ANWORTH MORTGAGE ASSET CORP
Form 10-Q
November 07, 2014

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 SEPTEMBER 30, 2014

OR

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission File Number 001-13709

ANWORTH MORTGAGE ASSET CORPORATION

(Exact name of registrant as specified in its charter)

MARYLAND	52-2059785
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1299 Ocean Avenue, Second Floor, Santa Monica, California	90401
(Address of principal executive offices)	(Zip Code)

Registrant’s telephone number, including area code: (310) 255-4493

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

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 (§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 x No ¨

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

Large Accelerated Filer x	Accelerated Filer ¨
Non-Accelerated Filer ¨ (Do not check if a smaller reporting company)	Smaller Reporting Company ¨

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

At November 4, 2014, the registrant had 113,270,017 shares of common stock issued and outstanding.

ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES

FORM 10-Q

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ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES

Part I. FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements
ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(in thousands, except per share amounts)

	September 30, 2014 (unaudited)	December 31, 2013
ASSETS		
Agency MBS:		
Agency MBS pledged to counterparties at fair value	$6,912,185	$8,060,567
Agency MBS at fair value	458,398	462,478
Paydowns receivable	40,669	33,401
	$7,411,252	$8,556,446
Residential properties	12,362	-
Cash and cash equivalents	1,402	7,368
Interest and dividends receivable	20,069	23,310
Derivative instruments at fair value	662,095	22,551
Prepaid expenses and other	9,972	9,816
Total Assets:	$8,117,152	$8,619,491
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Accrued interest payable	$11,835	$30,117
Repurchase agreements	6,550,000	7,580,000
Junior subordinated notes	37,380	37,380
Derivative instruments at fair value	671,288	55,914
Dividends payable on Series A Preferred Stock	1,035	1,035
Dividends payable on Series B Preferred Stock	394	394
Dividends payable on common stock	16,598	11,097
Accrued expenses and other	4,299	1,368
Total Liabilities:	$7,292,829	$7,717,305
Series B Cumulative Convertible Preferred Stock: par value $0.01 per share; liquidating preference $25.00 per share ($25,241 and $25,241, respectively); 1,010 and 1,010 shares issued and outstanding at September 30, 2014 and December 31, 2013, respectively	$23,924	$23,924
Stockholders' Equity:		
Series A Cumulative Preferred Stock: par value $0.01 per share; liquidating	$46,537	$46,537

preference $25.00 per share ($47,984 and $47,984, respectively); 1,919 and 1,919 shares issued and outstanding at September 30, 2014 and December 31, 2013, respectively		
Common Stock: par value $0.01 per share; authorized 200,000 shares, 118,554 and 138,717 issued and outstanding at September 30, 2014 and December 31, 2013, respectively	1,186	1,387
Additional paid-in capital	1,076,185	1,185,369
Accumulated other comprehensive (loss) consisting of unrealized gains and losses	(46,469)	(92,008)
Accumulated deficit	(277,040)	(263,023)
Total Stockholders' Equity:	$800,399	$878,262
Total Liabilities and Stockholders' Equity:	$8,117,152	$8,619,491

See accompanying notes to unaudited consolidated financial statements.

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ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(in thousands, except per share amounts)

(unaudited)

	Three Months Ended September 30, 2014	2013	Nine Months Ended September 30, 2014	2013
Interest Income:				
Interest on Agency MBS	$37,057	$42,646	$122,852	$131,326
Income on rental properties	197	-	268	-
Other interest income	10	11	31	42
	37,264	42,657	123,151	131,368
Interest Expense:				
Interest expense on repurchase agreements	19,024	22,484	72,238	63,432
Interest expense on junior subordinated notes	318	321	947	962
	19,342	22,805	73,185	64,394
Net interest income	17,922	19,852	49,966	66,974
Other Income:				
(Loss) gain on sales of Agency MBS	(5,617)	1,991	(4,022)	9,237
Gain on interest rate swaps, net	10,947	-	9,568	-
(Loss) gain on derivatives-TBA securities	(779)	-	798	-
Derivative income-TBA securities	366	-	366	-
Gain on derivatives-Eurodollar Futures Contracts	111	-	111	-
Recovery on Non-Agency MBS	37	100	108	333
Total other income	5,065	2,091	6,929	9,570
Operating Expenses:				
Management fee to related party	(2,609)	(2,982)	(8,248)	(9,009)
General and administrative expenses	(888)	(953)	(5,739)	(2,905)
Total operating expenses	(3,497)	(3,935)	(13,987)	(11,914)
Net income	$19,490	$18,008	$42,908	$64,630
Dividend on Series A Cumulative Preferred Stock	(1,035)	(1,035)	(3,105)	(3,107)
Dividend on Series B Cumulative Convertible Preferred Stock	(394)	(394)	(1,182)	(1,200)
Net income to common stockholders	$18,061	$16,579	$38,621	$60,323
Basic earnings per common share	$0.15	$0.12	$0.30	$0.42
Diluted earnings per common share	$0.15	$0.12	$0.30	$0.42
Basic weighted average number of shares outstanding	121,061	142,380	128,174	143,176
Diluted weighted average number of shares outstanding	125,192	146,287	132,254	147,118

See accompanying notes to unaudited consolidated financial statements.

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ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(in thousands)

(unaudited)

	Three Month Ended		Nine Month Ended	
	September 30,		September 30,	
	2014	2013	2014	2013
Net income	$19,490	$18,008	$42,908	$64,630
Available-for-sale Agency MBS, fair value adjustment	(13,625)	10,247	62,104	(198,882)
Reclassification adjustment for loss (gain) on sales of Agency MBS included in net income	5,617	(1,991)	4,022	(9,237)
Unrealized gains (losses) on derivatives	987	(40,863)	(73,959)	(10,715)
Reclassification adjustment for interest expense on swap agreements included in net income	13,382	14,633	53,372	38,426
Other comprehensive income (loss)	6,361	(17,974)	45,539	(180,408)
Comprehensive income (loss)	$25,851	$34	$88,447	$(115,778)

See accompanying notes to unaudited consolidated financial statements.

ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(in thousands, except per share amounts)

(unaudited)

	Series A Preferred Stock Shares	Common Stock Shares	Series A Preferred Stock Par Value	Common Stock Par Value	Additional Paid-In Capital	Accum. Other Comp. Income (Loss) Agency MBS	Accum. Other Comp. (Loss) Derivatives	Accum. (Deficit)	Total
Balance, December 31, 2013	1,919	138,717	$46,537	$1,387	$1,185,369	$(58,646)	$(33,362)	$(263,023)	$878,262
Issuance of common stock		56		1	257				258
Redemption of common stock		(5,281)		(53)	(26,465)				(26,518)
Other comprehensive income, fair value adjustments and reclassifications				-		29,722	(9,200)		20,522
Net income								13,371	13,371
Treasury Stock					(1,805)				(1,805)
Amortization of restricted stock					24				24
Dividend declared - $0.539063 per Series A preferred share								(1,035)	(1,035)
Dividend declared - $0.390625 per Series B								(394)	(394)

preferred share									
Dividend declared - $0.14 per common share								(18,708)	(18,708)
Balance, March 31, 2014	1,919	133,492	$46,537	$1,335	$1,157,380	$(28,924)	$(42,562)	$(269,789)	$863,977
Issuance of common stock		82		1	389				390
Redemption of common stock		(9,776)		(98)	(51,802)				(51,900)
Other comprehensive income, fair value adjustments and reclassifications						44,412	(25,756)		18,656
Net income								10,047	10,047
Treasury Stock					1,805				1,805
Amortization of restricted stock					24				24
Dividend declared - $0.539063 per Series A preferred share								(1,035)	(1,035)
Dividend declared - $0.390625 per Series B preferred share								(394)	(394)
Dividend declared - $0.14 per common share								(17,332)	(17,332)
Balance, June 30, 2014	1,919	123,798	$46,537	$1,238	$1,107,796	$15,488	$(68,318)	$(278,503)	$824,238
Issuance of common stock		76		1	299				300
Redemption of common stock		(5,320)		(53)	(27,365)				(27,418)
Other comprehensive income, fair value adjustments						(8,008)	14,369		6,361

and reclassifications									
Net income								19,490	19,490
Treasury Stock					(4,569)				(4,569)
Amortization of restricted stock					24				24
Dividend declared - $0.539063 per Series A preferred share								(1,035)	(1,035)
Dividend declared - $0.390625 per Series B preferred share								(394)	(394)
Dividend declared - $0.14 per common share								(16,598)	(16,598)
Balance, September 30, 2014	1,919	118,554	$46,537	$1,186	$1,076,185	$7,480	$(53,949)	$(277,040)	$800,399

See accompanying notes to unaudited consolidated financial statements.

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ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Operating Activities:				
Net income	$19,490	$18,008	$42,908	$64,630
Adjustments to reconcile net income to net cash provided by operating activities:				
Amortization of premium and discounts (Agency MBS)	11,768	15,478	33,382	50,481
Depreciation on rental properties	85	-	149	-
Loss (Gain) on sales of Agency MBS	5,617	(1,991)	4,022	(9,237)
Amortization of restricted stock	24	51	72	152
Recovery on Non-Agency MBS	(37)	(100)	(108)	(333)
Periodic net settlements on interest rate swaps, net of amortization	(5,643)	-	(6,644)	-
(Gain) on interest rate swaps, net	(10,947)	-	(9,568)	-
Loss (gain) on derivatives, net of derivative income - TBA Securities	413	-	(1,164)	-
(Gain) on derivatives - Eurodollar Futures Contracts	(111)	-	(111)	-
Changes in assets and liabilities:				
Decrease in interest receivable	1,672	2,251	3,240	2,236
Decrease (increase) in prepaid expenses and other	8,149	(8,600)	(1,463)	(1,375)
(Decrease) increase in accrued interest payable	(6,097)	6,621	(8,053)	3,561
Increase in accrued expenses	945	25	2,931	1,588
Net cash provided by operating activities	$25,328	$31,743	$59,593	$111,703
Investing Activities:				
Available-for-sale Agency MBS:				
Proceeds from sale	$304,248	$342,479	$501,951	$636,807
Purchases	(92,803)	(149,736)	(430,779)	(2,170,895)
Principal payments	421,311	637,215	1,102,849	1,946,224
Residential properties purchases	(2,026)	-	(12,511)	-
Net cash provided by investing activities	$630,730	$829,958	$1,161,510	$412,136
Financing Activities:				
Borrowings from repurchase agreements	$8,593,002	$11,055,507	$26,303,067	$33,602,580
Repayments on repurchase agreements	(9,161,502)	(11,885,507)	(27,333,067)	(34,047,580)
Net settlement on TBA commitments	96	-	800	-
Settlements on terminated interest rate swaps	(36,987)		(36,987)	
Proceeds from common stock issued, net of common stock repurchased	(31,688)	(3,085)	(109,458)	(2,560)

Proceeds on Series B Preferred Stock issued	-	-	-	1,335
Proceeds on Series A Preferred Stock issued	-	-	-	1,090
Series A Preferred stock dividends paid	(1,035)	(1,035)	(3,105)	(3,082)
Series B Preferred stock dividends paid	(394)	(394)	(1,182)	(1,221)
Common stock dividends paid	(17,332)	(21,353)	(47,137)	(64,308)
Net cash (used in) financing activities	$(655,840)	$(855,867)	$(1,227,069)	$(513,746)
Net increase (decrease) in cash and cash equivalents	$218	$5,834	$(5,966)	$10,093
Cash and cash equivalents at beginning of period	1,184	7,169	7,368	2,910
Cash and cash equivalents at end of period	$1,402	$13,003	$1,402	$13,003
Supplemental Disclosure of Cash Flow Information:				
Cash paid for interest	$41,311	$16,184	$98,110	$60,832
Conversions of Series B Preferred Stock into common stock	$-	$-	$-	$2,633
Common stock repurchased	$31,987	$6,707	$110,404	$24,877
Change in payable for securities purchased	$-	$147,049	$-	$182,722

See accompanying notes to unaudited consolidated financial statements.

ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

As used in this Quarterly Report on Form 10-Q, “Company,” “we,” “us,” “our,” and “Anworth” refer to Anworth Mortgage Asset Corporation.

NOTE 1. ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

We were incorporated in Maryland on October 20, 1997 and we commenced operations on March 17, 1998. We are in the business of investing primarily in United States, or U.S., agency mortgage-backed securities, or Agency MBS. Agency MBS are securities representing obligations guaranteed by the U.S. government, such as Ginnie Mae, or guaranteed by federally sponsored enterprises, such as Fannie Mae or Freddie Mac. Our principal business objective is to generate net income for distribution to our stockholders based upon the spread between the interest income on our mortgage assets and the costs of borrowing to finance our acquisition of those assets.

We have elected to be taxed as a real estate investment trust, or REIT, under the Internal Revenue Code of 1986, or the Code. As a REIT, we routinely distribute substantially all of the taxable income generated from our operations to our stockholders. As long as we retain our REIT status, we generally will not be subject to federal or state taxes on our income to the extent that we distribute our taxable net income to our stockholders.

In February 2014, the Company incorporated its wholly-owned Qualified REIT Subsidiary (“QRS”), Anworth Properties, Inc., which commenced operations in March 2014. The Company also incorporated Anworth Property Services, Inc., a Taxable REIT Subsidiary (“TRS”) that is wholly-owned by the Company and currently is not in operation. The Company’s QRS will provide the entity through which the Company may own REIT-qualified real estate assets such as: (1) other types of mortgage assets, from which the Company would receive interest income; and (2) real estate assets, from which the Company would receive rental income and potential price appreciation. The Company’s TRS will provide the entity through which the Company may participate in various real estate-related activities which would earn profits that the IRS considers to be taxable income. Unlike a REIT, a TRS pays standard corporate taxes on its income earned from these activities in the mortgage and real estate markets. These other activities include almost everything other than receiving rent on properties owned and collecting interest on real estate mortgages owned. Examples of these other activities include: the securitization of mortgage loans; mortgage origination; leasing and managing rental properties; and owning properties acquired through the foreclosure process.

Effective as of December 31, 2011, we entered into a Management Agreement, or the Management Agreement, with Anworth Management, LLC, or the Manager, which effected the externalization of our management function, or the Externalization. Since the effective date, our day-to-day operations are being conducted by the Manager through the authority delegated to it under the Management Agreement and pursuant to the policies established by our board of directors. The Manager is supervised and directed by our board of directors and is responsible for (i) the selection, purchase and sale of our investment portfolio; (ii) our financing and hedging activities; and (iii) providing us with management services. The Manager will also perform such other services and activities relating to our assets and operations as may be appropriate. In exchange for these services, the Manager receives a management fee paid monthly in arrears in an amount equal to one-twelfth of 1.20% of our Equity (as defined in the Management Agreement).

BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements are prepared on the accrual basis of accounting in accordance with generally accepted accounting principles utilized in the United States of America, or GAAP. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Material estimates that are susceptible to change relate to the determination of the fair value of securities, amortization of security premiums and accretion of security discounts and accounting for derivatives and hedging activities. Actual results could materially differ from these estimates. In the opinion of management, all material adjustments, consisting of normal recurring adjustments, considered necessary for a fair presentation have been included. The operating results for the three and nine months ended September 30, 2014 and 2013 are not necessarily indicative of the results that may be expected for the calendar year. The interim financial information in the accompanying unaudited consolidated financial statements and the notes thereto should be read in conjunction with the audited financial statements included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2013.

The following is a summary of our significant accounting policies:

Cash and Cash Equivalents

Cash and cash equivalents include cash on hand and highly liquid investments with original maturities of three months or less. The carrying amount of cash equivalents approximates their fair value.

Mortgage-Backed Securities (MBS)

Agency MBS are securities that are obligations (including principal and interest) guaranteed by the U.S. government, such as Ginnie Mae, or guaranteed by federally sponsored enterprises, such as Fannie Mae or Freddie Mac. Our investment-grade Agency MBS portfolio is invested primarily in fixed-rate and adjustable-rate mortgage-backed pass-through certificates and hybrid adjustable-rate MBS. Hybrid adjustable-rate MBS have an initial interest rate that is fixed for a certain period, usually three to ten years, and then adjusts annually for the remainder of the term of the asset. We structure our investment portfolio to be diversified with a variety of prepayment characteristics, investing in mortgage assets with prepayment penalties, investing in certain mortgage security structures that have prepayment protections and purchasing mortgage assets at a premium and at a discount. Our portfolio also includes a small amount of Non-Agency MBS (approximately $11 thousand) which are included with the Agency MBS. Prior period balances have been presented consistent with this treatment.

We classify our MBS as either trading investments, available-for-sale investments or held-to-maturity investments. Our management determines the appropriate classification of the securities at the time they are acquired and evaluates the appropriateness of such classifications at each balance sheet date. We currently classify all of our MBS as available-for-sale. All assets that are classified as available-for-sale are carried at fair value and unrealized gains or losses are generally included in “Other comprehensive income (loss)” as a component of stockholders’ equity. Losses that are credit-related on securities classified as available-for-sale, which are determined by management to be other-than-temporary in nature, are reclassified from “Other comprehensive income” to income (loss).

The most significant source of our revenue is derived from our investments in MBS. Interest income on Agency MBS is accrued based on the actual coupon rate and the outstanding principal amount of the underlying mortgages. Premiums and discounts are amortized or accreted into interest income over the estimated lives of the securities using the effective interest yield method, adjusted for the effects of actual and estimated prepayments based on the Financial Accounting Standards Board, or FASB, Accounting Standards Codification, or ASC, 320-10. Our policy for estimating prepayment speeds for calculating the effective yield is to evaluate historical performance, street consensus prepayment speeds and current market conditions. If our estimate of prepayments is materially incorrect, as compared to the aforementioned references, we may be required to make an adjustment to the amortization or accretion of premiums and discounts that would have an impact on future income, which could be material and adverse.

Securities are recorded on the date the securities are purchased or sold. Realized gains or losses from securities transactions are determined based on the specific identified cost of the securities.

The following table shows our investments’ gross unrealized losses and fair value of those individual securities that have been in a continuous unrealized loss position at September 30, 2014 and December 31, 2013, aggregated by investment category and length of time (dollar amounts in thousands):

September 30, 2014

Description of Securities	Less Than 12 Months Number of Securities	Fair Value	Unrealized Losses	12 Months or More Number of Securities	Fair Value	Unrealized Losses	Total Number of Securities	Fair Value	Unrealized Losses
Agency MBS	117	$757,413	$ (1,952)	355	$3,325,533	$ (76,617)	472	$4,082,946	$ (78,569)

December 31, 2013

Description of Securities	Less Than 12 Months Number of Securities	Fair Value	Unrealized Losses	12 Months or More Number of Securities	Fair Value	Unrealized Losses	Total Number of Securities	Fair Value	Unrealized Losses
Agency MBS	202	$4,262,712	$(122,890)	230	$763,911	$ (23,089)	432	$5,026,623	$(145,979)

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We do not consider those Agency MBS that have been in a continuous loss position for 12 months or more to be other-than-temporarily impaired. The unrealized losses on our investments in Agency MBS were caused by fluctuations in interest rates. We purchased the Agency MBS primarily at a premium relative to their face value and the contractual cash flows of those investments are guaranteed by the U.S. government or government-sponsored agencies. Since September 2008, the government-sponsored agencies have been in the conservatorship of the U.S. government. We currently do not have the intent to sell the Agency MBS at a price less than the amortized cost basis of our investments. Because the decline in market value of the Agency MBS is attributable to changes in interest rates and not the credit quality of the Agency MBS in our portfolio, and because we do not have the intent to sell these investments nor is it more likely than not that we will be required to sell these investments before recovery of their amortized cost basis, which may be at maturity, we do not consider these investments to be other-than-temporarily impaired at September 30, 2014.

Residential Properties

Residential properties are stated at cost and consist of land, buildings and improvements, including other costs incurred during their acquisition, possession and renovation. Residential properties purchased that are not subject to an existing lease are treated as asset acquisitions and, as such, are recorded at their purchase price, including acquisition and renovation costs, all of which are allocated to land and building based upon their relative fair values at the date of acquisition. Residential properties acquired either subject to an existing lease or as part of a portfolio level transaction are treated as a business combination under Accounting Standards Codification (“ASC”) 805, Business Combinations, and, as such, are recorded at fair value, allocated to land, building and the existing lease, if applicable, based upon their relative fair values at the date of acquisition, with acquisition fees and other costs expensed as incurred.

Building depreciation is computed on a straight-line basis over the estimated useful lives of the assets. We will generally use a 27.5 year estimated life with no salvage value. We will incur costs to prepare our acquired properties to be leased. These costs will be capitalized and allocated to building costs. Costs related to the restoration, renovation, or improvement of our properties that improve and extend their useful lives are capitalized and depreciated over their estimated useful lives. Expenditures for ordinary repairs and maintenance are expensed as incurred. Costs incurred by us to lease the properties will be capitalized and amortized over the life of the lease. Escrow deposits include refundable and non-refundable cash and earnest money on deposit with independent third parties for property purchases.

Repurchase Agreements

We finance the acquisition of MBS primarily through the use of repurchase agreements. Under these repurchase agreements, we sell securities to a lender and agree to repurchase the same securities in the future for a price that is higher than the original sales price. The difference between the sale price that we receive and the repurchase price that we pay represents interest paid to the lender. Although structured as a sale and repurchase obligation, a repurchase agreement operates as a financing under which we pledge our securities and accrued interest as collateral to secure a loan which is equal in value to a specified percentage of the estimated fair value of the pledged collateral. We retain beneficial ownership of the pledged collateral. Upon the maturity of a repurchase agreement, we are required to repay the loan and concurrently receive back our pledged collateral from the lender or, with the consent of the lender, we may renew such agreement at the then-prevailing financing rate. These repurchase agreements may require us to pledge additional assets to the lender in the event the estimated fair value of the existing pledged collateral declines.

Derivative Financial Instruments

Risk Management

We primarily use short-term (less than or equal to 12 months) repurchase agreements to finance the purchase of MBS. These obligations expose us to variability in interest payments due to changes in interest rates. We continuously monitor changes in interest rate exposures and evaluate various opportunities to mitigate this risk. Our objective is to limit the impact of interest rate changes on earnings and cash flows. The principal instruments we use to achieve this are interest rate swaps and Eurodollar Futures Contracts. Interest rate swaps effectively convert a percentage of our repurchase agreements to fixed-rate obligations over a period of up to ten years. Under interest rate swaps, we agree to pay an amount equal to a specified fixed rate of interest times a notional principal amount and to receive in return an amount equal to a specified variable-rate of interest times a notional amount, generally based on the London Interbank Offered Rate, or LIBOR. The notional amounts are not exchanged. We do not issue or hold the interest rate swaps and the Eurodollar Futures Contracts (“Futures Contracts”) for speculative purposes. See Note 13 for more information on the Futures Contracts.

We may also enter into To-Be-Announced ("TBA") securities as a means of investing in and financing agency securities or as a means of disposing of or reducing our exposure to agency securities. Pursuant to TBA contracts, we agree to purchase or sell, for future delivery, agency securities with certain principal and interest terms and certain types of collateral, but the particular agency securities to be delivered are not identified until shortly before the TBA settlement date. We also may choose, prior to settlement, to move the settlement of these securities out to a later date by entering into an offsetting short or long position (referred to as a "pair off"), net settling the paired off positions for cash, and simultaneously purchasing a similar TBA contract for a later settlement date. This transaction is commonly referred to as a "dollar roll." The agency securities purchased or sold for a forward settlement date are typically priced at a discount to agency securities for settlement in the current month. This difference (or discount) is referred to as the "price drop." The price drop represents compensation to us for foregoing net interest margin (interest income less repurchase agreement financing cost) and is referred to as "dollar roll income (loss)". TBA Securities are accounted for as derivative instruments since they do not meet the exemption allowed for a "regular way" security trade under ASC 815, as either the TBA contracts do not settle in the shortest period of time possible or we cannot assess that it is probable at inception that we will take physical delivery of the security or that we will not settle on a net basis.

Accounting for Derivative and Hedging Activities

We account for derivative instruments in accordance with ASC 815, which requires recognition of all derivatives as either assets or liabilities and measurement of those instruments at fair value, which is typically based on values obtained from large financial institutions who are market makers for these types of instruments. The accounting for changes in the fair value or derivative instruments depends on whether the instruments are designated and qualify as hedges in accordance with ASC 815. Changes in fair value related to derivatives not designated as hedges are recorded in our consolidated statements of income as "Gain (loss) on derivatives" and specifically identified as either relating to interest rate swaps, Futures Contracts, or TBA securities. For a derivative to qualify for hedge accounting, we must anticipate that the hedge will be highly "effective" as defined by ASC 815-10. A hedge of the variability of cash flows that are to be received or paid in connection with a recognized asset or liability is known as a "cash flow" hedge. Changes in the fair value of a derivative that is highly effective and that is designated as a cash flow hedge, to the extent the hedge is effective, are recorded in "Accumulated Other Comprehensive Income", or "AOCI" and reclassified to income when the forecasted transaction affects income (e.g. when periodic settlement interest payments are due on repurchase agreements). Hedge ineffectiveness, if any, is recorded in current period income.

When we discontinue hedge accounting, the gain or loss on the derivative remains in AOCI and is reclassified into income when the forecasted transaction affects income. In all situations where hedge accounting is discontinued and the derivative remains outstanding, we carry the derivative at its fair value on our balance sheet, recognizing changes in fair value in current period income. All of our swaps had historically been accounted for as cash flow hedges under ASC 815. However, on March 17, 2014, we discontinued hedge accounting on approximately $1.685 billion in notional amounts by de-designating these swaps as cash flow hedges. On August 22, 2014, we decided to discontinue hedge accounting on the remainder of our swaps. In September 2014, we terminated 32 of our swaps with a notional amount of $1.81 billion. As a result of discontinuing hedge accounting for our swaps, beginning March 18, 2014 and August 22, 2014, changes in the fair value of these swaps are recorded in "Gain (loss) on interest rate swaps, net" in our consolidated statements of income rather than in AOCI. Also, net interest paid or received on these swaps which, through March 17, 2014 and August 23, 2014, was recognized in "interest expense", is instead recognized in "Gain (loss) on interest rate swaps, net." These continue to be reported as assets or liabilities on our consolidated balance sheets at their fair value.

As long as the forecasted transactions that were being hedged (i.e. rollovers of our repurchase agreement borrowings) are still expected to occur, the balance in AOCI from the activity in these swaps through March 17, 2014 and August 22, 2014 will remain in AOCI and be recognized in our consolidated statements of income as "interest expense" over the remaining term of these swaps.

For purposes of the consolidated statements of cash flows, cash flows hedges were classified with the cash flows from the hedged item. Cash flows from derivatives that are not hedges are classified according to the underlying nature or purpose of the derivative transaction.

For more details on the amounts and other qualitative information on all our derivative transactions, see Note 13. For more information on the fair value of our derivative instruments, see Note 7.

Credit Risk

At September 30, 2014, we have attempted to limit our exposure to credit losses on our MBS by purchasing securities primarily through Freddie Mac and Fannie Mae. The payment of principal and interest on the Freddie Mac and Fannie Mae MBS are guaranteed by those respective enterprises. In September 2008, both Freddie Mac and Fannie Mae were placed in the conservatorship of the U.S. government. While it is the intent that the conservatorship will help stabilize Freddie Mac’s and Fannie Mae’s losses and overall financial position, there can be no assurance that it will succeed or that, if necessary, Freddie Mac and Fannie Mae will be able to satisfy its guarantees of Agency MBS. There have also been concerns as to what the U.S. government will do regarding winding down the operations of Freddie Mac and Fannie Mae. There have also been concerns over the past few years regarding the credit standing of Freddie Mac, Fannie Mae, and U.S. sovereign debt. We do not know what effect any future ratings of Freddie Mac, Fannie Mae and U.S. sovereign debt may ultimately have on the U.S. economy, the value of our securities, or the ability of Freddie Mac and Fannie Mae to satisfy its guarantees of Agency MBS, if necessary.

Our adjustable-rate MBS are subject to periodic and lifetime interest rate caps. Periodic caps can limit the amount an interest rate can increase during any given period. Some adjustable-rate MBS subject to periodic payment caps may result in a portion of the interest being deferred and added to the principal outstanding.

We may invest in Non-Agency MBS, which are securities that are secured by pools of residential mortgages which are not issued by government sponsored enterprises and are not guaranteed by any agency of the U.S. government or any federally chartered corporation. Such investments carry a risk that the borrower on the underlying mortgage may default on their obligation to make full and timely payments of principal and interest.

Other-than-temporary losses on our available-for-sale MBS, as measured by the amount of decline in estimated fair value attributable to credit losses that are considered to be other-than-temporary, are charged against income, resulting in an adjustment of the cost basis of such securities. Based on the criteria in ASC 320-10, the determination of whether a security is other-than-temporarily impaired, or OTTI, involves judgments and assumptions based on both subjective and objective factors. When a security is impaired, an OTTI is considered to have occurred if (i) we intend to sell the security, (ii) it is more likely than not that we will be required to sell the security before recovery of its amortized cost basis or (iii) we do not expect to recover its amortized cost basis (i.e., there is a credit-related loss). The following are among, but not all of, the factors considered in determining whether and to what extent an OTTI exists and the portion that is related to credit loss: (i) the expected cash flow from the investment; (ii) whether there has been an other-than-temporary deterioration of the credit quality of the underlying mortgages; (iii) the credit protection available to the related mortgage pool for MBS; (iv) any other market information available, including analysts' assessments and statements, public statements and filings made by the debtor or counterparty; (v) management's internal analysis of the security, considering all known relevant information at the time of assessment; and (vi) the magnitude and duration of historical decline in market prices. Because management's assessments are based on factual information as well as subjective information available at the time of assessment, the determination as to whether an other-than-temporary decline exists and, if so, the amount considered impaired, is also subjective and therefore constitutes material estimates that are susceptible to significant change.

For all interest rate swaps entered into on or before September 9, 2013, we are exposed to credit losses in the event of non-performance by counterparties to interest rate swap agreements. In order to limit this risk, our practice was to only enter into swaps with large financial institution counterparties who were market makers for these types of instruments, limit our exposure on each swap to a single counterparty under our defined guidelines and either pay or receive collateral to or from each counterparty on a periodic basis to cover the net fair market position of the swaps held with that counterparty. For all swaps entered into on or after September 9, 2013, all swap participants are required by rules of the Commodities Futures Trading Commission, or CFTC, under authority granted to it pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act, or the Dodd-Frank Act, to clear swaps through a registered derivatives clearing organization, or "swap execution facility," through standardized documents under which each swap counterparty transfers its position to another entity whereby a central clearinghouse effectively becomes the counterparty on each side of the swap. Both the swap execution facility and the central clearinghouse could require greater initial and periodic margin (collateral) requirements and additional transaction fees. It is the intent of the Dodd-Frank Act that the clearing of swaps in this manner is designed to avoid concentration of risk in any single entity by spreading and centralizing the risk in the clearinghouse and its members.

Income Taxes

We have elected to be taxed as a REIT and to comply with the provisions of the Code with respect thereto. Accordingly, we will not be subject to federal income tax to the extent that our distributions to our stockholders satisfy the REIT requirements and that certain asset, income and stock ownership tests are met.

We have no unrecognized tax benefits and do not anticipate any increase in unrecognized benefits during 2014 relative to any tax positions taken prior to January 1, 2014. Should the accrual of any interest or penalties relative to unrecognized tax benefits be necessary, it is our policy to record such accruals in our income taxes accounts; and no such accruals existed at September 30, 2014. We file REIT U.S. federal and California income tax returns. These returns are generally open to examination by the IRS and the California Franchise Tax Board for all years after 2009 and 2008, respectively.

Cumulative Convertible Preferred Stock

We classify our Series B Cumulative Convertible Preferred Stock, or Series B Preferred Stock, on our balance sheets using the guidance in ASC 480-10-S99. The Series B Preferred Stock contains certain fundamental change provisions that allow the holder to redeem the preferred stock for cash only if certain events occur, such as a change in control. As redemption under these circumstances is not solely within our control, we have classified the Series B Preferred Stock as temporary equity.

We have analyzed whether the conversion features in the Series B Preferred Stock should be bifurcated under the guidance in ASC 815-10 and have determined that bifurcation is not necessary.

Stock-Based Expense

In accordance with ASC 718-10, any expense relating to share-based payment transactions is recognized in the unaudited consolidated financial statements.

Restricted stock is expensed over the vesting period (see Note 10).

Earnings Per Share

Basic earnings per share, or EPS, is computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted EPS assumes the conversion, exercise or issuance of all potential common stock equivalents (which includes stock options and convertible preferred stock) and the adding back of the Series B Preferred Stock dividends unless the effect is to reduce a loss or increase the income per share.

The computation of EPS for the three and nine months ended September 30, 2014 and 2013 is as follows (amounts in thousands, except per share data):

	Net Income Available to Common Stockholders	Average Shares	Earnings per Share
For the three months ended September 30, 2014			
Basic EPS	$ 18,061	121,061	$ 0.15
Effect of dilutive securities	394	4,131	-
Diluted EPS	$ 18,455	125,192	$ 0.15
For the three months ended September 30, 2013			
Basic EPS	$ 16,579	142,380	$ 0.12
Effect of dilutive securities	394	3,907	-
Diluted EPS	$ 16,973	146,287	$ 0.12

	Net Income	Average	Earnings

	Available to Common Stockholders	Shares	per Share
For the nine months ended September 30, 2014			
Basic EPS	$ 38,621	128,174	$ 0.30
Effect of dilutive securities	1,182	4,080	-
Diluted EPS	$ 39,803	132,254	$ 0.30
For the nine months ended September 30, 2013			
Basic EPS	$ 60,323	143,176	$ 0.42
Effect of dilutive securities	1,200	3,942	-
Diluted EPS	$ 61,523	147,118	$ 0.42

For the three and nine months ended September 30, 2014 and 2013, options to purchase 5,000 and 5,000 shares of common stock, respectively, were outstanding and not included in the computation of diluted EPS as their exercise price and option expense exceeded the average stock price for those respective periods.

Accumulated Other Comprehensive Income

In accordance with ASC 220-10-55-2, total comprehensive income is divided into net income and other comprehensive income, which includes unrealized gains and losses on marketable securities classified as available-for-sale, and unrealized gains and losses on derivative financial instruments. In accordance with ASU 2013-02, we have identified, in our Statements of Comprehensive Income, items that are reclassified and included in our Statements of Income.

USE OF ESTIMATES

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could materially differ from those estimates.

RECENT ACCOUNTING PRONOUNCEMENTS

In the first quarter of 2013, the FASB issued ASU 2013-04, “Liabilities (Topic 405): Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation Is Fixed at the Reporting Date.” This ASU requires an entity to measure obligations resulting from joint and several liability arrangements for which the total amount of the obligation within the scope of this ASU is fixed at the reporting date, as the sum of the following: (a) the amount the reporting entity agreed to pay on the basis of its arrangement among its co-obligors; and (b) any additional amount the reporting entity expects to pay on behalf of its co-obligors. This ASU also requires an entity to disclose the nature and amount of the obligation as well as other information about the obligations including the terms and conditions of the arrangement. Examples of obligations within the scope of this ASU include debt arrangements, other contractual obligations, and settled litigation and judicial rulings. This ASU was effective for our financial statements beginning with the quarter ended March 31, 2014. We have adopted this ASU and it did not have a material impact on our financial statements.

In May 2014, the FASB issued a new standard on revenue recognition, ASU No. 2014-09, “Revenue from Contracts with Customers (Topic 606).” This new standard will replace more than 200 ad hoc pronouncements on revenue recognition. This ASU requires companies to recognize revenue in a way that shows the transfer of goods or services to customers in amounts that reflect the payment that a company expects to be entitled to in exchange for those goods or services. To do that, companies will now have to go through a five-step process: (1) tie the contract to a customer; (2) identify the contract’s performance obligations; (3) determine the transaction price; (4) connect the transaction price to the performance obligations in the contract; and (5) recognize revenue when (or as) a company satisfies the performance obligation. This ASU only affects an entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets, unless those contracts are within other standards (for example, insurance contracts or lease contracts). This ASU is effective for a public entity for the financial statements beginning with the quarter ending March 31, 2017. We do not believe that this ASU will have a material impact on our financial statements.

In June 2014, the FASB issued a new standard on repurchase agreements, ASU No. 2014-11, “Transfers and Servicing: Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures (Topic 860).” This new standard introduces two major changes to the existing accounting guidance: (1) it requires transferors and transferees to account for repurchase-to-maturity transactions as secured borrowings, where the transferor maintains control over the transferred asset instead of accounting for these as a sale; and (2) it requires separate accounting for a transfer of a financial asset executed contemporaneously with a repurchase agreement with the same counterparty, causing the repurchase agreement to be accounted for as a secured borrowing. For these types of transactions, there is additional disclosure about the nature of the transaction. This ASU also requires the following disclosures for all repurchase agreements, securities lending transactions and repurchase-to-maturity transactions that are accounted for as secured borrowings: (i) a disaggregation of the gross obligation by the class of collateral pledged; (ii) the remaining contractual tenor of the agreements; and (iii) a discussion of the potential risks associated with the agreements and the related collateral pledged, including obligations arising from a decline in the fair value of the collateral pledged and how those risks are managed. This ASU is effective for a public entity for the financial statements beginning with the quarter ending March 31, 2015. We do not believe that this ASU will have a material impact on our financial statements.

NOTE 2. REVERSE REPURCHASE AGREEMENTS

At September 30, 2014, we did not have any reverse repurchase agreements outstanding. During the three months ended September 30, 2014, the maximum amount of reverse repurchase agreements outstanding was $46 million and the average amount of reverse repurchase agreements outstanding was approximately $973 thousand. These investments are used as a means of investing excess cash. The collateral for these loans would be U.S. Treasury securities or Agency MBS with an aggregate fair value equal to the amount of the loans. At December 31, 2013, there were no reverse repurchase agreements outstanding.

NOTE 3. MORTGAGE-BACKED SECURITIES (MBS)

The following tables summarize our MBS, classified as available-for-sale, at September 30, 2014 and December 31, 2013, which are carried at their fair value (amounts in thousands):

September 30, 2014

By Agency	Ginnie Mae	Freddie Mac	Fannie Mae	Non-Agency MBS	Total MBS
Amortized cost	$12,148	$3,082,283	$4,268,672	$ -	$7,363,103
Paydowns receivable(1)	-	40,669	-	-	40,669
Unrealized gains	32	20,336	65,670	11	86,049
Unrealized losses	(155)	(44,740)	(33,674)	-	(78,569)
Fair value	$12,025	$3,098,548	$4,300,668	$ 11	$7,411,252

By Security Type	ARMs	Hybrids	15-Year Fixed-Rate	20-Year and 30-Year Fixed-Rate	Other(1)	Total MBS
Amortized cost	$1,772,230	$4,209,618	$1,149,902	$230,173	$1,180	$7,363,103
Paydowns receivable(2)	3,131	37,538	-	-	-	40,669
Unrealized gains	52,856	21,334	3,266	8,577	16	86,049
Unrealized losses	(4,991)	(52,693)	(20,847)	(35)	(3)	(78,569)
Fair value	$1,823,226	$4,215,797	$1,132,321	$238,715	$1,193	$7,411,252

(1) Includes floating-rate collateralized mortgage obligations ("CMO") and Non-Agency MBS.
(2) Paydowns receivable are generated when the Company receives notice from Freddie Mac of prepayments but does not receive the actual cash with respect to such prepayments until the 15th day of the following month.

During the three months ended September 30, 2014, there were no gross realized gains on sales of Agency MBS. During the nine months ended September 30, 2014, there were gross realized gains on sales of Agency MBS of approximately $1.6 million. During the three and nine months ended September 30, 2014, there were gross realized losses on sales of Agency MBS of approximately $5.6 million and $5.6 million, respectively. During the three and nine months ended September 30, 2013, there were gross realized gains on sales of Agency MBS of approximately $7.64 million and $14.89 million, respectively, and gross realized losses of approximately $5.65 million and $5.65 million, respectively million.

December 31, 2013

By Agency	Ginnie Mae	Freddie Mac	Fannie Mae	Non-Agency MBS	Total MBS
Amortized cost	$13,374	$3,618,312	$4,950,005	$ -	$8,581,691
Paydowns receivable[(1)]	-	33,401	-	-	33,401
Unrealized gains	10	18,384	68,860	79	87,333
Unrealized losses	(124)	(89,263)	(56,592)	-	(145,979)
Fair value	$13,260	$3,580,834	$4,962,273	$ 79	$8,556,446

By Security Type	ARMs	Hybrids	15-Year Fixed-Rate	30-Year Fixed-Rate	Floating-Rate CMOs[(2)]	Total MBS
Amortized cost	$1,594,183	$5,168,156	$1,714,427	$103,476	$ 1,449	$8,581,691
Paydowns receivable[(1)]	2,843	30,558	-	-	-	33,401
Unrealized gains	46,294	31,668	1,695	7,591	85	87,333
Unrealized losses	(2,560)	(85,614)	(57,774)	(29)	(2)	(145,979)
Fair value	$1,640,760	$5,144,768	$1,658,348	$111,038	$ 1,532	$8,556,446

(1) Paydowns receivable are generated when the Company receives notice from Freddie Mac of prepayments but does not receive the actual cash with respect to such prepayments until the 15th day of the following month.
(2) Non-Agency MBS are included in the Floating-Rate CMOs category.

NOTE 4. RESIDENTIAL PROPERTIES

As of September 30, 2014, we owned 79 single-family residential properties which are all located in Southeastern Florida and are carried at a total cost of approximately $12.4 million. As we did not start this operation until March 2014, we did not own any single-family residential properties as of December 31, 2013. The income from these properties is included in our Statements of Income as “Income on rental properties.” The expenses on these properties are included in our Statements of Income in “Other expenses” and the details are included in Note 15.

NOTE 5. REPURCHASE AGREEMENTS

We have entered into repurchase agreements with large financial institutions to finance most of our Agency MBS. The repurchase agreements are short-term borrowings that are secured by the market value of our MBS and bear fixed interest rates that have historically been based upon LIBOR.

At September 30, 2014 and December 31, 2013, the repurchase agreements had the following balances (dollar amounts in thousands), weighted average interest rates and remaining weighted average maturities:

	September 30, 2014			December 31, 2013		
	Balance	Weighted Average Interest Rate		Balance	Weighted Average Interest Rate	
Overnight	$-	-	%	$-	-	%
Less than 30 days	2,705,000	0.32		3,105,000	0.39	
30 days to 90 days	3,795,000	0.32		4,475,000	0.39	
Over 90 days to less than 1 year	50,000	0.33		-	-	
1 year to 2 years	-	-		-	-	
Demand	-	-		-	-	
	$6,550,000	0.32	%	$7,580,000	0.39	%
Weighted average maturity	38 days			38 days		
Weighted average interest rate after adjusting for interest rate swaps	1.08 %			1.50 %		
Weighted average maturity after adjusting for interest rate swaps	845 days			1,010 days		
Agency MBS pledged as collateral under the repurchase agreements and swap agreements	$6,912,185			$8,060,567		

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The following tables present information about certain assets and liabilities that are subject to master netting arrangements (or similar agreements) only in the event of default on a contract. See Notes 1, 7 and 13 for more information on the Company's interest rate swaps (both items that were hedges and also for discontinued hedges) and other derivative instruments.

September 30, 2014 (in thousands)	Gross Amounts of Recognized Assets or Liabilities	Gross Amounts Offset in the Balance Sheets	Net Amounts of Assets or Liabilities Presented in the Balance Sheets	Gross Amounts Not Offset in the Balance Sheets[1] Financial Instruments	Cash Collateral Received	Net Amounts
Derivative assets at fair value	$ 662,095	$ -	$ 662,095	$ (662,095)	$ -	$ -
Total	$ 662,095	$ -	$ 662,095	$ (662,095)	$ -	$ -
Repurchase Agreements[3]	$ 6,550,000	$ -	$ 6,550,000	$ (6,550,000)	$ -	$ -
Derivative liabilities at fair value[2]	671,288	-	671,288	(671,288)	-	-
Total	$ 7,221,288	$ -	$ 7,221,288	$ (7,221,288)	$ -	$ - \

December 31, 2013 (in thousands)	Gross Amounts of Recognized Assets or Liabilities	Gross Amounts Offset in the Balance Sheets	Net Amounts of Assets or Liabilities Presented in the Balance Sheets	Gross Amounts Not Offset in the Balance Sheets[1] Financial Instruments	Cash Collateral Received	Net Amounts
Derivative assets at fair value[2]	$ 22,551	$ -	$ 22,551	$ (22,551)	$ -	$ -
Total	$ 22,551	$ -	$ 22,551	$ (22,551)	$ -	$ -
Repurchase Agreements[3]	$ 7,580,000	$ -	$ 7,580,000	$ (7,580,000)	$ -	$ -

Derivative liabilities at fair value[2]	55,914	-	55,914	(55,914)	-	-
Total	$7,635,914	$ -	$7,635,914	$(7,635,914)	$ -	$ -

(1) Amounts presented are limited to collateral pledged sufficient to reduce the related net amount to zero in accordance with ASU No. 2011-11, as amended by ASU No. 2013-01.
(2) At September 30, 2014, we had pledged approximately $26.1 million in Agency MBS as collateral and paid another approximately $7.2 million on swap margin calls on our swap derivatives. At December 31, 2013, we had pledged approximately $84.2 million in Agency MBS as collateral and paid another approximately $7.1 million on swap margin calls on our swap derivatives.
(3) At September 30, 2014, we had pledged approximately $6.89 billion in Agency MBS as collateral on our repurchase agreements. At December 31, 2013, we had pledged approximately $7.98 billion in Agency MBS as collateral on our repurchase agreements.

NOTE 6. JUNIOR SUBORDINATED NOTES

On March 15, 2005, we issued $37,380,000 of junior subordinated notes to a newly-formed statutory trust, Anworth Capital Trust I, organized by us under Delaware law. The trust issued $36,250,000 in trust preferred securities to unrelated third party investors. Both the notes and the trust preferred securities require quarterly payments and bear interest at the prevailing three-month LIBOR rate plus 3.10%, reset quarterly. The first interest payments were made on June 30, 2005. Both the notes and the trust preferred securities will mature in 2035 and are currently redeemable, at our option, in whole or in part, without penalty. We used the net proceeds of this private placement to invest in Agency MBS. We have reviewed the structure of the transaction under ASC 810-10 and concluded that Anworth Capital Trust I does not meet the requirements for consolidation. On September 26, 2005, the notes, the trust preferred securities and the related agreements were amended. The only material change was that one of the class holders requested that interest payments be made quarterly on January 30, April 30, July 30 and October 30 instead of at the end of each calendar quarter. This became effective with the quarterly payments after September 30, 2005. As of the date of this filing, we have not redeemed any of the notes or trust preferred securities.

NOTE 7. FAIR VALUES OF FINANCIAL INSTRUMENTS

As defined in ASC 820-10, fair value is the price that would be received from the sale of an asset or paid to transfer or settle a liability in an orderly transaction between market participants in the principal (or most advantageous) market for the asset or liability. ASC 820-10 establishes a fair value hierarchy that ranks the quality and reliability of the information used to determine fair values. Financial assets and liabilities carried at fair value are classified and disclosed in one of the three following categories:

Level 1: Quoted market prices in active markets for identical assets or liabilities.

Level 2: Observable market based inputs or unobservable inputs that are corroborated by market data. This includes those financial instruments that are valued using models or other valuation methodologies where substantially all of the assumptions are observable in the marketplace, can be derived from observable market data or are supported by observable levels at which transactions are executed in the marketplace. We consider the inputs utilized to fair value our Agency MBS to be Level 2. Management bases the fair value for these investments primarily on third party bid price indications provided by dealers who make markets in these instruments. The Agency MBS market is primarily an over-the-counter market. As such, there are no standard, public market quotations or published trading data for individual MBS securities. As our portfolio consists of hundreds of similar, but distinct, securities that have each been traded with only one broker counterparty, we generally seek to have each Agency MBS security priced by one broker. The prices received are non-binding offers to trade, but are indicative quotations of the market value of our securities as of the market close on the last day of each quarter. The brokers receive trading data from several traders that participate in the active markets for these securities and directly observe numerous trades of securities similar to the securities owned by us. Given the volume of market activity for Agency MBS, it is our belief that the broker pricing accurately reflects market information for actual, contemporaneous transactions. We do not adjust quotes or prices we obtain from brokers and pricing services. In the limited instances where valuations are received on a security from multiple brokers, we use the median value of the prices received to determine fair value. To validate the prices we obtain, to ensure our fair value determinations are consistent with ASC 820, and to ensure that we properly classify these securities in the fair value hierarchy, we evaluate the pricing information we receive taking into account factors such as coupon, prepayment experience, fixed/adjustable rate, coupon index, time to reset and issuing agency, among other factors. Based on these factors, broker prices are compared to prices of similar securities provided by other brokers. If we determine (based on such a comparison and our market knowledge and expertise) that a security is priced significantly differently than similar securities, the broker is contacted and requested to revisit their valuation of the security. If a broker refuses to reconsider its valuation, we will request pricing from another broker and use the median value of the prices received to determine fair value. If we are unable to receive a valuation from another broker, the price received from an independent third party pricing service will be used, if it is determined (based on our market knowledge and expertise) to be more reliable than the broker pricing. However, the fair value reported may not be indicative of the amounts that could be realized in an actual market exchange.

Our derivative assets and derivative liabilities include: interest rate swaps (in which we pay a fixed-rate of interest and receive a variable-rate of interest that is based on LIBOR), TBA securities receivable, TBA securities payable and contracts to buy or sell TBA securities. Our derivative assets also include Eurodollar Futures Contracts. The fair value of both the derivatives and the swaps are reported to us independently from dealers who are large financial institutions and are market makers for these types of instruments. The LIBOR swap rate is observable at commonly quoted intervals over the full term of the swaps and therefore is considered a Level 2 item. The fair value of the derivative instruments' assets and liabilities are the estimated amounts the Company would either receive or pay to terminate these agreements at the reporting date, taking into account current interest rates and the Company's credit worthiness. For more information on all our swaps (both hedged swaps and de-designated swaps) and other derivative instruments, see Note 1 and Note 13.

Level 3: Unobservable inputs that are not corroborated by market data. This is comprised of financial instruments whose fair value is estimated based on internally developed models or methodologies utilizing significant inputs that are generally less readily observable from objective sources.

In determining the appropriate levels, we perform a detailed analysis of the assets and liabilities that are subject to ASC 820-10. At each reporting period, all assets and liabilities for which the fair value measurement is based on significant unobservable inputs are classified as Level 3.

At September 30, 2014, fair value measurements on a recurring basis were as follows (in thousands):

	Level 1	Level 2	Level 3	Total
Assets				
Agency MBS[(1)]	$ -	$7,411,252	$ -	$7,411,252
Derivative instruments[(2)]	$ -	$662,095	$ -	$662,095
Liabilities				
Derivative instruments[(2)]	$ -	$671,288	$ -	$671,288

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(1) For more detail about the fair value of our MBS by agency and type of security, see Note 3.
(2) Derivative instruments include discontinued hedges under ASC 815-10. For more detail about our derivative instruments, see Notes 1 and 13.

At December 31, 2013, fair value measurements on a recurring basis were as follows (in thousands):

	Level 1	Level 2	Level 3	Total
Assets				
Agency MBS(1)	$ -	$8,556,446	$ -	$8,556,446
Derivative instruments(2)	$ -	$22,551	$ -	$22,551
Liabilities				
Derivative instruments(2)	$ -	$55,914	$ -	$55,914

(1) For more detail about the fair value of our MBS by agency and type of security, see Note 3.
(2) Derivative instruments are hedging instruments under ASC 815-10. For more detail about our derivative instruments, see Notes 1 and 13.

At September 30, 2014 and December 31, 2013, cash and cash equivalents, restricted cash, escrow deposits, interest receivable, repurchase agreements and interest payable are reflected in our consolidated financial statements at cost, which approximate fair value because of the nature and short term of these instruments.

Junior subordinated notes are variable-rate debt and, as we believe the spread would be consistent with the expectations of market participants as of September 30, 2014 and December 31, 2013, the carrying value approximates fair value.

NOTE 8. INCOME TAXES

We have elected to be taxed as a REIT and to comply with the provisions of the Code with respect thereto. Accordingly, we will not be subject to federal or state income taxes to the extent that our distributions to stockholders satisfy the REIT requirements and certain asset, gross income and stock ownership tests are met. We believe we currently meet all REIT requirements regarding the ownership of our common stock and the distribution of our taxable net income. Therefore, we believe that we continue to qualify as a REIT under the provisions of the Code.

NOTE 9. SERIES B CUMULATIVE CONVERTIBLE PREFERRED STOCK

Our Series B Preferred Stock has a par value of $0.01 per share and a liquidation preference of $25.00 per share plus accrued and unpaid dividends (whether or not declared). The holders of our Series B Preferred Stock must receive dividends at a rate of 6.25% per year on the $25.00 liquidation preference before holders of our common stock are entitled to receive any dividends. Our Series B Preferred Stock is senior to our common stock and on parity with our 8.625% Series A Cumulative Preferred Stock, or Series A Preferred Stock, with respect to the payment of distributions and amounts, upon liquidation, dissolution or winding up. So long as any shares of our Series B Preferred

Stock remain outstanding, we will not, without the affirmative vote or consent of the holders of at least two-thirds of the shares of our Series B Preferred Stock outstanding at the time, authorize or create, or increase the authorized or issued amount of, any class or series of capital stock ranking senior to our Series B Preferred Stock with respect to payment of dividends or the distribution of assets upon liquidation, dissolution or winding up.

Our Series B Preferred Stock has no maturity date, is not redeemable and is convertible at the then-current conversion rate into shares of our common stock per $25.00 liquidation preference. The conversion rate is adjusted in any fiscal quarter in which the cash dividends paid to common stockholders results in an annualized common stock dividend yield that is greater than 6.25%. The conversion ratio is also subject to adjustment upon the occurrence of certain specific events such as a change in control. Our Series B Preferred Stock is convertible into shares of our common stock at the option of the holder(s) of Series B Preferred Stock at any time at the then-prevailing conversion rate. On or after January 25, 2012, we may, at our option, under certain circumstances, convert each share of Series B Preferred Stock into a number of shares of our common stock at the then-prevailing conversion rate. We may exercise this conversion option only if our common stock price equals or exceeds 130% of the then-prevailing conversion price of our Series B Preferred Stock for at least twenty (20) trading days in a period of thirty (30) consecutive trading days (including the last trading day of such period) ending on the trading day immediately prior to our issuance of a press release announcing the exercise of the conversion option. During the three months ended September 30, 2014, we have not, at our option, converted any shares of Series B Preferred Stock. Our Series B Preferred Stock contains certain fundamental change provisions that allow the holder to redeem our Series B Preferred Stock for cash if certain events occur, such as a change in control. Our Series B Preferred Stock generally does not have voting rights, except if dividends on the Series B Preferred Stock are in arrears for six or more quarterly periods (whether or not consecutive). Under such circumstances, the holders of Series B Preferred Stock, together with the holders of Series A Preferred

Stock, would be entitled to elect two additional directors to our board of directors to serve until all unpaid dividends have been paid or declared and set aside for payment. In addition, certain material and adverse changes to the terms of our Series B Preferred Stock may not be taken without the affirmative vote of at least two-thirds of the outstanding shares of Series B Preferred Stock and Series A Preferred Stock voting together as a single class. Through September 30, 2014, we have declared and set aside for payment the required dividends for our Series B Preferred Stock.

NOTE 10. PUBLIC OFFERINGS AND CAPITAL STOCK

At September 30, 2014, our authorized capital included 200,000,000 shares of common stock, of which 118,554,025 shares were issued and outstanding.

At September 30, 2014, our authorized capital included 20,000,000 shares of $0.01 par value preferred stock, of which 5,150,000 shares had been designated 8.625% Series A Cumulative Preferred Stock (liquidation preference $25.00 per share) and 3,150,000 shares had been designated 6.25% Series B Cumulative Convertible Preferred Stock (liquidation preference $25.00 per share). The undesignated shares of preferred stock may be issued in one or more classes or series, with such distinctive designations, rights and preferences as determined by our board of directors. At September 30, 2014, there were 1,919,378 shares of Series A Preferred Stock issued and outstanding and 1,009,640 shares of Series B Preferred Stock issued and outstanding.

On October 3, 2011, we announced that our Board had authorized a share repurchase program which permits us to acquire up to 2,000,000 shares of our common stock. The shares are expected to be acquired at prevailing prices through open market transactions. The manner, price, number and timing of share repurchases will be subject to market conditions and applicable SEC rules. On December 13, 2013, we announced that our board of directors had authorized us to acquire up to an additional 5,000,000 shares of our common stock; on March 14, 2014, we announced that our board of directors had authorized the Company to acquire up to an additional 10,000,000 shares of our common stock; and on May 22, 2014, we announced that our board of directors had authorized the Company to acquire up to an additional 10,000,000 shares of our common stock, in each case through our share repurchase program. During the three months ended September 30, 2014, we repurchased an aggregate of 6,819,372 shares at a weighted average price of $5.10 per share under our share repurchase program.

Our Dividend Reinvestment and Stock Purchase Plan allows stockholders and non-stockholders to purchase shares of our common stock and to reinvest dividends therefrom to acquire additional shares of our common stock. On March 14, 2012, we filed a shelf registration statement on Form S-3 with the U.S. Securities and Exchange Commission, or the SEC, registering up to 27,000,000 shares of our common stock for our 2012 Dividend Reinvestment and Stock Purchase Plan, or the 2012 Plan. During the three months ended September 30, 2014, we issued an aggregate of 75,783 shares of our common stock at a weighted average price of $5.18 per share under the 2012 Plan, resulting in proceeds to us of approximately $393 thousand. At September 30, 2014, there were approximately 16.56 million shares remaining under the 2012 Plan.

On March 20, 2013, we filed a shelf registration statement on Form S-3 with the SEC and on April 5, 2013 we filed a pre-effective amendment thereto with the SEC, offering up to $544,727,778 of our capital stock. The registration statement was declared effective on April 8, 2013. At September 30, 2014, approximately $544.7 million of our capital stock was available for future issuance under the registration statement.

On August 5, 2014, we filed a registration statement on Form S-8 with the SEC to register an aggregate of up to 2,000,000 shares of our common stock to be issued pursuant to the Anworth Mortgage Asset Corporation 2014 Equity Compensation Plan, or the 2014 Equity Plan. During the third quarter of 2014, we issued 10,000 restricted stock units under the 2014 Equity Plan.

NOTE 11. TRANSACTIONS WITH AFFILIATES

Management Agreement and Externalization

Effective as of December 31, 2011, we entered into the Management Agreement with the Manager, pursuant to which our day-to-day operations are being conducted by the Manager. The Manager is supervised and directed by our board of directors and is responsible for (i) the selection, purchase and sale of our investment portfolio; (ii) our financing and hedging activities; and (iii) providing us with management services. The Manager will also perform such other services and activities relating to our assets and operations as may be appropriate. In exchange for these services, the Manager receives a management fee paid monthly in arrears in an amount equal to one-twelfth of 1.20% of our Equity (as defined in the Management Agreement).

On the effective date of the Management Agreement, the employment agreements with our executives were terminated, our employees became employees of the Manager, and we took such other actions as we believed were reasonably necessary to implement the Management Agreement and externalize our management function.

A trust controlled by Mr. Lloyd McAdams, our Chairman, Chief Executive Officer and President, and Ms. Heather U. Baines, an Executive Vice President of the Manager, beneficially owns 50% of the outstanding membership interests of the Manager; Mr. Joseph E. McAdams, the Chief Investment Officer of the Manager, beneficially owns 45% of the outstanding membership interests of the Manager; and Mr. Thad M. Brown, our Chief Financial Officer, beneficially owns 5% of the outstanding membership interests of the Manager.

The Management Agreement may only be terminated without cause, as defined in the agreement, after the expiration of each annual renewal term. We are required to provide 180-days prior notice of non-renewal of the Management Agreement and must pay a termination fee on the last day of the initial term or any automatic renewal term, equal to three times the average annual management fee earned by the Manager during the prior 24-month period immediately preceding the most recently completed month prior to the effective date of termination. We may only not renew the Management Agreement with or without cause with the consent of the majority of our independent directors. These provisions make it difficult to terminate the Management Agreement and increase the effective cost to us of not renewing the Management Agreement.

Certain of our officers were previously granted restricted stock and other equity awards (see Note 12), including dividend equivalent rights, in connection with their service to us, and certain of our officers had agreements under which they would receive payments if the Company is subject to a change in control (discussed later in this Note 11). In connection with the Externalization, certain of the agreements under which our officers were granted equity awards and would be paid payments in the event of a change in control were modified so that such agreements will continue with respect to our officers and employees after they became officers and employees of the Manager. In addition, as officers of our Company and employees of the Manager, they will continue to be eligible to receive equity awards under equity compensation plans in effect now or in the future.

Messrs. Lloyd McAdams, Joseph E. McAdams, Charles J. Siegel, John T. Hillman and Ms. Heather U. Baines and others are officers and employees of PIA Farmland, Inc. and its external manager, PIA, where they devote a portion of their time. PIA Farmland, Inc., a privately-held real estate investment trust investing in U.S. farmland properties to lease to independent farm operators, was incorporated in February 2013 and acquired its first farm property in October 2013. These officers and employees are under no contractual obligations to PIA Farmland, Inc., its external manager, PIA, or to Anworth or its external manager, Anworth Management, LLC, as to their time commitment. Mr. Steven Koomar, the Chief Executive Officer of PIA Farmland, Inc., has no involvement with either Anworth or its external manager, Anworth Management, LLC.

Change in Control and Arbitration Agreements

On June 27, 2006, we entered into Change in Control and Arbitration Agreements with each of Mr. Thad M. Brown, our Chief Financial Officer, Mr. Charles J. Siegel, our then Senior Vice President-Finance, Ms. Bistra Pashamova, our then Senior Vice President and Portfolio Manager, and Mr. Evangelos Karagiannis, our then Vice President and Portfolio Manager, as well as certain of our other officers. In connection with the Externalization, we amended these agreements to provide that should a change in control (as defined in the amended agreements) occur, each of these officers will receive certain severance and other benefits valued as of December 31, 2011. Under the amended agreements, in the event that a change in control occurs, each of these officers will receive a lump sum payment equal to (i) 12 months annual base salary in effect on December 31, 2011, plus (ii) the average annual incentive compensation received for the two complete fiscal years prior December 31, 2011, plus (iii) the average annual bonus received for the two complete fiscal years prior to December 31, 2011, as well as other benefits. The amended Change in Control and Arbitration Agreements also provide for accelerated vesting of equity awards granted to these officers upon a change in control.

Agreements with Pacific Income Advisers, Inc.

On January 26, 2012, we entered into a sublease agreement that became effective on July 1, 2012 with PIA. Under the sublease agreement, we lease, on a pass-through basis, 7,300 square feet of office space from PIA at the same location and pay rent at an annual rate equal to PIA's obligation, which is currently $61.67 per square foot. The base monthly rental for us is $37,518.40, which will be increased by 3% per annum on July 1, 2015. The sublease agreement runs through June 30, 2022 unless earlier terminated pursuant to the master lease. During the three and nine months ended September 30, 2014, we expensed $126 thousand and $377 thousand, respectively, in rent and related expenses to PIA under this sublease agreement. During the three and nine months ended September 30, 2013, we expensed $123 thousand and $366 thousand, respectively, in rent and related expenses to PIA under this sublease agreement.

At September 30, 2014, the future minimum lease commitment is as follows (in whole dollars):

Year	2014	2015	2016	2017	2018	Thereafter	Total Commitment
Commitment	$112,555	$456,987	$470,720	$484,852	$499,398	$1,866,753	$3,891,265

On July 25, 2008, we entered into an administrative services agreement with PIA, which was amended and restated on August 20, 2010. Under this agreement, PIA provides administrative services and equipment to us including human resources, operational support and information technology, and we pay an annual fee of 5 basis points on the first $225 million of stockholders' equity and 1.00 basis points thereafter (paid quarterly in arrears) for those services. The administrative services agreement had an initial term of one year and renews for successive one-year terms thereafter unless either party gives notice of termination no less than 30 days before the expiration of the then-current annual term. We may also terminate the administrative services agreement upon 30 days prior written notice for any reason and immediately if there is a material breach by PIA. During the three and nine months ended September 30, 2014, we paid fees of $49 thousand and $152 thousand, respectively, to PIA in connection with this agreement. During the three and nine months ended September 30, 2013, we paid fees of $53 thousand and $159 thousand, respectively, to PIA in connection with this agreement.

NOTE 12. EQUITY COMPENSATION PLAN

2014 Equity Compensation Plan

We filed a registration statement on Form S-8 on August 5, 2014 to register up to an aggregate of 2,000,000 shares of our common stock to be issued pursuant to the 2014 Equity Compensation Plan, or the 2014 Equity Plan. During the three months ended September 30, 2014, we issued 10,000 restricted stock units under the 2014 Equity Plan.

In October 2005, our board of directors approved the grant of an aggregate of 200,780 shares of restricted stock to various officers under the 2004 Equity Compensation Plan. The stock price on the grant date was $7.72. The restricted stock vests 10% per year on each anniversary date for a ten-year period and shall also vest immediately upon the death of the grantee or upon the grantee reaching age 65. Each grantee shall have the right to sell 40% of the restricted stock any time after such shares have vested. The remaining 60% of such vested restricted stock may not be sold until after termination of employment with us. We amortize the restricted stock over the vesting period, which is the lesser of ten years or the remaining number of years to age 65.

In October 2006, our board of directors approved a grant of an aggregate of 197,362 shares of performance-based restricted stock to various officers under the 2004 Equity Compensation Plan. Such grant was made effective on October 18, 2006. The closing stock price on the effective date of the grant was $9.12. The shares vest in equal annual installments over a three-year period provided that the annually compounded rate of return on our common stock, including dividends, exceeds 12% measured on an annual basis as of the anniversary date of the grant. If the annually compounded rate of return does not exceed 12%, then the shares will vest on the anniversary date thereafter when the annually compounded rate of return exceeds 12%. If the annually compounded rate of return does not exceed 12% within ten years after the effective date of the grant, then the shares will be forfeited. The shares will fully vest within the ten-year period upon the death of a grantee. Upon vesting, each grantee shall have the right to sell 40% of the restricted stock any time after such shares have vested. The remaining 60% of such vested restricted stock may not be sold, transferred or pledged until after termination of employment with us or upon the tenth anniversary of the effective date.

We recognize the expense related to restricted stock over the ten-year vesting period. During the three and nine months ended September 30, 2014, we expensed approximately $24 thousand and $72 thousand, respectively, related to these restricted stock grants. During the three and nine months ended September 30, 2013, we expensed approximately $51 thousand and $152 thousand, respectively, related to these restricted stock grants.

At our May 24, 2007 annual meeting of stockholders, our stockholders adopted the Anworth Mortgage Asset Corporation 2007 Dividend Equivalent Rights Plan, or the 2007 Dividend Equivalent Rights Plan. A dividend equivalent right, or DER, is a right to receive amounts equal in value to the dividend distributions paid on a share of our common stock. DERs are paid in either cash or shares of our common stock, whichever is specified by our Compensation Committee at the time of grant, at such times as dividends are paid on shares of our common stock during the period between the date a DER is issued and the date the DER expires or earlier terminates. The Compensation Committee may impose such other conditions to the grant of DERs as it may deem appropriate. The maximum term for DERs under the 2007 Dividend Equivalent Rights Plan is ten years from the date of grant. Prior to January 1, 2012, an aggregate of 582,000 DERs were issued to our officers under the 2007 Dividend Equivalent Rights Plan. These DERs are not attached to any stock and only have the right to receive the same cash distribution per common share distributed to our common stockholders during the term of the grant. All of these grants have a five-year term from the date of the grant. During the three and nine months ended September 30, 2014, we paid or accrued $80 thousand and $243 thousand, respectively, related to DERs granted. During the three and nine months ended September 30, 2013, we paid or accrued $70 thousand and $245 thousand, respectively, related to DERs granted.

Certain of our officers have previously been granted restricted stock and other equity incentive awards, including dividend equivalent rights, in connection with their service to us. In connection with the Externalization, certain of the agreements under which our officers have been granted equity awards were modified so that such agreements will continue with respect to our officers after they became officers and employees of the Manager. As a result, these awards and any future grants will be accounted for as non-employee awards. In addition, as officers of the Company and employees of the Manager, they will continue to be eligible to receive equity incentive awards under equity incentive plans in effect now or in the future. In accordance with the Externalization effective as of December 31, 2011, the DERs previously granted to all of our officers, with the exception of our Chief Executive Officer and Chief Financial Officer, were terminated under the 2007 Dividend Equivalent Rights Plan and were reissued under the 2004 Equity Plan with the same amounts, terms and conditions. The 2004 Equity Plan was subsequently replaced by the 2014 Equity Plan.

NOTE 13. DERIVATIVE INSTRUMENTS

The table below presents the fair value of our derivative instruments as well as their classification in our consolidated balance sheets as of September 30, 2014 and December 31, 2013:

Derivative Instruments	Balance Sheet Location	September 30, 2014	December 31, 2013
		(in thousands)	
Hedged interest rate swaps	Derivative Assets	$ -	$ 22,551
De-designated interest rate swaps	Derivative Assets	-	-
Eurodollar Futures Contracts	Derivative Assets	1,419	-
TBA Securities - Open Contract	Derivative Assets	660,676	-
		$ 662,095	$ 22,551
Hedged interest rate swaps	Derivative Liabilities	$ -	$ 55,914
TBA Securities - Payable	Derivative Liabilities	660,310	-
De-designated interest rate swaps	Derivative Liabilities	10,978	-
		$ 671,288	$ 55,914

Interest Rate Swap Agreements

At September 30, 2014, we were a counterparty to interest rate swaps, which are derivative instruments as defined by ASC 815-10, with an aggregate notional amount of $3.81 billion and a weighted average maturity of approximately four years. During the three months ended September 30, 2014, we added four new swap agreements with an aggregate notional balance of $350 million. During the three months ended September 30, 2014, no swap agreements matured. However, 32 swaps with a notional amount of $1.81 billion were terminated. We utilize interest rate swaps to manage interest rate risk relating to our repurchase agreements and do not anticipate entering into derivative transactions for speculative or trading purposes. In accordance with the swap agreements, we will pay a fixed-rate of interest during the term of the swap agreements (ranging from 0.578% to 3.06%) and receive a payment that varies with the three-month LIBOR rate.

At September 30, 2014 and December 31, 2013, our swaps had the following notional amounts (dollar amounts in thousands), weighted average fixed rates and remaining terms (in months):

	September 30, 2014			December 31, 2013		
Maturity	Notional	Weighted	Remaining	Notional	Weighted	Remaining

	Amount	Average Fixed Rate		Term in Months	Amount	Average Fixed Rate		Term in Months
Less than 12 months	$85,000	1.15	%	1	$410,000	2.07	%	4
1 year to 2 years	500,000	0.90		22	680,000	2.07		18
2 years to 3 years	925,000	1.06		31	1,145,000	1.82		29
3 years to 5 years	1,390,000	1.44		47	1,715,000	1.18		48
5 years to 7 years	555,000	2.35		75	925,000	2.11		76
7 years to 10 years	350,000	2.93		103	500,000	2.84		107
	$3,805,000	1.54	%	48	$5,375,000	1.81	%	47

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Swap Agreements by Counterparty

	September 30, 2014	December 31, 2013
	(in thousands)	
Chicago Mercantile Exchange(1)	$780,000	$400,000
JPMorgan Securities	775,000	1,175,000
Deutsche Bank Securities	715,000	1,165,000
ING Financial Markets LLC	650,000	650,000
RBS Greenwich Capital	350,000	800,000
Nomura Securities International	300,000	650,000
Bank of New York	160,000	260,000
Credit Suisse	75,000	75,000
Morgan Stanley	-	150,000
LBBW Securities, LLC	-	50,000
	$3,805,000	$5,375,000

(1) For all swap agreements entered into after September 9, 2013, the counterparty is the Chicago Mercantile Exchange regardless of who the trading party is. See the section entitled "Derivative Financial Instruments – Interest Rate Risk Management" in Note 1 for additional details.

During the nine months ended September 30, 2014, there was an increase in unrealized losses of approximately $20.6 million, from approximately $33.3 million in unrealized losses at December 31, 2013 to approximately $53.9 million in unrealized losses, on our swap agreements included in "Other comprehensive income" (this increase in unrealized losses consisted of unrealized losses on derivatives of $74 million and a reclassification adjustment for interest expense included in net income of $53.4 million).

On March 17, 2014, we decided to discontinue hedge accounting on certain swaps with a notional balance of approximately $1.685 billion. On August 22, 2014, we decided to discontinue hedge accounting on the remainder of our swaps. During September 2014, 32 of our swaps with a notional balance of $ 1.81 billion were terminated. For both the terminated swaps and the de-designated swaps, as long as there is the probability that the forecasted transactions that were being hedged (i.e., rollovers of our repurchase agreement borrowings) are still expected to occur, the amount of the gain or less in AOCI remains in AOCI and is amortized over the remaining term of the swaps. During the three and nine months ended September 30, 2014, the net gain on these interest rate swaps was approximately $10.9 million and $9.6 million, respectively.

Eurodollar Futures Contracts

Each Futures Contract embodies $1 million of notional value and is effective for a term of approximately three months. We do not designate these contracts as hedges for accounting purposes. As a result, realized and unrealized changes in fair value are recognized in earnings in the period in which the changes occur. At September 30, 2014, we had 5,500 Futures Contracts representing $5.5 billion in notional amount. The fair value of these Futures Contracts was approximately $1.4 million. For the three and nine months ended September 30, 2014, we had gains on Futures Contracts of approximately $111 thousand and $111 thousand, respectively. We did not enter into these types of contracts during 2013.

TBA Securities

We may also enter TBA contracts and recognize a gain or loss on the sale of the contracts or dollar roll income. See the section in Note 1 on “Derivative Financial Instruments – TBA Securities” for more information on TBA securities. During the three and nine months ended September 30, 2014, we recognized a loss on derivatives-TBA securities of approximately $779 thousand and a gain of approximately $798 thousand, respectively. During the three and nine months ended September 30, 2014, we also recognized derivative income on the TBA securities of approximately $366 thousand. During the three and nine months ended September 30, 2013, we did not enter into any TBA contracts. The types of securities involved in these TBA contracts are Fannie Mae 15-year fixed-rate securities with coupons ranging from 2.5% to 3.5%.

For more information on our accounting policies, the objectives and risk exposures relating to derivatives and hedging agreements, see the section on “Derivative Financial Instruments” in Note 1. For more information on the fair value of our swap agreements, see Note 7.

NOTE 14. COMMITMENTS AND CONTINGENCIES

Lease Commitment and Administrative Services Commitment — We sublease office space and use administrative services from PIA, as more fully described in Note 11.

NOTE 15. OTHER EXPENSES

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
	(in thousands)		(in thousands)	
Legal and professional fees[1]	$(218)	$120	$2,423	$385
Printing and stockholder communications	15	27	584	204
Directors and Officers insurance	129	118	374	348
DERs expense	80	70	243	245
Amortization of restricted stock	24	51	72	152
Software implementation and maintenance	80	75	234	220
Administrative service fees	49	53	152	159
Rent	126	123	377	366
Stock exchange and filing fees	46	54	136	162
Custodian and clearing fees	70	34	215	103
Sarbanes-Oxley consulting fees	25	25	76	82
Board of directors fees and expenses	105	103	265	257
Securities data services	34	33	100	99
Leasing commissions on rental properties	59	-	69	-
Other expenses on rental properties	83	-	103	-
Depreciation expense on residential properties	85	-	149	-
Property taxes on residential properties	45	-	45	-
Other	51	67	122	123
Total of other expenses:	$888	$953	$5,739	$2,905

(1) During the third quarter 2014, there was a reversal of expenses previously accrued on legal and professional fees related to the proxy solicitation contest and a consulting agreement in connection with our review of strategic options.

NOTE 16. SUBSEQUENT EVENTS

The conversion rate of our Series B Preferred Stock increased on October 1, 2014 from 4.0919 shares of our common stock to 4.1519 shares of our common stock using the following information: (1) the average closing price of our common stock for the ten (10) consecutive trading day period was $5.05 and (2) the annualized common stock dividend yield was 11.0935%. When we pay any cash dividend during any quarterly fiscal period to all or substantially all of our common stockholders in an amount that results in an annualized common stock dividend yield that is greater than 6.25% (the dividend yield on our Series B Preferred Stock), the conversion rate on our Series B Preferred Stock is adjusted based on a formula specified in the Articles Supplementary Establishing and Fixing the Rights and Preferences of the Series B Preferred Stock.

From October 1, 2014 through November 4, 2014, we purchased and committed to purchase approximately $52 million of Non-Agency MBS.

From October 1, 2014 through November 4, 2014, we issued an aggregate of 75,492 shares of common stock at a weighted average price of $5.16 per share under the 2012 Dividend Reinvestment and Stock Purchase Plan, resulting in proceeds to us of approximately $389 thousand.

From October 1, 2014 through November 4, 2014, we had repurchased an aggregate of 5,671,500 shares of our common stock at a weighted average price of $5.09 per share under our share repurchase program.

From October 1, 2014 through November 4, 2014, two swaps with an aggregate notional amount of $85 million matured.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations
As used in this Quarterly Report on Form 10-Q, "Company," "we," "us," "our," and "Anworth" refer to Anworth Mortgage Asset Corporation.

You should read the following discussion and analysis in conjunction with the unaudited consolidated financial statements and related notes thereto contained in Item 1 of Part I of this Quarterly Report on Form 10-Q. The information contained in this Quarterly Report on Form 10-Q is not a complete description of our business or the risks associated with an investment in our stock. We urge you to carefully review and consider the various disclosures made by us in this Quarterly Report on Form 10-Q and in our other reports filed with the SEC, including our Annual Report on Form 10-K for the fiscal year ended December 31, 2013.

Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the 1933 Act and Section 21E of the Securities Exchange Act of 1934, as amended, and, as such, may involve known and unknown risks, uncertainties and assumptions. Forward-looking statements are those that predict or describe future events or trends and that do not relate solely to historical matters. You can generally identify forward-looking statements as statements containing the words "may," "will," "believe," "expect," "anticipate," "intend," "estimate," "assume," similar expressions. You should not rely on our forward-looking statements because the matters they describe are subject to assumptions, known and unknown risks, uncertainties and other unpredictable factors, many of which are beyond our control. Therefore, our actual results could differ materially and adversely from those expressed in any forward-looking statements as a result of various factors, some of which are listed under the section "Risk Factors," Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2013.

Statements regarding the following subjects, among others, may be forward-looking: changes in interest rates and the market value of our mortgage-backed securities ("MBS"); risks associated with investing in mortgage assets; changes in the yield curve; the availability of MBS for purchase; changes in the prepayment rates on the mortgage loans securing our MBS; our ability to borrow to finance our assets and, if available, the terms of any financing; implementation of or changes in government regulations or programs affecting our business; changes in business conditions and the general economy, including the consequences of actions by the U.S. government and other foreign governments to address the global financial crisis; our ability to maintain our qualification as a real estate investment trust ("REIT") for federal income tax purposes; our ability to maintain our exemption from registration under the Investment Company Act of 1940, as amended; and our ability to manage our growth. All forward-looking statements speak only as of the date they are made. New risks and uncertainties arise over time and it is not possible to predict those events or how they may affect us. Except as required by law, we do not intend to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

General

The Company

We were incorporated in Maryland on October 20, 1997 and we commenced operations on March 17, 1998. We are in the business of investing primarily in U.S. agency mortgage-backed securities, or Agency MBS, which are securities representing obligations guaranteed by the U.S. government, such as Ginnie Mae, or federally sponsored enterprises, such as Fannie Mae or Freddie Mac. Our principal business objective is to generate net income for distribution to our stockholders based upon the spread between the interest income on our mortgage assets and the costs of borrowing to finance our acquisition of those assets.

In February of 2014, the Company incorporated its wholly-owned Qualified REIT Subsidiary ("QRS"), Anworth Properties, which commenced operations in March 2014. The Company incorporated Anworth Property Services, Inc., a Taxable REIT Subsidiary ("TRS") that is wholly-owned by the Company and currently not in operation. The Company's QRS will provide the entity through which the Company may own REIT-qualified real estate assets such as: (1) other types of mortgage assets, from which the Company would receive interest income; and (2) real estate assets, from which the Company would receive rental income and potential price appreciation. The Company's TRS will provide the entity through which the Company may participate in various real estate-related activities which would earn profits that the IRS considers to be taxable income. Unlike a REIT, a TRS pays standard corporate taxes on its income earned from these activities in the mortgage and real estate markets. These other activities include almost everything other than receiving rent on properties owned and collecting interest on real estate mortgages owned. Examples of these other activities include: the securitization of mortgage loans; mortgage origination; leasing and managing rental properties; and owning properties acquired through the foreclosure process.

We have elected to be taxed as a REIT under the Code and are organized for tax purposes as a REIT. Accordingly, we generally distribute substantially all of our taxable earnings to stockholders without paying federal or state income tax at the corporate level on the distributed earnings. At September 30, 2014, our qualified REIT assets (real estate assets, as defined under the Code, cash and cash items and government securities) were greater than 91% of our total assets, as compared to the Code requirement that at least 75% of our total assets must be qualified REIT assets. Greater than 99% of our 2013 revenue qualified for both the 75% source of income test and the 95% source of income test under the REIT rules. At September 30, 2014, we believe we met all REIT requirements regarding the ownership of our common stock and the distributions of our taxable net income. Therefore, we believe that we continue to qualify as a REIT under the provisions of the Code.

Pursuant to a Management Agreement, or the Management Agreement, between us and Anworth Management, LLC, or the Manager, effective as of December 31, 2011, our day-to-day operations are being conducted by the Manager. The Manager is supervised and directed by our board of directors and is responsible for (i) the selection, purchase and sale of our investment portfolio; (ii) our financing and hedging activities; and (iii) providing us with management services. The Manager will also perform such other services and activities relating to our assets and operations as may be appropriate. In exchange for these services, the Manager receives a management fee paid monthly in arrears in an amount equal to one-twelfth of 1.20% of our Equity (as defined in the Management Agreement). The term of the Management Agreement expired on December 31, 2013 and automatically renews for successive one-year renewal terms unless either party elects not to renew. If we terminate the Management Agreement, or elect not to renew without cause, then we will be required to pay a termination fee equal to three times the average annual management fee earned during the prior 24-month period. At September 30, 2014, if this hypothetical event had occurred, the termination fee would have been approximately $34.8 million.

Government Activity

Developments Concerning Fannie Mae and Freddie Mac

Payments on the Agency MBS in which we invest are guaranteed by Fannie Mae and Freddie Mac. Since 2008, these agencies have been under the conservatorship of the U.S. government. Separate legislation has been introduced in both houses of the U.S. Congress to wind-down both of these agencies. On June 25, 2013, a bipartisan group of U.S. Senators introduced a draft bill (better known as the Corker-Warner bill) to the U.S. Senate titled, “Housing Finance Reform and Taxpayer Act of 2013,” which may serve as a catalyst for congressional discussion on the reform of Fannie Mae and Freddie Mac. On July 11, 2013, members of the House Committee on Financial Services introduced a draft bill to the U.S. House of Representatives tilted, “Protecting American Taxpayers and Homeowners Act.” The Corker-Warner bill failed to garner enough support to make it to the Senate floor for a vote. The House bill still does not have enough support to make it out of the House Committee on Financial Services. During the first quarter 2014, Senate Banking Committee Chairman Tim Johnson (D-South Dakota) and ranking member Mike Crapo (R-Idaho) introduced a bipartisan housing finance reform bill that builds on the earlier Corker-Warner bill. This new Senate bill would also wind-down and eliminate Fannie Mae and Freddie Mac, as well as establish a Federal Mortgage Insurance Corporation (FMIC) in their place that would guarantee qualified mortgages. In May 2014, this bill received the approval of the Senate Banking Committee but it is not expected to be brought to the full Senate for this year. Lenders would be required to bear any losses on the first 10% of capital. The bill also calls for the creation of a “member-only securitization platform that would issue a single, standardized FMIC-wrapped security, and permit private label securities to be issued in a manner that encourages standardization and improved market liquidity.” It is currently unknown if, and when, any of these bills would become law and, if they did, what impact that would have on housing finance in general and what the impact would be on the existing securities guaranteed by Fannie Mae and Freddie Mac, as well as the impact on the pricing, supply, liquidity and value of the MBS in which we invest.

Actions of the Federal Reserve

In September 2012, the Fed Open Market Committee of the Federal Reserve, or FOMC, announced an open-ended program to purchase an additional $40 billion of Agency MBS per month until economic conditions (primarily the unemployment rate) improved. This program, combined with the then-existing Fed bond-buying program of Treasury securities, was to increase the Federal Reserve’s holdings by $85 billion per month. The Federal Reserve also announced its projection that the federal funds rate would likely remain at exceptionally low levels until at least mid-2015. In May and June 2013, then Federal Reserve Chairman Ben Bernanke commented that if there was continued improvement in the U.S. economy, the pace of purchases could be slowed down or tapered. These comments had a great effect on the bond market, as longer-term interest rates rose while short-term interest rates remained constant. The resulting steepened yield curve caused a decline in the value of MBS. At the FOMC meeting on December 18, 2013, the Federal Reserve announced that it would begin the tapering of its bond-buying program down from the $85 billion per month and would continue to re-evaluate this at subsequent FOMC meetings. At its recent meeting in October 2014, the Federal Reserve ended its monthly purchases of Agency MBS and Treasury securities. Most Federal Reserve officials previously announced in the June 2014 meeting that they expected the first hike in interest rates to come sometime in 2015. During its recent meeting, Federal Reserve officials indicated that the timing of any increase in interest rates could change if job growth either exceeds or disappoints their expectations.

Other Recent Activity

On January 2, 2013, the U.S. Congress passed the American Taxpayer Relief Act of 2012, or the Taxpayer Relief Act, which extended, for most Americans, tax cuts implemented under President George W. Bush's administration. However, the Taxpayer Relief Act also delayed the implementation of the budget sequestration provisions of the Budget Control Act of 2011, which provided for automatic spending cuts, which went into effect on March 1, 2013. During 2013, Congress passed several interim measures of providing temporary funding to the U.S. government and temporarily increasing the debt ceiling. On October 1, 2013, the U.S. government was partially shut-down for sixteen days due to the inability by the U.S. Congress to pass a continuous funding resolution to provide funding for most government agencies and functions. On October 17, 2013, President Obama signed into law a bill passed by the U.S. Congress that funded the government through January 15, 2014, extended the debt ceiling through February 7, 2014, called for Congressional agreement on a long-term budget by mid-December 2013 and continued the budget sequestration provisions of the Budget Control Act of 2011. In January 2014, Congress passed a $1.1 trillion spending bill that funded the U.S. government through September 30, 2014. On February 12, 2014, Congress passed a bill, which was signed into law by President Obama, suspending the debt ceiling until March 2015. In September 2014, Congress passed a continuing resolution that will fund the U.S. government through December 11, 2014 at the current 2014 funding levels. A failure by the U.S. government to reach agreement on future budgets and debt ceilings, reduce its budget deficit or a future downgrade of U.S. sovereign debt and government-sponsored agencies debt could have a material adverse effect on the U.S. economy and the global economy. These events could have a material adverse effect on our borrowing costs, the availability of financing and the liquidity and valuation of securities in general and also on the securities in our portfolio.

In 2010, the Group of Governors and Heads of Supervisors of the Basel Committee on Banking Supervision, the oversight body of the Basel Committee, published its capital standards for major banking institutions ("Basel III). Under these standards, when fully phased-in on January 1, 2019, banking institutions will be required to maintain heightened capital ratio requirements. As of September 2013, the majority of participating nations had formally adopted most provisions of Basel III, with implementations generally beginning on January 1, 2014. It is unclear how the adoption of Basel III will affect our business at this time; however, increased capital requirements for banks could adversely affect our borrowing costs, availability of financing and the lending capacity of banks which, in turn, would affect the availability of MBS that we could acquire.

During 2012 and 2013, U.S. and British banking authorities assessed fines on several major financial institutions for LIBOR manipulation. LIBOR is an unregulated rate based on estimates that lenders submitted to the British Bankers' Association, or BBA, a trade group that compiled the information and published daily the LIBOR rate. In September 2013, oversight of LIBOR was transferred over to United Kingdom regulators, the Financial Conduct Authority. The administration of LIBOR was to be transferred to the NYSE Euronext Rate Administration Limited but was renamed to the ICE Benchmark Administration Limited (the "IBA") upon the successful completion of the acquisition of NYSE Euronext by the Intercontinental Exchange in November 2013. On February 1, 2014, the administration of LIBOR was transferred from the BBA to the IBA following authorization by the Financial Conduct Authority. In October 2014, the IBA proposed a package of measures designed to make LIBOR more accurate and less susceptible to manipulation, including defining which trades can be used to calculate bank borrowing costs and to ensure the calculation of LIBOR is based on actual trades as opposed to estimates. The proposal is out for comments to be submitted back to the IBA by December 19, 2014. The calculation of LIBOR under the IBA is the average of the interest rates that some of the world's leading banks charge each other for short-term loans. It is unclear at this time how this change will affect the interest rates that repurchase agreement counterparties charge on borrowings in general and how they could specifically affect our borrowing agreements.

Although the U.S. government and other foreign governments have taken various actions intended to protect their respective economies, their respective housing and mortgage markets, their banking systems and financial institutions, we continue to operate under very difficult market conditions. There can be no assurance that these various actions will have a beneficial impact on the global financial markets and, more specifically, the market for the securities we currently own in our portfolio. We cannot predict what, if any, impact these actions or future actions by either the U.S. government or foreign governments could have on our business, results of operations and financial conditions. These events may impact the availability of financing, borrowing costs and the liquidity and valuation of securities in general and also on the securities in our portfolio.

Our Portfolio

At September 30, 2014 and December 31, 2013, our total assets, the fair value of our Agency MBS portfolio (including the TBA Agency securities) and its allocation were approximately as follows:

	September 30, 2014		December 31, 2013	
	(dollar amounts in thousands)			
Total assets	$8,117,152		$8,619,491	
Fair value of Agency MBS	$8,071,928		$8,556,446	
Adjustable-rate Agency MBS (less than 1 year reset)	23	%	19	%
Adjustable-rate Agency MBS (1-2 year reset)	13		9	
Adjustable-rate Agency MBS (2-3 year reset)	11		15	
Adjustable-rate Agency MBS (3-4 year reset)	2		10	
Adjustable-rate Agency MBS (4-5 year reset)	6		3	
Adjustable-rate Agency MBS (5-7 year reset)	12		15	
Adjustable-rate Agency MBS (>7 year reset)	8		8	
15-year fixed-rate Agency MBS	14		20	
15-year fixed-rate TBA Agency securities	8		-	
20-year and 30-year fixed-rate Agency MBS	3		1	
	100	%	100	%

As of September 30, 2014, we also owned 79 single-family residential properties which are all located in Southeastern Florida and are carried at a total cost of approximately $12.4 million. As we did not start this operation until March 2014, we did not own any single-family residential properties as of December 31, 2013.

Stockholders’ equity available to common stockholders at September 30, 2014 was approximately $751.1 million, or $6.34 per share. The $751.1 million equals total stockholders’ equity of $800.4 million less the Series A Preferred Stock liquidating value of approximately $48 million and less the difference between the Series B Preferred Stock liquidating value of approximately $25.2 million and the proceeds from its sale of approximately $23.9 million.

Results of Operations

Three Months Ended September 30, 2014 Compared to September 30, 2013

For the three months ended September 30, 2014, our net income available to common stockholders was approximately $18.1 million, or $0.15 per diluted share, based on a weighted average of 125.2 million fully diluted shares outstanding. This includes net income of $19.5 million minus the payment of preferred dividends of $1.4 million. For the three months ended September 30, 2013, our net income available to common stockholders was $16.6 million, or $0.12 per diluted share, based on a weighted average of 146.3 million fully diluted shares outstanding. This included net income of $18 million minus the payment of preferred dividends of $1.4 million.

Net interest income for the three months ended September 30, 2014 was approximately $17.9 million, or 36.6% of gross income, compared to approximately $19.9 million, or 34.1% of gross income, for the three months ended

September 30, 2013. Net interest income is comprised of the interest income earned on mortgage investments (net of premium amortization expense) less interest expense from borrowings. Interest income (net of premium amortization expense) for the three months ended September 30, 2014 was approximately $37.3 million, compared to approximately $42.7 million for the three months ended September 30, 2013, a decrease of 12.6% due primarily to a decrease in the coupons on our MBS (from 2.60% during the three months ended September 30, 2013 to 2.553% during the three months ended September 30, 2014), and by a decrease in the average MBS outstanding (from $8.85 billion during the three months ended September 30, 2013 to $7.65 billion during the three months ended September 30, 2014), partially offset by a decrease in the premium amortization of approximately $3.7 million. Interest expense for the three months ended September 30, 2014 was approximately $19.3 million, compared to approximately $22.8 million for the three months ended September 30, 2013, a decrease of 15.2%, which resulted primarily from a decrease in weighted average interest rates after the effect of the swap agreements (from 1.11% at September 30, 2013 to 1.09% at September 30, 2014) and a decrease in the average repurchase agreement borrowings outstanding (from $8.05 billion at September 30, 2013 to $6.9 billion at September 30, 2014).

The results of our operations are affected by a number of factors, many of which are beyond our control, and primarily depend on, among other things, the level of our net interest income, the market value of our MBS, the supply of, and demand for, MBS in the marketplace, and the terms and availability of financing. Our net interest income varies primarily as a result of changes in interest rates, the slope of the yield curve (the differential between long-term and short-term interest rates), borrowing costs (our interest expense) and prepayment speeds on our MBS portfolios, the behavior of which involves various risks and uncertainties. Interest rates and prepayment speeds, as measured by the constant prepayment rate, or CPR, vary according to the type of investment, conditions in the financial markets, competition and other factors, none of which can be predicted with any certainty. With respect to our business operations, increases in interest rates, in general, may, over time, cause: (i) the interest expense associated with our borrowings, which are primarily comprised of repurchase agreements, to increase; (ii) the value of our MBS portfolios and, correspondingly, our stockholders' equity to decline; (iii) coupons on our MBS to reset, although on a delayed basis, to higher interest rates; (iv) prepayments on our MBS portfolios to slow, thereby slowing the amortization of our MBS purchase premiums; and (v) the value of our interest rate swap agreements and, correspondingly, our stockholders' equity to increase. Conversely, decreases in interest rates, in general, may, over time, cause: (i) prepayments on our MBS portfolios to increase, thereby accelerating the amortization of our MBS purchase premiums; (ii) the interest expense associated with our borrowings to decrease; (iii) the value of our MBS portfolios and, correspondingly, our stockholders' equity to increase; (iv) the value of our interest rate swap agreements and, correspondingly, our stockholders' equity to decrease; and (v) coupons on our MBS to reset, although on a delayed basis, to lower interest rates. In addition, our borrowing costs and credit lines are further affected by the type of collateral pledged and general conditions in the credit markets.

During the three months ended September 30, 2014, premium amortization expense decreased approximately $3.7 million, or 24%, from $15.5 million during the three months ended September 30, 2013 to $11.8 million, due primarily to lower future CPR projections as shown in the table below. We estimate our future CPR projections on a quarterly basis by evaluating historical performance, street consensus, prepayment speeds and current market conditions. The primary drivers of the current realized CPR are the incentives that mortgage borrowers had when they were considering the refinance of their mortgage several weeks or months earlier. The primary incentive is whether or not the new mortgage rate is greater or less than the borrower's current mortgage rate. Another significant factor is the mortgage borrower believing that mortgage interest rates will either increase or decrease in the future. The prepayment rate assumptions used in our projection of long-term CPR percentages are based primarily on historical prepayment rates on mortgage pools similar to the pool being evaluated. Another significant factor is our assumptions about future mortgage rates and their probable impact on future CPRs. To assess the sustainability of our projection of average long-term CPR percentages, we primarily evaluate the sustainability of current monetary policy and fiscal policy. Other factors which can affect this sustainability are: (1) the development of new mortgage financing techniques and products and (2) changes in the level of employment/unemployment rates, which could result in borrowers changing their prepayment patterns.

Although the actual prepayment experience was higher than the prior quarter (as shown in the table below) due to lower mortgage interest rates, the actual premium amortization during the three months ended September 30, 2014 (approximately $11.8 million) was approximately the same as in the prior quarter ($11.8 million) due to less unearned premium being amortized because of paydown and sales of Agency MBS. Our current long-term CPR projection is 18%. That level is where actual prepayments are, where the market level currently is and also due to the expectation of increased interest rates in 2015 (based on indications from the Federal Reserve), we estimate that our long-time CPR projection will remain around that level. When compared to the same period of last year as noted above, the premium amortization expense decreased approximately $3.7 million due primarily to lower actual and future CPR projections.

The following table shows the approximate CPR of our Agency MBS for each of the following quarters:

	2014			2013		
Portfolio	First	Second	Third	First	Second	Third

	Quarter	Quarter	Quarter	Quarter	Quarter	Quarter
Agency MBS	12%	14 %	18 %	24%	24 %	23 %

During the three months ended September 30, 2014 and 2013, there was no gain or loss recognized in earnings due to hedge ineffectiveness. We determined that our hedges were considered "highly effective." There were no components of the derivative instruments' gain or loss excluded from the assessment of hedge effectiveness.

We review our MBS portfolio relative to current market conditions, trading prices of individual MBS, the general level of mortgage interest rates, prepayment activity, other investment opportunities and the duration of our portfolio versus the duration of our liabilities. Although there is no set pattern or expectation of a trend to sales of Agency MBS, we may sell some of the securities in our portfolio based upon these factors. During the three months ended September 30, 2014, we received proceeds of approximately $304 million from the sales of Agency MBS and recognized a loss of approximately $5.6 million. We had no set plan to sell these securities nor were we required to do so. During the three months ended September 30, 2013, we received proceeds of approximately $342 million from the sales of Agency MBS and recognized a net gain of approximately $2 million. During the three months ended September 30, 2014, we sold approximately $1.17 Billion of TBA securities and recognized a loss of approximately $779 thousand. During the three months ended September 30, 2014, we also had derivative income on the TBA securities of approximately $366 thousand. During the three months ended September 30, 2013, we did not enter into any TBA securities contracts.

During the three months ended September 30, 2014, we also had a gain on interest rate swaps of approximately $10.9 million due primarily to the change in the fair value of the swaps.

Total expenses were approximately $3.5 million for the three months ended September 30, 2014, compared to approximately $3.9 million for the three months ended September 30, 2013. For the three months ended September 30, 2014, we incurred management fees of approximately $2.6 million, as compared to management fees of approximately $3.0 million for the three months ended September 30, 2013, due primarily to management fees being calculated as a percentage of stockholders' equity (excluding accumulated other comprehensive income), which decreased from the three months ended September 30, 2013. "Other expenses" decreased approximately $65 thousand as detailed in Note 15 to our unaudited consolidated financial statements.

Non-GAAP Measure

In addition to our operating results presented in accordance with GAAP, the following table reconciles our "net income to common stockholders" for the three months ended September 30, 2014 to "core earnings" (which is a non-GAAP financial measure) for the same periods. "Core earnings" represent "net income to common stockholders" (which is the nearest comparable GAAP measure), adjusted for the items shown in the table below. The Company's management believes that the non-GAAP financial measure of "core earnings" is useful because it provide investors with greater transparency to the information we use in our financial and operational decision-making process. Management also believes the presentation of this measure, when analyzed in conjunction with our GAAP operating results, allows investors to more effectively evaluate and compare our performance to that of our peers, particularly those that have discontinued hedge accounting and those that have used similar portfolio and derivative strategies. This non-GAAP financial measure should not be used as a substitute for the Company's operating results for the three months ended September 30, 2014. An analysis of any non-GAAP financial measure should be used in conjunction with results presented in accordance with GAAP.

	Three Months Ended September 30, 2014	
	Amount (in thousands)	Per Share
Net income to common stockholders	$18,061	$0.15
Adjustments to derive core earnings:		
Loss on sales of Agency MBS	5,617	0.04
Gain on interest rate swaps, net	(10,947)	(0.09)
Loss on derivatives-TBA securities	779	0.01
Derivative income-TBA securities	(366)	(0.01)
Gain on derivatives-Eurodollar Futures Contracts	(111)	0.00
Recovery on Non-Agency MBS	(37)	0.00
Amortization of other comprehensive income on de-designated swaps(1)	5,650	0.05
Periodic net settlement on interest rate swaps after de-designation(2)	(5,296)	(0.04)
Dollar roll income on TBA securities(3)	2,503	0.02
Core earnings	$15,853	$0.13

Basic weighted average number of shares outstanding	121,061

(1) This amount represents the amortization of the balance remaining in "accumulated other comprehensive income" as a result of the Company's discontinuation of hedge accounting and is recorded in our income statement as a portion of interest expense in accordance with GAAP.

(2) Periodic net settlements on interest rate swaps after de-designation include all subsequent net payments made on interest rate swaps which were de-designated as hedges in August 2014. Net payments on the interest rate swaps made prior to de-designation are recognized in GAAP net income available to common stockholders. This adjustment does not include net payments of approximately $6 million made on interest rate swaps which were previously de-designated in March 2014 and were subsequently terminated during the current quarter or have subsequently matured.

(3) Dollar roll income on TBA securities is the income resulting from the price discount typically obtained by extending the settlement of TBA securities to a later date. This is a component of both the "(loss) gain on derivatives-TBA securities" and "derivative income-TBA securities" that are shown on our income statement.

Nine Months Ended September 30, 2014 Compared to September 30, 2013

For the nine months ended September 30, 2014, our net income available to common stockholders was $38.6 million, or $0.30 per diluted share, based on a weighted average of 132.3 million fully diluted shares outstanding. This includes net income of $42.9 million minus the payment of preferred dividends of $4.3 million. For the nine months ended September 30, 2013, our net income available to common stockholders was $60.3 million, or $0.42 per diluted share, based on a weighted average of 147.1 million fully diluted shares outstanding. This included net income of $64.6 million minus the payment of preferred dividends of $4.3 million.

Net interest income for the nine months ended September 30, 2014 was approximately $50 million, or 31.9% of gross income, compared to approximately $67 million, or 36.8% of gross income, for the nine months ended September 30, 2013. Interest income (net of premium amortization expense) for the nine months ended September 30, 2014 was approximately $123.2 million, compared to approximately $131.4 million for the nine months ended September 30, 2013, a decrease of 6.3% due primarily to a decrease in the coupons on our MBS (from 2.70% during the three months ended September 30, 2013 to 2.57% during the three months ended September 30, 2014), and by a decrease in the average MBS outstanding (from $8.96 billion during the nine months ended September 30, 2013 to $8.14 billion during the nine months ended September 30, 2014), partially offset by a decrease in the premium amortization of approximately $17.1 million and an increase in income on rental properties of $257 thousand. Interest expense for the nine months ended September 30, 2014 was approximately $73.2 million, compared to approximately $64.4 million for the three months ended September 30, 2013, an increase of 13.7%, which resulted primarily from an increase in weighted average interest rates after the effect of the swap agreements (from 1.04% at September 30, 2013 to 1.32% at September 30, 2014), partially offset by a decrease in the average repurchase agreement borrowings outstanding, from $8.13 billion at September 30, 2013 to $7.3 billion at September 30, 2014.

During the nine months ended September 30, 2014, premium amortization expense decreased $17.1 million, or 33.9%, from $50.5 million during the nine months ended September 30, 2013 to $33.4 million, due primarily to average lower actual CPR as shown in the table above, lower future CPR projections and less unamortized premium that is being amortized due to paydowns and sales of Agency MBS. We estimate our future CPR projections on a quarterly basis by evaluating historical performance, street consensus, prepayment speeds and current market conditions (see the discussion in the previous section related to the three months ended September 30, 2014 compared to the three months ended September 30, 2013 above).

During the nine months ended September 30, 2014 and 2013, there was no gain or loss recognized in earnings due to hedge ineffectiveness. We determined that our hedges were considered “highly effective.” There were no components of the derivative instruments’ gain or loss excluded from the assessment of hedge effectiveness.

During the nine months ended September 30, 2014, we received proceeds of approximately $502 million from the sales of Agency MBS and recognized a net loss of approximately $4 million. During the nine months ended September 30, 2013, we received proceeds of approximately $637 million from the sales of Agency MBS and recognized a net gain of approximately $9.2 million.

During the nine months ended September 30, 2014, we sold approximately $1.59 billion of TBA securities (face amount plus premium) and recognized a net gain of approximately $799 thousand. We also had derivative income on the TBA securities of approximately $366 thousand during the nine months ended September 30, 2014. During the nine months ended September 30, 2013, we did not enter into any TBA securities contracts.

During the nine months ended September 30, 2014, we also had a gain on interest rate swaps of approximately $9.6 million due primarily to the change in the fair value of the swaps.

Total expenses were approximately $14 million for the nine months ended September 30, 2014, compared to approximately $11.9 million for the nine months ended September 30, 2013. For the nine months ended September 30, 2014, we incurred management fees of approximately $8.2 million, as compared to management fees of approximately $9 million for the nine months ended September 30, 2013, due primarily to management fees being calculated as a percentage of stockholders' equity (excluding accumulated other comprehensive income), which decreased from the nine months ended September 30, 2013. "Other expenses" (as detailed in Note 15 to our unaudited consolidated financial statements) increased approximately $2.8 million due primarily to an increase in legal and other professional fees (approximately $2 million) and also printing fees (approximately $0.4 million) related to the Company's proxy solicitation contest and a consulting agreement in connection with our review of strategic options and approximately $366 thousand in expenses on rental properties.

Financial Condition

MBS Portfolio

At September 30, 2014, we held agency mortgage assets which had an amortized cost of approximately $7.36 billion, consisting primarily of approximately $5.98 billion of adjustable-rate Agency MBS and approximately $1.38 billion of fixed-rate Agency MBS. This amount represents an approximately 14.2% decrease from the $8.58 billion held at December 31, 2013 due primarily to sales of Agency MBS and paydowns on Agency MBS. Of the adjustable-rate Agency MBS owned by us, approximately 30% were adjustable-rate pass-through certificates which had coupons that reset within one year. The remaining 70% consisted of hybrid adjustable-rate Agency MBS which had coupons that will reset between one year and ten years. Hybrid adjustable-rate Agency MBS have an initial interest rate that is fixed for a certain period, usually three to ten years, and thereafter adjust annually for the remainder of the term of the loan.

The following table presents a schedule of the fair value of our MBS owned at September 30, 2014 and December 31, 2013, classified by type of issuer (dollar amounts in thousands):

	September 30, 2014			December 31, 2013		
Agency	Fair Value	Portfolio Percentage		Fair Value	Portfolio Percentage	
Fannie Mae (FNM)	$4,300,668	58.0	%	$4,962,273	58.0	%
Freddie Mac (FHLMC)	3,098,548	41.8		3,580,834	41.8	
Ginnie Mae (GNMA)	12,025	0.2		13,260	0.2	
Non-Agency MBS	11	-		79	-	
Total MBS:	$7,411,252	100.0	%	$8,556,446	100.0	%

The following table classifies the fair value of our MBS owned at September 30, 2014 and December 31, 2013 by type of interest rate index (dollar amounts in thousands):

	September 30, 2014			December 31, 2013		
Index	Fair Value	Portfolio Percentage		Fair Value	Portfolio Percentage	
One-month LIBOR	$1,193	-	%	$1,532	-	%
Six-month LIBOR	45,345	0.6		51,301	0.6	
One-year LIBOR	5,774,707	77.9		6,488,980	75.8	
Six-month certificate of deposit	915	-		992	-	
Six-month constant maturity treasury	183	-		227	-	
One-year constant maturity treasury	203,951	2.8		227,805	2.7	
Cost of Funds Index	13,922	0.2		16,223	0.2	
15-year fixed-rate	1,132,321	15.3		1,658,348	19.4	
20-year and 30-year fixed-rate	238,715	3.2		111,038	1.3	
Total MBS:	$7,411,252	100.00	%	$8,556,446	100.0	%

The fair values indicated do not include interest earned but not yet paid. With respect to our hybrid adjustable-rate Agency MBS, the fair value of these securities appears on the line associated with the index based on which the security will eventually reset once the initial fixed interest rate period has expired. The fair value of our MBS is reported to us independently from dealers who are major financial institutions and are considered to be market makers for these types of instruments. For more detail on the fair value of our MBS, see Note 7 to the accompanying unaudited consolidated financial statements.

The weighted average coupons and average amortized costs of our MBS (excluding TBA Agency securities) at September 30, 2014, June 30, 2014, March 31, 2014 and December 31, 2013 were as follows:

	September 30, 2014	June 30, 2014	March 31, 2014	December 31, 2013
Weighted Average Coupon				
Adjustable-rate Agency MBS	2.58 %	2.60 %	2.57 %	2.52 %
Hybrid adjustable-rate Agency MBS	2.55	2.57	2.59	2.62
15-year fixed-rate Agency MBS	2.69	2.65	2.68	2.66
20-year and 30-year fixed-rate Agency MBS	4.40	5.01	5.04	5.71
Total Agency MBS:	2.64 %	2.63 %	2.65 %	2.65 %
Average Amortized Cost				
Adjustable-rate Agency MBS	102.81 %	102.65 %	102.56 %	102.46 %
Hybrid adjustable-rate Agency MBS	103.60	103.58	103.55	103.45
15-year fixed-rate Agency MBS	103.14	103.16	103.10	103.39
20-year and 30-year fixed-rate Agency MBS	103.17	102.86	102.91	101.31
Total Agency MBS:	103.32 %	103.28 %	103.24 %	103.23 %
Current yield on Agency MBS (weighted average coupon divided by average amortized cost)	2.56 %	2.55 %	2.57 %	2.57 %

The following information pertains to our repurchase agreement borrowings at September 30, 2014, June 30, 2014, March 31, 2014 and December 31, 2013:

	September 30, 2014	June 30, 2014	March 31, 2014	December 31, 2013
	(dollar amounts in thousands)			
Repurchase agreements outstanding	$6,550,000	$7,118,500	$7,510,000	$7,580,000
Average repurchase agreements outstanding	$6,901,889	$7,434,984	$7,565,029	$7,644,822
Maximum monthly amount during quarter	$7,041,000	$7,551,000	$7,563,000	$7,635,000
Average interest rate on outstanding repurchase agreements	0.32 %	0.32 %	0.35 %	0.39 %
Average days to maturity	38 days	37 days	37 days	38 days
Average interest rate after adjusting for interest rate swaps	1.08 %	1.47 %	1.48 %	1.50 %
Weighted average maturity after adjusting for interest rate swaps	845 days	992 days	1,008 days	1,010 days
Weighted average haircuts[1]	4.95 %	4.98 %	5.03 %	5.05 %

(1) A haircut represents the reduction of value to securities used as collateral in a lending arrangement so as to provide the lender with a cushion in case the market value of the securities decreases.

At September 30, 2014 and December 31, 2013, the unamortized net premium paid for our Agency MBS was approximately $236.9 million and $268.1 million, respectively.

At September 30, 2014, the current yield of 2.56% increased by 1 basis point from June 30, 2014. For the three months ended September 30, 2014, the weighted average coupon for our total Agency MBS increased by 1 basis point from June 30, 2014. One of the factors that also impacts the reported yield on our MBS portfolio is the actual prepayment rate on the underlying mortgages. We analyze our MBS and the extent to which prepayments impact the yield. When the rate of prepayments exceeds expectations, we amortize the premiums paid on mortgage assets over a shorter time period, resulting in a reduced yield to maturity on our mortgage assets. Conversely, if actual prepayments are less than the assumed CPR, the premium would be amortized over a longer time period, resulting in a higher yield to maturity.

Our repurchase agreements outstanding decreased from approximately $7.58 billion at December 31, 2013 and from approximately $7.118 billion at June 30, 2014 to approximately $6.55 billion at September 30, 2014 due to less financing needed as our portfolio declines due to paydowns and sales of Agency MBS. We anticipate this trend to continue as we continue to use more of our funds for repurchasing shares of our common stock.

The average interest rate on outstanding repurchase agreements, after adjusting for all interest rate swaps, decreased from 1.50% at December 31, 2013 to 1.08% at September 30, 2014 due primarily to the termination of 32 swaps at a notional amount of $1.81 billion, which were at higher rates. The weighted average term to next rate adjustment after adjusting for all interest rate swaps decreased from 1,010 days at December 31, 2013 to 845 days at September 30, 2014.

Residential Properties Portfolio

As of September 30, 2014, we owned 79 single-family residential properties which are all located in Southeastern Florida and are carried at a total cost of approximately $12.4 million. As we did not start this operation until March 2014, we did not own any single-family residential properties as of December 31, 2013.

Derivatives

We periodically enter into derivative transactions, in the form of interest rate swaps, which are intended to economically hedge our exposure to rising interest rates on funds borrowed to finance our investments in securities. Prior to March 17, 2014 and August 22, 2014, we designated interest rate swaps as cash flow hedges. We also periodically enter into derivative transactions, in the form of TBA securities and Eurodollar Futures Contracts, which are not designated as hedges. To the extent that we enter into hedging transactions to reduce our interest rate risk on indebtedness incurred to acquire or carry real estate assets, any income or gain from the disposition of those hedging transactions should be qualifying income under the REIT rules for purposes of the 95% gross income test and 75% gross income test. To qualify for this exclusion, the hedging transaction must be clearly identified as such before the close of the day on which it was acquired, originated or entered into. The transaction also must hedge indebtedness incurred or to be incurred by us to acquire or carry real estate assets.

As part of our asset/liability management policy, we may enter into hedging agreements such as interest rate caps, floors or swaps. These agreements are entered into to try to reduce interest rate risk and are designed to provide us with income and capital appreciation in the event of certain changes in interest rates. We review the need for hedging agreements on a regular basis consistent with our capital investment policy. Swaps are derivative instruments as defined by ASC 815-10. We do not anticipate entering into derivative transactions for speculative or trading purposes. In accordance with the swap agreements, we pay a fixed rate of interest during the term of the swaps and receive a payment that varies with the three-month LIBOR rate.

The following table pertains to all of our swaps at September 30, 2014, June 30, 2014, March 31, 2014 and December 31, 2013, respectively:

	September 30, 2014	June 30, 2014	March 31, 2014	December 31, 2013
Aggregate notional amount of swap agreements	$3.805 billion	$5.265 billion	$5.44 billion	$5.375 billion
Average maturity of swap agreements	4.0 years	3.7 years	3.8 years	3.9 years
Weighted average fixed rate paid on swap agreements	1.54 %	1.78 %	1.79 %	1.81 %
Aggregate notional amount of Eurodollars Futures Contracts	$5.50 billion	$ 0	$ 0	$ 0

Swap agreements are used to provide protection from increases in interest rates having a negative impact on the market value of our portfolio that could result in our lenders requiring additional collateral for our repurchase agreement borrowings. An increase or decrease in the notional value of our swap agreements usually provides an increase or decrease in protection to our portfolio’s change in value due to interest rate changes. However, there are other methods that can also lessen our portfolio’s change in value due to interest rate increases. Among them are:

acquiring mortgages that are inherently less sensitive to interest rate changes and borrowings using long-term agreements.

On March 17, 2014, we decided to discontinue hedge accounting on certain swaps with notional balances of approximately $1.685 billion. On August 22, 2014, we decided to discontinue hedge accounting on the remainder of our swaps. During September 2014, we terminated 32 swap agreements with an aggregate notional amount of $1.81 billion. Most of these swaps that were terminated had a remaining term of less than two years and had higher interest rates, which is the primary reason for the decline in the average fixed pay swap rate, from 1.81% at December 31, 2013 to 1.54% at September 30, 2014. While these were still effective under GAAP, they were becoming less viable economically and for asset/liability management. They were replaced with the Eurodollar Futures Contracts, which require no payments of interest during their term. For both the terminated swaps and the de-designated swaps, as long as there is the probability that the forecasted transactions that were being hedged (i.e., rollovers of our repurchase agreement borrowings) are still expected to occur, the amount of the gain or loss in AOCI remains in AOCI and is amortized over the remaining term of the swaps. During the three and nine months ended September 30, 2014, the net gain on these interest rate swaps was approximately $10.9 million and $9.6 million, respectively.

Each Futures Contract embodies $1 million of notional value. We do not designate these contracts as hedges for accounting purposes. As a result, realized and unrealized changes in fair value are recognized in earnings in the period in which the changes occur. At September 30, 2014, we had 5,500 Futures Contracts representing $5.5 billion in notional amount. The effective term of these contracts is three months. The fair value of these contracts was approximately $1.4 million. For the three and nine months ended

September 30, 2014, we had gains on Futures Contracts of approximately $111 thousand and $111 thousand, respectively. We did not enter into these types of contracts during 2013.

For more information on the amounts, policies, objectives and other qualitative data on our derivatives, see Notes 1, 7 and 13 to the accompanying unaudited consolidated financial statements.

Liquidity and Capital Resources

MBS Portfolio

Our primary source of funds consists of repurchase agreements which totaled approximately $6.55 billion at September 30, 2014. As collateral for our repurchase agreements and interest rate swaps, we pledged approximately $6.91 billion in MBS. Our other significant source of funds for the three months ended September 30, 2014 consisted of payments of principal from our MBS portfolio in the amount of approximately $421.3 million.

For the three months ended September 30, 2014, there was a net increase in cash and cash equivalents of approximately $0.2 million. This consisted of the following components:

- Net cash provided by operating activities for the three months ended September 30, 2014 was approximately $25.3 million. This is comprised of net income of approximately $19.5 million and adding back the following non-cash items: the amortization of premiums and discounts of approximately $11.8 million, the amortization of restricted stock of $24 thousand, depreciation of rental properties of $85 thousand, net loss on sales of Agency MBS of approximately $5.6 million and a net loss on derivatives-TBA securities of approximately $413 thousand, partially offset by recoveries on Non-Agency MBS of approximately $37 thousand, periodic net settlements net of amortization related to interest rate swaps of approximately $5.6 million, a gain on derivatives-interest rate swaps of approximately $10.9 million and a gain on derivatives-Eurodollar Futures Contracts of approximately $111 thousand. Net cash provided by operating activities also included an increase in accrued expenses and other of approximately $0.9 million, a decrease in prepaid expenses and other of approximately $8.1 million and a decrease in accrued interest receivable of approximately $1.7 million, partially offset by an decrease in interest payable of approximately $6.1 million;
- Net cash provided by investing activities for the three months ended September 30, 2014 was approximately $630.7 million, which consisted of $421.3 million from principal payments on Agency MBS and proceeds from the sales of Agency MBS of approximately $304.2 million, partially offset by purchases of Agency MBS of approximately $92.8 million and purchases of residential properties of approximately $2 million; and
- Net cash used in financing activities for the three months ended September 30, 2014 was approximately $655.8 million. This consisted of borrowings on repurchase agreements of approximately $8.593 billion, offset by repayments on repurchase agreements of approximately $9.162 billion. This also included payments on terminated swaps of approximately $37 million, common stock repurchased net of common stock issued of approximately $31.7 million and dividends paid of approximately $17.3 million on common stock and dividends paid of approximately $1.4 million on preferred stock, partially offset by net settlements of TBA commitments of approximately $96 thousand.

Relative to our MBS portfolio at September 30, 2014, all of our repurchase agreements were fixed-rate term repurchase agreements with original maturities ranging from 30 days to 112 days. At September 30, 2014, we had borrowed funds under repurchase agreements with 25 different financial institutions. As the repurchase agreements mature, we enter into new repurchase agreements to take their place. Because we borrow money based on the fair value of our MBS and because increases in short-term interest rates or increasing market concern about the liquidity or value of our MBS can negatively impact the valuation of MBS, our borrowing ability could be reduced and lenders may initiate margin calls in the event short-term interest rates increase or the value of our MBS declines for other reasons. Typically, most margin calls by lenders arise each month due to prepayments. The value of the MBS pledged is reduced by an amount equal to any prepaid principal in order to reestablish the required ratio of borrowing to collateral value. The pledging of additional collateral is usually done on the same day or the following day. We had adequate cash flow, liquid assets and unpledged collateral with which to meet our margin requirements during the three months ended September 30, 2014, but there can be no assurance we will have adequate cash flow, liquid assets and unpledged collateral with which to meet our margin requirements in the future.

At September 30, 2014, our leverage on capital (including all preferred stock and junior subordinated notes) was 7.6x, which declined from our leverage multiple of 8.1x at December 31, 2013.

In the future, we expect that our primary sources of funds will continue to consist of borrowed funds under repurchase agreement transactions and monthly payments of principal and interest on our MBS portfolio. Our liquid assets generally consist of unpledged MBS, cash and cash equivalents. A large negative change in the market value of our MBS might reduce our liquidity, requiring us to sell assets with the likely result of realized losses upon sale.

During the three months ended September 30, 2014, we raised approximately $393 thousand in capital under our 2012 Dividend Reinvestment and Stock Purchase Plan.

Disclosure of Contractual Obligations

During the three months ended September 30, 2014, there were no material changes outside the normal course of business to the contractual obligations identified in our Annual Report on Form 10-K for the fiscal year ended December 31, 2013.

Stockholders' Equity

We use available-for-sale treatment for our MBS, which are carried on our balance sheets at fair value rather than historical cost. Based upon this treatment, our total equity base at September 30, 2014 was approximately $800.4 million. Common stockholders' equity was approximately $751.1 million, or a book value of $6.34 per share. "Common stockholders' equity" serves as the basis for how book value per common share is calculated.

Under our available-for-sale accounting treatment, unrealized fluctuations in fair values of assets are assessed to determine whether they are other-than-temporary. To the extent we determine that these unrealized fluctuations are temporary, they do not impact GAAP income or taxable income but rather are reflected on our balance sheets by changing the carrying value of the assets and reflecting the change in stockholders' equity under "Accumulated other comprehensive income, unrealized gain (loss) on available-for-sale securities."

As a result of this mark-to-market accounting treatment, our book value and book value per share are likely to fluctuate far more than if we used historical amortized cost accounting on all of our assets. As a result, comparisons with some companies that use historical cost accounting for all of their balance sheets may not be meaningful.

Unrealized changes in the fair value of MBS have one significant and direct effect on our potential earnings and dividends: positive mark-to-market changes will increase our equity base and allow us to increase our borrowing capacity, while negative changes will tend to reduce borrowing capacity under our capital investment policy. A very large negative change in the net market value of our MBS might reduce our liquidity, requiring us to sell assets with the likely result of realized losses upon sale. "Accumulated other comprehensive income" on available-for-sale Agency MBS was approximately $7.5 million, or 0.1% of the amortized cost of our Agency MBS, at September 30, 2014. This, along with "Accumulated other comprehensive loss, derivatives" of approximately $53.9 million, constitutes the total "Accumulated other comprehensive loss" of approximately $46.4 million.

Non-GAAP Measure

The following table represents our "common stockholders' equity" and "common stockholders' equity with and without accumulated other comprehensive income," or AOCI, which are non-GAAP financial measures, at September 30, 2014 and December 31, 2013, respectively, which are reconciled to the nearest comparable GAAP financial measure, which is "Total stockholders' equity." The Company's management believes that these financial measures, when considered together with our GAAP financial measures, provides information that is useful to investors in understanding the differences between our common stockholders' equity including AOCI and our common stockholders' equity without AOCI and the effect of each on our book value per share. We believe that "common stockholders' equity without AOCI" is a relevant measure to provide investors because AOCI fluctuates on a quarterly and yearly basis based upon changes in fair market values on our securities and swap agreements. Showing "common stockholders' equity without AOCI" allows investors to evaluate how our "common stockholders' equity" has changed exclusive of the changes in AOCI. These financial measures should not be used as a substitute in assessing the Company's financial condition at September 30, 2014 and December 31, 2013, respectively. An analysis of any non-GAAP financial measure should be used in conjunction with results presented in accordance with GAAP.

	September 30, 2014	December 31, 2013
	(in thousands)	
Common stockholders' equity without AOCI	$797,567	$ 920,969
AOCI – unrealized (loss) income	(46,469)	(92,008)
Common stockholders' equity	$751,098	$ 828,961
Series A Preferred Stock liquidation value	47,984	47,984
Series B Preferred Stock liquidation value	25,241	25,241
Less: Series B Preferred Stock proceeds from issuance	(23,924)	(23,924)
Total stockholders' equity per balance sheets	$800,399	$ 878,262

The primary reason for the decrease in "common stockholders' equity without AOCI," from approximately $921 million at December 31, 2013 to approximately $798 million at September 30, 2014, was our repurchase of our common stock.

Critical Accounting Policies

Management has the obligation to ensure that its policies and methodologies are in accordance with GAAP. Management has reviewed and evaluated its critical accounting policies and believes them to be appropriate.

The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions in certain circumstances that affect amounts reported in the accompanying unaudited consolidated financial statements. In preparing these unaudited consolidated financial statements, management has made its best estimates and judgments on the basis of information then readily available to it of certain amounts included in the unaudited consolidated financial statements, giving due consideration to materiality. Application of these accounting policies involves the exercise of judgment and use of assumptions as to future uncertainties and, as a result, actual results could differ materially and adversely from these estimates.

Our accounting policies are described in Note 1 to the accompanying unaudited consolidated financial statements. Management believes the more significant of our accounting policies are the following:

Revenue Recognition

The most significant source of our revenue is derived from our investments in MBS. We reflect income using the effective yield method which, through amortization of premiums and accretion of discounts at an effective yield, recognizes periodic income over the estimated life of the investment on a constant yield basis, as adjusted for actual prepayment activity and estimated prepayments. Management believes our revenue recognition policies are appropriate to reflect the substance of the underlying transactions.

Interest income on our MBS is accrued based on the actual coupon rate and the outstanding principal amounts of the underlying mortgages. Premiums and discounts are amortized or accreted into interest income over the expected lives of the securities using the effective interest yield method, adjusted for the effects of actual prepayments and estimated prepayments based on ASC 320-10. Our policy for estimating prepayment speeds for calculating the effective yield is to evaluate historical performance, street consensus prepayment speeds and current market conditions. If our estimate of prepayments is incorrect, we may be required to make an adjustment to the amortization or accretion of premiums and discounts that would have an impact on future income, which could be material and adverse.

Valuation and Classification of Investment Securities

We carry our investment securities on our balance sheet at fair value. The fair values of our Agency MBS are generally based on third party bid price indications provided by certain dealers who make markets in such securities. If, in the opinion of management, one or more securities prices reported to us are not reliable or unavailable, management reviews the fair value based on characteristics of the security it receives from the issuer and available market information. The fair values reported reflect estimates and may not necessarily be indicative of the amounts we could realize in a current market exchange. We review various factors (i.e., expected cash flows, changes in interest rates, credit protection, etc.) in determining whether and to what extent an other-than-temporary impairment exists. To the extent that unrealized losses on our Agency MBS are attributable to changes in interest rates and not credit quality, and because we do not have the intent to sell these investments nor is it not more likely than not that we will be required to sell these investments before recovery of their amortized cost bases, which may be at maturity, we do not consider these investments to be other-than-temporarily impaired. Losses (that are related to credit quality) on securities classified as available-for-sale, which are determined by management to be other-than-temporary in nature, are reclassified from "Accumulated other comprehensive income (loss)" to current-period income (loss). For more detail on the fair value of our securities, see Note 7 to the accompanying unaudited consolidated financial statements.

Accounting for Derivatives and Hedging Activities

In accordance with ASC 815, we recognize all derivatives as either assets or liabilities and we measure these investments at fair value. Changes in fair value for derivatives not designated as hedges are recorded in our consolidated statements of income as “Gain (loss) on derivatives.”

In accordance with ASC 815-10, a derivative that is designated as a hedge is recognized as an asset/liability and measured at estimated fair value. In order for our interest rate swap agreements to qualify for hedge accounting, upon entering into the swap agreement, we must anticipate that the hedge will be highly “effective,” as defined by ASC 815-10.

Prior to March 18, 2014 and August 22, 2014, when we de-designated our swaps from hedge accounting, on the date we entered into a derivative contract, we designated the derivative as a hedge of the variability of cash flows that were to be received or paid in connection with a recognized asset or liability (a “cash flow” hedge). Changes in the fair value of a derivative that were highly effective and that were designated and qualified as a cash flow hedge, to the extent that the hedge was effective, were recorded in “Other comprehensive income” and reclassified to income when the forecasted transaction affected income (e.g., when periodic settlement interest payments were due on repurchase agreements). The swap agreements were carried on our balance sheets at their fair value based on values obtained from large financial institutions, who were market makers for these types of instruments. Hedge ineffectiveness, if any, was recorded in current-period income.

We formally assessed, both at the hedge’s inception and on an ongoing basis, whether the derivatives that were used in hedging transactions were highly effective in offsetting changes in the cash flows of hedged items and whether those derivatives were expected to remain highly effective in future periods. If it was determined that a derivative was not (or ceased to be) highly effective as a hedge, we discontinued hedge accounting.

When we discontinued hedge accounting, the gain or loss on the derivative remained in “Accumulated other comprehensive income (loss)” and is reclassified into income when the forecasted transaction affects income. In all situations in which hedge accounting is discontinued and the derivative remains outstanding, we carry the derivative at its fair value on the balance sheet, recognizing changes in the fair value in current-period income.

For purposes of the cash flow statement, cash flow hedges were classified with the cash flows from the hedged item. Cash flows from derivatives that are not hedges are classified according to the underlying nature or purpose of the derivative. For more detail on our derivative instruments, see Notes 1, 7 and 13 to the accompanying unaudited consolidated financial statements.

Income Taxes

Our financial results do not reflect provisions for current or deferred income taxes. Management believes that we have and intend to continue to operate in a manner that will allow us to be taxed as a REIT and, as a result, management does not expect to pay substantial, if any, corporate level taxes. Many of these requirements, however, are highly technical and complex. If we were to fail to meet these requirements, we would be subject to federal income tax.

Recent Accounting Pronouncements

A description of recent accounting pronouncements, the date adoption is required and the impact on our unaudited consolidated financial statements is contained in Note 1 to the accompanying unaudited consolidated financial statements.

Subsequent Events

The conversion rate of our Series B Preferred Stock increased on October 1, 2014 from 4.0919 shares of our common stock to 4.1519 shares of our common stock using the following information: (1) the average closing price of our common stock for the ten (10) consecutive trading day period was $5.05 and (2) the annualized common stock dividend yield was 11.0935%. When we pay any cash dividend during any quarterly fiscal period to all or substantially all of our common stockholders in an amount that results in an annualized common stock dividend yield that is greater than 6.25% (the dividend yield on our Series B Preferred Stock), the conversion rate on our Series B Preferred Stock is adjusted based on a formula specified in the Articles Supplementary Establishing and Fixing the Rights and Preferences of the Series B Preferred Stock.

From October 1, 2014 through November 4, 2014, we purchased or committed to purchase approximately $52 million of Non-Agency MBS.

From October 1, 2014 through November 4, 2014, we issued an aggregate of 75,492 shares of common stock at a weighted average price of $5.16 per share under the 2012 Dividend Reinvestment and Stock Purchase Plan, resulting in proceeds to us of approximately $389 thousand.

From October 1, 2014 through November 4, 2014, we had repurchased an aggregate of 5,671,500 shares of our common stock at a weighted average price of $5.09 per share under our share repurchase program.

From October 1, 2014 through November 4, 2014, two swaps with an aggregate notional amount of $85 million matured.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We seek to manage the interest rate, market value, liquidity, prepayment and credit risks inherent in all financial instruments in a prudent manner designed to insure our longevity while, at the same time, seeking to provide an opportunity for stockholders to realize attractive total rates of return through ownership of our common stock. While we do not seek to avoid risk completely, we do seek, to the best of our ability, to assume risk that can be quantified from historical experience, to actively manage that risk, to earn sufficient returns to justify taking those risks and to maintain capital levels consistent with the risks we undertake.

Interest Rate Risk

We primarily invest in adjustable-rate, hybrid adjustable-rate and fixed-rate mortgage assets. Hybrid mortgages are ARMs that have a fixed interest rate for an initial period of time (typically three years or greater) and then convert to an adjustable-rate for the remaining loan term. Our debt obligations are generally repurchase agreements of limited duration that are periodically refinanced at current market rates.

ARMs are typically subject to periodic and lifetime interest rate caps that limit the amount an ARM interest rate can change during any given period. ARMs are also typically subject to a minimum interest rate payable. Our borrowings are not subject to similar restrictions. Hence, in a period of increasing interest rates, interest rates on our borrowings could increase without limitation, while the interest rates on our mortgage assets could be limited. This problem would be magnified to the extent we acquire mortgage assets that are not fully indexed. Further, some ARM assets may be subject to periodic payment caps that result in some portion of the interest being deferred and added to the principal outstanding. These factors could lower our net interest income or cause a net loss during periods of rising interest rates, which would negatively impact our liquidity, net income and our ability to make distributions to stockholders.

We fund the purchase of a substantial portion of our ARM assets with borrowings that have interest rates based on indices and repricing terms similar to, but of shorter maturities than, the interest rate indices and repricing terms of our mortgage assets. Thus, we anticipate that in most cases the interest rate indices and repricing terms of our mortgage assets and our funding sources will not be identical, thereby creating an interest rate mismatch between assets and liabilities. During periods of changing interest rates, such interest rate mismatches could negatively impact our net interest income, dividend yield and the market price of our common stock.

Most of our adjustable-rate assets are based on the one-year constant maturity treasury rate and the one-year LIBOR rate and our debt obligations are generally based on LIBOR. These indices generally move in the same direction, but there can be no assurance that this will continue to occur.

Our ARM assets and borrowings reset at various different dates for the specific asset or obligation. In general, the repricing of our debt obligations occurs more quickly than on our assets. Therefore, on average, our cost of funds may rise or fall more quickly than does our earnings rate on the assets.

Further, our net income may vary somewhat as the spread between one-month interest rates and six- and twelve-month interest rates varies.

At September 30, 2014, our MBS (including our TBA Agency securities) and the related borrowings will prospectively reprice based on the following time frames (dollar amounts in thousands):

	Investments[1][2]			Borrowings		
	Amount	Percentage of Total Investments		Amount	Percentage of Total Borrowings	
Investment Type/Rate Reset Dates						
15-year fixed-rate investments	$1,132,321	14.0	%	$-	-	%
15-year fixed-rate TBA Agency securities	660,676	8.2		-	-	
20-year and 30-year fixed-rate investments	238,715	3.0		-	-	
Adjustable-Rate Investments/Obligations						
Less than 3 months	473,151	5.9		6,500,000	99.2	
Greater than 3 months and less than 1 year	1,351,262	16.8		50,000	0.8	
Greater than 1 year and less than 2 years	1,028,124	12.7		-	-	
Greater than 2 years and less than 3 years	932,127	11.5		-	-	
Greater than 3 years and less than 4 years	180,571	2.2		-	-	
Greater than 4 years and less than 5 years	508,014	6.3				
Greater than 5 years and less than 7 years	933,558	11.6				
Greater than 7 years	633,409	7.8		-	-	
Total:	$8,071,928	100.0	%	$6,550,000	100.0	%

(1) Based on when they contractually reprice and does not consider the effect of any prepayments.
(2) We assume that if the repricing of the investment is beyond 3 months but less than 4 months, it is included in the "Less than 3 months" category.

At December 31, 2013, our MBS and the related borrowings will prospectively reprice based on the following time frames (dollar amounts in thousands):

	Investments[1][2]			Borrowings		
	Amount	Percentage of Total Investments		Amount	Percentage of Total Borrowings	
Investment Type/Rate Reset Dates						
15-year fixed-rate investments	$1,658,348	19.4	%	$-	-	%
30-year fixed-rate investments	111,038	1.3		-	-	
Adjustable-Rate Investments/Obligations						
Less than 3 months	528,776	6.2		7,580,000	100.0	
Greater than 3 months and less than 1 year	1,113,514	13.0		-	-	
Greater than 1 year and less than 2 years	730,340	8.5		-	-	
Greater than 2 years and less than 3 years	1,273,775	14.9		-	-	
Greater than 3 years and less than 4 years	873,407	10.2		-	-	
Greater than 4 years and less than 5 years	293,402	3.4		-	-	
Greater than 5 years and less than 7 years	1,305,608	15.3		-	-	
Greater than 7 years	668,238	7.8				
Total:	$8,556,446	100.0	%	$7,580,000	100.00	%

(1) Based on when they contractually reprice and does not consider the effect of any prepayments.
(2) We assume that if the repricing of the investment is beyond 3 months but less than 4 months, it is included in the "Less than 3 months" category.

Market Value Risk

All of our MBS are classified as available-for-sale assets. As such, they are reflected at fair value (i.e., market value) with the periodic adjustment to fair value (that is not considered to be an other-than-temporary impairment) reflected as part of "Accumulated other comprehensive income" that is included in the equity section of our balance sheet. The market value of our assets can fluctuate due to changes in interest rates and other factors.

Liquidity Risk

Our primary liquidity risk arises from financing long-maturity MBS with short-term debt. The interest rates on our borrowings generally adjust more frequently than the interest rates on our adjustable-rate MBS. For example, at September 30, 2014, our Agency MBS had a weighted average term to next rate adjustment of approximately 37 months while our borrowings had a weighted average term to next rate adjustment of 38 days. After adjusting for all interest rate swaps, the weighted average term to next rate adjustment was 845 days. Accordingly, in a period of rising interest rates, our borrowing costs will usually increase faster than our interest earnings from MBS. As a result, we could experience a decrease in net income or a net loss during these periods. Our assets that are pledged to secure short-term borrowings are high-quality liquid assets. As a result, we have been able to roll over our short-term borrowings as they mature. There can be no assurance that we will always be able to roll over our short-term debt.

During the past few years, there have been continuing liquidity and credit concerns surrounding the mortgage markets and the general global economy. While the U.S. government and other foreign governments have taken various actions to address these concerns, there are also concerns about the ability of the U.S. government to meet the obligations of the Budget Control Act of 2011 and to reduce its budget deficit and about possible future rating downgrades of U.S. sovereign debt and government-sponsored agency debt. On October 17, 2013, President Obama signed into law a bill passed by the U.S. Congress that funded the government through January 15, 2014, extended the debt ceiling through February 7, 2014, called for Congressional agreement on a long-term budget by mid-December 2013 and continued the budget sequestration provisions of the Budget Control Act of 2011. In January 2014, Congress passed a $1.1 trillion spending bill that funded the U.S. government through September 30, 2014. On February 12, 2014, Congress passed a bill, which was signed into law by President Obama, suspending the debt ceiling until March 2015. In September 2014, Congress passed a continuing resolution that will fund the U.S. government through December 11, 2014 at the current 2014 funding levels. A failure by the U.S. government to reach agreement on future budgets and debt ceilings, reduce its budget deficit or a future downgrade of U.S. sovereign debt and government-sponsored agencies debt could have a material adverse effect on the U.S. economy and the global economy. These events could have a material adverse effect on our borrowing costs, the availability of financing and the liquidity and valuation of securities in general and also on the securities in our portfolio. As a result, there continues to be concerns about the potential impact on product availability, liquidity, interest rates and changes in the yield curve. While we have been able to meet all of our liquidity needs to date, there are still concerns in the mortgage sector about the availability of financing generally.

At September 30, 2014, we had unrestricted cash of approximately $1.4 million and approximately $458.4 million in unpledged MBS available to meet margin calls on short-term borrowings that could be caused by asset value declines or changes in lender collateralization requirements.

Prepayment Risk

Prepayments are the full or partial repayment of principal prior to the original term to maturity of a mortgage loan and typically occur due to refinancing of mortgage loans. Prepayment rates on mortgage securities and mortgage loans vary from time to time and may cause changes in the amount of our net interest income. Prepayments of ARM loans usually can be expected to increase when mortgage interest rates fall below the then-current interest rates on such loans and decrease when mortgage interest rates exceed the then-current interest rate on such loans, although such effects are not entirely predictable. Prepayment rates may also be affected by the conditions in the housing and financial markets, general economic conditions and the relative interest rates on fixed-rate loans and ARM loans underlying MBS. The purchase prices of MBS are generally based upon assumptions regarding the expected amounts and rates of prepayments. Where slow prepayment assumptions are made, we may pay a premium for MBS. To the extent such assumptions differ from the actual amounts of prepayments, we could experience reduced earnings or losses. The total prepayment of any MBS purchased at a premium by us would result in the immediate write-off of any remaining capitalized premium amount and a reduction of our net interest income by such amount. In addition, in the event that we are unable to acquire new MBS to replace the prepaid MBS, our financial condition, cash flows and results of operations could be harmed.

We often purchase mortgage assets that have a higher interest rate than the market interest rate at the time. In exchange for this higher interest rate, we must pay a premium over par value to acquire these assets. In accordance with accounting rules, we amortize this premium over the term of the MBS. As we receive repayments of mortgage principal, we amortize the premium balances as a reduction to our income. If the mortgage loans underlying MBS were prepaid at a faster rate than we anticipate, we would amortize the premium at a faster rate. This would reduce our income.

General

Many assumptions are made to present the information in the tables below and, as such, there can be no assurance that assumed events will occur, or that other events that could affect the outcomes will not occur; therefore, the tables below and all related disclosures constitute forward-looking statements.

The analyses presented utilize assumptions and estimates based on management's judgment and experience. Furthermore, future sales, acquisitions and restructuring could materially change the interest rate risk profile for us. The tables quantify the potential changes in net income and portfolio value should interest rates immediately change (are "shocked") and remain at the new level for the next twelve months. The results of interest rate shocks of plus and minus 100 and 200 basis points are presented. The cash flows from our portfolio of mortgage assets for each rate shock scenario are projected, based on a variety of assumptions including prepayment speeds, time until coupon reset, yield on future acquisitions, slope of the yield curve and size of the portfolio. Assumptions made on the interest rate-sensitive liabilities, which are repurchase agreements, include anticipated interest rates (no negative rates are utilized), collateral requirements as a percent of the repurchase agreement and amount of borrowing. Assumptions made in calculating the impact on net asset value of interest rate shocks include projected changes in U.S. Treasury interest rates, prepayment rates and the yield spread of mortgage assets relative to prevailing U.S. Treasury interest rates.

Tabular Presentation

The information presented in the table below projects the impact of instantaneous parallel shifts in interest rates on our annual projected net income (relative to the unchanged interest rate scenario), and the impact of the same instantaneous parallel shifts on our projected portfolio value (the value of our assets, including the value of any derivative instruments or hedges, such as interest rate swap agreements). These projections are based on investments in place at September 30, 2014 and include all of our interest rate sensitive assets, liabilities and hedges, such as interest rate swap agreements.

Change in Interest Rates	Percentage Change in Projected Net Interest Income	Percentage Change in Projected Portfolio Value
–2%	–58%	–2.0%
–1%	–15%	0.0%
0%	0%	0%
1%	–24%	–1.0%
2%	–46%	–2.5%

The information presented in the table below projects the impact of the same sudden changes in interest rates on our annual projected net income and projected portfolio value compared to the base case used in the table above, and the only difference is that it excludes the effect of the interest rate swap agreements on both net interest income and portfolio value. As of September 30, 2014, the aggregate notional amount of our interest rate swap agreements was approximately $3.81 billion and the weighted average maturity was 4 years.

Change in Interest Rates	Percentage Change in Projected Net Interest Income	Percentage Change in Projected Portfolio Value
–2%	31%	2.0%
–1%	73%	2.0%
0%	0%	0%
1%	–1%	–3.0%
2%	–81%	–6.4%

Item 4. Controls and Procedures

Disclosure Controls and Procedures

We maintain disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, or the Exchange Act) that are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules, regulations and forms and that such information is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness in design and operation of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on such evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, our disclosure controls and procedures are effective in the timely and accurate recording, processing, summarizing and reporting of information required to be disclosed by us in our reports filed or submitted under the Exchange Act within the time periods specified in the SEC's rules, regulations and forms. Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has concluded that our disclosure controls and procedures are also effective to ensure that information required to be disclosed in the reports that we file or submit under the Exchange Act is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during our last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings.

We are currently not a party to any material pending legal proceedings.

Item 1A. Risk Factors.

The following are changes to certain risk factors and additional risk factors to the ones previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2013. The materialization of any risks and uncertainties identified below and in our forward-looking statements contained in this Quarterly Report on Form 10-Q, together with those previously disclosed in our Annual Report on Form 10-K, or those that are presently unforeseen, could result in material and adverse effects on our financial condition, results of operations and cash flows. See Item 2, “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Forward-Looking Statements” in this Quarterly Report on Form 10-Q.

If we elect to not renew the Management Agreement without cause, we would be required to pay the Manager a substantial termination fee.

It will be costly for us if we elect not to renew the Management Agreement without cause.

With the consent of the majority of our independent directors, and with at least 180-days’ prior written notice before the end of the calendar year, we may elect to not renew the Management Agreement at the end of the calendar year. If we elect not to renew the Management Agreement without cause, we will be required to pay the Manager a termination fee equal to three times the average annual management fee earned by the Manager during the 24-month period immediately preceding the most recently completed quarter prior to the year-end termination of the Management Agreement.

After giving notice of our intent to not renew the Management Agreement without cause, we will continue to be required to pay the Manager the management fees stated in the Management Agreement until the end of the calendar year that the Management Agreement is not renewed. If such notice is given less than 180 days prior to the end of the calendar year, the management fees will be paid until termination of the Management Agreement at the end of the following calendar year.

At September 30, 2014, if this termination event had occurred, the termination fee, based on the average annual management fee earned by the Manager during the 24-month period immediately preceding the most recently completed quarter prior to the effective date of termination, would be approximately $34.8 million.

If we elect not to renew the Management Agreement without cause, we are also likely to become a party to employment litigation for wrongful termination and other issues under the laws of California.

If we do not renew the Management Agreement for any reason, we would continue to be obligated to pay the sublease on our office premises in California.

Our obligation to pay the sublease on our office premises does not end with termination of the Management Agreement. There can be no assurance that we can sublease our office space to another tenant at a rate which eliminates this obligation and is satisfactory to the sublessor and the building owner.

Various corporate actions require the approval of the majority of all shareholders.

There are corporate actions which can be implemented only if a majority of all shareholders approves at a convened meeting of shareholders. There can be no assurance that a majority of all shareholders will vote to approve any measure that only a majority of the voting shareholders had previously approved. Examples of actions which require the approval of a majority of all shareholders to pass are: an agreement of consolidation, merger, share exchange or transfer of assets; for dissolution of the Corporation; or for a business combination between the Corporation and an interested stockholder.

During the two years after we elect without cause to not renew the Management Agreement, we will likely not be able to retain any of the Manager's employees to assist us in managing the Company on a full-time or interim basis.

The Management Agreement provides that, without the consent of the Manager, the Company may not, for two years after termination of the Management Agreement, employ any employee of the Manager or any of its Affiliates or any Person who has been employed by the Manager or any of its Affiliates at any time within the two-year period immediately preceding the date on which the Person commences employment with the Company. This provision would make it unlikely that the Company would be able to immediately rely on the experience and knowledge of the employees of the former Manager to assist in any changes made by the board of directors, including assisting with the sale or liquidation of a substantial portion of the assets or a sale of the Company.

In the event of a change of control, we will owe certain of the officers and employees of the Manager a payment as specified in their Change of Control and Arbitration Agreement between these officers/employees and the Company.

In the event of a change of control of the Company, the Company would incur the costs of paying lump sum payments and other employee benefits to certain of the officers and employees of the Manager as specified in their Change of Control and Arbitration Agreement between these officers/employees and the Company.

Risk Factors for Residential Properties Business

We are in a relatively new industry that has significant competition, and we have limited operating history in this sector, which makes this business difficult to evaluate and may affect our ability to operate this business in a profitable manner.

Until very recently, the single-family residential rental business consisted primarily of private individual investors in local markets and was managed individually or by small local property managers. Within the past few years, several institutional companies and REITs have entered this market and have attempted to acquire and operate single-family properties on a large-scale basis and to achieve attractive yields employing technology through a disciplined approach to acquisitions and leasing, marketing and management. Many of our competitors may be larger and have greater financial, technical, leasing, marketing and other resources than we do, which may affect our ability to acquire our target properties at attractive prices and attract quality tenants.

In addition, although we have several employees who have previously personally engaged in this business on a small scale, we have limited operating history as a company in this business and contract with various third-party professionals to assist us in acquiring and managing our properties and providing services to tenants. If these professionals do a poor job or don’t perform to our expectations, it could affect the prices we pay to acquire properties, our relationships with our tenants, the operation of our properties, and our reputation in this business. These factors make this business difficult to evaluate, and may affect our ability to operate this business in a profitable manner.

Many factors affect the single-family residential rental market and the profitability of this business will be affected both by our assumptions about this market and this market’s conditions in our target areas.

The success of our business model will depend upon many factors including, but not limited to: the availability of properties that meet our investment criteria and our ability to acquire such properties at favorable prices; real estate appreciation or depreciation in our target markets; the condition of our properties; our ability to contain renovation, maintenance, marketing and other operating costs for our properties; our ability to maintain high occupancy rates and target rent levels; general economic conditions in our target markets, such as changes in employment and household earnings and expenses; the effects of rent controls, stabilization laws and other laws or regulations regarding rental rates and tenant rights; and changes in, and changes in enforcement of, laws, regulations and government policies including health, safety, environmental, property, zoning and tax laws. We will have no control over many of these factors, which could adversely affect the profitability of this business. Our success will also depend, in part, on our assumptions about our target properties, our target renters, our renovation, maintenance and other operating costs, and our rental rates and occupancy levels and, if our assumptions prove to be inaccurate, this may adversely affect the profitability of this business.

Initially, our portfolio of properties will be geographically concentrated and any adverse developments in local economic conditions, or the demand for single-family rental homes in these markets, or the occurrence of natural disasters may adversely affect the operating results of this business.

Initially, our target markets will be in the east coast of Florida and we will be exposed to any adverse developments in local economic conditions or natural disasters in that area. Due to this geographic concentration, any such developments could affect our business to a greater extent than if our properties were less geographically concentrated.

Poor resident selection and defaults by renters may adversely affect the financial performance of this business and harm our reputation.

Our success depends, in large part, upon our ability to attract and retain qualified tenants. This will depend, in turn, upon our ability to screen applicants, identify good residents, avoid tenants who may default, and the willingness of our tenants to renew their leases. When properties are vacant, we are not earning rental income and incur maintenance costs as well as turnover costs associated with re-leasing the properties, such as marketing and leasing commissions. Additionally, if we have to evict tenants, we will incur legal costs and may have renovation costs if the tenants don't properly maintain the properties or cause damage to the properties. Our reputation in the communities where our properties are located may be harmed if our tenants are not good neighbors or do damage to our properties or to the local communities.

Declining real estate values and impairment charges could adversely affect the earnings and financial condition of this business.

Our success depends upon our ability to acquire rental properties at attractive values, such that we can earn a satisfactory return on our investment primarily through rental income and secondarily through increases in property values. If we overpay for properties, or if their values subsequently decline or fail to rise because of market factors, we may not achieve our financial objectives. Additionally, U.S. GAAP requires companies to take an impairment charge if there is a permanent decline in the value of a property based upon a review of various market factors. An impairment charge would reduce the net income in the period in which it was taken. Even if we concluded that an impairment charge was not needed, a decline in the value of a property may become manifest over time through reduced rental income from the property, which would affect the earnings and financial condition of this business.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.
None.

Item 3. Defaults Upon Senior Securities.
None.

Item 4. Mine Safety Disclosures.
Not applicable.

Item 5. Other Information.
(a) Additional Disclosures. None.
(b) Stockholder Nominations. There have been no material changes to the procedures by which stockholders may recommend nominees to our board of directors during the quarter ended September 30, 2014. Please see the discussion of our procedures in our most recent proxy statement filed with the SEC on April 14, 2014 as DEFC 14A.

Item 6. Exhibits.
The following exhibits are either filed herewith or incorporated herein by reference:

Exhibit Number	Description
1.1	Controlled Equity Offering Sales Agreement dated May 27, 2011 between Anworth Mortgage Asset Corporation and Cantor Fitzgerald & Co. (incorporated by reference from our Current Report on Form 8-K

filed with the SEC on May 27, 2011)

3.1	Amended Articles of Incorporation of Anworth (incorporated by reference from our Registration Statement on Form S-11, Registration No. 333-38641, which became effective under the Securities Act of 1933, as amended, on March 12, 1998)
3.2	Articles of Amendment to Amended Articles of Incorporation (incorporated by reference from our Definitive Proxy Statement filed, pursuant to Section 14(a) of the Securities Exchange Act of 1934, as amended, with the SEC on May 14, 2003)
3.3	Articles of Amendment to Amended Articles of Incorporation (incorporated by reference from our Current Report on Form 8-K filed with the SEC on May 28, 2008)
3.4	Amended Bylaws of the Company (incorporated by reference from our Current Report on Form 8-K filed with the SEC on March 13, 2009)
3.5	Amendment of Bylaws to Amended Bylaws of the Company (incorporated by reference from our Current Report on Form 8-K filed with the SEC on April 1, 2014)
3.6	Articles Supplementary for Series A Cumulative Preferred Stock (incorporated by reference from our Current Report on Form 8-K filed with the SEC on November 3, 2004)
3.7	Articles Supplementary for Series A Cumulative Preferred Stock (incorporated by reference from our Current Report on Form 8-K filed with the SEC on January 21, 2005)
3.8	Articles Supplementary for Series B Cumulative Convertible Preferred Stock (incorporated by reference from our Current Report on Form 8-K filed with the SEC on January 30, 2007)

Exhibit Number	Description
3.9	Articles Supplementary for Series B Cumulative Convertible Preferred Stock (incorporated by reference from our Current Report on Form 8-K filed with the SEC on May 21, 2007)
4.1	Specimen Common Stock Certificate (incorporated by reference from our Registration Statement on Form S-11, Registration No. 333-38641, which became effective under the Securities Act of 1933, as amended, on March 12, 1998)
4.2	Specimen Series A Cumulative Preferred Stock Certificate (incorporated by reference from our Current Report on Form 8-K filed with the SEC on November 3, 2004)
4.3	Specimen Series B Cumulative Convertible Preferred Stock Certificate (incorporated by reference from our Current Report on Form 8-K filed with the SEC on January 30, 2007)
4.4	Specimen Anworth Capital Trust I Floating Rate Preferred Stock Certificate (liquidation amount $1,000 per Preferred Security) (incorporated by reference from our Current Report on Form 8-K filed with the SEC on March 16, 2005)
4.5	Specimen Anworth Capital Trust I Floating Rate Common Stock Certificate (liquidation amount $1,000 per Common Security) (incorporated by reference from our Current Report on Form 8-K filed with the SEC on March 16, 2005)
4.6	Specimen Anworth Floating Rate Junior Subordinated Note Due 2035 (incorporated by reference from our Current Report on Form 8-K filed with the SEC on March 16, 2005)
4.7	Junior Subordinated Indenture dated as of March 15, 2005, between Anworth and JPMorgan Chase Bank (incorporated by reference from our Current Report on Form 8-K filed with the SEC on March 16, 2005)
10.1*	2014 Equity Compensation Plan (incorporated by reference from our Registration Statement on Form S-8 filed with the SEC on August 5, 2014)
10.2*	2007 Dividend Equivalent Rights Plan (incorporated by reference from our Definitive Proxy Statement filed, pursuant to Section 14(a) of the Securities Exchange Act of 1934, as amended, with the SEC on April 26, 2007)

10.3*	2012 Dividend Reinvestment and Stock Purchase Plan (incorporated by reference from our Registration Statement on Form S-3, Registration No. 333-180093, which became effective under the Securities Act of 1933, as amended, on March 14, 2012)
10.4	Termination Agreement, dated as of December 31, 2011, between Anworth and Lloyd McAdams, with respect to the Employment Agreement, dated as of January 1, 2002, between Anworth and Lloyd McAdams, as amended (incorporated by reference from our Current Report on Form 8-K filed with the SEC on January 3, 2012)
10.5	Termination Agreement, dated as of December 31, 2011, between Anworth and Heather U. Baines, with respect to the Employment Agreement, dated as of January 1, 2002, between Anworth and Heather U. Baines, as amended (incorporated by reference from our Current Report on Form 8-K filed with the SEC on January 3, 2012)
10.6	Termination Agreement, dated as of December 31, 2011, between Anworth and Joseph E. McAdams, with respect to the Employment Agreement, dated as of January 1, 2002, between Anworth and Joseph E. McAdams, as amended (incorporated by reference from our Current Report on Form 8-K filed with the SEC on January 3, 2012)
10.7	Purchase Agreement dated as of March 15, 2005, by and among Anworth, Anworth Capital Trust I, TABERNA Preferred Funding I, Ltd., and Merrill Lynch International (incorporated by reference from our Current Report on Form 8-K filed with the SEC on March 16, 2005)
10.8	Second Amended and Restated Trust Agreement dated as of September 26, 2005 by and among Anworth, JPMorgan Chase Bank, National Association, Chase Bank USA, National Association, Lloyd McAdams, Joseph McAdams, Thad Brown and the several Holders, as defined therein (incorporated by reference from our Annual Report on Form 10-K for the fiscal year ended December 31, 2005, as filed with the SEC on March 16, 2006)
10.9*	Change in Control and Arbitration Agreement, dated June 27, 2006, between Anworth and Thad M. Brown (incorporated by reference from our Current Report on Form 8-K filed with the SEC on June 28, 2006), as amended by Amendment to Anworth Mortgage Asset Corporation Change in Control and Arbitration Agreement, effective December 31, 2011, between Anworth and Thad M. Brown (incorporated by reference from our Current Report on Form 8-K filed with the SEC on January 3, 2012)
10.10	Amended and Restated Administrative Services Agreement dated August 20, 2010, between Anworth and PIA (incorporated by reference from our Current Report on Form 8-K filed with the SEC on August 20, 2010)
10.11	Management Agreement dated as of December 31, 2011 by and between Anworth and Anworth Management, LLC (incorporated by reference from our Current Report on Form 8-K filed with the SEC on January 3, 2012)

Exhibit Number	Description
10.12	Sublease dated as of January 26, 2012, between Anworth and PIA (incorporated by reference from our Quarterly Report on Form 10-Q for the quarter ended June 30, 2012, as filed with the SEC on August 6, 2012)
31.1	Certification of the Principal Executive Officer, as required by Rule 13a-14(a) of the Securities Exchange Act of 1934
31.2	Certification of the Principal Financial Officer, as required by Rule 13a-14(a) of the Securities Exchange Act of 1934
32.1	Certifications of the Principal Executive Officer provided pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certifications of the Principal Financial Officer provided pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101	XBRL Instance Document
101	XBRL Taxonomy Extension Schema Document
101	XBRL Taxonomy Extension Calculation Linkbase Document
101	XBRL Taxonomy Definition Linkbase Document
101	XBRL Taxonomy Extension Labels Linkbase Document
101	XBRL Taxonomy Extension Presentation Linkbase Document

* Represents a management contract or compensatory plan, contract or arrangement in which any director or any of the named executives participates.

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.

ANWORTH MORTGAGE ASSET CORPORATION

Dated: November 7, 2014 /S/ JOSEPH LLOYD MCADAMS
Joseph Lloyd McAdams
Chairman of the Board, President and Chief Executive Officer
(Chief Executive Officer)

Dated: November 7, 2014 /s/ THAD M. BROWN
Thad M. Brown
Chief Financial Officer
(Chief Financial Officer and Principal Accounting Officer)