CHIMERA INVESTMENT CORP
Form 10-Q
May 09, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

# FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED: MARCH 31, 2011

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: 1-33796

CHIMERA INVESTMENT CORPORATION
(Exact name of Registrant as specified in its Charter)

| MARYLAND | 26-0630461 |
|---|---|
| (State or other jurisdiction of incorporation or organization) | (IRS Employer Identification No.) |

1211 AVENUE OF THE AMERICAS, SUITE 2902
NEW YORK, NEW YORK
(Address of principal executive offices)

10036
(Zip Code)

(646) 454-3759
(Registrant's telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all documents and 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 þ No o

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

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

Large accelerated filer þ Accelerated filer o Non-accelerated filer o Smaller reporting company o

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No þ

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the last practicable date:

| Class | Outstanding at May 9, 2011 |
| --- | --- |
| Common Stock, $.01 par value | 1,027,125,679 |

CHIMERA INVESTMENT CORPORATION

FORM 10-Q

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CHIMERA INVESTMENT CORPORATION
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
(dollars in thousands, except share and per share data)

| | March 31, 2011 (unaudited) | December 31, 2010 (1) |
|---|---|---|
| Assets: | | |
| Cash and cash equivalents | $16,295 | $7,173 |
| Non-Agency Mortgage-Backed Securities, at fair value | | |
| Senior ($143.4 million and $484.1 million resulting from consolidation of VIEs) | 329,782 | 987,685 |
| Subordinated ($1.6 billion and $1.5 billion resulting from consolidation of VIEs) | 2,266,560 | 2,210,858 |
| Senior, non-retained (held in consolidated VIEs) | 2,368,212 | 2,330,568 |
| Agency Mortgage-Backed Securities, at fair value | 4,879,382 | 2,133,584 |
| Securitized loans held for investment (held in consolidated VIEs), net of allowance for loan losses of $8.0 million and $6.6 million, respectively | 326,295 | 353,532 |
| Receivable for investments sold | 6,192 | - |
| Accrued interest receivable | 58,570 | 49,088 |
| Other assets | 1,270 | 1,212 |
| Interest rate swaps, at fair value | 5,876 | - |
| Total assets | $10,258,434 | $8,073,700 |
| | | |
| Liabilities: | | |
| Repurchase agreements, Agency RMBS ($4.1 billion and $1.7 billion of RMBS pledged as collateral, respectively) | $3,870,407 | $1,600,078 |
| Repurchase agreements, non-Agency RMBS ($0 and $249.4 million of RMBS pledged as collateral, respectively) | - | 208,719 |
| Securitized debt issued by consolidated VIEs, ($281.3 million and $302.9 million of securitized loans pledged as collateral, respectively) | 266,363 | 289,236 |
| Securitized debt issued by consolidated VIEs, non-retained ($2.4 billion and $2.3 billion of non-retained RMBS pledged as collateral, respectively) | 2,091,371 | 1,956,079 |
| Payable for investments purchased | 311,610 | 127,693 |
| Accrued interest payable | 12,543 | 11,641 |
| Dividends payable | 143,676 | 174,445 |
| Accounts payable and other liabilities | 1,234 | 393 |
| Investment management fees payable to affiliate | 12,807 | 12,422 |
| Interest rate swaps, at fair value ($13.6 million and $12.8 million of RMBS pledged as collateral, respectively) | 6,033 | 9,988 |
| Total liabilities | $6,716,044 | $4,390,694 |
| | | |
| Commitments and Contingencies (Note 15) | - | - |
| | | |
| Stockholders' Equity: | | |
| Common stock: par value $0.01 per share; 1,500,000,000 shares authorized, 1,027,107,362 and 1,027,034,357 shares issued and outstanding, respectively | $10,262 | $10,261 |
| Additional paid-in-capital | 3,602,339 | 3,601,890 |
| Accumulated other comprehensive income (loss) | 113,899 | 274,651 |
| Retained earnings (accumulated deficit) | (184,110) | (203,796) |

| | | |
|---|---|---|
| Total stockholders' equity | $3,542,390 | $3,683,006 |
| Total liabilities and stockholders' equity | $10,258,434 | $8,073,700 |

(1) Derived from the audited consolidated financial statements at December 31, 2010.
See notes to consolidated financial statements.

CHIMERA INVESTMENT CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)
(dollars in thousands, except share and per share data)
(unaudited)

| | For the Quarter Ended | |
|---|---|---|
| | March 31, 2011 | March 31, 2010 |
| Net Interest Income: | | |
| Interest income | $206,574 | $128,984 |
| Interest expense | 10,849 | 7,374 |
| | | |
| Interest income, non-retained | 21,159 | 50,861 |
| Interest expense, non-retained | 27,575 | 33,830 |
| Net interest income (expense) | 189,309 | 138,641 |
| Other-than-temporary impairments: | | |
| Total other-than-temporary impairment losses | (4,205) | (22,687) |
| Non-credit portion of loss recognized in other comprehensive income (loss) | 1,580 | 20,143 |
| Net other-than-temporary credit impairment losses | (2,625) | (2,544) |
| Other gains (losses): | | |
| Unrealized gains (losses) on interest rate swaps | 9,831 | - |
| Realized gains (losses) on sales of investments, net | 2,744 | 342 |
| Realized losses on principal write-downs of non-Agency RMBS | (19,520) | (949) |
| Total other gains (losses) | (6,945) | (607) |
| Net investment income (loss) | 179,739 | 135,490 |
| Other expenses: | | |
| Management fee | 12,750 | 8,114 |
| Provision for loan losses | 1,442 | 606 |
| General and administrative expenses | 1,487 | 1,160 |
| Total other expenses | 15,679 | 9,880 |
| Income (loss) before income taxes | 164,060 | 125,610 |
| Income taxes | 698 | - |
| Net income (loss) | $163,362 | $125,610 |
| | | |
| Net income (loss) per share-basic and diluted | $0.16 | $0.19 |
| Weighted average number of shares outstanding-basic and diluted | 1,027,063,055 | 670,371,022 |
| Comprehensive income (loss): | | |
| Net income (loss) | $163,362 | $125,610 |
| Other comprehensive income (loss): | | |
| Unrealized gains (losses) on available-for-sale securities, net | (180,153) | 241,581 |
| Reclassification adjustment for net losses included in net income (loss) for other-than-temporary credit impairment losses | 2,625 | 2,544 |
| Reclassification adjustment for realized losses (gains) included in net income (loss) | 16,776 | 607 |
| Other comprehensive income (loss) | (160,752) | 244,732 |
| Comprehensive income (loss) | $2,610 | $370,342 |

See notes to consolidated financial statements.

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CHIMERA INVESTMENT CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
(dollars in thousands, except per share data)
(unaudited)

| | Common Stock Par Value | Additional Paid-in Capital | Accumulated Other Comprehensive Income (Loss) | Retained Earnings (Accumulated Deficit) | Total |
|---|---|---|---|---|---|
| Balance, December 31, 2009 | $6,693 | $2,290,614 | $ (99,754 ) | $ (70,991 ) | $2,126,562 |
| Net income (loss) | - | - | - | 125,610 | 125,610 |
| Cumulative effect of change in accounting principle | - | - | - | (88,187 ) | (88,187 ) |
| Other comprehensive income (loss) | - | - | 244,732 | - | 244,732 |
| Proceeds from common stock offerings | - | (100 ) | - | - | (100 ) |
| Restricted stock grants | 1 | 122 | - | - | 123 |
| Common dividends declared, $0.17 per share | - | - | - | (113,793 ) | (113,793 ) |
| Balance, March 31, 2010 | $6,694 | $2,290,636 | $ 144,978 | $ (147,361 ) | $2,294,947 |
| | | | | | |
| Balance, December 31, 2010 | $10,261 | $3,601,890 | $ 274,651 | $ (203,796 ) | $3,683,006 |
| Net income (loss) | - | - | - | 163,362 | 163,362 |
| Other comprehensive income (loss) | - | - | (160,752 ) | - | (160,752 ) |
| Proceeds from direct purchase and dividend reinvestment | 1 | 310 | - | - | 311 |
| Proceeds from common stock offerings | - | 11 | - | - | 11 |
| Restricted stock grants | - | 128 | - | - | 128 |
| Common dividends declared, $0.14 per share | - | - | - | (143,676 ) | (143,676 ) |
| Balance, March 31, 2011 | $10,262 | $3,602,339 | $ 113,899 | $ (184,110 ) | $3,542,390 |

See notes to consolidated financial statements.

CHIMERA INVESTMENT CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(dollars in thousands)
(unaudited)

| | For the Quarter Ended March 31, 2011 | For the Quarter Ended March 31, 2010 |
|---|---|---|
| Cash Flows From Operating Activities: | | |
| Net income (loss) | $163,362 | $125,610 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | | |
| (Accretion) amortization of investment discounts/premiums | (64,425) | (53,842) |
| Unrealized losses (gains) on interest rate swaps | (9,831) | - |
| Realized losses (gains) on sales of investments | (2,744) | (342) |
| Realized losses on principal write-downs of non-Agency RMBS | 19,520 | 949 |
| Net other-than-temporary credit impairment losses | 2,625 | 2,544 |
| Provision for loan losses | 1,442 | 606 |
| Restricted stock grants | 128 | 123 |
| Changes in operating assets: | | |
| Decrease (increase) in accrued interest receivable | (9,163) | (6,509) |
| Decrease (increase) in other assets | (58) | 43 |
| Changes in operating liabilities: | | |
| Increase (decrease) in accounts payable and other liabilities | 841 | 17 |
| Increase (decrease) in investment management fees payable to affiliate | 385 | (405) |
| Increase (decrease) in accrued interest payable | 902 | 6,456 |
| Net cash provided by (used in) operating activities | $102,984 | $75,250 |
| Cash Flows From Investing Activities: | | |
| Mortgage-Backed Securities portfolio: | | |
| Purchases | $(3,095,715) | $(442,919) |
| Sales | 646,356 | 44,211 |
| Principal payments | 152,169 | 184,831 |
| Mortgage-Backed Securities portfolio, non-retained: | | |
| Principal payments | 178,084 | 145,421 |
| Securitized loans: | | |
| Principal payments | 25,337 | 28,666 |
| Net cash provided by (used in) investing activities | $(2,093,769) | $(39,790) |
| Cash Flows From Financing Activities: | | |
| Proceeds from repurchase agreements | $4,563,683 | $6,776,126 |
| Payments on repurchase agreements | (2,502,073) | (7,065,291) |
| Net proceeds from common stock offerings | 11 | (100) |
| Payments on securitized debt borrowings | (22,873) | (26,572) |
| Proceeds from securitized debt borrowings, non-retained | 311,012 | 498,720 |
| Payments on securitized debt borrowings, non-retained | (175,719) | (84,634) |
| Net proceeds from direct purchase and dividend reinvestment | 311 | - |
| Common dividends paid | (174,445) | (113,788) |
| Net cash provided by (used in) financing activities | $1,999,907 | $(15,539) |
| Net increase (decrease) in cash and cash equivalents | 9,122 | 19,921 |

| | | |
|---|---|---|
| Cash and cash equivalents at beginning of period | 7,173 | 24,279 |
| Cash and cash equivalents at end of period | $16,295 | $44,200 |

CHIMERA INVESTMENT CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOW
(dollars in thousands)
(unaudited)

| | | |
|---|---|---|
| Supplemental disclosure of cash flow information: | | |
| Interest paid | $37,522 | $34,748 |
| Taxes paid | $698 | $- |
| | | |
| Non-cash investing activities: | | |
| Receivable for investments sold | $6,192 | $47,185 |
| Payable for investments purchased | $311,610 | $41,822 |
| Net change in unrealized gain on available-for sale securities | $(160,752) | $244,732 |
| Non-cash financing activities: | | |
| Common dividends declared, not yet paid | $143,676 | $113,793 |

See notes to consolidated financial statements.

CHIMERA INVESTMENT CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE QUARTER ENDED MARCH 31, 2011
(unaudited)

1. Organization

Chimera Investment Corporation ("Company") was organized in Maryland on June 1, 2007. The Company commenced operations on November 21, 2007 when it completed its initial public offering. The Company has elected to be taxed as a real estate investment trust ("REIT"), under the Internal Revenue Code of 1986, as amended. As long as the Company qualifies as a REIT, the Company will generally not be subject to U.S. federal or state corporate taxes on its income to the extent that the Company distributes at least 90% of its taxable net income to its stockholders. In July 2008, the Company formed Chimera Securities Holdings, LLC, a wholly-owned subsidiary. In June 2009, the Company formed Chimera Asset Holding LLC and Chimera Holding LLC, both wholly-owned subsidiaries. In January 2010, the Company formed Chimera Special Holding LLC, which is a wholly-owned subsidiary of Chimera Asset Holding LLC. In July 2010, the Company formed CIM Trading Company LLC, a wholly-owned subsidiary. Chimera Securities Holdings, LLC, Chimera Asset Holding LLC, Chimera Holding LLC, and Chimera Special Holding LLC are qualified REIT subsidiaries. CIM Trading Company LLC is a taxable REIT subsidiary ("TRS"). Annaly Capital Management, Inc. ("Annaly") owns approximately 4.38% of the Company's common shares. The Company is managed by Fixed Income Discount Advisory Company ("FIDAC"), an investment advisor registered with the Securities and Exchange Commission ("SEC"). FIDAC is a wholly-owned subsidiary of Annaly.

2. Summary of the Significant Accounting Policies

(a) Basis of Presentation
The consolidated financial statements include the accounts of the Company and its direct and indirect wholly-owned subsidiaries. All intercompany balances and transactions have been eliminated.

(b) Cash and Cash Equivalents
Cash and cash equivalents include cash on hand and cash deposited overnight in money market funds.

(c) Non-Agency and Agency Residential Mortgage-Backed Securities
The Company invests in residential mortgage-backed securities ("RMBS") representing interests in obligations backed by pools of mortgage loans. The Company delineates between (1) Agency RMBS, (2) non-Agency RMBS, and (3) non-Agency, non-retained securities as follows: The Agency RMBS are mortgage pass-through certificates, collateralized mortgage obligations ("CMOs"), and other mortgage-backed securities representing interests in or obligations backed by pools of mortgage loans issued or guaranteed as to principal and/or interest repayment by agencies of the U.S. Government or federally chartered corporations such Ginnie Mae, Freddie Mac or Fannie Mae. The non-Agency RMBS portfolio is not issued or guaranteed by Fannie Mae, Freddie Mac, or Ginnie Mae and is therefore subject to credit risk. Non-Agency, non-retained securities are further detailed in Note 8 to these consolidated financial statements.

The Company holds its RMBS as available-for-sale, records investments at estimated fair value as described in Note 5 of these consolidated financial statements, and includes unrealized gains and losses in other comprehensive income (loss) in the consolidated statements of operations and comprehensive income (loss). From time to time, as part of the overall management of its portfolio, the Company may sell any of its RMBS investments and recognize a realized gain or loss as a component of earnings in the consolidated statements of operations and comprehensive income (loss) utilizing the specific identification method.

Interest income on RMBS is computed on the remaining principal balance of the investment security.  Premium or discount amortization/accretion on Agency RMBS is recognized over the life of the investment using the effective interest method.  Premium or discount amortization/accretion on non-Agency RMBS is recognized in accordance with Accounting Standards Codification ("ASC") 325-40, Investment-Other: Beneficial Interests in Securitized Financial Assets.  For non-Agency RMBS, the Company estimates at the time of purchase expected future cash flows, prepayment speeds, credit losses, loss severity, and loss timing based on the Company's observation of available market data, its experience, and the collective judgment of its management team to determine the effective interest rate on the RMBS.  Not less than quarterly, the Company reevaluates, and if necessary, makes adjustments to its analysis utilizing internal models, external market research and sources in conjunction with its view on performance in the non-Agency RMBS sector.  Changes to the Company's assumptions subsequent to the purchase date may increase or decrease the amortization/accretion of premiums or discounts which affects interest income.  Changes to assumptions that decrease expected future cash flows may result in other-than-temporary impairment ("OTTI").

The Company evaluates each investment in its RMBS portfolio for OTTI quarterly or more often if market conditions warrant. The Company determines if it (1) has the intent to sell the security, (2) is more likely than not that it will be required to sell the securities before recovery, or (3) does not expect to recover the entire amortized cost basis of the security. Further, the security is analyzed for credit loss by comparing the difference between the present value of cash flows expected to be collected and the amortized cost basis. The credit loss, if any, will then be recognized in earnings, while the balance of impairment related to other factors will be recognized in other comprehensive income (loss).

(d) Securitized Loans Held for Investment

The Company's securitized residential mortgage loans are comprised of fixed-rate and variable-rate loans. Mortgage loans are designated as held for investment, recorded on trade date, and are carried at their principal balance outstanding, plus any premiums or discounts, less allowances for loan losses. Interest income on loans held for investment is recognized over the life of the investment using the effective interest method. Income recognition is suspended for loans when, in the opinion of management, a full recovery of income and principal becomes doubtful. Income recognition is resumed when the loan becomes contractually current and performance is demonstrated to be resumed. The Company estimates fair value of securitized loans as described in Note 5 of these consolidated financial statements.

(e) Allowance for Loan Losses

The Company has established an allowance for loan losses at a level that management believes is adequate based on an evaluation of known and inherent risks related to the Company's loan portfolio. The estimate is based on a variety of factors including current economic conditions, industry loss experience, the loan originator's loss experience, credit quality trends, loan portfolio composition, delinquency trends, national and local economic trends, national unemployment data, changes in housing appreciation or depreciation and whether specific geographic areas where the Company has significant loan concentrations are experiencing adverse economic conditions and events such as natural disasters that may affect the local economy or property values. Upon purchase of a pool of loans, the Company obtains written representations and warranties from the sellers that the Company could be reimbursed for the value of the loan if the loan fails to meet the agreed upon origination standards. While the Company has little history of its own to establish loan trends, delinquency trends of the originators and the current market conditions aid in determining the allowance for loan losses. The Company has created an unallocated provision for probable loan losses estimated as a percentage of the remaining unpaid principal balance on the loans. Management's estimate is based on historical experience of similarly underwritten pools in conjunction with current and expected market trends.

When the Company determines it is probable that specific contractually due amounts are uncollectible, the amount is considered impaired. Where impairment is indicated, a valuation write-off is measured based upon the excess of the recorded investment over the net fair value of the collateral, reduced by selling costs. Any deficiency between the carrying amount of an asset and the net sales price of repossessed collateral is charged to the allowance for loan losses.

(f) Repurchase Agreements

The Company may finance the acquisition of its investment securities through the use of repurchase agreements. Repurchase agreements are treated as collateralized financing transactions and are carried at their contractual amounts, including accrued interest, as specified in the respective agreements.

(g) Securitized Debt and Securitized Debt, Non-Retained

The Company has issued securitized debt to finance its residential mortgage loan portfolio and has re-securitized RMBS to finance a portion of its RMBS portfolio. Certain transactions involving residential mortgage loans are accounted for as financings, and are recorded as an asset called "Securitized loans held for investment" and the corresponding debt as "Securitized debt" in the consolidated statements of financial condition. These securitizations are

collateralized by residential adjustable or fixed rate mortgage loans that have been placed in a trust and pay interest and principal payments to the debt holders of that securitization. Re-securitization transactions classified as "Securitized debt, non-retained" reflect the transfer to a trust of fixed or adjustable rate RMBS which are classified as "Non-Agency Mortgage-Backed Securities Senior, non-retained" that pay interest and principal payments to the debt holders of that re-securitization. Re-securitization transactions completed by the Company are accounted for as financings pursuant to ASC 810, Consolidation. The holders of Securitized debt and Securitized debt, non-retained have no recourse to the Company, and the Company does not receive any interest or principal paid on such debt. The Company estimates fair value of securitized debt and securitized debt, non-retained as described in Note 5 to these consolidated financial statements. The associated liabilities are carried at amortized cost.

(h) Fair Value Disclosure
A complete discussion of the methodology utilized by the Company to fair value its financial instruments is included in Note 5 to these consolidated financial statements.

(i) Derivative Financial Instruments and Hedging Activity
The Company's policies permit it to enter into derivative contracts, including interest rate swaps and interest rate caps, as a means of mitigating its interest rate risk. The Company intends to use interest rate derivative instruments to mitigate interest rate risk rather than to enhance returns. Interest rate swaps are recorded as either assets or liabilities in the consolidated statement of financial condition, and measured at fair value with realized and unrealized gains and losses recognized in earnings. The Company estimates fair value of interest rate swaps as described in Note 5 of these consolidated financial statements.

(j) Sales, Securitizations, and Re-Securitizations
The Company periodically enters into transactions in which it sells financial assets, such as RMBS, mortgage loans and other assets. Gains and losses on sales of assets are computed on the specific identification method whereby the Company records a gain or loss on the difference between the carrying value of the asset and the proceeds from the sale. In addition, the Company from time to time securitizes or re-securitizes assets and sells tranches in the newly securitized assets. These transactions may be recorded as either a sale and the assets contributed to the securitization are removed from the consolidated statements of financial condition and a gain or loss is recognized, or as a financing whereby the assets contributed to the securitization are not derecognized but rather the liabilities issued by the securitization are recorded to reflect the term financing of the assets. In these securitizations and re-securitizations, the Company may retain senior or subordinated interests in the securitized and/or re-securitized assets.

(k) Income Taxes
The Company qualifies to be taxed as a REIT, and therefore it generally will not be subject to corporate, federal, or state income tax to the extent that qualifying distributions are made to stockholders and the REIT requirements, including certain asset, income, distribution and stock ownership tests are met. If the Company failed to qualify as a REIT and did not qualify for certain statutory relief provisions, the Company would be subject to federal, state and local income taxes and may be precluded from qualifying as a REIT for the subsequent four taxable years following the year in which the REIT qualification was lost. The Company and its subsidiary CIM Trading Company LLC made a joint election to treat the subsidiary as a taxable REIT subsidiary. As such, CIM Trading Company LLC is taxable as a domestic C corporation and subject to federal, state, and local income taxes based upon its taxable income.

The provisions of FASB ASC 740, Income Taxes, clarify the accounting for uncertainty in income taxes recognized in financial statements and prescribe a recognition threshold and measurement attribute for tax positions taken or expected to be taken on a tax return. FASB ASC 740 also requires that interest and penalties related to unrecognized tax benefits be recognized in financial statements. The Company does not have any unrecognized tax benefits that would affect its financial position. Thus, no accruals for penalties and interest were necessary as of March 31, 2011.

(l) Net Income per Share
The Company calculates basic net income per share by dividing net income for the period by the weighted-average shares of its common stock outstanding for that period. Diluted net income per share takes into account the effect of dilutive instruments, such as stock options, but uses the average share price for the period in determining the number of incremental shares that are to be added to the weighted average number of shares outstanding. The Company had no potentially dilutive securities outstanding during the periods presented.

(m) Stock-Based Compensation

The Company accounts for stock based compensation awards granted to the employees of FIDAC and its affiliates in accordance with ASC 505-50, Equity-Based Payments to Non-Employees. Accounting principles generally accepted in the United States of America ("GAAP") requires the Company to measure the fair value of the equity instrument using the stock prices and other measurement assumptions as of the earlier of either the date at which a performance commitment by the counterparty is reached or the date at which the counterparty's performance is complete. Compensation expense related to the grants of stock and stock options is recognized over the vesting period of such grants based on the fair value of the stock on the vesting date.

(n) Use of Estimates

The preparation of the consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The most significant estimates are related to the following: all investment securities classified as available-for-sale and interest rate swaps are reported at their estimated fair value; all investment securities are amortized/accreted based on yields that incorporate management's assumptions as to the expected performance of the investment over time; and the loan loss provision reflects management estimates with regard to expected losses of the securitized loan portfolio. Actual results could differ from those estimates.

(o) Recent Accounting Pronouncements

Assets

Receivables (ASC 310)

In July 2010, the FASB released ASU 2010-20, which addresses disclosures about the credit quality of financing receivables and the allowance for credit losses. The purpose of this update is to provide greater transparency regarding the allowance for credit losses and the credit quality of financing receivables as well as to assist in the assessment of credit risk exposures and evaluation of the adequacy of allowances for credit losses. Additional disclosures must be provided on a disaggregated basis. The update defines two levels of disaggregation – portfolio segment and class of financing receivable. Additionally, the update requires disclosure of credit quality indicators, past due information and modifications of financing receivables. The update is not applicable to mortgage banking activities (loans originated or purchased for resale to investors); derivative instruments; debt securities; a transferors interest in securitization transactions accounted for as sales under ASC 860; and purchased beneficial interests in securitized financial assets. This update was effective for the Company for interim or annual periods ending on or after December 15, 2010. Adoption of this guidance results in increased footnote disclosure in the Company's consolidated financial statements.

Broad Transactions

Fair Value Measurements and Disclosures (ASC 820)

In January 2010, FASB issued ASU 2010-06 which increases disclosures regarding the fair value of assets. A majority of this update was effective for the Company on January 1, 2010. However, the guidance also required that the disclosures on any Level 3 assets present separately information about purchases, sales, issuances and settlements. In other words, Level 3 assets are presented on a gross basis rather than as one net number. This portion of the guidance is effective for the Company on January 1, 2011. Adoption of this portion of the guidance results in increased footnote disclosure in the Company's consolidated financial statements to the extent that Level 3 assets are held.

Transfers and Servicing (ASC 860)

In April 2011, FASB issued ASU 2011-03 regarding repurchase agreements. In a typical repurchase agreement transaction, an entity transfers financial assets to a counterparty in exchange for cash with an agreement for the counterparty to return the same or equivalent financial assets for a fixed price in the future. Prior to this update one of the factors in determining whether sale treatment could be used was whether the transferor maintained effective control of the transferred assets and in order to do so, the transferor must have the ability to repurchase such assets. Based on this update, FASB concluded that the assessment of effective control should focus on a transferor's contractual rights and obligations with respect to transferred financial assets, rather than on whether the transferor has the practical ability to perform in accordance with those rights or obligations. Therefore, this update removes the transferor's ability criterion from consideration of effective control. This update is effective for the first interim or annual period beginning on or after December 15, 2011. As the Company records repurchase agreements as secured borrowings and not sales, this update will have no effect on the Company's consolidated financial statements.

3. Mortgage-Backed Securities

The following tables present the principal value, unamortized premium, unamortized discount, gross unrealized gain, gross unrealized loss, and fair value of the Company's available-for-sale RMBS portfolio as of March 31, 2011 and December 31, 2010, at fair value by asset class. The RMBS portfolio is composed of Agency and non-Agency RMBS collateralized by residential mortgage loans. The Agency RMBS are mortgage pass-through certificates, CMOs, and other mortgage-backed securities representing interests in or obligations backed by pools of mortgage loans issued or guaranteed by Fannie Mae, Freddie Mac, or Ginnie Mae. The non-Agency RMBS portfolio is not issued or guaranteed by Fannie Mae, Freddie Mac, or Ginnie Mae and is therefore subject to credit risk. The Company classifies its non-Agency RMBS into senior, subordinated, and senior, non-retained interests. Senior interests in non-Agency RMBS are considered to be entitled to the first principal repayments in their pro-rata ownership interests. Securities identified as senior, non-retained have been consolidated pursuant to the adoption of ASC 810. See Note 8 of these consolidated financial statements for a detailed discussion.

March 31, 2011
(dollars in thousands)

| | Principal Value | Unamortized Premium | Unamortized Discount | Gross Unrealized Gain | Gross Unrealized Loss | Fair Value |
|---|---|---|---|---|---|---|
| Non-Agency RMBS | | | | | | |
| Senior | $9,612 | $409,222 | $(109) | $11,819 | $(100,762) | $329,782 |
| Subordinated | 4,917,240 | 58,083 | (2,640,129) | 203,913 | (272,547) | 2,266,560 |
| Senior, non-retained | 2,136,669 | 57,530 | (98,356) | 303,544 | (31,175) | 2,368,212 |
| Agency RMBS | 4,749,061 | 131,376 | (162) | 36,036 | (36,929) | 4,879,382 |
| Total | $11,812,582 | $656,211 | $(2,738,756) | $555,312 | $(441,413) | $9,843,936 |

December 31, 2010
(dollars in thousands)

| | Principal Value | Unamortized Premium | Unamortized Discount | Gross Unrealized Gain | Gross Unrealized Loss | Fair Value |
|---|---|---|---|---|---|---|
| Non-Agency RMBS | | | | | | |
| Senior | $664,251 | $420,657 | $(9,320) | $21,758 | $(109,661) | $987,685 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Subordinated | 4,962,829 | 58,298 | (2,789,906 ) | 206,189 | (226,552 ) | 2,210,858 |
| Senior, non-retained | 2,008,167 | 79,730 | (109,619 ) | 428,213 | (75,923 ) | 2,330,568 |
| Agency RMBS | 2,035,823 | 67,134 | - | 47,717 | (17,090 ) | 2,133,584 |
| Total | $9,671,070 | $625,819 | $(2,908,845 ) | $703,877 | $(429,226 ) | $7,662,695 |

The following tables present the gross unrealized losses and estimated fair value of the Company's RMBS by length of time that such securities have been in a continuous unrealized loss position at March 31, 2011 and December 31, 2010. The securities in an unrealized loss position have been evaluated by the Company for OTTI as discussed in the paragraphs following these tables. Five securities have been in a continuous unrealized loss position for greater than twelve months, all of which are subordinated interests held by the Company that, although performing in line with the Company's expectations, are in unrealized loss position due to significant market value declines consistent with similar asset classes.

March 31, 2011
(dollars in thousands)

| | Unrealized Loss Position For: | | | | | |
|---|---|---|---|---|---|---|
| | Less than 12 Months | | 12 Months or More | | Total | |
| RMBS | Estimated Fair Value | Unrealized Losses | Estimated Fair Value | Unrealized Losses | Estimated Fair Value | Unrealized Losses |
| Non-Agency RMBS | | | | | | |
| Senior | $179,966 | $(48,923) | $29,477 | $(51,839) | $209,443 | $(100,762) |
| Subordinated | 1,150,933 | (237,333) | 62,012 | (35,214) | 1,212,945 | (272,547) |
| Senior, non-retained | 725,895 | (31,044) | 22,475 | (131) | 748,370 | (31,175) |
| Agency | 3,198,390 | (36,929) | - | - | 3,198,390 | (36,929) |
| Total | $5,255,184 | $(354,229) | $113,964 | $(87,184) | $5,369,148 | $(441,413) |

December 31, 2010
(dollars in thousands)

| | Unrealized Loss Position For: | | | | | |
|---|---|---|---|---|---|---|
| | Less than 12 Months | | 12 Months or More | | Total | |
| RMBS | Estimated Fair Value | Unrealized Losses | Estimated Fair Value | Unrealized Losses | Estimated Fair Value | Unrealized Losses |
| Non-Agency RMBS | | | | | | |
| Senior | $549,968 | $(109,662) | $- | $- | $549,968 | $(109,662) |
| Subordinated | 1,178,493 | (217,224) | 12,826 | (9,328) | 1,191,319 | (226,552) |
| Senior, non-retained | 764,724 | (75,923) | - | - | 764,724 | (75,923) |
| Agency | 600,464 | (17,090) | - | - | 600,464 | (17,090) |
| Total | $3,093,649 | $(419,899) | $12,826 | $(9,328) | $3,106,475 | $(429,227) |

The Company recorded a $2.6 million other-than-temporary credit impairment during the quarter ended March 31, 2011 on investments where the expected future cash flows of certain non-Agency RMBS were less than their amortized cost basis.  The impairment recorded during the quarter ended March 31, 2011 was related to fourteen securities.  The impaired investments were interests in non-Agency RMBS.  As of March 31, 2011, the impaired securities had cumulative losses ranging from 0% up to 14%, three-month prepayments speeds between 0 and 69 Constant Prepayment Rate ("CPR"), 60+ day delinquencies between 0% and 45% of the pool balance, and weighted average FICO scores on the pools between 666 and 753.

The Company evaluates each investment in its RMBS portfolio for OTTI quarterly or more often if market conditions warrant.  The amortized cost of each investment in an unrealized loss position is compared to the present value of expected future cash flows of the position.  In estimating future cash flows, the Company evaluated the non-Agency RMBS for OTTI by considering delinquencies, credit losses, loss severities, prepayment speeds, geographic data, borrower characteristics, loan to value ratios, seasoning and credit support in conjunction with broader macroeconomic expectations such as home price depreciation, expectations of future delinquencies and loss severities and the ability of the borrower to refinance or modify their loans.  If after determining the expected future cash flows of the position, the amortized cost of the security is less than the present value of its expected future cash flows, an other-than-temporary credit impairment has occurred.  If the Company does not intend to sell and is not more likely than not required to sell the debt security prior to its anticipated recovery, the credit loss, if any, is recognized in earnings, while the balance of impairment related to other factors is recognized in other comprehensive income (loss).  If the Company intends to sell the debt security, or will be more likely than not required to sell the security before its anticipated recovery, the full unrealized loss is recognized in earnings.  The determination cannot be overcome by

management judgment of the probability of collecting all cash flows previously projected. A summary of the OTTI included in earnings for the quarters ended March 31, 2011 and 2010 is presented below.

| | March 31, 2011 | March 31, 2010 |
|---|---|---|
| | (dollars in thousands) | |
| Cumulative credit loss beginning balance | $22,674 | $9,996 |
| Additions: | | |
| Other-than-temporary impairments not previously recognized | 988 | 2,462 |
| Increases related to other-than-temporary impairments on securities with previously recognized other-than-temporary impairments | 1,637 | 82 |
| Cumulative credit loss ending balance | $25,299 | $12,540 |

The following tables present details of each asset class in the Company's RMBS portfolio at March 31, 2011 and December 31, 2010. The principal or notional value represents the interest income earning balance of each class. The weighted average amortized cost, fair value, coupon, yield, and CPR at period-end are weighted by each investment's respective principal/notional value in the asset class. The figure presenting the annualized yield over the current quarter is the annualized interest income earned on the asset class during the quarter, divided by the average of the beginning and ending amortized cost of the asset class.

| March 31, 2011 | | | | | | | |
|---|---|---|---|---|---|---|---|
| | Principal or Notional Value at Period-End | Weighted Average Amortized Cost Basis at Period-End | Weighted Average Fair Value at Period-End | Weighted Average Coupon at Period-End | Weighted Average Yield (Loss Adjusted) at Period-End | Annualized Yield Over Current Quarter* | Weighted Average 3 Month CPR at Period-End |
| Non-Agency Mortgage-Backed Securities | | | | | | | |
| Senior | $ 9,612 | $ 98.86 | $ 94.20 | 1.22 % | 2.66 % | 2.21 % | 6 % |
| Senior, interest only | $ 6,352,256 | $ 6.44 | $ 5.05 | 2.02 % | 12.91 % | 4.78 % | 17 % |
| Subordinated | $ 4,917,240 | $ 46.88 | $ 45.44 | 4.12 % | 14.43 % | 24.27 % | 16 % |
| Subordinated, interest only | $ 303,427 | $ 9.93 | $ 10.56 | 2.97 % | 26.06 % | 35.83 % | 14 % |
| Senior, non-retained | $ 2,136,669 | $ 98.09 | $ 110.84 (1 ) | 5.21 % | 4.88 % | 3.50 % | 16 % |
| Agency Mortgage-Backed Securities | $ 4,800,913 | $ 102.76 | $ 102.74 | 4.71 % | 4.26 % | 4.48 % | 20 % |
| Securitized loans | | | | | | | |
| Senior | $ 273,178 | $ 101.19 | $ 101.19 | 5.46 % | 5.50 % | 4.92 % | 25 % |
| Senior, interest only | $ 288,661 | $ 0.01 | $ 0.01 | 0.41 % | 100.00 % | 4586.67 % | 24 % |
| Subordinated | $ 57,473 | $ 100.66 | $ 100.66 | 5.23 % | -1.95 % | 4.05 % | 25 % |

* Includes the effect of realized loss on principal write-downs.
(1) See discussion of Financial Condition on page 35 for a review of GAAP book value.

| | December 31, 2010 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Principal or Notional Value at Period-End | Weighted Average Amortized Cost Basis at Period-End | Weighted Average Fair Value at Period-End | | Weighted Average Coupon at Period-End | Weighted Average Yield (Loss Adjusted) at Period-End | Annualized Yield Over Current Quarter* | Weighted Average 3 Month CPR at Period-End |
| Non-Agency Mortgage-Backed Securities | | | | | | | | |
| Senior | $ 664,251 | $ 99.64 | $ 101.56 | | 4.48 % | 4.65 % | 5.03 % | 16 % |
| Senior, interest only | $ 5,929,634 | $ 6.98 | $ 5.28 | | 1.74 % | 14.71 % | 29.03 % | 16 % |
| Subordinated | $ 4,962,829 | $ 44.35 | $ 43.88 | | 4.11 % | 16.78 % | 25.17 % | 15 % |
| Subordinated, interest only | $ 304,993 | $ 9.93 | $ 10.81 | | 3.03 % | 27.60 % | 24.62 % | 16 % |
| Senior, non-retained | $ 2,008,167 | $ 98.51 | $ 116.05 | (1 ) | 5.17 % | 4.36 % | 6.85 % | 15 % |
| Agency Mortgage-Backed Securities | $ 2,092,465 | $ 103.30 | $ 104.80 | | 5.05 % | 4.51 % | 3.34 % | 24 % |
| Securitized loans | | | | | | | | |
| Senior | $ 296,458 | $ 101.19 | $ 101.19 | | 5.50 % | 5.54 % | 4.82 % | 28 % |
| Senior, interest only | $ 313,720 | $ 0.01 | $ 0.01 | | 0.41 % | 100.00 % | 3795.92 % | 29 % |
| Subordinated | $ 59,540 | $ 100.93 | $ 100.93 | | 5.36 % | 2.85 % | 5.72 % | 30 % |

* Includes the effect of realized loss on principal write-downs.
(1) See discussion of Financial Condition on page 35 for a review of GAAP book value.

The Company's investment guidelines place no restrictions on the credit rating of the assets the Company is able to hold in its portfolio. The portfolio is most heavily weighted to contain RMBS with credit risk. The Company chooses assets for the portfolio after carefully evaluating each investment's risk profile.

| | March 31, 2011 | December 31, 2010 |
|---|---|---|
| AAA | 13.25% | 41.25% |
| AA | 4.98% | 7.91% |
| A | 1.26% | 1.92% |
| BBB | 0.64% | 0.80% |
| BB | 0.01% | 0.01% |
| B | 0.00% | 0.01% |
| Below B or not rated | 79.86% | 48.10% |
| Total | 100.00% | 100.00% |

The table above reflects the credit rating of the Company's consolidated RMBS portfolio. At March 31, 2011, approximately 18% of the AAA, AA, and A securities balance reflected in the table above include senior, non-retained, non-Agency RMBS.

The AAA rated assets in the RMBS portfolio are predominantly Agency RMBS and senior non-retained non-Agency RMBS. As the Company securitizes or re-securitizes assets, it expects the Below B or not rated percentages in the

portfolio to increase as the Company typically retains the subordinated tranches of these types of transactions.

Actual maturities of mortgage-backed securities are generally shorter than stated contractual maturities. Actual maturities of the Company's RMBS are affected by the contractual lives of the underlying mortgages, periodic payments of principal and prepayments of principal. The following tables summarize the Company's RMBS at March 31, 2011 and December 31, 2010 according to their estimated weighted-average life classifications. The weighted-average lives of the mortgage-backed securities at March 31, 2011 and December 31, 2010 in the tables below are based on consensus constant prepayment speeds. The prepayment model considers current yield, forward yield, steepness of the interest rate curve, current mortgage rates, mortgage rates of the outstanding loan, loan age, margin and volatility.

March 31, 2011
(dollars in thousands)

| | Weighted Average Life | | | |
|---|---|---|---|---|
| | Less than one year | Greater than one year and less than five years | Greater than five years | Total |
| Fair value | | | | |
| Non-Agency RMBS | | | | |
| Senior | $30,676 | $297,368 | $1,738 | $329,782 |
| Subordinated | 82,245 | 238,001 | 1,946,314 | 2,266,560 |
| Senior, non-retained | 298,446 | 1,872,126 | 197,640 | 2,368,212 |
| Agency RMBS | - | 504,157 | 4,375,225 | 4,879,382 |
| Total fair value | $411,367 | $2,911,652 | $6,520,917 | $9,843,936 |
| Amortized cost | | | | |
| Non-Agency RMBS | | | | |
| Senior | $26,386 | $371,715 | $20,624 | $418,725 |
| Subordinated | 120,874 | 266,462 | 1,947,858 | 2,335,194 |
| Senior, non-retained | 213,976 | 1,699,136 | 182,731 | 2,095,843 |
| Agency RMBS | - | 481,964 | 4,398,311 | 4,880,275 |
| Total amortized cost | $361,236 | $2,819,277 | $6,549,524 | $9,730,037 |

December 31, 2010
(dollars in thousands)

| | Weighted Average Life | | | |
|---|---|---|---|---|
| | Less than one year | Greater than one year and less than five years | Greater than five years | Total |
| Fair value | | | | |
| Non-Agency RMBS | | | | |
| Senior | $26,962 | $587,075 | $373,648 | $987,685 |
| Subordinated | 7,941 | 218,986 | 1,983,931 | 2,210,858 |
| Senior, non-retained | 200,468 | 1,889,732 | 240,368 | 2,330,568 |
| Agency RMBS | - | 1,560,859 | 572,725 | 2,133,584 |
| Total fair value | $235,371 | $4,256,652 | $3,170,672 | $7,662,695 |
| Amortized cost | | | | |
| Non-Agency RMBS | | | | |
| Senior | $26,920 | $584,859 | $463,810 | $1,075,589 |
| Subordinated | 11,076 | 253,558 | 1,966,587 | 2,231,221 |
| Senior, non-retained | 251,579 | 1,500,955 | 225,744 | 1,978,278 |
| Agency RMBS | - | 1,513,644 | 589,313 | 2,102,957 |
| Total amortized cost | $289,575 | $3,853,016 | $3,245,454 | $7,388,045 |

The non-Agency RMBS portfolio is subject to credit risk. The Company seeks to mitigate credit risk through its asset selection process. The non-Agency RMBS portfolio is primarily collateralized by what the Company classifies as Alt-A first lien mortgages. The Company categorizes collateral as Alt-A regardless of whether the loans were originally described as “prime” if the behavior of the collateral when the Company purchased the security more typically

resembles Alt-A. The Company defines Alt-A collateral characteristics to be when the 60+ day delinquency bucket of the pool is greater than 5% and weighted average FICO scores are greater than 650 at origination. At March 31, 2011, 99% of the non-Agency RMBS were Alt-A collateral. At December 31, 2010, 99% of the non-Agency RMBS were Alt-A collateral. The non-Agency securities contained in this portion of the portfolio have the following collateral characteristics at March 31, 2011 and December 31, 2010.

| | | March 31, 2011 | | | December 31, 2010 | |
|---|---|---|---|---|---|---|
| Number of securities in portfolio | | 527 | | | 581 | |
| Weighted average maturity (years) | | 27.2 | | | 27.4 | |
| Weighted average amortized loan to value | | 72.4 | % | | 72.5 | % |
| Weighted average FICO | | 716.3 | | | 717.3 | |
| Weighted average loan balance (in thousands) | | $ 470.0 | | | $ 447.6 | |
| Weighted average percentage owner occupied | | 90.4 | % | | 83.3 | % |
| Weighted average percentage single family residence | | 63.5 | % | | 63.1 | % |
| Weighted average current credit enhancement | | 13.6 | % | | 16.0 | % |
| Weighted average geographic concentration | CA | 38.3 | % | CA | 38.5 | % |
| | FL | 8.8 | % | FL | 8.9 | % |
| | NY | 5.3 | % | NY | 4.9 | % |
| | NJ | 2.4 | % | VA | 2.6 | % |
| | VA | 2.2 | % | NJ | 2.2 | % |

The information presented in the table above includes senior, non-retained, non-Agency RMBS consolidated pursuant to the adoption of ASC 810 on January 1, 2010 by the Company.

The table below presents origination year for the Company's portfolio of non-Agency RMBS at March 31, 2011 and December 31, 2010.

| Origination Year as a Percentage of Outstanding Principal Balance | March 31, 2011 | December 31, 2010 |
|---|---|---|
| 2004 | 0.1% | 0.1% |
| 2005 | 11.5% | 13.4% |
| 2006 | 27.0% | 27.0% |
| 2007 | 58.3% | 56.1% |
| 2008 | 3.1% | 3.3% |
| 2009 | 0.0% | 0.1% |
| 2010 | 0.0% | 0.0% |
| Total | 100.0% | 100.0% |

On January 29, 2010, the Company transferred $1.7 billion in principal value of its RMBS to the CSMC 2010-1R Trust in a re-securitization transaction. This transaction was recorded as a "secured borrowing" pursuant to ASC Topics 860 and 810. In this transaction, the Company financed through the transaction $271.6 million of AAA-rated fixed rate bonds to third party investors for net proceeds of $268.1 million. The Company retained $391.9 million of AAA-rated bonds, $1.0 billion in subordinated bonds and the owner trust certificate, and interest only bonds with a notional value of $1.6 billion on the date of transfer. The subordinated bonds and the owner trust certificate provide credit support to the AAA-rated bonds. The bonds issued by the trust are collateralized by RMBS that were transferred to the CSMC 2010-1R Trust.

During the quarter ended March 31, 2011, the Company sold RMBS with a carrying value of $649.8 million for realized gains of $2.7 million. During the quarter ended March 31, 2010, the Company sold RMBS with a carrying value of $89.6 million for realized gains of $342 thousand.

In addition, during the quarter ended March 31, 2011, the Company recorded non-recourse financing with third party investors related to re-securitizations executed in prior periods. The Company financed through these transactions

$306.6 million of AAA-rated fixed rate bonds with third party investors for net proceeds of $311.0 million. During the quarter ended March 31, 2010, the Company financed through these transactions $225.8 million of AAA-rated fixed rate bonds with third party investors for net proceeds of $227.4 million.

4. Securitized Loans Held for Investment

The following table represents the Company's securitized residential mortgage loans classified as held for investment at March 31, 2011 and December 31, 2010. At March 31, 2011, approximately 56% of the Company's securitized loans are adjustable rate mortgage loans and 44% are fixed rate mortgage loans. All of the adjustable rate loans held for investment are hybrid adjustable rate mortgages ("ARMs"). Hybrid ARMs are mortgages that have interest rates that are fixed for an initial period (typically three, five, seven or ten years) and thereafter reset at regular intervals subject to interest rate caps. The periodic cap on all hybrid ARMs in the securitized loan portfolio range from 0.00% to 3.00% as of March 31, 2011 and December 31, 2010. The securitized loans held for investment are carried at their principal balance outstanding, plus premiums or discounts, less an allowance for loan losses.

| | March 31, 2011 | December 31, 2010 |
|---|---|---|
| | (dollars in thousands) | |
| Securitized loans, at amortized cost | $ 334,313 | $ 360,118 |
| Less: allowance for loan losses | 8,018 | 6,586 |
| Securitized loans held for investment | $ 326,295 | $ 353,532 |

The securitized loan portfolio is collateralized by prime, jumbo, first lien residential mortgages of which 56% were originated during 2008 and 42% were originated during 2007 and the remaining 2% of the loans were originated prior to 2007. A summary of key characteristics of these loans follows.

| | | March 31, 2011 | | December 31, 2010 |
|---|---|---|---|---|
| Number of loans | | 477 | | 513 |
| Weighted average maturity (years) | | 26.3 | | 26.6 |
| Weighted average amortized loan to value | | 74.8 % | | 74.5 % |
| Weighted average FICO | | 753 | | 755 |
| Weighted average loan balance (in thousands) | | $ 693.50 | | $ 694.30 |
| Weighted average percentage owner occupied | | 90.5 % | | 90.5 % |
| Weighted average percentage single family residence | | 57.8 % | | 58.2 % |
| Weighted average geographic concentration | CA | 33.7 % | CA | 33.3 % |
| | FL | 6.7 % | FL | 6.7 % |
| | AZ | 5.5 % | NJ | 5.3 % |
| | NJ | 5.4 % | IL | 5.3 % |
| | IL | 5.3 % | AZ | 5.2 % |

The following table summarizes the changes in the allowance for loan losses for the securitized mortgage loan portfolio during the quarters ended March 31, 2011 and 2010.

| | March 31, 2011 | March 31, 2010 |
|---|---|---|
| Balance, beginning of period | $ 6,586 | $ 4,551 |
| Provision for loan losses | 1,442 | 606 |
| Charge-offs | (10 ) | (603 ) |
| Balance, end of period | $ 8,018 | $ 4,554 |

On a quarterly basis, the Company evaluates the adequacy of its allowance for loan losses which is calculated to reflect management's estimate of possible losses in the securitized loan portfolio at the reporting date. The Company's provision for loan losses considers the quality of the collateral, performance of like collateral, and expectations of future market conditions as described more fully in Note 2(e). The Company's provision for loan losses is calculated on the outstanding principal balance of the portfolio, 60+ day delinquencies for like collateral and current and expected severities for similarly underwritten loans. The Company's allowance for loan losses at March 31, 2011 was $8.0 million, representing 243 basis points of the principal balance of the Company's securitized mortgage loan portfolio. The Company's allowance for loan losses at December 31, 2010 was $6.6 million, representing 185 basis points of the principal balance of the Company's securitized mortgage loan portfolio. At March 31, 2011, 2.60% of the securitized loans held for investment were greater than 60 days delinquent and 2.28% were in some stage of bankruptcy, foreclosure, or were real estate owned. At December 31, 2010, 3.12% of the securitized loans held for investment were greater than 60 days delinquent and 0.93% were in some stage of bankruptcy, foreclosure, or were real estate owned.

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5. Fair Value Measurements

GAAP defines fair value, establishes a framework for measuring fair value, establishes a three-level valuation hierarchy for disclosure of fair value measurement and enhances disclosure requirements for fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

Level 1 – inputs to the valuation methodology are quoted prices (unadjusted) for identical assets and liabilities in active markets.

Level 2 – inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level 3 – inputs to the valuation methodology are unobservable and significant to fair value.

The following discussion describes the methodologies utilized by the Company to fair value its financial instruments by instrument class.

Short-term Instruments
The carrying value of cash and cash equivalents, accrued interest receivable, dividends payable, accounts payable, and accrued interest payable generally approximates estimated fair value due to the short term nature of these financial instruments.

Non-Agency and Agency RMBS
Generally, the Company determines the fair value of its investment securities utilizing a pricing model that incorporates such factors as coupon, prepayment speeds, weighted average life, collateral composition, borrower characteristics, expected interest rates, life caps, periodic caps, reset dates, collateral seasoning, expected losses, expected default severity, credit enhancement, and other pertinent factors. Certain very liquid asset classes, such as Agency fixed-rate pass-throughs may be priced using independent sources such as quoted prices for "To-Be-Announced" securities. Management reviews the fair values generated by the model to determine whether prices are reflective of the current market. Management performs a validation of the fair value calculated by the pricing model by comparing its results to independent prices provided by dealers in the securities and/or third party pricing services. The Company believes the observable inputs used in its model in conjunction with dealer and/or third party pricing services meets the criteria for classification as Level 2.

Non-Agency, Non-Retained RMBS
The non-Agency, non-retained securities reflected in the consolidated financial statements are securities consolidated pursuant to the Company's adoption of ASC 860 and ASC 810 on January 1, 2010. These assets have been financed with third parties without recourse to the Company in the normal course of the Company's portfolio optimization strategy. The Company fair values these assets as described above in Non-Agency and Agency RMBS. See Note 8 to these consolidated financial statements for a detailed discussion of these securities.

Interest Rate Swaps
The Company obtains quotations from third parties to determine the fair values of its interest rate swaps. The Company compares the third party quotations received to its own estimate of fair value to evaluate for reasonableness. The dealer quotes incorporate common market pricing methods, including a spread measurement to the Treasury yield curve or interest rate swap curve as well as underlying characteristics of the particular contract. Interest rate swaps are modeled by the Company by incorporating such factors as the term to maturity, Treasury curve,

LIBOR rates, and the payment rates on the fixed portion of the interest rate swaps.

Any changes to the valuation methodology are reviewed by management to ensure the changes are appropriate. As markets and products develop and the pricing for certain products becomes more transparent, the Company will continue to refine its valuation methodologies. The methods used to produce a fair value calculation may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Company believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies, or assumptions, to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.  The Company uses inputs that are current as of the measurement date, which may include periods of market dislocation, during which price transparency may be reduced.



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During times of market dislocation, as has been experienced for some time, the observability of prices and inputs can be reduced for certain instruments. If dealers or independent pricing services are unable to provide a price for an asset, or if the price provided by them is deemed unreliable by the Company, then the asset will be valued at its fair value as determined in good faith by the Company. In addition, validating third party pricing for the Company's investments may be more subjective as fewer participants may be willing to provide this service to the Company. Illiquid investments typically experience greater price volatility as a ready market does not exist. As fair value is not an entity-specific measure and is a market-based approach which considers the value of an asset or liability from the perspective of a market participant, observability of prices and inputs can vary significantly from period to period. A condition such as this can cause instruments to be reclassified from Level 1 to Level 2 or Level 2 to Level 3 when the Company is unable to obtain third party pricing verification.

If at the valuation date, the fair value of an investment security is less than its amortized cost at the date of the consolidated statement of financial condition, the Company analyzes the investment security for OTTI. Management evaluates the Company's RMBS for OTTI at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been lower than carrying value, (2) the intent of the Company to sell the investment prior to recovery in fair value (3) whether the Company will more likely than not be required to sell the investment before the expected recovery, and (4) the expected future cash flows of the investment in relation to its amortized cost. Unrealized losses on assets that are considered OTTI due to credit are recognized in earnings and the cost basis of the assets are adjusted.

At March 31, 2011 and December 31, 2010, the Company classified its assets and liabilities as Level 2. The Company's financial assets and liabilities carried at fair value on a recurring basis are valued at March 31, 2011 and December 31, 2010 as presented below.

| | March 31, 2011 | | |
|---|---|---|---|
| | Level 1 | Level 2 | Level 3 |
| | | (dollars in thousands) | |
| Assets: | | | |
| Non-Agency RMBS | | | |
| Senior | $ - | $ 329,782 | $ - |
| Subordinated | - | 2,266,560 | - |
| Senior, non-retained | - | 2,368,212 | - |
| Agency mortgage-backed securities | - | 4,879,382 | - |
| Interest rate swaps | - | 5,876 | - |
| | | | |
| Liabilities: | | | |
| Interest rate swaps | - | 6,033 | - |

| | December 31, 2010 | | |
|---|---|---|---|
| | Level 1 | Level 2 | Level 3 |
| | | (dollars in thousands) | |
| Assets: | | | |
| Non-Agency RMBS | | | |
| Senior | $ - | $ 987,685 | $ - |
| Subordinated | - | 2,210,858 | - |
| Senior, non-retained | - | 2,330,568 | - |
| Agency mortgage-backed securities | - | 2,133,584 | - |

| | | | |
|---|---|---|---|
| Liabilities: | | | |
| Interest rate swaps | - | 9,988 | - |

In the aggregate, the Company’s fair valuations of RMBS investments were 0.11% higher than the aggregated dealer marks for the quarter ended March 31, 2011 and 0.76% higher than the aggregated dealer marks for the quarter ended March 31, 2010.

Securitized Loans Held for Investment

The Company records securitized loans held for investment when it securitizes loans and records the transaction as a "financing." The Company carries securitized loans held for investment at principal value, plus premiums or discounts paid, less an allowance for loan losses. The Company estimates the fair value of its securitized loans held for investment at the loss adjusted expected future cash flows of the collateral. The Company models each underlying asset by considering, among other items, the nature of the underlying collateral, coupon, servicer, actual and expected defaults, actual and expected default severities, reset indices, and prepayment speeds in conjunction with market research for similar collateral performance and management's expectations of general economic conditions in the sector and greater economy.

Repurchase Agreements

The Company records repurchase agreements at their contractual amounts including accrued interest payable. Repurchase agreements are collateralized financing transactions utilized by the Company to acquire investment securities. Due to the short term nature of these financial instruments, the Company estimated the fair value of these repurchase agreements to be the contractual obligation plus accrued interest payable at maturity.

Securitized Debt and Securitized Debt, Non-Retained

The Company records securitized debt for certificates or notes financed without recourse to the Company in securitization or re-securitization transactions treated as "financings" pursuant to ASC 860. The Company carries securitized debt at the principal balance outstanding on non-retained notes associated with its securitized loans held for investment plus premiums or discounts recorded with the sale of the notes to third parties. The premiums or discounts associated with the sale of the notes or certificates are amortized over the life of the instrument. The Company estimates the fair value of securitized debt by estimating the future cash flows associated with underlying assets collateralizing the secured debt outstanding. The Company models each underlying asset by considering, among other items, the structure of the underlying security, coupon, servicer, actual and expected defaults, actual and expected default severities, reset indices, and prepayment speeds in conjunction with market research for similar collateral performance and management's expectations of general economic conditions in the sector and greater economy.

The following table presents the carrying value and estimated fair value, as described above, of the Company's financial instruments at March 31, 2011 and December 31, 2010.

| | March 31, 2011 | | December 31, 2010 | |
|---|---|---|---|---|
| | Carrying Amount | Estimated Fair Value | Carrying Amount | Estimated Fair Value |
| | (dollars in thousands) | | | |
| Non-Agency RMBS | $4,964,554 | $4,964,554 | $5,529,111 | $5,529,111 |
| Agency RMBS | 4,879,382 | 4,879,382 | 2,133,584 | 2,133,584 |
| Securitized loans held for investment | 326,295 | 319,851 | 353,532 | 345,410 |
| Interest rate swaps | 5,876 | 5,876 | - | - |
| Repurchase agreements | (3,870,407) | (3,873,355) | (1,808,797) | (1,811,575) |
| Securitized debt | (266,363) | (279,242) | (289,236) | (303,102) |
| Securitized debt, non-retained | (2,091,371) | (2,053,003) | (1,956,079) | (1,887,121) |
| Interest rate swaps | (6,033) | (6,033) | (9,988) | (9,988) |

6. Repurchase Agreements

The Company had outstanding $3.9 billion and $1.8 billion of repurchase agreements with weighted average borrowing rates of 0.31% and 0.45% and weighted average remaining maturities of 37 and 49 days as of March 31,

2011 and December 31, 2010, respectively. At March 31, 2011 and December 31, 2010, RMBS pledged as collateral under these repurchase agreements had an estimated fair value of $4.1 billion and $2.0 billion, respectively. The average daily balances of the Company's repurchase agreements for the quarters ended March 31, 2011 and December 31, 2010 were $3.4 billion and $1.6 billion, respectively. The interest rates of these repurchase agreements are generally indexed to the one-month or the three-month LIBOR rate and re-price accordingly.

At March 31, 2011 and December 31, 2010, the repurchase agreements collateralized by RMBS had the following remaining maturities.

| | March 31, 2011 | December 31, 2010 |
|---|---|---|
| | (dollars in thousands) | |
| Overnight | $ 279,261 | $ - |
| 1-30 days | 1,340,897 | 232,265 |
| 30 to 59 days | 1,836,427 | 970,394 |
| 60 to 89 days | 413,822 | 545,442 |
| 90 to 119 days | - | 60,696 |
| Greater than or equal to 120 days | - | - |
| Total | $ 3,870,407 | $ 1,808,797 |

At March 31, 2011 and December 31, 2010, the Company did not have an amount at risk greater than 10% of its equity with any counterparty.

7. Securitized Debt

All of the Company's securitized debt is collateralized by residential mortgage loans or RMBS. For financial reporting purposes, the Company's securitized debt is accounted for as a financing. Thus, the residential mortgage loans or RMBS held as collateral are recorded in the assets of the Company as securitized loans held for investment or RMBS and the securitized debt is recorded as a liability in the statements of financial condition.

At March 31, 2011, the Company's securitized debt collateralized by residential mortgage loans had a principal balance of $279.2 million. The debt matures between the years 2023 and 2038. At March 31, 2011, the debt carried a weighted average cost of financing equal to 5.48%, that is secured by residential mortgage loans of which approximately 44% of the remaining principal balance pays a fixed rate of 6.25% and 56% of the remaining principal balance pays a variable rate of 5.41%. At December 31, 2010, the Company's securitized debt collateralized by residential mortgage loans had a principal balance of $303.1 million. The debt matures between the years 2023 and 2038. At December 31, 2010, the debt carried a weighted average cost of financing equal to 5.52%, that is secured by residential mortgage loans of which approximately 44% of the remaining principal balance pays a fixed rate of 6.29% and 56% of the remaining principal balance pays a variable rate of 5.47%.

At March 31, 2011, the Company's securitized debt, non-retained, collateralized by RMBS had a principal balance of $2.1 billion. The debt matures between the years 2035 and 2047. At March 31, 2011, the debt carried a weighted average cost of financing equal to 5.21%. At December 31, 2010, the Company's securitized debt, non-retained, collateralized by RMBS had a principal balance of $2.0 billion. The debt matures between the years 2035 and 2047. At December 31, 2010, the debt carried a weighted average cost of financing equal to 5.17%.

The following table presents the estimated principal repayment schedule of the securitized debt and securitized debt, non-retained held by the Company at March 31, 2011 and December 31, 2010, based on expected cash flows of the residential mortgage loans or RMBS, as adjusted for projected losses, collateralizing the debt. All of the securitized debt recorded in the Company's consolidated statements of financial condition is non-recourse to the Company.

| | March 31, 2011 | December 31, 2010 |
|---|---|---|
| | (dollars in thousands) | |
| Within One Year | $ 614,591 | $ 634,988 |
| One to Three Years | 916,090 | 831,305 |
| Three to Five Years | 373,830 | 305,953 |
| Greater Than or Equal to Five Years | 427,734 | 417,977 |

| | | | | |
|---|---|---|---|---|
| Total | $ | 2,332,245 | $ | 2,190,223 |

Maturities of the Company's securitized debt are dependent upon cash flows received from the underlying loans. The estimate of their repayment is based on scheduled principal payments on the underlying loans. This estimate will differ from actual amounts to the extent prepayments and/or loan losses are experienced. See Note 4 for a more detailed discussion of the loans collateralizing the securitized debt.

8. Consolidation

In June 2009, the FASB issued two new accounting standards that amended guidance applicable to the accounting for transfers of financial assets and the consolidation of Variable Interest Entities ("VIEs") (ASC 860 and ASC 810, respectively). The primary effect of these standards was to eliminate the concept of a QPSE when transferring assets and to remove the exemption of a QSPE when applying the consolidation standard. The Company adopted these new accounting standards as of January 1, 2010.

The Company uses securitization trusts or variable interest entities in its securitization and re-securitization transactions. Prior to January 1, 2010, these variable interest entities met the definition of QSPE's and, as such, were not subject to consolidation. Effective January 1, 2010, all such variable interest entities were considered for consolidation based on the criteria in ASC 810.

Per ASC 810, an entity shall consolidate a VIE when that entity has a variable interest that provides the reporting entity with a controlling financial interest. The assessment of the characteristics of the reporting entity's VIE shall consider the VIEs purpose and design. A controlling financial interest is defined as (a) the power to direct the activities of a VIE that most significantly impact the VIEs economic performance and (b) the obligation to absorb losses of the VIE that could potentially be significant to the VIE and/or the right to receive benefits from the VIE that could potentially be significant to the VIE.

Since the Company's inception, the Company has created VIEs for the purpose of securitizing whole mortgage loans or re-securitizing RMBS and obtaining permanent, non-recourse term financing. The Company evaluated its interest in each securitization trust VIE to determine the primary beneficiary status. The Company determined that seven trusts, one of which had been consolidated since its inception, met the requirements of consolidation. The Company determined that in these seven securitizations, based on holding all of the subordinate interests, it maintains the obligation to absorb losses and/or the right to receive benefits from the VIE that could be significant to the VIE. In addition, the Company had the power to direct activities of the trust or was determined to have the ability to control the trust due to its contribution in the purpose and design of the structure. The remaining two trusts evaluated did not meet the requirements to consolidate due to the inability to control one of the trusts and the lack of obligations to absorb losses on the other trust.

VIEs for Which the Company is the Primary Beneficiary
Based on the Company's consolidation evaluation, the Company consolidated three VIEs on January 1, 2010 that were not previously consolidated and consolidated three VIEs that it created during 2010. The Company's retained beneficial interest is typically the subordinated tranches of these re-securitizations and in some cases the Company may hold interests in additional tranches. The effect is the inclusion of an additional $2.4 billion of non-Agency mortgage-backed securities at fair value no longer retained by the Company and the inclusion in its liabilities of $2.1 billion of non-recourse securitized debt associated with these re-securitizations.

On an ongoing basis, the Company expects that the VIEs will be fair valued as Level 2 assets. Line items pertaining to the third-party owned interests are separately stated within the Company's consolidated financial statements and labeled as "non-retained".

The trusts are structured as pass through entities that receive principal and interest on the underlying collateral and distribute those payments to the certificate holders. The assets and other instruments held by the securitization entities are restricted in that they can only be used to fulfill the obligations of the securitization entity. Additionally, the obligations of the securitization entities do not have any recourse to the general credit of any other consolidated subsidiaries, nor to the Company as the primary beneficiary. The Company's risks associated with its involvement with these VIEs is limited to its risks and rights as a certificate holder of the bonds it has retained. See Note 5 for a

discussion of the fair value measurement of the assets and liabilities.

The assets of the securitization entities consolidated by the Company are similar in nature to the Company's portfolio as a whole. The securitization entities are all composed of RMBS of the quality and characteristics of assets reflected in the RMBS classifications found in the Company's consolidated financial statements. See Note 3 for a discussion of the securities characteristics of the portfolio.

The table below presents the assets and liabilities of consolidated entities as of January 1, 2010. The cumulative effect adjustment reflects the reversal of realized gains of $98.1 million previously recorded on the sales of these newly consolidated trusts net of the additional accretion of discounts due to consolidating the trusts.

| | Carrying Value (1) (dollars in thousands) |
|---|---|
| Assets | |
| Non-Agency RMBS | |
| Senior, non-retained | $1,114,034 |
| Liabilities | |
| Securitized debt, non-retained | 1,202,221 |
| Net assets and liabilities of newly consolidated entities | (88,187) |
| Cumulative effect adjustment to retained earnings upon adoption | $(88,187) |

(1) Carrying value represents the amount the assets would have been recorded at in the consolidated financial statements at January 1, 2010 had they been recorded in the consolidated financial statements on the date the Company first met the conditions for consolidation.

The cumulative effect of adopting ASC 810 on January 1, 2010 based on the shares outstanding on that date was to reduce the beginning book value of the Company by $0.13 per share.

The table below reflects the assets and liabilities recorded in the consolidated statements of financial condition related to consolidated securitization entities as of March 31, 2011 and December 31, 2010.

| | March 31, 2011 | December 31, 2010 |
|---|---|---|
| | (dollars in thousands) | |
| Assets | | |
| Non-Agency RMBS | $4,105,766 | $4,357,631 |
| Liabilities | | |
| Securitized debt, non-retained | $2,091,371 | $1,956,079 |

The consolidation of these securitization entities increases both the income and expense recorded in the consolidated statements of operations for the Company as detailed in the table below.

| | For the Quarter Ended March 31, 2011 | For the Quarter Ended March 31, 2010 |
|---|---|---|
| | (dollars in thousands) | |
| Interest income, non-retained | $ 21,159 | $ 50,861 |
| Interest expense, non-retained | 27,575 | 33,830 |
| Net interest income, non-retained | $ (6,416) | $ 17,031 |

A discussion of the significant accounting policies of the Company to record income and expense is included in Note 2 to these consolidated financial statements. The effect of adopting ASC 810 based on the weighted average shares outstanding was to decrease the net interest income of the Company by approximately $0.01 for the quarter ended March 31, 2011.

The effect of the consolidation of these securitization entities on the consolidated statements of cash flows for the Company is presented in the table below for the periods presented.

| | March 31, 2011 | March 31, 2010 |
|---|---|---|
| | (dollars in thousands) | |
| Proceeds from securitized debt borrowings, non-retained | $ 311,012 | $ 498,720 |
| Payments on securitized debt borrowings, non-retained | (175,719 ) | (84,634 ) |
| Increase (decrease) in accrued interest receivable | 142 | (7,841 ) |
| Increase (decrease) in accrued interest payable | (596 ) | 8,142 |
| Net cash flows, non-retained | $ 134,839 | $ 414,387 |

VIEs for Which the Company is Not the Primary Beneficiary

The table below represents the carrying amounts and classification of assets recorded on the Company's consolidated financial statements related to its variable interests in non-consolidated VIEs, as well as its maximum exposure to loss as a result of its involvement with these VIEs.

| | March 31, 2011 | | December 31, 2010 | |
|---|---|---|---|---|
| | Amortized Cost | Fair Value | Amortized Cost | Fair Value |
| | (dollars in thousands) | | | |
| Assets | | | | |
| Non-Agency RMBS | | | | |
| Senior | $341 | $524 | $400 | $559 |
| Subordinated | 6,952 | 6,198 | 7,664 | 6,485 |
| Agency RMBS | 2,454 | 2,456 | 2,680 | 2,530 |
| Total | $9,747 | $9,178 | $10,744 | $9,574 |

The Company's involvement with VIEs for which it is not the primary beneficiary generally are in the form of purchasing securities issued by the trusts similar to its investments in other RMBS that are not part of a trust it has evaluated for consolidation. The Company's maximum exposure to loss in these entities is represented by the fair value of these assets. This amount does not include OTTI or other write-downs that the Company previously recognized through earnings.

9. Interest Rate Swaps

In connection with the Company's interest rate risk management strategy, the Company economically hedges a portion of its interest rate risk by entering into derivative financial instrument contracts. These derivative financial instrument contracts do not qualify as hedges under ASC 815. As of March 31, 2011 and December 31, 2010, such instruments are comprised of interest rate swaps, which in effect modify the cash flows on repurchase agreements. The use of interest rate swaps creates exposure to credit risk relating to potential losses that could be recognized if the counterparties to these instruments fail to perform their obligations under the contracts. In the event of a default by the counterparty, the Company could have difficulty obtaining its RMBS pledged as collateral for swaps. The Company does not anticipate any defaults by its counterparties.

The Company's swaps are used to lock in a fixed rate related to a portion of its current and anticipated repurchase agreements.

The table below summarizes the location and fair value of interest rate swaps reported in the Consolidated Statements of Financial Condition as of March 31, 2011 and December 31, 2010.

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| | Location on Consolidated Statement of Financial Condition | Notional Amount | Net Estimated Fair Value/Carrying Value |
|---|---|---|---|
| | | (dollars in thousands) | |
| March 31, 2011 | Assets | $ 500,000 | $ 5,876 |
| March 31, 2011 | Liabilities | $ 450,000 | $ (6,033 ) |
| December 31, 2010 | Assets | $ - | $ - |
| December 31, 2010 | Liabilities | $ 450,000 | $ (9,988 ) |

The effect of the Company's interest rate swaps on the Consolidated Statement of Operations and Comprehensive Income (Loss) is presented below.

| | Location on Consolidated Statements of Operations and Comprehensive Income (Loss) | |
|---|---|---|
| | Interest Expense | Unrealized Gain (Loss) on Interest Rate Swaps |
| | (dollars in thousands) | |
| For the quarter ended: | | |
| March 31, 2011 | $ 2,847 | $ 9,831 |

The weighted average pay rate on the Company's interest rate swaps at March 31, 2011 was 2.08% and the weighted average receive rate was 0.25%. The Company had no interest rate swaps outstanding as of March 31, 2010.

10. Common Stock

On January 28, 2011 the Company entered into an equity distribution agreement with FIDAC and UBS Securities LLC ("UBS"). Through this agreement, the Company may sell through UBS, as its sales agent, up to 125,000,000 shares of its common stock in ordinary brokers' transactions at market prices or other transactions as agreed between the Company and UBS. The Company did not sell any shares of its common stock under the equity distribution agreement during the quarter ended March 31, 2011.

On September 24, 2009, the Company implemented a dividend reinvestment and share purchase plan ("DRSPP"). The DRSPP provides holders of record of its common stock an opportunity to automatically reinvest all or a portion of their cash distributions received on common stock in additional shares of our common stock as well as to make optional cash payments to purchase shares of our common stock. Persons who are not already stockholders may also purchase our common stock under the plan through optional cash payments. The DRSPP is administered by the Administrator, The Bank of New York Mellon. During the quarter ended March 31, 2011, the Company raised $311,000 by issuing 73,567 shares through the DRSPP. During the quarter ended March 31, 2010 no shares were issued under the DRSPP.

During the quarter ended March 31, 2011, the Company declared dividends to common shareholders totaling $143.7 million or $0.14 per share. During the quarter ended March 31, 2010, the Company declared dividends to common shareholders totaling $113.8 million or $0.17 per share.

There was no preferred stock issued or outstanding as of March 31, 2011 and December 31, 2010.

11. Long Term Incentive Plan

The Company has adopted a long term stock incentive plan to provide incentives to its independent directors and employees of FIDAC and its affiliates, to stimulate their efforts towards the Company's continued success, long-term growth and profitability and to attract, reward and retain personnel and other service providers. The incentive plan authorizes the Compensation Committee of the board of directors to grant awards, including incentive stock options, non-qualified stock options, restricted shares and other types of incentive awards. The specific award granted to an individual is based upon, in part, the individual's position within FIDAC, the individual's position within the Company, his or her contribution to the Company's performance, market practices, as well as the recommendations of FIDAC. The incentive plan authorizes the granting of options or other awards for an aggregate of the greater of 8.0% of the outstanding shares of the Company's common stock up to a ceiling of 40,000,000 shares.

On January 2, 2008, the Company granted restricted stock awards in the amount of 1,301,000 shares to FIDAC's employees and the Company's independent directors. The awards to the independent directors vested on the date of grant and the awards to FIDAC's employees vest quarterly over a period of 10 years. Of these shares, as of March 31, 2011, 447,800 shares have vested and 43,587 shares were forfeited or cancelled.

As of March 31, 2011, there was $15.1 million of total unrecognized compensation costs related to non-vested share-based compensation arrangements granted under the long term incentive plan, based on the closing price of the shares on the grant date. That cost is expected to be recognized over a weighted-average period of 6.8 years. The total fair value of shares vested, less those forfeited, during the quarter ended March 31, 2011 was $128,000, based on the closing price of the stock on the vesting date.

12. Income Taxes

As a REIT, the Company is not subject to Federal income tax to the extent that it makes qualifying distributions to its stockholders, and provided it satisfies on a continuing basis, through actual investment and operating results, the REIT requirements including certain asset, income, distribution and stock ownership tests. Most states recognize REIT status as well. During the quarter ended March 31, 2011, the Company recorded $698,000 in income tax expense related to earnings of its TRS and state income taxes. During the quarter ended March 31, 2010, the Company recorded no income tax expense.

In general, common stock cash dividends declared by the Company will be considered ordinary income to stockholders for income tax purposes. From time to time, a portion of the Company's dividends may be characterized as capital gains or return of capital. For the quarters ended March 31, 2011 and December 31, 2010, the Company estimates that all income distributed in the form of dividends will be characterized as ordinary income.

The Company files tax returns in several U.S. jurisdictions, including New York State and New York City. The 2010 tax year remains open to U.S. Federal, State, and local examinations.

13. Credit Risk and Interest Rate Risk

The Company's primary components of market risk are credit risk and interest rate risk. The Company is subject to interest rate risk in connection with its investments in Agency and non-Agency residential mortgage loans and credit sensitive mortgage-backed securities. When the Company assumes interest rate risk, it attempts to minimize interest rate risk through asset selection, hedging and matching the income earned on mortgage assets with the cost of related liabilities. The Company is subject to interest rate risk, primarily in connection with its investments in fixed-rate and adjustable-rate mortgage-backed securities, residential mortgage loans, and borrowings under repurchase agreements. The Company attempts to minimize credit risk through due diligence and asset selection by purchasing loans underwritten to agreed-upon specifications of selected originators. The Company has established a whole loan target market including prime borrowers with FICO scores generally greater than 650, Alt-A documentation, geographic diversification, owner-occupied property, and moderate loan to value ratio. These factors are considered to be important indicators of credit risk.

14. Management Agreement and Related Party Transactions

The Company has entered into a management agreement with FIDAC, which provided for an initial term through December 31, 2010 with an automatic one-year extension option and subject to certain termination rights. On November 18, 2010, the Compensation Committee of the Board of Directors renewed the management agreement through December 31, 2011. The Company pays FIDAC a quarterly management fee equal to 1.50% per annum of the gross Stockholders' Equity (as defined in the management agreement) of the Company.

Management fees accrued and paid to FIDAC for the quarters ended March 31, 2011 and 2010 were $12.8 million and $8.1 million, respectively.

The Company is obligated to reimburse FIDAC for its costs incurred under the management agreement. In addition, the management agreement permits FIDAC to require the Company to pay for its pro rata portion of rent, telephone, utilities, office furniture, equipment, machinery and other office, internal and overhead expenses that FIDAC incurred in the operation of the Company. These expenses are allocated between FIDAC and the Company based on the ratio of the Company's proportion of gross assets compared to all remaining gross assets managed by FIDAC as calculated at each quarter end. FIDAC and the Company will modify this allocation methodology, subject to the Company's board of directors' approval if the allocation becomes inequitable (i.e., if the Company becomes very highly leveraged compared to FIDAC's other funds and accounts). During the quarter ended March 31, 2011, the Company reimbursed FIDAC approximately $146,000 for such expenses. During the quarter ended March 31, 2010, FIDAC waived its right to request reimbursement from the Company for these expenses.

During the quarters ended March 31, 2011 and March 31, 2010, 31,600 shares and 32,225 shares of restricted stock issued by the Company to FIDAC's employees vested, respectively as discussed in Note 11. During the quarters ended March 31, 2011 and March 31, 2010, 585 shares and 562 shares of restricted stock issued by the Company to FIDAC's employees were forfeited, respectively.

In April 2009, the Company entered into a Securities Industry and Financial Markets Association standard preprinted form Master Repurchase Agreement with RCap Securities, Inc., a wholly owned subsidiary of Annaly. This standard agreement does not contain any sort of liquidity, net worth or other similar types of positive or negative covenants. Rather, the agreement contains covenants that require the buyer and seller of securities to deliver collateral or securities, and similar covenants which are customary in master repurchase agreements. At March 31, 2011 and December 31, 2010, the Company had no financing under this agreement. The Company has been in compliance with all covenants of this agreement since it entered into this agreement.

In March 2008, the Company entered into a Securities Industry and Financial Markets Association standard preprinted form Master Repurchase Agreement with Annaly. This standard agreement does not contain any sort of liquidity, net worth or other similar types of positive or negative covenants. Rather, the agreement contains covenants that require the buyer and seller of securities to deliver collateral or securities, and similar covenants which are customary in master repurchase agreements. At March 31, 2011 and December 31, 2010, the Company had no financing under this agreement. The Company has been in compliance with all covenants of this agreement since it entered into this agreement.

15. Commitments and Contingencies

The Company has reviewed subsequent events occuring through the date that these consolidated financial statements were available to be issued, and determined that no subsequent events occurred that would require accrual or additional discloure. The Company may become involved in various claims and legal actions arising in the ordinary course of business. Management is not aware of any reported or unreported contingencies at March 31, 2011.

16. Subsequent Events

The Company has reviewed subsequent events occuring through the date that these consolidated financial statements were available to be 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

Special Note Regarding Forward-Looking Statements

We make forward-looking statements in this report that are subject to risks and uncertainties. These forward-looking statements include information about possible or assumed future results of our business, financial condition, liquidity, results of operations, plans and objectives. When we use the words ''believe,'' ''expect,'' ''anticipate,'' ''estimate,'' ''plan,'' ''continue,'' ''intend,'' ''should,'' ''may,'' ''would,'' ''will'' or similar expressions, we intend to identify forward-looking statements. Statements regarding the following subjects, among others, are forward-looking by their nature:

- our business and investment strategy;
- our projected financial and operating results;
- our ability to maintain existing financing arrangements, obtain future financing arrangements and the terms of such arrangements;
- general volatility of the securities markets in which we invest;
- the impact of and changes to various government programs;
- our expected investments;
- changes in the value of our investments;
- interest rate mismatches between our investments and our borrowings used to fund such purchases;
- changes in interest rates and mortgage prepayment rates;
- effects of interest rate caps on our adjustable-rate investments;
- rates of default or decreased recovery rates on our investments;
- prepayments of the mortgage and other loans underlying our mortgage-backed or other asset-backed securities;
- the degree to which our hedging strategies may or may not protect us from interest rate volatility;
- impact of and changes in governmental regulations, tax law and rates, accounting guidance, and similar matters;
- availability of investment opportunities in real estate-related and other securities;
- availability of qualified personnel;
- estimates relating to our ability to make distributions to our stockholders in the future;
- our understanding of our competition; and
- market trends in our industry, interest rates, 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 caption ‘‘Risk Factors’’ in our most recent Annual Report on Form 10-K and any subsequent Quarterly Reports on Form 10-Q. 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 from time to time, and it is impossible 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.

Executive Summary

We are a specialty finance company that acquires, either directly or indirectly through our subsidiaries, residential mortgage-backed securities, or RMBS, residential mortgage loans, commercial mortgage loans, real estate related securities and various other asset classes. We are externally managed by Fixed Income Discount Advisory Company, which we refer to as FIDAC or our Manager. FIDAC is a fixed-income investment management company that is registered as an investment adviser with the Securities and Exchange Commission, or SEC. FIDAC is a wholly owned subsidiary of Annaly Capital Management, Inc., or Annaly. FIDAC has a broad range of experience in managing investments in Agency RMBS, which are mortgage pass-through certificates, collateralized mortgage obligations, or CMOs, and other mortgage-backed securities representing interests in or obligations backed by pools of mortgage loans issued or guaranteed by Fannie Mae, Freddie Mac, and Ginnie Mae, non-Agency RMBS, collateralized debt obligations, or CDOs, and other real estate related investments.

We have elected and intend to qualify to be taxed as a REIT for federal income tax purposes commencing with our taxable year ended December 31, 2007. Our targeted asset classes and the principal investments we expect to make in each are as follows:

| Asset Class | Principal Investments |
| --- | --- |
| Residential Mortgage-Backed Securities | · Non-Agency RMBS, including investment-grade and non-investment grade classes, including the BB-rated, B-rated and non-rated classes.<br><br>· Agency RMBS. |
| Residential Mortgage Loans | · Prime mortgage loans, which are mortgage loans that conform to the underwriting guidelines of Fannie Mae and Freddie Mac, which we refer to as Agency Guidelines; and jumbo prime mortgage loans, which are mortgage loans that conform to the Agency Guidelines except as to loan size.<br><br>· Alt-A mortgage loans, which are mortgage loans that may have been originated using documentation standards that are less stringent than the documentation standards applied by certain other first lien mortgage loan purchase programs, such as the Agency Guidelines, but have one or more compensating factors such as a borrower with a strong credit or mortgage history or significant assets. |

| | |
|---|---|
| Commercial Mortgage Loans | · First or second lien loans secured by multifamily properties, which are residential rental properties consisting of five or more dwelling units; and mixed residential or other commercial properties; retail properties; office properties; or industrial properties, which may or may not conform to the Agency Guidelines. |
| Other Asset-Backed Securities | · CMBS.<br>· Debt and equity tranches of CDOs.<br>· Consumer and non-consumer ABS, including investment-grade and non-investment grade classes, including the BB-rated, B-rated and non-rated classes. |

We completed our initial public offering on November 21, 2007. In that offering and in a concurrent private offering we raised net proceeds of approximately $533.6 million from the sales of shares of our common stock. Since then we have raised an aggregate of approximately $3.1 billion in follow-on offerings from the sales of shares of our common stock.

Our objective is to provide attractive risk-adjusted returns to our investors over the long-term, primarily through dividends and secondarily through capital appreciation. We intend to achieve this objective by investing in a broad class of financial assets to construct an investment portfolio that is designed to achieve attractive risk-adjusted returns and that is structured to comply with the various federal income tax requirements for REIT status and to maintain our exemption from the Investment Company Act of 1940, or the 1940 Act.

Since we commenced operations in November 2007, we have focused our investment activities on acquiring non-Agency RMBS and on purchasing residential mortgage loans that have been originated by select high-quality originators, including the retail lending operations of leading commercial banks. Our investment portfolio is weighted toward non-Agency RMBS. At March 31, 2011, approximately 71.7% of our investment portfolio's principal value was non-Agency RMBS, 25.1% of our investment portfolio's principal value was Agency RMBS, and 3.2% of our investment portfolio's principal value was secured residential mortgage loans. At December 31, 2010, approximately 83.4% of our investment portfolio's principal value was non-Agency RMBS, 12.6% of our investment portfolio's principal value was Agency RMBS, and 4.0% of our investment portfolio's principal value was secured residential mortgage loans. We expect that over the near term our investment portfolio will continue to be weighted toward RMBS, subject to maintaining our REIT qualification and our 1940 Act exemption.

Our investment strategy is intended to take advantage of opportunities in the current interest rate and credit environment. We will adjust our strategy to changing market conditions by shifting our asset allocations across these various asset classes as interest rate and credit cycles change over time. We believe that our strategy, combined with FIDAC's experience, will enable us to pay dividends and achieve capital appreciation throughout changing market cycles. We expect to take a long-term view of assets and liabilities, and our reported earnings and mark-to-market valuations at the end of a financial reporting period will not significantly impact our objective of providing attractive risk-adjusted returns to our stockholders over the long-term.

We use leverage to seek to increase our potential returns and to fund the acquisition of our assets. Our income is generated primarily by the difference, or net spread, between the income we earn on our assets and the cost of our

borrowings. We expect to finance our investments using a variety of financing sources including, when available, repurchase agreements, warehouse facilities, securitizations, commercial paper and term financing CDOs. We may manage our debt by utilizing interest rate hedges, such as interest rate swaps, to reduce the effect of interest rate fluctuations related to our debt.

Recent Developments

During the period of market dislocation that commenced in August 2007, fiscal and monetary policymakers established new liquidity facilities for primary dealers and commercial banks, reduced short-term interest rates, and passed legislation that is intended to address the challenges of mortgage borrowers and lenders. In September 2008 Fannie Mae and Freddie Mac were placed into the conservatorship of the Federal Housing Finance Agency, or FHFA, their federal regulator, pursuant to its powers under The Federal Housing Finance Regulatory Reform Act of 2008, a part of the Housing and Economic Recovery Act of 2008. In addition to FHFA becoming the conservator of Fannie Mae and Freddie Mac, the Treasury and FHFA entered into preferred stock purchase agreements (PSPAs) between the Treasury and Fannie Mae and Freddie Mac pursuant to which the Treasury will ensure that each of Fannie Mae and Freddie Mac maintains a positive net worth. On December 24, 2009, the Treasury amended the terms of the PSPAs with Fannie Mae and Freddie Mac to remove the $200 billion per institution limit established under the PSPAs until the end of 2012. The Treasury also amended the PSPAs with respect to the requirements for Fannie Mae and Freddie Mac to reduce their portfolios.

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act, or the Dodd-Frank Act. The Dodd-Frank Act provides for new regulations on financial institutions and creates new supervisory and advisory bodies, including the new Consumer Financial Protection Bureau. The Dodd-Frank Act tasks many agencies with issuing a variety of new regulations, including rules related to mortgage origination and servicing, securitization and derivatives. As the Dodd-Frank Act has only recently been enacted and because a significant number of regulations have yet to be proposed or adopted in final form, it is not possible for us to predict how the Dodd-Frank Act will impact our business.

On February 11, 2011, the U.S Department of the Treasury issued a White Paper titled "Reforming America's Housing Finance Market" that lays out, among other things, proposals to limit or potentially wind down the role that Fannie Mae and Freddie Mac play in the mortgage market. Any such proposals, if enacted, may have broad adverse implications for the mortgage-backed securities market and our business, operations and financial condition. We expect such proposals to be the subject of significant discussion and it is not yet possible to determine whether or when such proposals may be enacted, what form any final legislation or policies might take and how proposals, legislation or policies emanating from the White Paper may impact the mortgage-backed securities market and our business, operations and financial condition. We are evaluating the potential impact of the proposals set forth in the White Paper.

Market conditions are evolving on a number of fronts. Regulatory and technical dynamics continue to develop, and monetary policy initiatives, including additional large scale asset purchases by the Federal Reserve, continue to support asset prices and lower yields across a wide range of market sectors, including ours.

Trends

We expect the results of our operations to be affected by various factors, many of which are beyond our control. Our results of operations will primarily depend on, among other things, the level of our net interest income, the market value of our assets, and the supply of and demand for such assets. Our net interest income, which reflects the amortization of purchase premiums and accretion of discounts, varies primarily as a result of changes in interest rates, borrowing costs, and prepayment speeds, which is a measurement of how quickly borrowers pay down the unpaid principal balance on their mortgage loans.

Prepayment Speeds. Prepayment speeds, as reflected by the Constant Prepayment Rate, or CPR, vary according to interest rates, the type of investment, conditions in financial markets, and other factors, none of which can be predicted with any certainty. In general, when interest rates rise, it is relatively less attractive for borrowers to

refinance their mortgage loans, and as a result, prepayment speeds tend to decrease.  When interest rates fall, prepayment speeds tend to increase. For mortgage loan and RMBS investments purchased at a premium, as prepayment speeds increase, the amount of income we earn decreases because the purchase premium we paid for the bonds amortizes faster than expected.  Conversely, decreases in prepayment speeds result in increased income and can extend the period over which we amortize the purchase premium. For mortgage loan and RMBS investments purchased at a discount, as prepayment speeds increase, the amount of income we earn increases because of the acceleration of the accretion of the discount into interest income. Conversely, decreases in prepayment speeds result in decreased income and can extend the period over which we accrete the purchase discount into interest income.

Rising Interest Rate Environment. As indicated above, as interest rates rise, prepayment speeds generally decrease. Rising interest rates, however, increase our financing costs which may result in a net negative impact on our net interest income. In addition, if we acquire Agency and non-Agency RMBS collateralized by monthly reset adjustable-rate mortgages, or ARMs, and three- and five-year hybrid ARMs, such interest rate increases could result in decreases in our net investment income, as there could be a timing mismatch between the interest rate reset dates on our RMBS portfolio and the financing costs of these investments. We expect, that our fixed-rate assets would decline in value in a rising interest rate environment and that our net interest spreads on fixed rate assets could decline in a rising interest rate environment to the extent such assets are financed with floating rate debt.

Falling Interest Rate Environment. As interest rates fall, prepayment speeds generally increase. Falling interest rates, however, decrease our financing costs which may result in a net positive impact on our net interest income. In addition, if we acquire Agency and non-Agency RMBS collateralized by monthly reset adjustable-rate mortgages, or ARMs, and three- and five-year hybrid ARMs, such interest rate decreases could result in increases in our net investment income, as there could be a timing mismatch between the interest rate reset dates on our RMBS portfolio and the financing costs of these investments. We expect, however, that our fixed-rate assets would increase in value in a falling interest rate environment and that our net interest spreads on fixed rate assets could increase in a falling interest rate environment to the extent such assets are financed with floating rate debt.

Credit Risk. One of our strategic focuses is acquiring assets which we believe to be of high credit quality. We believe this strategy will generally keep our credit losses and financing costs low. We also focus on acquiring distressed assets non-Agency RMBS have been downgraded because of defaults in the mortgages collateralizing such RMBS. When we acquire such RMBS we attempt to purchase it at a price such that its loss-adjusted return profile is in line with our targeted yields. We retain the risk of potential credit losses on all of the residential mortgage loans we hold in our portfolio as well as all of the non-Agency RMBS. We attempt to mitigate credit risk in the asset selection process. Prior to the purchase of investments, we conduct a credit-risk based analysis of the collateral securing our investment that includes examining borrower characteristics, geographic concentrations, current and projected delinquencies, current and projected severities, and actual and expected prepayment speeds among other characteristics to formulate expected losses.

Size of Investment Portfolio. The size of our investment portfolio, as measured by the aggregate unpaid principal balance of our mortgage loans and aggregate principal balance of our mortgage related securities and the other assets we own is also a key revenue driver. Generally, as the size of our investment portfolio grows, the amount of interest income we receive increases. The larger investment portfolio, however, drives increased expenses as we incur additional interest expense to finance the purchase of our assets.

Current Environment. We expect to use a number of sources to finance our investments, including repurchase agreements, warehouse facilities, securitizations, asset-backed commercial paper and term CDOs. Current market conditions have affected the cost and availability of financing from each of these sources and their individual providers to different degrees; some sources generally are unavailable, some are available but at a high cost, and some are largely unaffected.

In the current market, it may be difficult or impossible to obtain third party pricing on the investments we purchase. In addition, validating third party pricing for our investments may be more subjective as fewer participants may be willing to provide this service to us. Moreover, the current market is more illiquid than in recent history for some of the investments we purchase. Illiquid investments typically experience greater price volatility as a ready market does not exist. As volatility increases or liquidity decreases we may have greater difficulty financing our investments which may negatively impact our earnings and the execution of our investment strategy.

Critical Accounting Policies

Our consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America, or GAAP. These accounting principles may require us to make some complex and subjective decisions and assessments. Our most critical accounting policies will involve decisions and assessments that could affect our reported assets and liabilities, as well as our reported revenues and expenses. We believe that all of the decisions and assessments upon which our consolidated financial statements are based will be reasonable at the time made and based upon information available to us at that time. The following are our most critical accounting policies:

Valuation of Investments

Accounting Standards Codification, or ASC 820, Fair Value Measurements and Disclosures, establishes a framework for measuring fair value, and establishes a three-level valuation hierarchy for disclosure of fair value measurement and enhances disclosure requirements for fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

Level 1 – inputs to the valuation methodology are quoted prices (unadjusted) for identical assets and liabilities in active markets.

Level 2 – inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level 3 – inputs to the valuation methodology are unobservable and significant to overall fair value.

Non-Agency and Agency RMBS are valued using a pricing model. The RMBS pricing model incorporates such factors as coupons, prepayment speeds, spread to the Treasury and swap curves, convexity, duration, periodic and life caps, and credit enhancement. Management reviews the fair values determined by the pricing model and compares its results to dealer quotes received on each investment to validate the reasonableness of the valuations indicated by the pricing models. The dealer quotes incorporate common market pricing methods, including a spread measurement to the Treasury curve or interest rate swap curve as well as underlying characteristics of the particular security including coupon, periodic and life caps, rate reset period, issuer, additional credit support and expected life of the security.

Although we utilize a pricing model to compute the fair value of the securities in our portfolio, we validate our fair values by seeking indications of fair value from third-party dealers and/or pricing services. The variability of fair value among dealers and pricing services can be wide at this time as full liquidity for the non-Agency market has yet to return. In addition, there are fewer participants in the RMBS sector available to fair value investments. Our internal valuations of the securities on which we received dealer marks were 0.11% higher at March 31, 2011 and 0.76% higher at March 31, 2010 than the aggregated dealer marks.

Any changes to the valuation methodology are reviewed by management to ensure the changes are appropriate. As markets and products develop and the pricing for certain products becomes more transparent, we continue to refine our valuation methodologies. The methods used by us may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while we believe our valuation methods are appropriate and consistent with other market participants, the use of different methodologies, or assumptions, to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date. We use inputs that are current as of the measurement date, which may include periods of market dislocation, during which price transparency may be reduced. This condition could cause our financial instruments to be reclassified from Level 2 to Level 3.

Other-than-Temporary Impairments

We evaluate each investment in our RMBS portfolio for other-than-temporary impairments, or OTTI, quarterly or more often if market conditions warrant. Each investment is analyzed and we determine if we (1) have the intent to sell the security, (2) are more likely than not to be required to sell the security before recovery, or (3) we do not expect to recover the entire amortized cost basis of the security. Further, each security is analyzed for credit loss by comparing the difference between the present value of cash flows expected to be collected and the amortized cost

basis. The credit loss, if any, is then recognized in the consolidated statements of operations, while the balance of impairment related to other factors is recognized in other comprehensive income (loss).

Interest Income

Interest income on RMBS and loans held for investment is recognized over the life of the investment using the effective interest method. The effective interest method requires significant management judgment in calculating the yields utilized to accrete discounts and amortize premiums. The assumptions used by us to calculate the expected yield include current and future prepayment assumptions, expected principal write-downs, loss severities, changes in interest rates, and other factors that affect the expected yield. Income recognition is suspended for loans when, in the opinion of management, a full recovery of income and principal becomes doubtful. Income recognition is resumed when the loan becomes contractually current and performance is demonstrated to be resumed.

Accounting For Derivative Financial Instruments and Hedging Activities

Our policies permit us to enter into derivative contracts, including interest rate swaps and interest rate caps, as a means of mitigating our interest rate risk. We use interest rate derivative instruments to mitigate interest rate risk rather than to enhance returns. We account for these instruments as free-standing derivatives. Accordingly, they are carried at fair value with realized and unrealized gains and losses recognized in earnings.

We recognize all derivatives as either assets or liabilities in the statement of financial condition and measure those instruments at fair value. Additionally, the fair value adjustments will affect net income as we did not elect to use hedge accounting.

Derivatives will be used for economic hedging purposes rather than speculation. We will rely on quotations from third parties to determine fair values. We compare the dealer quotes received by us to the fair values generated by our own internal pricing model which incorporates such factors as term to maturity, the Treasury curve, LIBOR rates, and payment rates on the fixed portion of the interest rate swaps. If our hedging activities do not achieve our desired results, our reported earnings may be adversely affected.

Allowance for Probable Credit Losses

We have established an allowance for loan losses at a level that management believes is adequate based on an evaluation of known and inherent probable losses related to our loan portfolio. The estimate is based on a variety of factors including current economic conditions, industry loss experience, the loan originator's loss experience, credit quality trends, loan portfolio composition, delinquency trends, national and local economic trends, national unemployment data, changes in housing appreciation or depreciation and whether specific geographic areas where we have significant loan concentrations are experiencing adverse economic conditions and events such as natural disasters that may affect the local economy or property values. Upon purchase of the pools of loans, we obtained written representations and warranties from the sellers that we could be reimbursed for the value of the loan if the loan fails to meet the agreed upon origination standards. While we have little history of our own to establish loan trends, delinquency trends of the originators and the current market conditions aid in determining the allowance for loan losses. We also performed due diligence procedures on a sample of loans that met our criteria during the purchase process. We have created an unallocated provision for probable loan losses estimated as a percentage of the remaining principal on the loans. Management's estimate is based on historical experience of similarly underwritten pools.

When we determine it is probable that specific contractually due amounts are uncollectible, the amount is considered impaired. Where impairment is indicated, a valuation write-off is measured based upon the excess of the recorded investment over the net fair value of the collateral, reduced by selling costs. Any deficiency between the carrying amount of an asset and the net sales price of repossessed collateral is charged to the allowance for loan losses.

Income Taxes

We have elected and intend to qualify to be taxed as a REIT. Therefore we will generally not be subject to corporate federal or state income tax to the extent that we make qualifying distributions to our stockholders, and provided we satisfy on a continuing basis, through actual investment and operating results, the REIT requirements including certain asset, income, distribution and stock ownership tests.

If we fail to qualify as a REIT, and do not qualify for certain statutory relief provisions, we will be subject to federal, state and local income taxes and may be precluded from qualifying as a REIT for the subsequent four taxable years following the year in which we lost our REIT qualification. Accordingly, our failure to qualify as a REIT could have

a material adverse impact on our results of operations and amounts available for distribution to our stockholders.

The dividends paid deduction of a REIT for qualifying dividends to its stockholders is computed using our taxable income as opposed to net income reported on the consolidated financial statements.  Taxable income, generally, will differ from net income reported on the consolidated financial statements because the determination of taxable income is based on tax provisions and not financial accounting principles.

Financial Condition

Estimated Economic Book Value

This Management Discussion and Analysis section contains analysis and discussion of financial information that utilizes or presents ratios based on GAAP book value. The table and discussion below present our estimated economic book value. We calculate and disclose this non-GAAP measurement because we believe it represents our estimated economic book value at the measurement date.

On January 1, 2010 GAAP required us to consolidate certain re-securitization transactions we consummated during 2009 and 2010. In these re-securitizations, we transferred assets to the re-securitization trusts, which issued tranches of senior and subordinate notes or certificates. We sold the senior tranches and therefore have no continuing involvement in these trusts other than being a holder of notes or certificates issued by the trusts, with the same rights of other holders of the notes or certificates. The notes and certificates we own that were issued by the trusts are largely subordinated interests in those trusts. The trusts have no recourse to our assets other than pursuant to a breach by us of the transaction documents related to the transfer of the assets by us to the trusts.

GAAP requires us to fair value and present the assets of these trusts on our consolidated statements of financial condition as if we still owned the underlying securities we transferred to the trusts. We present the assets related to the consolidated trusts in our consolidated statements of financial position as a component of non-Agency mortgage-backed securities identified as senior, non-retained, and the liabilities as securitized debt, non-retained. We have fair valued the underlying securities we transferred to the trusts for the calculation of GAAP book value in accordance with our pricing policy, as described more fully in our critical accounting estimates, and recorded the corresponding liability for the notes or certificates sold to third parties. All fair value adjustments are recorded in Other Comprehensive Income.

However, because of the governing documents of the trusts we are unable to sell the underlying securities we transferred into the trusts as we no longer own those securities, we also present our estimated economic book value. We believe this measure represents the estimated value of the securities issued by these trusts that we own. In contrast to GAAP book value, our estimated economic book value considers only the assets we own or are able to dispose of, pledge, or otherwise monetize. To determine our estimated economic book value, we fair value the notes or certificates issued by the re-securitization trusts that we actually own in accordance with our pricing policy. Accordingly, our estimated economic book value does not include assets or liabilities for which we have no continuing involvement, specifically the notes or certificates of the re-securitization trusts that were sold to third parties. We believe this estimate represents the value of the assets that we hold in our portfolio should we decide to sell, pledge, or otherwise dispose of assets as of the measurement date.

At March 31, 2011 the difference between GAAP book value and estimated economic book value was determined to be $276.8 million. At December 31, 2010 the difference between GAAP book value and estimated economic book value was determined to be $374.5 million. This difference is primarily driven by the nature of the assets we have retained in these re-securitization transactions as compared to the nature of underlying securities in these transactions. In these re-securitization transactions, we retained the subordinated, typically non-rated, first loss notes or certificates issued by the re-securitization trusts. These securities are complex, typically locked out as to principal repayment, relatively illiquid, and do not necessarily appreciate or depreciate in tandem with the broader non-Agency RMBS market or with the underlying securities owned by the trusts. The tables below present the adjustments to GAAP book value that we believe necessary to adequately reflect our calculation of estimated economic book value as of March 31, 2011 and December 31, 2010.

| | March 31, 2011 | | |
|---|---|---|---|
| | GAAP Book Value | Adjustments | Estimated Economic Book Value |
| | (dollars in thousands) | | |
| Assets: | | | |
| Non-Agency Mortgage-Backed Securities, at fair value | | | |
| Senior | $329,782 | $- | $329,782 |
| Subordinated | 2,266,560 | - | 2,266,560 |
| Senior, non-retained | 2,368,212 | (2,368,212) | - |
| Agency Mortgage-Backed Securities, at fair value | 4,879,382 | - | 4,879,382 |
| Securitized loans held for investment, net of allowance for loan losses | 326,295 | - | 326,295 |
| Other current assets | 88,203 | - | 88,203 |
| Total assets | $10,258,434 | $(2,368,212) | $7,890,222 |
| | | | |
| Repurchase agreements | 3,870,407 | - | 3,870,407 |
| Securitized debt | 266,363 | - | 266,363 |
| Securitized debt, non-retained | 2,091,371 | (2,091,371) | - |
| Other liabilities | 487,903 | - | 487,903 |
| Total liabilities | 6,716,044 | (2,091,371) | 4,624,673 |
| | | | |
| Total stockholders' equity | 3,542,390 | (276,841) | 3,265,549 |
| Total liabilities and stockholders' equity | $10,258,434 | $(2,368,212) | $7,890,222 |
| | | | |
| Book Value Per Share | $3.45 | $(0.27) | $3.18 |

| | December 31, 2010 | | |
|---|---|---|---|
| | GAAP Book Value | Adjustments | Estimated Economic Book Value |
| Assets: | (dollars in thousands) | | |
| Non-Agency Mortgage-Backed Securities, at fair value | | | |
| Senior | $987,685 | $- | $987,685 |
| Subordinated | 2,210,858 | - | 2,210,858 |
| Senior, non-retained | 2,330,568 | (2,330,568) | - |
| Agency Mortgage-Backed Securities, at fair value | 2,133,584 | - | 2,133,584 |
| Securitized loans held for investment, net of allowance for loan losses | 353,532 | - | 353,532 |
| Other current assets | 57,473 | - | 57,473 |
| Total assets | $8,073,700 | $(2,330,568) | $5,743,132 |
| | | | |
| Repurchase agreements | 1,808,797 | - | 1,808,797 |
| Securitized debt | 289,236 | - | 289,236 |
| Securitized debt, non-retained | 1,956,079 | (1,956,079) | - |

| | | | |
|---|---|---|---|
| Other liabilities | 336,582 | - | 336,582 |
| Total liabilities | 4,390,694 | (1,956,079 ) | 2,434,615 |
| | | | |
| | | | |
| Total stockholders' equity | 3,683,006 | (374,489 ) | 3,308,517 |
| Total liabilities and stockholders' equity | $8,073,700 | $(2,330,568 ) | $5,743,132 |
| | | | |
| Book Value Per Share | $3.59 | $(0.36 ) | $3.23 |

Our estimate of economic book value has important limitations. Our estimate of fair value is as of a point in time and subject to significant judgment. Other market participants may derive a different fair value for each asset than we calculate. Should we sell the assets in our portfolio, we may realize materially different proceeds from the sale than we have estimated as of the reporting date.

Although we believe that the calculation of estimated economic value described above helps our management and investors understand the fair value of the assets we own and the liabilities for which we are legally obligated, it is of limited usefulness as an analytical tool. It does not take account of the fair value of assets that we do not own, but regarding which we will be the principal beneficiary of increases in value above, and will bear the principal burden of reductions in value to below, what currently is anticipated. Therefore, the estimated economic book value should not be viewed in isolation and is not a substitute for book value computed in accordance with GAAP.

Portfolio Review

At March 31, 2011, our portfolio consisted of $5.0 billion of non-Agency RMBS, $4.9 billion of Agency RMBS, at fair value, and $326.3 million of securitized mortgage loans, at amortized cost. At December 31, 2010, our portfolio consisted of $5.5 billion of non-Agency RMBS, $2.1 billion of Agency RMBS and $353.5 million of securitized mortgage loans.

The following table summarizes certain characteristics of our portfolio at March 31, 2011 and 2010, and December 31, 2010:

| | March 31, 2011 | | March 31, 2010 | | December 31, 2010 | |
|---|---|---|---|---|---|---|
| Interest earning assets at period-end * | $ 10,170,231 | | $ 6,023,722 | | $ 8,016,227 | |
| Interest bearing liabilities at period-end | $ 6,228,141 | | $ 3,687,339 | | $ 4,054,112 | |
| Leverage at period-end | 1.8:1 | | 1.6:1 | | 1.1:1 | |
| Leverage at period-end (recourse) | 1.1:1 | | 0.7:1 | | 0.5:1 | |
| Portfolio Composition, at principal value | | | | | | |
| Non-Agency RMBS | 71.7 | % | 76.5 | % | 83.4 | % |
| Senior | 0.1 | % | 15.7 | % | 4.0 | % |
| Senior, interest only | 33.2 | % | 15.6 | % | 35.7 | % |
| Subordinated | 25.6 | % | 25.8 | % | 29.8 | % |
| Subordinated, interest only | 1.6 | % | 2.8 | % | 1.8 | % |
| Senior, non-retained | 11.2 | % | 16.6 | % | 12.1 | % |
| Agency RMBS | 25.1 | % | 15.4 | % | 12.6 | % |
| Securitized loans | 3.2 | % | 8.1 | % | 4.0 | % |
| Fixed-rate percentage of portfolio | 79.8 | % | 66.2 | % | 51.7 | % |
| Adjustable-rate percentage of portfolio | 20.2 | % | 33.8 | % | 48.3 | % |
| Annualized yield on average interest earning assets for the quarter ended** | 7.41 | % | 9.99 | % | 8.17 | % |
| Annualized cost of funds on average borrowed funds for the quarter ended | 2.70 | % | 4.50 | % | 4.10 | % |

* Excludes cash and cash equivalents.
** Includes the effect of realized loss on principal write-downs.

The following table presents details of each asset class in our portfolio at March 31, 2011. The principal or notional value represents the interest income earning balance of each class. The weighted average amortized cost, fair value, coupon, yield, and CPR at period-end are weighted by each investment's respective principal/notional value in the asset class. The figure presenting the annualized yield over the current quarter is the annualized interest income earned on the asset class during the quarter, including the effect of principal write-downs, divided by the average of the beginning and ending amortized cost of the asset class.

| | March 31, 2011 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Principal or Notional Value at Period-End | Weighted Average Amortized Cost Basis at Period-End | Weighted Average Fair Value at Period-End | Weighted Average Coupon at Period-End | Weighted Average Yield (Loss Adjusted) at Period-End | Annualized Yield Over Current Quarter* | Weighted Average 3 Month CPR at Period-End |
| Non-Agency Mortgage-Backed Securities | | | | | | | |
| Senior | $ 9,612 | $ 98.86 | $ 94.20 | 1.22 % | 2.66 % | 2.21 % | 6 % |
| Senior, interest only | $ 6,352,256 | $ 6.44 | $ 5.05 | 2.02 % | 12.91 % | 4.78 % | 17 % |
| Subordinated | $ 4,917,240 | $ 46.88 | $ 45.44 | 4.12 % | 14.43 % | 24.27 % | 16 % |
| Subordinated, interest only | $ 303,427 | $ 9.93 | $ 10.56 | 2.97 % | 26.06 % | 35.83 % | 14 % |
| Senior, non-retained | $ 2,136,669 | $ 98.09 | $ 110.84 (1 ) | 5.21 % | 4.88 % | 3.50 % | 16 % |
| Agency Mortgage-Backed Securities | $ 4,800,913 | $ 102.76 | $ 102.74 | 4.71 % | 4.26 % | 4.48 % | 20 % |
| Securitized loans | | | | | | | |
| Senior | $ 273,178 | $ 101.19 | $ 101.19 | 5.46 % | 5.50 % | 4.92 % | 25 % |
| Senior, interest only | $ 288,661 | $ 0.01 | $ 0.01 | 0.41 % | 100.00 % | 4586.67 % | 24 % |
| Subordinated | $ 57,473 | $ 100.66 | $ 100.66 | 5.23 % | -1.95 % | 4.05 % | 25 % |

* Includes the effect of realized loss on principal write-downs.
(1) See discussion of Financial Condition on page 35 for a review of GAAP book value.

Our portfolio is primarily comprised of non-Agency RMBS which is subject to risk of loss with regard to principal repayment. The following table summarizes certain characteristics of our non-Agency portfolio at March 31, 2011 and December 31, 2010.

| | March 31, 2011 | | December 31, 2010 | |
|---|---|---|---|---|
| Number of securities in portfolio | | 527 | | 581 |
| Weighted average maturity (years) | | 27.2 | | 27.4 |
| Weighted average amortized loan to value | | 72.4 % | | 72.5 % |
| Weighted average FICO | | 716.3 | | 717.3 |
| Weighted average loan balance (in thousands) | | $ 470.0 | | $ 447.6 |
| Weighted average percentage owner occupied | | 90.4 % | | 83.3 % |
| Weighted average percentage single family residence | | 63.5 % | | 63.1 % |
| Weighted average current credit enhancement | | 13.6 % | | 16.0 % |
| Weighted average geographic concentration | CA | 38.3 % | CA | 38.5 % |
| | FL | 8.8 % | FL | 8.9 % |
| | NY | 5.3 % | NY | 4.9 % |
| | NJ | 2.4 % | VA | 2.6 % |
| | VA | 2.2 % | NJ | 2.2 % |

The table below summarizes the credit ratings of our RMBS investments at March 31, 2011 and December 31, 2010. Our investment guidelines place no restrictions on the credit ratings of the assets we may acquire or retain. In

addition, the table below includes AAA rated non-Agency senior securities consolidated pursuant to the adoption of ASC 810, but for which we have no continuing involvement.

| | March 31, 2011 | December 31, 2010 |
|---|---|---|
| AAA | 13.25% | 41.25% |
| AA | 4.98% | 7.91% |
| A | 1.26% | 1.92% |
| BBB | 0.64% | 0.80% |
| BB | 0.01% | 0.01% |
| B | 0.00% | 0.01% |
| Below B or not rated | 79.86% | 48.10% |
| Total | 100.00% | 100.00% |

Our management team evaluates each investment based on the characteristics of the underlying collateral rather than relying on the ratings assigned to the asset by rating agencies.

Results of Operations for the Quarters Ended March 31, 2011 and 2010.

Net Income (Loss) Summary

Our net income for the quarter ended March 31, 21011 was $163.4 million, or $0.16 per share. Our net income was generated primarily by interest income on our portfolio. Our net income for the quarter ended March 31, 2010 was $125.6 million, or $0.19 per share. We attribute the decrease in our net income per share for the quarter ended March 31, 2011 as compared to March 31, 2010 to the decrease in our interest rate spread and an increase in realized losses on principal write-downs of non-Agency RMBS.

The table below presents the net income (loss) summary for the quarters ended March 31, 2011 and 2010.

Net Income (Loss) Summary
(dollars in thousands, except for share and per share data)
(unaudited)

| | March 31, 2011 | March 31, 2010 |
|---|---|---|
| Net Interest Income: | | |
| Interest income | $206,574 | $128,984 |
| Interest expense | 10,849 | 7,374 |
| | | |
| Interest income, non-retained | 21,159 | 50,861 |
| Interest expense, non-retained | 27,575 | 33,830 |
| Net interest income (expense) | 189,309 | 138,641 |
| Other-than-temporary impairments: | | |
| Total other-than-temporary impairment losses | (4,205) | (22,687) |
| Non-credit portion of loss recognized in other comprehensive income (loss) | 1,580 | 20,143 |
| Net other-than-temporary credit impairment losses | (2,625) | (2,544) |
| Other gains (losses): | | |
| Unrealized gains (losses) on interest rate swaps | 9,831 | - |
| Realized gains (losses) on sales of investments, net | 2,744 | 342 |
| Realized losses on principal write-downs of non-Agency RMBS | (19,520) | (949) |
| Total other gains (losses) | (6,945) | (607) |
| Net investment income (loss) | 179,739 | 135,490 |
| Other expenses: | | |
| Management fee | 12,750 | 8,114 |
| Provision for loan losses | 1,442 | 606 |
| General and administrative expenses | 1,487 | 1,160 |
| Total other expenses | 15,679 | 9,880 |
| Income (loss) before income taxes | 164,060 | 125,610 |
| Income taxes | 698 | - |
| Net income (loss) | $163,362 | $125,610 |
| | | |
| Net income (loss) per share-basic and diluted | $0.16 | $0.19 |
| Weighted average number of shares outstanding-basic and diluted | 1,027,063,055 | 670,371,022 |
| Comprehensive income (loss): | | |
| Net income (loss) | $163,362 | $125,610 |

| | | |
|---|---|---|
| Other comprehensive income (loss): | | |
| Unrealized gains (losses) on available-for-sale securities, net | (180,153) | 241,581 |
| Reclassification adjustment for net losses included in net income (loss) for other-than-temporary credit impairment losses | 2,625 | 2,544 |
| Reclassification adjustment for realized losses (gains) included in net income (loss) | 16,776 | 607 |
| Other comprehensive income (loss) | (160,752) | 244,732 |
| Comprehensive income (loss) | $2,610 | $370,342 |

Net Interest Income and Average Earning Asset Yield

We had average earning assets of $11.2 billion and $7.2 billion for the quarters ended March 31, 2011 and 2010, respectively. Our interest income was $227.7 million and $179.8 million for the quarters ended March 31, 2011 and 2010, respectively, reflecting an increase of $47.9 million. Our interest income increase resulted from the increase in our interest earning assets which followed our 2010 secondary offerings. The annualized yield on our portfolio was 8.11% and 10.04% for the quarters ended March 31, 2011 and 2010, respectively. The decrease in the annualized yield is attributed to a decline in weighted average coupon on our portfolio.

Our net interest income, which equals interest income less interest expense, totaled $189.3 million and $138.6 million for the quarters ended March 31, 2011 and 2010, respectively, reflecting an increase of $50.7 million. Our net interest spread, which equals the yield on our average assets for the period less the average cost of funds for the period, was 5.41% and 5.54% for the quarters ended March 31, 2011 and 2010, respectively. We attribute the increase in net interest income to the increase in our portfolio of higher yielding interest earning assets following our secondary offerings. We attribute the decrease in net interest spread to increased amortization of premiums paid to purchase IO securities, increased debt issue cost amortization and increased interest expense associated with interest rate swaps.

The table below shows our average assets held, total interest earned on assets, yield on average interest earning assets, average debt balance, interest expense, average cost of funds, net interest income, and net interest rate spread for the quarters ended March 31, 2011, December 31, 2010, September 30, 2010, June 30, 2010, and March 31, 2010 and the year ended December 31, 2010.

Net Interest Income

| | Average Earning Assets Held * | Interest Earned on Assets * | Yield on Average Interest Earning Assets | Average Debt Balance | Interest Expense | Average Cost of Funds | Net Interest Income | Net Interest Rate Spread |
|---|---|---|---|---|---|---|---|---|
| | (Ratios have been annualized, dollars in thousands) | | | | | | | |
| For the quarter ended March 31, 2011 | $ 11,235,639 | $ 227,722 | 8.11 % | $ 5,688,313 | $ 38,424 | 2.70 % | $ 189,298 | 5.41 % |
| For the year ended December 31, 2010 | $ 8,479,109 | $ 755,398 | 8.91 % | $ 3,793,049 | $ 152,236 | 4.01 % | $ 603,162 | 4.90 % |
| For the quarter ended December 31, 2010 | $ 9,311,588 | $ 193,744 | 8.32 % | $ 3,871,908 | $ 39,649 | 4.10 % | $ 154,095 | 4.22 % |
| For the quarter ended | $ 8,801,534 | $ 198,461 | 9.02 % | $ 3,733,893 | $ 42,764 | 4.58 % | $ 155,697 | 4.44 % |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| September 30, 2010 | | | | | | | | |
| For the quarter ended June 30, 2010 | $ 8,640,373 | $ 183,349 | 8.49 % | $ 3,906,061 | $ 28,619 | 2.93 % | $ 154,730 | 5.56 % |
| For the quarter ended March 31, 2010 | $ 7,162,943 | $ 179,845 | 10.04 % | $ 3,660,334 | $ 41,204 | 4.50 % | $ 138,641 | 5.54 % |

* Excludes cash and cash equivalents

Interest Expense and the Cost of Funds

We had average borrowed funds of $5.7 billion and $3.7 billion and total interest expense of $38.4 million and $41.2 million for the quarters ended March 31, 2011 and 2010, respectively. Our annualized cost of funds was 2.70% and 4.50% for the quarters ended March 31, 2011 and 2010, respectively. The decrease in interest expense is related primarily to a decline in the weighted average borrowing rate on our liabilities.

The table below shows our average borrowed funds, interest expense, average cost of funds, average one-month LIBOR, average six-month LIBOR, average one-month LIBOR relative to average six-month LIBOR, and average cost of funds relative to average one- and six- month LIBOR for the quarters ended March 31, 2011, December 31, 2010, September 30, 2010, June 30, 2010, and March 31, 2010 and the year ended December 31, 2010.

Average Cost of Funds

| | Average Borrowed Funds | Interest Expense | Average Cost of Funds | Average One-Month LIBOR | Average Six-Month LIBOR | Average One-Month LIBOR Relative to Average Six-Month LIBOR | Average Cost of Funds Relative to Average One-Month LIBOR | Average Cost of Funds Relative to Average Six-Month LIBOR |
|---|---|---|---|---|---|---|---|---|
| | (Ratios have been annualized, dollars in thousands) | | | | | | | |
| For the quarter ended March 31, 2011 | $ 5,688,313 | $ 38,424 | 2.70 % | 0.26 % | 0.46 % | (0.20 %) | 2.44 % | 2.24 % |
| For the year ended December 31, 2010 | $ 3,793,049 | $ 152,236 | 4.01 % | 0.27 % | 0.52 % | (0.25 %) | 3.74 % | 3.49 % |
| For the quarter ended December 31, 2010 | $ 3,871,908 | $ 39,649 | 4.10 % | 0.26 % | 0.45 % | (0.19 %) | 3.84 % | 3.65 % |
| For the quarter ended September 30, 2010 | $ 3,733,893 | $ 42,764 | 4.58 % | 0.29 % | 0.59 % | (0.30 %) | 4.29 % | 3.99 % |
| For the quarter ended June 30, 2010 | $ 3,906,061 | $ 28,619 | 2.93 % | 0.32 % | 0.63 % | (0.31 %) | 2.61 % | 2.30 % |
| For the quarter ended March 31, 2010 | $ 3,660,334 | $ 41,204 | 4.50 % | 0.23 % | 0.40 % | (0.17 %) | 4.27 % | 4.10 % |

Gains and Losses on Sales of Assets

During the quarter ended March 31, 2011, we sold RMBS with a carrying value of $649.8 million for realized gains of $2.7 million.  During the quarter ended March 31, 2010 we sold assets with a carrying value of $89.6 million which resulted in net gains of approximately $342 thousand.

Secured Debt Financing Transactions

We did not re-securitize RMBS during the quarter ended March 31, 2011.

On January 29, 2010, we transferred $1.7 billion in principal value of our RMBS to the CSMC 2010-1R Trust in a re-securitization transaction.  This transaction was recorded as a “secured borrowing” pursuant to ASC Topics 860 and 810.  In this transaction, we financed $271.6 million of AAA-rated fixed rate bonds to third party investors for net proceeds of $268.1 million.  We retained $391.9 million of AAA-rated bonds, $1.0 billion in subordinated bonds and the owner trust certificate, and interest only bonds with a notional value of $1.6 billion on the date of transfer.  The subordinated bonds and the owner trust certificate provide credit support to the AAA-rated bonds.  The bonds issued

by the trust are collateralized by RMBS that were transferred to the CSMC 2010-1R Trust.

In addition, during the quarter ended March 31, 2011, we recorded non-recourse financing with third party investors related to re-securitizations executed in prior periods. We financed through these transactions $306.6 million of AAA-rated fixed rate bonds with third party investors for net proceeds of $311.0 million. During the quarter ended March 31, 2010, we financed through these transactions $225.8 million of AAA-rated fixed rate bonds with third party investors for net proceeds of $227.4 million.

Management Fee and General and Administrative Expenses

We paid FIDAC a management fee of $12.8 million and $8.1 million for the quarters ended March 31, 2011 and 2010, respectively. The management fee is based on our stockholders' equity and the increase in the management fee for the quarter ended March 31, 2011 as compared to the quarter ended March 31, 2010 resulted from the increased equity due to the completion of secondary offerings of common stock during 2010.

General and administrative (or G&A) expenses, including the provision for loan losses, were $2.9 million and $1.8 million for the quarters ended March 31, 2011 and 2010, respectively. G&A expenses increased during the period due primarily to an increase in our loan loss provision.

Total expenses as a percentage of average total assets were 0.68% and 0.73% for the quarters ended March 31, 2011 and 2010, respectively. The decrease in total expenses as a percentage of average total assets is the result of an increase in the asset base due to the completion of three secondary offerings of common stock during 2010.

During the quarter ended March 31, 2011 we reimbursed FIDAC approximately $146,000 for our pro rata portion of rent, telephone, utilities, office furniture, equipment, machinery and other office, internal and overhead expenses of FIDAC and its affiliates required for our operations. During the quarter ended March 31, 2010, FIDAC waived its right to request reimbursement from the Company for these expenses.

The table below shows our total management fee and G&A expenses as compared to average total assets and average equity for the quarters ended March 31, 2011, December 31, 2010, September 30, 2010, June 30, 2010, and March 31, 2010 and for the year ended December 31, 2010.

Management Fees, Loan Loss Provision and G&A Expenses and Operating Expense Ratios

| | Total Management Fee, Loan Loss Provision and G&A Expenses | Total Management Fee, Loan Loss Provision and G&A Expenses/Total Assets | | Total Management Fee, Loan Loss Provision and G&A Expenses/Average Equity | |
|---|---|---|---|---|---|
| | (Ratios have been annualized, dollars in thousands) | | | | |
| For the quarter ended March 31, 2011 | $15,679 | 0.68 | % | 1.74 | % |
| For the year ended December 31, 2010 | $49,628 | 0.78 | % | 1.71 | % |
| For the quarter ended December 31, 2010 | $14,454 | 0.76 | % | 1.76 | % |
| For the quarter ended September 30, 2010 | $13,598 | 0.77 | % | 1.87 | % |
| For the quarter ended June 30, 2010 | $11,696 | 0.72 | % | 1.80 | % |
| For the quarter ended March 31, 2010 | $9,880 | 0.73 | % | 1.79 | % |

Net Income (Loss) and Return on Average Equity

Our net income was $163.4 million and $125.6 million for the quarters ended March 31, 2011 and 2010, respectively. The table below shows our net interest income, gains (losses) on sale of assets, unrealized gains (losses) on interest rate swaps, total expenses, income tax, each as a percentage of average equity, and the return on average equity for the quarters ended March 31, 2011, December 31, 2010, September 30, 2010, June 30, 2010, and March 31, 2010 and the year ended December 31, 2010. Our return on average equity decreased from 22.73% for the quarter ended March 31, 2010 to 18.09% for the quarter ended March 31, 2011 due to the increase in realized losses on principal write-downs from $949,000 for the quarter ended March 31, 2010 to $19.5 million for the quarter ended March 31, 2011.

Components of Return on Average Equity

| | Net Interest Income/Average Equity | Realized Gains (Losses) on Sales, Credit | Unrealized Gains (Losses) on Interest | Total Expenses/ Average Equity | Income Tax/Average Equity | Return on Average Equity |
|---|---|---|---|---|---|---|

| | | Losses and OTTI/Average Equity | Rate Swaps/Average Equity | | | |
|---|---|---|---|---|---|---|
| | (Ratios have been annualized) | | | | | |
| For the quarter ended March 31, 2011 | 20.96 % | (2.15 %) | 1.10 % | (1.74 %) | (0.08 %) | 18.09 % |
| For the year ended December 31, 2010 | 20.77 % | (0.34 %) | (0.34 %) | (1.71 %) | (0.03 %) | 18.35 % |
| For the quarter ended December 31, 2010 | 18.72 % | 0.22 % | 1.80 % | (1.76 %) | 0.00 % | 18.98 % |
| For the quarter ended September 30, 2010 | 21.42 % | (0.19 %) | (1.87 %) | (1.87 %) | (0.10 %) | 17.39 % |
| For the quarter ended June 30, 2010 | 23.78 % | (1.11 %) | (1.73 %) | (1.80 %) | 0.00 % | 19.14 % |
| For the quarter ended March 31, 2010 | 25.09 % | (0.57 %) | 0.00 % | (1.79 %) | 0.00 % | 22.73 % |

Liquidity and Capital Resources

Liquidity measures our ability to meet cash requirements, including ongoing commitments to repay our borrowings, fund and maintain RMBS, mortgage loans and other assets, pay dividends and other general business needs. Our principal sources of capital and funds for additional investments primarily include earnings from our investments, borrowings under securitizations and re-securitizations, repurchase agreements and other financing facilities, and proceeds from equity offerings. We expect these sources of financing will be sufficient to meet our short-term liquidity needs.

We expect to continue to borrow funds in the form of repurchase agreements and, subject to market conditions, other types of financing. The terms of the repurchase transaction borrowings under our master repurchase agreements generally conform to the terms in the standard master repurchase agreement as published by the Securities Industry and Financial Markets Association, or SIFMA, as to repayment, margin requirements and the segregation of all securities we have initially sold under the repurchase transaction. In addition, each lender typically requires that we include supplemental terms and conditions to the standard master repurchase agreement. Typical supplemental terms and conditions include changes to the margin maintenance requirements, required haircuts, and purchase price maintenance requirements, requirements that all controversies related to the repurchase agreement be litigated in a particular jurisdiction and cross default provisions. These provisions will differ for each of our lenders and will not be determined until we engage in a specific repurchase transaction.

For our short-term (one year or less) and long-term liquidity, which include investing and compliance with collateralization requirements under our repurchase agreements (if the pledged collateral decreases in value or in the event of margin calls created by prepayments of the pledged collateral), we also rely on the cash flow from investments, primarily monthly principal and interest payments to be received on our RMBS and whole mortgage loans, cash flow from the sale of securities as well as any primary securities offerings authorized by our board of directors.

Based on our current portfolio, leverage ratio and available borrowing arrangements, we believe our assets will be sufficient to enable us to meet anticipated short-term (one year or less) liquidity requirements such as to fund our investment activities, pay fees under our management agreement, fund our distributions to stockholders and pay general corporate expenses. However, a decline in the value of our collateral or a decrease in prepayment rates substantially below our expectations could cause a temporary liquidity shortfall due to the timing of the necessary margin calls on the financing arrangements and the actual receipt of the cash related to principal paydowns. If our cash resources are at any time insufficient to satisfy our liquidity requirements, we may have to sell investments or issue debt or additional equity securities in a common stock offering. If required, the sale of RMBS or whole mortgage loans at prices lower than their carrying value would result in losses and reduced income.

Our ability to meet our long-term (greater than one year) liquidity and capital resource requirements will be subject to obtaining additional debt financing and equity capital. Subject to our maintaining our qualification as a REIT as well as market conditions, we expect to use a number of sources to finance our investments, including repurchase agreements, warehouse facilities, securitization, commercial paper and term financing CDOs. Such financing will depend on market conditions for capital raises and for the investment of any 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. Upon liquidation, holders of our debt securities and shares of preferred stock and lenders with respect to other borrowings will receive a distribution of our available assets prior to the holders of our common stock.

We held cash and cash equivalents of approximately $16.3 million and $44.2 million at March 31, 2011 and 2010, respectively. Our cash and cash equivalents decreased due to normal quarterly 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 approximately $103.0 million and $75.3 million for the quarters ended March 31, 2011 and 2010, respectively. The cash provided by operating activities increased due to the increase in net interest income earned by the portfolio which resulted from the increase in interest earning assets to $10.2 billion in investments at March 31, 2011 as compared to $6.0 billion at March 31, 2010.

Our investing activities used net cash of $2.1 billion and $39.8 million for the quarters ended March 31, 2011 and 2010, respectively. During the quarter ended March 31, 2011, we utilized cash to purchase $3.1 billion in securities which were offset by proceeds from asset sales of $646.4 million and principal repayments of $355.6 million. During the quarter ended March 31, 2010 we utilized cash to purchase $442.9 million in securities which were offset by proceeds from asset sales that provided approximately $44.2 million and principal repayments of $358.9 million. The increase in cash used for investing activities is the result of our using additional capital raised during 2010.

Our financing activities provided net cash of $2.0 billion and used net cash of $15.5 million for the quarters ended March 31, 2011 and 2010, respectively. The quarter ended March 31, 2011 reflected net proceeds on repurchase agreements of $2.1 billion as compared to net payments of $289.2 million for the quarter ended March 31, 2010. In addition, the quarter ended March 31, 2011 reflected net proceeds from securitized debt borrowings of $311.0 million as compared to $498.7 million for the quarter ended March 31, 2010. The increase in cash provided by financing activities is from the utilization of repurchase agreements to finance asset purchases. Recourse debt increased to 1.1:1 at March 31, 2011 as compared to 0.7:1 at March 31, 2010.

At March 31, 2011 and December 31, 2010, the remaining maturities of repurchase agreements for RMBS is presented below.

| | March 31, 2011 | December 31, 2010 |
|---|---|---|
| | (dollars in thousands) | |
| Overnight | $279,261 | $- |
| 1-30 days | 1,340,897 | 232,265 |
| 30 to 59 days | 1,836,427 | 970,394 |
| 60 to 89 days | 413,822 | 545,442 |
| 90 to 119 days | - | 60,696 |
| Greater than or equal to 120 days | - | - |
| Total | $3,870,407 | $1,808,797 |

We are not required to maintain any specific debt-to-equity ratio as we believe the appropriate leverage for the particular assets we are financing depends on the credit quality and risk of those assets. At March 31, 2011 and December 31, 2010 our total debt was approximately $6.2 billion and $4.1 billion, which represented a debt-to-equity ratio of approximately 1.8:1 and 1.1:1, respectively. We include repurchase agreements, securitized debt, and securitized debt, non-retained in the numerator of our debt-to-equity ratio and stockholders' equity as the denominator.

Stockholders' Equity

On January 28, 2011, we entered into an equity distribution agreement with FIDAC and UBS Securities LLC, or UBS. Through this agreement, we may sell through UBS, as our sales agent, up to 125,000,000 shares of our common stock in ordinary brokers' transactions at market prices or other transactions as agreed between us and UBS. We did not sell any shares of our common stock under the equity distribution agreement during the quarter ended March 31, 2011.

On September 24, 2009, we implemented a dividend reinvestment and share purchase plan ("DRSPP"). The DRSPP provides holders of record of our common stock an opportunity to automatically reinvest all or a portion of their cash distributions received on common stock in additional shares of our common stock as well as to make optional cash payments to purchase shares of our common stock. Persons who are not already stockholders may also purchase our common stock under the plan through optional cash payments. The DRSPP is administered by the Administrator, The Bank of New York Mellon. During the quarter ended March 31, 2011, we raised $311,000 by issuing 73,567 shares through the DRSPP. During the quarter ended March 31, 2010 no shares were issued under the DRSPP.

During the quarter ended March 31, 2011, we declared dividends to common shareholders totaling $143.7 million or $0.14 per share. During the quarter ended March 31, 2010, we declared dividends to common shareholders totaling $113.8 million or $0.17 per share.

There was no preferred stock issued or outstanding as of March 31, 2011 and December 31, 2010.

Related Party Transactions

Management Agreement

On November 15, 2007 we entered into a management agreement with FIDAC, pursuant to which FIDAC is entitled to receive a management fee and, in certain circumstances, a termination fee and reimbursement of certain expenses as described in the management agreement. Such fees and expenses do not have fixed and determinable payments. The management fee is payable quarterly in arrears in an amount equal to 1.50% per annum, calculated quarterly, of our stockholders' equity (as defined in the management agreement). FIDAC uses the proceeds from its management fee in part to pay compensation to its officers and employees who, notwithstanding that certain of them also are our officers, receive no cash compensation directly from us. The management fee will be reduced, but not below zero, by our proportionate share of any CDO base management fees FIDAC receives in connection with the CDOs in which we invest, based on the percentage of equity we hold in such CDOs.

Financing Arrangements with Affiliates

In April 2009, we entered into a Securities Industry and Financial Markets Association standard preprinted form Master Repurchase Agreement with RCap Securities, Inc., a wholly owned subsidiary of Annaly. This standard agreement does not contain any sort of liquidity, net worth or other similar types of positive or negative covenants. Rather, the agreement contains covenants that require the buyer and seller of securities to deliver collateral or securities, and similar covenants which are customary in master repurchase agreements. At March 31, 2011 and December 31, 2010 we had no financing under this agreement. We have been in compliance with all covenants of this agreement since we entered into this agreement.

In March 2008, we entered into a Securities Industry and Financial Markets Association standard preprinted form Master Repurchase Agreement with Annaly. This standard agreement does not contain any sort of liquidity, net worth or other similar types of positive or negative covenants. Rather, the agreement contains covenants that require the buyer and seller of securities to deliver collateral or securities, and similar covenants which are customary in master repurchase agreements. At March 31, 2011 and December 31, 2010 we had no financing under this agreement. We have been in compliance with all covenants of this agreement since we entered into this agreement.

Restricted Stock Grants

We granted 1,301,000 shares of restricted stock to our Manager's employees and members of our board of directors during the year ended December 31, 2008. During the quarter ended March 31, 2011 and 2010, 31,600 and 32,225 shares of restricted stock we had awarded to our Manager's employees vested and 562 and 585 shares were forfeited or cancelled, respectively. We did not grant any incentive awards during the quarter ended March 31, 2011. At March 31, 2011 and 2010 there were approximately 853,000 and 999,000 unvested shares of restricted stock issued to employees of FIDAC, respectively. For the quarters ended March 31, 2011 and 2010, compensation expense less general and administrative costs associated with the amortization of the fair value of the restricted stock totaled $128,000 and $125,000, respectively.

Contractual Obligations and Commitments

The following tables summarize our contractual obligations at March 31, 2011.

| | | March 31, 2011 | | | |
|---|---|---|---|---|---|
| Contractual Obligations | Within One Year | One to Three Years | Three to Five Years | Greater Than or Equal to | Total |

| | | | | Five Years | |
|---|---|---|---|---|---|
| | | | (dollars in thousands) | | |
| Repurchase agreements for RMBS | $3,870,407 | $- | $- | $- | $3,870,407 |
| Securitized debt | 614,591 | 916,090 | 373,830 | 427,734 | 2,332,245 |
| Interest expense on RMBS repurchase agreements (1) | 1,192 | - | - | - | 1,192 |
| Interest expense on securitized debt (1) | 101,971 | 135,354 | 80,270 | 222,941 | 540,536 |
| Total | $4,588,161 | $1,051,444 | $454,100 | $650,675 | $6,744,380 |

(1) Interest is based on variable rates in effect as of March 31, 2011.

Off-Balance Sheet Arrangements

We do not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. Further, we have not guaranteed any obligations of unconsolidated entities nor do we have any commitment or intent to provide funding to any such entities.

Capital Resources

At March 31, 2011 and December 31, 2010, we had no material commitments or capital expenditures.

Dividends

To qualify as a REIT, we must pay annual dividends to our stockholders of at least 90% of our taxable income, determined without regard to the deduction for dividends paid and excluding any net capital gains. We intend to pay regular quarterly dividends to our stockholders. Before we pay any dividend, whether for U.S. federal income tax purposes or otherwise, which would only be paid out of available cash to the extent permitted under our financing facilities, we must first meet any operating requirements and scheduled debt service on our financing facilities and other debt payable.

Inflation

Virtually all of our assets and liabilities are interest rate sensitive in nature. As a result, interest rates and other factors influence our performance far more so than does inflation. Changes in interest rates do not necessarily correlate with inflation rates or changes in inflation rates. Our consolidated financial statements are prepared in accordance with GAAP and our distributions will be determined by our board of directors consistent with our obligation to distribute to our stockholders at least 90% of our REIT taxable income on an annual basis in order to maintain our REIT qualification; in each case, our activities and balance sheet are measured with reference to historical cost and/or fair market value without considering inflation.

Subsequent Events

None.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The primary components of our market risk are related to credit risk, interest rate risk, prepayment risk, market value risk and real estate risk. 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.

Credit Risk

We are subject to credit risk in connection with our investments and face more credit risk on assets we own which are rated below ‘‘AAA’’. The credit risk related to these investments pertains to the ability and willingness of the borrowers to pay, which is assessed before credit is granted or renewed and periodically reviewed throughout the loan or security term. We believe that residual loan credit quality is primarily determined by the borrowers’ credit profiles and loan characteristics. FIDAC uses a comprehensive credit review process. FIDAC’s analysis of loans includes borrower profiles, as well as valuation and appraisal data. FIDAC uses compensating factors such as liquid assets, low loan to value ratios and job stability in evaluating loans. FIDAC’s resources include a proprietary portfolio management system, as well as third party software systems. FIDAC utilizes a third party due diligence firm to perform an independent underwriting review to insure compliance with existing guidelines. FIDAC selects loans for review predicated on risk-based criteria such as loan-to-value, borrower’s credit score(s) and loan size. FIDAC also outsources underwriting services to review higher risk loans, either due to borrower credit profiles or collateral valuation issues. In addition to statistical sampling techniques, FIDAC creates adverse credit and valuation samples, which we individually review. FIDAC rejects loans that fail to conform to our standards. FIDAC accepts only those loans which meet our underwriting criteria. Once we own a loan, FIDAC’s surveillance process includes ongoing analysis through our proprietary data warehouse and servicer files. Additionally, the non-Agency RMBS and other ABS which we acquire for our portfolio are reviewed by FIDAC to ensure that they satisfy our risk based criteria. FIDAC’s review of non-Agency RMBS and other ABS includes utilizing its proprietary portfolio management system. FIDAC’s review of non-Agency RMBS and other ABS is based on quantitative and qualitative analysis of the risk-adjusted returns on non-Agency RMBS and other ABS present.

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 related debt obligations, which are generally repurchase agreements, warehouse facilities, securitization, commercial paper and term financing CDOs. Our repurchase agreements and warehouse facilities may be of limited duration that are periodically refinanced at current market rates. We intend to mitigate this risk through utilization of derivative contracts, primarily interest rate swap agreements.

Interest Rate Effect on Net Interest Income

Our operating results depend, in large part, on differences between the income from our investments and our borrowing costs. Most of our warehouse facilities and repurchase agreements provide financing based on a floating rate of interest calculated on a fixed spread over LIBOR. The fixed spread varies depending on the type of underlying asset which collateralizes the financing. Accordingly, the portion of our portfolio which consists of floating interest rate assets will be match-funded utilizing our expected sources of short-term financing, while our fixed interest rate assets will not be 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 will result in a 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 fixed-rate and hybrid adjustable-rate mortgage loans and RMBS. If prepayments are slower or faster than assumed, the life of the mortgage loans and 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 changes in interest rates will have on the fair value of the assets we acquire. We face the risk that the fair value of our assets will increase or decrease at different rates than that 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 essentially 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.

It is important to note that the impact of changing interest rates on fair value can change significantly when interest rates change beyond 100 basis points from current levels. Therefore, the volatility in the fair value of our assets could increase significantly when interest rates change beyond 100 basis points. 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, in the event of changes in actual interest rates, the change in the fair value of our assets would likely differ from that shown above and such difference might be material and adverse to our stockholders.

Interest Rate Cap Risk

We also invest in adjustable-rate mortgage loans and RMBS. These are mortgages or RMBS in which the underlying mortgages are typically subject to periodic and lifetime interest rate caps and floors, which limit the amount by which the security's interest yield may change during any given period. However, our borrowing costs pursuant to our financing agreements will not be subject to similar restrictions. Therefore, in a period of increasing interest rates, interest rate costs on our borrowings could increase without limitation by caps, while the interest-rate yields on our adjustable-rate mortgage loans and RMBS would effectively be limited. This problem will be magnified to the extent we acquire adjustable-rate RMBS that are not based on mortgages which are fully indexed. In addition, the mortgages or the underlying mortgages in an RMBS may be subject to periodic payment caps that result in some portion of the interest being deferred and added to the principal outstanding. This could result in our receipt of less cash income on our adjustable-rate mortgages or RMBS than we need in order to pay the interest cost on our related borrowings. These factors could lower our net interest income or cause a net loss during periods of rising interest rates, which would harm our financial condition, cash flows and results of operations.

Interest Rate Mismatch Risk

We fund a substantial portion of our acquisitions of hybrid adjustable-rate mortgages and RMBS with borrowings that, after the effect of hedging, have interest rates based on indices and re-pricing terms similar to, but of somewhat shorter maturities than, the interest rate indices and re-pricing terms of the mortgages and RMBS. Thus, in most cases the interest rate indices and re-pricing terms of our mortgage assets and our funding sources will not be identical, thereby creating an interest rate mismatch between assets and liabilities. Therefore, our cost of funds would likely rise or fall more quickly than would our earnings rate on assets. During periods of changing interest rates, such interest rate mismatches could negatively impact our financial condition, cash flows and results of operations. To mitigate interest rate mismatches, we may utilize the hedging strategies discussed above. Our analysis of risks is based on FIDAC's experience, estimates, models and assumptions. These analyses rely on models which utilize estimates of fair value and interest rate sensitivity. Actual economic conditions or implementation of investment decisions by our management may produce results that differ significantly from the estimates and assumptions used in our models and the projected results shown in this Form 10-Q.

Our profitability and the value of our portfolio (including interest rate swaps) may be adversely affected during any period as a result of changing interest rates. The following table quantifies the potential changes in net interest

income and portfolio value should interest rates go up or down 25, 50, and 75 basis points, assuming the yield curves of the rate shocks will be parallel to each other and the current yield curve. All changes in income and value are measured as percentage changes from the projected net interest income and portfolio value at the base interest rate scenario. The base interest rate scenario assumes interest rates at March 31, 2011 and various estimates regarding prepayment and all activities are made at each level of rate shock. Actual results could differ significantly from these estimates.

| Change in Interest Rate | Projected Percentage Change in Net Interest Income | Projected Percentage Change in Portfolio Value |
|---|---|---|
| -75 Basis Points | (11.31 %) | 3.58 % |
| -50 Basis Points | (8.77 %) | 2.41 % |
| -25 Basis Points | (6.24 %) | 1.22 % |
| Base Interest Rate | - | - |
| +25 Basis Points | 1.18 % | (1.24 %) |
| +50 Basis Points | 1.63 % | (2.50 %) |
| +75 Basis Points | 2.08 % | (3.79 %) |

Prepayment Risk

As we receive prepayments of principal on these investments, premiums and discounts on such investments will be amortized or accreted 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

FIDAC computes the projected weighted-average life of our investments based on assumptions regarding the rate at which the borrowers will prepay the underlying mortgages. In general, when fixed-rate or hybrid adjustable-rate mortgage loans or RMBS are 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 assets. However, if prepayment rates decrease in a rising interest rate environment, 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. The estimated fair value of these securities fluctuates primarily due to changes in interest rates, prepayment speeds, market liquidity, credit quality, 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. As market volatility increases or liquidity decreases, the fair value of our investments may be adversely impacted.

Real Estate Market Risk

We own assets secured by real property and may own real property directly in the future. Residential property values are subject to volatility and may be affected adversely 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 an oversupply of housing); 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.

Risk Management

To the extent consistent with maintaining our REIT status, we seek to manage risk exposure to protect our portfolio of residential mortgage loans, RMBS, and other assets and related debt against the effects of major interest rate changes. We generally seek to manage our risk by:

- monitoring and adjusting, if necessary, the reset index and interest rate related to our RMBS and our financings;
- attempting to structure our financing agreements to have a range of different maturities, terms, amortizations and interest rate adjustment periods;
- using derivatives, financial futures, swaps, options, caps, floors and forward sales to adjust the interest rate sensitivity of our investments and our borrowings;
- using securitization financing to lower average cost of funds relative to short-term financing vehicles further allowing us to receive the benefit of attractive terms for an extended period of time in contrast to short term financing and maturity dates of the investments included in the securitization; and
- actively managing, on an aggregate basis, the interest rate indices, interest rate adjustment periods, and gross reset margins of our investments and the interest rate indices and adjustment periods of our financings.

Our efforts to manage our assets and liabilities are concerned with the timing and magnitude of the re-pricing of assets and liabilities. We attempt to control risks associated with interest rate movements. Methods for evaluating interest rate risk include an analysis of our interest rate sensitivity “gap”, which is the difference between interest-earning assets and interest-bearing liabilities maturing or re-pricing within a given time period. A gap is considered positive when the amount of interest-rate sensitive assets exceeds the amount of interest-rate sensitive liabilities. A gap is considered negative when the amount of interest-rate sensitive liabilities exceeds interest-rate sensitive assets. During a period of rising interest rates, a negative gap would tend to adversely affect net interest income, while a positive gap would tend to result in an increase in net interest income. During a period of falling interest rates, a negative gap would tend to result in an increase in net interest income, while a positive gap would tend to affect net interest income adversely. Because different types of assets and liabilities with the same or similar maturities may react differently to changes in overall market rates or conditions, changes in interest rates may affect net interest income positively or negatively even if an institution were perfectly matched in each maturity category.

The following table sets forth the estimated maturity or re-pricing of our interest-earning assets and interest-bearing liabilities at March 31, 2011. The amounts of assets and liabilities shown within a particular period were determined in accordance with the contractual terms of the assets and liabilities, except adjustable-rate loans, and securities are included in the period in which their interest rates are first scheduled to adjust and not in the period in which they mature and does include the effect of the interest rate swaps. The interest rate sensitivity of our assets and liabilities in the table could vary substantially if based on actual prepayment experience.

| | Within 3 Months | 3-12 Months | 1 Year to 3 Years | Greater than 3 Years | Total |
|---|---|---|---|---|---|
| Rate sensitive assets | $15,821,481 | $1,131,791 | $1,068,940 | $1,117,217 | $19,139,429 |
| Cash equivalents | 16,295 | - | - | - | 16,295 |
| Total rate sensitive assets | 15,837,776 | 1,131,791 | 1,068,940 | 1,117,217 | 19,155,724 |
| | | | | | |
| Rate sensitive liabilities | 3,018,627 | 318,458 | 409,504 | 1,589,730 | 5,336,319 |
| Interest rate sensitivity gap | $12,819,149 | $813,333 | $659,436 | $(472,513) | $13,819,405 |

| | | | | |
|---|---|---|---|---|
| Cumulative rate sensitivity gap | $12,819,149 | $13,632,482 | $14,291,918 | $13,819,405 |
| Cumulative interest rate sensitivity gap as a percentage of total rate sensitive assets | 67 % | 71 % | 75 % | 72 % |

50

Our analysis of risks is based on our manager's experience, estimates, models and assumptions. These analyses rely on models which utilize estimates of fair value and interest rate sensitivity. Actual economic conditions or implementation of investment decisions by our manager may produce results that differ significantly from the estimates and assumptions used in our models and the projected results shown in the above tables and in this Form 10-Q. These analyses contain certain forward-looking statements and are subject to the safe harbor statement set forth under the heading, "Special Note Regarding Forward-Looking Statements."

ITEM 4. CONTROLS AND PROCEDURES

Our management, including our Chief Executive Officer, or CEO and Chief Financial Officer, or CFO, reviewed and evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) of the Securities Exchange Act) as of the end of the period covered by this quarterly report. Based on that review and evaluation, the CEO and CFO have concluded that our current disclosure controls and procedures, as designed and operating, (1) were effective in ensuring that information regarding the Company and its subsidiaries is made known to our management, including our CEO and CFO, as appropriate to allow timely decisions regarding required disclosure and (2) were effective in providing reasonable assurance that information the Company must disclose in its periodic reports under the Securities Exchange Act is recorded, processed, summarized and reported within the time periods prescribed by the SEC’s rules and forms.

There have been no changes in our “internal control over financial reporting” (as defined in Rule 13a-15(f) under the Securities Exchange Act) that occurred during the period covered by this quarterly report that has materially affected, or is reasonably likely to materially affect, our internal controls 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. In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on our consolidated financial statements.

Item 1A. RISK FACTORS

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2010, which could materially affect our business, financial condition or future results. The information presented below updates and should be read in conjunction with the risk factors and information disclosed in that Form 10-K.

We depend on third-party service providers, including mortgage servicers, for a variety of services related to our non-Agency RMBS and whole mortgage loans we may acquire. We are, therefore, subject to the risks associated with third-party service providers.

We depend on a variety of services provided by third-party service providers related to our non-Agency RMBS and whole mortgage loans we may acquire. We rely on the mortgage servicers who service the mortgage loans backing our non-Agency RMBS to, among other things, collect principal and interest payments on the underlying mortgages and perform loss mitigation services. Our mortgage servicers and other service providers to our non-Agency RMBS, such as trustees, bond insurance providers and custodians, may not perform in a manner that promotes our interests. In addition, recent legislation intended to reduce or prevent foreclosures through, among other things, loan modifications may reduce the value of mortgage loans backing our non-Agency RMBS or whole mortgage loans that we acquire. Mortgage servicers may be incentivized by the Federal government to pursue such loan modifications, as well as forbearance plans and other actions intended to prevent foreclosure, even if such loan modifications and other actions are not in the best interests of the beneficial owners of the mortgage loans. In addition to the recent legislation that creates financial incentives for mortgage loan servicers to modify loans and take other actions that are intended to prevent foreclosures, legislation has recently been adopted that creates a safe harbor from liability to creditors for servicers that undertake loan modifications and other actions that are intended to prevent foreclosures. Finally, recent laws delay the initiation or completion of foreclosure proceedings on specified types of residential mortgage loans (some for a limited period of time), or otherwise limit the ability of mortgage servicers to take actions that may be essential to preserve the value of the mortgage loans underlying the mortgage servicing rights. Any such limitations are likely to cause delayed or reduced collections from mortgagors and generally increase servicing costs. As a result of these recent legislative actions, the mortgage loan servicers on which we rely may not perform in our best interests or up to our expectations. If our third-party service providers do not perform as expected, as highlighted in recent press reports concerning certain foreclosure proceedings and investigations, our business, financial condition and results of operations and ability to make distributions to our shareholders may be materially adversely affected.

Item 5. OTHER INFORMATION

None.



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Item 6. EXHIBITS

Exhibits:

The exhibits required by this item are set forth on the Exhibit Index attached hereto

EXHIBIT INDEX

| Exhibit Number | Description |
|---|---|
| 3.1 | Articles of Amendment and Restatement of Chimera Investment Corporation (filed as Exhibit 3.1 to the Company's Registration Statement on Amendment No. 1 to Form S-11 (File No. 333-145525) filed on September 27, 2007 and incorporated herein by reference). |
| 3.2 | Articles of Amendment of Chimera Investment Corporation (filed as Exhibit 3.1 to the Company's Report on Form 8-K filed on May 28, 2009 and incorporated herein by reference) |
| 3.3 | Articles of Amendment of Chimera Investment Corporation (filed as Exhibit 3.1 to the Company's Report on Form 8-K filed on November 5, 2010 and incorporated herein by reference). |
| 3.4 | Amended and Restated Bylaws of Chimera Investment Corporation (filed as Exhibit 3.2 to the Company's Registration Statement on Amendment No. 2 to Form S-11 (File No. 333-145525) filed on November 5, 2007 and incorporated herein by reference). |
| 4.1 | Specimen Common Stock Certificate of Chimera Investment Corporation (filed as Exhibit 4.1 to the Company's Registration Statement on Amendment No. 1 to Form S-11 (File No. 333-145525) filed on September 27, 2007 and incorporated herein by reference). |
| 31.1 | Certification of Matthew Lambiase, Chief Executive Officer and President of the Registrant, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of A. Alexandra Denahan, Chief Financial Officer of the Registrant, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1 | Certification of Matthew Lambiase, Chief Executive Officer and President of the Registrant, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2 | Certification of A. Alexandra Denahan, Chief Financial Officer of the Registrant, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

| | |
|---|---|
| Exhibit 101.INS XBRL | Instance Document* |
| Exhibit 101.SCH XBRL | Taxonomy Extension Schema Document* |
| Exhibit 101.CAL XBRL | Taxonomy Extension Calculation Linkbase Document* |
| Exhibit 101.DEF XBRL | Additional Taxonomy Extension Definition Linkbase Document Created* |
| Exhibit 101.LAB XBRL | Taxonomy Extension Label Linkbase Document* |
| Exhibit 101.PRE XBRL | Taxonomy Extension Presentation Linkbase Document* |

* Submitted electronically herewith. Attached as Exhibit 101 to this report are the following documents formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Statements of Financial Condition at March 31, 2011 (Unaudited) and December 31, 2010 (Derived from the audited consolidated statement of financial condition at December 31, 2010); (ii) Consolidated Statements of Operations and Comprehensive Income (Unaudited) for the quarters ended March 31, 2011 and 2010; (iii) Consolidated Statements of Stockholders' Equity (Unaudited) for the quarters ended March 31, 2011 and 2010; (iv) Consolidated Statements of Cash Flows (Unaudited) for the quarters ended March 31, 2011 and 2010; and (v) Notes to Consolidated Financial Statements (Unaudited) for the quarter ended March 31, 2011. Users of this data are advised pursuant to Rule 406T of Regulation S-T that this interactive data file is deemed not filed or part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Securities and Exchange Act of 1934, and

otherwise is not subject to liability under these sections.

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

CHIMERA INVESTMENT CORPORATION

By: /s/ Matthew Lambiase
Matthew Lambiase
Chief Executive Officer and President
May 9, 2011

By: /s/ A. Alexandra Denahan
A. Alexandra Denahan
Chief Financial Officer (Principal Financial Officer)
May 9, 2011