------------------------------|-----------------------------|---------|---------------------------|---------|
|                                                   | 2019                        | 2018    | 2019                      | 2018    |
| Dividend income                                   | 1,007                       | 806     | 2,036                     | 2,094   |
| Gain (loss) on foreign currency transactions, net | —                           | (2,966) | —                         | (1,152) |
| Other investment income (loss), net               | 1,007                       | (2,160) | 2,036                     | 942     |

- (4) U.S. GAAP repurchase agreements interest expense on the condensed consolidated statements of operations includes the following components:

| \$ in thousands                                                               | Three Months Ended June 30, |         | Six Months Ended June 30, |          |
|-------------------------------------------------------------------------------|-----------------------------|---------|---------------------------|----------|
|                                                                               | 2019                        | 2018    | 2019                      | 2018     |
| Interest expense on repurchase agreements borrowings                          | 123,894                     | 76,287  | 231,620                   | 142,411  |
| Amortization of net deferred (gain) loss on de-designated interest rate swaps | (5,916)                     | (6,898) | (11,767)                  | (13,437) |
| Repurchase agreements interest expense                                        | 117,978                     | 69,389  | 219,853                   | 128,974  |

- (5) Core earnings per share attributable to common stockholders is equal to core earnings divided by the basic weighted average number of common shares outstanding.

The components of core income for the three and six months ended June 30, 2019 are:

| \$ in thousands                                        | Three Months Ended June 30, |          | Six Months Ended June 30, |          |
|--------------------------------------------------------|-----------------------------|----------|---------------------------|----------|
|                                                        | 2019                        | 2018     | 2019                      | 2018     |
| Effective net interest income <sup>(1)</sup>           | 79,894                      | 67,968   | 157,957                   | 140,041  |
| Dividend income                                        | 1,007                       | 806      | 2,036                     | 2,094    |
| Equity in earnings (losses) of unconsolidated ventures | 702                         | 798      | 1,394                     | 1,694    |
| Total expenses                                         | (11,369)                    | (11,627) | (23,161)                  | (23,604) |
| Total core earnings                                    | 70,234                      | 57,945   | 138,226                   | 120,225  |
| Dividends to preferred stockholders                    | (11,106)                    | (11,106) | (22,213)                  | (22,213) |
| Core earnings attributable to non-controlling interest | —                           | (731)    | —                         | (1,515)  |
| Core earnings attributable to common stockholders      | 59,128                      | 46,108   | 116,013                   | 96,497   |

(1) See below for a reconciliation of net interest income to effective net interest income, a non-GAAP measure.

Core earnings increased \$13.0 million in the three months ended June 30, 2019 compared to the same period in 2018 primarily due to a \$11.9 million increase in effective net interest income. Core earnings increased \$19.5 million in the six months ended June 30, 2019 compared to the same period in 2018 primarily due to a \$17.9 million increase in effective net interest income.

See below for a discussion of the increase in effective net interest income in the three and six months ended June 30, 2019 compared to the same period in 2018.

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

We calculate effective interest income (and by calculation, effective yield) as U.S. GAAP total interest income adjusted for GSE CRT embedded derivative coupon interest that is recorded as realized and unrealized credit derivative income (loss), net. We include our GSE CRT embedded derivative coupon interest in effective interest income because GSE CRT coupon interest is not accounted for consistently under U.S. GAAP. We account for GSE CRTs purchased prior to August 24, 2015 as hybrid financial instruments, but we have elected the fair value option for GSE CRTs purchased on or after August 24, 2015. Under U.S. GAAP, coupon interest on GSE CRTs accounted for using the fair value option is recorded as interest income, whereas coupon interest on GSE CRTs accounted for as hybrid financial instruments is recorded as realized and unrealized credit derivative income (loss). We add back GSE CRT embedded derivative coupon interest to our total interest income because we consider GSE CRT embedded derivative coupon interest a current component of our total interest income irrespective of whether we elected the fair value option for the GSE CRT or accounted for the GSE CRT as a hybrid financial instrument.

We calculate effective interest expense (and by calculation, effective cost of funds) as U.S. GAAP total interest expense adjusted for contractual net interest income (expense) on our interest rate swaps that is recorded as gain (loss) on derivative instruments, net and the amortization of net deferred gains (losses) on de-designated interest rate swaps that is recorded as repurchase agreements interest expense. We view our interest rate swaps as an economic hedge against increases in future market interest rates on our floating rate borrowings. We add back the net payments we make on our interest rate swap agreements to our total U.S. GAAP interest expense because we use interest rate swaps to add stability to interest expense. We exclude the amortization of net deferred gains (losses) on de-designated interest rate swaps from our calculation of effective interest expense because we do not consider the amortization a current component of our borrowing costs.

We calculate effective net interest income (and by calculation, effective interest rate margin) as U.S. GAAP net interest income adjusted for net interest income (expense) on our interest rate swaps that is recorded as gain (loss) on derivative instruments, amortization of net deferred gains (losses) on de-designated interest rate swaps that is recorded as repurchase agreements interest expense and GSE CRT embedded derivative coupon interest that is recorded as realized and unrealized credit derivative income (loss), net.

We believe the presentation of effective interest income, effective yield, effective interest expense, effective cost of funds, effective net interest income and effective interest rate margin measures, when considered together with U.S. GAAP financial measures, provide information that is useful to investors in understanding our borrowing costs and operating performance.

[Table of Contents](#)

The following tables reconcile total interest income to effective interest income and yield to effective yield for the following periods:

| \$ in thousands                                                                                                           | Three Months Ended June 30, |                       |                |                       |
|---------------------------------------------------------------------------------------------------------------------------|-----------------------------|-----------------------|----------------|-----------------------|
|                                                                                                                           | 2019                        |                       | 2018           |                       |
|                                                                                                                           | Reconciliation              | Yield/Effective Yield | Reconciliation | Yield/Effective Yield |
| Total interest income                                                                                                     | 202,221                     | 3.89%                 | 151,599        | 3.42%                 |
| Add: GSE CRT embedded derivative coupon interest recorded as realized and unrealized credit derivative income (loss), net | 5,300                       | 0.10%                 | 5,638          | 0.13%                 |
| Effective interest income                                                                                                 | 207,521                     | 3.99%                 | 157,237        | 3.55%                 |

  

| \$ in thousands                                                                                                           | Six Months Ended June 30, |                       |                |                       |
|---------------------------------------------------------------------------------------------------------------------------|---------------------------|-----------------------|----------------|-----------------------|
|                                                                                                                           | 2019                      |                       | 2018           |                       |
|                                                                                                                           | Reconciliation            | Yield/Effective Yield | Reconciliation | Yield/Effective Yield |
| Total interest income                                                                                                     | 389,295                   | 3.90%                 | 304,824        | 3.40%                 |
| Add: GSE CRT embedded derivative coupon interest recorded as realized and unrealized credit derivative income (loss), net | 10,650                    | 0.10%                 | 11,270         | 0.13%                 |
| Effective interest income                                                                                                 | 399,945                   | 4.00%                 | 316,094        | 3.53%                 |

Our effective interest income increased in the three and six months ended June 30, 2019 versus the same periods in 2018 primarily due to higher average earning assets and higher effective yield. Our average earning assets increased to \$20.8 billion and \$20.0 billion for the three and six months ended June 30, 2019, respectively, from \$17.7 billion and \$17.9 billion for the same periods in 2018 primarily because we invested and leveraged \$266.7 million in net proceeds from 2019 common stock issuances and \$168.2 million in proceeds from commercial loan repayments over the last eighteen months primarily into newly issued 30 year fixed-rate Agency RMBS and Agency CMBS securities. The increase in effective yield for the three and six months ended June 30, 2019 compared to the same period in 2018 was primarily due to the purchase of new securities at higher yields and higher index rates on floating and adjustable rate assets.

The following tables reconcile total interest expense to effective interest expense and cost of funds to effective cost of funds for the following periods.

| \$ in thousands                                                                                                                     | Three Months Ended June 30, |                                         |                |                                         |
|-------------------------------------------------------------------------------------------------------------------------------------|-----------------------------|-----------------------------------------|----------------|-----------------------------------------|
|                                                                                                                                     | 2019                        |                                         | 2018           |                                         |
|                                                                                                                                     | Reconciliation              | Cost of Funds / Effective Cost of Funds | Reconciliation | Cost of Funds / Effective Cost of Funds |
| Total interest expense                                                                                                              | 129,236                     | 2.73 %                                  | 77,860         | 2.04%                                   |
| Add (Less): Amortization of net deferred gain (loss) on de-designated interest rate swaps                                           | 5,916                       | 0.13 %                                  | 6,898          | 0.18%                                   |
| Add (Less): Contractual net interest expense (income) on interest rate swaps recorded as gain (loss) on derivative instruments, net | (7,525)                     | (0.16)%                                 | 4,511          | 0.12%                                   |
| Effective interest expense                                                                                                          | 127,627                     | 2.70 %                                  | 89,269         | 2.34%                                   |

| \$ in thousands                                                                                                                     | Six Months Ended June 30, |                                               |                |                                               |
|-------------------------------------------------------------------------------------------------------------------------------------|---------------------------|-----------------------------------------------|----------------|-----------------------------------------------|
|                                                                                                                                     | 2019                      |                                               | 2018           |                                               |
|                                                                                                                                     | Reconciliation            | Cost of Funds /<br>Effective Cost of<br>Funds | Reconciliation | Cost of Funds /<br>Effective Cost of<br>Funds |
| Total interest expense                                                                                                              | 242,255                   | 2.69 %                                        | 145,993        | 1.89%                                         |
| Add (Less): Amortization of net deferred gain (loss) on de-designated interest rate swaps                                           | 11,767                    | 0.13 %                                        | 13,437         | 0.17%                                         |
| Add (less): Contractual net interest expense (income) on interest rate swaps recorded as gain (loss) on derivative instruments, net | (12,034)                  | (0.13)%                                       | 16,624         | 0.22%                                         |
| Effective interest expense                                                                                                          | 241,988                   | 2.69 %                                        | 176,054        | 2.28%                                         |

Our effective interest expense and effective cost of funds increased during the three and six months ended June 30, 2019 compared to the same period in 2018 primarily due to increased borrowings and increases in the federal funds rate over the last twelve months. See the preceding caption "Interest Expense and Cost of Funds" for further discussion of these variances.

The following tables reconcile net interest income to effective net interest income and net interest rate margin to effective interest rate margin for the following periods.

| \$ in thousands                                                                                                                     | Three Months Ended June 30, |                                                                 |                |                                                                 |
|-------------------------------------------------------------------------------------------------------------------------------------|-----------------------------|-----------------------------------------------------------------|----------------|-----------------------------------------------------------------|
|                                                                                                                                     | 2019                        |                                                                 | 2018           |                                                                 |
|                                                                                                                                     | Reconciliation              | Net Interest Rate<br>Margin / Effective<br>Interest Rate Margin | Reconciliation | Net Interest Rate<br>Margin / Effective<br>Interest Rate Margin |
| Net interest income                                                                                                                 | 72,985                      | 1.16 %                                                          | 73,739         | 1.38 %                                                          |
| Add (Less): Amortization of net deferred (gain) loss on de-designated interest rate swaps                                           | (5,916)                     | (0.13)%                                                         | (6,898)        | (0.18)%                                                         |
| Add: GSE CRT embedded derivative coupon interest recorded as realized and unrealized credit derivative income (loss), net           | 5,300                       | 0.10 %                                                          | 5,638          | 0.13 %                                                          |
| Add (Less): Contractual net interest income (expense) on interest rate swaps recorded as gain (loss) on derivative instruments, net | 7,525                       | 0.16 %                                                          | (4,511)        | (0.12)%                                                         |
| Effective net interest income                                                                                                       | 79,894                      | 1.29 %                                                          | 67,968         | 1.21 %                                                          |

| \$ in thousands                                                                                                                     | Six Months Ended June 30, |                                                                 |                |                                                                 |
|-------------------------------------------------------------------------------------------------------------------------------------|---------------------------|-----------------------------------------------------------------|----------------|-----------------------------------------------------------------|
|                                                                                                                                     | 2019                      |                                                                 | 2018           |                                                                 |
|                                                                                                                                     | Reconciliation            | Net Interest Rate<br>Margin / Effective<br>Interest Rate Margin | Reconciliation | Net Interest Rate<br>Margin / Effective<br>Interest Rate Margin |
| Net interest income                                                                                                                 | 147,040                   | 1.21 %                                                          | 158,831        | 1.51 %                                                          |
| Add (Less): Amortization of net deferred (gain) loss on de-designated interest rate swaps                                           | (11,767)                  | (0.13)%                                                         | (13,437)       | (0.17)%                                                         |
| Add: GSE CRT embedded derivative coupon interest recorded as realized and unrealized credit derivative income (loss), net           | 10,650                    | 0.10 %                                                          | 11,270         | 0.13 %                                                          |
| Add (Less): Contractual net interest income (expense) on interest rate swaps recorded as gain (loss) on derivative instruments, net | 12,034                    | 0.13 %                                                          | (16,623)       | (0.22)%                                                         |
| Effective net interest income                                                                                                       | 157,957                   | 1.31 %                                                          | 140,041        | 1.25 %                                                          |

Effective net interest income for the three and six months ended June 30, 2019 increased primarily due to earning contractual net interest income on interest rate swaps of \$7.5 million and \$12.0 million in the three and six months ended June 30, 2019, respectively, compared to incurring contractual net interest expense of \$4.5 million and \$16.6 million in the three and six months ended June 30, 2019 primarily as a result of higher LIBOR rates in 2019.

Effective interest rate margin increased for the three and six months ended June 30, 2019 compared to the same periods in 2018 primarily due to increases in the federal funds rate over the past twelve months that had a greater impact on our average earning asset yields than on our average cost of funds.

### Repurchase Agreement Debt-to-Equity Ratio

The tables below show the allocation of our equity to our target assets, our debt-to-equity ratio, and our repurchase agreement debt-to-equity ratio as of June 30, 2019 and December 31, 2018. Our debt-to-equity ratio is calculated in accordance with U.S. GAAP and is the ratio of total debt (sum of repurchase agreements and secured loans) to total equity. We present a repurchase agreement debt-to-equity ratio, a non-GAAP financial measure of leverage, because the mortgage REIT industry primarily uses repurchase agreements, which typically mature within one year, to finance investments. We believe that presenting our repurchase agreement debt-to-equity ratio, when considered together with our U.S. GAAP financial measure of debt-to-equity ratio, provides information that is useful to investors in understanding our refinancing risks, and gives investors a comparable statistic to those other mortgage REITs who almost exclusively borrow using short-term repurchase agreements that are subject to refinancing risk.

#### June 30, 2019

| \$ in thousands                                                     | Agency RMBS | Agency CMBS | Commercial Credit <sup>(1)</sup> | Residential Credit <sup>(2)</sup> | Total       |
|---------------------------------------------------------------------|-------------|-------------|----------------------------------|-----------------------------------|-------------|
| Mortgage-backed and credit risk transfer securities                 | 12,935,301  | 2,926,243   | 3,651,586                        | 2,022,917                         | 21,536,047  |
| Cash and cash equivalents <sup>(3)</sup>                            | 44,940      | 9,724       | 31,996                           | 12,960                            | 99,620      |
| Restricted cash <sup>(4)</sup>                                      | 45,074      | 10,197      | —                                | —                                 | 55,271      |
| Derivative assets, at fair value <sup>(4)</sup>                     | 8,207       | 1,857       | 3                                | —                                 | 10,067      |
| Other assets                                                        | 91,609      | 77,742      | 113,682                          | 54,040                            | 337,073     |
| Total assets                                                        | 13,125,131  | 3,025,763   | 3,797,267                        | 2,089,917                         | 22,038,078  |
| Repurchase agreements                                               | 11,234,043  | 2,299,766   | 1,849,544                        | 1,691,712                         | 17,075,065  |
| Secured loans <sup>(5)</sup>                                        | 580,915     | —           | 1,069,085                        | —                                 | 1,650,000   |
| Derivative liabilities, at fair value <sup>(4)</sup>                | 29,904      | 6,765       | 300                              | —                                 | 36,969      |
| Other liabilities                                                   | 86,687      | 464,263     | 42,437                           | 12,556                            | 605,943     |
| Total liabilities                                                   | 11,931,549  | 2,770,794   | 2,961,366                        | 1,704,268                         | 19,367,977  |
| Total equity (allocated)                                            | 1,193,582   | 254,969     | 835,901                          | 385,649                           | 2,670,101   |
| Adjustments to calculate repurchase agreement debt-to-equity ratio: |             |             |                                  |                                   |             |
| Net equity in unsecured assets <sup>(6)</sup>                       | —           | —           | (49,996)                         | —                                 | (49,996)    |
| Collateral pledged against secured loans                            | (688,520)   | —           | (1,267,117)                      | —                                 | (1,955,637) |
| Secured loans                                                       | 580,915     | —           | 1,069,085                        | —                                 | 1,650,000   |
| Equity related to repurchase agreement debt                         | 1,085,977   | 254,969     | 587,873                          | 385,649                           | 2,314,468   |
| Debt-to-equity ratio <sup>(7)</sup>                                 | 9.9         | 9.0         | 3.5                              | 4.4                               | 7.0         |
| Repurchase agreement debt-to-equity ratio <sup>(8)</sup>            | 10.3        | 9.0         | 3.1                              | 4.4                               | 7.4         |

(1) Investments in non-Agency CMBS, commercial loans and investments in unconsolidated joint ventures are included in commercial credit.

(2) Investments in non-Agency RMBS, GSE CRT and a loan participation interest are included in residential credit.

(3) Cash and cash equivalents are allocated based on a percentage of equity for each asset class.

(4) Restricted cash, derivative assets and derivative liabilities are allocated based on the hedging strategy for each asset class.

(5) Secured loans are allocated based on amount of collateral pledged.

(6) Net equity in unsecured assets includes commercial loans, investments in unconsolidated joint ventures and other.

(7) Debt-to-equity ratio is calculated as the ratio of total debt (sum of repurchase agreements and secured loans) to total equity.

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

December 31, 2018

| \$ in thousands                                                     | Agency RMBS       | Agency CMBS      | Commercial Credit <sup>(1)</sup> | Residential Credit <sup>(2)</sup> | Total             |
|---------------------------------------------------------------------|-------------------|------------------|----------------------------------|-----------------------------------|-------------------|
| Mortgage-backed and credit risk transfer securities                 | 11,124,663        | 1,002,510        | 3,286,459                        | 1,983,010                         | 17,396,642        |
| Cash and cash equivalents <sup>(3)</sup>                            | 64,908            | 3,781            | 45,632                           | 21,296                            | 135,617           |
| Derivative assets, at fair value <sup>(4)</sup>                     | 13,842            | 1,247            | —                                | —                                 | 15,089            |
| Other assets                                                        | 84,452            | 4,065            | 115,908                          | 61,732                            | 266,157           |
| <b>Total assets</b>                                                 | <b>11,287,865</b> | <b>1,011,603</b> | <b>3,447,999</b>                 | <b>2,066,038</b>                  | <b>17,813,505</b> |
| Repurchase agreements                                               | 9,529,352         | 810,450          | 1,616,473                        | 1,646,209                         | 13,602,484        |
| Secured loans <sup>(5)</sup>                                        | 600,856           | —                | 1,049,144                        | —                                 | 1,650,000         |
| Derivative liabilities, at fair value <sup>(4)</sup>                | 21,300            | 1,919            | 171                              | —                                 | 23,390            |
| Other liabilities                                                   | 74,162            | 137,895          | 25,819                           | 13,058                            | 250,934           |
| <b>Total liabilities</b>                                            | <b>10,225,670</b> | <b>950,264</b>   | <b>2,691,607</b>                 | <b>1,659,267</b>                  | <b>15,526,808</b> |
| <b>Total equity (allocated)</b>                                     | <b>1,062,195</b>  | <b>61,339</b>    | <b>756,392</b>                   | <b>406,771</b>                    | <b>2,286,697</b>  |
| Adjustments to calculate repurchase agreement debt-to-equity ratio: |                   |                  |                                  |                                   |                   |
| Net equity in unsecured assets <sup>(6)</sup>                       | —                 | —                | (55,594)                         | —                                 | (55,594)          |
| Collateral pledged against secured loans                            | (702,952)         | —                | (1,227,412)                      | —                                 | (1,930,364)       |
| Secured loans                                                       | 600,856           | —                | 1,049,144                        | —                                 | 1,650,000         |
| Equity related to repurchase agreement debt                         | 960,099           | 61,339           | 522,530                          | 406,771                           | 1,950,739         |
| Debt-to-equity ratio <sup>(7)</sup>                                 | 9.5               | 13.2             | 3.5                              | 4.0                               | 6.7               |
| Repurchase agreement debt-to-equity ratio <sup>(8)</sup>            | 9.9               | 13.2             | 3.1                              | 4.0                               | 7.0               |

(1) Investments in non-Agency CMBS, commercial loans and investments in unconsolidated joint ventures are included in commercial credit.

(2) Investments in non-Agency RMBS and GSE CRT are included in residential credit.

(3) Cash and cash equivalents are allocated based on a percentage of equity for each asset class.

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

(5) Secured loans are allocated based on amount of collateral pledged.

(6) Net equity in unsecured assets includes commercial loans, investments in unconsolidated joint ventures and other.

(7) Debt-to-equity ratio is calculated as the ratio of total debt (sum of repurchase agreements and secured loans) to total equity.

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

## Liquidity and Capital Resources

Liquidity is a measurement of our ability to meet potential cash requirements, including ongoing commitments to pay dividends, fund investments, repayment of borrowings and other general business needs. Our primary sources of funds for liquidity consist of the net proceeds from our common and preferred equity offerings, net cash provided by operating activities, proceeds from repurchase agreements and other financing arrangements and future issuances of equity and/or debt securities.

We currently believe that we have sufficient liquidity and capital resources available for the acquisition of additional investments, repayments on borrowings, margin requirements and the payment of cash dividends as required for continued qualification as a REIT. We generally maintain liquidity to pay down borrowings under repurchase arrangements to reduce borrowing costs and otherwise efficiently manage our long-term investment capital. Because the level of these borrowings can be adjusted on a daily basis, the level of cash and cash equivalents carried on our condensed consolidated balance sheets is significantly less important than our potential liquidity available under borrowing arrangements. However, there can be no assurance that we will maintain sufficient levels of liquidity to meet any margin calls.

We held cash, cash equivalents and restricted cash of \$154.9 million at June 30, 2019 (June 30, 2018: \$70.3 million). Our cash, cash equivalents and restricted cash increased due to normal fluctuations in cash balances related to the timing of

principal and interest payments, repayments of debt, and asset purchases and sales. Our operating activities provided net cash of \$157.0 million for the six months ended June 30, 2019 (June 30, 2018: \$147.8 million).

Our investing activities used net cash of \$3.7 billion in the six months ended June 30, 2019 compared to net cash provided by investing activities of \$472.6 million in the six months ended June 30, 2018. We invested \$5.6 billion in mortgage-backed and credit risk transfer securities during the six months ended June 30, 2019 compared to investments of \$1.2 billion in mortgage-backed and credit risk transfer securities in the six months ended June 30, 2018. We generated \$760.6 million from principal payments of mortgage-backed and credit risk transfer securities during the six months ended June 30, 2019 (June 30, 2018: \$1.1 billion) and \$1.7 billion (June 30, 2018: \$387.7 million) from sales of mortgage-backed and credit risk transfer securities. We used cash of \$539.6 million to settle derivative contracts in the six months ended June 30, 2019 compared to cash provided on settlement of derivative contracts of \$149.9 million in the six months ended June 30, 2018. We also generated \$7.3 million in proceeds from commercial loan repayments in the six months ended June 30, 2019 (June 30, 2018: \$64.8 million).

Our financing activities provided net cash of \$3.6 billion for the six months ended June 30, 2019 compared to net cash used by financing activities of \$639.2 million in the six months ended June 30, 2018. Proceeds from issuance of common stock provided \$266.9 million for the six months ended June 30, 2019. Repurchase agreement borrowings provided net proceeds of \$3.5 billion (June 30, 2018: net use of \$378.4 million). We used cash of \$143.4 million to retire our exchangeable senior notes in the six months ended June 30, 2018. We also used cash of \$126.8 million for the six months ended June 30, 2019 (June 30, 2018: \$117.2 million) to pay dividends.

As of June 30, 2019, our wholly-owned subsidiary, IAS Services, had \$1.65 billion in outstanding secured loans from the FHLBI. The FHLBI secured loans were collateralized by non-Agency CMBS and Agency RMBS with a fair value of \$1.3 billion and \$688.5 million, respectively.

As of June 30, 2019, the average margin requirement (weighted by borrowing amount), or the percentage amount by which the collateral value must exceed the loan amount (also refer to as the "haircut") under our repurchase agreements was 5.0% for Agency RMBS, 5.2% for Agency CMBS, 17.8% for non-Agency RMBS, 18.3% for GSE CRT and 19.9% for non-Agency CMBS. Across our repurchase agreement facilities, the haircuts range from a low of 3.0% to a high of 20.0% for Agency RMBS, a low of 5.0% to a high of 10.0% for Agency CMBS, a low of 10.0% to a high of 35.0% for non-Agency RMBS, a low of 14.5% to a high of 25.0% for GSE CRT, a low of 10.0% to a high of 30.0% for non-Agency CMBS. Declines in the value of our securities portfolio can trigger margin calls by our lenders under our repurchase agreements. An event of default or termination event would give some of our counterparties the option to terminate all repurchase transactions existing with us and require any amount due by us to the counterparties to be payable immediately.

#### *Effects of Margin Requirements, Leverage and Credit Spreads*

Our securities have values that fluctuate according to market conditions and, as discussed above, the market value of our securities will decrease as prevailing interest rates or credit spreads increase. When the value of the securities pledged to secure a repurchase loan or a secured loan decreases to the point where the positive difference between the collateral value and the loan amount is less than the haircut, our lenders may issue a margin call, which means that the lender will require us to pay the margin call in cash or pledge additional collateral to meet that margin call. Under our repurchase facilities and secured loans, our lenders have full discretion to determine the value of the securities we pledge to them. Most of our lenders will value securities based on recent trades in the market. Lenders also issue margin calls as the published current principal balance factors change on the pool of mortgages underlying the securities pledged as collateral when scheduled and unscheduled paydowns are announced monthly.

We experience margin calls and increased collateral requirements in the ordinary course of our business. In seeking to effectively manage the margin requirements established by our lenders, we maintain a position of cash and unpledged securities. We refer to this position as our liquidity. The level of liquidity we have available to meet margin calls is directly affected by our leverage levels, our haircuts and the price changes on our securities. If interest rates increase as a result of a yield curve shift or for another reason or if credit spreads widen, then the prices of our collateral (and our unpledged assets that constitute our liquidity) will decline, we will experience margin calls, and we will use our liquidity to meet the margin calls. There can be no assurance that we will maintain sufficient levels of liquidity to meet any margin calls or increased collateral requirements. If our haircuts increase, our liquidity will proportionately decrease. In addition, if we increase our borrowings, our liquidity will decrease by the amount of additional haircut on the increased level of indebtedness.

We intend to maintain a level of liquidity in relation to our assets that enables us to meet reasonably anticipated margin calls and increased collateral requirements but that also allows us to be substantially invested in securities. We may misjudge the appropriate amount of our liquidity by maintaining excessive liquidity, which would lower our investment returns, or by maintaining insufficient liquidity, which would force us to liquidate assets into unfavorable market conditions and harm our results of operations and financial condition.

## [Table of Contents](#)

We are subject to financial covenants in connection with our lending, derivatives and other agreements we enter into in the normal course of our business. We intend to continue to operate in a manner which complies with all of our financial covenants. Our lending and derivative agreements provide that we may be declared in default of our obligations if our leverage ratio exceeds certain thresholds and we fail to maintain stockholders' equity or market value above certain thresholds over specified time periods.

### *Forward-Looking Statements Regarding Liquidity*

Based upon our current portfolio, leverage rate and available borrowing arrangements, we believe that cash flow from operations and available borrowing capacity will be sufficient to enable us to meet anticipated short-term (one year or less) liquidity requirements to fund our investment activities, pay fees under our management agreement, fund our distributions to stockholders and for other general corporate expenses.

Our ability to meet our long-term (greater than one year) liquidity and capital resource requirements will be subject to obtaining additional debt financing. We may increase our capital resources by obtaining long-term credit facilities or through public or private offerings of equity or debt securities, possibly including classes of preferred stock, common stock, and senior or subordinated notes. Such financing will depend on market conditions for capital raises and our ability to invest such offering proceeds. If we are unable to renew, replace or expand our sources of financing on substantially similar terms, it may have an adverse effect on our business and results of operations.

### **Contractual Obligations**

We have entered into an agreement with our Manager pursuant to which our Manager is entitled to receive a management fee and the reimbursement of certain expenses. The management fee is calculated and payable quarterly in arrears in an amount equal to 1.50% of our stockholders' equity, per annum. Refer to Note 11 - "Related Party Transactions" of our condensed consolidated financial statements for a description of adjustments made to our stockholders' equity for purposes of calculating our management fee. Our Manager uses the proceeds from its management fee in part to pay compensation to its officers and personnel who, notwithstanding that certain of those individuals are also our officers, receive no cash compensation directly from us. We are required to reimburse our Manager for operating expenses related to us incurred by our Manager, including certain salary expenses and other expenses relating to legal, accounting, due diligence and other services. Our reimbursement obligation is not subject to any dollar limitation. Refer to Note 11 - "Related Party Transactions" of our condensed consolidated financial statements for details of our reimbursements to our Manager.

As of June 30, 2019, we had the following contractual obligations:

| \$ in thousands       | Payments Due by Period |                  |           |           |               |
|-----------------------|------------------------|------------------|-----------|-----------|---------------|
|                       | Total                  | Less than 1 year | 1-3 years | 3-5 years | After 5 years |
| Repurchase agreements | 17,075,065             | 17,039,152       | 35,913    | —         | —             |
| Secured loans         | 1,650,000              | 300,000          | 100,000   | —         | 1,250,000     |
| Total <sup>(1)</sup>  | 18,725,065             | 17,339,152       | 135,913   | —         | 1,250,000     |

(1) Excluded from total contractual obligations are the amounts due to our Manager under the management agreement, as those obligations do not have fixed and determinable payments.

As of June 30, 2019, we have approximately \$105.3 million and \$213.2 million in contractual interest payments related to our repurchase agreements and secured loans, respectively.

### **Off-Balance Sheet Arrangements**

We have committed to invest up to \$122.6 million in unconsolidated ventures that are sponsored by an affiliate of our Manager. As of June 30, 2019, \$116.1 million of our commitment to these unconsolidated ventures has been called. We are committed to fund \$6.5 million in additional capital to fund future investments and cover future expenses should they occur.

As of June 30, 2019, we have an unfunded commitment on a loan participation interest of \$27.1 million.

## Share-Based Compensation

We established the 2009 Equity Incentive Plan for grants of common stock and other equity based awards to our independent directors and officers and employees of our Manager and its affiliates (the "Incentive Plan"). The Incentive Plan was amended and restated as of May 3, 2019 to extend the term of the plan until 2029 and to reduce the number of shares of common stock available for issuance under the Incentive Plan to 200,000.

We recognized compensation expense of approximately \$112,000 (June 30, 2018: \$106,000) and approximately \$225,000 (June 30, 2018: \$199,000) for shares issued to our independent directors under our 2009 Equity Incentive Plan (the "Incentive Plan") for the three and six months ended June 30, 2019, respectively. During the three months ended June 30, 2019 and 2018, we issued 6,895 shares and 6,465 shares of common stock, respectively, to our independent directors. During the six months ended June 30, 2019 and 2018, we issued 13,960 and 13,642 shares of common stock, respectively, to our independent directors. The fair market value of the shares granted was determined by the closing stock market price on the date of the grant. The grants vested immediately.

We recognized compensation expense of approximately \$18,000 (June 30, 2018: \$30,000) and approximately \$37,000 (June 30, 2018: \$44,000) for the three and six months ended June 30, 2019, respectively, for restricted stock units awarded to employees of our Manager and its affiliates under the Incentive Plan. Our Manager reimburses us for the cost of these restricted stock awards under the terms of our management agreement. At June 30, 2019 there was approximately \$167,000 of total unrecognized compensation cost related to restricted stock unit awards that is expected to be recognized over a period of up to 45 months, with a weighted-average remaining vesting period of 21 months.

The following table summarizes the activity related to restricted stock units awarded to employees of our Manager and its affiliates for the three and six months ended June 30, 2019.

|                                         | Three Months Ended June 30, |                                                       | Six Months Ended June 30, |                                                       |
|-----------------------------------------|-----------------------------|-------------------------------------------------------|---------------------------|-------------------------------------------------------|
|                                         | 2019                        |                                                       | 2019                      |                                                       |
|                                         | Restricted Stock Units      | Weighted Average Grant Date Fair Value <sup>(1)</sup> | Restricted Stock Units    | Weighted Average Grant Date Fair Value <sup>(1)</sup> |
| Unvested at the beginning of the period | 12,520                      | \$ 15.25                                              | 11,051                    | \$ 14.55                                              |
| Shares granted during the period        | —                           | —                                                     | 6,189                     | 15.92                                                 |
| Shares vested during the period         | —                           | —                                                     | (4,720)                   | 14.48                                                 |
| Unvested at the end of the period       | 12,520                      | \$ 15.25                                              | 12,520                    | \$ 15.25                                              |

(1) The grant date fair value of restricted stock awards is based on the closing market price of our common stock at the grant date.

## Dividends

We intend to continue regular quarterly distributions to holders of our common stock and preferred stock. U.S. federal income tax law generally requires that a REIT distribute at least 90% of its REIT taxable income annually, determined without regard to the deduction for dividends paid and excluding net capital gains, and that it pay tax at regular corporate rates to the extent that it annually distributes less than 100% of its taxable income. Before we pay any dividend, whether for U.S. federal income tax purposes or otherwise, we must first meet both our operating requirements and debt service on our repurchase agreements and other debt payable. If our cash available for distribution is less than our taxable income, we could be required to sell assets or borrow funds to make cash distributions, or we may make a portion of the required distribution in the form of a taxable stock distribution or distribution of debt securities.

## Inflation

Virtually all of our assets and liabilities are sensitive to interest rates. As a result, interest rates and other factors influence our performance far more than inflation. Changes in interest rates do not necessarily correlate with inflation rates or changes in inflation rates.

## Unrelated Business Taxable Income

We have not engaged in transactions that would result in a portion of our income being treated as unrelated business taxable income.

## Exposure to Financial Counterparties

We finance a substantial portion of our investment portfolio through repurchase agreements. Under these agreements, we pledge assets from our investment portfolio as collateral. Additionally, certain counterparties may require us to provide cash collateral in the event the market value of the assets declines to maintain a contractual repurchase agreement collateral ratio. If a counterparty were to default on its obligations, we would be exposed to potential losses to the extent the fair value of collateral pledged by us to the counterparty including any accrued interest receivable on such collateral exceeded the amount loaned to us by the counterparty plus interest due to the counterparty.

We also use bilateral interest rate swaps to manage our interest rate risk. Under these agreements, we pledge assets from our investment portfolio and cash as collateral. If a counterparty were to default on its obligations, we would be exposed to potential losses to the extent the amount of securities or cash pledged exceeded the unrealized loss for the associated derivative, including the impact of any accrued interest due to or from the counterparty. Additionally if a derivative was in an unrealized gain position, we would be exposed to potential losses to the extent that the unrealized gain for the associated derivative exceeded the amount of collateral received, including the impact of any accrued interest due to or from the counterparty.

The following table summarizes our exposure to counterparties by geographic concentration as of June 30, 2019:

| \$ in thousands                   | Number of Counterparties | Repurchase Agreement Financing | Interest Rate Swaps at Fair Value | Exposure  |
|-----------------------------------|--------------------------|--------------------------------|-----------------------------------|-----------|
| North America                     | 17                       | 7,087,389                      | (4,396)                           | 804,393   |
| Europe (excluding United Kingdom) | 6                        | 2,783,677                      | —                                 | 397,977   |
| Asia                              | 5                        | 3,766,111                      | —                                 | 246,186   |
| United Kingdom                    | 4                        | 3,437,888                      | (32,273)                          | 193,442   |
| Total                             | 32                       | 17,075,065                     | (36,669)                          | 1,641,998 |

## Other Matters

We believe that we satisfied each of the asset tests in Section 856(c)(4) of the Internal Revenue Code of 1986, as amended (the "Code") for the period ended June 30, 2019, and that our proposed method of operation will permit us to satisfy the asset tests, gross income tests, and distribution and stock ownership requirements for our taxable year that will end on December 31, 2019.

At all times, we intend to conduct our business so that neither we nor our Operating Partnership nor the subsidiaries of our Operating Partnership are required to register as an investment company under the 1940 Act. If we were required to register as an investment company, then our use of leverage would be substantially reduced. Because we are a holding company that conducts our business through our Operating Partnership and the Operating Partnership's wholly-owned or majority-owned subsidiaries, the securities issued by these subsidiaries that are excepted from the definition of "investment company" under Section 3(c)(1) or Section 3(c)(7) of the 1940 Act, together with any other investment securities the Operating Partnership may own, may not have a combined value in excess of 40% of the value of the Operating Partnership's total assets (exclusive of U.S. government securities and cash items) on an unconsolidated basis, which we refer to as the 40% test. This requirement limits the types of businesses in which we are permitted to engage in through our subsidiaries. In addition, we believe neither we nor the Operating Partnership are considered an investment company under Section 3(a)(1)(A) of the 1940 Act because they do not engage primarily or hold themselves out as being engaged primarily in the business of investing, reinvesting or trading in securities. Rather, through the Operating Partnership's wholly-owned or majority-owned subsidiaries, we and the Operating Partnership are primarily engaged in the non-investment company businesses of these subsidiaries. IAS Asset I LLC and certain of the Operating Partnership's other subsidiaries that we may form in the future rely upon the exclusion from the definition of "investment company" under the 1940 Act provided by Section 3(c)(5)(C) of the 1940 Act, which is available for entities "primarily engaged in the business of purchasing or otherwise acquiring mortgages and other liens on and interests in real estate." This exclusion generally requires that at least 55% of each subsidiary's portfolio be comprised of qualifying assets and at least 80% be comprised of qualifying assets and real estate-related assets (and no more than 20% comprised of miscellaneous assets). We calculate that as of June 30, 2019, we conducted our business so as not to be regulated as an investment company under the 1940 Act.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.**

The primary components of our market risk are related to interest rate, principal prepayment and market value. While we do not seek to avoid risk completely, we believe the risk can be quantified from historical experience and we seek to actively manage that risk, to earn sufficient compensation to justify taking those risks and to maintain capital levels consistent with the risks we undertake.

**Interest Rate Risk**

Interest rate risk is highly sensitive to many factors, including governmental, monetary and tax policies, domestic and international economic and political considerations, and other factors beyond our control. We are subject to interest rate risk in connection with our investments and our repurchase agreements. Our repurchase agreements are typically of limited duration and will be periodically refinanced at current market rates. We mitigate this risk through utilization of derivative contracts, primarily interest rate swap agreements, TBAs and futures contracts.

**Interest Rate Effect on Net Interest Income**

Our operating results depend in large part upon differences between the yields earned on our investments and our cost of borrowing and interest rate hedging activities. Most of our repurchase agreements provide financing based on a floating rate of interest calculated on a fixed spread over LIBOR. The fixed spread will vary depending on the type of underlying asset which collateralizes the financing. Accordingly, the portion of our portfolio which consists of floating interest rate assets are match-funded utilizing our expected sources of short-term financing, while our fixed interest rate assets are not match-funded. During periods of rising interest rates, the borrowing costs associated with our investments tend to increase while the income earned on our fixed interest rate investments may remain substantially unchanged. This increase in borrowing costs results in the narrowing of the net interest spread between the related assets and borrowings and may even result in losses. Further, during this portion of the interest rate and credit cycles, defaults could increase and result in credit losses to us, which could adversely affect our liquidity and operating results. Such delinquencies or defaults could also have an adverse effect on the spread between interest-earning assets and interest-bearing liabilities.

Hedging techniques are partly based on assumed levels of prepayments of our RMBS. If prepayments are slower or faster than assumed, the life of the RMBS will be longer or shorter, which would reduce the effectiveness of any hedging strategies we may use and may cause losses on such transactions. Hedging strategies involving the use of derivative securities are highly complex and may produce volatile returns.

**Interest Rate Effects on Fair Value**

Another component of interest rate risk is the effect that changes in interest rates will have on the market value of the assets that we acquire. We face the risk that the market value of our assets will increase or decrease at different rates than those of our liabilities, including our hedging instruments.

We primarily assess our interest rate risk by estimating the duration of our assets and the duration of our liabilities. Duration measures the market price volatility of financial instruments as interest rates change. We generally calculate duration using various financial models and empirical data. Different models and methodologies can produce different duration numbers for the same securities.

The impact of changing interest rates on fair value can change significantly when interest rates change materially. Therefore, the volatility in the fair value of our assets could increase significantly in the event interest rates change materially. In addition, other factors impact the fair value of our interest rate-sensitive investments and hedging instruments, such as the shape of the yield curve, market expectations as to future interest rate changes and other market conditions. Accordingly, changes in actual interest rates may have a material adverse effect on us.

**Spread Risk**

We employ a variety of spread risk management techniques that seek to mitigate the influences of spread changes on our book value and our liquidity to help us achieve our investment objectives. We refer to the difference between interest rates on our investments and interest rates on risk free instruments as spreads. The yield on our investments changes over time due to the level of risk free interest rates, the creditworthiness of the security, and the price of the perceived risk. The change in the market yield of our interest rate hedges also changes primarily with the level of risk free interest rates. We manage spread risk through careful asset selection, sector allocation, regulating our portfolio value-at-risk, and maintaining adequate liquidity. Changes in spreads impact our book value and our liquidity and could cause us to sell assets and to change our investment strategy in order to maintain liquidity and preserve book value.

**Prepayment Risk**

As we receive prepayments of principal on our investments, premiums paid on these investments are amortized against interest income. In general, an increase in prepayment rates will accelerate the amortization of purchase premiums, thereby reducing the interest income earned on the investments. Conversely, discounts on such investments are accreted into interest income. In general, an increase in prepayment rates will accelerate the accretion of purchase discounts, thereby increasing the interest income earned on the investments.

**Extension Risk**

We compute the projected weighted average life of our investments based upon assumptions regarding the rate at which the borrowers will prepay the underlying mortgages. In general, when a fixed-rate or hybrid adjustable-rate security is acquired with borrowings, we may, but are not required to, enter into an interest rate swap agreement or other hedging instrument that effectively fixes our borrowing costs for a period close to the anticipated average life of the fixed-rate portion of the related assets. This strategy is designed to protect us from rising interest rates, because the borrowing costs are fixed for the duration of the fixed-rate portion of the related target asset.

However, if prepayment rates decrease in a rising interest rate environment, then the life of the fixed-rate portion of the related assets could extend beyond the term of the swap agreement or other hedging instrument. This could have a negative impact on our results from operations, as borrowing costs would no longer be fixed after the end of the hedging instrument, while the income earned on the hybrid adjustable-rate assets would remain fixed. This situation may also cause the market value of our hybrid adjustable-rate assets to decline, with little or no offsetting gain from the related hedging transactions. In extreme situations, we may be forced to sell assets to maintain adequate liquidity, which could cause us to incur losses.

**Market Risk***Market Value Risk*

Our available-for-sale securities are reflected at their estimated fair value with unrealized gains and losses excluded from earnings and reported in other comprehensive income pursuant to ASC Topic 320. The estimated fair value of these securities fluctuates primarily due to changes in interest rates and other factors. Generally, in a rising interest rate environment, the estimated fair value of these securities would be expected to decrease; conversely, in a decreasing interest rate environment, the estimated fair value of these securities would be expected to increase.

The sensitivity analysis table presented below shows the estimated impact of an instantaneous parallel shift in the yield curve, up and down 50 and 100 basis points, on the market value of our interest rate-sensitive investments and net interest income, including net interest paid or received under interest rate swaps, at June 30, 2019, assuming a static portfolio. When evaluating the impact of changes in interest rates, prepayment assumptions and principal reinvestment rates are adjusted based on our Manager's expectations. The analysis presented utilized assumptions, models and estimates of our Manager based on our Manager's judgment and experience.

| Change in Interest Rates | Percentage Change in Projected<br>Net Interest Income | Percentage Change in Projected<br>Portfolio Value |
|--------------------------|-------------------------------------------------------|---------------------------------------------------|
| +1.00%                   | (9.49)%                                               | (1.28)%                                           |
| +0.50%                   | (1.53)%                                               | (0.44)%                                           |
| -0.50%                   | (3.43)%                                               | (0.14)%                                           |
| -1.00%                   | (24.02)%                                              | (0.88)%                                           |

Certain assumptions have been made in connection with the calculation of the information set forth in the foregoing interest rate sensitivity table and, as such, there can be no assurance that assumed events will occur or that other events will not

occur that would affect the outcomes. The base interest rate scenario assumes interest rates at June 30, 2019. Furthermore, while we generally expect to retain such assets and the associated interest rate risk to maturity, future purchases and sales of assets could materially change our interest rate risk profile.

Given the low interest rates at June 30, 2019, we applied a floor of 0% for all anticipated interest rates included in our assumptions. Because of this floor, we anticipate that any hypothetical interest rate shock decrease would have a limited positive impact on our funding costs; however, because prepayment speeds are unaffected by this floor, we expect that any increase in our prepayment speeds (occurring as a result of any interest rate decrease or otherwise) could result in an acceleration of our premium amortization on securities purchased at a premium, and accretion of discount on our securities purchased at a discount. As a result, because this floor limits the positive impact of any interest rate decrease on our funding costs, hypothetical interest rate decreases could cause the fair value of our financial instruments and our net interest income to decline.

The information set forth in the interest rate sensitivity table above and all related disclosures constitutes forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act. Actual results could differ significantly from those estimated in the foregoing interest rate sensitivity table.

#### *Real Estate Risk*

Residential and commercial property values are subject to volatility and may be adversely affected by a number of factors, including, but not limited to: national, regional and local economic conditions (which may be adversely affected by industry slowdowns and other factors); local real estate conditions (such as the supply of housing stock); changes or continued weakness in specific industry segments; construction quality, age and design; demographic factors; and retroactive changes to building or similar codes. In addition, decreases in property values reduce the value of the collateral and the potential proceeds available to a borrower to repay our loans, which could also cause us to suffer losses.

#### **Credit Risk**

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

#### **Foreign Exchange Rate Risk**

We have an investment in a commercial loan denominated in foreign currency and an investment in an unconsolidated joint venture whose net assets and results of operations are exposed to foreign currency translation risk when translated in U.S. dollars upon consolidation. We seek to hedge our foreign currency exposures by purchasing currency forward contracts.

#### **Risk Management**

To the extent consistent with maintaining our REIT qualification, we seek to manage risk exposure to protect our investment portfolio against the effects of major interest rate changes. We generally seek to manage this risk by:

- monitoring and adjusting, if necessary, the reset index and interest rate related to our target assets and our financings;
- attempting to structure our financing agreements to have a range of different maturities, terms, amortizations and interest rate adjustment periods;
- using hedging instruments, primarily interest rate swap agreements but also financial futures, options, interest rate cap agreements, floors and forward sales to adjust the interest rate sensitivity of our target assets and our borrowings; and
- actively managing, on an aggregate basis, the interest rate indices, interest rate adjustment periods, and gross reset margins of our target assets and the interest rate indices and adjustment periods of our financings.

**ITEM 4. CONTROLS AND PROCEDURES.**

Our management is responsible for establishing and maintaining disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act.

We have evaluated, with the participation of our principal executive officer and principal financial officer, the effectiveness of our disclosure controls and procedures as of June 30, 2019. Based upon our evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the applicable rules and forms, and that it is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives.

**Changes in Internal Control over Financial Reporting**

There has been no change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act) during the quarter ended June 30, 2019 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## **PART II – OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS.**

From time to time, we may be involved in various claims and legal actions arising in the ordinary course of business. As of June 30, 2019, we were not involved in any such legal proceedings.

### **ITEM 1A. RISK FACTORS.**

There were no material changes during the period covered by this Report to the risk factors previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2018, as filed with the SEC on February 20, 2019. Additional risks not presently known, or that we currently deem immaterial, also may have a material adverse effect on our business, financial condition and results of operations.

### **ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.**

During the three months ended June 30, 2019, we did not repurchase any shares of our common stock.

### **ITEM 3. DEFAULTS UPON SENIOR SECURITIES.**

None.

### **ITEM 4. MINE SAFETY DISCLOSURES.**

Not applicable.

### **ITEM 5. OTHER INFORMATION.**

None.

### **ITEM 6. EXHIBITS.**

A list of exhibits to this Form 10-Q is set forth on the Exhibit Index and is incorporated herein by reference.

**SIGNATURES**

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

INVESCO MORTGAGE CAPITAL INC.

August 7, 2019 By: /s/ John M. Anzalone  
John M. Anzalone  
Chief Executive Officer

August 7, 2019 By: /s/ R. Lee Phegley, Jr.  
R. Lee Phegley, Jr.  
Chief Financial Officer

**EXHIBIT INDEX****Item 6. Exhibits**

| <b>Exhibit<br/>No.</b> | <b>Description</b>                                                                                                                                                                                                                                                                                                                                                                                                                               |
|------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 3.1                    | <a href="#">Articles of Amendment and Restatement of Invesco Mortgage Capital Inc. (incorporated by reference to Exhibit 3.1 to our Quarterly Report on Form 10-Q, filed with the Securities and Exchange Commission ("SEC") on August 12, 2009).</a>                                                                                                                                                                                            |
| 3.2                    | <a href="#">Articles Supplementary of 7.75% Series A Cumulative Redeemable Preferred Stock (incorporated by reference to Exhibit 3.3 to the Registrant's Registration Statement on Form 8-A, filed with the SEC on July 23, 2012).</a>                                                                                                                                                                                                           |
| 3.3                    | <a href="#">Articles Supplementary classifying 1,500,000 shares of the Company's preferred stock as additional Series A Shares (incorporated by reference to Exhibit 3.1 to the Current Report on Form 8-K, filed with the SEC on March 19, 2019).</a>                                                                                                                                                                                           |
| 3.4                    | <a href="#">Articles Supplementary of 7.75% Fixed-to-Floating Series B Cumulative Redeemable Preferred Stock (incorporated by reference to Exhibit 3.3 to the Registrant's Registration Statement on Form 8-A, filed with the SEC on September 8, 2014).</a>                                                                                                                                                                                     |
| 3.5                    | <a href="#">Articles Supplementary classifying 1,500,000 shares of the Company's preferred stock as additional Series B Shares (incorporated by reference to Exhibit 3.2 to the Current Report on Form 8-K, filed with the SEC on March 19, 2019).</a>                                                                                                                                                                                           |
| 3.6                    | <a href="#">Articles Supplementary of 7.50% Fixed-to-Floating Series C Cumulative Redeemable Preferred Stock (incorporated by reference to Exhibit 3.4 to the Registrant's Registration Statement on Form 8-A, filed with the SEC on August 11, 2017).</a>                                                                                                                                                                                       |
| 3.7                    | <a href="#">Articles Supplementary classifying 4,000,000 shares of the Company's preferred stock as additional Series C Shares (incorporated by reference to Exhibit 3.3 to the Current Report on Form 8-K, filed with the SEC on March 19, 2019).</a>                                                                                                                                                                                           |
| 3.8                    | <a href="#">Amended and Restated Bylaws of Invesco Mortgage Capital Inc., incorporated by reference to Exhibit 3.1 to the Current Report on Form 8-K, filed with the SEC on February 17, 2017.</a>                                                                                                                                                                                                                                               |
| 31.1                   | <a href="#">Certification of John M. Anzalone pursuant to Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</a>                                                                                                                                                                                                                                                                                              |
| 31.2                   | <a href="#">Certification of R. Lee Phegley, Jr. pursuant to Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</a>                                                                                                                                                                                                                                                                                           |
| 32.1                   | <a href="#">Certification of John M. Anzalone pursuant to Rule 13a-14(b) and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</a>                                                                                                                                                                                                                                                                   |
| 32.2                   | <a href="#">Certification of R. Lee Phegley, Jr. pursuant to Rule 13a-14(b) and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</a>                                                                                                                                                                                                                                                                |
| 101                    | 101.INS XBRL Instance Document - The instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document.<br>101.SCH XBRL Taxonomy Extension Schema Document<br>101.CAL XBRL Taxonomy Calculation Linkbase Document<br>101.LAB XBRL Taxonomy Label Linkbase Document<br>101.PRE XBRL Taxonomy Presentation Linkbase Document<br>101.DEF XBRL Taxonomy Definition Linkbase Document |

**Certification Pursuant to  
Section 302 of the Sarbanes-Oxley Act of 2002**

I, John M. Anzalone, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Invesco Mortgage Capital Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

August 7, 2019

/s/ John M. Anzalone

---

**John M. Anzalone**  
**Chief Executive Officer**

**Certification Pursuant to  
Section 302 of the Sarbanes-Oxley Act of 2002**

I, R. Lee Phegley, Jr., certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Invesco Mortgage Capital Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

August 7, 2019

/s/ R. Lee Phegley, Jr.

---

**R. Lee Phegley, Jr.**  
**Chief Financial Officer**

**CERTIFICATION OF JOHN M. ANZALONE  
PURSUANT TO  
18 U.S.C. SECTION 1350  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with Invesco Mortgage Capital Inc.'s (the "Company") Quarterly Report on Form 10-Q for the period ended June 30, 2019 (the "Report"), I, John M. Anzalone, do hereby certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

1. the Report fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934; and
2. the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

August 7, 2019

/s/ John M. Anzalone

---

**John M. Anzalone**  
**Chief Executive Officer**

**CERTIFICATION OF R. LEE PHEGLEY, JR.  
PURSUANT TO  
18 U.S.C. SECTION 1350  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with Invesco Mortgage Capital Inc.'s (the "Company") Quarterly Report on Form 10-Q for the period ended June 30, 2019 (the "Report"), I, R. Lee Phegley, Jr., do hereby certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

1. the Report fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934; and
2. the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

August 7, 2019

/s/ R. Lee Phegley, Jr.

---

**R. Lee Phegley, Jr.**  
**Chief Financial Officer**