UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-K

x **Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the fiscal year ended December 31, 2018

or

o **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

Commission File Number: 1-9819

DYNEX CAPITAL, INC.
(Exact name of registrant as specified in its charter)

Virginia	**52-1549373**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
4991 Lake Brook Drive, Suite 100, Glen Allen, Virginia	**23060-9245**
(Address of principal executive offices)	(Zip Code)

(804) 217-5800
(Registrant's telephone number, including area code)

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

Title of each class	Name of each exchange on which registered
Common Stock, $.01 par value	New York Stock Exchange
8.50% Series A Cumulative Redeemable Preferred Stock, par value $0.01 per share	New York Stock Exchange
7.625% Series B Cumulative Redeemable Preferred Stock, par value $0.01 per share	New York Stock Exchange

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

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

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

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

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

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

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

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

As of June 30, 2018, the aggregate market value of the voting stock held by non-affiliates of the registrant was approximately $356,954,131 based on the closing sales price on the New York Stock Exchange of $6.53.

On February 25, 2019, the registrant had 70,818,525 shares outstanding of common stock, $0.01 par value, which is the registrant's only class of common stock.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Definitive Proxy Statement for the registrant's 2019 Annual Meeting of Shareholders, expected to be filed pursuant to Regulation 14A within 120 days from December 31, 2018, are incorporated by reference into Part III.

DYNEX CAPITAL, INC.
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CAUTIONARY STATEMENT – This Annual Report on Form 10-K contains "forward-looking" statements within the meaning of Section 27A of the Securities Act of 1933, as amended (or "1933 Act"), and Section 21E of the Securities Exchange Act of 1934, as amended (or "Exchange Act"). We caution that any such forward-looking statements made by us are not guarantees of future performance, and actual results may differ materially from those expressed or implied in such forward-looking statements. Some of the factors that could cause actual results to differ materially from estimates expressed or implied in our forward-looking statements are set forth in this Annual Report on Form 10-K for the year ended December 31, 2018. See Item 1A. "Risk Factors" as well as "Forward-Looking Statements" set forth in Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations" of this Annual Report on Form 10-K.

In this Annual Report on Form 10-K, we refer to Dynex Capital, Inc. and its subsidiaries as "the Company," "we," "us," or "our," unless we specifically state otherwise or the context indicates otherwise.

PART I.

ITEM 1. BUSINESS

COMPANY OVERVIEW

We are an internally managed mortgage real estate investment trust, or mortgage REIT, which primarily invests in residential and commercial mortgage-backed securities ("MBS") on a leveraged basis. We finance our investments principally with borrowings under repurchase agreements. Our objective is to provide attractive risk-adjusted returns to our shareholders over the long term that are reflective of a leveraged, high quality fixed income portfolio with a focus on capital preservation. We seek to provide returns to our shareholders primarily through the payment of regular dividends and also potentially through capital appreciation of our investments.

Our common stock is traded on the New York Stock Exchange ("NYSE") under the symbol "DX". We have two series of preferred stock outstanding, our 8.50% Series A Cumulative Redeemable Preferred Stock (the "Series A Preferred Stock") which is traded on the NYSE under the symbol "DXPRA", and our 7.625% Series B Cumulative Redeemable Preferred Stock (the "Series B Preferred Stock") which is traded on the NYSE under the symbol "DXPRB".

Our investments consist principally of Agency and non-Agency MBS including residential MBS ("RMBS"), commercial MBS ("CMBS") and CMBS interest-only ("IO") securities. Agency MBS have a guaranty of principal payment by an agency of the U.S. government or a U.S. government-sponsored entity ("GSE") such as Fannie Mae and Freddie Mac. Non-Agency MBS are issued by non-governmental enterprises and do not have a guaranty of principal payment. CMBS IO securities in which we invest may be issued by a GSE or a non-governmental enterprise. We may also invest in debt securities issued by the United States Department of the Treasury ("the Treasury" and such securities, "U.S. Treasuries").

Investment Strategy

Our investment strategy and the allocation of our capital to a particular sector or investment is driven by a "top-down" framework that focuses on the expected risk-adjusted outcome of any investment. Key points of this framework include the following:

- understanding macroeconomic conditions including the current state of the U.S. and global economies;
- understanding the regulatory environment, competition for assets, and the terms and availability of financing;
- sector analysis including understanding absolute returns, relative returns and risk-adjusted returns;
- security and financing analysis including sensitivity analysis on credit, interest rate volatility, and market value risk; and
- managing performance and inherent portfolio risks, including but not limited to interest rate, credit, prepayment, and liquidity risks.

In allocating our capital and executing our strategy, we seek to balance the risks of owning specific types of investments with the earnings opportunity on the investment. At various times during the last decade, we have allocated capital to a variety of investments including adjustable-rate and fixed-rate Agency RMBS, Agency CMBS, investment grade and unrated non-Agency RMBS and CMBS, Agency and non-Agency CMBS IO, and residual interests in securitized mortgage loans. Our investments in non-Agency MBS are generally higher quality senior or mezzanine classes (typically rated 'A' or better by one or more of the nationally recognized statistical rating organizations) because they are typically more liquid (i.e., they are more easily converted into cash either through sales or pledges as collateral for repurchase agreement borrowings) and have less exposure to credit losses than lower-rated non-Agency MBS. We regularly review our existing operations to determine whether our investment strategy or business model should change, including through capital reallocation, changing our targeted investments, and shifting our risk position.

RMBS. Substantially all of our investments in RMBS as of December 31, 2018 were Agency issued securities collateralized primarily by fixed-rate single-family mortgage loans. The remainder of our RMBS portfolio is collateralized by adjustable-rate mortgage loans (“ARMs”), which have interest rates that generally adjust at least annually to an increment over a specified interest rate index, and hybrid ARMs, which are loans that have a fixed rate of interest for a specified period (typically three to ten years) and then adjust their interest rate at least annually to an increment over a specified interest rate index (primarily one-year LIBOR).

We also purchase to-be-announced securities (“TBAs” or “TBA securities”) as a means of investing in non-specified fixed-rate Agency RMBS. A TBA security is a forward contract (“TBA contract”) for the purchase (“long position”) or sale (“short position”) of a fixed-rate Agency MBS at a predetermined price 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 settlement date. Our TBA purchases are financed by executing a series of transactions which effectively delay the settlement of a forward purchase of a non-specified Agency RMBS by entering into an offsetting TBA short position, net settling the paired-off positions in cash, and simultaneously entering into an identical TBA long position with a later settlement date. These net long TBA positions are referred to as “dollar roll positions”, and we view them as economically equivalent to investing in and financing Agency RMBS using short-term repurchase agreements. TBAs purchased for a forward settlement month are generally priced at a discount relative to TBAs sold for settlement in the current month. This discount, often referred to as “drop income”, represents the economic equivalent of net interest income (interest income less implied financing cost) on the underlying Agency security from trade date to settlement date. We account for TBAs as derivative instruments because we cannot assert that it is probable at inception and throughout the term of an individual TBA transaction that its settlement will result in physical delivery of the underlying Agency RMBS, or the individual TBA transaction will not settle in the shortest period possible.

CMBS. Substantially all of our CMBS investments as of December 31, 2018 were fixed-rate Agency-issued securities backed by multifamily housing loans. Loans underlying CMBS are generally fixed-rate, mature in eight to eighteen years, have amortization terms of up to 30 years, and are geographically dispersed. These loans typically have some form of prepayment protection provisions (such as prepayment lock-out) or prepayment compensation provisions (such as yield maintenance or prepayment penalty). Yield maintenance and prepayment penalty requirements are intended to create an economic disincentive for the loans to prepay. From time to time we have invested in non-Agency CMBS backed by loans on multifamily housing, office buildings, retail, hospitality, and health care properties.

CMBS IO. CMBS IO are interest-only securities issued as part of a CMBS securitization and represent the right to receive a portion of the monthly interest payments (but not principal cash flows) on the unpaid principal balance of the underlying pool of commercial mortgage loans. We invest in both Agency-issued and non-Agency issued CMBS IO. The loans collateralizing CMBS IO pools are very similar in composition to the pools of loans that collateralize CMBS as discussed above. Since CMBS IO securities have no principal associated with them, the interest payments received are based on the unpaid principal balance of the underlying pool of mortgage loans, which is often referred to as the notional amount. Most loans in these securities have some form of prepayment protection from early repayment including absolute loan prepayment lock-outs, loan prepayment penalties, or yield maintenance requirements similar to those typical for CMBS described above. There are no prepayment protections, however, if the loan defaults and is partially or wholly repaid earlier because of loss mitigation actions taken by the underlying loan servicer, and therefore yields on CMBS IO investments are dependent upon the underlying loan performance. Because Agency-issued MBS generally contain higher credit quality loans, Agency CMBS IO are expected to have a lower risk of default than non-Agency CMBS IO. Our CMBS IO investments are investment grade-rated with the majority rated ‘AAA’ by at least one of the nationally recognized statistical rating organizations.

The performance of our investment portfolio will depend on many factors including but not limited to interest rates, trends of interest rates, the steepness of interest rate curves, prepayment rates on our investments, demand for our investments, general market liquidity, and economic conditions and their impact on the credit performance of our investments. In addition, our business model may be impacted by other factors such as the state of the overall credit markets, which could impact the availability and costs of financing. See “Factors that Affect Our Results of Operations and Financial Condition” below, "Risk Factors-Risks Related to Our Business" in Item 1A of Part I, and Item 7A of Part II, “Quantitative and Qualitative Disclosures About Market Risk”, of this Annual Report on Form 10-K for further discussion.

Financing Strategy

We use leverage to enhance the returns on our invested capital by pledging our investments as collateral for borrowings primarily through the use of uncommitted repurchase agreements with major financial institutions and broker-dealers. We generally use the proceeds of these borrowings to acquire investment securities. The amount of leverage we utilize depends upon a variety of factors, including but not limited to general economic, political and financial market conditions; the actual and anticipated liquidity and price volatility of our assets; the gap between the duration of assets and liabilities, including hedges; the availability and cost of financing the assets; our opinion of the credit worthiness of financing counterparties; the health of the U.S. residential mortgage and housing markets; our outlook for the level, slope and volatility of interest rates; the credit quality of the loans underlying our investments; the rating assigned to securities; and our outlook for asset spreads. Repurchase agreements generally have original terms to maturity of overnight to six months, though in some instances we may enter into longer-dated maturities depending on market conditions. We pay interest on our repurchase agreement borrowings at a rate usually based on a spread to a short-term interest rate such as LIBOR and fixed for the term of the borrowing. Borrowings under these repurchase agreements are renewable at the discretion of our lenders and do not contain guaranteed roll-over terms.

Repurchase agreement financing is provided principally by major financial institutions and broker-dealers acting as financial intermediaries for money market funds and securities lenders that provide funds to the repurchase agreement markets. Repurchase agreement financing exposes us to counterparty risk to such financial intermediaries, principally related to the excess of our collateral pledged over the amount borrowed. We seek to mitigate this risk by diversifying our repurchase agreement lenders and limiting borrowings from lesser capitalized or lightly regulated counterparties. In limited instances, a money market fund or securities lender has directly provided funds to us without the involvement of a financial intermediary typically at a lower cost than we would incur borrowing from the financial intermediary. Borrowing directly from these sources also reduces our risk to the financial intermediaries.

Please refer to "Risk Factors-Risks Related to Our Business" in Item 1A of Part I of this Annual Report on Form 10-K for additional information regarding significant risks related to repurchase agreement financing.

Hedging Strategy

We use derivative instruments to economically hedge our exposure to adverse changes in interest rates resulting from our ownership of primarily fixed-rate investments financed with short-term repurchase agreements. Changes in interest rates can impact net interest income, the market value of our investments, and book value per common share. In a period of rising interest rates, our earnings and cash flow may be negatively impacted by borrowing costs increasing faster than interest income from our assets, and our book value may decline as a result of declining market values of our MBS. As of December 31, 2018, we primarily utilized pay-fixed interest rate swaps to hedge our interest rate risk. An interest rate swap is a contractual agreement between two counterparties under which each agrees to make periodic interest payments to the other for an agreed upon period based upon a notional amount. Under our pay-fixed interest rate swap agreements, we pay a fixed interest rate and receive a floating interest rate based on one or three-month LIBOR. We may from time to time also enter into “receive-fixed” interest rate swap agreements. Interest rate swap agreements with a forward starting date do not have an exchange of these interest costs until the effective date of such agreement.

To help manage the adverse impact of interest rate changes on the market value of our portfolio as well as our net interest earnings, we may at times enter into forward or futures contracts, including short securities, net short TBA positions, options, futures, swaps, caps, or similar instruments. During portions of 2018, we utilized net short TBA positions, Eurodollar futures, and U.S. Treasury futures to hedge interest rate risk.

In conducting our hedging activities, we intend to comply with REIT and tax limitations on our hedging instruments which could limit our activities and the instruments that we may use. We also intend to enter into derivative contracts only with the counterparties that we believe have a strong credit rating to help mitigate the risk of counterparty default or insolvency.

Operating Policies and Risk Management

We invest and manage our capital pursuant to Operating Policies approved by our Board of Directors. Our Operating Policies set forth investment and risk limitations as they relate to the Company's investment activities and set parameters for the Company's investment and capital allocation decisions. They require that we manage our operations and investments to comply with various REIT limitations (as discussed further below in “Federal Income Tax Considerations”) and to avoid qualifying as an investment company as such term is defined in the Investment Company Act of 1940 (the "1940 Act") or as a commodity pool operator under the Commodity Exchange Act.

Our Operating Policies place limits on certain risks to which we are exposed, such as interest rate and convexity risk, earnings at risk, and shareholders’ equity at risk from changes in fair value of our investment securities as a result of changes in interest rates, prepayment rates, investment prices and spreads, and other items. As part of our risk management process, our Operating Policies require us to perform a variety of stress tests to model the effect of adverse market conditions on our investment portfolio value and our liquidity.

Our Operating Policies limit our investment in non-Agency MBS that are rated BBB+ or lower at the time of purchase by any of the nationally recognized statistical ratings organizations to $250 million in market value and limit our shareholders’ equity at risk to a maximum of $50 million. We also conduct our own independent evaluation of the credit risk on any non-Agency MBS, such that we do not rely solely on the security’s credit rating. In addition, our purchases of non-rated MBS in recent years have been shorter duration securities which we believe to have less credit risk than typical non-rated MBS. Our Operating Policies also set forth limits for the Company’s overall leverage.

Within the overall limits established by our Operating Policies, our investment and capital allocation decisions depend on prevailing market conditions and other factors and may change over time in response to opportunities available in different economic and capital market environments. The Board may adjust the Operating Policies of the Company from time to time based on macroeconomic expectations, market conditions, and risk tolerances.

Factors that Affect Our Results of Operations and Financial Condition

Our financial performance is driven by the performance of our investment portfolio and related financing and hedging activity. In assessing our financial performance, management primarily focuses on net interest income, net interest spread, net income, comprehensive income, book value per common share, and core net operating income to common shareholders (a non-GAAP measure) and total economic return (measured as dividends declared plus changes in book value). Our financial performance may be impacted by a number of factors, many of which are related to or influenced by macroeconomic conditions, market volatility, geopolitical conditions, U.S. Federal Reserve policy, U.S. fiscal and regulatory policy, and foreign central bank and government policy. Other factors that may impact our financial performance include, but are not limited to, the absolute level of interest rates, the relative slope of interest rate curves, changes in interest rates and market expectations of future interest rates, actual and estimated future prepayment rates on our investments, supply of investments, competition for investments, economic conditions and their impact on the credit performance of our investments, and market required yields as reflected by market spreads. These factors are influenced by market forces beyond our control.

Our business model may also be impacted by the availability and cost of financing and the state of the overall credit markets. Reductions or limitations in the availability of financing for our investments could significantly impact our business or force us to sell assets, potentially at losses. Repurchase agreement lending markets have been stable for the last several years, but lending by larger U.S. domiciled banks has declined in recent years due to increased regulation and changes to regulatory capital requirements. Their repurchase market participation has been replaced by smaller independent broker dealers that are generally less regulated and by U.S. domiciled broker dealer subsidiaries of foreign financial institutions. It is uncertain how these relatively new participants will react during periods of market stress. Other factors that could also impact our business include changes in regulatory requirements, including requirements to qualify for registration under the 1940 Act, and REIT requirements.

We believe that regulatory impacts on financial institutions, many of which are our trading and financing counterparties, pose a potential threat to the overall liquidity in the capital markets. In 2017, the Federal Reserve began curtailing its reinvestment of principal payments received on its Agency RMBS portfolio. Prices in Agency RMBS generally have not been significantly impacted by the reduction, however prices may be more significantly impacted as the amount of curtailment increases each successive quarter. Market liquidity of our investments and the financing markets could be negatively impacted if the Federal Reserve's Federal Open Market Committee (or "FOMC") suddenly changes market expectations of the target Federal Funds Rate or takes other actions which have the effect of tightening monetary policy that are not anticipated by the market. And finally, there remains uncertainty as to the ultimate impact or outcome of certain regulations under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), and restrictions on market-making activities of large U.S. financial institutions could result in reduced liquidity in times of market stress.

As discussed above, investing in mortgage-related securities (including on a leveraged basis) subjects us to many risks including interest rate risk, prepayment and reinvestment risk, credit risk, spread risk, and liquidity risk. Please refer to Part I, Item 1A, "Risk Factors" as well as Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and Item 7A, "Quantitative and Qualitative Disclosures about Market Risk" of this Annual Report on Form 10-K for a detailed discussion of these factors and others that have the potential to impact our results of operations and financial condition.

From time to time, we also consider expanding our capital base as well as merger, acquisition or divestiture opportunities. We analyze and evaluate potential business opportunities that we identify or are presented to us, including possible merger, acquisition, or divestiture transactions, that might be a strategic fit for our investment strategy or asset allocation or otherwise maximize value for our shareholders. Pursuing such an opportunity or transaction could require us to issue additional equity or debt securities.

COMPETITION

The business models of mortgage REITs range from investing only in Agency MBS to investing substantially in non-investment grade MBS and originating and securitizing mortgage loans and investing in mortgage servicing rights. Some mortgage REITs will invest in RMBS and related investments only, some in CMBS and related investments only, and some in a mix. Each mortgage REIT will assume various types and degrees of risk in its investment strategy. In purchasing investments and obtaining financing, we compete with other mortgage REITs, broker dealers and investment banking firms, mutual funds, banks, hedge funds, mortgage bankers, insurance companies, governmental bodies, and other entities, many of which have greater financial resources and a lower cost of capital than we do. Increased competition in the market may reduce the available supply of investments and may drive prices of investments to unacceptable levels which would negatively impact our ability to earn an acceptable amount of income from these investments. Competition can also reduce the availability of borrowing capacity at our repurchase agreement counterparties as such capacity is not unlimited, and many of our repurchase agreement counterparties limit the amount of financing they offer to the mortgage REIT industry.

FEDERAL INCOME TAX CONSIDERATIONS

As a REIT, we are required to abide by certain requirements for qualification as a REIT under the Internal Revenue Code of 1986, as amended (the “Code”). To retain our REIT status, the REIT rules generally require that we invest primarily in real estate-related assets, that our activities be passive rather than active and that we distribute annually to our shareholders substantially all of our taxable income, after certain deductions, including deductions for our tax net operating loss (“NOL”) carryforward. We could be subject to income tax if we failed to satisfy those requirements. We use the calendar year for both tax and financial reporting purposes.

We may utilize our NOL carryforward to offset our taxable earnings after taking the REIT distribution requirements into account. As a result of our public offering of common stock in February 2012, we incurred an "ownership change" as such term is defined in Section 382 of the Code. Because of this ownership change, the amount of the NOL carryforward that we may use each year is limited to approximately $13.5 million, and portions of this amount not utilized are accumulated and rolled forward to the following year. The Tax Cuts and Jobs Act (“TCJA”) permits an NOL generated after December 31, 2017 to be carried forward indefinitely, but NOL carryforwards generated prior to that date are still subject to expiration 20 years after the year in which they are created. The majority of our NOL carryforward will expire in 2020. The following table provides a rollforward of our NOL carryforward for the periods indicated:

	NOL Available for Use	Total NOL
As of December 31, 2015:	$ 25,190	$ 89,775
NOL limitation release for the years ended:		
December 31, 2016	13,451	
December 31, 2017	13,451	
December 31, 2018	13,451	
NOL used for the years ended:		
December 31, 2016	—	—
December 31, 2017	—	—
December 31, 2018 [(1)]	—	—
As of December 31, 2018	$ 65,543	$ 89,775

(1) Subject to completion of our 2018 federal income tax return.

There may be differences between taxable income and net income computed in accordance with U.S. generally accepted accounting principles ("GAAP"). These differences primarily arise from timing differences in the recognition of revenue and expense for tax and GAAP purposes.

Failure to satisfy certain Code requirements could cause us to lose our status as a REIT. If we failed to qualify as a REIT for any taxable year, we may be subject to federal income tax at regular corporate rates and would not receive deductions for dividends paid to shareholders. We could, however, utilize our NOL carryforward to offset all or part of our taxable income to the extent the NOL is available to us based on the limitations described above. If we lost or otherwise surrendered our status as a REIT, we could not elect REIT status again for five years. Several of our investments in securitized mortgage loans have ownership restrictions limiting their ownership to REITs. Therefore, if we fail to maintain our REIT status, we would have to sell these investments or otherwise provide for REIT ownership of these investments. In addition, many of our repurchase agreement lenders and interest rate swap counterparties require us to maintain our REIT status. If we were to lose our REIT status, these lenders would have the right to terminate any repurchase agreement borrowings and interest rate swaps outstanding at that time.

Qualification as a REIT

Qualification as a REIT requires that we satisfy a variety of tests relating to our income, assets, distributions and ownership. The significant tests are summarized below.

Sources of Income. To continue qualifying as a REIT, we must satisfy two distinct tests with respect to the sources of our income: the "75% income test" and the "95% income test." The 75% income test requires that we derive at least 75% of our gross income (excluding gross income from prohibited transactions) from certain real estate-related sources. In order to satisfy the 95% income test, 95% of our gross income for the taxable year must consist of either income that qualifies under the 75% income test or certain other types of passive income.

If we fail to meet either the 75% income test or the 95% income test, or both, in a taxable year, we might nonetheless continue to qualify as a REIT, if our failure was due to reasonable cause and not willful neglect and the nature and amounts of our items of gross income were properly disclosed to the Internal Revenue Service (the "IRS"). However, in such a case we would be required to pay a tax equal to 100% of any excess non-qualifying income.

Nature and Diversification of Assets. At the end of each calendar quarter, we must meet multiple asset tests. Under the "75% asset test", at least 75% of the value of our total assets must represent cash or cash items (including receivables), government securities or real estate assets. Under the “10% asset test,” we may not own more than 10% of the outstanding voting power or value of securities of any single non-governmental issuer, provided such securities do not qualify under the 75% asset test or relate to taxable REIT subsidiaries. Under the “5% asset test,” ownership of any stocks or securities that do not qualify under the 75% asset test must be limited, in respect of any single non-governmental issuer, to an amount not greater than 5% of the value of our total assets (excluding ownership of any taxable REIT subsidiaries).

If we inadvertently fail to satisfy one or more of the asset tests at the end of a calendar quarter, such failure would not cause us to lose our REIT status, provided that (i) we satisfied all of the asset tests at the close of the preceding calendar quarter and (ii) the discrepancy between the values of our assets and the standards imposed by the asset tests either did not exist immediately after the acquisition of any particular asset or was not wholly or partially caused by such an acquisition. If the condition described in clause (ii) of the preceding sentence was not satisfied, we still could avoid disqualification by eliminating any discrepancy within 30 days after the close of the calendar quarter in which it arose.

Ownership. In order to maintain our REIT status, we must not be deemed to be closely held and must have more than 100 shareholders. The closely held prohibition requires that not more than 50% of the value of our outstanding shares be owned by five or fewer persons at any time during the last half of our taxable year. The "more than 100 shareholders" rule requires that we have at least 100 shareholders for 335 days of a twelve-month taxable year. If we failed to satisfy the ownership requirements, we would be subject to fines and be required to take curative action to meet the ownership requirements in order to maintain our REIT status.

TCJA

TCJA made significant changes to the U.S. federal income tax laws applicable to businesses and their owners, including REITs and their stockholders. Pursuant to this legislation, among other items, as of January 1, 2018, (1) the federal income tax rate applicable to corporations was reduced to 21%, (2) the highest marginal individual income tax rate was reduced to 37%, (3) the corporate alternative minimum tax was repealed and (4) the allowable NOL deduction for a given year was reduced to 80% of a corporation’s (including a REIT’s) pre-NOL deduction taxable income. In addition, under the TCJA, individuals, estates and trusts may deduct up to 20% of certain pass-through income, including ordinary REIT dividends that are not “capital gain dividends” or “qualified dividend income,” subject to certain limitations. For taxpayers qualifying for the full deduction, the effective maximum tax rate on ordinary REIT dividends is 29.6% (plus a 3.8% surtax on net investment income, if applicable). The maximum rate of withholding with respect to our distributions to certain foreign owners that are treated as attributable to gains from the sale or exchange of U.S. real property interests was also reduced from 35% to 21%. The deductibility of net interest expense is limited for all businesses; however, certain businesses, including certain real estate businesses, may elect to not be subject to such limitations, in which case they would be required to depreciate their real property-related assets over longer depreciable lives. To the extent that a taxable REIT subsidiary has interest expense that exceeds its interest income, the net interest expense limitation could potentially apply to such taxable REIT subsidiary. The reduced corporate tax rate of 21% applies to our taxable REIT subsidiaries. The individual and collective impact of these changes on REITs and their security holders remains uncertain and may not become evident for some period. Prospective and current investors should consult their tax advisors regarding the implications of the TCJA on their investment.

EMPLOYEES

As of December 31, 2018, we have 19 employees and our corporate office is located in Glen Allen, Virginia. None of our employees are covered by any collective bargaining agreements, and we are not aware of any union organizing activity relating to our employees.

Executive Officers of the Company

Name (Age)	Current Title	Business Experience
Byron L. Boston (60)	Chief Executive Officer, President, Co-Chief Investment Officer, and Director	Chief Executive Officer and Co-Chief Investment Officer effective January 1, 2014; President and Director since 2012; Chief Investment Officer since 2008.
Stephen J. Benedetti (56)	Executive Vice President, Chief Financial Officer, and Chief Operating Officer	Executive Vice President and Chief Operating Officer since 2005; Executive Vice President and Chief Financial Officer from 2001 to 2005 and beginning again in 2008.
Smriti L. Popenoe (50)	Executive Vice President and Co-Chief Investment Officer	Executive Vice President and Co-Chief Investment Officer effective January 1, 2014; Chief Risk Officer of PHH Corporation between 2010 and 2013; Senior Vice President, Balance Sheet Management, of Wachovia Bank, from 2006 to 2009.

AVAILABLE INFORMATION

We are subject to the reporting requirements of the Exchange Act and its rules and regulations. The Exchange Act requires us to file reports, proxy statements, and other information with the Securities Exchange Commission (the "SEC"). These materials may be obtained electronically by accessing the SEC's home page at www.sec.gov.

Our website can be found at www.dynexcapital.com. Our annual reports on Form 10-K, our quarterly reports on Form 10-Q, our current reports on Form 8-K, and amendments to those reports, filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act, are made available free of charge through our website as soon as reasonably practicable after such material is electronically filed with or furnished to the SEC.

We have adopted a Code of Business Conduct and Ethics ("Code of Conduct") that applies to all of our employees, officers and directors. Our Code of Conduct is also available free of charge on our website, along with our Audit Committee Charter, our Nominating and Corporate Governance Committee Charter, and our Compensation Committee Charter. We will post on our website amendments to the Code of Conduct or waivers from its provisions, if any, which are applicable to any of our directors or executive officers in accordance with SEC or NYSE requirements.

ITEM 1A. RISK FACTORS

The following is a summary of the risk factors that we believe are most relevant to our business. These are factors which, individually or in the aggregate, we think could cause our actual results to differ significantly from anticipated or historical results. In addition to understanding the key risks described below, investors should understand that it is not possible to predict or identify all risk factors, and consequently, the following is not a complete discussion of all potential risks or uncertainties.

RISKS RELATED TO OUR BUSINESS

Our use of leverage to enhance returns to shareholders increases the risk of volatility in our results and could lead to material decreases in net interest income, net income, comprehensive income, dividends, book value per common share, and liquidity.

Leverage increases returns on our invested capital if we can earn a greater return on investments than our cost of borrowing, but can decrease returns if borrowing costs increase and we have not adequately hedged against such an increase. Further, using leverage magnifies the potential losses to shareholders' equity and book value per common share if the market value of our investments declines, net of associated hedges.

We also have increased liquidity risk stemming from the potential for margin calls by our lenders for fluctuations in investment collateral values, or if the lender fails to renew or roll over the financing at maturity. If we are unable to access leverage at reasonable terms, our ability to generate adequate returns for our shareholders will be severely impacted. Our ability to access leverage in the conduct of our operations is impacted by the following:

- market conditions and overall market volatility and liquidity;
- regulation of our lenders and other regulatory factors;
- the liquidity of our investments;
- the market value of our investments;
- the advance rates by our lenders on investment collateral pledged, and;
- the willingness of our lenders to finance the types of investments we choose.

Many of these factors are beyond our control and are difficult to predict, which could lead to sudden and material adverse effects on our results of operations, financial condition, business, liquidity, and ability to make distributions to shareholders, and could force us to sell assets at significantly depressed prices to maintain adequate liquidity.

For more information about our operating policies regarding leverage and historic leverage levels, please see “Liquidity and Capital Resources” within Part II, Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operation.”

Fluctuations in the market value of our investments could negatively impact our net income, comprehensive income, shareholders' equity, book value per common share, and liquidity.

Our investments fluctuate in value due to changes in credit spreads, spot and forward interest rates, actual and anticipated prepayments, and other factors. Our investments may also fluctuate in value due to increased or reduced demand for the types of investments we own which could be impacted by, among other things, interest rates, capital flows, and government and regulatory policies. Changes in the market values of our investments are reflected in our consolidated financial statements in other comprehensive income, shareholders' equity and book value per common share. Changes in credit spreads represent the market's valuation of the perceived riskiness of assets relative to risk-free rates, and widening credit spreads reduce the market value of our investments as market participants require additional yield to hold riskier assets. Credit spreads could change based on macro-economic or systemic factors specific to a particular security such as prepayment performance or credit performance. Other factors that could impact credit spreads include technical issues such as supply and demand for a particular type of security, market psychology, and FOMC monetary policy. In addition, most of our investments are fixed rate or reset in rate over a period of time, and as interest rates rise, the market value of these investments will decrease. If market values decrease significantly, we may be forced to sell assets at losses in order to maintain liquidity and repay or renew repurchase agreements at maturity.

Our use of hedging strategies to mitigate our interest rate exposure may not be effective and may adversely affect our net income, comprehensive income, liquidity, shareholders’ equity and book value per common share.

We may use interest rate swap agreements, Eurodollar futures, interest rate caps, options, forward contracts and other derivative transactions (collectively, “hedging instruments”) to help mitigate increased financing costs and volatility in the market value of our investments (and therefore shareholders’ equity and book value) from adverse changes in interest rates. Our hedging activity will vary in scope based on. among other things, our portfolio construction and objectives, the actual and implied level and volatility of interest rates, our forecast of future interest rates, and financing sources used. No hedging strategy can completely insulate us from the interest rate risks to which we are exposed, and there can be no assurance that the implementation of any hedging strategy will have the desired impact on our results of operations or financial condition. Hedging instruments we use may adversely affect our results of operations and book value (particularly if interest rates decline) as the fair value of hedging instruments fluctuates with changes in rates (and require us to post margin to counterparties) and also involve an expense that we will incur regardless of the effectiveness of the hedging activity. In periods of rapidly changing interest rates, particularly declining interest rates, our liquidity could be negatively impacted if declines in the value of the hedges is greater than the increase in fair value of the hedged investments.

Our hedging instruments can be traded on an exchange or administered through a clearing house or under bilateral agreements between us and a counterparty. Bilateral agreements expose us to increased counterparty risk, and we may be at risk of loss of any collateral held by a hedging counterparty if the counterparty becomes insolvent or files for bankruptcy.

Interest rate hedging may fail to protect or could adversely affect us because, among other things:

- The performance of instruments used to hedge may not completely correlate with the performance of the assets or liabilities being hedged;
- Interest rate hedging can be expensive, particularly during periods of volatile interest rates;
- Available hedging instruments may not correspond directly with the interest rate risk from which we seek protection;
- The duration of the hedge may not match the duration of the related asset or liability given management's expectation of future changes in interest rates or a result of the inaccuracies of models in forecasting cash flows on the asset being hedged;
- The value of derivatives used for hedging will be adjusted from time to time in accordance with GAAP to reflect changes in fair value, and downward adjustments, or “mark-to-market losses,” would reduce our earnings, shareholders’ equity, and book value;
- The amount of income that a REIT may earn from hedging transactions (other than through taxable REIT subsidiaries) to offset interest rate losses may be limited by U.S. federal income tax provisions governing REITs;
- The credit quality of the party owing money on the hedge may be downgraded to such an extent that it impairs our ability to sell or assign our side of the hedging transaction; and
- The party owing money in the hedging transaction may default on its obligation to pay.

Our hedging transactions, which are intended to limit losses, may actually adversely affect our earnings, which could reduce our ability to pay dividends to our shareholders.

Fluctuations in interest rates may have various negative effects on us and could lead to reduced net interest income, comprehensive income, book value per common share, and liquidity.

Fluctuations in interest rates impact us in a number of ways. For example, in a period of rising rates, particularly increases in the targeted Federal Funds Rate, we may experience a decline in our profitability from borrowing rates increasing faster than interest coupons on our investments reset or our investments mature. We may also experience a decline in profitability from our investments adjusting less frequently or relative to a different index (e.g., six month or one-year LIBOR) from our borrowings (repurchase agreements are typically based on short-term rates like one-month or three-month LIBOR). Once the Federal Reserve announces a higher targeted range or if markets determine that the Federal Reserve is likely to announce a higher targeted range for the Federal Funds Rate, our borrowing costs are likely to immediately increase, thereby negatively impacting our results of operations, financial condition, and book value per common share.

Fluctuations in interest rates may also negatively affect the market value of our securities. Since our MBS are fixed rate or adjust generally over longer-term periods, rising interest rates will reduce the market value of our MBS as a result of higher yield requirements by the market for these types of securities. Reductions in the market value of our MBS could result in margin calls from our lenders, potentially forcing us to sell securities at a loss. Conversely, while declining interest rates are more favorable for us, we may experience increasing prepayments, resulting in reduced profitability due to reinvestment of our capital in lower yielding investments.

Repurchase agreements are generally uncommitted short-term financings with no guaranty of renewal at maturity. Changes to terms of such financing may adversely affect our profitability and our liquidity.

The majority of our repurchase agreements are uncommitted financings from lenders with an average term of ninety days or less. Because repurchase agreements are short-term financing commitments, changes in conditions in the repurchase markets may make it more difficult for us to secure continued financing particularly in periods of high volatility. Additionally, regulatory capital requirements imposed on our lenders by financial and banking regulators have changed significantly in recent years, and as a result, the cost of financing has increased and may continue to increase. In addition, many lenders may find it unprofitable to lend against certain collateral types due to higher regulatory costs and regulatory capital requirements, and thus restrict their lending against such collateral. Because we rely heavily on borrowings under repurchase agreements to finance our investments, our ability to achieve our investment and profitability objectives can depend on our ability to access repurchase agreement financing in sufficient amounts and on favorable terms, and to renew or replace maturing financings on a continuing basis. If the terms on which we borrow change in a meaningful way, or if borrowings are not available, we may be forced to sell assets or our borrowing costs could increase, potentially reducing our profitability and dividends to our shareholders.

We invest in to-be-announced, or TBA, securities and execute TBA dollar roll transactions. It could be uneconomical to roll our TBA contracts or we may be unable to meet margin calls on our TBA contracts, which could negatively affect our financial condition and results of operations.

The Company executes TBA dollar roll transactions which effectively delay the settlement of a forward purchase of a TBA by entering into an offsetting TBA short position, net settling the paired-off positions in cash, and simultaneously entering an identical TBA long position with a later settlement date. Under certain market conditions, TBA dollar roll transactions may result in negative net interest income whereby the Agency RMBS purchased for forward settlement under a TBA contract are priced at a premium to Agency RMBS for settlement in the current month. Market conditions could also adversely impact the TBA dollar roll market. In particular, the announced reduction in the Federal Reserve's reinvestment of principal payments on Agency RMBS could adversely impact the TBA dollar roll market as this reduction is implemented. Under such conditions, it may be uneconomical to roll our TBA positions prior to the settlement date, and we could have to take physical delivery of the underlying securities and settle our obligations for cash. We may not have sufficient funds or alternative financing sources available to settle such obligations. In addition, pursuant to the margin provisions established by the Mortgage-Backed Securities Division ("MBSD") of the Fixed Income Clearing Corporation we are subject to margin calls on our TBA contracts and our trading counterparties may require us to post additional margin above the levels established by the MBSD. Negative income on TBA dollar roll transactions or failure to procure adequate financing to settle our obligations or meet margin calls under our TBA contracts could result in defaults or force us to sell assets under adverse market conditions or through foreclosure and adversely affect our financial condition and results of operations.

We invest in assets that are traded in over-the-counter ("OTC") markets which are less liquid and have less price transparency than securities exchanges. Owning securities that are traded in OTC markets may increase our liquidity risk, particularly in a volatile market environment, because our assets may be more difficult to borrow against or sell in a prompt manner and on terms acceptable to us, and we may not realize the full value at which we previously recorded the investments and/or may incur losses upon sale of these assets.

Though Agency MBS are generally deemed to be very liquid securities, turbulent market conditions in the past have at times significantly and negatively impacted the liquidity of these assets, resulting in reductions in their market value. Non-Agency MBS are typically more difficult to value, less liquid, and experience greater price volatility than Agency MBS. In addition, market values for non-Agency MBS are typically more subjective than Agency MBS. Because of these factors, the number of lenders willing to provide financing for non-Agency MBS or accept them as collateral has generally been limited compared to Agency MBS. Given the trading of our investments in OTC markets, in an extreme case of market stress, a market may not exist for certain of our assets at any price. If the MBS market were to experience a severe or extended period of illiquidity, lenders may refuse to accept our assets as collateral for repurchase agreement financing, which could have a material adverse effect on our results of operations, financial condition and business. A sudden reduction in the liquidity of our investments could limit our ability to finance or could make it difficult to sell investments if the need arises. If we are required to liquidate all or a portion of our portfolio quickly, we may realize significantly less than the fair value at which we have previously recorded our investments which would result in lower than anticipated gains or higher losses.

Purchases and sales of Agency RMBS by the Federal Reserve may adversely affect the price and return associated with Agency RMBS, which could negatively impact the value of our investments, comprehensive income, book value per common share, and liquidity.

The Federal Reserve owns approximately $1.6 trillion of Agency RMBS as of December 31, 2018. The Federal Reserve is gradually reducing its investment in Agency RMBS by approximately $20 billion a month by not reinvesting principal repayments up to that amount. Any announced or actual increase in the reduction, or if the reduction is not slowed in response to market conditions, prices of Agency RMBS could materially decline which would have a negative impact on the market value of our investments, negatively impacting our comprehensive income, book value per common share, and our liquidity.

Our repurchase agreements and agreements governing certain derivative instruments may contain financial and non-financial covenants. Our inability to meet these covenants could adversely affect our financial condition, results of operations, and cash flows.

In connection with certain of our repurchase agreements and interest rate swap agreements, we are required to maintain certain financial and non-financial covenants. As of January 31, 2019, the most restrictive financial covenants require that we have a minimum of $30 million of liquidity and declines in shareholders' equity no greater than 25% in any quarter and 35% in any year. In addition, virtually all of our repurchase agreements and interest rate swap agreements require us to maintain our status as a REIT and to be exempted from the provisions of the 1940 Act. Compliance with these covenants depends on market factors and the strength of our business and operating results. Various risks, uncertainties and events beyond our control, including significant fluctuations in interest rates and changes in market conditions, could affect our ability to comply with these covenants. Failure to comply with these covenants could result in an event of default, termination of an agreement, acceleration of all amounts owed under an agreement, and generally would give the counterparty the right to exercise certain other remedies under the repurchase agreement, including the sale of the asset subject to repurchase at the time of default, unless we were able to negotiate a waiver in connection with any such default related to failure to comply with a covenant. Any such waiver could be conditioned on an amendment to the underlying agreement and any related guaranty agreement on terms that may be unfavorable to us. If we are unable to negotiate a covenant waiver or replace or refinance our assets under a new repurchase facility on favorable terms or at all, our financial condition, results of operations and cash flows could be adversely affected. Further, certain of our repurchase agreements and interest rate swap agreements have cross-default, cross-acceleration or similar provisions, such that if we were to violate a covenant under one agreement, that violation could lead to defaults, accelerations, or other adverse events under other agreements, as well.

Prepayment rates on the mortgage loans underlying our investments may adversely affect our profitability and the market value of our investments. Changes in prepayment rates may also subject us to reinvestment risk.

We are subject to prepayment risk to the extent that we own investments at premiums to their par value or at yields at a premium to current market yields. Our investment portfolio consists substantially of RMBS and CMBS owned at premiums, and CMBS IO securities which consist entirely of premium, representing the right to receive interest payments on the underlying pools of CMBS loans included in the securitization trust. We amortize the premiums we pay on a security using the effective yield method, which is impacted by actual and projected borrower prepayments of principal on the loans. Prepayments on our investments can occur both on a voluntary and involuntary (i.e., a loan default and subsequent foreclosure and liquidation) basis. Voluntary prepayments tend to increase when interest rates are declining or based on the shape of the yield curve. CMBS and CMBS IO are generally protected from voluntary prepayment for a portion of their expected lives either by an absolute prepayment lock-out on the loan or by yield maintenance or prepayment penalty provisions which serve as full or partial compensation for future lost interest income on the loan. In certain circumstances, compensation for voluntary prepayment on CMBS IO securities may not be sufficient to compensate us for the loss of future excess interest as a result of the prepayment, thereby adversely affecting our results of operations. RMBS provide no specific protection from voluntary prepayment. The actual level of prepayments on our investments will be impacted by economic and market conditions, the absolute levels of interest rates and relative levels of interest rates, the general availability of mortgage credit, and other factors. We have no protection from involuntary prepayments which tend to increase in periods of economic stress and may occur for any of our investment types. Involuntary prepayments on CMBS IO are particularly acute since the investment consists entirely of premium. If we experience actual prepayments in excess of our projections or increase our expectations of future prepayment activity, we will amortize investment premiums at an accelerated rate which could materially reduce our interest income, net income and comprehensive income. In addition, we may reinvest prepayments in lower yielding investments which could lead to lower net interest income and reduced profitability.

Increases in actual prepayment rates or market expectations of prepayment rates could also negatively impact the market value of our investments. Faster prepayments generally negatively impact the market value of RMBS due to less predictability of payments on the underlying mortgage loans and will increase the required market yield on such security. Faster prepayments will also negatively impact the market value of CMBS IO, depending on the amount of prepayment protection for a given security. Increasing prepayments will typically reduce the value of our securities owned at premiums which will negatively impact our book value. We are also more likely to experience margin calls from our lenders as a result of the decline in value of our securities.

Prepayments on large balance, single loan Agency CMBS could result in margin calls by lenders in excess of our available liquidity. As such, we may be at risk of defaulting on a repurchase agreement which could force us to sell assets at a loss.

We may own large balance Agency CMBS which are collateralized by a single-loan. While these Agency CMBS have some form of prepayment protection such as yield maintenance which would compensate us for the prepayment, these securities are collateralizing repurchase agreements. If the single loan CMBS prepays, typically there is a 20-day delay between the announcement of such prepayment and the receipt of cash from the prepayment; however, the repurchase agreement lender may initiate a margin call when the prepayment is announced. If the margin call were large enough, we might not be able to meet such margin call from available liquidity, and we could be forced to sell assets quickly and on terms unfavorable to us to meet the margin call. If we cannot meet the margin call, we may be in default under the repurchase agreement until we receive the cash from the prepayment. Because some of our repurchase agreement borrowings contain cross-default provisions, such default could trigger defaults on and margin calls with respect to other of our repurchase agreement borrowings.

Provisions requiring yield maintenance charges, prepayment penalties, defeasance, or lock-outs in CMBS IO securities may not be enforceable.

Provisions in loan documents for mortgages in CMBS IO securities in which we invest requiring yield maintenance charges, prepayment penalties, defeasance, or lock-out periods may not be enforceable in some states and under federal bankruptcy law. Provisions in the loan documents requiring yield maintenance charges and prepayment penalties may also be interpreted as constituting the collection of interest for usury purposes. Accordingly, we cannot be assured that the obligation of a borrower to pay any yield maintenance charge or prepayment penalty under a loan document in a CMBS IO security will be enforceable. Also, we cannot be assured that foreclosure proceeds under a loan document in a CMBS IO security will be sufficient to pay an enforceable yield maintenance charge. If yield maintenance charges and prepayment penalties are not collected, or if a lock-out period is not enforced, we may incur losses to write-down the value of the CMBS IO security for the present value of the amounts not collected, and we will experience lower yields and lower interest income. This would also likely cause margin calls from any lender on the CMBS IO impacted which could have a material adverse effect on our liquidity.

We invest in securities guaranteed by Fannie Mae and Freddie Mac which are currently under conservatorship by the Federal Housing Finance Administration (the "FHFA"). As conservator, the FHFA has assumed all the powers of the shareholders, directors and officers of the GSEs with the goal of preserving and conserving their assets. Both Fannie Mae's and Freddie Mac's solvency is being supported by the Treasury through their committed purchases of Fannie Mae and Freddie Mac preferred stock. The ultimate impact on the operations of Fannie Mae and Freddie Mac from the conservatorships and the support they receive from the U.S. government is not determinable and could affect Fannie Mae and Freddie Mac in such a way that our business, operations and financial condition may be adversely affected.

The FHFA placed Fannie Mae and Freddie Mac under federal conservatorship in 2008. As its conservator, the FHFA has broad regulatory powers over Fannie Mae and Freddie Mac and has entered into Preferred Stock Purchase Agreements, as amended, ("PSPAs") pursuant to which the Treasury ensures that Fannie Mae and Freddie Mac will separately maintain a positive net worth by committing to purchase their preferred stock. The FHFA as the regulator of the GSEs has proposed several reforms including, among other things, building a common, single, securitization platform between the two entities and gradually contracting their presence in the mortgage marketplace. In addition, the U.S. Congress at various times has considered structural changes to the GSEs, including winding down the GSEs and replacing them with a privately capitalized system that is intended to preserve market liquidity and protect taxpayers from future GSE losses due to economic downturns.

The outcome of the conservatorship and the scope and nature of actions that may ultimately be taken by the U.S. Congress to reform the GSEs and the housing finance system, are not predictable at this point. Actions limiting the guarantee on future Agency MBS could impact the amount of Agency MBS available to be purchased which could lead to increased competition and reduced returns from these assets. It could also negatively impact our ability to comply with the provisions of the 1940 Act (see further discussion below regarding the 1940 Act). On the other hand, actions expanding the guarantee on future Agency MBS could make Agency MBS more expensive and could impact potential returns on these investments.

Fannie Mae's and Freddie Mac's long-term financial viability is highly dependent on governmental support. If the Treasury withdraws its support, the value of Agency MBS could significantly decline, which would make it difficult for us to obtain repurchase agreement financing and could force us to sell assets at substantial losses. In addition, future policies that change the relationship between Fannie Mae and Freddie Mac and the U.S. government, including those that result in their winding down, release from conservatorship, nationalization, privatization, or elimination, may create market uncertainty and have the effect of reducing the actual or perceived credit quality of securities issued or guaranteed by Fannie Mae and Freddie Mac. As a result, such policies could increase the risk of loss on investments in Agency MBS. It also is possible that such policies could adversely impact the market for such securities and spreads at which they trade, and thereby adversely impact the profitability of our investments.

All of the foregoing could materially adversely affect the availability, pricing, liquidity, market value and financing of our assets and materially adversely affect our business, operations and financial condition.

Our investment strategy includes investing in non-Agency MBS with credit risk. Many of these securities have some form of subordinate credit enhancement within the security structure. The performance of these securities is dependent in large part on the performance of the underlying mortgage loans relative to the amount of the subordinate credit enhancement within the security structure. These mortgage loans are subject to defaults, foreclosure timeline extension, fraud, price depreciation, and unfavorable modification of loan principal amount, interest rate, and premium, any of which could result in losses to us.

Non-Agency MBS are secured by mortgage loans (generally single-family residential properties for RMBS and pools of commercial mortgage loans for CMBS) that have no guarantee of repayment. Typically, non-Agency MBS have non-rated or low rated tranches or classes that are subordinate to principal payments to higher rated classes and absorb losses on the liquidation of the underlying loans. We own securities that generally have some form of credit subordination to our investment with respect to credit losses on the underlying mortgage loans. We bear a risk of loss of principal on our security to the extent losses experienced on the loans in these securities are in excess of such subordination.

Commercial mortgage loans that collateralize CMBS and CMBS IO generally have a higher principal balance, and the ability of a borrower to repay a loan secured by an income-producing property typically is dependent upon the successful operation of the property rather than upon the existence of independent income or assets of the borrower. If the net operating income of a commercial property is reduced, the borrower's ability to repay the loan may be impaired. Net operating income of an income-producing property can be affected by, among other things, economic conditions, tenancy, location and condition, property management decisions, competition, regulations, environmental conditions, occupancy rates, interest rates and real estate tax rates and other operating expenses. Losses on underlying commercial mortgage loans will potentially impact the yield on the CMBS and CMBS IO securities we own and could also negatively impact their market value. Negative impacts on yields will reduce our net income and reductions in market values could lead to margin calls by our lenders which, if significant, could force us to sell assets possibly at losses to meet margin calls.

RMBS securities are generally collateralized by pools of single-family mortgage loans which have less idiosyncratic risk than CMBS and CMBS IO. The ability of a borrower to repay a mortgage loan secured by a residential property is dependent upon the income or assets of the borrower. Many factors may impair borrowers' abilities to repay their loans, including among other things, their employment situation, economic conditions, and the availability of refinancing. In the event of defaults on the residential mortgage loans that underlie our investments in RMBS and the exhaustion of any underlying or any additional credit support, we may not realize our anticipated return on our investments and we may incur a loss on these investments.

The implementation of the Single Security Initiative may adversely affect our financial condition and results of operations.

The Single Security Initiative is a joint initiative of Fannie Mae and Freddie Mac, under the direction of the FHFA, the GSEs' regulator and conservator, to develop a common MBS that will be issued by the GSEs. The 2014 Strategic Plan for the Conservatorships of Fannie Mae and Freddie Mac includes the goal of developing a common MBS. The Single Security would finance the same types of fixed-rate mortgages that currently back Agency MBS eligible for delivery into the TBA market. The GSEs expect to complete the Single Security initiative and issue the first Single Security in the second quarter of 2019 with the impact on forward trading in the TBA market to commence in the first quarter of 2019. Because our primary investments are Agency MBS, we may be adversely impacted by the Single Security Initiative in ways including, but not limited to:

- the Single Security Initiative may introduce uncertainty and/or negative impacts to the Agency mortgage-backed market which reduce our liquidity, affect asset values, or increase our financing costs;

- our operational preparations may be insufficient, resulting in operational impacts or missed opportunities;
- opting to convert legacy Freddie Mac positions to the Uniform Mortgage-Backed Securities (UMBS) will increase the number of delay days between factor changes and payment which could negatively impact our liquidity.

Changes in the method of determining LIBOR, or the replacement of LIBOR with an alternative reference rate, may adversely affect interest expense related to outstanding debt.

In 2012, as the result of an investigation into the manipulation of LIBOR, British regulators published a report concluding that LIBOR should undergo comprehensive reform if it was to be retained as a benchmark. Based on this report, final rules for the regulation and supervision of LIBOR by the Financial Conduct Authority ("FCA") were published and came into effect on April 2, 2013 (the "FCA Rules"). In particular, the FCA Rules include requirements that (i) an independent LIBOR administrator monitor and survey LIBOR submissions to identify breaches of practice standards and/or potentially manipulative behavior, and (ii) firms submitting LIBOR-related data to the administrator establish and maintain a clear conflict-of-interest policy and appropriate systems and controls. In response, ICE Benchmark Administration Limited ("IBA") was appointed as the independent LIBOR administrator, effective in early 2014. It is not possible to predict the effect of the FCA Rules, any changes in the methods pursuant to which LIBOR is determined, the administration of LIBOR by IBA, and any other reforms to LIBOR that will be enacted in the United Kingdom and elsewhere. In addition, any changes announced by the British Banker's Association (the "BBA"), FCA, IBA, or any other successor governance or oversight body, or future changes adopted by such body, in the method pursuant to which LIBOR is determined, as well as manipulative practices or the cessation thereof, may result in a sudden or prolonged increase or decrease in reported LIBOR, which could have an adverse impact on the level of the index. Fluctuation or discontinuation of LIBOR could affect our interest expense and the fair value of certain of our derivative instruments. We rely on interest rate hedges to mitigate our exposure to such interest rate risk on a portion of our debt obligations, but there is no assurance these arrangements will be effective in reducing our exposure to changes in interest rates.

In November 2014, the U.S. Federal Reserve established a working group composed of large U.S. financial institutions, the Alternative Reference Rates Committee ("ARRC"), to identify a set of alternative interest reference rates to LIBOR. In June 2017, the ARRC selected the Secured Overnight Financing Rate ("SOFR"), a new index calculated by reference to short-term repurchase agreements backed by U.S. Treasury securities, as its preferred replacement for U.S. dollar LIBOR. SOFR is an observed, backward looking, overnight rate for which it is not currently feasible to create reliable, forward-looking term rates and so SOFR stands in contrast to LIBOR, which is an estimated forward-looking rate and relies, to some degree, on the expert judgment of submitting panel members. Given that SOFR is a secured rate backed by government securities, it does not incorporate bank credit risk (as is the case with LIBOR). SOFR is therefore likely to be lower than LIBOR and is less likely to correlate with the funding costs of financial institutions. The development of a SOFR term structure is uncertain, presenting risks regarding how various types of financial instruments and securitization vehicles should react to a discontinuation of LIBOR. Therefore, whether or not SOFR attains market acceptance as a LIBOR replacement tool remains in question.

On July 27, 2017, the FCA announced that it would phase out LIBOR as a benchmark by the end of 2021. It is unclear whether new methods of calculating LIBOR will be established such that it continues to exist after 2021. When LIBOR ceases to exist, we may need to amend certain agreements with our lenders that utilize LIBOR as a factor in determining the interest rate based on a new standard that is established, if any. The transition to an alternative rate will require careful and deliberate consideration and implementation so as not to disrupt the stability of financial markets. There is no guarantee that a transition from LIBOR to an alternative will not result in financial market disruptions, significant increases in benchmark rates, or borrowing costs to borrowers, any of which could have an adverse effect on our business, results of operations, and our financial condition.

We may change our investment strategy, operating policies, dividend policy, and/or asset allocations without shareholder consent and/or in a manner in which shareholders, analysts, and capital markets may not agree, which could adversely affect our financial condition, results of operations, the market price of our common stock, and our ability to pay dividends to our shareholders.

A change in our investment strategy or asset allocation may materially change our exposure to interest rate and/or credit risk, default risk and real estate market fluctuations. These changes could have a material impact on our ability to continue to pay a dividend at a level that we had previously paid before the change in strategy. Furthermore, if any change in investment strategy, asset allocation, operating or dividend policy is perceived negatively by the markets or analysts covering our stock, our stock price may decline. Part of our investment strategy includes deciding whether to reinvest payments received on our existing investment portfolio. Based on market conditions, our leverage, and our liquidity profile, we may decide to not reinvest the cash flows we receive from our investment portfolio. If we retain, rather than reinvest, these cash flows, the size of our investment portfolio and the amount of net interest income generated by our investment portfolio will likely decline. In addition, if the assets we acquire in the future earn lower yields than the assets we currently own, our reported earnings per share will likely decline over time as the older assets pay down or are sold.

Competition may prevent us from acquiring new investments at favorable yields, and we may not be able to achieve our investment objectives which may potentially have a negative impact on our profitability.

Our comprehensive income will largely depend on our ability to acquire mortgage-related assets with acceptable risk-return profiles at favorable spreads over our borrowing costs. The availability of mortgage-related assets meeting our investment criteria depends upon, among other things, the level of activity in the real estate market and the quality of and demand for securities in the mortgage securitization and secondary markets. The size and level of activity in real estate lending markets depends on various factors, including interest rates, regional and national economic conditions, and real estate values. In acquiring investments, we may compete with other purchasers of these types of investments, including but not limited to other mortgage REITs, broker-dealers, hedge funds, banks, insurance companies, mutual funds, GSEs and other entities that purchase assets similar to ours, many of which have greater financial resources than we do. Because of these factors, we may not be able to acquire sufficient assets at acceptable spreads to our borrowing costs, which would adversely affect our profitability.

Clearing facilities or exchanges may increase the margin requirements we are required to post when entering into derivative instruments, which may negatively impact our ability to hedge and our liquidity.

We are required to post margin when entering into a hedging instrument which is traded on an exchange or administered through a clearing house. The amount of margin is set for each derivative by the exchange or clearinghouse and in prior periods, exchanges have required additional margin in response to events having or expected to have adverse economic consequences. In the event that future adverse economic developments or market uncertainty (including those due to governmental, regulatory, or legislative action or inaction) result in increased margin requirements for our hedging instruments, it could materially adversely affect our liquidity position, business, financial condition and results of operations.

We may be subject to the risks associated with inadequate or untimely services from third-party service providers, which may negatively impact our results of operations. We also rely on corporate trustees to act on behalf of us and other holders of securities in enforcing our rights.

Loans underlying non-Agency MBS we own are serviced by third-party service providers. These servicers provide for the primary and special servicing of these securities. In that capacity these service providers control all aspects of loan collection, loss mitigation, default management and ultimate resolution of a defaulted loan including as applicable the foreclosure and sale of the real estate owned. The servicer has a fiduciary obligation to act in the best interest of the securitization trust, but significant latitude exists with respect to certain of its servicing activities. We have no contractual rights with respect to these servicers, and our risk management operations may not be successful in limiting future delinquencies, defaults, and losses. If a third-party servicer fails to perform its duties under the securitization documents, this may result in a material increase in delinquencies or losses to the securities. As a result, the value of the securities may be impacted, and we may incur losses on our investment.

In addition, should a servicer experience financial difficulties, it may not be able to perform its obligations. Due to application of provisions of bankruptcy law, servicers who have sought bankruptcy protection may not be required to make advance payments required under the terms of the agreements governing the securities of amounts due from loan borrowers. Even if a servicer were able to advance amounts in respect of delinquent loans, its obligation to make the advances may be limited to the extent that is does not expect to recover the advances due to the deteriorating credit of the delinquent loans.

We also rely on corporate trustees to act on behalf of us and other holders of securities in enforcing our rights. Under the terms of most securities we hold we do not have the right to directly enforce remedies against the issuer of the security, but instead must rely on a trustee to act on behalf of us and other security holders. Should a trustee not be required to take action under the terms of the securities, or fail to take action, we could experience losses.

Credit ratings assigned to debt securities by the credit rating agencies may not accurately reflect the risks associated with those securities. Changes in credit ratings for securities we own or for similar securities might negatively impact the market value of these securities.

Rating agencies rate securities based upon their assessment of the safety of the receipt of principal and interest payments on the securities. Rating agencies do not consider the risks of fluctuations in fair value or other factors that may influence the value of securities and, therefore, the assigned credit rating may not fully reflect the true risks of an investment in securities. Also, rating agencies may fail to make timely adjustments to credit ratings based on available data or changes in economic outlook or may otherwise fail to make changes in credit ratings in response to subsequent events, so the credit quality of our investments may be better or worse than the ratings indicate. We attempt to reduce the impact of the risk that a credit rating may not accurately reflect the risks associated with a particular debt security by not relying solely on credit ratings as the indicator of the quality of an investment. We make our acquisition decisions after factoring in other information that we have obtained about the loans underlying the security and the credit subordination structure of the security. Despite these efforts, our assessment of the quality of an investment may also prove to be inaccurate and we may incur credit losses in excess of our initial expectations.

Credit rating agencies may change their methods of evaluating credit risk and determining ratings on securities backed by real estate loans and securities. These changes may occur quickly and often. The market's ability to understand and absorb these changes, and the impact to the securitization market in general, are difficult to predict. Such changes may have a negative impact on the value of securities that we own.

If a lender to us in a repurchase transaction defaults on its obligation to resell the underlying security back to us at the end of the transaction term, or if we default on our obligations under a repurchase agreement, we will incur losses.

Repurchase agreement transactions are legally structured as the sale of a security to a lender in return for cash from the lender. These transactions are accounted for as financing agreements because the lenders are obligated to resell the same securities back to us at the end of the transaction term. Because the cash we receive from the lender when we initially sell the securities to the lender is less than the value of those securities, if the lender defaults on its obligation to resell the same securities back to us, we would incur a loss on the transaction equal to the difference between the value of the securities sold and the amount borrowed from the lender. The lender may default on its obligation to resell if it experiences financial difficulty or if the lender has re-hypothecated the security to another party who fails to transfer the security back to the lender. Additionally, if we default on one of our obligations under a repurchase agreement, the lender can terminate the transaction, sell the underlying collateral and cease entering into any other repurchase transactions with us. Any losses we incur on our repurchase transactions could adversely affect our earnings and reduce our ability to pay dividends to our shareholders.

In the event of bankruptcy either by ourselves or one or more of our third-party lenders, under the U.S. Bankruptcy Code, assets pledged as collateral under repurchase agreements may not be recoverable by us. We may incur losses equal to the excess of the collateral pledged over the amount of the associated repurchase agreement borrowing.

In the event that one of our lenders under a repurchase agreement files for bankruptcy, it may be difficult for us to recover our assets pledged as collateral to such lender. In addition, if we ever file for bankruptcy, lenders under our repurchase agreements may be able to avoid the automatic stay provisions of the U.S. Bankruptcy Code and take possession of and liquidate our collateral under our repurchase agreements without delay. In the event of a bankruptcy by one of our lenders, or us, we may incur losses in amounts equal to the excess of our collateral pledged over the amount of repurchase agreement borrowing due to the lender.

If we fail to properly conduct our operations, we could become subject to regulation under the 1940 Act. Conducting our business in a manner so that we are exempt from registration under and compliance with the 1940 Act may reduce our flexibility and could limit our ability to pursue certain opportunities.

We seek to conduct our operations to avoid falling under the definition of an investment company pursuant to the 1940 Act. Specifically, we seek to conduct our operations under the exemption provided under Section 3(c)(5)(C) of the 1940 Act, a provision available to companies primarily engaged in the business of purchasing and otherwise acquiring mortgages and other liens on and interests in real estate. According to SEC no-action letters, companies relying on this exemption must ensure that at least 55% of their assets are mortgage loans and other qualifying assets, and at least 80% of their assets are real estate-related.

The 1940 Act requires that we and each of our subsidiaries evaluate our qualification for exemption under the Act. Our subsidiaries will rely either on Section 3(c)(5)(C) or other sections that provide exemptions from registering under the 1940 Act, including Sections 3(a)(1)(C) and 3(c)(7). The SEC issued a concept release in 2011 announcing that it was reviewing the Section 3(c)(5)(C) exemption, particularly as it relates to mortgage REITs, but has not taken any action or issued any interpretive guidance since that time. We believe that we are operating our business in accordance with the exemption requirements of Section 3(c)(5)(C).

Under the 1940 Act, an investment company is required to register with the SEC and is subject to extensive restrictive and potentially adverse regulations relating to, among other things, operating methods, management, capital structure, leverage, dividends, and transactions with affiliates. If we were determined to be an investment company, our ability to use leverage and conduct business as we do today would be substantially impaired.

If we fail to abide by certain Commodity Futures Trading Commission ("CFTC") rules and regulations, we may be subject enforcement action by the CFTC.

On December 7, 2012, the CFTC's Division of Swap Dealer and Intermediary Oversight (the "Division") issued no-action relief from commodity pool operator ("CPO") registration to mortgage REITs that use CFTC-regulated products ("commodity interests") and that satisfy certain enumerated criteria. Pursuant to the no-action letter, the Division will not recommend that the CFTC take enforcement action against a mortgage REIT if its operator fails to register as a CPO, provided that the mortgage REIT (i) submits a claim to take advantage of the relief and (ii) the mortgage REIT: (a) limits the initial margin and premiums required to establish its commodity interest positions to no greater than 5% of the fair market value of the mortgage REIT's total assets; (b) limits the net income derived annually from its commodity interest positions, excluding the income from commodity interest positions that are "qualifying hedging transactions," to less than 5% of its annual gross income; (c) does not market interests in the mortgage REIT to the public as interests in a commodity pool or otherwise in a vehicle for trading in the commodity futures, commodity options or swaps markets; and (d) either: (A) identified itself as a "mortgage REIT" in Item G of its last U.S. income tax return on Form 1120-REIT; or (B) if it has not yet filed its first U.S. income tax return on Form 1120-REIT, it discloses to its shareholders that it intends to identify itself as a "mortgage REIT" in its first U.S. income tax return on Form 1120-REIT.

We believe that we have complied with all of the requirements set forth above as of and for the year ended December 31, 2018. If we fail to satisfy the criteria set forth above, or if the criteria change, we may become subject to CFTC regulation or enforcement action, the consequences of which could have a material adverse effect on our financial condition or results of operations.

We are highly dependent on information and communication systems and third parties, and systems failures or cybersecurity incidents could significantly disrupt our business or lead to significant losses, which may, in turn, negatively affect the market price of our common and preferred stocks and our ability to operate our business.

Our business is highly dependent on communications and information systems particularly as it relates to the custodians of our investments and our lenders. Any failure or interruption of our communication or information systems, or any cyber-attack or security breach of our networks or systems, could cause delays or other problems in our trading or borrowing activities, including MBS trading and repurchase agreement borrowing activities, or could lead to unauthorized trading activity, any of which could have a significant adverse effect on our financial condition or results of operations. A disruption or breach could also lead to unauthorized access to and release, misuse, loss or destruction of our confidential information or personal or confidential information of our employees or third parties, which could lead to regulatory fines, costs of remediating the breach, reputational harm, and fewer third parties that are willing to conduct business with us. In addition, we also face the risk of operational failure, termination or capacity constraints of any of the third parties with which we do business or that facilitate our business activities, including custodians, clearing agents or other financial intermediaries we use to facilitate our securities transactions, if their respective communication or information systems experience failure, interruption, cyber-attacks, or security breaches. We may face increased costs as we continue to evolve our cyber defenses in order to contend with changing risks and to monitor our systems for cyber-attacks and security threats. These costs and losses associated with these risks are difficult to predict and quantify and could have a significant adverse effect on our results of operations.

Computer malware, viruses, computer hacking. and phishing attacks have become more prevalent and may occur on our systems. Although we have not detected a material cybersecurity breach to date, other financial services institutions have reported material breaches of their systems, some of which have been significant. Even with all reasonable security efforts, not every breach can be prevented or even detected, and it is possible that we have experienced an undetected breach. There is no assurance that we, or the third parties that facilitate our business activities, have not or will not experience a breach. It is difficult to determine what, if any, negative impact may directly result from any specific interruption or cyber-attacks or security breaches of our networks or systems (or the networks or systems of third parties that facilitate our business activities) or any failure to maintain performance, reliability and security of our technical infrastructure, but such computer malware, viruses, and computer hacking and phishing attacks may negatively affect our operations. We rely heavily on our financial, accounting and other data processing systems, and any failure to maintain performance, reliability and security of these systems and our other technical infrastructure could have a significant adverse effect on our financial condition or results of operations.

We pay a monthly dividend to our shareholders. A monthly dividend strategy could attract shareholders that are especially sensitive to the level and frequency of the dividend. If we were to reduce the dividend or change back to a quarterly payment cycle, our share price could materially decline.

Our strategy of paying a monthly dividend is designed in part to attract retail shareholders that invest in stocks which pay a monthly dividend. The ownership of our stock may become overly concentrated in shareholders who only invest in monthly dividend paying stocks. These shareholders may be more sensitive to reductions in the dividend or a change in the payment cycle and our share price could materially decline if we were to reduce the dividend or change the payment cycle of our dividend.

RISKS RELATED TO REGULATORY POLICY

The effects of legislative and regulatory changes on our business, the housing finance industry, and the markets in which we invest and borrow are uncertain and may be adverse to our business, results of operations, and financial condition.

As a result of the financial crisis in 2007 to 2008, Congress passed the Dodd-Frank Act in July 2010 which significantly increased the regulation of, and as a result significantly reduced certain activities of affected financial institutions. It also created agencies such as the Consumer Financial Protection Bureau ("CFPB") and expanded certain powers of government regulatory agencies in an effort to enhance oversight of the financial services industry, including the housing finance industry. Although much of the Dodd-Frank Act has been implemented, there are some key aspects of the legislation not yet implemented. There is significant uncertainty regarding the legislative and regulatory changes that will be implemented or proposed by the administration of President Trump and the current U.S. Congress, particularly regarding the possible repeal of portions of the Dodd-Frank Act, housing policy and housing finance reform in the U.S., and the future roles of regulatory agencies such as the CFPB. Due to this uncertainty, it is not possible for us to predict how legislative or regulatory changes will affect our business, and there can be no assurance that these regulations will not have an adverse impact on our business, results of operations, or financial condition.

In addition, there is an ongoing debate over the degree and kind of regulation that should be applied to entities that participate in what is popularly referred to as “shadow banking.” While there is no authoritative definition of what “shadow banking” is, it generally refers to financial intermediation involving entities and activities outside of the traditional depositary banking system, such as mortgage REITs, repurchase agreement financing, securitizations, private equity funds and hedge funds. A general policy concern is that an aspect or component of shadow banking that is not subject to banking regulation - such as safety and soundness regulation and capital requirements - or other government oversight could be a source of financial instability or pose systemic risk to the broader banking and financial markets. Several organizations, including the Financial Stability Board (an international organization comprised of representatives from national financial authorities, central banks and international finance organizations primarily from the Group of Twenty Nations) and the Financial Stability Oversight Council (established by the Dodd-Frank Act) have issued policy recommendations to strengthen oversight and regulation of shadow banking. While at this stage it is difficult to predict the type and scope of any new regulations that may be adopted, if such regulations were to extend the regulatory and supervisory requirements currently applicable to banks, such as capital and liquidity standards, to our business or that of our financing counterparties or mortgage originators, or were to otherwise classify all or a portion of our business (including financing strategy) as shadow banking, our regulatory and operating costs, particularly borrowing costs, could increase, which may have a material adverse effect on our business.

RISKS RELATED TO OUR TAXATION AS A REIT AND OTHER TAX RELATED MATTERS

Qualifying as a REIT involves highly technical and complex provisions of the Code, and a technical or inadvertent violation could jeopardize our REIT qualification. Maintaining our REIT status may reduce our flexibility to manage our operations.

Qualification as a REIT involves the application of highly technical and complex Code provisions for which only limited judicial and administrative authorities exist. Even a technical or inadvertent violation could jeopardize our REIT qualification. Our qualification as a REIT will depend on our satisfaction of certain asset, income, organizational, distribution, stockholder ownership and other requirements on a continuing basis. Our operations and use of leverage also subject us to interpretations of the Code, and technical or inadvertent violations of the relevant requirements under the Code could cause us to lose our REIT status or to pay significant penalties and interest. In addition, our ability to satisfy the requirements to qualify as a REIT depends in part on the actions of third parties over which we have no control or only limited influence, including in cases where we own an equity interest in an entity that is classified as a partnership for U.S. federal income tax purposes.

Maintaining our REIT status may limit flexibility in managing our operations. For instance:

- If we make frequent asset sales from our REIT entities to persons deemed customers, we could be viewed as a “dealer,” and thus subject to 100% prohibited transaction taxes or other entity level taxes on income from such transactions.
- Compliance with the REIT income and asset requirements may limit the type or extent of hedging that we can undertake and could limit our ability to invest in TBA securities.
- Our ability to own non-real estate related assets and earn non-real estate related income is limited. Our ability to own equity interests in other entities is limited. If we fail to comply with these limits, we may be forced to liquidate attractive assets on short notice on unfavorable terms in order to maintain our REIT status.
- Our ability to invest in taxable subsidiaries is limited under the REIT rules. Maintaining compliance with this limitation could require us to constrain the growth of future taxable REIT affiliates.
- Notwithstanding our NOL carryforward, meeting minimum REIT dividend distribution requirements could reduce our liquidity. Earning non-cash REIT taxable income could necessitate our selling assets, incurring debt, or raising new equity in order to fund dividend distributions.
- Stock ownership tests may limit our ability to raise significant amounts of equity capital from one source.

If we do not qualify as a REIT or fail to remain qualified as a REIT, we may be subject to tax as a regular corporation and could face a tax liability, which would reduce the amount of cash available for distribution to our shareholders.

We intend to operate in a manner that will allow us to qualify as a REIT for federal income tax purposes. Our qualification as a REIT will depend on our satisfaction of certain asset, income, organizational, distribution, stockholder ownership and other requirements on a continuing basis. Our ability to satisfy the asset tests depends upon our analysis of the characterization and fair market values of our assets, some of which are not susceptible to a precise determination, and for which we will not obtain independent appraisals. Our compliance with the REIT income and quarterly asset requirements also depends upon our ability to successfully manage the composition of our income and assets on an ongoing basis.

If we were to fail to qualify as a REIT in any taxable year, we would be subject to federal income tax, after consideration of our NOL carryforward but not considering any dividends paid to our shareholders during the respective tax year. If we could not otherwise offset this taxable income with our NOL carryforward, the resulting corporate tax liability could be material to our results and would reduce the amount of cash available for distribution to our shareholders, which in turn could have an adverse impact on the value of our common stock. Unless we were entitled to relief under certain Code provisions, we also would be disqualified from taxation as a REIT until the fifth taxable year following the year for which we failed to qualify as a REIT.

The passage of TCJA may adversely affect the U.S. residential housing market, which could adversely affect our business.

The TCJA includes changes that could have an adverse impact on the U.S. residential housing and housing finance markets and potentially impact the market value of our investments. Among other items, the TCJA imposes new restrictions on the deductibility of interest on mortgage debt, state and local income taxes, and sales and property taxes, which may reduce home affordability and/or demand for residential real estate and adversely affect home prices. In addition, such changes may increase taxes payable by certain borrowers, thereby reducing their available cash and adversely impacting their ability to make payments on their residential mortgages, which in turn, could cause losses on our investments.

Dividends payable by REITs do not qualify for the reduced tax rates available for some dividends.

The maximum tax rate applicable to "qualified dividend income" payable to U.S. stockholders that are taxed at individual rates is lower than corresponding maximum ordinary income tax rates. Dividends payable by REITs, however, are generally not eligible for the reduced rates on qualified dividend income. Rather, under the recently enacted TCJA, qualified REIT dividends constitute "qualified business income" and thus a 20% deduction is available to individual taxpayers with respect to such dividends, resulting in a 29.6% maximum federal tax rate (plus the 3.8% surtax on net investment income, if applicable) for individual U.S. stockholders. Additionally, without further legislative action, the 20% deduction applicable to qualified REIT dividends will expire on January 1, 2026. The more favorable rates applicable to regular corporate qualified dividends could cause investors who are taxed at individual rates to perceive investments in REITs to be relatively less attractive than investments in the stocks of non-REIT corporations that pay dividends, which could adversely affect the value of the shares of REITs, including our common stock.

Legislative or other actions affecting REITs could materially and adversely affect us and our stockholders.

The rules dealing with U.S. federal income taxation are constantly under review by persons involved in the legislative process and by the IRS and the U.S. Department of the Treasury. Changes to the tax laws, with or without retroactive application, could materially and adversely affect us and our stockholders. We cannot predict how changes in the tax laws might affect us or our stockholders. New legislation, U.S. Treasury regulations, administrative interpretations or court decisions could significantly and negatively affect our ability to qualify as a REIT or the U.S. federal income tax consequences of such qualification.

In addition, the effect of substantive changes made by the TCJA is highly uncertain, both in terms of their direct effect on the taxation of an investment in our common stock and their indirect effect on the value of our assets. Furthermore, many of the provisions of the TCJA will require guidance through the issuance of U.S. Treasury regulations in order to assess their effect. There may be a substantial delay before such regulations are promulgated, increasing the uncertainty as to the ultimate effect of the statutory amendments on us. It is also likely that there will be technical corrections legislation proposed with respect to the TCJA, the timing and effect of which cannot be predicted and may be adverse to us or our stockholders.

We have not established a minimum dividend payment level and we cannot assure you of our ability to pay dividends in the future.

We intend to pay regular dividends to our common stockholders and to make distributions to our shareholders in amounts such that all or substantially all of our taxable income, subject to certain adjustments including utilization of our NOL, is distributed. However, we have not established a minimum dividend payment level, and the amount of our dividend will fluctuate. Our ability to pay dividends may be adversely affected by the risk factors described herein. All distributions will be made at the discretion of our Board of Directors and will depend on our GAAP and tax earnings, our financial condition, the requirements for REIT qualification and such other factors as our Board of Directors may deem relevant from time to time. We may not be able to make distributions, or our Board of Directors may change our dividend policy in the future. To the extent that we decide to pay dividends in excess of our current and accumulated tax earnings and profits, such distributions would generally be considered a return of capital for federal income tax purposes. A return of capital reduces the basis of a stockholder's investment in our common stock to the extent of such basis and is treated as capital gain thereafter.

Our ability to invest in and dispose of TBA securities could be limited by our REIT status, and we could lose our REIT status as a result of these investments.

The Code is unclear regarding whether TBA securities are qualifying assets for the 75% asset test and whether income and gains from dispositions of TBA securities are qualifying income for the 75% gross income test. In addition, there is uncertainty under the Code pursuant to the “5% asset test,” whereby ownership of any stocks or securities that do not qualify under the 75% asset test must be limited, in respect of any single non-governmental issuer, to an amount not greater than 5% of the value of our total assets (excluding ownership of any taxable REIT subsidiaries). Given the uncertainty regarding the tax treatment of TBAs, we will seek to limit our investment in TBAs and any other non-qualifying assets to no more than 25% of our assets at the end of any calendar quarter and will limit our investments in TBAs with a single counterparty to no more than 5% of our total assets at the end of any calendar quarter. Further, we will attempt to limit our gains from TBA transactions and any other non-qualifying income to no more than 25% of our gross income for each calendar year. Accordingly, our ability to invest in TBAs utilizing dollar roll transactions could be limited. If at some point in the future we receive a written opinion that TBAs are more likely than not to be qualifying assets for the 75% asset test and to generate qualifying income for the 75% gross income test, we may subsequently increase our investment in TBAs.

Moreover, even if we receive an opinion that TBAs and the related transactions should be treated as qualifying assets or that income and gains from dispositions of TBAs should be treated as qualifying income, the IRS could successfully challenge that position. In that event, we could be subject to a penalty tax or we could fail to qualify as a REIT if (i) the value of our TBAs, together with our other non-qualifying assets for the 75% asset test, exceeded 25% of our gross assets at the end of any calendar quarter or if the value of our investments in TBAs with a single counterparty exceeded 5% of our total assets at the end of any calendar quarter or (ii) our income and gains from the disposition of TBAs, together with our other non-qualifying income for the 75% gross income test, exceeded 25% of our gross income for any taxable year. Any such penalty tax or failure to qualify as a REIT could adversely affect our business operations, financial condition or results of operations.

For REIT test purposes, we treat repurchase agreement transactions as financing of the investments pledged as collateral. If the IRS disagrees with this treatment our ability to qualify as a REIT could be adversely affected.

Repurchase agreement financing arrangements are structured legally as a sale and repurchase whereby we sell certain of our investments to a counterparty and simultaneously enter into an agreement to repurchase these securities at a later date in exchange for a purchase price. Economically, these agreements are financings which are secured by the investments sold pursuant thereto. We believe that we would be treated for REIT asset and income test purposes as the owner of the securities that are the subject of any such sale and repurchase agreement, notwithstanding that such agreement may legally transfer record ownership of the securities to the counterparty during the term of the agreement. It is possible, however, that the IRS could assert that we did not own the securities during the term of the sale and repurchase agreement, in which case we could fail to qualify as a REIT.

Even if we remain qualified as a REIT, we may face other tax liabilities that reduce our cash flow and our profitability.

Even if we remain qualified for taxation as a REIT, we may be subject to certain federal, state and local taxes on our income and assets, including taxes on any undistributed income, tax on income from some activities conducted as a result of a foreclosure or considered prohibited transactions under the Code, and state or local income taxes. Any of these taxes would decrease cash available for distribution to our shareholders. In addition, in order to meet the REIT qualification requirements, or to avert the imposition of a 100% tax that applies to certain gains derived by a REIT from prohibited transactions, we may hold some of our assets through a taxable REIT subsidiary (“TRS”) or other subsidiary corporations that will be subject to corporate-level income tax at regular rates to the extent that such TRS does not have an NOL carryforward. Any of these taxes would decrease cash available for distribution to our shareholders.

Recognition of excess inclusion income by us could have adverse consequences to us or our shareholders.

Certain of our securities have historically generated excess inclusion income and may continue to do so in the future. Certain categories of shareholders, such as foreign shareholders eligible for treaty or other benefits, shareholders with NOLs, and certain tax-exempt shareholders that are subject to unrelated business income tax, could be subject to increased taxes on a portion of their dividend income from us that is attributable to excess inclusion income. In addition, to the extent that our stock is owned by tax-exempt “disqualified organizations,” such as certain government-related entities and charitable remainder trusts that are not subject to tax on unrelated business income, we may incur a corporate level tax on a portion of our income. In that case, we may reduce the amount of our distributions to any disqualified organization whose stock ownership gave rise to the tax.

Our future use of our tax NOL carryforward is limited under Section 382 of the Code, which could result in higher taxable income and greater distribution requirements in order to maintain our REIT status. Further, if we unknowingly undergo another ownership change pursuant to Section 382, or miscalculate the limitations imposed by a known ownership change,

and utilize an impermissible amount of the NOL, we may fail to meet the distribution requirements of a REIT and therefore we could lose our REIT status.

We can use our tax NOL carryforward to offset our taxable earnings after taking the REIT distribution requirements into account. Section 382 of the Code limits the amount of NOL that could be used to offset taxable earnings after an "ownership change" occurs. A Section 382 ownership change generally occurs if one or more shareholders who own at least 5% of our stock, or certain groups of shareholders, increase their aggregate ownership by more than 50 percentage points over their lowest ownership percentage within a rolling three-year period.

In 2012, we experienced an ownership change under Section 382 and based on management's analysis and expert third-party advice, which necessarily includes certain assumptions regarding the application of Section 382, we determined that the ownership change under Section 382 will limit our ability to use our NOL carryforward to offset our taxable income to an estimated maximum amount of $13.5 million per year. This annual limitation may effectively limit the cumulative amount of pre-ownership change losses and certain recognized built-in losses that we may utilize. This would result in higher taxable income and greater distribution requirements in order to maintain REIT qualification than if such limitation were not in effect.

We may incur additional ownership changes under Section 382 in the future, in which case the use of our NOL could be further limited. If further ownership changes occur, Section 382 would impose stricter annual limits on the amount of pre-ownership change NOLs and other losses we could use to reduce our taxable income.

If we unknowingly undergo another ownership change under Section 382 or miscalculate the limitations imposed by a known ownership change, the use of the NOL could be more limited than we have determined, and we may utilize (or may have utilized) more of the NOL than we otherwise expected. In such an instance, we may be required to pay taxes, penalties, and interest on the excess amount of NOL used, or we may be required to declare a deficiency dividend to our shareholders for the excess amount. In addition, if any impermissible use of the NOL led to a failure to comply with the REIT distribution requirements, we could fail to qualify as a REIT.

RISKS RELATED TO OUR CORPORATE STRUCTURE

The stock ownership limit imposed by the Code for REITs and our Articles of Incorporation may restrict our business combination opportunities. The stock ownership limitation may also result in reduced liquidity in our stock and may result in losses to an acquiring shareholder.

To qualify as a REIT under the Code, not more than 50% in value of our outstanding stock may be owned, directly or indirectly, by five or fewer individuals (as defined in the Code to include certain entities) at any time during the last half of each taxable year. Our Articles of Incorporation, with certain exceptions, authorize our Board of Directors to take the actions that are necessary and desirable to qualify as a REIT. Pursuant to our Articles of Incorporation, no person may beneficially or constructively own more than 9.8% of our capital stock (including our common stock, Series A Preferred Stock, and Series B Preferred Stock). Our Board of Directors may grant an exemption from this 9.8% stock ownership limitation, in its sole discretion, subject to such conditions, representations and undertakings as it may determine are reasonably necessary.

Whether we would waive the ownership limitation for any other shareholder will be determined by our Board of Directors on a case by case basis. Our Articles of Incorporation's constructive ownership rules are complex and may cause the outstanding stock owned by a group of related individuals or entities to be deemed as constructively owned by one individual or entity. As a result, the acquisition of less than these percentages of the outstanding stock by an individual or entity could cause that individual or entity to own constructively in excess of these percentages of the outstanding stock and thus be subject to the ownership limit. The Board of Directors has the right to refuse to transfer any shares of our capital stock in a transaction that would result in ownership in excess of the ownership limit. In addition, we have the right to redeem shares of our capital stock held in excess of the ownership limit.

The ownership limits imposed by the tax law are based upon direct or indirect ownership by "individuals," but only during the last half of a tax year. The ownership limits contained in our Articles of Incorporation apply to the ownership at any time by any "person," which includes entities, and are intended to assist us in complying with the tax law requirements and to minimize administrative burdens. However, these ownership limits might also delay or prevent a transaction or a change in our control that might involve a premium price for our stock or otherwise be in the best interest of our shareholders.

The stock ownership limit imposed by the Code for REITs and our Articles of Incorporation may impair the ability of holders to convert shares of our Series A Preferred Stock or Series B Preferred Stock into shares of our common stock upon a change of control.

The terms of our Series A Preferred Stock and Series B Preferred Stock provide that, upon occurrence of a change of control (as defined in the Articles of Incorporation), each holder of Series A Preferred Stock or Series B Preferred Stock will potentially have the right to convert in conjunction with a change in control all or part of the Series A Preferred Stock and Series B Preferred Stock held by such holder into a number of shares of our common stock per share of Series A Preferred Stock or Series B Preferred Stock, respectively, based on formulas set forth in our Articles of Incorporation. However, the stock ownership restrictions in our Articles of Incorporation also restrict ownership of shares of our Series A Preferred Stock and Series B Preferred Stock. As a result, no holder of Series A Preferred Stock or Series B Preferred Stock will be entitled to convert such stock into our common stock to the extent that receipt of our common stock would cause the holder to exceed the ownership limitations contained in our Articles of Incorporation, endanger the tax status of one or more real estate mortgage investment conduits ("REMICs") in which we have or plan to have an interest, or result in the imposition of a direct or indirect penalty tax on us. These provisions may limit the ability of a holder of Series A Preferred Stock or Series B Preferred Stock to convert shares of Series A Preferred Stock or Series B Preferred Stock into our common stock upon a change of control, which could adversely affect the market price of shares of our Series A Preferred Stock or of our Series B Preferred Stock.

ITEM 1B. UNRESOLVED STAFF COMMENTS

There are no unresolved comments from the SEC Staff.

ITEM 2. PROPERTIES

We lease one facility located at 4991 Lake Brook Drive, Suite 100, Glen Allen, Virginia 23060 which provides 9,350 square feet of office space for our executive officers and employees. The term of the lease expires in March 2020 but may be renewed at our option for four additional periods of one year each at a rental rate 2.5% greater than the rate in effect during the preceding 12-month period or for one additional five-year period at the fair market rental rate for the period such determination is being made for office space of comparable condition and location.

ITEM 3. LEGAL PROCEEDINGS

As previously disclosed, the Company and DCI Commercial, Inc. (“DCI”), a former affiliate of the Company and formerly known as Dynex Commercial, Inc., were defendants in litigation filed by Basic Capital Management, Inc., et al. (the “DCI Plaintiffs”) regarding the activities of DCI while it was an operating subsidiary of an affiliate of the Company (the “DCI Litigation”). The DCI Litigation concluded in 2004 and, after various appeals by the DCI Plaintiffs, no judgment or damages were entered against the Company. Final judgment in the principal amount of $46.5 million, including damages of $25.6 million and attorneys' fees and post-judgment interest of $20.9 million, was entered in the DCI Litigation against only DCI (the “DCI Judgment”). On April 26, 2017, the DCI Plaintiffs filed a suit, case no. DC-17-04848 (the “Suit”), in the 191st District Court of Dallas County, Texas, (the “191st District Court”) naming the Company and DCI as co-defendants. The case was removed to the United States District Court for the Northern District of Texas (the “U.S. District Court, Northern District of Texas”). The Suit represents the DCI Plaintiffs’ attempt to collect the DCI Judgment from the Company and alleges that the Company and DCI conspired to fraudulently transfer DCI assets to the Company and to commit related acts to defraud the DCI Plaintiffs with respect to recovery on the DCI Judgment. The Suit also alleges that the Company and DCI are a single business enterprise. On May 7, 2018, the Suit was dismissed, and the DCI Plaintiffs filed an amended complaint on June 4, 2018, adding former corporate affiliates of the Company and a current executive officer as defendants. On January 25, 2019, the U.S. District Court, Northern District of Texas, dismissed the amended complaint, finding that the DCI Plaintiffs’ allegations as they relate to the single enterprise claims were conclusory without alleging particular supporting facts to state a claim, and in the case of the former corporate affiliates and our executive officer, for lack of personal jurisdiction. The U.S. District Court, Northern District of Texas, also found that the DCI Plaintiffs’ allegations as they relate to fraudulent transfers did not sufficiently allege facts to enable the Court to draw reasonable inference that the Company or DCI acted with constructive or actual fraudulent intent. The DCI Plaintiffs have until March 8, 2019 to file an amended complaint.

One of the DCI Plaintiffs also filed a claim against the Company for $11.3 million on May 24, 2018 in the 68th District Court of Dallas County, Texas (the “68th District Court”) seeking payment allegedly pursuant to the provisions of a litigation cost sharing agreement, as amended, entered into initially in December 2000 between the Company and DCI. On June 20, 2018, the Company removed the matter to the United States District Court, and on June 21, 2018, the Company filed a motion to transfer the lawsuit to the U.S. District Court for the Eastern District of Virginia. The Company has filed a declaratory judgment action in the Eastern District of Virginia seeking a declaration that the Company is not obligated under the litigation cost sharing agreement to pay any portion of the DCI Judgment. On January 30, 2019, the U.S. District Court, Northern District of Texas, remanded the case back to the 68th District Court. The Company has moved to dismiss the case from the 68th District Court for lack of subject matter jurisdiction. The declaratory judgment action in the U.S. District Court in the Eastern District of Virginia is still pending as of February 27, 2019.

The Company believes that the above matters against it are baseless and without merit and intends to continue to defend itself vigorously in these actions. The Company believes, based upon information currently available, that the above matters will be resolved without a material adverse effect on the Company’s consolidated financial statements as a whole. The outcome, however, of any legal proceeding, including the above matters, cannot be predicted with certainty. As such, no assurances can be given that the Company will be successful in its defense of these actions on the merits or otherwise. If the Company is not successful in its defense efforts, the resolution of these matters could have a material adverse effect on the Company’s consolidated financial statements in a given future reporting period.

Separately, and as previously disclosed, in 2014, third parties were awarded a judgment against certain of the DCI Plaintiffs in a matter not involving the Company or DCI. Those parties (the “Garnishment Plaintiffs”) are currently pursuing a garnishment action against the DCI Judgment. The Garnishment Plaintiffs have requested from the Company and DCI via post-judgment discovery certain information related to DCI while it was an operating subsidiary of an affiliate of the Company and certain other information related to the activities of DCI.

Other than as described above, to the Company’s knowledge, there are no pending or threatened legal proceedings, which, in management’s opinion, individually or in the aggregate, would have a material adverse effect on the Company’s results of operations or financial condition.

ITEM 4. MINE SAFETY DISCLOSURES

None.

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS, AND ISSUER PURCHASES OF EQUITY SECURITIES

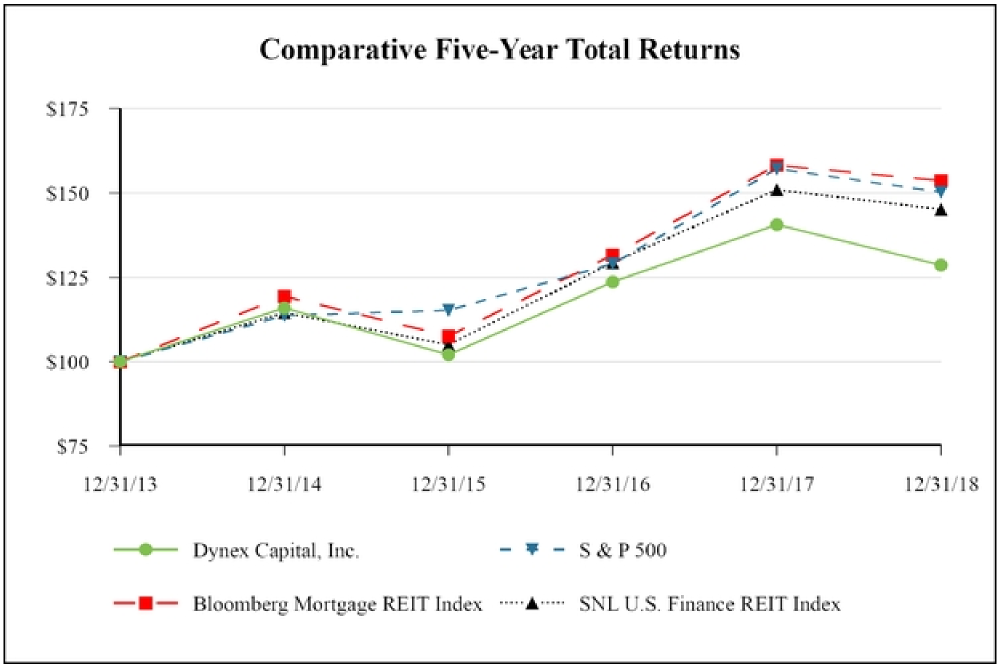
Our common stock is traded on the New York Stock Exchange under the trading symbol “DX”. The common stock was held by approximately 21,742 holders of record as of February 20, 2019. On that date, the closing price of our common stock on the New York Stock Exchange was $6.03 per share.

When declaring dividends, the Board of Directors considers the requirements for maintaining our REIT status and maintaining compliance with dividend requirements of the Series A Preferred Stock and Series B Preferred Stock. In addition, the Board considers, among other things, the Company's long-term outlook, the Company’s financial conditions and results of operations during recent financial periods, and trends in the investment and financing markets.

The following table summarizes dividends declared per share and their related tax characterization for the years ended December 31, 2018 and December 31, 2017:

	Tax Characterization			Total Dividends Declared Per Share
	Ordinary	Capital Gain	Return of Capital	
Common dividends declared:				
Year ended December 31, 2018	$ 0.1586272	$ —	$ 0.5613728	$ 0.7200
Year ended December 31, 2017	$ 0.2151908	$ —	$ 0.5048092	$ 0.7200
Preferred Series A dividends declared:				
Year ended December 31, 2018	$ 2.1250000	$ —	$ —	$ 2.1250
Year ended December 31, 2017	$ 2.1250000	$ —	$ —	$ 2.1250
Preferred Series B dividends declared:				
Year ended December 31, 2018	$ 1.9062500	$ —	$ —	$ 1.9063
Year ended December 31, 2017	$ 1.9062500	$ —	$ —	$ 1.9063

The following graph is a five-year comparison of cumulative total returns for the shares of our common stock, the Standard & Poor’s 500 Stock Index (“S&P 500”), the Bloomberg Mortgage REIT Index, and the SNL U.S. Finance REIT Index. The table below assumes $100 was invested at the close of trading on December 31, 2013 in each of our common stock, the S&P 500, the Bloomberg Mortgage REIT Index, and the SNL U.S. Finance REIT Index and assumes reinvestment of dividends.



	Cumulative Total Stockholder Returns as of December 31,					
Index	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**
Dynex Capital, Inc. Common Stock	$ 100.00	$ 115.98	$ 102.02	$ 123.68	$ 140.64	$ 128.69
S&P 500	$ 100.00	$ 113.68	$ 115.24	$ 129.02	$ 157.17	$ 150.27
Bloomberg Mortgage REIT Index	$ 100.00	$ 119.43	$ 107.61	$ 131.58	$ 158.25	$ 153.65
SNL U.S. Finance REIT Index	$ 100.00	$ 114.52	$ 105.02	$ 129.36	$ 150.94	$ 145.09

The sources of this information are Bloomberg, SNL Financial, and Standard & Poor's, which management believes to be reliable sources. The historical information set forth above is not necessarily indicative of future performance. Accordingly, we do not make or endorse any predictions as to future share performance.

The Company's Board of Directors has authorized the repurchase up to $40 million of the Company's outstanding shares of common stock through December 31, 2020. Subject to applicable securities laws and the terms of the Series A Preferred Stock designation and the Series B Preferred Stock designation, both of which are contained in our Articles of Incorporation, future repurchases of common stock will be made at times and in amounts as the Company deems appropriate, provided that the repurchase price per share is less than the Company's estimate of the current net book value of a share of common stock. Repurchases may be suspended or discontinued at any time. The Company did not repurchase any shares during the three months ended December 31, 2018.

ITEM 6. SELECTED FINANCIAL DATA

Our selected financial data presented below is derived from our audited financial statements and should be read in conjunction with our consolidated financial statements and the accompanying notes included under Item 8 of this Annual Report on Form 10-K.

	As of/For the Year Ended December 31,				
	2018	2017	2016	2015	2014
Balance Sheet Data:	*($ in thousands except per share data)*				
Mortgage-backed securities	$ 3,749,464	$ 3,026,989	$ 3,212,084	$ 3,493,701	$ 3,516,239
U.S. Treasuries	—	146,530	—	—	—
Total assets	3,886,089	3,305,778	3,397,731	3,670,048	3,688,311
Repurchase agreements	3,267,984	2,565,902	2,898,952	2,589,420	3,013,110
Total liabilities	3,358,936	2,748,720	2,930,547	3,178,023	3,081,009
Shareholders' equity	527,153	557,058	467,184	492,025	607,302
Common shares outstanding	62,817,218	55,831,549	49,153,463	49,047,335	54,739,111
Book value per common share	$ 6.02	$ 7.34	$ 7.18	$ 7.71	$ 9.02
Leverage (1)	8.0	6.4	6.3	6.5	5.1
Statement of Comprehensive Income Data:					
Interest income	$ 110,051	$ 94,502	$ 91,898	$ 100,244	$ 105,644
Interest expense	59,574	36,178	25,231	22,605	25,915
Net interest income	50,477	58,324	66,667	77,639	79,729
(Loss) gain on sale of investments, net	(23,373)	(11,530)	(4,238)	(978)	16,223
(Loss) gain on derivative instruments, net	(3,461)	3,044	(5,606)	(43,128)	(53,393)
General and administrative expenses	(15,105)	(15,819)	(14,707)	(17,668)	(16,007)
Net (loss) income to common shareholders	(4,778)	23,099	33,914	7,368	18,630
Comprehensive (loss) income to common shareholders	(31,860)	47,011	14,073	(26,716)	73,762
Average common shares outstanding	57,704,818	50,416,520	49,114,497	52,847,197	54,701,485
Net (loss) income per common share-basic and diluted	$ (0.08)	$ 0.46	$ 0.69	$ 0.14	$ 0.34
Comprehensive (loss) income per common share-basic and diluted	$ (0.55)	$ 0.93	$ 0.29	$ (0.51)	$ 1.35
Dividends declared per share:					
Common	$ 0.72	$ 0.72	$ 0.84	$ 0.96	$ 1.00
Series A Preferred	$ 2.13	$ 2.13	$ 2.13	$ 2.13	$ 2.13
Series B Preferred	$ 1.91	$ 1.91	$ 1.91	$ 1.91	$ 1.91

(1) Leverage is calculated by dividing total liabilities by total shareholders' equity as of each period end except for December 31, 2018 and December 31, 2017 which include TBA long positions at cost (as if settled) of $882.2 million and $829.4 million, respectively, within total liabilities.

	For the Year Ended December 31,				
	2018	2017	2016	2015	2014
Other Data Including Non-GAAP Financial Measures:	*($ in thousands except per share data)*				
Adjusted interest expense (1)	$ 53,981	$ 39,863	$ 27,943	$ 24,836	$ 27,345
Adjusted net interest income (1)	70,756	63,817	63,955	75,408	78,299
Core net operating income to common shareholders (1)	42,283	37,003	40,943	49,174	54,162
Core net operating income per common share (1)	$ 0.73	$ 0.73	$ 0.83	$ 0.93	$ 0.99
Average interest earning assets	$ 3,219,642	$ 3,052,372	$ 3,236,903	$ 3,685,936	$ 3,822,870
Average balance of borrowings	2,734,855	2,697,601	2,912,426	3,269,711	3,347,701
Effective yield (2)	3.37%	3.06%	2.82%	2.71%	2.76%
Cost of funds (2)	2.15%	1.32%	0.85%	0.68%	0.76%
Net interest spread	1.22%	1.74%	1.97%	2.03%	2.00%
Adjusted cost of funds (1)	1.94%	1.46%	0.94%	0.75%	0.81%
Adjusted net interest spread (3)	1.48%	1.64%	1.88%	1.96%	1.95%

(1) Represents a non-GAAP financial measure. See reconciliations provided below.

(2) Recalculation of weighted average effective yields using interest income and cost of funds using interest expense may not be possible because certain income and expense items are based on a 360-day year for the calculation while others are based on actual number of days in the year.

(3) Adjusted net interest spread is calculated by adding the impact of drop income from TBA dollar roll positions to effective yield and deducting adjusted cost of funds.

Non-GAAP Financial Measures

In addition to the Company's operating results presented in accordance with GAAP, the information presented above and within Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" of this Annual Report on Form 10-K contains the following non-GAAP financial measures: core net operating income to common shareholders (including per common share), adjusted interest expense, adjusted net interest income, and the related metrics adjusted cost of funds and adjusted net interest spread. Because these measures are used in the Company's internal analysis of financial and operating performance, management believes that they provide greater transparency to our investors of management's view of our economic performance. Management also believes the presentation of these measures, when analyzed in conjunction with the Company's GAAP operating results, allows investors to more effectively evaluate and compare the performance of the Company to that of its peers, although the Company's presentation of its non-GAAP measures may not be comparable to other similarly-titled measures of other companies. Schedules reconciling core net operating income to common shareholders, adjusted interest expense, and adjusted net interest income to GAAP financial measures are provided below.

Management views core net operating income to common shareholders as an estimate of the Company’s financial performance excluding changes in fair value of its investments and derivatives. In addition to the non-GAAP reconciliation set forth below, which derives core net operating income to common shareholders from GAAP net income to common shareholders as the nearest GAAP equivalent measure, core net operating income to common shareholders can also be determined by adjusting net interest income to include interest rate swap periodic interest costs, drop income on TBA dollar roll positions, general and administrative expenses, and preferred dividends. Management includes drop income, which is included in "gain (loss) on derivatives instruments, net" on the Company's consolidated statements of comprehensive income, in core net operating income and in adjusted net interest income because TBA dollar roll positions are viewed by management as economically equivalent to holding and financing Agency RMBS using short-term repurchase agreements. Management also includes periodic interest costs from its interest rate swaps, which are also included in "gain (loss) on derivatives instruments, net", in adjusted net interest expense, and in adjusted net interest income because interest rate swaps are used by the Company to economically hedge the impact of changing interest rates on its borrowing costs from repurchase agreements, and including periodic interest costs from interest rate swaps is a helpful indicator of the Company's total cost of financing in addition to GAAP interest expense. However, these non-GAAP measures do not provide a full perspective on our results of operations, and therefore, their usefulness is limited. For example, these non-GAAP measures do not include gains or losses from available-for-sale investments, changes in fair value of and costs of terminating interest rate swaps, as well as realized and unrealized gains or losses from any instrument used by management to economically hedge the impact of changing interest rates on its portfolio and book value per common share. **As a result, these non-GAAP measures should be considered as a supplement to, and not as a substitute for, the Company's GAAP results as reported on its consolidated statements of comprehensive income.**

	For the Year Ended December 31,				
	2018	2017	2016	2015	2014
Reconciliations of GAAP to Non-GAAP Financial Measures:	*($ in thousands except per share data)*				
GAAP net (loss) income to common shareholders	$ (4,778)	$ 23,099	$ 33,914	$ 7,368	$ 18,630
Less:					
Change in fair value of derivative instruments, net [(1)]	23,977	2,717	3,145	37,398	45,175
Loss (gain) on sale of investments, net	23,373	11,530	4,238	978	(16,223)
(Accretion) amortization of de-designated cash flow hedges [(2)]	(237)	(268)	(251)	3,499	6,788
Fair value adjustments, net	(52)	(75)	(103)	(69)	(208)
Core net operating income to common shareholders	$ 42,283	$ 37,003	$ 40,943	$ 49,174	$ 54,162
Average common shares outstanding	57,704,818	50,416,520	49,114,497	52,847,197	54,701,485
Core net operating income per common share	$ 0.73	$ 0.73	$ 0.83	$ 0.93	$ 0.99
GAAP interest expense	$ 59,574	$ 36,178	$ 25,231	$ 22,605	$ 25,915
Add: net periodic interest (benefit) cost of derivative instruments	(5,830)	3,417	2,461	5,730	8,218
Less: accretion (amortization) of de-designated cash flow hedges [(2)]	237	268	251	(3,499)	(6,788)
Adjusted interest expense	$ 53,981	$ 39,863	$ 27,943	$ 24,836	$ 27,345
Average balance of borrowings	2,734,855	2,697,601	2,912,426	3,269,711	3,347,701
Adjusted cost of funds	1.94%	1.46%	0.94%	0.75%	0.81%
GAAP net interest income	$ 50,477	$ 58,324	$ 66,667	$ 77,639	$ 79,729
Add:					
TBA drop income	14,686	9,178	—	—	—
Net periodic interest benefit (cost) of derivative instruments	5,830	(3,417)	(2,461)	(5,730)	(8,218)
Less: (accretion) amortization of de-designated cash flow hedges [(1)]	(237)	(268)	(251)	3,499	6,788
Adjusted net interest income	$ 70,756	$ 63,817	$ 63,955	$ 75,408	$ 78,299
Adjusted net interest spread	1.48%	1.64%	1.88%	1.96%	1.95%

(1)
(2)

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with our financial statements and the related notes included in Item 8, "Financial Statements and Supplementary Data" in this Annual Report on Form 10-K.

This discussion contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors including, but not limited to, those disclosed in Item 1A, "Risk Factors" elsewhere in this Annual Report on Form 10-K and in other documents filed with the SEC and otherwise publicly disclosed. Please refer to "Forward-Looking Statements" contained within this Item 7 for additional information. This discussion also contains non-GAAP financial measures. Please refer to Item 6 of this Annual Report on Form 10-K for reconciliations of these non-GAAP measures and additional information.

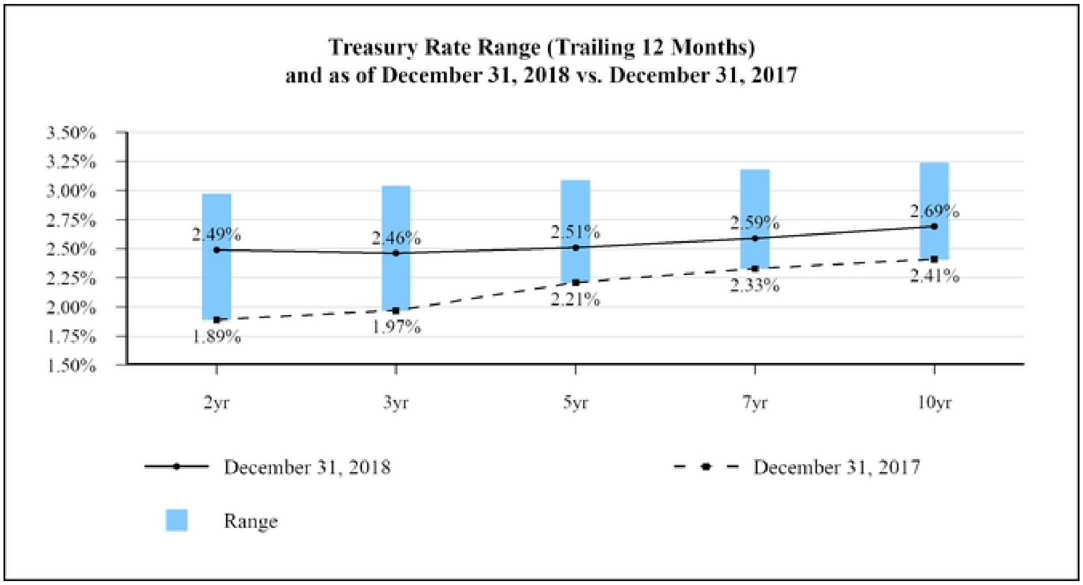
For a complete description of our business including our operating policies, investment philosophy and strategy, financing and hedging strategies, and other important information, please refer to Item 1 of Part I of this Annual Report on Form 10-K.

EXECUTIVE OVERVIEW

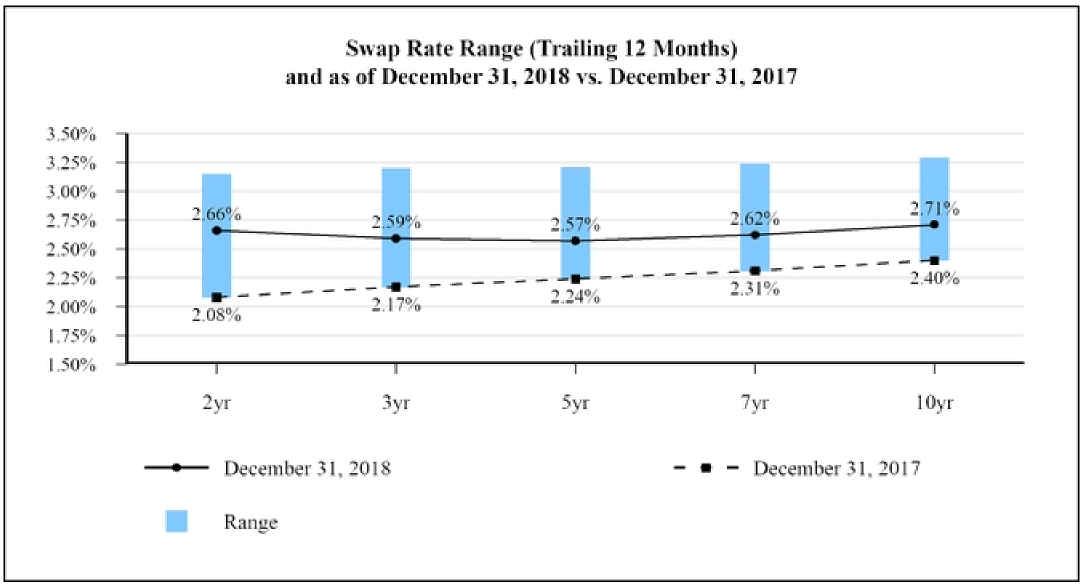
Our investment strategy of maintaining a diversified portfolio of residential and commercial MBS with higher liquidity and lower credit risk continued to benefit our shareholders in spite of a volatile and challenging global economic environment. During 2018, we were able to maintain steady quarterly dividends for our shareholders as we generated solid cash flow from our investment portfolio despite the 100-basis point increase in the U.S. Federal Funds rate and corresponding increases in our funding costs. Though we experienced a lower return environment and our book value declined throughout 2018, we were able to raise new capital and maintain strong liquidity into the fourth quarter when the most recent return of market volatility led to opportunities to invest capital at wider credit spreads and higher expected returns.

Though interest rates along the entire curve increased during 2018, longer-term interest rates were range bound while shorter-term interest rates rose in response to continued increases in the Federal Funds rate causing both the U.S. Treasury and swap curves to flatten during the year. Economic growth in the U.S. was steady and inflation remained well contained throughout the year, limiting the upward pressure on medium and long-term interest rates. In the fourth quarter of 2018, market participants grew increasingly concerned over the potential negative impact on economic growth from U.S. monetary and fiscal policy, causing credit spreads on risk assets to widen while Treasury and swap rates rallied. As a result of the wider credit spreads, the fair value of our MBS declined significantly late in the fourth quarter of 2018, causing the majority of the Company's loss of $(1.32) in its book value per common share during 2018, which ended the year at $6.02 per common share compared to $7.34 as of December 31, 2017.

The chart below shows the highest and lowest rates during the year ended December 31, 2018 as well as the rates as of December 31, 2018 and December 31, 2017 for the indicated U.S. Treasury securities:



The chart below shows the highest and lowest swap rates during the year ended December 31, 2018 as well as the swap rates as of December 31, 2018 and December 31, 2017:



A flattening yield curve puts pressure on our net interest spread because our repurchase agreement borrowing costs, which are based on short-term interest rates, increase faster than the interest income we earn on our investments. The table below shows the declines in net interest spread for the majority of our investments as a result of higher funding costs and the flatter yield curve:

	Agency MBS (1)			CMBS IO (2)		
Quarter Ended	Yield	Cost (3)	Net Interest Spread	Yield	Cost (3)	Net Interest Spread
December 31, 2018	3.28%	2.41%	0.87%	3.89%	2.99%	0.90%
September 30, 2018	3.12%	2.13%	0.99%	3.98%	2.76%	1.22%
June 30, 2018	2.94%	1.93%	1.01%	3.78%	2.59%	1.19%
March 31, 2018	2.85%	1.60%	1.25%	3.84%	2.33%	1.51%
December 31, 2017	2.77%	1.36%	1.41%	3.82%	2.13%	1.69%

(1) Includes Agency RMBS and CMBS.

(2) Includes Agency and non-Agency issued securities.

(3) Excludes net periodic interest benefit/cost of interest rate swaps used to economically hedge the interest rate risk of using repurchase agreement borrowings to finance our investments.

Summary of 2018 Results

For the year ended December 31, 2018, we reported a comprehensive loss to common shareholders of $(31.9) million, which consisted of net loss to common shareholders of $(4.8) million and other comprehensive loss of $(27.1) million. Higher interest rates and wider credit spreads drove larger declines in the fair value of our MBS (including TBAs) relative to the increases in the fair value of our derivative instruments used to hedge interest rate risk from our assets. Net unrealized losses on MBS of $(50.2) million and net realized losses on TBA dollar roll positions of $(10.7) million were partially offset by net realized gains of $7.3 million on our hedging instruments. Net interest income declined during 2018 to $50.5 million compared to $58.3 million during 2017 as the impact of the higher interest rate environment on our repurchase agreement borrowing costs outpaced the benefits of increased leverage and having a larger investment portfolio during 2018. The remainder of our net loss for 2018 was primarily comprised of general and administrative expenses of $(15.1) million and preferred dividends $(11.8) million. Please refer to "Results of Operations" within this Item 7 for further discussion of these components of comprehensive loss.

For the year ended December 31, 2017, we reported comprehensive income to common shareholders of $47.0 million, which was comprised of net income to common shareholders of $23.1 million and other comprehensive income of $23.9 million. Because the fair value of our financial instruments is influenced by market factors outside of management's control, it is difficult to compare our net income (loss) and comprehensive income (loss) with those same measures in other reporting periods, particularly those periods with significant market volatility. As such, management uses a non-GAAP measure, core net operating income to common shareholders, to evaluate and compare the Company's performance to prior periods because it excludes the impact of market volatility on the fair value of its financial instruments. Core net operating income to common shareholders was $42.3 million for the year ended December 31, 2018 compared to $37.0 million for the year ended December 31, 2017. We received a net benefit of $5.8 million on our interest rate swaps for the year ended December 31, 2018 compared to a net cost of $(3.4) million for the prior year, which partially offset the increase in our repurchase agreement borrowing costs mentioned above. In addition, TBA drop income increased $5.5 million due to a larger volume of TBA dollar roll transactions and general and administrative expenses decreased $(0.7) million for the year ended December 31, 2018 compared to the prior year. Please refer to "Non-GAAP Financial Measures" contained within Item 6 of this Annual Report on Form 10-K for additional important information regarding the Company's use of non-GAAP financial measures.

Management Outlook

As asset managers and investors of capital, we seek to assess the probability of events and to identify the most dominant factors that may ultimately influence the future path of economic activity, interest rates, and global asset prices. Today, we believe that we are in a lower return environment characterized by interest rates that will spend more time in a narrower range than in recent history. Fundamentally, we believe that increasing global debt, demographic trends, technology advances, and human conflict could keep the 10-year U.S. Treasury below 3.5% and within a broader range of 2% to 4% substantially into the future. As of February 15, 2019, negative interest rates on debt globally is trending higher again after trending lower since a peak in 2016. Additionally, there are multiple global factors that could rapidly force interest rates to and even below the lower bound of this narrower interest rate range.

Negative side effects of monetary policy tightening are already developing in the global economy and impacting global capital markets, which has limited the most recent rise in interest rates in the U.S. Markets have quickly repriced the expected number of Federal Funds rate increases for the remainder of this cycle. As tightening cycles end, typically the yield curve steepens, increasing returns on capital in marginal investment opportunities. Such a steepening may take a number of quarters to evolve, but even if the yield curve remains relatively flat, we anticipate that MBS will continue to provide attractive leveraged returns on investment capital during 2019.

Longer term, there are factors that management believes continue to favor our business model. An increasingly aging population worldwide continues to support a growing demand for cash yield which should favorably benefit long-term valuations of mortgage REITs. We believe securitized mortgage assets supported by the U.S. government are among the safest yielding investments in an uncertain global environment. In addition, as the Federal Reserve reduces its investment in Agency RMBS and if, as widely expected, the GSEs are reformed, we believe the need for private capital in the U.S. housing finance system will create new investment opportunities with attractive total return profiles. In the meantime, we believe our investment strategy of maintaining a diversified highly liquid, low credit risk portfolio allows us to generate solid cash flow while also providing us with flexibility to respond to surprising global events.

Market volatility experienced in the fourth quarter of 2018 has modestly subsided thus far in 2019, resulting in tighter credit spreads on Agency RMBS and CMBS, thereby improving our book value per common share since December 31, 2018. In addition, we raised approximately $46.1 million in capital at the end of January 2019 by closing a public offering of over 8 million shares of our common stock. The timing of this capital raise was crucial as it allowed us to deploy the proceeds into assets we believe will provide higher returns relative to the returns available in recent history.

CRITICAL ACCOUNTING POLICIES

The discussion and analysis of our financial condition and results of operations are based in large part upon our consolidated financial statements, which have been prepared in accordance with GAAP. The preparation of our consolidated financial statements requires management to make estimates, judgments and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and disclosure of contingent assets and liabilities. We base these estimates and judgments on historical experience and assumptions believed to be reasonable under current facts and circumstances. Actual results, however, may differ from the estimated amounts we have recorded.

Critical accounting policies are defined as those that require management's most difficult, subjective or complex judgments, and which may result in materially different results under different assumptions and conditions. The following discussion provides information on our accounting policies that require the most significant management estimates, judgments, or assumptions, or that management believes includes the most significant uncertainties, and are considered most critical to our results of operations or financial position.

Fair Value Measurements. Our Agency MBS, as well as a majority of our non-Agency MBS, are substantially similar to securities that either are actively traded or have been recently traded in their respective market. Pricing services and brokers have access to observable market information through trading desks and various information services. We receive a price evaluation for each of our MBS from a primary pricing service selected by the Company. To determine each security's valuation, the primary pricing service uses either a market approach or income approach, both of which rely on observable market data. The market approach uses prices and other relevant information that is generated by market transactions of identical or similar securities, while the income approach uses valuation techniques to convert estimated future cash flows to a discounted present value. Management reviews the assumptions and inputs utilized in the valuation techniques. Examples of these observable inputs and assumptions include market interest rates, credit spreads, and projected prepayment speeds, among other things. The Company compares the price received from its primary pricing service to other prices received from additional third-party pricing services and multiple broker quotes for reasonableness.

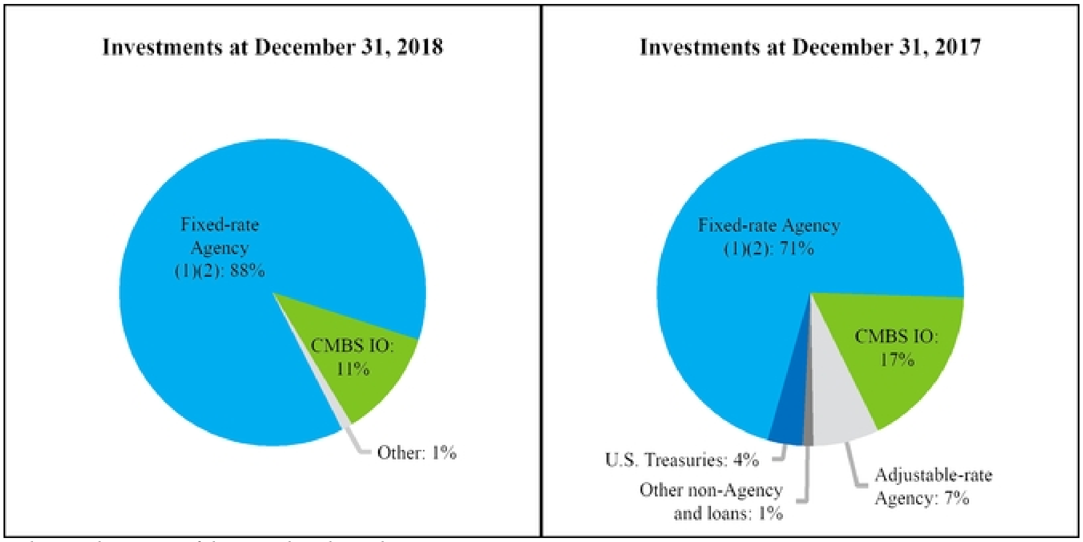
We typically receive a total of three to six bid-side prices from pricing services and brokers for each of our securities; prices obtained from brokers are not binding on either the broker or us. Management does not adjust the prices received, but, for securities on which we receive five or more prices, the high and low prices are excluded from the calculation of the average price. In addition, management reviews the prices received for each security by comparing those prices to actual purchase and sale transactions, our internally modeled prices that are calculated based on observable market rates and credit spreads, and the prices that our borrowing counterparties use in financing our securities. Management reviews prices which vary significantly from the pricing service and may exclude such prices from its calculation of fair value. The decision to exclude any price from use in the calculation of the fair values used in our consolidated financial statements is reviewed and approved by management independent of the pricing process. The average of the remaining prices received is used for the fair values included in our consolidated financial statements. If the price of a security is obtained from quoted prices for similar instruments or model-derived valuations whose inputs are observable, the security is classified as a level 2 security. The security is classified as a level 3 security if the inputs are unobservable, resulting in an estimate of fair value based primarily on management's judgment. As of December 31, 2018, less than 0.1% of our MBS are level 3 securities. Please refer to Note 5 of the Notes to our Consolidated Financial Statements contained within Part II, Item 8 of this Annual Report on Form 10-K for additional information on fair value measurements.

Other-than-Temporary Impairments. When the fair value of an available-for-sale security is less than its amortized cost as of the reporting date, the security is considered impaired. We assess our securities for impairment on at least a quarterly basis and determine if the impairments are either temporary or other-than-temporary. We assess our ability to hold any Agency MBS or non-Agency MBS with an unrealized loss until the recovery in its value. Our ability to hold any such MBS is based on our current investment strategy and significance of the related investment as well as our current leverage and anticipated liquidity. Although Fannie Mae and Freddie Mac are not explicitly backed by the full faith and credit of the United States, given their guarantee and commitments for support received from the Treasury as well as the credit quality inherent in Agency MBS, we do not typically consider any of the unrealized losses on our Agency MBS to be credit-related. For our non-Agency MBS, we review the credit ratings of these MBS and the seasoning of the mortgage loans collateralizing these securities as well as the estimated future cash flows, which include any projected losses, in order to evaluate whether we believe any portion of the unrealized loss at the reporting date is related to credit losses.

The determination as to whether an other-than-temporary impairment ("OTTI") exists, as well as its amount, is subjective, as such determinations are based not only on factual information available at the time of assessment but also on management's estimates of future performance and cash flow projections. As a result, the timing and amount of any OTTI may constitute a material estimate that is susceptible to significant change. Our expectations with respect to our securities in an unrealized loss position may change over time, given, among other things, the dynamic nature of markets and other variables. For example, if the GSEs suffer losses or cease to exist, our view of the credit worthiness of our Agency MBS could materially change, which may affect our assessment of OTTI for Agency MBS in future periods. Future sales or changes in our expectations with respect to Agency or non-Agency securities in an unrealized loss position could result in us recognizing other-than-temporary impairment charges or realizing losses on sales of MBS in the future.

FINANCIAL CONDITION

Our investment portfolio is comprised mostly of Agency fixed-rate investments. As of December 31, 2018, approximately 65% of our investments are 30-year Agency RMBS including TBA dollar roll positions, which we continue to invest in given their more favorable risk-return profile and current liquidity in the market versus other types of MBS. Approximately 23% of our investments are Agency CMBS, mainly in the multifamily sector. Relative to RMBS, CMBS have more predictable prepayment profiles and are therefore less costly to hedge. The following charts compare our portfolio investment allocations as of December 31, 2018 to December 31, 2017:



(1) Includes securities pending settlement as of the periods indicated.

(2) Includes net long positions in TBAs used for investment purposes at their implied market value as if settled. All TBAs are accounted for as "derivative assets (liabilities)" on our consolidated balance sheet.

The following table provides a summary of the amortized cost and fair value of our investment portfolio (including TBA dollar roll positions and securities pending settlement) used for investment purposes as of the dates indicated:

	December 31, 2018		December 31, 2017	
($ in thousands)	**Amortized Cost**	**Fair Value**	**Amortized Cost**	**Fair Value**
Agency RMBS, fixed-rate	$ 2,142,717	$ 2,124,810	$ 903,270	$ 898,678
TBAs, fixed-rate (1)	882,230	888,469	829,425	830,908
Agency RMBS, adjustable rate	32,666	33,211	289,304	285,583
Agency CMBS, fixed-rate	1,080,424	1,057,015	1,134,409	1,124,351
CMBS IO (2)	527,743	532,154	683,833	692,522
Non-Agency other (3)	1,859	2,274	23,536	25,855
U.S. Treasuries	—	—	148,267	146,530
Mortgage loans held for investment, net (4)	11,527	8,566	15,738	12,973
Total investment portfolio including TBA dollar roll positions	$ 4,679,166	$ 4,646,499	$ 4,027,782	$ 4,017,400

(1) Consists of long positions in TBAs used for investment purposes at their implied cost basis and implied market value, respectively, as if settled and excludes short positions in TBAs used for economic hedging purposes. All TBAs are accounted for as "derivative assets (liabilities)" on our consolidated balance sheet.

(2)

(3)

(4) Recorded on consolidated balance sheet at amortized cost.

The following table details the activity related to our MBS portfolio including TBA dollar roll positions during the year ended December 31, 2018:

($ in thousands)	Agency Fixed-Rate 30-Year RMBS (1) (2)	Agency Fixed-Rate CMBS	CMBS IO (3)	Agency Adjustable Rate RMBS	Non-Agency Other (4)	Total
Balance as of December 31, 2017	$ 1,729,586	$ 1,124,351	$ 692,522	$ 285,583	$ 25,855	$ 3,857,897
Purchases	1,396,408	235,897	4,780	—	—	1,637,085
Principal payments	(99,246)	(36,348)	—	(29,809)	(23,675)	(189,078)
Sales	—	(251,247)	(24,198)	(225,622)	—	(501,067)
(Amortization) accretion	(4,910)	(2,287)	(136,672)	(1,207)	1,998	(143,078)
Change in fair value	(8,559)	(13,351)	(4,278)	4,266	(1,904)	(23,826)
Balance as of December 31, 2018	$ 3,013,279	$ 1,057,015	$ 532,154	$ 33,211	$ 2,274	$ 4,637,933

(1) Includes securities pending settlement as of dates indicated.
(2) Includes long positions in TBAs used for investment purposes at their implied market value as if settled and excludes short positions in TBAs used for economic hedging purposes. All TBAs are accounted for as "derivative assets (liabilities)" on our consolidated balance sheet.
(3)
(4)

RMBS

The following table provides information on our Agency RMBS investments including securities pending settlement and TBA dollar roll positions as of the dates indicated:

	December 31, 2018						
				Weighted Average			
Coupon	**Par**	**Amortized Cost/ Implied Cost Basis (1)(3)**	**Fair Value (2)(3)**	**Original Loan Balance (4)**	**Loan Age (in months) (4)**	**3 Month CPR (4)(5)**	**Duration (6)**
		($ in thousands)					
30-year fixed-rate:							
3.0%	$ 223,573	$ 225,148	$ 218,286	$ 233,855	26	5.7%	5.66
4.0%	1,651,854	1,699,012	1,687,390	272,159	10	5.2%	4.06
4.5%	211,429	218,557	219,134	291,874	5	5.3%	2.48
TBA 4.0%	110,000	111,175	112,101	n/a	n/a	n/a	3.54
TBA 4.5%	750,000	771,055	776,368	n/a	n/a	n/a	2.61
Total 30-year fixed-rate	$ 2,946,856	$ 3,024,947	$ 3,013,279	$ 270,053	11	5.3%	3.67
Adjustable-rate:							
4.3% (7)	$ 31,782	$ 32,666	$ 33,211	$ 210,597	132	25.6%	0.52
Total Agency RMBS (including TBA dollar roll positions)	$ 2,978,638	$ 3,057,613	$ 3,046,490	$ 269,161	13	5.6%	3.63

	December 31, 2017						
				Weighted Average			
Coupon	**Par**	**Amortized Cost/ Implied Cost Basis (1)(3)**	**Fair Value (2)(3)**	**Original Loan Balance (4)**	**Loan Age (in months) (4)**	**3 Month CPR (4)(5)**	**Duration (6)**
		($ in thousands)					
30-year fixed-rate:							
3.0%	$ 244,374	$ 246,155	$ 244,818	$ 233,584	13	5.0%	6.30
4.0%	623,293	657,114	653,860	274,965	4	4.0%	3.91
TBA 4.0%	795,000	829,425	830,908	n/a	n/a	n/a	2.95
Total 30-year fixed-rate	$ 1,662,667	$ 1,732,694	$ 1,729,586	$ 263,310	6	4.3%	3.80
Adjustable-rate:							
3.1% (7)	$ 278,886	$ 289,305	$ 285,583	$ 271,516	74	16.0%	2.28
Total Agency RMBS (including TBA dollar roll positions)	$ 1,941,553	$ 2,021,999	$ 2,015,169	$ 265,306	23	7.1%	3.58

(1) Implied cost basis of TBA dollar roll positions represents the forward price to be paid for the underlying Agency MBS as if settled.

(2) Fair value of TBA dollar roll positions is the implied market value of the underlying Agency security as of the end of the period if settled.

(3) The net carrying value of TBA dollar roll positions, which is the difference between their implied market value and implied cost basis, was $6.2 million as of December 31, 2018 and $1.5 million as of December 31, 2017 and is included on the consolidated balance sheet within "derivative assets".

(4) TBA dollar roll positions are excluded from this calculation as they do not have a defined weighted-average loan balance or age until mortgages have been assigned to the pool.

(5) *Constant prepayment rate ("CPR") represents the 3-month CPR of Agency RMBS held as of date indicated. Securities with no prepayment history are excluded from this calculation.*
(6) *Duration measures the sensitivity of a security's price to the change in interest rates and represents the percent change in price of a security for a 100-basis point increase in interest rates. We calculate duration using third-party financial models and empirical data. Different models and methodologies can produce different estimates of duration for the same securities.*
(7) *Coupon of adjustable-rate Agency RMBS represents the weighted average coupon based on amortized cost.*

CMBS

The following table presents the par value, amortized cost, and weighted average months to estimated maturity of our CMBS investments as of the dates indicated by year of origination:

	December 31, 2018			December 31, 2017		
($ in thousands)	**Par Value**	**Amortized Cost**	**Months to Estimated Maturity (1)**	**Par Value**	**Amortized Cost**	**Months to Estimated Maturity (1)**
Year of Origination:						
2008 and prior	$ 20,302	$ 18,868	33	$ 34,065	$ 31,026	41
2009 to 2012	74,935	76,567	23	106,619	109,234	27
2013 to 2014	13,516	13,790	73	20,237	20,600	82
2015	210,679	212,755	97	468,296	469,657	103
2016	238,559	240,033	98	239,139	240,831	110
2017	280,530	283,567	106	282,112	285,527	118
2018	236,425	235,847	142	—	—	—
	$ 1,074,946	$ 1,081,427	102	$ 1,150,468	$ 1,156,875	99

(1) *Months to estimated maturity is an average weighted by the amortized cost of the investment.*

Because Agency CMBS are guaranteed by the GSEs with respect to return of principal, our credit exposure is limited to any unamortized premium remaining on those securities. The amortized cost of our non-Agency CMBS as of December 31, 2018 declined to $1.0 million compared to $22.5 million as of December 31, 2017 due to significant prepayment activity during 2018. The non-Agency CMBS remaining as of December 31, 2018 are comprised of securities collateralized by loans originated prior to 2000.

CMBS IO

As of December 31, 2018, our CMBS IO investments comprised approximately 11% of our total portfolio, of which approximately 55% are Agency-issued, relatively unchanged since December 31, 2017. Given supply-demand imbalances in CMBS IO markets, which have led to less attractive marginal returns, we have not actively purchased these securities in 2018.

Income earned from CMBS IO is based on interest payments received on the underlying commercial mortgage loan pools. Our return on these investments may be negatively impacted by any change in scheduled cash flows such as modifications of the mortgage loans or involuntary prepayments including defaults, foreclosures, and liquidations on or of the underlying mortgage loans prior to its contractual maturity date. In order to manage our exposure to credit performance, we generally invest in senior tranches of these securities and where we have evaluated the credit profile of the underlying loan pool and can monitor credit performance. In addition, to address changes in market fundamentals and the composition of mortgage loans collateralizing an investment, we consider the year of origination of the loans underlying CMBS IO in our selection of investments.

The following table presents our CMBS IO investments as of December 31, 2018 by year of origination:

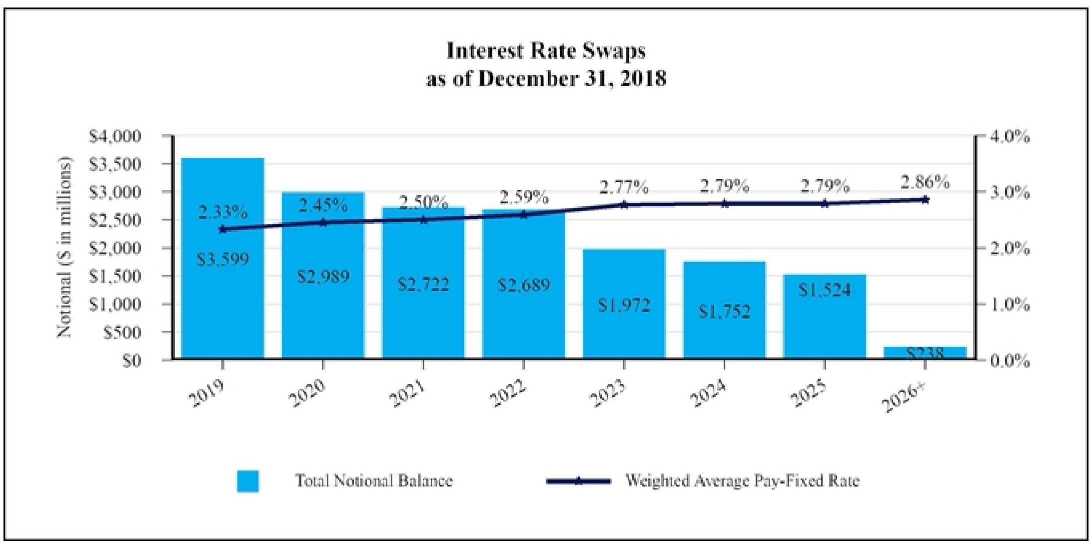
	December 31, 2018			December 31, 2017		
($ in thousands)	Amortized Cost	Fair Value	Remaining WAL [(1)]	Amortized Cost	Fair Value	Remaining WAL [(1)]
Year of Origination:						
2010	$ 3,493	$ 3,474	8	$ 6,421	$ 6,554	13
2011	16,542	17,295	13	25,652	26,720	18
2012	39,558	39,994	19	71,615	72,913	22
2013	72,649	73,073	22	103,730	104,568	28
2014	134,114	134,808	30	171,285	173,043	34
2015	143,163	144,673	35	170,663	172,974	40
2016	67,625	68,015	41	82,698	83,444	47
2017	46,125	46,336	48	51,769	52,306	53
2018	4,474	4,486	73	—	—	—
	$ 527,743	$ 532,154	32	$ 683,833	$ 692,522	36

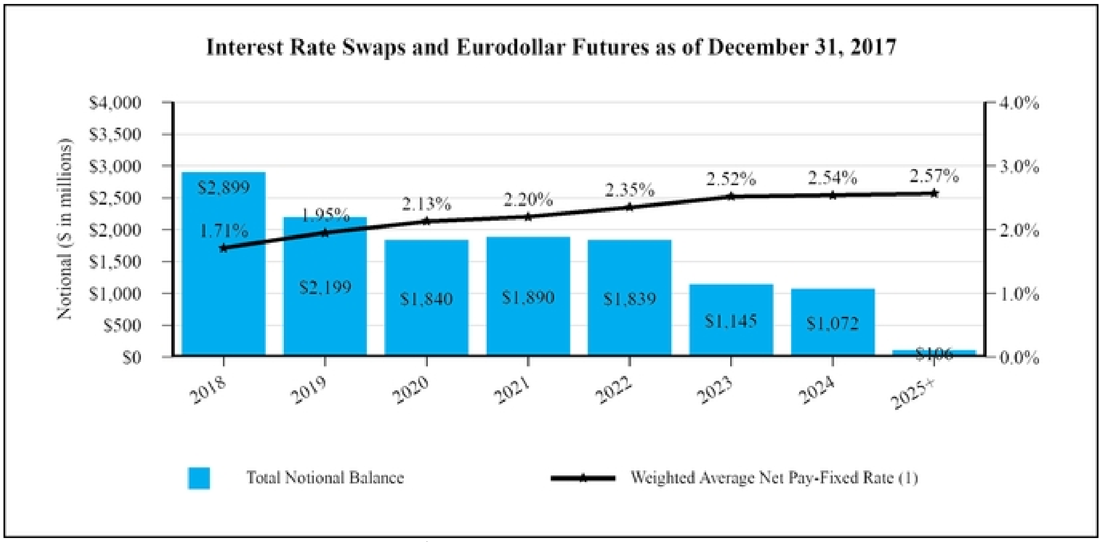
(1) Remaining weighted average life ("WAL") represents an estimate of the number of months of interest earnings remaining for the investments by year of origination.

Derivative Assets and Liabilities

We regularly monitor and adjust our hedging portfolio in response to many factors including, but not limited to, changes in our investment portfolio, shifts in the yield curve, and our expectations with respect to the future path of interest rates and interest rate volatility. Please refer to "Quantitative and Qualitative Disclosures about Market Risk" in Part I, Item 3 of this Annual Report on Form 10-K for more information.

Interest rate derivatives. As of December 31, 2018, we used interest rate swaps to hedge a portion of our earnings and book value exposure to fluctuations in interest rates. As of December 31, 2017, we held interest rate swaps as well as Eurodollar futures. The following graphs present the effective notional balance outstanding and weighted average net pay-fixed rate for our interest rate derivatives outstanding as of the periods indicated:





(1) Includes one receive-fixed interest rate swap at a notional amount of $100.0 million with a receive-fixed rate of 1.70% as of December 31, 2017.

During the year ended December 31, 2018, we added interest rate swaps with a combined notional balance of $1.8 billion at a weighted average net pay-fixed rate of 2.97% in order to increase our protection from rising short-term interest rates. We had interest rate swaps with a notional balance of $2.4 billion and a weighted average pay-fixed rate of 1.32% mature during the twelve months ended December 31, 2018. During that same period, we realized a gain of $7.2 million from terminated interest rate swaps with a notional balance of $0.7 billion and realized a gain of $2.6 million for Eurodollar futures with a notional balance of $2.0 billion that matured during that same period.

During the year ended December 31, 2018, we terminated options on U.S. Treasury futures with an aggregate notional balance of $800.0 million, for which we realized a loss of $0.7 million. We entered the options to enhance returns if interest rates decline while limiting our downside to the premium paid if interest rates increase. Additionally, during the twelve months ended December 31, 2018, we added U.S. Treasury futures with an aggregate notional balance of $0.5 billion and terminated $0.4 billion with a realized loss of $3.4 million. Utilizing U.S. Treasury futures and options on U.S. Treasury futures enabled us to mitigate the impact of interest rate changes on our tangible net asset value. In addition, these instruments provided economic advantages compared to other hedging alternatives given the market environment during the year.

TBAs. Please refer to “RMBS” above in this section of Part I, Item 2 for additional information about long positions in TBAs, or TBA dollar roll positions, which are used as a means of investing in and financing fixed-rate Agency RMBS. We may also periodically enter into short positions in TBAs to partially hedge the impact of adverse changes in interest rates on the fair value of our fixed-rate Agency RMBS. We did not hold any short positions in TBA securities as of December 31, 2018. As of December 31, 2017, we held one TBA short position with a coupon of 3.5% and an implied cost basis (if settled) of $(153.8) million, which is included in our derivative liabilities at that date at its net carrying value of $(0.3) million.

Repurchase Agreements

The majority of our repurchase agreement borrowings are collateralized with Agency MBS which have historically had lower liquidity risk than non-Agency MBS. As of December 31, 2018, all non-Agency MBS pledged as collateral for repurchase agreements were CMBS IO, of which approximately 82% are rated AAA and less than 4% are rated A or below. As of December 31, 2017, approximately 77% of non-Agency MBS pledged as collateral for repurchase agreements were CMBS IO rated AAA and less than 11% were CMBS and CMBS IO rated A or below. Please refer to Note 3 of the Notes to the Consolidated Financial Statements contained within this Annual Report on Form 10-K as well as “Results of Operations” and “Liquidity and Capital Resources” contained within this Item 2 for additional information relating to our repurchase agreement borrowings.

Shareholder's Equity

During the year ended December 31, 2018, we issued 65.9 thousand shares of Series B Preferred Stock under our preferred stock ATM program at a discount of approximately 3% to the par value of $25.00 per share. Cash proceeds were $1.6 million, net of 1.5% broker commissions and other fees. We also issued 6.8 million shares of common stock pursuant to our ATM common stock program during 2018 for net cash proceeds of $41.7 million at an average share price of $6.21. We typically use the cash proceeds from these capital raises in combination with repurchase agreement borrowings to purchase additional interest earning assets for our investment portfolio. Please refer to Note 11 of the Notes to the Consolidated Financial Statements contained within this Annual Report on Form 10-K for information regarding a public offering and sale of common stock subsequent to December 31, 2018.

We recorded other comprehensive loss of $(27.1) million for the year ended December 31, 2018 related primarily to declines in fair value of our available-for-sale debt securities. The decline in fair value for the majority of our MBS was primarily the result of increasing interest rates throughout 2018 and widening credit spreads during the fourth quarter of 2018. The following table includes detail of the accumulated other comprehensive income (loss) position and change in fair value by type of debt security as of and for the periods indicated:

($ in thousands)	Accumulated Other Comprehensive (Loss) Income As of December 31, 2017	Other Comprehensive (Loss) Income (1) For the Year Ended December 31, 2018	Accumulated Other Comprehensive (Loss) Income As of December 31, 2018
Fixed-rate Agency RMBS	$ (4,592)	$ (13,315)	$ (17,907)
Adjustable-rate Agency RMBS	(3,721)	4,266	545
Agency CMBS	(10,058)	(13,351)	(23,409)
CMBS IO (2)	8,689	(4,278)	4,411
Non-Agency other (3)	2,319	(1,904)	415
U.S. Treasuries	(1,737)	1,737	—
De-designated cash flow hedges	403	(237)	166
Total	$ (8,697)	$ (27,082)	$ (35,779)

(1) Includes amounts reclassified from accumulated other comprehensive loss into net income as "gain (loss) on sale of investments, net" as well as amounts reclassified into "interest expense" related to the accretion of the balance remaining in accumulated other comprehensive loss as a result of the Company's discontinuation of cash flow hedge accounting effective June 30, 2013.
(2)
(3)

RESULTS OF OPERATIONS

The discussions below provide information on certain items on our consolidated statements of comprehensive income. These discussions include both GAAP and non-GAAP financial measures which management utilizes in its internal analysis of financial and operating performance. Please read the section "Non-GAAP Financial Measures" at the end of "Executive Overview" in Item 2 of this Annual Report on Form 10-K for additional important information about these measures.

Year Ended December 31, 2018 Compared to Year Ended December 31, 2017

Net Interest Income for the Year Ended December 31, 2018 Compared to the Year Ended December 31, 2017

Net interest income and net interest spread declined for the year ended December 31, 2018 compared to the same period in 2017 due to higher borrowing costs as a result of significant increases in short-term interest rates and lower prepayment penalty compensation and discount accretion on our CMBS and CMBS IO during the year ended December 31, 2018. The following table presents certain information about our interest-earning assets and interest-bearing liabilities and their performance for the year ended December 31, 2018 and December 31, 2017:

($ in thousands)	Year Ended December 31, 2018 Interest Income/Expense	2018 Average Balance (1)(2)	2018 Effective Yield/ Cost of Funds (3)(4)	2017 Interest Income/Expense	2017 Average Balance (1)(2)	2017 Effective Yield/ Cost of Funds (3)(4)
Interest-earning assets:						
Agency RMBS-fixed rate	$ 44,017	$ 1,325,261	3.32 %	$ 5,995	$ 200,908	2.98 %
Agency CMBS-fixed rate	30,053	1,033,094	2.87 %	35,011	1,234,913	2.80 %
Agency RMBS-adjustable rate	3,472	151,273	2.30 %	13,276	773,331	1.72 %
CMBS IO (5)	25,987	606,280	4.29 %	32,177	736,773	4.37 %
Non-Agency other (6)	2,644	7,806	33.87 %	6,198	60,162	10.30 %
U.S. Treasuries	2,012	82,136	2.45 %	616	28,848	2.14 %
Other investments (7)	1,866	13,792	4.21 %	1,229	17,437	4.01 %
Total:	$ 110,051	$ 3,219,642	3.37 %	$ 94,502	$ 3,052,372	3.06 %
Interest-bearing liabilities:						
Repurchase agreements	$ 59,674	$ 2,730,295	2.16 %	$ 36,345	$ 2,691,650	1.33 %
Non-recourse collateralized financing	137	4,560	2.97 %	101	5,951	1.68 %
De-designated cash flow hedge accretion (8)	(237)	n/a	(0.01)%	(268)	n/a	(0.01)%
Total:	$ 59,574	$ 2,734,855	2.15 %	$ 36,178	$ 2,697,601	1.32 %
Net interest income/net interest spread	$ 50,477		1.22 %	$ 58,324		1.74 %

(1) *Average balance for assets is calculated as a simple average of the daily amortized cost and excludes unrealized gains and losses as well as securities pending settlement if applicable.*

(2) *Average balance for liabilities is calculated as a simple average of the daily borrowings outstanding during the period.*

(3) *Effective yield is calculated by dividing the sum of gross interest income and scheduled premium amortization/discount accretion (both of which are annualized for any reporting period less than 12 months) and prepayment compensation and premium amortization/discount accretion adjustments (collectively, "prepayment adjustments"), which are not annualized, by the average balance of asset type outstanding during the reporting period.*

(4) *Cost of funds is calculated by dividing annualized interest expense by the total average balance of borrowings outstanding during the period with an assumption of 360 days in a year.*

(5)

(6)

(7) *Interest income for other investments consists of $583 thousand from mortgage loans held for investment, net and $1,283 thousand from cash and cash equivalents for the year ended December 31, 2018 compared to $698 thousand and $531 thousand for the year ended December 31, 2017, respectively. Average balances and yields shown for other investments includes amortized cost of mortgage loans held for investment and excludes cash.*

(8)

Interest income increased $15.5 million for the year ended December 31, 2018 compared to the same period in 2017 due to the growth in the average interest earning assets in our portfolio, particularly into higher yielding 30-year fixed-rate Agency RMBS. Interest expense increased $23.4 million for the year ended December 31, 2018 compared to the same period in 2017 due to higher borrowing rates on our repurchase agreements. Our borrowing rates are based primarily on one-month LIBOR which averaged approximately 2.02% during the year ended December 31, 2018 compared to an average of 1.11% for the same period in 2017.

Rate/Volume Analysis. The following table presents the estimated impact on our net interest income due to changes in rate (effective yield/cost of funds) and changes in volume (average balance) of our interest-earning assets and interest-bearing liabilities for the periods indicated:

	Year Ended December 31, 2018 Compared to December 31, 2017			
	Increase (Decrease) Due to Change In			Total Change in Interest Income/Expense
($ in thousands)	Rate	Volume	Prepayment Adjustments (1)	
Interest-earning assets:				
Agency RMBS-fixed rate	$ 4,473	$ 33,549	$ —	$ 38,022
Agency CMBS-fixed rate	825	(5,619)	(164)	(4,958)
Agency RMBS-adjustable rate	500	(12,093)	1,789	(9,804)
CMBS IO (2)	45	(4,867)	(1,368)	(6,190)
Non-Agency other (3)	855	(3,542)	(867)	(3,554)
Treasuries	258	1,138	—	1,396
Other investments (4)	36	601	—	637
Total increase (decrease) in interest income	$ 6,992	$ 9,167	$ (610)	$ 15,549
Interest-bearing liabilities:				
Repurchase agreements	$ 22,485	$ 844	$ —	$ 23,329
Non-recourse collateralized financing, net of other (5)	109	(42)	—	67
Total increase in interest expense	22,594	802	—	23,396
Total net change in net interest income	$ (15,602)	$ 8,365	$ (610)	$ (7,847)

(1) Prepayment adjustments represent effective interest amortization adjustments related to changes in actual and projected prepayment speeds for adjustable-rate RMBS and prepayment compensation, net of amortization adjustments for CMBS and CMBS IO and are not annualized in the calculation of effective yield.

(2) Includes Agency and non-Agency issued securities.

(3) Includes privately-issued RMBS and CMBS.

(4) Increase of $752 thousand in other interest income from cash and cash equivalents is included as a change in volume.

(5) Decrease of $31 thousand in de-designated cash flow hedge accretion is included as a change in rate.

The increase of $7.0 million in interest income due to rate is primarily related to our sales and pay downs of lower yielding MBS across most asset classes since December 31, 2017, which resulted in the average effective yield increasing for the remaining securities in our portfolio for the year ended December 31, 2018 compared to the same period in 2017. The proceeds from those sales and pay downs have been predominantly reinvested into higher yielding fixed-rate Agency RMBS since December 31, 2017. The average effective yield for CMBS IO declined 8 basis points, which was primarily due to lower prepayment penalty compensation during the year ended December 31, 2018 compared to the same period in 2017.

Adjusted Net Interest Income for the Year Ended December 31, 2018 Compared to the Year Ended December 31, 2017

Management includes drop income from TBA dollar roll transactions and net periodic interest benefit (cost) of interest rate swaps in a non-GAAP financial measure "adjusted net interest income" when evaluating the economic performance of its investments and financings. Please refer to "Non-GAAP Financial Measures" of Item 6 of this Annual Report on Form 10-K for additional information and a reconciliation of this non-GAAP measure.

Adjusted net interest income increased $6.9 million for the year ended December 31, 2018 compared to the same period in 2017 primarily because we received a net periodic interest benefit from interest rate swaps of $5.8 million for the year ended December 31, 2018 compared to a net cost of $(3.4) million for the year ended December 31, 2017. The floating rate we receive on the majority of our pay-fixed interest rate swaps is based on 3-month LIBOR which averaged approximately 2.31% for the year ended December 31, 2018 compared to 1.26% for the same period in 2017. Please refer to "(Loss) Gain on Derivatives, Net" below for additional information regarding our interest rate swaps.

In addition, higher TBA drop income due to a larger volume of TBA dollar roll transactions contributed to the increase in our adjusted net interest income for the year ended December 31, 2018 compared to the same period in 2017. The following table summarizes information related to our drop income from TBA dollar roll transactions for the periods indicated:

	Year Ended December 31,				Year Ended December 31, 2018 Compared to Year Ended December 31, 2017		
	2018		2017			Due to Change In	
($ in thousands)	Amount	Average Yield/Cost	Amount	Average Yield/Cost	Total Change	Rate	Volume
TBA implied interest income [(1)]	$ 31,335	3.63%	$ 15,162	3.01%	$ 16,173	$ 5,463	$ 10,710
TBA implied interest expense [(2)]	16,649	1.93%	5,984	1.19%	10,665	6,438	4,227
TBA drop income/net yield [(3)]	$ 14,686	1.70%	$ 9,178	1.82%	$ 5,508	$ (975)	$ 6,483
Average amortized cost basis	$ 861,483		$ 504,859				

(1) *Average yield for TBA dollar roll positions is extrapolated by adding average cost (see footnote 2) to the net yield (see footnote 3). Implied interest income is calculated by multiplying the average yield by the TBA cost basis outstanding during the period.*

(2) *Average funding cost for TBA dollar roll positions is determined using the "price drop" between the near settling TBA contract and the price for the same contract with a later settlement date and market-based assumptions regarding the "cheapest-to-deliver" collateral that can satisfy the TBA contract, such as the security's coupon, maturity, and projected prepayment rate anticipated for the collateral. TBA implied interest expense is calculated by multiplying the average funding cost by the average TBA cost basis outstanding during the period.*

(3) *TBA net yield is calculated by dividing drop income by the average TBA cost basis outstanding during the period.*

(Loss) Gain on Derivative Instruments, Net

Changes in the fair value of derivative instruments and net periodic interest costs are impacted by changing market interest rates and adjustments that we may make to our derivative positions in any given period. Because of the changes made to our derivatives portfolio from one reporting period to the next, results of any given reporting period are generally not comparable to results of another.

The following table provides information on our financial instruments accounted for as derivative instruments for the periods indicated:

($ in thousands)	Year Ended December 31, 2018	Year Ended December 31, 2017
Interest rate derivatives:		
Interest rate swaps:		
Net periodic interest benefit (cost)	$ 5,830	$ (3,417)
Change in fair value (1)	4,533	785
Total interest rate swap gains (losses), net	10,363	(2,632)
U.S. Treasury and Eurodollar futures:		
Change in fair value (1)	(2,722)	821
TBA short positions (economic hedges):		
Change in fair value (2)	293	(902)
Total interest rate derivative gains (losses), net	7,934	(2,713)
TBA dollar roll positions:		
TBA drop income	14,686	9,178
Change in fair value (2)	(25,423)	(3,421)
Total TBA dollar roll (losses) gains, net	(10,737)	5,757
Other derivatives:		
Options on U.S. Treasury futures	(658)	—
Total gain (loss) on derivative instruments, net	$ (3,461)	$ 3,044

(1) Changes in fair value for interest rate swaps and Eurodollar futures include unrealized gains (losses) from current and forward starting derivative instruments and realized gains (losses) from terminated derivative instruments.

(2) Changes in fair value for TBA positions include unrealized gains (losses) from open TBA contracts and realized gains (losses) on paired off or terminated positions.

Loss on derivative instruments, net for the year ended December 31, 2018 included net realized gains of $7.2 million on interest rate swaps terminated during the year and a net realized loss of $(0.8) million on Eurodollar and U.S. Treasury futures that matured during 2018. The decline in fair value of TBA dollar roll positions of $(10.7) million was driven primarily by the increase in interest rates during 2018 and is comprised of a net realized loss of $(15.5) million and a net unrealized gain of $4.8 million. For the year ended December 31, 2017, gain (loss) on derivative instruments, net included $(6.0) million of net losses on terminated interest rate swaps with a net notional balance of $1.1 billion and $3.6 million of net gains on TBAs that were realized during the year.

During 2018, we maintained our interest rate swap hedge position at approximately 80% of our average borrowings and net TBAs outstanding as shown in the table below. The floating rate we receive on the majority of our pay-fixed interest rate swaps is based on 3-month LIBOR which increased to an average of 2.31% during the year ended December 31, 2018 compared to 1.26% for the year ended December 31, 2017. As a result, we earned a net periodic interest benefit of $5.8 million from our interest rate swaps during 2018 compared to a net periodic interest cost of $(3.4) million during 2017, which partially offset the increase in our interest expense from higher interest rates on our repurchase agreement borrowings. The following table provides details on the effective interest rate swaps outstanding during the periods indicated:

($ in thousands)	Year Ended December 31, 2018	2017
Average repurchase agreement borrowings outstanding	$ 2,730,295	$ 2,691,650
Average net TBAs outstanding - at cost (1)	845,931	498,059
Average borrowings and net TBAs outstanding	3,576,226	3,189,709
Average notional amount of interest rate swaps outstanding (excluding forward starting swaps)	2,863,877	2,409,918
Ratio of average interest rate swaps to average borrowings and net TBAs outstanding (1)	0.8	0.8
Average interest rate swap net pay-fixed rate (excluding forward starting swaps) (2)	1.95 %	1.38%
Average interest rate swap net receive-floating rate (2)	2.12 %	1.22%
Average interest rate swap net pay/(receive) rate	(0.17)%	0.16%

(1) Because the Company executes TBA dollar roll transactions, which economically represent the purchase and financing of fixed-rate Agency RMBS, the average TBAs outstanding are included in the ratio calculation.

(2) Net rates include receive-fixed (pay-floating) interest rate swaps.

As mentioned in "Financial Condition" of this Annual Report on Form 10-K, we hold long positions in TBA securities which management views as economically equivalent to investing in and financing Agency RMBS using short-term repurchase agreements. We execute a series of transactions which effectively delay the settlement of a forward purchase of a non-specified Agency RMBS by entering into an offsetting TBA short position, net settling the paired-off positions in cash, and simultaneously entering into an identical TBA long position with a later settlement date. A portion of the total change in fair value of TBAs is referred to by management as "drop income (loss)" and is calculated as the difference in price between the TBA security purchased for a forward settlement month and the price of a TBA security sold for settlement in the current month times its notional amount.

Loss on Sale of Investments, Net

Sales of our investments occur in the ordinary course of business as we manage our risk, capital and liquidity profiles, and as we reallocate capital to various investments. The following tables provide information related to our loss on sale of investments, net for the periods indicated:

	Year Ended December 31, 2018		2017	
($ in thousands)	Amortized cost basis sold	(Loss) gain on sale of investments, net	Amortized cost basis sold	(Loss) gain on sale of investments, net
Agency RMBS	$ 225,622	$ (7,785)	$ 728,952	$ (12,392)
Agency CMBS	251,247	(9,218)	252,759	(135)
Agency CMBS IO	15,554	146	—	—
Non-Agency CMBS IO	8,644	51	—	—
Non-Agency CMBS	—	—	34,506	1,199
Non-Agency RMBS	—	—	16,365	42
U.S. Treasuries	255,370	(6,567)	52,041	(244)
	$ 756,437	$ (23,373)	$ 1,084,623	$ (11,530)

During the years ended December 31, 2018 and December 31, 2017, we sold a significant portion of our investment portfolio in anticipation of higher interest rates and a flattening yield curve. Included in these sales was a majority of our adjustable-rate Agency RMBS, which generally underperform in a flat yield curve environment, and certain Agency CMBS which were either expected to mature in the near term or had lower weighted average coupons than newer issue Agency CMBS. We also sold an Agency CMBS which had a relatively larger principal balance with higher liquidity risk due to its margin call requirements in the event of prepayment. The sale of U.S. Treasuries in 2017 and 2018 was to reallocate capital principally into higher yielding Agency fixed-rate RMBS. During the year ended December 31, 2017, we also sold approximately half of our non-Agency CMBS investments because their risk-adjusted returns were lower relative to fixed-rate Agency RMBS and sold the majority of our non-Agency RMBS because these investments were generally within a year of their expected maturity.

General and Administrative Expenses

General and administrative expenses decreased $0.7 million for the year ended December 31, 2018 compared to the year ended December 31, 2017. Compensation and benefits expense declined $1.9 million primarily due to lower bonus and stock-based compensation expense based on Company performance for 2018 versus 2017. Partially offsetting that decline was a $1.2 million increase in other general and administrative expenses primarily related to the litigation discussed in Part I, Item 3, "Legal Proceedings" as well as higher information technology and consulting expenses.

Other Comprehensive (Loss) Income

The following table provides detail on the changes in fair value by type of available-for-sale investment which are recorded as unrealized gains (losses) in other comprehensive income on our consolidated statements of operations for the periods indicated:

	Year Ended December 31,	
($ in thousands)	**2018**	**2017**
Fixed-rate Agency RMBS	$ (13,315)	$ (4,592)
Adjustable-rate Agency RMBS	4,266	9,398
Agency CMBS	(13,351)	12,238
CMBS IO [(1)]	(4,278)	12,035
Non-Agency other [(2)]	(1,904)	(3,162)
U.S. Treasuries	1,737	(1,737)
Unrealized (loss) gain on available-for-sale investments	(26,845)	24,180
Reclassification adjustment for de-designated cash flow hedges	(237)	(268)
Total other comprehensive (loss) income	$ (27,082)	$ 23,912

(1)
(2)

During the year ended December 31, 2018, we recorded a net unrealized loss of $(26.8) million on our available-for-sale investments which declined in fair value primarily as a result of increasing interest rates throughout 2018 and widening credit spreads during the fourth quarter of 2018.

During the year ended December 31, 2017, we recorded a net unrealized gain of $24.2 million on our available-for-sale investments because the fair value of our Agency CMBS as well as our CMBS IO were favorably impacted by credit spread tightening, which more than offset unfavorable impacts on our investments from increasing interest rates.

Year Ended December 31, 2017 Compared to Year Ended December 31, 2016

Net Interest Income for the Year Ended December 31, 2017 Compared to the Year Ended December 31, 2016

The following table presents certain information about our interest-earning assets and interest-bearing liabilities and their performance for the periods indicated:

	Year Ended December 31,					
	2017			2016		
($ in thousands)	Interest Income/Expense	Average Balance (1)(2)	Effective Yield/ Cost of Funds (3)(4)	Interest Income/Expense	Average Balance (1)(2)	Effective Yield/ Cost of Funds (3)(4)
Interest-earning assets:						
Agency RMBS-fixed rate	$ 5,995	$ 200,908	2.98 %	$ —	$ —	— %
Agency CMBS-fixed rate	35,011	1,234,913	2.80 %	27,447	917,404	2.95 %
Agency RMBS-adjustable rate	13,276	773,331	1.72 %	23,788	1,393,328	1.71 %
CMBS IO (5)	32,177	736,773	4.37 %	31,067	746,458	4.16 %
Non-Agency other (6)	6,198	60,162	10.30 %	8,647	157,707	5.48 %
U.S. Treasuries	616	28,848	2.14 %	—	—	— %
Other investments (7)	1,229	17,437	4.01 %	949	22,006	3.89 %
Total:	$ 94,502	$ 3,052,372	3.06 %	$ 91,898	$ 3,236,903	2.82 %
Interest-bearing liabilities:						
Repurchase agreements	$ 36,345	$ 2,691,650	1.33 %	$ 24,191	$ 2,659,809	0.89 %
FHLB advances	—	—	— %	1,193	244,967	0.48 %
Non-recourse collateralized financing	101	5,951	1.68 %	98	7,650	1.27 %
De-designated cash flow hedge accretion (8)	(268)	n/a	(0.01)%	(251)	n/a	(0.01)%
Total:	$ 36,178	$ 2,697,601	1.32 %	$ 25,231	$ 2,912,426	0.85 %
Net interest income/net interest spread	$ 58,324		1.74 %	$ 66,667		1.97 %

(1) Average balance for assets is calculated as a simple average of the daily amortized cost and excludes unrealized gains and losses as well as securities pending settlement if applicable.

(2) Average balance for liabilities is calculated as a simple average of the daily borrowings outstanding during the period.

(3) Effective yield is calculated by dividing the sum of gross interest income and scheduled premium amortization/discount accretion (both of which are annualized for any reporting period less than 12 months) and prepayment compensation and premium amortization/discount accretion adjustments (collectively, "prepayment adjustments"), which are not annualized, by the average balance of asset type outstanding during the reporting period.

(4) Cost of funds is calculated by dividing annualized interest expense by the total average balance of borrowings outstanding during the period with an assumption of 360 days in a year.

(5)

(6)

(7) Interest income for other investments consists of $698 thousand from mortgage loans held for investment, net and $531 thousand from cash and cash equivalents for the year ended December 31, 2017 compared to $856 thousand and $93 thousand for the year ended December 31, 2016, respectively. Average balances and yields shown for other investments includes amortized cost of mortgage loans held for investment and excludes cash.

(8)

Interest income and effective yields on our total MBS portfolio for the year ended December 31, 2017 increased compared to the year ended December 31, 2016 primarily due to higher prepayment penalty income from CMBS and CMBS IO. Interest income and effective yields on MBS also increased overall as a result of our shift in investment strategy to higher yielding 30-year fixed-rate securities.

Increases in interest expense for the year ended December 31, 2017 compared to the same periods in 2016 were due to higher borrowing rates on our repurchase agreements. Our borrowing rates are based primarily on one-month LIBOR which increased approximately 79 basis points from December 31, 2016 to December 31, 2017.

During the fourth quarter of 2017, we purchased U.S. Treasuries which yielded 2.14% on an average balance of $114.5 million outstanding during the quarter. These highly liquid securities allow us a low-cost method of earning a return on available cash without increasing spread risk while monitoring the availability of higher yielding MBS with attractive risk/return profiles. We did not own any U.S. Treasuries prior to these fourth quarter 2017 purchases.

Rate/Volume Analysis. The following table presents the estimated impact on our net interest income due to changes in rate (effective yield/cost of funds) and changes in volume (average balance) of our interest-earning assets and interest-bearing liabilities for the periods indicated:

	Year Ended December 31, 2017 Compared to December 31, 2016			
	Increase (Decrease) Due to Change In			Total Change in Interest Income/Expense
($ in thousands)	Rate	Volume	Prepayment Adjustments (1)	
Interest-earning assets:				
Agency RMBS-fixed rate	$ —	$ 5,995	$ —	$ 5,995
Agency CMBS-fixed rate	51	7,557	(40)	7,568
Agency RMBS-adjustable rate	357	(11,069)	200	(10,512)
CMBS IO (2)	(350)	(364)	1,824	1,110
Non-Agency other (3)	(2)	(3,957)	1,506	(2,453)
Treasuries	—	616	—	616
Other investments (4)	21	256	3	280
Total increase (decrease) in interest income	$ 77	$ (966)	$ 3,493	$ 2,604
Interest-bearing liabilities:				
Repurchase agreements and FHLB advances	$ 12,807	$ (1,846)	$ —	$ 10,961
Non-recourse collateralized financing, net of other (5)	(14)	—	—	(14)
Total increase (decrease) in interest expense	12,793	(1,846)	—	10,947
Total net change in net interest income	$ (12,716)	$ 880	$ 3,493	$ (8,343)

(1) Prepayment adjustments represent effective interest amortization adjustments related to changes in actual and projected prepayment speeds for adjustable-rate RMBS and prepayment compensation, net of amortization adjustments for CMBS and CMBS IO and are not annualized in the calculation of effective yield.

(2) Includes Agency and non-Agency issued securities.

(3) Includes privately-issued RMBS and CMBS.

(4) Increase of $438 thousand in other interest income from cash and cash equivalents is included as a change in volume.

(5) Includes increase of $17 thousand in de-designated cash flow hedge accretion as a change in rate.

Net interest income and net interest spread declined during the year ended December 31, 2017 due to higher borrowing costs compared to the year ended December 31, 2016. Higher borrowings costs were partially mitigated by the increase in interest income for the year ended December 31, 2017 compared to the year ended December 31, 2016, which primarily resulted from higher prepayment penalty income from CMBS and CMBS IO as well as our replacement of lower yielding adjustable-rate RMBS with higher yielding fixed-rate MBS during 2017.

Adjusted Net Interest Income for the Year Ended December 31, 2017 Compared to the Year Ended December 31, 2016

Adjusted net interest income remained relatively stable at $63.8 million for the year ended December 31, 2017 compared to $64.0 million for the year ended December 31, 2016. The increase in repurchase agreement borrowing costs and net periodic interest costs were partially offset by $9.2 million in drop income from TBA dollar roll positions generated during the year ended December 31, 2017. Please refer to "Non-GAAP Financial Measures" in Item 6 of this Annual Report on Form 10-K for a reconciliation of this non-GAAP measure.

Gain (Loss) on Derivative Instruments, Net

Changes in the fair value of derivative instruments and net periodic interest costs are impacted by changing market interest rates and adjustments that we may make to our derivative positions in any given period. Because of the changes made to our derivatives portfolio from one reporting period to the next, results of any given reporting period are generally not comparable to results of another.

The following table provides information on our financial instruments accounted for as derivative instruments for the periods indicated:

	Year Ended December 31,	
($ in thousands)	**2017**	**2016**
Interest rate derivatives:		
Interest rate swaps:		
Net periodic interest costs	$ (3,417)	$ (2,461)
Change in fair value (1)	785	1,670
Total interest rate swap gains (losses), net	(2,632)	(791)
Eurodollar futures:		
Change in fair value (1)	821	(4,815)
TBA short positions (economic hedges):		
Change in fair value (2)	(902)	—
Total interest rate derivative gains (losses), net	(2,713)	(5,606)
TBA dollar roll positions:		
TBA drop income	9,178	—
Change in fair value (2)	(3,421)	—
Total TBA dollar roll gains (losses), net	5,757	—
Total gain (loss) on derivative instruments, net	$ 3,044	$ (5,606)

(1) Changes in fair value for interest rate swaps and Eurodollar futures include unrealized gains (losses) from current and forward starting derivative instruments and realized gains (losses) from terminated derivative instruments.

(2) Changes in fair value for TBA positions include unrealized gains (losses) from open TBA contracts and realized gains (losses) on paired off or terminated positions.

Gain (loss) on derivative instruments, net for the year ended December 31, 2017 included $(6.0) million of net losses on interest rate swaps with a net notional balance of $1.1 billion that were terminated during 2017 and $3.6 million of net gains on TBAs that were realized during the year.

Net periodic interest costs from interest rate swaps increased primarily because our average notional balance of effective interest rate swaps outstanding during the year ended December 31, 2017 was $2.4 billion at a weighted average net pay-fixed rate of 1.38% compared to an average notional balance outstanding during the year ended December 31, 2016 of $0.5 billion at a weighted average net pay-fixed rate of 0.99%. All of our interest rate swaps are based on 3-month LIBOR which averaged 1.26% for the year ended December 31, 2017 compared to 0.74% for the same period in 2016.

As mentioned in "Financial Condition" of this Part II, Item 7 and in Part I, Item 1 of this Annual Report on Form 10-K, we hold long and short positions in TBA securities. Our long positions are viewed by management as economically equivalent to investing in and financing Agency RMBS using short-term repurchase agreements. We execute a series of transactions which effectively delay the settlement of a forward purchase of a non-specified Agency RMBS by entering into an offsetting TBA short position, net settling the paired-off positions in cash, and simultaneously entering into an identical TBA long position with a later settlement date. A portion of the total change in fair value of TBAs is referred to by management as "drop income (loss)" and is calculated as the difference in price between the TBA security purchased for a forward settlement month and the price of a TBA security sold for settlement in the current month times its notional amount.

We periodically enter into short positions in TBAs to hedge the impact of adverse changes in interest rates on the fair value of our fixed-rate Agency RMBS. Unlike long positions in TBAs in which we execute dollar roll transactions, we do not simultaneously enter into an identical TBA short position with a later settlement date when we pair off initial short positions. Therefore, short positions in TBAs used as economic hedges do not generate drop income (loss).

Loss on Sale of Investments, Net

Sales of our investments occur in the ordinary course of business as we manage our risk, capital and liquidity profiles, and as we reallocate capital to various investments. As mentioned previously, we have been reallocating our capital from adjustable-rate Agency RMBS to specified and non-specified pools of fixed-rate Agency RMBS, which we believe to be more liquid and less vulnerable to loss in book value from credit spread widening versus other investments in the current macroeconomic environment. The following tables provide information related to our loss on sale of investments, net for the periods indicated:

	Year Ended December 31,			
	2017		2016	
($ in thousands)	Amortized cost basis sold	(Loss) gain on sale of investments, net	Amortized cost basis sold	(Loss) gain on sale of investments, net
Agency RMBS	$ 728,952	$ (12,392)	$ 57,188	$ (3,010)
Agency CMBS	252,759	(135)	—	—
Non-Agency CMBS	34,506	1,199	34,868	(1,228)
Non-Agency RMBS	16,365	42	—	—
U.S. Treasuries	52,041	(244)	—	—
	$ 1,084,623	$ (11,530)	$ 92,056	$ (4,238)

We sold the majority of our investments in adjustable-rate Agency RMBS during the year ended December 31, 2017 as we expected these assets to underperform other asset classes in the then-current flat yield curve environment. In addition, we also sold certain Agency CMBS which were either expected to mature in the near term, had lower weighted average coupons than other Agency CMBS, or had a relatively larger principal balance with higher liquidity risk due to its margin call requirements in the event of prepayment. During the same period, we also sold approximately half of our non-Agency CMBS investments because their risk-adjusted returns were lower relative to fixed-rate Agency RMBS and sold the majority of our non-Agency RMBS because these investments were generally within a year of their expected maturity.

General and Administrative Expenses

General and administrative expenses increased to $15.8 million for the year ended December 31, 2017 compared to $14.7 million for the year ended December 31, 2016 due primarily to an increase of 13% in compensation and benefits expense resulting from higher bonus expenses for 2017 compared to 2016. During the year ended December 31, 2016, the Company did not achieve certain performance measures which resulted in lower bonus expenses during that period. Incentive compensation is based on meeting estimated annual performance measures and discretionary components and is granted to employees, including named executive officers.

Other Comprehensive Income (Loss)

The following table provides detail on the changes in fair value by type of available-for-sale investment which are recorded as unrealized gains (losses) in other comprehensive income on our consolidated statements of operations for the periods indicated:

	Year Ended December 31,	
($ in thousands)	**2017**	**2016**
Fixed-rate Agency RMBS	$ (4,592)	$ —
Adjustable-rate Agency RMBS	9,398	2,709
Agency CMBS	12,238	(16,640)
CMBS IO [1]	12,035	(5,790)
Non-Agency other [2]	(3,162)	131
U.S. Treasuries	(1,737)	—
Unrealized gain (loss) on available-for-sale investments	24,180	(19,590)
Reclassification adjustment for de-designated cash flow hedges	(268)	(251)
Total other comprehensive income (loss)	$ 23,912	$ (19,841)

(1)
(2)

During the year ended December 31, 2017, we recorded a net unrealized gain of $24.2 million on our available-for-sale investments because the fair value of our Agency CMBS as well as our CMBS IO were favorably impacted by credit spread tightening, which more than offset unfavorable impacts on our investments from increasing interest rates. During the year ended December 31, 2016, we recorded unrealized losses of $(19.6) million due to the overall increase in interest rates from December 31, 2015 to December 31, 2016, which occurred primarily in the fourth quarter of 2016.

LIQUIDITY AND CAPITAL RESOURCES

Our primary sources of liquidity include borrowings under repurchase arrangements and monthly principal and interest payments we receive on our investments. Additional sources may also include proceeds from the sale of investments, equity offerings, and payments received from counterparties from interest rate swap agreements and other derivative instruments. We use our liquidity to purchase investments and to pay our operating expenses and dividends on our common and preferred stock. We also use our liquidity to post initial and variation margins on our repurchase agreements and derivative transactions, including TBA contracts, when required under the terms of the related agreements. We may also use liquidity to repurchase shares of our common stock periodically.

Our liquidity fluctuates based on our investment activities, our financing and capital raising activities, and changes in the fair value of our investments and derivative instruments. We seek to maintain sufficient liquidity to support our operations and to meet our anticipated liquidity demands, including potential margin calls from lenders (as discussed further below). Our most liquid assets include unrestricted cash and cash equivalents and unencumbered Agency RMBS, CMBS, and CMBS IO. As of December 31, 2018, our most liquid assets were $210.8 million compared to $283.9 million as of December 31, 2017. Our liquid assets declined in 2018 as we used a portion of these assets to post initial haircut and variation margin on repurchase borrowings as we grew our investment portfolio and initial and variation margin on derivative instruments.

We perform sensitivity analysis on our liquidity based on changes in the fair value of our investments due to, among other things, changes in the absolute level of interest rates and the shape of the yield curve, credit spreads, lender haircuts, and prepayment speeds as well as changes in the fair value of our derivative instruments due to changes in the absolute level of interest rates and the shape of the yield curve. In performing this analysis, we will also consider the current state of the fixed income markets and the repurchase agreement markets in order to determine if market forces such as supply-demand imbalances or structural changes to these markets could change the liquidity of MBS or the availability of financing. The objective of our analysis is to assess the adequacy of our liquidity to withstand potential adverse events. We may change our leverage targets based on market conditions and our perceptions of the liquidity of our investments.

We closely monitor our debt-to-invested equity ratio (which is the ratio of debt financing to invested equity for any investment) as part of our liquidity management process as well as our overall enterprise level debt-to-equity ratio. We also monitor the ratio of our available liquidity to outstanding repurchase agreement borrowings, which fluctuates due to changes in the fair value of collateral we have pledged to our lenders. We also include our TBA dollar roll positions (at cost if settled) in evaluating the Company's leverage because it is possible under certain market conditions that it may be uneconomical for us to roll our TBA dollar roll positions into future months, which may result in us having to take physical delivery of the underlying securities and use cash or other financing sources to fund our total purchase commitment. Including our TBA dollar roll positions at cost (if settled), which was $882.2 million as of December 31, 2018, our leverage was 8.0 times shareholders' equity compared to 6.4 times shareholders' equity as of December 31, 2017. This increase in leverage is primarily due to the increase in invested capital during the year ended December 31, 2018. Additionally, our shareholders' equity declined, primarily from the declining fair value of our MBS as a result of increasing interest rates and widening credit spreads.

The following table presents information regarding the balances of our repurchase agreement borrowings and our TBA dollar roll positions for the periods indicated:

	Repurchase Agreements			**TBA Dollar Roll Positions (1)**	
($ in thousands)	**Balance Outstanding As of Quarter End**	**Average Balance Outstanding For the Quarter Ended**	**Maximum Balance Outstanding During the Quarter Ended**	**Balance Outstanding As of Quarter End**	**Average Balance Outstanding For the Quarter Ended**
December 31, 2018	$ 3,267,984	$ 2,992,513	$ 3,269,307	$ 882,230	$ 814,478
September 30, 2018	2,690,858	2,564,863	2,701,797	780,865	982,665
June 30, 2018	2,514,984	2,716,097	2,844,225	782,408	722,005
March 31, 2018	2,613,892	2,645,714	2,716,729	844,941	863,615
December 31, 2017	2,565,902	2,557,573	2,677,894	829,425	928,329
September 30, 2017	2,519,230	2,616,250	2,801,418	683,813	745,270
June 30, 2017	2,540,759	2,753,019	2,826,005	416,312	305,720
March 31, 2017	2,825,945	2,843,733	2,913,617	—	—
December 31, 2016	2,898,952	2,768,769	2,938,745	—	—
September 30, 2016	2,478,278	2,536,562	2,599,491	—	—
June 30, 2016	2,600,480	2,645,431	2,722,019	—	—
March 31, 2016	2,722,019	2,688,633	2,838,607	—	—

(1) Balance outstanding as of quarter end and average balance outstanding for the quarter ended includes TBA dollar roll positions as reported at cost (as if settled). Does not include short TBA positions used to hedge interest rate risk exposure from fixed-rate Agency RMBS in applicable periods.

Depending on our liquidity levels, investment opportunities, the condition of the credit markets, and other factors, we may from time to time consider the issuance of debt, equity, or other securities. We have generally had access to the debt and equity capital markets on reasonable terms. In times of market stress, we may need to sell investments in order to provide additional liquidity for our business. While we will attempt to avoid dilutive or otherwise costly issuances, depending on market conditions and in order to manage our liquidity, we could be forced to issue equity or debt securities which may be dilutive to our capital base or our profitability.

Repurchase Agreements

Our repurchase agreement borrowings are principally uncommitted and have short-term maturities. As such, we attempt to maintain unused capacity under our existing repurchase agreement credit lines with multiple counterparties which helps protect us in the event of a counterparty's failure to renew existing repurchase agreements. As of December 31, 2018, we had repurchase agreement borrowings outstanding with 17 of our 36 available repurchase agreement counterparties at a weighted average borrowing rate of 2.69% compared to 1.67% as of December 31, 2017. Our repurchase agreement borrowings generally carry a rate of interest based on a spread to an index such as LIBOR.

For our repurchase agreement borrowings, we are required to post and maintain margin to the lender (i.e., collateral in excess of the repurchase agreement financing) in order to support the amount of the financing. This excess collateral is often referred to as a “haircut” (and which we also refer to as equity at risk) and is intended to provide the lender some protection against fluctuations in fair value of the collateral and/or the failure by us to repay the borrowing at maturity. The majority of the collateral pledged to our repurchase agreement counterparties is MBS, the fair value of which fluctuates depending on market conditions. If the fair value of the collateral falls below the haircut required by the lender, the lender has the right to demand additional margin, or collateral, to increase the haircut back to the initial amount. These demands are typically referred to as “margin calls”. Declines in the value of investments occur for any number of reasons including but not limited to changes in interest rates, changes in ratings on an investment, changes in actual or perceived liquidity of the investment, or changes in overall market risk perceptions. Additionally, values in Agency RMBS will also decline from the payment delay feature of those securities. Agency RMBS have a payment delay feature whereby Fannie Mae and Freddie Mac announce principal payments on Agency RMBS but do not remit the actual principal payments and interest for 20 days in the case of Fannie Mae and 40 days in the case of Freddie Mac. Because these securities are financed with repurchase agreements, the repurchase agreement lender generally makes a margin call for an amount equal to the product of their advance rate on the repurchase agreement and the announced principal payments on the Agency RMBS. A margin call made by a lender reduces our liquidity until we receive the principal payments and interest 20 to 40 days later.

If we fail to meet any margin call, our lenders also have the right to terminate the repurchase agreement and sell any collateral pledged. Therefore, we attempt to maintain cash and other liquid securities in sufficient amounts to manage our exposure to margin calls by lenders. The lender also has the right to change the required haircut at maturity of the repurchase agreement (if the term is renewed) which would require us to post additional collateral to the lender. The following table presents the weighted average minimum haircut contractually required by our counterparties for MBS pledged as collateral for our repurchase agreement borrowings as of the dates indicated:

	December 31, 2018	**September 30, 2018**	**June 30, 2018**	**March 31, 2018**	**December 31, 2017**
Agency CMBS and RMBS	4.9%	4.8%	4.9%	4.8%	4.9%
CMBS IO	13.4%	13.3%	13.3%	13.7%	14.6%
Non-Agency CMBS and RMBS	—%	—%	—%	—%	15.0%

The counterparties with whom we have the greatest amounts of equity at risk may vary significantly during any given period due to the short-term and generally uncommitted nature of the repurchase agreement borrowings. Equity at risk represents the potential loss to the Company if the counterparty is unable or unwilling to return collateral securing the repurchase agreement borrowing at its maturity. Please refer to Note 3 for information regarding counterparties with whom we have the greatest amount of equity at risk as of December 31, 2018.

The following table discloses our repurchase agreement amounts outstanding and the value of the related collateral pledged by geographic region of our counterparties as of the dates indicated:

($ in thousands)	December 31, 2018 Amount Outstanding	December 31, 2018 Market Value of Collateral Pledged	December 31, 2017 Amount Outstanding	December 31, 2017 Market Value of Collateral Pledged
North America	$ 2,190,361	$ 2,365,132	$ 1,551,758	$ 1,700,582
Asia	594,435	633,078	489,376	515,593
Europe	483,188	513,394	524,768	548,924
	$ 3,267,984	$ 3,511,604	$ 2,565,902	$ 2,765,099

Certain of our repurchase agreement counterparties require us to comply with various operating and financial covenants. The financial covenants include, among other things, requirements that we maintain minimum shareholders' equity (usually a set minimum, or a percentage of the highest amount of shareholders' equity since the date of the agreement), limits on maximum decline in shareholders' equity (expressed as a percentage decline in any given period), and limits on maximum leverage (as a multiple of shareholders' equity). Operating requirements include, among other things, requirements to maintain our status as a REIT and to maintain our listing on the NYSE. Violations of one or more of these covenants could result in the lender declaring an event of default which would result in the termination of the repurchase agreement and immediate acceleration of amounts due thereunder. In addition, some of the agreements contain cross default features, whereby default with one lender simultaneously causes default under agreements with other lenders. Violations could also restrict us from paying dividends or engaging in other transactions that are necessary for us to maintain our REIT status.

We monitor and evaluate on an ongoing basis the impact these customary financial covenants may have on our operating and financing flexibility. Currently, we do not believe we are subject to any covenants that materially restrict our financing flexibility.

Derivative Instruments

We are party to certain types of financial instruments that are accounted for as derivative instruments including interest rate swaps, Eurodollar futures and long and short positions in TBA securities. Certain of these derivative instruments may require us to post initial margin at inception and daily variation margin based on subsequent changes in their fair value. The collateral posted as margin by us is typically in the form of cash or Agency MBS. In addition, counterparties may have to post variation margin to us. Generally, as interest rates decline, we will be required to post collateral with counterparties on our interest rate derivatives, and vice versa as interest rates increase. As of December 31, 2018, we had cash of $54.1 million posted as collateral under these agreements.

As of December 31, 2018, approximately $160 million of the Company’s interest rate swaps were entered into under bilateral agreements which contain cross-default provisions with other agreements between the parties. In addition, these bilateral agreements contain financial and operational covenants similar to those contained in our repurchase agreements, as described above. Currently, we do not believe we are subject to any covenants that materially restrict our hedging flexibility.

Our TBA contracts are subject to master securities forward transaction agreements published by the Securities Industry and Financial Markets Association as well as supplemental terms and conditions with each counterparty. Under the terms of these agreements, we may be required to pledge collateral to, or have the right to receive collateral from, our counterparties when initiated or in the event the fair value of our TBA contracts declines. Declines in the fair value of TBA contracts are generally related to such factors as rising interest rates, increases in expected prepayment speeds, or widening spreads. Our TBA contracts generally provide that valuations for our TBA contracts and any pledged collateral are to be obtained from a generally recognized source agreed to by both parties. However, in certain circumstances, our counterparties have the sole discretion to determine the value of the TBA contract and any pledged collateral. In such instances, our counterparties are required to act in good faith in making determinations of value. In the event of a margin call, we must generally provide additional collateral on the same business day.

Dividends

As a REIT, we are required to distribute to our shareholders amounts equal to at least 90% of our REIT taxable income for each taxable year after consideration of our tax NOL carryforwards. We generally fund our dividend distributions through our cash flows from operations. If we make dividend distributions in excess of our operating cash flows during the period, whether for purposes of meeting our REIT distribution requirements or other strategic reasons, those distributions are generally funded either through our existing cash balances or through the return of principal from our investments (either through repayment or sale).

We have a net operating tax loss ("NOL") carryforward that we could use to offset our REIT taxable income distribution requirement. This NOL carryforward had an estimated balance of $89.8 million as of December 31, 2018, which will begin to substantially expire in 2020. We also have deferred tax hedge losses on terminated derivative instruments, which will be recognized over the original periods being hedged by those terminated derivatives. These losses have already been recognized in our GAAP earnings but will reduce taxable income over the next ten years as noted in the following table:

($ in thousands)	Tax Hedge Loss Deduction
2019	$ 17,226
2020	5,173
2021 - 2028	2,294
	$ 24,693

If any of the deferred tax hedge losses for the years noted in the table above result in dividend distributions to our shareholders in excess of REIT taxable income, the excess dividends distributed will be considered a return of capital to the shareholder. Approximately 78% of our common stock dividends declared during the year ended December 31, 2018 will represent a return of capital to shareholders and not a distribution of REIT taxable income, principally as a result of the amount of the tax hedge loss deduction.

Contractual Obligations

The following table summarizes our contractual obligations by payment due date as of December 31, 2018:

($ in thousands)	Payments due by period				
Contractual Obligations:	**Total**	**< 1 year**	**1-3 years**	**3-5 years**	**> 5 years**
Repurchase agreements (1)	$ 3,355,766	$ 3,355,766	$ —	$ —	$ —
Non-recourse collateralized financing (2)	3,502	1,056	1,441	766	239
Operating lease obligations	273	218	55	—	—
Total	$ 3,359,541	$ 3,357,040	$ 1,496	$ 766	$ 239

(1) Includes estimated interest payments calculated using interest rates in effect as of December 31, 2018.

(2) Amounts shown are for principal only and exclude interest obligations as those amounts are not significant. Non-recourse collateralized financing represents securitization financing that is payable solely from loans and securities pledged as collateral. Payments due by period were estimated based on the principal repayments forecasted for the underlying loans and securities, substantially all of which is used to repay the associated financing outstanding.

Other Matters

As of December 31, 2018, we do not believe that any off-balance sheet arrangements exist that are reasonably likely to have a material effect on our current or future financial condition, results of operations, or liquidity other than as discussed above. In addition, we do not have any material commitments for capital expenditures and have not obtained any commitments for funds to fulfill any capital obligations.

RECENT ACCOUNTING PRONOUNCEMENTS

There were no accounting pronouncements issued during the year ended December 31, 2018 that are expected to have a material impact on the Company's financial condition or results of operations.

FORWARD-LOOKING STATEMENTS

Certain written statements in this Annual Report on Form 10-K that are not historical facts constitute "forward-looking statements" within the meaning of Section 27A of the 1933 Act and Section 21E of the Exchange Act. Statements in this report addressing expectations, assumptions, beliefs, projections, future plans and strategies, future events, developments that we expect or anticipate will occur in the future, and future operating results are forward-looking statements. Forward-looking statements are based upon management's beliefs, assumptions, and expectations as of the date of this report regarding future events and operating performance, taking into account all information currently available to us, and are applicable only as of the date of this report. Forward-looking statements generally can be identified by use of words such as "believe", "expect", "anticipate", "estimate", "plan" "may", "will", "intend", "should", "could" or similar expressions. We caution readers not to place undue reliance on our forward-looking statements, which are not historical facts and may be based on projections, assumptions, expectations, and anticipated events that do not materialize. Except as required by law, we are not obligated to, and do not intend to, update or revise any forward-looking statement whether as a result of new information, future events, or otherwise.

Forward-looking statements in this Annual Report on Form 10-K may include, but are not limited to statements about:

- Our business and investment strategy including our ability to generate acceptable risk-adjusted returns and our target investment allocations, and our views on the future performance of MBS and other investments;
- Our views on conditions in the investment, credit, and derivatives markets;
- Our views on the effect of actual or proposed actions of the U.S. Federal Reserve, the FOMC, or other central banks with respect to monetary policy (including the targeted Federal Funds Rate), and the potential impact of these actions on interest rates, inflation or unemployment;
- The effect of regulatory initiatives of the Federal Reserve (including the FOMC), other financial regulators, and other central banks;
- Our financing strategy including our target leverage ratios, our use of TBA dollar roll transactions, and anticipated trends in financing costs, and our hedging strategy including changes to the derivative instruments to which we are a party, and changes to government regulation of hedging instruments and our use of these instruments;
- Our investment portfolio composition and target investments;
- Our investment portfolio performance, including the fair value, yields, and forecasted prepayment speeds of our investments;
- Our liquidity and ability to access financing, and the anticipated availability and cost of financing;
- Our capital stock activity including the impact of stock issuances and repurchases;
- Our use of and restrictions on using our tax NOL carryforward;
- The status of pending litigation;
- The competitive environment in the future, including competition for investments and the availability of financing;
- Estimates of future interest expenses, including related to the Company’s repurchase agreements and derivative instruments;
- The status and effect of legislative reforms and regulatory rule-making or review processes, and the status of reform efforts and other business developments in the repurchase agreement financing market;
- Market, industry and economic trends, and how these trends and related economic data may impact the behavior of market participants and financial regulators; and
- Market interest rates and market spreads.

Forward-looking statements are inherently subject to risks, uncertainties and other factors that could cause our actual results to differ materially from historical results or from any results expressed or implied by such forward-looking statements. Not all of these risks and other factors are known to us. New risks and uncertainties arise over time, and it is not possible to predict those events or how they may affect us. The projections, assumptions, expectations or beliefs upon which the forward-looking statements are based can also change as a result of these risks or other factors. If such a risk or other factor materializes in future periods, our business, financial condition, liquidity and results of operations may vary materially from those expressed or implied in our forward-looking statements.

While it is not possible to identify all factors that may cause actual results to differ from historical results or from any results expressed or implied by forward-looking statements, or that may cause our projections, assumptions, expectations or beliefs to change, some of those factors include the following:

- the risks and uncertainties referenced in this Annual Report on Form 10-K, particularly those set forth under and incorporated by reference into Part II, Item 1A, “Risk Factors”;
- our ability to find suitable reinvestment opportunities;
- changes in domestic economic conditions;
- changes in interest rates and interest rate spreads, including the repricing of interest-earning assets and interest-bearing liabilities;

- our investment portfolio performance particularly as it relates to cash flow, prepayment rates and credit performance;
- the impact on markets and asset prices from the Federal Reserve's balance sheet normalization process through the reduction in its holdings of Agency RMBS and U.S. Treasuries;
- actual or anticipated changes in Federal Reserve monetary policy or the monetary policy of other central banks;
- adverse reactions in U.S. financial markets related to actions of foreign central banks or the economic performance of foreign economies including in particular China, Japan, the European Union, and the United Kingdom;
- uncertainty concerning the long-term fiscal health and stability of the United States;
- the cost and availability of financing, including the future availability of financing due to changes to regulation of, and capital requirements imposed upon, financial institutions;
- the cost and availability of new equity capital;
- changes in our use of leverage;
- changes to our investment strategy, operating policies, dividend policy or asset allocations;
- the quality of performance of third-party servicer providers of our loans and loans underlying our securities;
- the level of defaults by borrowers on loans we have securitized;
- changes in our industry;
- increased competition;
- changes in government regulations affecting our business;
- changes or volatility in the repurchase agreement financing markets and other credit markets;
- changes to the market for interest rate swaps and other derivative instruments, including changes to margin requirements on derivative instruments;
- uncertainty regarding continued government support of the U.S. financial system and U.S. housing and real estate markets; or to reform the U.S. housing finance system including the resolution of the conservatorship of Fannie Mae and Freddie Mac;
- the composition of the Board of Governors of the Federal Reserve System;
- ownership shifts under Section 382 that further limit the use of our tax NOL carryforward;
- systems failures or cybersecurity incidents; and
- exposure to current and future claims and litigation.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk is the exposure to losses resulting from changes in market factors. Our business strategy exposes us to a variety of market risks, including interest rate, spread, prepayment, reinvestment, credit, and liquidity risks. These risks can and do cause fluctuations in our comprehensive income and book value as discussed below.

Interest Rate Risk

Investing in interest-rate sensitive investments such as MBS and TBA securities subjects us to interest rate risk. Interest rate risk results from investing in securities that have a fixed coupon or when the coupon may not immediately adjust for changes in interest rates. Interest rate risk also results from the mismatch between the duration of our assets versus the duration of our liabilities and hedges.

The measures of an instrument's price sensitivity to interest rate fluctuations are its duration and convexity. Duration measures the percentage change in projected market value of our investments and derivative instruments given a change in interest rates. The duration of RMBS and TBA securities tend to increase when interest rates rise and decrease when interest rates fall, which is commonly referred to as negative convexity. This occurs because prepayments of the mortgage loans underlying the RMBS tend to decline when interest rates rise (which extends the life of the security) and increase when interest rates fall (which shortens the life of the security). The fair value of TBA securities react similarly to RMBS to changes in interest rates as they are based on an underlying non-specified pool of fixed-rate residential mortgage loans. CMBS and CMBS IO, however, generally have little convexity because the mortgage loans underlying the securities contain some form of prepayment protection provision (such as prepayment lock-outs) or prepayment compensation provisions (such as yield maintenance or prepayment penalties) which create an economic disincentive for the loans to prepay.

We attempt to manage our exposure to changes in interest rates that results from the duration mismatch between our assets and liabilities by entering into interest rate swaps and other derivative instruments to hedge this risk. We manage interest rate risk within tolerances set by our Board of Directors. Our portfolio duration changes based on the composition of our investment portfolio and our hedge positions as well as market factors. We calculate our portfolio duration based on modeled projected cash flows, and such calculated duration can be an imprecise measure of actual interest rate risk. In the case of Agency RMBS and TBA securities, the primary input to the calculated duration is the anticipated prepayment speed of the underlying mortgage loans, which is sensitive to future interest rates and borrowers' behavior. Changes in the level of interest rates can affect the rate of mortgage prepayments and the market value of our assets. Our hedging techniques are highly complex and are partly based on assumed levels of prepayments of our assets. If prepayments are slower or faster than assumed, the maturity our investments will also differ from our expectations, which could reduce the effectiveness of our hedging strategies and may cause losses on such transactions and adversely affect our cash flow. Estimates of prepayment speeds can vary significantly by investor for the same security, and therefore estimates of security and portfolio duration can vary significantly.

During a period of rising interest rates (particularly short-term rates in a flattening yield curve environment), normally our borrowing costs will increase faster than our asset yields, negatively impacting our net interest income. The amount of the impact will depend on the composition of our portfolio, our hedging strategy, the effectiveness of our hedging instruments as well as the magnitude and the duration of the increase in interest rates.

Changes in types of our investments, the returns earned on these investments, future interest rates, credit spreads, the shape of the yield curve, the availability of financing, and/or the mix of our investments and financings including derivative instruments may cause actual results to differ significantly from the modeled results shown in the tables below. There can be no assurance that assumed events used to model the results shown below will occur, or that other events will not occur, that will affect the outcomes; therefore, the modeled results shown in the tables below and all related disclosures constitute forward-looking statements.

The table below shows the projected sensitivity of our net interest income and net periodic interest costs on our interest rate swaps as of the periods indicated:

	Projected Change in Net Interest Income and Net Periodic Interest Costs Due To			
	Decrease in Interest Rates of		Increase in Interest Rates of	
	50 Basis Points	100 Basis Points	50 Basis Points	100 Basis Points
As of December 31, 2018	(8.0)%	(21.1)%	4.2 %	6.1 %
As of December 31, 2017	0.7 %	2.3 %	(3.2)%	(8.1)%

(1) *Includes estimated changes in net interest income as well as net periodic interest costs on our interest rate swaps recorded in "gain (loss) on derivatives instruments, net" and does not include estimated changes to TBA drop income generated by TBA dollar roll transactions, which are accounted for as derivative instruments in accordance with GAAP.*

The table below shows the projected sensitivity of the market value of our financial instruments [(1)] and the percentage change in shareholders' equity based on an instantaneous parallel shift in market interest rates as of the dates indicated:

	As of December 31, 2018							
	Decrease in Interest Rates of				Increase in Interest Rates of			
	50 Basis Points		100 Basis Points		50 Basis Points		100 Basis Points	
Type of Instrument [(1)]	% of Market Value	% of Total Equity	% of Market Value	% of Total Equity	% of Market Value	% of Total Equity	% of Market Value	% of Total Equity
RMBS	1.0 %	7.0 %	1.6 %	11.2 %	(1.3)%	(9.4)%	(2.9)%	(20.6)%
CMBS	1.0 %	7.1 %	2.0 %	14.6 %	(1.0)%	(6.8)%	(1.9)%	(13.4)%
CMBS IO	0.3 %	1.8 %	0.4 %	3.1 %	(0.1)%	(0.7)%	(0.3)%	(1.9)%
TBAs	0.2 %	1.7 %	0.4 %	2.5 %	(0.4)%	(2.9)%	(0.9)%	(6.7)%
Derivatives	(2.7)%	(19.0)%	(5.5)%	(39.0)%	2.5 %	18.1 %	4.9 %	35.3 %
Total	(0.2)%	(1.3)%	(1.1)%	(7.6)%	(0.3)%	(1.7)%	(1.0)%	(7.3)%

	As of December 31, 2017							
	Decrease in Interest Rates by				Increase in Interest Rates by			
	50 Basis Points		100 Basis Points		50 Basis Points		100 Basis Points	
Type of Instrument [(1)]	% of Market Value	% of Total Equity	% of Market Value	% of Total Equity	% of Market Value	% of Total Equity	% of Market Value	% of Total Equity
RMBS	0.7 %	3.7 %	1.1 %	6.5 %	(0.8)%	(4.7)%	(1.8)%	(10.3)%
CMBS	1.2 %	6.6 %	2.3 %	13.4 %	(1.1)%	(6.5)%	(2.2)%	(12.7)%
CMBS IO	0.3 %	1.7 %	0.6 %	3.5 %	(0.3)%	(1.7)%	(0.6)%	(3.4)%
TBAs	0.2 %	1.1 %	0.3 %	1.5 %	(0.4)%	(2.1)%	(0.9)%	(4.9)%
Treasuries	0.2 %	0.8 %	0.3 %	1.7 %	(0.1)%	(0.8)%	(0.3)%	(1.6)%
Derivatives	(2.1)%	(12.2)%	(4.4)%	(25.0)%	2.1 %	11.7 %	4.0 %	23.0 %
Total	0.3 %	1.8 %	0.3 %	1.6 %	(0.7)%	(4.0)%	(1.7)%	(10.0)%

(1) *Changes in market value of our financings are excluded because they are not carried at fair value on our balance sheet. The projections for market value do not assume any change in credit spreads.*

Management also considers changes in the shape of the interest rate curves in assessing and managing portfolio interest rate risk. Often interest rates do not move in a parallel fashion from quarter to quarter. The table below shows the percentage change in projected market value of our financial instruments [(1)] for instantaneous changes in the shape of the U.S. Treasury ("UST") curve (with similar changes to the interest rate swap curves) as of the dates indicated:

		December 31, 2018		December 31, 2017	
Basis Point Change in		Percentage Change in			
2-year UST	10-year UST	Market Value of Investments (1)	Shareholders' Equity	Market Value of Investments (1)	Shareholders' Equity
+25	+50	(0.1)%	(0.8)%	(0.5)%	(3.0)%
+25	+0	— %	(0.3)%	(0.2)%	(0.9)%
+50	+25	(0.2)%	(1.1)%	(0.5)%	(2.8)%
+50	+100	(0.8)%	(5.7)%	(1.3)%	(7.7)%
-10	-50	(0.4)%	(2.6)%	0.1 %	0.8 %

(1) Includes changes in market value of our investments and derivative instruments, including TBA securities, but excludes changes in market value of our financings because they are not carried at fair value on our balance sheet. The projections for market value do not assume any change in credit spreads.

Spread Risk

Spread risk is the risk of loss from an increase in the market spread between the yield on an investment versus its benchmark index. Changes in market spreads represent the market's valuation of the perceived riskiness of an asset relative to risk-free rates, and widening spreads reduce the market value of our investments as market participants require additional yield to hold riskier assets. Market spreads could change based on macroeconomic or systemic factors as well as the factors specific to a particular security such as prepayment performance or credit performance. Other factors that could impact credit spreads include technical issues such as supply and demand for a particular type of security or FOMC monetary policy. Likewise, most of our investments are fixed-rate or reset in rate over a period of time, and as interest rates rise, we would expect the market value of these investments to decrease. While we use derivative instruments to mitigate interest rate risk on our financial instruments, we do not hedge spread risk given the complexity of hedging credit spreads and the lack of liquid instruments available to use as hedges.

Fluctuations in spreads typically vary based on the type of investment. Sensitivity to changes in market spreads is derived from models that are dependent on various assumptions, and actual changes in market value in response to changes in market spreads could differ materially from the projected sensitivity if actual conditions differ from these assumptions.

The table below shows the projected sensitivity of the market value of our investments (1) given the indicated change in market spreads as of the dates indicated:

	December 31, 2018		December 31, 2017	
	Percentage Change in			
Basis Point Change in Market Spreads	Market Value of Investments (1)	Shareholders' Equity	Market Value of Investments (1)	Shareholders' Equity
+20/+50 (2)	(1.3)%	(9.5)%	(1.4)%	(7.7)%
+10	(0.6)%	(4.5)%	(0.6)%	(3.3)%
-10	0.7 %	5.0 %	0.6 %	3.5 %
-20/-50 (2)	1.5 %	11.0 %	1.4 %	8.1 %

(1) Includes changes in market value of our MBS investments, including TBA securities.
(2) Assumes a 20-basis point shift in Agency and non-Agency RMBS and CMBS and a 50-basis point shift in Agency and non-Agency CMBS IO.

Prepayment and Reinvestment Risk

Prepayment risk is the risk of an early, unscheduled return of principal on an investment. We are subject to prepayment risk from premiums paid on investments, which are amortized as a reduction in interest income using the effective yield method under GAAP. Principal prepayments on our investments are influenced by changes in market interest rates and a variety of economic, geographic, government policy, and other factors beyond our control.

Loans underlying our CMBS and CMBS IO securities typically have some form of prepayment protection provisions (such as prepayment lock-outs) or prepayment compensation provisions (such as yield maintenance or prepayment penalties). Yield maintenance and prepayment penalty requirements are intended to create an economic disincentive for the loans to prepay; however, the amount of the prepayment penalty required to be paid may decline over time, and as loans age, interest rates decline, or market values of collateral supporting the loans increase, prepayment penalties may lessen as an economic disincentive to the borrower. Generally, our experience has been that prepayment lock-out and yield maintenance provisions result in stable prepayment performance from period to period. There are no prepayment protections, however, if the loan defaults and is partially or wholly repaid earlier as a result of loss mitigation actions taken by the underlying loan servicer. Historically, we have experienced low default rates on loans underlying CMBS and CMBS IO.

Because CMBS IO consist of rights to interest on the underlying commercial mortgage loan pools and do not have rights to principal payments on the underlying loans, prepayment risk on these securities would be particularly acute without these prepayment protection provisions. CMBS IO prepayment protection and compensation provisions vary by issuer of the security (i.e. Freddie Mac, Fannie Mae, Ginnie Mae, or non-Agency). The majority of our Agency CMBS IO are issued by Freddie Mac and these securities generally have initial prepayment lock-outs followed by a defeasance period which on average extends to within six months of the stated maturities of the underlying loans. Non-Agency CMBS IO generally have prepayment protection in the form of prepayment lock-outs and defeasance provisions.

Prepayments on the loans underlying our RMBS generally accelerate in a declining interest rate environment, as the loans age, and, with respect to ARMS, as the loans near their respective interest rate reset dates, particularly the initial reset date, or if expectations are that interest rates will rise in the future. Our prepayment models anticipate an acceleration of prepayments in these events. To the extent the actual prepayments exceed our modeled prepayments, or, with respect to adjustable-rate RMBS, if we change our future prepayment expectations, we will record adjustments to our premium amortization which may negatively impact our net interest income. In addition, changes in market expectations of prepayments could impact the fair value of our RMBS.

We seek to manage our prepayment risk on our MBS by diversifying our investments, seeking investments which we believe will have superior prepayment performance, and investing in securities which have some sort of prepayment prohibition or yield maintenance (as is the case with CMBS and CMBS IO). With respect to RMBS, when we invest in RMBS at a premium to the security’s par value, we tend to favor securities in which we believe the underlying borrowers have some disincentive to refinance as a result of the size of each loan’s principal balance, credit characteristics of the borrower, or geographic location of the property, among other factors.

We are also subject to reinvestment risk as a result of the prepayment, repayment and sales of our investments. In order to maintain our investment portfolio size and our earnings, we need to reinvest capital received from these events into new interest-earning assets or TBA securities. If we are unable to find suitable reinvestment opportunities or if yields on assets in which we reinvest are lower than yields on existing assets, our results and cash flows could be negatively impacted. In addition, based on market conditions, our leverage, and our liquidity profile, we may decide to not reinvest the cash flows we receive from our investment portfolio even when attractive reinvestment opportunities are available, or we may decide to reinvest in assets with lower yield but greater liquidity. If we retain capital or pay dividends to return capital to shareholders rather than reinvest capital, or if we invest capital in lower yielding assets for liquidity reasons, the size of our investment portfolio and the amount of income generated by our investment portfolio will likely decline.

Credit Risk

Credit risk is the risk that we will not receive all contractual amounts due on investments that we own due to default by the borrower or due to a deficiency in proceeds from the liquidation of the collateral securing the obligation. Credit losses on loans could result in lower or negative yields on our investments.

Agency RMBS and Agency CMBS have credit risk to the extent that Fannie Mae or Freddie Mac fails to remit payments on the MBS for which they have issued a guaranty of payment. Given the improved financial performance and conservatorship of these entities and the continued support of the U.S. government, we believe this risk is low. Since Agency CMBS IO represent the right to excess interest and not principal on the underlying loans, these securities are exposed to the loss of investment basis in the event a loan collateralizing the security liquidates without paying yield maintenance or prepayment penalty, which typically occurs when an involuntarily liquidating loan repays all or a portion of its related principal balance.

We attempt to mitigate our credit risk on our non-Agency securities through asset selection and by purchasing higher quality securities. Our non-Agency MBS are typically investment grade rated securities which we believe will have good credit performance. The majority of our non-Agency securities are CMBS IO and the return we earn on these securities is dependent on the credit performance of the underlying commercial loans. In particular, since investments in CMBS IO pay interest from the underlying commercial mortgage loan pools, returns generally are more negatively impacted by liquidations of loans in the underlying loan pool.

Liquidity Risk

We have liquidity risk principally from the use of recourse repurchase agreements to finance our ownership of securities. Our repurchase agreements are renewable at the discretion of our lenders and do not contain guaranteed roll-over terms. If we fail to repay the lender at maturity, the lender has the right to immediately sell the collateral and pursue us for any shortfall if the sales proceeds are inadequate to cover the repurchase agreement financing. In addition, declines in the market value of our investments pledged as collateral for repurchase agreement borrowings may result in counterparties initiating margin calls for additional collateral.

Our use of TBA long positions as a means of investing in and financing Agency RMBS also exposes us to liquidity risk in the event that we are unable to roll or terminate our TBA contracts prior to their settlement date. If we are unable to roll or terminate our TBA long positions, we could be required to take physical delivery of the underlying securities and settle our obligations for cash, which could negatively impact our liquidity position or force us to sell assets under adverse conditions if financing is not available to us on acceptable terms.

For further information, including how we attempt to mitigate liquidity risk and monitor our liquidity position, please refer to “Liquidity and Capital Resources” in Part I, Item 2 of this Annual Report on Form 10-K.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Our consolidated financial statements and the related notes, together with the Reports of the Independent Registered Public Accounting Firm thereon, are set forth beginning on page F-1 of this Annual Report on Form 10-K.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

Our management evaluated, with the participation of our Principal Executive Officer and Principal Financial Officer, the effectiveness of our disclosure controls and procedures, as defined in Exchange Act Rule 13a-15(e), as of the end of the period covered by this report. Based on that evaluation, our Principal Executive Officer and Principal Financial Officer concluded that our disclosure controls and procedures were effective as of December 31, 2018 to ensure that information required to be disclosed 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 and forms, and that such information is accumulated and communicated to our management, including our Principal Executive Officer and Principal Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting during the three months ended December 31, 2018 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Management's Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) of the Exchange Act. Because of inherent limitations, a system of internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate due to a change in conditions, or that the degree of compliance with policies or procedures may deteriorate.

Our management evaluated, with the participation of our principal executive officer and principal financial officer, the effectiveness of our internal control over financial reporting using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") (2013) in "Internal Control-Integrated Framework." Based on that evaluation, our principal executive officer and principal financial officer concluded that our internal control over financial reporting was effective as of the end of the period covered by this report.

The Company's internal control over financial reporting as of December 31, 2018 has been audited by BDO USA, LLP, the independent registered public accounting firm that also audited the Company's consolidated financial statements included in this Annual Report on Form 10-K. The attestation report of BDO USA, LLP on the effectiveness of the Company's internal control over financial reporting appears on page F-4 herein.

ITEM 9B. OTHER INFORMATION

None.

PART III.

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information about our executive officers required by this item is included in Part I, Item I of this Annual Report on Form 10-K under the caption "Executive Officers of the Company". The remaining information required by Item 10 will be included in our definitive proxy statement for use in connection with our 2019 Annual Meeting of Shareholders ("2019 Proxy Statement") under the captions "Election of Directors," "Committees of the Board," "Code of Ethics" and "Section 16(a) Beneficial Ownership Reporting Compliance," and is incorporated herein by reference.

ITEM 11. EXECUTIVE COMPENSATION

The information required by Item 11 will be included in the 2019 Proxy Statement under the captions “Executive Compensation” and “Directors’ Compensation” and is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The following table sets forth information as of December 31, 2018 with respect to our equity compensation plans under which shares of our common stock are authorized for issuance.

	Number of Securities to Be Issued upon Exercise of Outstanding Options, Warrants and Rights	Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (1)
Equity Compensation Plans Approved by Shareholders:			
2018 Stock and Incentive Plan	—	—	2,963,076
Equity Compensation Plans Not Approved by Shareholders (2)	—	—	—
Total	—	$ —	2,963,076

(1) Reflects shares available to be granted under the 2018 Stock and Incentive Plan in the form of stock options, stock appreciation rights, stock awards, dividend equivalent rights, performance share awards, stock units and incentive awards.
(2) The Company does not have any equity compensation plans that have not been approved by shareholders.

The remaining information required by Item 12 will be included in the 2019 Proxy Statement under the caption “Ownership of Stock” and is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by Item 13 will be included in the 2019 Proxy Statement under the captions “Related Person Transactions” and “Director Independence,” and is incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by Item 14 will be included in the 2019 Proxy Statement under the caption “Audit Information,” and is incorporated herein by reference.

PART IV.

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a)(1) and (a)(2) Financial Statements and Schedules:

1. and 2.	Financial Statements and Schedules: The information required by this section of Item 15 is set forth in the Consolidated Financial Statements and Reports of Independent Registered Public Accounting Firm beginning at page F-1 of this Annual Report on Form 10-K. The index to the Financial Statements is set forth at page F-2 of this Annual Report on Form 10-K.

(a)(3) Documents filed as part of this report:

Exhibit No.	Description
3.1	Restated Articles of Incorporation, effective June 2, 2014 (incorporated herein by reference to Exhibit 3.1 to Dynex's Registration Statement on Form S-8 filed September 17, 2014).
3.2	Amended and Restated Bylaws, effective as of January 1, 2019 (filed herewith).
10.11*	Dynex Capital, Inc. 2009 Stock and Incentive Plan, effective as of May 13, 2009 (incorporated herein by reference to Appendix A to Dynex's Proxy Statement filed April 3, 2009).
10.14	Equity Distribution Agreement between Dynex Capital, Inc. and JMP Securities LLC, dated June 24, 2010 (incorporated herein by reference to Exhibit 10.14 to Dynex's Current Report on Form 8-K filed June 24, 2010).
10.14.1	Amendment No. 1 to Equity Distribution Agreement between Dynex Capital, Inc. and JMP Securities LLC, dated December 23, 2011 (incorporated herein by reference to Exhibit 10.14.1 to Dynex's Current Report on Form 8-K filed December 23, 2011).
10.16*	Form of Restricted Stock Agreement for Executive Officers under the Dynex Capital, Inc. 2009 Stock and Incentive Plan (incorporated herein by reference to Exhibit 10.16 to Dynex's Annual Report on Form 10-K for the year ended December 31, 2010).
10.18*	Non-employee directors' annual compensation for Dynex Capital, Inc. (incorporated herein by reference to Exhibit 10.18 to Dynex's Annual Report on Form 10-K for the year ended December 31, 2017).
10.23	Master Repurchase and Securities Contract dated as of August 6, 2012 between Issued Holdings Capital Corporation, Dynex Capital, Inc. (as guarantor) and Wells Fargo Bank, National Association (incorporated herein by reference to Exhibit 10.23 to Dynex's Current Report on Form 8-K filed August 8, 2012).
10.23.1	Amendment No. 1 to Master Repurchase and Securities Contract dated as of October 1, 2013 between Issued Holdings Capital Corporation, Dynex Capital, Inc. (as guarantor) and Wells Fargo Bank, N.A. (incorporated herein by reference to Exhibit 10.23.1 to Dynex's Current Report on Form 8-K filed October 7, 2013).
10.23.2	Amendment No. 2 to Master Repurchase and Securities Contract dated as of February 5, 2015 between Issued Holdings Capital Corporation, Dynex Capital, Inc. (as guarantor) and Wells Fargo Bank, N.A. (incorporated herein by reference to Exhibit 10.23.2 to Dynex's Current Report on Form 8-K filed February 11, 2015).
10.23.3	Amendment No. 3 to Master Repurchase and Securities Contract dated as of April 29, 2016 between Issued Holdings Capital Corporation, Dynex Capital, Inc. (as guarantor) and Wells Fargo Bank, N.A. (incorporated herein by reference to Exhibit 10.23.3 to Dynex's Current Report on Form 8-K filed May 3, 2016).
10.23.4	Amendment No. 4 to Master Repurchase and Securities Contract dated as of May 12, 2017 between Issued Holdings Capital Corporation, Dynex Capital, Inc. (as guarantor) and Wells Fargo Bank, N.A. (incorporated herein by reference to Exhibit 10.23.4 to Dynex's Current Report on Form 8-K filed May 17, 2017).

Exhibit No.	Description
10.24	Guarantee Agreement dated as of August 6, 2012 by Dynex Capital, Inc. in favor of Wells Fargo Bank, National Association (incorporated herein by reference to Exhibit 10.24 to Dynex's Current Report on Form 8-K filed August 8, 2012).
10.24.1	Amendment No. 1 to Guarantee Agreement by Dynex Capital, Inc. in favor of Wells Fargo Bank, National Association, dated September 13, 2018 (incorporated herein by reference to Exhibit 10.24.1 to Dynex's Quarterly Report on Form 10-Q for the quarter ended September 30, 2018).
10.28*	Dynex Capital, Inc. Executive Incentive Plan (as amended February 22, 2018) (incorporated herein by reference to Exhibit 10.28 to Dynex's Annual Report on Form 10-K for the year ended December 31, 2017).
10.29	Equity Distribution Agreement among Dynex Capital, Inc., Ladenburg Thalmann & Co. Inc. and JonesTrading Institutional Services LLC, dated November 21, 2016 (incorporated herein by reference to Exhibit 10.29 to Dynex's Current Report on Form 8-K filed November 22, 2016).
10.29.1	Amendment No. 1, dated September 4, 2018, to Equity Distribution Agreement by and among Dynex Capital, Inc., Ladenburg Thalmann & Co. Inc., and JonesTrading Institutional Services LLC (incorporated herein by reference to Exhibit 10.29.1 to Dynex's Current Report on Form 8-K filed September 4, 2018).
10.30*	Employment Agreement, dated as of December 8, 2016, between Dynex Capital, Inc. and Byron L. Boston (incorporated herein by reference to Exhibit 10.30 to Dynex's Current Report on Form 8-K filed December 9, 2016).
10.31*	Form of Restricted Stock Agreement for Executive Officers under the Dynex Capital, Inc. 2009 Stock and Incentive Plan (incorporated herein by reference to Exhibit 10.31 to Dynex's Current Report on Form 8-K filed February 13, 2017).
10.32*	Employment Agreement, dated as of March 3, 2017, between Dynex Capital, Inc. and Stephen J. Benedetti (incorporated herein by reference to Exhibit 10.32 to Dynex's Current Report on Form 8-K filed March 8, 2017).
10.33*	Employment Agreement, dated as of March 3, 2017, between Dynex Capital, Inc. and Smriti L. Popenoe (incorporated herein by reference to Exhibit 10.33 to Dynex's Current Report on Form 8-K filed March 8, 2017).
10.34	Amended and Restated Equity Distribution Agreement between Dynex Capital, Inc. and JMP Securities LLC, dated March 31, 2017 (incorporated herein by reference to Exhibit 10.34 to Dynex's Current Report on Form 8-K filed April 3, 2017).
10.34.1	Amendment No. 1, dated December 27, 2017, to Amended and Restated Equity Distribution Agreement between Dynex Capital, Inc. and JMP Securities LLC, dated March 31, 2017 (incorporated herein by reference to Exhibit 10.34.1 to Dynex's Current Report on Form 8-K filed December 27, 2017).
10.35	Distribution Agreement, dated June 29, 2018, among J.P. Morgan Securities LLC, JMP Securities LLC, and Dynex Capital, Inc. (incorporated herein by reference to Exhibit 10.35 to Dynex's Current Report on Form 8-K filed June 29, 2018).
10.36*	Dynex Capital, Inc. 2018 Stock and Incentive Plan, effective as of May 15, 2018 (incorporated herein by reference to Exhibit 99.1 to Dynex's Registration Statement on Form S-8 filed May 16, 2018).
10.36.1*	Form of Restricted Stock Agreement for Non-Employee Directors (approved May 15, 2018) under the Dynex Capital, Inc. 2018 Stock and Incentive Plan (incorporated herein by reference to Exhibit 10.36.1 to Dynex's Quarterly Report on Form 10-Q for the quarter ended June 30, 2018).
10.37	Underwriting Agreement, dated January 28, 2019, between Dynex Capital, Inc. and J.P. Morgan Securities LLC, as underwriter (incorporated herein by reference to Exhibit 1.1 to Dynex's Current Report on Form 8-K filed on January 30, 2019).
21.1	List of consolidated entities of Dynex Capital, Inc. (filed herewith).
23.1	Consent of BDO USA, LLP (filed herewith).
31.1	Certification of principal executive officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).

Exhibit No.	Description
31.2	Certification of principal financial officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
32.1	Certification of principal executive officer and principal financial officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith).
101	The following materials from Dynex Capital, Inc.'s Annual Report on Form 10-K for the year ended December 31, 2018, formatted in iXBRL (Inline Extensible Business Reporting Language), filed herewith: (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Comprehensive Income (Loss), (iii) Consolidated Statements of Shareholders’ Equity, (iv) Consolidated Statements of Cash Flows, and (v) Notes to Consolidated Financial Statements.

* Denotes management contract.

(b) Exhibits: See Item 15(a)(3) above.

(c) Financial Statement Schedules: None.

ITEM 16. FORM 10-K SUMMARY

None.

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.

DYNEX CAPITAL, INC.
(Registrant)

February 27, 2019

/s/ Stephen J. Benedetti
Stephen J. Benedetti, Executive Vice President, Chief Financial Officer and Chief Operating Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ Byron L. Boston Byron L. Boston	Chief Executive Officer, President, Co-Chief Investment Officer, and Director (Principal Executive Officer)	February 27, 2019
/s/ Stephen J. Benedetti Stephen J. Benedetti	Executive Vice President, Chief Financial Officer and Chief Operating Officer (Principal Financial Officer)	February 27, 2019
/s/ Jeffrey L. Childress Jeffrey L. Childress	Vice President and Controller (Principal Accounting Officer)	February 27, 2019
/s/ Michael R. Hughes Michael R. Hughes	Director	February 27, 2019
/s/ Barry A. Igdaloff Barry A. Igdaloff	Director	February 27, 2019
/s/ Valerie A. Mosley Valerie A. Mosley	Director	February 27, 2019
/s/ Robert A. Salcetti Robert A. Salcetti	Director	February 27, 2019
/s/ David H. Stevens David H. Stevens	Director	February 27, 2019

DYNEX CAPITAL, INC.

CONSOLIDATED FINANCIAL STATEMENTS AND

REPORTS OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

For Inclusion in Annual Report on Form 10-K

Filed with Securities and Exchange Commission

December 31, 2018

DYNEX CAPITAL, INC.
INDEX TO FINANCIAL STATEMENTS

Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders
Dynex Capital, Inc.
Glen Allen, Virginia

Opinion on the Consolidated Financial Statements

We have audited the accompanying consolidated balance sheets of Dynex Capital, Inc. (the "Company") and subsidiaries as of December 31, 2018 and 2017, the related consolidated statements of comprehensive income (loss), shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2018, and the related notes (collectively referred to as the "consolidated financial statements"). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company and subsidiaries at December 31, 2018 and 2017, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2018**,** in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) ("PCAOB"), the Company's internal control over financial reporting as of December 31, 2018, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") and our report dated February 27, 2019 expressed an unqualified opinion thereon.

Basis for Opinion

These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's consolidated financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud.

Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ BDO USA, LLP

We have served as the Company's auditor since 2005.

Richmond, Virginia

February 27, 2019

Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders
Dynex Capital, Inc.
Glen Allen, Virginia

Opinion on Internal Control over Financial Reporting

We have audited Dynex Capital, Inc.'s (the "Company's") internal control over financial reporting as of December 31, 2018, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the "COSO criteria"). In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2018, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) ("PCAOB"), the consolidated balance sheets of the Company and subsidiaries as of December 31, 2018 and 2017, the related consolidated statements of comprehensive income (loss), shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2018, and the related notes and our report dated February 27, 2019 expressed an unqualified opinion thereon.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Item 9A, Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit of internal control over financial reporting in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ BDO USA, LLP

Richmond, Virginia

February 27, 2019

DYNEX CAPITAL, INC.
CONSOLIDATED BALANCE SHEETS
(amounts in thousands except share data)

	December 31, 2018	December 31, 2017
ASSETS		
Investments in debt securities, at fair value:		
Mortgage-backed securities (including pledged of $3,511,604 and $2,640,884 respectively)	$ 3,749,464	$ 3,026,989
U.S. Treasuries (including pledged of $0 and $124,215, respectively)	—	146,530
Mortgage loans held for investment, net	11,527	15,738
Cash and cash equivalents	34,598	40,867
Restricted cash	54,106	46,333
Derivative assets	6,563	2,940
Accrued interest receivable	21,019	19,819
Other assets, net	8,812	6,562
Total assets	$ 3,886,089	$ 3,305,778
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities:		
Repurchase agreements	$ 3,267,984	$ 2,565,902
Payable for unsettled securities	58,915	156,899
Non-recourse collateralized financing	3,458	5,520
Derivative liabilities	1,218	269
Accrued interest payable	10,308	3,734
Accrued dividends payable	13,810	12,526
Other liabilities	3,243	3,870
Total liabilities	3,358,936	2,748,720
Shareholders' equity:		
Preferred stock, par value $.01 per share; 50,000,000 shares authorized; 5,954,594 and 5,888,680 shares issued and outstanding, respectively ($148,865 and $147,217 aggregate liquidation preference, respectively)	$ 142,883	$ 141,294
Common stock, par value $.01 per share, 200,000,000 shares authorized; 62,817,218 and 55,831,549 shares issued and outstanding, respectively	628	558
Additional paid-in capital	818,442	775,873
Accumulated other comprehensive loss	(35,779)	(8,697)
Accumulated deficit	(399,021)	(351,970)
Total shareholders' equity	527,153	557,058
Total liabilities and shareholders' equity	$ 3,886,089	$ 3,305,778

See notes to the consolidated financial statements.

DYNEX CAPITAL, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(amounts in thousands except per share data)

	Year Ended December 31,		
	2018	2017	2016
Interest income	$ 110,051	$ 94,502	$ 91,898
Interest expense	59,574	36,178	25,231
Net interest income	50,477	58,324	66,667
(Loss) gain on derivative instruments, net	(3,461)	3,044	(5,606)
Loss on sale of investments, net	(23,373)	(11,530)	(4,238)
Fair value adjustments, net	52	75	103
Other operating (expense) income, net	(1,567)	(201)	880
General and administrative expenses:			
Compensation and benefits	(6,605)	(8,509)	(7,550)
Other general and administrative	(8,500)	(7,310)	(7,157)
Net income	7,023	33,893	43,099
Preferred stock dividends	(11,801)	(10,794)	(9,185)
Net (loss) income to common shareholders	$ (4,778)	$ 23,099	$ 33,914
Other comprehensive income:			
Unrealized (loss) gain on available-for-sale investments, net	$ (50,218)	$ 12,650	$ (23,828)
Reclassification adjustment for loss on sale of investments, net	23,373	11,530	4,238
Reclassification adjustment for de-designated cash flow hedges	(237)	(268)	(251)
Total other comprehensive (loss) income	(27,082)	23,912	(19,841)
Comprehensive (loss) income to common shareholders	$ (31,860)	$ 47,011	$ 14,073
Net (loss) income per common share-basic and diluted	$ (0.08)	$ 0.46	$ 0.69
Weighted average common shares-basic and diluted	57,705	50,417	49,114

See notes to the consolidated financial statements.

DYNEX CAPITAL, INC.
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
($ in thousands)

	Preferred Stock		Common Stock		Additional Paid-in Capital	Accumulated Other Comprehensive Loss	Accumulated Deficit	Total Shareholders' Equity
	Shares	Amount	Shares	Amount				
Balance as of December 31, 2015	**4,550,000**	**$ 109,658**	**49,047,335**	**$ 490**	**$ 725,358**	**$ (12,768)**	**$ (330,713)**	**$ 492,025**
Stock issuance	21,937	548	20,582	1	136	—	—	685
Restricted stock granted, net of amortization	—	—	214,878	2	2,707	—	—	2,709
Adjustments for tax withholding on share-based compensation	—	—	(80,888)	(1)	(484)	—	—	(485)
Stock issuance costs	—	(201)	—	—	(38)	—	—	(239)
Common stock repurchased	—	—	(48,444)	—	(310)	—	—	(310)
Net income	—	—	—	—	—	—	43,099	43,099
Dividends on preferred stock	—	—	—	—	—	—	(9,185)	(9,185)
Dividends on common stock	—	—	—	—	—	—	(41,274)	(41,274)
Other comprehensive loss	—	—	—	—	—	(19,841)	—	(19,841)
Balance as of December 31, 2016	**4,571,937**	**$ 110,005**	**49,153,463**	**$ 492**	**$ 727,369**	**$ (32,609)**	**$ (338,073)**	**$ 467,184**
Stock issuance	1,316,743	31,350	6,617,487	66	47,116	—	—	78,532
Restricted stock granted, net of amortization	—	—	138,166	1	1,953	—	—	1,954
Adjustments for tax withholding on share-based compensation	—	—	(77,567)	(1)	(520)	—	—	(521)
Stock issuance costs	—	(61)	—	—	(45)	—	—	(106)
Net income	—	—	—	—	—	—	33,893	33,893
Dividends on preferred stock	—	—	—	—	—	—	(10,794)	(10,794)
Dividends on common stock	—	—	—	—	—	—	(36,996)	(36,996)
Other comprehensive income	—	—	—	—	—	23,912	—	23,912
Balance as of December 31, 2017	**5,888,680**	**$ 141,294**	**55,831,549**	**$ 558**	**$ 775,873**	**$ (8,697)**	**$ (351,970)**	**$ 557,058**
Stock issuance	65,914	1,599	6,829,647	69	41,789	—	—	43,457
Restricted stock granted, net of amortization	—	—	213,157	2	1,228	—	—	1,230
Adjustments for tax withholding on share-based compensation	—	—	(57,135)	(1)	(363)	—	—	(364)
Stock issuance costs	—	(10)	—	—	(85)	—	—	(95)
Net income	—	—	—	—	—	—	7,023	7,023
Dividends on preferred stock	—	—	—	—	—	—	(11,801)	(11,801)
Dividends on common stock	—	—	—	—	—	—	(42,273)	(42,273)
Other comprehensive loss	—	—	—	—	—	(27,082)	—	(27,082)
Balance as of December 31, 2018	**5,954,594**	**$ 142,883**	**62,817,218**	**$ 628**	**$ 818,442**	**$ (35,779)**	**$ (399,021)**	**$ 527,153**

See notes to the consolidated financial statements.

DYNEX CAPITAL, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
($ in thousands)

	Year Ended December 31,		
	2018	2017	2016
Operating activities:			
Net income	$ 7,023	$ 33,893	$ 43,099
Adjustments to reconcile net income to cash provided by operating activities:			
(Increase) decrease in accrued interest receivable	(1,200)	577	2,368
Increase (decrease) in accrued interest payable	6,574	578	1,413
Loss (gain) on derivative instruments, net	3,461	(3,044)	5,606
Loss on sale of investments, net	23,373	11,530	4,238
Fair value adjustments, net	(52)	(75)	(103)
Amortization of investment premiums, net	143,036	157,706	150,729
Other amortization and depreciation, net	1,232	1,287	1,502
Stock-based compensation expense	1,231	1,954	2,709
Change in other assets and liabilities, net	(4,118)	42	(1,047)
Net cash and cash equivalents provided by operating activities	180,560	204,448	210,514
Investing activities:			
Purchase of investments	(1,789,272)	(1,317,959)	(435,046)
Principal payments received on investments	188,898	307,133	448,567
Proceeds from sales of investments	733,064	1,073,093	99,284
Principal payments received on mortgage loans held for investment, net	4,210	3,386	4,953
Distributions received from limited partnership	—	—	10,835
Net receipts on derivatives, including terminations	(6,135)	21,986	(60,588)
Other investing activities	(102)	(206)	(37)
Net cash and cash equivalents (used in) provided by investing activities	(869,337)	87,433	67,968
Financing activities:			
Borrowings under repurchase agreements	105,236,233	84,876,542	40,594,639
Repayments of repurchase agreement borrowings	(104,534,151)	(85,209,592)	(40,805,107)
Principal payments on non-recourse collateralized financing	(2,094)	(938)	(2,039)
Proceeds from issuance of preferred stock	1,599	31,350	548
Proceeds from issuance of common stock	41,858	47,182	137
Cash paid for stock issuance costs	(10)	(61)	(201)
Cash paid for repurchases of common stock	—	—	(310)
Payments related to tax withholding for stock-based compensation	(364)	(521)	(485)
Dividends paid	(52,790)	(47,532)	(51,900)
Net cash and cash equivalents provided by (used in) financing activities	690,281	(303,570)	(264,718)
Net increase (decrease) in cash, cash equivalents, and restricted cash	1,504	(11,689)	13,764
Cash, cash equivalents, and restricted cash at beginning of period	87,200	98,889	85,125
Cash, cash equivalents, and restricted cash at end of period	$ 88,704	$ 87,200	$ 98,889
Supplemental Disclosure of Cash Activity:			
Cash paid for interest	$ 53,205	$ 35,851	$ 24,033

See notes to the consolidated financial statements.

NOTE 1 – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

Dynex Capital, Inc., ("Company") was incorporated in the Commonwealth of Virginia on December 18, 1987 and commenced operations in February 1988. The Company primarily earns income from investing on a leveraged basis in debt securities, the majority of which are specified pools of Agency and non-Agency mortgage-backed securities ("MBS") consisting of residential MBS ("RMBS"), commercial MBS ("CMBS") and CMBS interest-only ("IO") securities that are issued or guaranteed by the U.S. Government or U.S. Government sponsored agencies ("Agency MBS") and MBS issued by others ("non-Agency MBS"). The Company also invests in other types of mortgage-related securities, such as to-be-announced securities ("TBAs" or "TBA securities").

Basis of Presentation

The accompanying consolidated financial statements of Dynex Capital, Inc. and its subsidiaries (together, "Dynex" or, as appropriate, the "Company") have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP") the instructions to the Annual Report on Form 10-K and Article 3 of Regulation S-X promulgated by the Securities and Exchange Commission (the "SEC").

Consolidation and Variable Interest Entities

The consolidated financial statements include the accounts of the Company and the accounts of its majority owned subsidiaries and variable interest entities ("VIE") for which it is the primary beneficiary. All intercompany accounts and transactions have been eliminated in consolidation.

The Company consolidates a VIE if the Company is determined to be the VIE's primary beneficiary, which is defined as the party that has both: (i) the power to control the activities that most significantly impact the VIE's financial performance and (ii) the right to receive benefits or absorb losses that could potentially be significant to the VIE. The Company reconsiders its evaluation of whether to consolidate a VIE on an ongoing basis, based on changes in the facts and circumstances pertaining to the VIE.

The Company consolidates a securitization trust, which has residential mortgage loans included in "Mortgage loans held for investment, net" on its consolidated balance sheet, of which a portion is pledged as collateral for one remaining bond recorded as "Non-recourse collateralized financing" on its consolidated balance sheet. The Company owns the subordinate class in the trust and has been deemed the primary beneficiary. Please refer to Note 7 for financial information regarding this trust.

Though the Company invests in Agency and non-Agency MBS which are generally considered to be interests in VIEs, the Company does not consolidate these entities because it does not meet the criteria necessary to be deemed a primary beneficiary. Please refer to Note 2 for financial information regarding the Company's investments in these debt securities.

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 the disclosure of contingent assets and liabilities at the date of the financial statements as well as the reported amounts of revenue and expenses during the reported period. Actual results could differ from those estimates. The most significant estimates used by management include, but are not limited to, amortization of premiums and discounts, fair value measurements of its investments, and other-than-temporary impairments. These items are discussed further below within this note to the consolidated financial statements.

Income Taxes

The Company has elected to be taxed as a real estate investment trust (“REIT”) under the Internal Revenue Code of 1986 and the corresponding provisions of state law. To qualify as a REIT, the Company must meet certain tests including investing in primarily real estate-related assets and the required distribution of at least 90% of its annual REIT taxable income to stockholders after consideration of its net operating loss (“NOL”) carryforward and not including taxable income retained in its taxable subsidiaries. As a REIT, the Company generally will not be subject to federal income tax on the amount of its income or capital gains that is distributed as dividends to shareholders.

The Company assesses its tax positions for all open tax years and determines whether the Company has any material unrecognized liabilities in accordance with Accounting Standards Codification (“ASC”) Topic 740. The Company records these liabilities, if any, to the extent they are deemed more likely than not to have been incurred.

Net Income (Loss) Per Common Share

The Company calculates basic net income per common share by dividing net income to common shareholders for the period by weighted-average shares of common stock outstanding for that period. The Company did not have any potentially dilutive securities outstanding during the years ended December 31, 2018, December 31, 2017, or December 31, 2016.

Holders of unvested shares of the Company’s issued and outstanding restricted common stock are eligible to receive non-forfeitable dividends. As such, these unvested shares are considered participating securities as per ASC Topic 260-10 and therefore are included in the computation of basic net income per common share using the two-class method. Upon vesting, restrictions on transfer expire on each share of restricted stock, and each such share of restricted stock represents one unrestricted share of common stock.

Because the Company’s 8.50% Series A Cumulative Redeemable Preferred Stock (the “Series A Preferred Stock”) and 7.625% Series B Cumulative Redeemable Preferred Stock (the “Series B Preferred Stock”) are redeemable at the Company’s option for cash only and may convert into shares of common stock only upon a change of control of the Company, the effect of those shares and their related dividends is excluded from the calculation of diluted net income per common share.

Cash and Cash Equivalents

Cash and cash equivalents include cash on hand and highly liquid investments with original maturities of three months or less.

Restricted Cash

Restricted cash consists of cash the Company has pledged to cover initial and variation margin with its financing and derivative counterparties.

The Company has adopted Accounting Standards Update ("ASU") No. 2016-18, *Statement of Cash Flows (Topic 230) - Restricted Cash*, which requires amounts generally described as restricted cash or restricted cash equivalents to be included with cash and cash equivalents when reconciling the beginning of period and end of period total amounts shown on the statement of cash flows. Because this ASU is to be applied retrospectively to each period presented, “net cash and cash equivalents used in financing activities” on the Company’s consolidated statement of cash flows for the year ended December 31, 2016 now omits the change in restricted cash as previously reported for that period, and that change is now included within “net increase in cash, cash equivalents, and restricted cash” in order to conform to the current period’s presentation.

The following table provides a reconciliation of cash, cash equivalents, and restricted cash reported on the Company's consolidated balance sheet as of December 31, 2018 that sum to the total of the same such amounts shown on the Company’s consolidated statement of cash flows for the year ended December 31, 2018:

		December 31, 2018
Cash and cash equivalents	$	34,598
Restricted cash		54,106
Total cash, cash equivalents, and restricted cash shown on consolidated statement of cash flows	$	88,704

Investments in Debt Securities

The Company's investments in debt securities are designated as available-for-sale ("AFS") and are recorded at fair value on the Company's consolidated balance sheet. Changes in unrealized gain (loss) on the Company's debt securities are reported in other comprehensive income ("OCI") until the investment is sold, matures, or is determined to be other than temporarily impaired. Although the Company generally intends to hold its AFS securities until maturity, it may sell any of these securities as part of the overall management of its business. Upon the sale of an AFS security, any unrealized gain or loss is reclassified out of accumulated other comprehensive income ("AOCI") into net income as a realized "gain (loss) on sale of investments, net" using the specific identification method.

The fair value of the Company's debt securities pledged as collateral against repurchase agreements and derivative instruments is disclosed parenthetically on the Company's consolidated balance sheets.

Interest Income, Premium Amortization, and Discount Accretion. Interest income on debt securities is accrued based on the outstanding principal balance (or notional balance in the case of interest-only, or "IO", securities) and their contractual terms. Premiums or discounts associated with the purchase of Agency MBS as well as any non-Agency MBS rated 'AA' and higher are amortized or accreted into interest income over the expected life of such securities using the effective yield method, and adjustments to premium amortization and discount accretion are made for actual cash payments. The Company may also adjust premium amortization and discount accretion for changes in projected future cash payments. The Company's projections of future cash payments are based on input and analysis received from external sources and internal models and include assumptions about the amount and timing of loan prepayment rates, fluctuations in interest rates, credit losses, and other factors. On at least a quarterly basis, the Company reviews and makes any necessary adjustments to its cash flow projections and updates the yield recognized on these assets. The Company does not estimate future prepayments on its fixed-rate Agency RMBS.

The Company holds certain non-Agency MBS that had credit ratings of less than 'AA' at the time of purchase or were not rated by any of the nationally recognized credit rating agencies. A portion of these non-Agency MBS were purchased at discounts to their par value, which management does not believe to be substantial. The discount is accreted into income over the security's expected life based on management's estimate of the security's projected cash flows. Future changes in the timing of projected cash flows or differences arising between projected cash flows and actual cash flows received may result in a prospective change in the effective yield on those securities.

Determination of MBS Fair Value. The Company estimates the fair value of the majority of its MBS based upon prices obtained from third-party pricing services and broker quotes. The remainder of the Company's MBS are valued by discounting the estimated future cash flows derived from cash flow models that utilize information such as the security's coupon rate, estimated prepayment speeds, expected weighted average life, collateral composition, estimated future interest rates, expected losses, and credit enhancements as well as certain other relevant information. Refer to Note 5 for further discussion of MBS fair value measurements.

Other-than-Temporary Impairment. An MBS is considered impaired when its fair value is less than its amortized cost. The Company evaluates all of its impaired MBS for other-than-temporary impairments ("OTTI") on at least a quarterly basis. An impairment is considered other-than-temporary if: (1) the Company intends to sell the MBS; (2) it is more likely than not that the Company will be required to sell the MBS before its fair value recovers; or (3) the Company does not expect to recover the full amortized cost basis of the MBS. If either of the first two conditions is met, the entire amount of the impairment is recognized in earnings. If the impairment is solely due to the inability to fully recover the amortized cost basis, the security is further analyzed to quantify any credit loss, which is the difference between the present value of cash flows expected to be collected on the MBS and its amortized cost. The credit loss, if any, is then recognized in earnings, while the balance of impairment related to other factors is recognized in other comprehensive income.

Following the recognition of an OTTI through earnings, a new cost basis is established for the security. Any subsequent recoveries in fair value may be accreted back into the amortized cost basis of the MBS on a prospective basis through interest income. Please see Note 2 for additional information related to the Company's evaluation for OTTI.

Repurchase Agreements

The Company's repurchase agreements, which are used to finance its purchases of debt securities, are accounted for as secured borrowings under which the Company pledges its securities as collateral to secure a loan, which is equal in value to a specified percentage of the estimated fair value of the pledged collateral. The Company retains beneficial ownership of the pledged collateral. At the maturity of a repurchase agreement, the Company is required to repay the loan and concurrently receives back its pledged collateral from the lender or, with the consent of the lender, the Company may renew the agreement at the then prevailing financing rate. A repurchase agreement lender may require the Company to pledge additional collateral in the event of a decline in the fair value of the collateral pledged. Repurchase agreement financing is recourse to the Company and the assets pledged. Most of the Company's repurchase agreements are based on the September 1996 version of the Bond Market Association Master Repurchase Agreement, which generally provides that the lender, as buyer, is responsible for obtaining collateral valuations from a generally recognized source agreed to by both the Company and the lender, or, in an instance when such source is not available, the value determination is made by the lender.

Derivative Instruments

The Company's derivative instruments generally include interest rate swaps, futures, and forward contracts for the purchase or sale of non-specified Agency RMBS, commonly referred to as "TBA securities" or "TBA contracts". Derivative instruments are accounted for at the fair value of their unit of account. Derivative instruments in a gain position are reported as derivative assets and derivative instruments in a loss position are reported as derivative liabilities on the Company's consolidated balance sheet. All periodic interest costs and changes in fair value of derivative instruments, including gains and losses realized upon termination, maturity, or settlement are recorded in "gain (loss) on derivative instruments, net" on the Company's consolidated statement of comprehensive income. Cash receipts and payments related to derivative instruments are classified in the investing activities section of the consolidated statements of cash flows in accordance with the underlying nature or purpose of the derivative transactions.

The Company's interest rate swap agreements are privately negotiated in the over-the-counter ("OTC") market and the majority of these agreements are centrally cleared through the Chicago Mercantile Exchange ("CME") with the rest being subject to bilateral agreements between the Company and the swap counterparty. The Company's CME cleared swaps require that the Company post initial margin as determined by the CME, and in addition, variation margin is exchanged, typically in cash, for changes in the fair value of the CME cleared swaps. Beginning in January 2017, as a result of a change in the CME's rulebook, the exchange of variation margin for CME cleared swaps is legally considered to be the settlement of the derivative itself as opposed to a pledge of collateral. Accordingly, beginning in 2017, the Company accounts for the daily exchange of variation margin associated with its CME cleared interest rate swaps as a direct increase or decrease to the carrying value of the related derivative asset or liability. The carrying value of derivative instruments on the Company's consolidated balance sheets is the unsettled fair value of the instruments subject to bilateral agreements and not centrally cleared through the CME.

A TBA security is a forward contract ("TBA contract") for the purchase ("long position") or sale ("short position") of a non-specified Agency MBS at a predetermined price 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 settlement date. The Company accounts for long and short positions in TBAs as derivative instruments because the Company cannot assert that it is probable at inception and throughout the term of an individual TBA transaction that its settlement will result in physical delivery of the underlying Agency RMBS, or the individual TBA transaction will not settle in the shortest time period possible.

Please refer to Note 4 for additional information regarding the Company's derivative instruments as well as Note 5 for information on how the fair value of these instruments are calculated.

Share-Based Compensation

Pursuant to the Company’s 2018 Stock and Incentive Plan (“2018 Plan”), the Company may grant share-based compensation to eligible employees, non-employee directors or consultants or advisors to the Company, including restricted stock awards, stock options, stock appreciation rights, performance units, restricted stock units, and performance cash awards. The Company’s restricted stock currently issued and outstanding may be settled only in shares of its common stock, and therefore are treated as equity awards with their fair value measured at the grant date and recognized as compensation cost over the requisite service period with a corresponding credit to shareholders’ equity. The requisite service period is the period during which a participant is required to provide service in exchange for an award, which is equivalent to the vesting period specified in the terms of the time-based restricted stock award. None of the Company’s restricted stock awards have performance-based conditions. The Company does not currently have any share-based compensation issued or outstanding other than restricted stock issued to its employees, officers, and directors.

Contingencies

In the normal course of business, there may be various lawsuits, claims, and other contingencies pending against the Company. On a quarterly basis, the Company evaluates whether to establish provisions for estimated losses from those matters. The Company recognizes a liability for a contingent loss when: (a) the underlying causal event has occurred prior to the balance sheet date; (b) it is probable that a loss has been incurred; and (c) there is a reasonable basis for estimating that loss. A liability is not recognized for a contingent loss when it is only possible or remotely possible that a loss has been incurred, however, possible contingent losses shall be disclosed. If the contingent loss (or an additional loss in excess of any accrual) is at least a reasonable possibility and material, then the Company discloses a reasonable estimate of the possible loss or range of loss, if such reasonable estimate can be made. If the Company cannot make a reasonable estimate of the possible material loss, or range of loss, then that fact is disclosed.

Recent Accounting Pronouncements

The Company will be adopting Accounting Standards Update ("ASU") No. 2016-02, *Leases,* effective January 1, 2019. The Company has one operating lease for its office facilities which will be recognized as a right-of-use asset and a lease liability at the present value of the remaining minimum rental payments on its consolidated balance sheet, and the cost of the lease will be allocated over the remaining lease term on a straight-line basis in the consolidated statement of comprehensive income. The adoption of this ASU will not have a material impact on the Company’s financial condition or results of operations.

In June 2016, the Financial Accounting Standards Board (“FASB”) issued ASU No. 2016-13, *Financial Instruments - Credit Losses,* which replaces the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. For assets measured at amortized cost, the amendments in this ASU eliminate the probable initial recognition threshold in current GAAP and broaden the information that an entity must consider in developing its expected credit loss estimate to include the use of forecasted information. For assets classified as available-for-sale with changes in fair value recorded in other comprehensive income, measurement of credit losses will be similar to current GAAP. However, the amendments in this ASU require that credit losses be presented as an allowance rather than as a write-down, which is referred to in current GAAP as an other-than-temporary impairment. An entity will be able to record reversals of credit losses, if credit loss estimates decline, in net income for the current period. The amendments in this ASU will not permit an entity to use the length of time a debt security has been in an unrealized loss position to avoid recording a credit loss and removes the requirements to consider historical and implied volatility of the fair value of a security as well as recoveries or declines in fair value after the balance sheet date. The amendments in this ASU will affect an entity by varying degrees depending on a number of factors, including but not limited to, the credit quality of the assets held by the entity, their duration, and how the entity applies current GAAP. These amendments will become effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. An entity will apply the amendments in this ASU through a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective. The Company is currently evaluating the impact this ASU will have on its financial condition and results of operations.

(amounts in thousands except share data)

NOTE 2 – INVESTMENTS IN DEBT SECURITIES

The majority of the Company's debt securities are pledged as collateral for the Company's repurchase agreements. The following tables present the Company's debt securities by investment type (including securities pending settlement) as of the dates indicated:

	December 31, 2018						
	Par	Net Premium (Discount)	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value	WAC [(1)]
RMBS:							
Agency	$ 2,118,639	$ 56,744	$ 2,175,383	$ 8,902	$ (26,264)	$ 2,158,021	3.95%
Non-Agency	856	—	856	24	(22)	858	6.75%
	2,119,495	56,744	2,176,239	8,926	(26,286)	2,158,879	
CMBS:							
Agency	1,071,906	8,518	1,080,424	6,141	(29,550)	1,057,015	3.22%
Non-Agency	3,040	(2,037)	1,003	413	—	1,416	6.47%
	1,074,946	6,481	1,081,427	6,554	(29,550)	1,058,431	
CMBS IO [(2)]:							
Agency	—	287,062	287,062	4,281	(239)	291,104	0.55%
Non-Agency	—	240,681	240,681	1,675	(1,306)	241,050	0.57%
	—	527,743	527,743	5,956	(1,545)	532,154	
U.S. Treasuries:	—	—	—	—	—	—	—%
Total AFS securities:	$ 3,194,441	$ 590,968	$ 3,785,409	$ 21,436	$ (57,381)	$ 3,749,464	

(1) The weighted average coupon ("WAC") is the gross interest rate of the security weighted by the outstanding principal balance (or by notional balance in the case of an IO security).
(2) The notional balance for Agency CMBS IO and non-Agency CMBS IO was $13,048,666 and $10,275,494 respectively, as of December 31, 2018.

	December 31, 2017						
	Par	Net Premium (Discount)	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value	WAC (1)
RMBS:							
Agency	$ 1,146,553	$ 46,021	$ 1,192,574	$ 1,626	$ (9,939)	$ 1,184,261	3.56%
Non-Agency	1,070	—	1,070	41	(20)	1,091	6.75%
	1,147,623	46,021	1,193,644	1,667	(9,959)	1,185,352	
CMBS:							
Agency	1,123,967	10,442	1,134,409	3,514	(13,572)	1,124,351	3.03%
Non-Agency	26,501	(4,035)	22,466	2,298	—	24,764	5.47%
	1,150,468	6,407	1,156,875	5,812	(13,572)	1,149,115	
CMBS IO (2):							
Agency	—	375,361	375,361	5,238	(293)	380,306	0.62%
Non-Agency	—	308,472	308,472	4,468	(724)	312,216	0.61%
	—	683,833	683,833	9,706	(1,017)	692,522	
U.S. Treasuries:	148,400	(133)	148,267	—	(1,737)	146,530	2.13%
Total AFS securities:	$ 2,446,491	$ 736,128	$ 3,182,619	$ 17,185	$ (26,285)	$ 3,173,519	

(1) The WAC is the gross interest rate of the security weighted by the outstanding principal balance (or by notional balance in the case of an IO security).
(2) The notional balance for the Agency CMBS IO and non-Agency CMBS IO was $14,196,122 and $11,006,463, respectively, as of December 31, 2017.

Actual maturities of MBS are affected by the contractual lives of the underlying mortgage collateral, periodic payments of principal, prepayments of principal, and the payment priority structure of the security; therefore, actual maturities are generally shorter than the securities' stated contractual maturities. The following table categorizes the Company’s debt securities according to their stated maturity as of the dates indicated:

	December 31, 2018		December 31, 2017	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Less than 1 year	$ 39,868	$ 39,808	$ 4,480	$ 4,542
≥1 and <5 years	151,041	152,917	208,046	210,727
≥5 and <10 years	828,543	806,015	1,334,795	1,326,178
≥ 10 years	2,765,957	2,750,724	1,635,298	1,632,072
	$ 3,785,409	$ 3,749,464	$ 3,182,619	$ 3,173,519

The following table presents information regarding the sales that generated the “loss on sale of investments, net” on the Company’s consolidated statements of comprehensive income (loss) for the periods indicated:

	Year Ended December 31,					
	2018		2017		2016	
	Proceeds Received	Realized Gain (Loss)	Proceeds Received	Realized Gain (Loss)	Proceeds Received	Realized Gain (Loss)
Agency RMBS	$ 217,837	$ (7,785)	$ 716,560	$ (12,392)	$ 54,178	$ (3,010)
Agency CMBS	242,029	(9,218)	252,624	(135)	—	—
Agency CMBS IO	15,700	146	—	—	—	—
Non-Agency CMBS	—	—	35,705	1,199	33,640	(1,228)
Non-Agency RMBS	—	—	16,407	42	—	—
Non-Agency CMBS IO	8,695	51	—	—	—	—
U.S. Treasuries	248,803	(6,567)	51,797	(244)	—	—
	$ 733,064	$ (23,373)	$ 1,073,093	$ (11,530)	$ 87,818	$ (4,238)

The following table presents certain information for the AFS securities in an unrealized loss position as of the dates indicated:

	December 31, 2018			December 31, 2017		
	Fair Value	Gross Unrealized Losses	# of Securities	Fair Value	Gross Unrealized Losses	# of Securities
Continuous unrealized loss position for less than 12 months:						
Agency MBS	$ 581,440	$ (1,793)	28	$ 1,293,798	$ (9,769)	71
Non-Agency MBS	70,876	(581)	22	51,406	(421)	11
U.S. Treasuries	—	—	0	146,530	(1,737)	1
Continuous unrealized loss position for 12 months or longer:						
Agency MBS	$ 1,543,892	$ (54,260)	88	$ 423,698	$ (14,035)	30
Non-Agency MBS	46,154	(747)	19	20,414	(323)	12

Because the principal related to Agency MBS is guaranteed by the government-sponsored entities Fannie Mae and Freddie Mac which have AAA ratings due to the Treasury's commitment of capital under the Senior Preferred Stock Purchase Agreement, the Company does not consider any of the unrealized losses on its Agency MBS to be credit related. Although the unrealized losses are not credit related, the Company assesses its ability and intent to hold any Agency MBS with an unrealized loss until the recovery in its value in accordance with GAAP. This assessment is based on the amount of the unrealized loss and significance of the related investment as well as the Company's leverage and liquidity position. Based on this analysis, the Company has determined that the unrealized losses on its Agency MBS as of December 31, 2018 and December 31, 2017 were temporary.

The Company reviews any non-Agency MBS in an unrealized loss position to evaluate whether any decline in fair value represents an OTTI. The evaluation includes a review of the credit ratings of the non-Agency MBS, the credit characteristics of the mortgage loans collateralizing these securities, and the estimated future cash flows including projected collateral losses. The Company also assesses its ability and intent to hold any non-Agency MBS with an unrealized loss until the recovery in its value in accordance with GAAP. The Company performed this evaluation for its non-Agency MBS in an unrealized loss position and has determined that there have not been any adverse changes in the timing or amount of estimated future cash flows that necessitate a recognition of OTTI amounts as of December 31, 2018 or December 31, 2017.

NOTE 3 – REPURCHASE AGREEMENTS

The Company's repurchase agreements outstanding as of December 31, 2018 and December 31, 2017 are summarized in the following tables:

	December 31, 2018			December 31, 2017		
Collateral Type	**Balance**	**Weighted Average Rate**	**Fair Value of Collateral Pledged**	**Balance**	**Weighted Average Rate**	**Fair Value of Collateral Pledged**
Agency RMBS	$ 1,887,878	2.66%	$ 1,998,922	$ 836,281	1.47%	$ 867,120
Agency CMBS	919,833	2.51%	986,861	1,003,146	1.44%	1,071,904
Agency CMBS IO	253,258	2.96%	285,247	324,163	2.17%	372,077
Non-Agency CMBS IO	207,015	3.38%	240,574	263,694	2.43%	311,571
Non-Agency CMBS	—	—%	—	15,508	2.47%	18,212
U.S. Treasuries	—	—%	—	123,110	1.85%	124,215
Total repurchase agreements	$ 3,267,984	2.69%	$ 3,511,604	$ 2,565,902	1.67%	$ 2,765,099

The Company also had $58,915 and $156,899 payable to counterparties as of December 31, 2018 and December 31, 2017, respectively, which consisted of securities pending settlement as of those respective dates.

The following table provides information on the remaining term to maturity and original term to maturity for the Company's repurchase agreements as of the dates indicated:

	December 31, 2018		December 31, 2017	
Remaining Term to Maturity	**Balance**	**WAVG Original Term to Maturity**	**Balance**	**WAVG Original Term to Maturity**
Less than 30 days	$ 2,319,911	56	$ 2,240,791	49
30 to 90 days	948,073	89	274,231	90
91 to 180 days	—	—	50,880	121
Total	$ 3,267,984	66	$ 2,565,902	54

The following table lists the counterparties with whom the Company had approximately 10% or more of its shareholders' equity at risk (defined as the excess of collateral pledged over the borrowings outstanding) as of the date indicated:

	December 31, 2018		
Counterparty Name	**Balance**	**Weighted Average Rate**	**Equity at Risk**
Wells Fargo Bank, N. A. and affiliates	$ 292,859	3.19%	$ 43,698

Of the amount outstanding with Wells Fargo Bank, N.A. and affiliates, $160,280 is under a committed repurchase facility which has an aggregate maximum borrowing capacity of $400,000 and is scheduled to mature on May 12, 2019, subject to early termination provisions contained in the master repurchase agreement. The facility is collateralized by CMBS IO, and its weighted average borrowing rate as of December 31, 2018 was 3.38%.

As of December 31, 2018, the Company had repurchase agreement amounts outstanding with 17 of its 36 available repurchase agreement counterparties. The Company's counterparties, as set forth in the master repurchase agreement with the counterparty, require the Company to comply with various customary operating and financial covenants, including, but not limited to, minimum net worth and earnings, maximum declines in net worth in a given period, and maximum leverage requirements as well as maintaining the Company’s REIT status. In addition, some of the agreements contain cross default features, whereby default under an agreement with one lender simultaneously causes default under agreements with other lenders. To the extent that the Company fails to comply with the covenants contained in these financing agreements or is otherwise found to be in default under the terms of such agreements, the counterparty has the right to accelerate amounts due under the master repurchase agreement. The Company was in full compliance with all covenants as of December 31, 2018.

The Company's repurchase agreements are subject to underlying agreements with master netting or similar arrangements, which provide for the right of offset in the event of default or in the event of bankruptcy of either party to the transactions. The Company reports its repurchase agreements to these arrangements on a gross basis. The following tables present information regarding the Company's repurchase agreements as if the Company had presented them on a net basis as of December 31, 2018 and December 31, 2017:

				Gross Amount Not Offset in the Balance Sheet [1]		
	Gross Amount of Recognized Liabilities	Gross Amount Offset in the Balance Sheet	Net Amount of Liabilities Presented in the Balance Sheet	Financial Instruments Posted as Collateral	Cash Posted as Collateral	Net Amount
December 31, 2018						
Repurchase agreements	$ 3,267,984	$ —	$ 3,267,984	$ (3,267,984)	$ —	$ —
December 31, 2017						
Repurchase agreements	$ 2,565,902	$ —	$ 2,565,902	$ (2,565,902)	$ —	$ —

(1) Amounts disclosed for collateral received by or posted to the same counterparty include cash and the fair value of debt securities up to and not exceeding the net amount of the repurchase agreement liability presented in the balance sheet. The fair value of the total collateral received by or posted to the same counterparty may exceed the amounts presented.

Please see Note 4 for information related to the Company’s derivatives which are also subject to underlying agreements with master netting or similar arrangements.

NOTE 4 – DERIVATIVES

The Company is a party to certain types of financial instruments that are accounted for as derivative instruments. Please refer to Note 1 for information related to the Company’s accounting policy for its derivative instruments.

Types and Uses of Derivatives Instruments

Interest Rate Derivatives. Changing interest rates impact the fair value of the Company’s investments as well as the interest rates on the Company’s repurchase agreement borrowings used to finance its investments. The Company primarily uses interest rate swaps as economic hedges to mitigate declines in book value and to protect some portion of the Company's earnings from rising interest rates. The Company may also periodically utilize other types of interest rate derivatives, such as Eurodollar and U.S. Treasury futures as economic hedges.

TBA Transactions. The Company also holds long positions in TBA securities by executing a series of transactions which effectively delay the settlement of a forward purchase of a non-specified Agency RMBS by entering into an offsetting TBA short position, net settling the paired-off positions in cash, and simultaneously entering into an identical TBA long position with a later settlement date. These long positions in TBA securities (“dollar roll positions”) are viewed by management as economically equivalent to investing in and financing non-specified fixed-rate Agency RMBS. TBA securities purchased for a forward settlement month are generally priced at a discount relative to TBA securities sold for settlement in the current month. This discount, often referred to as “drop income” represents the economic equivalent of net interest income (interest income less implied financing cost) on the underlying Agency security from trade date to settlement date.

Periodically, the Company may also hold short positions in TBA securities for the purpose of economically hedging a portion of the impact of changing interest rates on the fair value of the Company’s fixed-rate Agency RMBS. The Company did not hold any short positions in TBA securities as of December 31, 2018.

The table below summarizes information about the fair value by type of derivative instrument on the Company's consolidated balance sheets as of the dates indicated:

Type of Derivative Instrument	Balance Sheet Location	Purpose	December 31, 2018	December 31, 2017
Interest rate swaps	Derivative assets	Economic hedging	$ 324	$ 791
Eurodollar futures	Derivative assets	Economic hedging	—	666
TBA securities	Derivative assets	Trading	6,239	1,483
			$ 6,563	$ 2,940
U.S. Treasury futures	Derivative liabilities	Economic hedging	$ (1,218)	$ —
TBA securities	Derivative liabilities	Economic hedging	—	(269)
			$ (1,218)	$ (269)

The table below provides detail of the Company's "(loss) gain on derivative instruments, net" by type of derivative for the periods indicated:

	Year Ended December 31,		
Type of Derivative Instrument	2018	2017	2016
Receive-fixed interest rate swaps	$ (1,658)	$ 23	$ 2,515
Pay-fixed interest rate swaps	12,021	(2,655)	(3,306)
Eurodollar futures	1,887	821	(4,815)
TBA dollar roll positions	(10,737)	5,757	—
TBA economic hedges	293	(902)	—
U.S. Treasury futures	(4,609)	—	—
Options on U.S. Treasury futures	(658)	—	—
(Loss) gain on derivative instruments, net	$ (3,461)	$ 3,044	$ (5,606)

There is a net unrealized gain of $165 remaining in AOCI on the Company's consolidated balance sheet as of December 31, 2018 which represents the activity related to interest rate swap agreements while they were previously designated as cash flow hedges, and this amount will be recognized in the Company's net income as an adjustment to "interest expense" over the remaining contractual life of the agreements. The Company estimates a credit of $126 will be reclassified to net income as a reduction of "interest expense" within the next 12 months.

Interest Rate Swaps

The following tables present information about the Company's interest rate swaps as of the dates indicated:

	December 31, 2018			
		Weighted-Average:		
Years to Maturity:	**Net Notional Amount [1]**	**Pay Rate [2]**	**Life Remaining (in Years)**	**Fair Value [3]**
≤ 3 years	$ 1,560,000	1.96%	1.4	$ 324
>3 and ≤ 6 years	1,230,000	2.23%	4.4	—
>6 and ≤ 10 years	1,505,000	2.80%	8.3	—
>10 years	220,000	2.81%	21.9	—
Total	$ 4,515,000	2.35%	5.5	$ 324

	December 31, 2017			
		Weighted-Average:		
Years to Maturity:	**Net Notional Amount [1]**	**Pay Rate [2]**	**Life Remaining (in Years)**	**Fair Value [3]**
≤ 3 years	$ 3,320,000	1.35%	0.7	$ 791
>3 and ≤ 6 years	1,210,000	2.00%	4.6	—
>6 and ≤ 10 years	1,025,000	2.49%	8.0	—
>10 years	120,000	2.75%	17.3	—
Total	$ 5,675,000	1.71%	3.1	$ 791

(1) The net notional amounts included in the tables above represent pay-fixed interest rate swaps, net of any receive-fixed interest rate swaps, and include $775,000 and $2,655,000 of pay-fixed forward starting interest rate swaps as of December 31, 2018 and December 31, 2017, respectively.

(2) Excluding forward starting pay-fixed interest rate swaps, the weighted average pay rate was 2.29% and 1.36% as of December 31, 2018 and December 31, 2017, respectively.

(3) The majority of the Company's interest rate swap agreements are centrally cleared through the CME. Please refer to Note 1 for information regarding the exchange of variation margin being legally considered as settlement of the derivative as opposed to a pledge of collateral.

A portion of the Company's interest rate swaps were entered into under bilateral agreements which contain cross-default provisions with other agreements between the parties. In addition, these bilateral agreements contain financial and operational covenants similar to those contained in the repurchase agreements as described in Note 3. The Company was in compliance with all covenants with respect to bilateral agreements under which interest rate swaps were entered into as of December 31, 2018.

TBA Securities

The following table summarizes information about the Company's TBA securities as of the dates indicated:

TBA Securities:	December 31, 2018 Notional Amount (1)	Implied Cost Basis (2)	Implied Market Value (3)	Net Carrying Value (4)
Dollar roll positions	$ 860,000	$ 882,230	$ 888,469	$ 6,239
	December 31, 2017			
	Notional Amount (1)	**Implied Cost Basis (2)**	**Implied Market Value (3)**	**Net Carrying Value (4)**
Dollar roll positions	$ 795,000	$ 829,425	$ 830,908	$ 1,483
Economic hedges	$ 150,000	$ (153,797)	$ (154,066)	$ (269)

(1) Notional amount represents the par value (or principal balance) of the underlying Agency MBS as if settled as of the date indicated.

(2) Implied cost basis represents the forward price to be paid for the underlying Agency MBS as if settled as of the date indicated.

(3) Implied market value represents the estimated fair value of the underlying Agency MBS as if settled as of the date indicated.

(4) Net carrying value is the amount included on the consolidated balance sheets within "derivative assets (liabilities)" and represents the difference between the implied market value and the implied cost basis of the TBA security as of the date indicated.

Volume of Activity

The tables below summarize changes in the Company's derivative instruments for the periods indicated:

Type of Derivative Instrument	Notional Amount as of December 31, 2017	Additions	Settlements, Terminations, or Pair-Offs	Notional Amount as of December 31, 2018
Receive-fixed interest rate swaps	$ 100,000	$ —	$ (100,000)	$ —
Pay-fixed interest rate swaps	5,775,000	1,770,000	(3,030,000)	4,515,000
Eurodollar futures (1)	1,950,000	—	(1,950,000)	—
TBA dollar roll positions	795,000	9,689,000	(9,624,000)	860,000
TBA economic hedges	150,000	—	(150,000)	—
U.S. Treasury futures	—	470,000	(420,000)	50,000
Options on U.S. Treasury futures	—	800,000	(800,000)	—

(1) The Eurodollar futures notional amounts represent the total notional of the 3-month contracts all of which expired in 2018. The maximum notional outstanding for any future 3-month period did not exceed $650,000 during the period indicated.

Offsetting

The Company's derivatives are subject to underlying agreements with master netting or similar arrangements, which provide for the right of offset in the event of default or in the event of bankruptcy of either party to the transactions. The Company reports its derivative assets and liabilities subject to these arrangements on a gross basis. The following tables present information regarding those derivative assets and liabilities subject to such arrangements as if the Company had presented them on a net basis as of December 31, 2018 and December 31, 2017:

Offsetting of Assets						
				Gross Amount Not Offset in the Balance Sheet [1]		
	Gross Amount of Recognized Assets	Gross Amount Offset in the Balance Sheet	Net Amount of Assets Presented in the Balance Sheet	Financial Instruments Received as Collateral	Cash Received as Collateral	Net Amount
December 31, 2018						
Interest rate swaps	$ 324	$ —	$ 324	$ —	$ —	$ 324
TBA securities	6,239	—	6,239	—	(1,719)	4,520
Derivative assets	$ 6,563	$ —	$ 6,563	$ —	$ (1,719)	$ 4,844
December 31, 2017						
Interest rate swaps	$ 791	$ —	$ 791	$ —	$ —	$ 791
Eurodollar futures	666	—	666	—	(666)	—
TBA securities	1,483	—	1,483	(180)	—	1,303
Derivative assets	$ 2,940	$ —	$ 2,940	$ (180)	$ (666)	$ 2,094

Offsetting of Liabilities						
				Gross Amount Not Offset in the Balance Sheet [1]		
	Gross Amount of Recognized Liabilities	Gross Amount Offset in the Balance Sheet	Net Amount of Liabilities Presented in the Balance Sheet	Financial Instruments Posted as Collateral	Cash Posted as Collateral	Net Amount
December 31, 2018						
Interest rate swaps	$ —	$ —	$ —	$ —	$ —	$ —
U.S. Treasury futures	1,218	—	1,218	—	(1,218)	—
Derivative liabilities	$ 1,218	$ —	$ 1,218	$ —	$ (1,218)	$ —
December 31, 2017						
Interest rate swaps	$ —	$ —	$ —	$ —	$ —	$ —
TBA securities	269	—	269	(180)	—	89
Derivative liabilities	$ 269	$ —	$ 269	$ (180)	$ —	$ 89

(1) Amounts disclosed for collateral received by or posted to the same counterparty include cash and the fair value of MBS up to and not exceeding the net amount of the derivative asset or liability presented in the balance sheet. The fair value of the total collateral received by or posted to the same counterparty may exceed the amounts presented. Please refer to the consolidated balance sheets for the total cash posted as collateral, which is recorded as "restricted cash", and the total fair value of financial instruments pledged as collateral for derivatives and repurchase agreements, which is shown parenthetically.

Please see Note 3 for information related to the Company's repurchase agreements which are also subject to underlying agreements with master netting or similar arrangements.

NOTE 5 – FAIR VALUE OF FINANCIAL INSTRUMENTS

ASC Topic 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC Topic 820 clarifies that fair value should be based on the assumptions market participants would use when pricing an asset or liability and also requires an entity to consider all aspects of nonperformance risk, including the entity's own credit standing, when measuring fair value of a liability. ASC Topic 820 established a valuation hierarchy of three levels as follows:

- Level 1 – Inputs are unadjusted, quoted prices in active markets for identical assets or liabilities as of the measurement date.
- Level 2 – Inputs include quoted prices in active markets for similar assets or liabilities; quoted prices in inactive markets for identical or similar assets or liabilities; or inputs either directly observable or indirectly observable through correlation with market data at the measurement date and for the duration of the instrument's anticipated life.
- Level 3 – Unobservable inputs are supported by little or no market activity. The unobservable inputs represent management's best estimate of how market participants would price the asset or liability at the measurement date. Consideration is given to the risk inherent in the valuation technique and the risk inherent in the inputs to the model.

The following table presents the Company's financial instruments that are measured at fair value on a recurring basis by their valuation hierarchy levels as of the dates indicated:

	December 31, 2018				December 31, 2017			
	Fair Value	Level 1	Level 2	Level 3	Fair Value	Level 1	Level 2	Level 3
Assets carried at fair value:								
Investments in debt securities:								
MBS	$ 3,749,464	$ —	$ 3,747,190	$ 2,274	$ 3,026,989	$ —	$ 3,019,746	$ 7,243
U.S. Treasuries	—	—	—	—	146,530	146,530	—	—
Derivative assets:								
Interest rate swaps	324	—	324	—	791	—	791	—
Eurodollar futures	—	—	—	—	666	666	—	—
TBA securities	6,239	—	6,239	—	1,483	—	1,483	—
Total assets carried at fair value	$ 3,756,027	$ —	$ 3,753,753	$ 2,274	$ 3,176,459	$ 147,196	$ 3,022,020	$ 7,243
Liabilities carried at fair value:								
U.S. Treasury futures	$ 1,218	$ 1,218	$ —	$ —	$ —	$ —	$ —	$ —
TBA securities	—	—	—	—	269	—	269	—
Total liabilities carried at fair value	$ 1,218	$ 1,218	$ —	$ —	$ 269	$ —	$ 269	$ —

The fair value of interest rate swaps is measured using the income approach with the primary input being the forward interest rate swap curve, which is considered an observable input, and thus their fair values are considered Level 2 measurements. Eurodollar futures and U.S. Treasury futures are valued based on closing exchange prices on these contracts and are classified accordingly as Level 1 measurements. The fair value of TBA securities is estimated using methods similar those used to fair value the Company's Level 2 MBS.

The fair value measurements for a majority of the Company's MBS are considered Level 2 because these securities are substantially similar to securities that either are actively traded or have been recently traded in their respective markets. The Company determines the fair value of its Level 2 securities based on prices received from the Company's primary pricing service as well as other pricing services and brokers. The Company evaluates the third-party prices it receives to assess their reasonableness. Although the Company does not adjust third-party prices, they may be excluded from use in the determination of a security's fair value if they are significantly different from other observable market data. In valuing a security, the primary pricing service uses either a market approach, which uses observable prices and other relevant information that is generated by market transactions of identical or similar securities, or an income approach, which uses valuation techniques to convert future amounts to a single, discounted present value amount. The Company also reviews the assumptions and inputs utilized in the valuation techniques of its primary pricing service. Examples of these observable inputs and assumptions include market interest rates, credit spreads, and projected prepayment speeds, among other things.

The Company owns certain non-Agency MBS for which there are not sufficiently recent trades of substantially similar securities, and their fair value measurements are thus considered Level 3. The Company determines the fair value of its Level 3 securities by discounting the estimated future cash flows derived from cash flow models using significant inputs which are determined by the Company when market observable inputs are not available. Information utilized in those pricing models include the security's credit rating, coupon rate, estimated prepayment speeds, expected weighted average life, collateral composition, estimated future interest rates, expected credit losses, and credit enhancement as well as certain other relevant information. Significant changes in any of these inputs in isolation may result in a significantly different fair value measurement. Level 3 assets are generally most sensitive to the default rate and severity assumptions.

The activity of the Company's non-Agency MBS measured at fair value on a recurring basis using Level 3 inputs is presented in the following table for the periods indicated:

	Year Ended December 31,	
	2018	**2017**
Balance as of beginning of period	$ 7,243	$ 10,927
Unrealized loss included in OCI	(1,850)	(1,733)
Principal payments	(5,071)	(4,351)
Accretion	1,952	2,400
Balance as of end of period	$ 2,274	$ 7,243

The Company reviews the classification of its financial instruments within the fair value hierarchy on a quarterly basis, and management may conclude that its financial instruments should be reclassified to a different level in the future if a change in type of inputs occurs.

The following table presents a summary of the carrying value and estimated fair values of the Company's financial instruments as of the dates indicated:

	December 31, 2018		December 31, 2017	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Assets:				
Mortgage-backed securities	$ 3,749,464	$ 3,749,464	$ 3,026,989	$ 3,026,989
U.S. Treasuries	—	—	146,530	146,530
Mortgage loans held for investment, net (1)	11,527	8,566	15,738	12,973
Derivative assets	6,563	6,563	2,940	2,940
Liabilities:				
Repurchase agreements (2)	$ 3,267,984	$ 3,267,984	$ 2,565,902	$ 2,565,902
Non-recourse collateralized financing (1)	3,458	3,475	5,520	5,554
Derivative liabilities	1,218	1,218	269	269

(1) The Company determines the fair value of its mortgage loans held for investment, net and its non-recourse collateralized financing using internally developed cash flow models with inputs similar to those used to estimate the fair value of the Company's Level 3 non-Agency MBS.
(2) The carrying value of repurchase agreements generally approximates fair value due to their short-term maturities.

NOTE 6 – SHAREHOLDERS' EQUITY AND SHARE-BASED COMPENSATION

Preferred Stock

The Company's articles of incorporation authorize the issuance of up to 50,000,000 shares of preferred stock, par value $0.01 per share, of which the Company's Board of Directors has designated 8,000,000 shares of 8.50% Series A Preferred Stock and 7,000,000 shares of 7.625% Series B Preferred Stock, (the Series A Preferred Stock and the Series B Preferred Stock collectively, the "Preferred Stock"). The Company had 2,300,000 shares of its Series A Preferred Stock and 3,654,594 shares of its Series B Preferred Stock issued and outstanding as of December 31, 2018 compared to 2,300,000 shares of Series A Preferred Stock and 3,588,680 shares of Series B Preferred Stock as of December 31, 2017.

The Preferred Stock has no maturity and will remain outstanding indefinitely unless redeemed or otherwise repurchased or converted into common stock pursuant to the terms of the Preferred Stock. The Company's Preferred Stock may be redeemed in whole, or in part, at any time and from time to time at the Company's option at a cash redemption price of $25.00 per share plus any accumulated and unpaid dividends. Because the Preferred Stock is redeemable only at the option of the issuer, it is classified as equity on the Company's consolidated balance sheet. The Series A Preferred Stock pays a cumulative cash dividend equivalent to 8.50% of the $25.00 liquidation preference per share each year and the Series B Preferred Stock pays a cumulative cash dividend equivalent to 7.625% of the $25.00 liquidation preference per share each year. The Company paid its regular quarterly dividends on its Preferred Stock for the fourth quarter on January 15, 2019 to shareholders of record as of January 1, 2019.

Common Stock

The Company declared a fourth quarter common stock dividend of $0.18 per share that was paid on January 31, 2019 to shareholders of record as of December 31, 2018.

Stock and Incentive Plans. The Company's Board adopted the 2018 Stock and Incentive Plan which was approved by the Company's shareholders on May 15, 2018. The 2018 Plan, which replaced the Company's 2009 Stock and Incentive Plan (the "2009 Plan"), reserves for issuance up to 3,000,000 shares of common stock for eligible employees, non-employee directors, consultants, and advisors to the Company to be granted in the form of stock options, restricted stock awards, restricted stock units, stock appreciation rights, performance units, and performance cash awards. During the year ended December 31, 2018, 36,924 shares of restricted stock were issued under the 2018 Plan. Awards previously granted under the 2009 Plan will remain outstanding in accordance with their terms, but the Company will not grant any new equity awards under the 2009 Plan.

Total stock-based compensation expense recognized by the Company for the year ended December 31, 2018 was $1,231 compared to $1,954 and $2,709 for the years ended December 31, 2017 and December 31, 2016, respectively. The following table presents a rollforward of the restricted stock activity for the periods indicated:

	Year Ended December 31,					
	2018		2017		2016	
	Shares	Weighted Average Grant Date Fair Value Per Share	Shares	Weighted Average Grant Date Fair Value Per Share	Shares	Weighted Average Grant Date Fair Value Per Share
Restricted stock outstanding as of beginning of period	353,103	$ 7.01	553,396	$ 7.55	696,597	$ 8.54
Restricted stock granted	213,157	6.28	138,166	6.76	214,878	6.28
Restricted stock vested	(224,547)	7.28	(338,459)	7.80	(358,079)	8.71
Restricted stock outstanding as of end of period	341,713	$ 6.37	353,103	$ 7.01	553,396	$ 7.55

As of December 31, 2018, the grant date fair value of the Company's remaining nonvested restricted stock is $1,233 which will be amortized into compensation expense over a weighted average period of 1.7 years.

NOTE 7 – MORTGAGE LOANS HELD FOR INVESTMENT, NET AND RELATED NON-RECOURSE COLLATERALIZED FINANCING

The Company's mortgage loans held for investment, net are single-family mortgage loans which were originated or purchased by the Company prior to 2000. The amortized cost of these loans declined to $11,623 as of December 31, 2018 from $15,885 as of December 31, 2017 due primarily to principal payments. An allowance has been established for currently existing and probable losses on the Company's mortgage loans held for investment, which was $96 as of December 31, 2018 compared to $147 as of December 31, 2017. The Company's single-family mortgage loans are evaluated individually for impairment on a quarterly basis considering various factors including whether a loan is delinquent, the Company's historical experience with similar types of loans, historical cure rates of delinquent loans, and historical and anticipated loss severity of the mortgage loans as they are liquidated. The Company recorded $50, $80, and $130 as provision for loan losses for the years ended December 31, 2018, 2017, and 2016, respectively, which is included within "other operating (expense) income, net" on the Company's consolidated statements of comprehensive income (loss).

The majority of the Company's mortgage loans held for investment, net is pledged as collateral for the one remaining class of the Company's single-family securitization financing bond, which is recorded on the Company's balance sheet as "non-recourse collateralized financing". As of December 31, 2018, $4,141 of the principal balance of the Company's mortgage loans held for investment was pledged as collateral for the Company's non-recourse collateralized financing which had a remaining principal balance of $3,502. As of December 31, 2017, $6,233 of the principal balance of the Company's mortgage loans held for investment was pledged as collateral for the remaining principal balance of the outstanding bonds of $5,596.

NOTE 8 – INCOME TAXES

The Company's estimated REIT taxable income before consideration of its NOL carryforward was $21,085 for the year ended December 31, 2018, $21,332 for the year ended December 31, 2017, and $21,702 for the year ended December 31, 2016. After common and preferred dividend distributions during those years as well as utilization of the Company's NOL carryforward to offset taxable earnings, the Company does not expect to incur any income tax liability for the year ended December 31, 2018 and did not incur any material income tax liability for the years ending December 31, 2017 or December 31, 2016.

The Company's estimated NOL carryforward as of December 31, 2018 is $89,775. Because the Company incurred an "ownership change" under Section 382 of the Internal Revenue Code ("Section 382"), the Company's ability to utilize its NOL carryforward to offset its taxable income after any required dividend distributions is limited to approximately $13,451 per year with any unused amounts being accumulated and carried forward for use in subsequent years. As of December 31, 2018, the Company had $65,543 of NOL that is not subject to the existing Section 382 limitations available to offset any future taxable income. The NOL will expire beginning in 2020 to the extent it is not used.

After reviewing for any potentially uncertain income tax positions, the Company has concluded that it does not have any uncertain tax positions that meet the recognition or measurement criteria of ASC 740 as of December 31, 2018, December 31, 2017, or December 31, 2016, although its tax returns for those tax years are open to examination by the IRS. In the event that the Company incurs income tax related interest and penalties, its policy is to classify them as a component of provision for income taxes.

NOTE 9 – RELATED PARTY TRANSACTIONS

As noted in previous filings, DCI Commercial, Inc. (“DCI”), a former affiliate of the Company and formerly known as Dynex Commercial, Inc., was named a party to several lawsuits in 1999 and 2000 regarding the activities of DCI while it was an operating subsidiary of an affiliate of the Company. The Company was named a party to several of the lawsuits (the “DCI Litigation”) due to its affiliation with DCI. In December 2000, the Company and DCI entered into a Litigation Cost Sharing Agreement (the “Agreement”) whereby the Company agreed to advance DCI's portion of the costs of defending against the DCI Litigation. All matters related to the DCI Litigation have concluded. As discussed in Part 1, Item 3 of this Annual Report on Form 10-K, plaintiffs in one matter are seeking to enforce a judgment obtained against DCI against the Company under various legal theories including pursuant to the Agreement. The Company continues to fund the costs of defense for DCI under the Agreement. DCI costs advanced by the Company are loans and bear simple interest at the rate of Prime plus 8.0% per annum. The Company's advances to cover DCI's costs during the years ended December 31, 2018, 2017, and 2016 were $307, $30, and $173, respectively. The total amount due to the Company under the Litigation Cost Sharing Agreement including interest was $11,396 as of December 31, 2018 compared to $10,615 as of December 31, 2017. Because DCI does not currently have any assets, the amount due as of December 31, 2018 has been fully reserved for collectability by the Company. DCI is currently wholly owned by a company unaffiliated with the Company. An executive of the Company is the sole shareholder of this unaffiliated company.

NOTE 10 - QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

	Year Ended December 31, 2018			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Operating results:				
Interest income	$ 25,190	$ 25,922	$ 26,925	$ 32,014
Interest expense	11,595	14,175	14,751	19,053
Net interest income	13,595	11,747	12,174	12,961
Gain (loss) on derivative instruments, net	38,354	20,667	19,499	(81,981)
Loss on sale of investments, net	(3,775)	(12,444)	(1,726)	(5,428)
Fair value adjustments	29	27	12	(16)
Other operating expense, net	(253)	(339)	(409)	(566)
General and administrative expenses	(3,643)	(4,006)	(3,964)	(3,492)
Preferred stock dividends	(2,940)	(2,942)	(2,956)	(2,963)
Net income (loss) to common shareholders	41,367	12,710	22,630	(81,485)
Other comprehensive (loss) income	(45,462)	(9,760)	(21,914)	50,054
Comprehensive (loss) income to common shareholders	$ (4,095)	$ 2,950	$ 716	$ (31,431)
Net income (loss) per common share	$ 0.74	$ 0.23	$ 0.39	$ (1.34)
Dividends declared per common share	$ 0.18	$ 0.18	$ 0.18	$ 0.18

	Year Ended December 31, 2017			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Operating results:				
Interest income	$ 22,419	$ 24,856	$ 23,103	$ 24,124
Interest expense	7,519	8,714	9,889	10,056
Net interest income	14,900	16,142	13,214	14,068
Gain (loss) on derivative instruments, net	175	(15,802)	5,993	12,678
Loss on sale of investments, net	(1,708)	(3,709)	(5,211)	(902)
Fair value adjustments	10	30	23	12
Other operating (expense) income, net	(46)	4	(109)	(50)
General and administrative expenses	(4,280)	(4,097)	(3,599)	(3,843)
Preferred stock dividends	(2,435)	(2,641)	(2,808)	(2,910)
Net income (loss) to common shareholders	6,616	(10,073)	7,503	19,053
Other comprehensive income (loss)	19,977	12,375	6,144	(14,584)
Comprehensive income (loss) to common shareholders	$ 26,593	$ 2,302	$ 13,647	$ 4,469
Net income (loss) per common share	$ 0.13	$ (0.20)	$ 0.15	$ 0.36
Dividends declared per common share	$ 0.18	$ 0.18	$ 0.18	$ 0.18

NOTE 11 – SUBSEQUENT EVENTS

Management has evaluated events and circumstances occurring as of and through the date this Annual Report on Form 10-K was filed with the SEC and has determined that there have been no significant events or circumstances that qualify as a "recognized" subsequent event as defined by ASC Topic 855. Management has determined that the following events or circumstances qualify as "nonrecognized" subsequent events as defined by ASC Topic 855:

- Subsequent to December 31, 2018, the Company received net proceeds of $46,105 from the issuance of 8,050,000 shares of the Company's common stock through an underwritten public offering.

Exhibit 3.2

AMENDED AND RESTATED BYLAWS

OF

DYNEX CAPITAL, INC.,
a Virginia corporation

Adopted as of January 1, 2019

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ARTICLE I

Offices and Fiscal Year

SECTION 1.01 Principal Office. The principal office of the Corporation shall be located at 4991 Lake Brook Drive, Suite 100, Glen Allen, Virginia 23060, until otherwise established by a vote of a majority of the Board of Directors.

SECTION 1.02 Other Offices. The Corporation also may have offices at such places within or without the Commonwealth of Virginia as the Board of Directors may from time to time designate or the business of the Corporation may require.

SECTION 1.03 Fiscal Year. The fiscal year of the Corporation shall begin on the first day of January and end on the 31st day of December.

ARTICLE II

Meetings of Shareholders

SECTION 2.01 Places of Meeting. All meetings of the shareholders of the Corporation shall be held at such place, either within or without the Commonwealth of Virginia, as from time to time may be fixed by the President or by the Board of Directors in the notice of such meeting.

SECTION 2.02 Annual Meetings. The President or the Board of Directors may fix the date and time of the annual meeting of the shareholders, but if no such date and time is fixed by the President or the Board of Directors, the meeting for any calendar year shall be held on the fourth Monday in April in such year, if not a legal holiday under the laws of Virginia, and, if a legal holiday, then on the next succeeding business day, at 10:00 a.m., and at such meeting the shareholders then entitled to vote shall elect directors and shall transact such other business as may properly be brought before the meeting. Failure to hold an annual meeting does not invalidate the Corporation's existence or affect any otherwise valid corporate acts.

SECTION 2.03 Special Meetings. Special meetings of the shareholders of the Corporation for any purpose or purposes may be called at any time by the President, the Chairman of the Board of Directors, by a majority of the Board of Directors, by a majority of the Independent Directors (as defined in Section 3.02 hereof), or by shareholders entitled to cast at least twenty-five percent (25%) of the votes which all shareholders are entitled to cast at the particular meeting.

At any time, upon the written request of any person or persons who have duly called a special meeting, which written request shall state the object of the meeting, it shall be the duty of the Secretary to fix the date of the meeting to be held at such date and time as the Secretary may fix, not less than ten nor more than sixty days after the receipt of the request, and to give due notice thereof. If the Secretary shall neglect or refuse to fix the date and time of such meeting and give notice thereof, the person or persons calling the meeting may do so.

SECTION 2.04 Notice of Meetings. Written notice of every meeting of the shareholders, whether annual or special, shall be given to each shareholder of record entitled to vote at the meeting, at least ten and not more than sixty days prior to the day named for the meeting, except that notice of a meeting of shareholders to act on an amendment to the Articles of Incorporation, a plan of merger or share exchange, a proposed sale of assets pursuant to Va. Code § 13.1-724, or the dissolution of the Corporation shall be given not less than twenty-five nor more than sixty days prior to the day named for the meeting. Every notice of a special meeting shall state briefly the purpose or purposes thereof, and no business, other than that specified in such notice and matters germane thereto, shall be transacted at any special meeting without further notice to shareholders not present in person or by proxy.

Whenever the language of a proposed resolution is included in a written notice of a meeting of shareholders, the resolution may be adopted at such meeting with such clarifying or other amendments as do not enlarge its original purpose without further notice to shareholders not present in person or by proxy.

SECTION 2.05 Quorum, Manner of Acting and Adjournment. The presence in person or by proxy of shareholders entitled to cast a majority of the votes which all shareholders are entitled to cast on the particular matter shall constitute a quorum for the purpose of considering such matter. The shareholders present in person or by proxy at a duly organized meeting can continue to do business until adjournment, notwithstanding the withdrawal of enough shareholders from the meeting so that less than a quorum remains.

In the absence of a quorum or for any other reason, the chairman of the meeting or the Board of Directors or the shareholders present in person or by proxy acting by a majority vote and without notice other than by announcement at the meeting may adjourn the meeting from time to time but not for a period exceeding 120 days after the original meeting date.

Except as otherwise specified in the Articles of Incorporation or these Bylaws or provided by applicable law, at a duly organized meeting at which a quorum is present in person or by proxy, action on any matter (other than the election of directors) is approved by the shareholders if the votes cast favoring the matter exceed the votes cast opposing the matter.

SECTION 2.06 Organization. Every meeting of shareholders shall be conducted by a director or officer of the Corporation appointed by the Board of Directors or the Chairman of the Board to be chairman of the meeting or, in the absence of such appointment, by the Chairman of the Board or, in the case of a vacancy in the office or absence of the Chairman of the Board, by one of the following officers present at the meeting in the order stated: the Vice Chairman of the Board, if there be one, the President, the Vice Presidents in their order of rank and seniority, or, in the absence of such officers, a chairman chosen by the shareholders by the vote of a majority of the votes cast by shareholders present in person or by proxy. The Secretary, or, in the Secretary's absence, an assistant secretary, or in the absence of both the Secretary and assistant secretaries, an individual appointed by the Board of Directors or, in the absence of such appointment, an individual appointed by the chairman of the meeting shall act as secretary. In the event that the Secretary presides as chairman at a meeting of shareholders, an assistant secretary, or in the absence of an assistant secretary, an individual appointed by the Board of Directors or the chairman of the meeting, shall record the minutes of the meeting.

At any meeting of shareholders of the Corporation, the chairman of the meeting shall have the right and authority to prescribe such rules, regulations and procedures and to do all such acts and things as are necessary or desirable for the proper conduct of the meeting, including, without limitation, the establishment of procedures for the dismissal of business not properly presented, the maintenance of order and safety, limitations on the time allotted to questions or comments on the affairs of the Corporation, restrictions on entry to such meeting after the time prescribed for the commencement thereof and the opening and closing of the voting polls. Unless otherwise determined by the chairman of the meeting, meetings of shareholders shall not be required to be held in accordance with the rules of parliamentary procedure. This Section 2.06 shall not limit the right of shareholders to speak at meetings of shareholders on matters germane to the Corporation's business, subject to any rules for the orderly conduct of the meeting imposed by the chairman of the meeting.

SECTION 2.07 Voting. Every shareholder entitled to vote at a meeting of shareholders or to express consent or dissent to corporate action in writing without a meeting may authorize another person or persons to act for him by proxy. Every proxy shall be executed in writing by the shareholder or by his duly authorized attorney-in-fact and filed with the Secretary of the Corporation. A proxy, unless coupled with an interest, shall be revocable at will, notwithstanding any other agreement or any provision in the proxy to the contrary, but the revocation of a proxy shall not be effective until notice thereof has been given to the Secretary. No unrevoked proxy shall be valid after eleven months from the date of its execution, unless a longer time is expressly provided therein. A proxy shall not be revoked by the death or incapacity of the maker unless, before the authority is exercised, written notice of such death or incapacity is given to the Secretary. A shareholder shall not sell his vote or execute a proxy to any person for any sum of money or anything of value.

Except as provided in Article III of the Articles of Incorporation, each shareholder of record, except the holder of shares which have been called for redemption and with respect to which an irrevocable deposit of funds has been made, shall have the right, at every shareholder meeting, to one vote for every share, and to a fraction of a vote equal to every fractional share.

SECTION 2.08 Voting Lists. After the Board of Directors fixes a record date for a shareholder meeting, the officer or agent of the Corporation having charge of the share transfer books of the Corporation shall prepare an alphabetical list of the shareholders entitled to notice of such meeting. The shareholders' list for notice shall be available for inspection by any shareholder beginning two business days after notice of the meeting is given for which the list was prepared and continuing through the meeting, at the Corporation's principal office or at a place identified in the meeting notice in the county or city where the meeting shall be held. Such shareholders' list shall be arranged by voting group, and within each voting group by class or series of shares, and show the address of and number of shares held by each shareholder. In the event the Board of Directors has fixed a different record date to determine which shareholders are entitled to vote at such meeting, a shareholders' list for voting, prepared in the same manner as the shareholders' list for notice, shall be similarly available for inspection promptly after the record date for voting. The Corporation shall make the list of shareholders entitled to vote available at the meeting, and any shareholder, or the shareholder's agent or attorney, is entitled to inspect the list at any time during the meeting or any adjournment.

The original share transfer books, or a duplicate thereof, shall be prima facie evidence as to who are the shareholders entitled to examine such list or to vote, in person or by proxy, at any meeting of shareholders.

SECTION 2.09 Judges of Election. The vote upon any matter, including the election of directors, need not be by ballot. In advance of any meeting of shareholders the Board of Directors may appoint judges of election, who need not be shareholders, to act at such meeting or any adjournment thereof. If judges of election are not so appointed, the chairman of any such meeting may, and upon the demand of any shareholder or his proxy at the meeting and before voting begins shall, appoint judges of election. The number of judges shall be either one or three, as determined, in the case of judges appointed upon demand of a shareholder, by shareholders present entitled to cast a majority of the votes which all shareholders present are entitled to cast thereon. No person who is a candidate for office shall act as a judge. In case any person appointed as judge fails to appear or fails or refuses to act, the vacancy may be filled by appointment made by the Board of Directors in advance of the convening of the meeting, or at a meeting by the chairman of the meeting.

If judges of election are appointed as aforesaid, they shall determine the number of shares outstanding and the voting power of each, the shares represented at the meeting, the existence of a quorum, the authenticity, validity and effect of proxies, receive votes or ballots, hear and determine all challenges and questions in any way arising in connection with the right to vote, count and tabulate all votes, determine the result, and do such acts as may be proper to conduct the election or vote with fairness to all shareholders. If there be three judges of election, the decision, act or certificate of a majority shall be effective in all respects as the decision, act or certificate of all.

On request of the chairman of the meeting or of any shareholder or his proxy, the judges shall make a report in writing of any challenge or question or matter determined by them and execute a certificate of any fact found by them.

SECTION 2.10 Determination of Shareholders of Record. The Board of Directors may fix a date, not more than seventy nor less than ten days preceding the date of any meeting of shareholders, and not more than seventy days preceding the date fixed for the payment of any dividend or distribution, or the date for the allotment of rights, or the date when any change or conversion or exchange of shares will be made or go into effect, as a record date for the determination of the shareholders entitled to notice of, or to vote at, any such meeting, or entitled to receive any such allotment of rights, or to exercise the rights in respect to any such change, conversion or exchange of shares; and in such case, if otherwise entitled to notice of, or to vote at, such meeting, or to receive payment of such dividend or distribution or to receive such allotment of rights, or exercise such rights, as the case may be, notwithstanding any transfer of any shares on the books of the Corporation after any such record date fixed as aforesaid.

Unless a record date is fixed by the Board of Directors for such purpose, transferees of shares which are transferred on the books within ten days next preceding the date of such meeting shall not be entitled to notice of, or to vote at, such meeting.

SECTION 2.11 Consent of Shareholders in Lieu of Meeting. Any action which may be taken at a meeting of the shareholders or a class of shareholders of the Corporation may be taken without a meeting if a consent or consents in writing, setting forth the actions so taken, shall be signed by all the shareholders who would be entitled to vote at a meeting of the shareholders or of a class of shareholders for such purpose and shall be filed with the Secretary.

SECTION 2.12 Order of Business. At any meeting of shareholders of the Corporation, only that business that is properly brought before the meeting may be presented to and acted upon by shareholders. To be properly brought before an annual meeting, business must be brought (a) by or at the direction of the Board of Directors or (b) by any shareholder of the Corporation who shall be entitled to vote at such meeting and who complies with the notice procedures set forth in this Section 2.12. At a special meeting of shareholders, no business shall be transacted and no corporate action taken other than that stated in the notice of the meeting.

In addition to any other applicable requirements, for business to be properly brought before an annual meeting by a shareholder, the shareholder must have given timely notice thereof in writing to the Secretary of the Corporation. To be timely, a shareholder’s notice must be given, either by personal delivery or by United States certified mail, postage prepaid, and received at the principal executive offices of the Corporation (i) not less than 90 days nor more than 180 days before the first anniversary of the date of the Corporation’s proxy statement in connection with the last annual meeting of shareholders or (b) if no annual meeting was held in the previous year or the date of the applicable annual meeting has been changed by more than 30 days from the date contemplated at the time of the previous year’s proxy statement, not less than 90 days before the date of the applicable annual meeting. A shareholder’s notice to the Secretary must set forth as to each matter the shareholder proposes to bring before the annual meeting (a) a brief description of the business desired to be brought before the annual meeting, including the complete text of any resolutions to be presented at the annual meeting, and the reasons for conducting such business at the annual meeting, (b) the name and address, as they appear on the Corporation's share transfer books, of such shareholder proposing such business, (c) a representation that such shareholder is a shareholder of record and intends to appear in person or by proxy at such meeting to bring the business before the meeting specified in the notice, (d) the class and number of shares of stock of the Corporation beneficially owned by the shareholder and (e) any material interest of the shareholder in such business. The Secretary of the Corporation shall deliver each such shareholder's notice that has been timely received to the Board of Directors or a committee designated by the Board of Directors for review.

Notwithstanding anything in the Bylaws to the contrary, no business shall be conducted at an annual meeting except in accordance with the procedures set forth in this Section 2.12. The chairman of a meeting shall, if the facts warrant, determine that the business was not brought before the meeting in accordance with the procedures prescribed by this Section 2.12, and if he should so determine, he shall so declare to the meeting and the business not properly brought before the meeting shall not be transacted.

In addition to the foregoing provisions of this Section 2.12, a shareholder seeking to have a proposal included in the Corporation's proxy statement must comply with the requirements of Regulation 14A under the Securities Exchange Act of 1934, as amended (including, but not limited to, Rule 14a-8 or its successor provision). The Corporation shall not have any obligation to communicate with shareholders regarding any business or director nomination submitted by a shareholder in accordance with this Section 2.12 unless otherwise required by law.

ARTICLE III

Board of Directors

SECTION 3.01 Powers. The Board of Directors shall have full power to conduct, manage, and direct the business and affairs of the Corporation, and all powers of the Corporation, except those specifically reserved or granted to the shareholders by statute or by the Articles of Incorporation or these Bylaws, are hereby granted to and vested in the Board of Directors.

SECTION 3.02 Number, Election and Term. The Board of Directors shall consist of six directors, subject to automatic increase in accordance with the Articles of Incorporation. If the Corporation seeks to qualify as a real estate investment trust, the number of directors shall be increased or decreased from time to time by vote of a majority of the Board of Directors; provided, however, that the number of directors may not exceed fifteen nor be less than three except as permitted by law, and provided further, that the tenure of office of a director shall not be affected by any decrease or increase in the number of directors so made by the Board of Directors.

Except as otherwise specified in the Articles of Incorporation or these Bylaws or provided by applicable law, a nominee for director shall be elected to the Board of Directors at any meeting of shareholders at which a quorum is present if the votes cast for such nominee's election exceed the votes cast against such nominee's election; provided, however, that nominees for director shall be elected by a plurality of the votes cast at any meeting of shareholders for which the number of nominees exceeds the number of directors to be elected. If a nominee who is an incumbent director is not elected to the Board of Directors and no successor has been elected at such meeting of shareholders, such nominee shall offer his or her resignation promptly to the Board of Directors. Within 90 days following certification of the election results, the Board of Directors will determine whether to accept or reject the offered resignation, or whether to take other action. In making such determination, the Board of Directors shall consider the recommendation of the committee responsible for the nomination of directors, the factors considered by that committee and any additional information and factors that the Board of Directors believes to be relevant. A director who offers a resignation shall not participate in the recommendation of the committee or the decision of the Board of Directors with respect to such director's resignation.

At all times, except in the case of a vacancy, a majority of the Board of Directors shall be Independent Directors (as hereinafter defined). For purposes of these Bylaws, "Independent Director" shall mean a director of the Corporation who meets the independence requirements under the rules and regulations of the stock exchange upon which the Corporation's common stock is then listed and the Securities and Exchange Commission, as then in effect and applicable to the Corporation. At each annual meeting, the shareholders shall elect directors to hold office until the next annual meeting or until their successors are elected and qualify. Directors need not be shareholders in the Corporation.

Except as provided in Article III of the Articles of Incorporation, no person shall be eligible for election as a director unless nominated in accordance with the procedures set forth in this Section 3.02. Nominations of persons for election to the Board of Directors may be made by the Board of Directors or any committee designated by the Board of Directors or by any shareholder entitled to vote for the election of directors at the applicable meeting of shareholders who complies with the notice procedures set forth in this Section 3.02. Such nominations, other than those made by the Board of Directors or any committee designated by the Board of Directors, may be made only if written notice of a shareholder's intent to nominate one or more persons for election as directors at the applicable meeting of shareholders has been given, either by personal delivery or by United States certified mail, postage prepaid, to the Secretary of the Corporation and received (a) not less than 90 days nor more than 180 days before the first anniversary of the date of the Corporation's proxy statement in connection with the last annual meeting of shareholders, or (b) if no annual meeting was held in the previous year or the date of the applicable annual meeting has been changed by more than 30 days from the date contemplated at the time of the previous year's proxy statement, not less than 90 days before the date of the applicable annual meeting. Each such shareholder's notice must set forth (i) as to the shareholder giving the notice, (1) the name and address, as they appear on the Corporation's share transfer books, of such shareholder, (2) a representation that such shareholder is a shareholder of record and intends to appear in person or by proxy at such meeting to nominate the person or persons specified in the notice, (3) the class and number of shares of stock of the Corporation beneficially owned by such shareholder, and (4) a description of all arrangements or understandings between such shareholder and each nominee and any other person or persons (naming such person or persons) pursuant to which the nomination or nominations are to be made by such shareholder; and (ii) as to each person whom the shareholder proposes to nominate for election as a director, (1) the name, age, business address and, if known, residence address of such person, (2) the principal occupation or employment of such person, (3) the class and number of shares of stock of the Corporation which are beneficially owned by such person, (4) any other information relating to such person that is required to be disclosed in solicitations of proxies for election of directors or is otherwise required by the rules and regulations of the Securities and Exchange Commission promulgated under the Securities Exchange Act of 1934, as amended, and (5) the written consent of such person to be named in the proxy statement as a nominee and to serve as a director if elected. The Secretary of the Corporation shall deliver each such shareholder's notice that has been timely received to the Board of Directors or a committee designated by the Board of Directors for review. Any person nominated for election as director by the Board of Directors or any committee designated by the Board of Directors shall, upon the request of the Board of Directors or such committee, furnish to the Secretary of the Corporation all such information pertaining to such person that is required to be set forth in a shareholder's notice of nomination. The chairman of the meeting of shareholders shall, if the facts warrant, determine that a nomination was not made in accordance with the procedures prescribed by this Section 3.02, and if he should so determine, he shall so declare to the meeting and the defective nomination shall be disregarded.

At any time when the Chairman of the Board is not an Independent Director, a lead Independent Director shall be designated by majority vote of the Independent Directors.

SECTION 3.03 Resignations. Any director or member of a committee may resign at any time. Such resignation shall be made in writing and shall take effect at the time specified therein, or if no time be specified, at the time of the receipt by the Chairman of the Board, the President or the Secretary.

SECTION 3.04 Removal. At any meeting of shareholders, duly called and at which a quorum is present, the shareholders may, by the affirmative vote of the holders of a majority of the votes entitled to be cast thereon, remove any director or directors from office with or without cause, and may elect a successor or successors to fill any resulting vacancies for the unexpired terms of removed directors.

SECTION 3.05 Committees of the Board. The Board of Directors may appoint from among its members an executive committee and other committees comprised of three or more members. The composition of each committee, including the total number of members and the number of Independent Directors, shall at all times comply with the listing requirements and rules and regulations of the stock exchange upon which the Corporation's common stock is then listed and the rules and regulations of the Securities and Exchange Commission, in each case as then in effect and applicable to the Corporation. The Board of Directors may delegate to any committee any of the powers of the Board of Directors except the power to elect directors, declare dividends or distributions on stock, recommend to the shareholders any action which requires shareholder approval, amend the Articles of Incorporation, amend or repeal the Bylaws, approve any merger or share exchange which does not require shareholder approval or issue stock. However, if the Board of Directors has given general authorization for the issuance of stock, a committee of the Board, in accordance with a general formula or method specified by the Board of Directors by resolution or by adoption of a stock option plan, may fix the terms of stock subject to classification or reclassification and the terms on which any stock may be issued.

Notice of committee meetings shall be given in the same manner as notice for special meetings of the Board of Directors.

One-third, but not less than two, of the members of any committee shall be present in person at any meeting of such committee in order to constitute a quorum for the transaction of business at such meeting, and the act of a majority present shall be the act of such committee.

The Board of Directors may designate a chairman of any committee, and such chairman or any two members of any committee may fix the time and place of its meetings unless the Board shall otherwise provide. In the absence or disqualification of any member of any such committee, the members thereof present at any meeting and not disqualified from voting, whether or not they constitute a quorum, may unanimously appoint another member to act at the meeting in the place of such absent or disqualified members; provided, however, that in the event of the absence or disqualification of an Independent Director, such appointee shall be an Independent Director.

Each committee shall keep minutes of its proceedings and shall report the same to the Board of Directors at the meeting next succeeding and any action by the committees shall be subject to revision and alteration by the Board of Directors, provided that no rights of third persons shall be affected by any such revision or alteration.

Subject to the provisions hereof, the Board of Directors shall have the power at any time to change the membership of any committee, to fill all vacancies, to designate alternative members to replace any absent or disqualified member, or to dissolve any such committee.

SECTION 3.06 Meetings of the Board of Directors. Meetings of the Board of Directors, regular or special, may be held at any place in or out of the Commonwealth of Virginia as the Board may from time to time determine or as shall be specified in the notice of such meeting.

The first meeting of each newly elected Board of Directors shall be held as soon as practicable after the annual meeting of the shareholders at which the directors were elected. The meeting may be held at such time and place as shall be specified in a notice given as hereinafter provided for special meetings of the Board of Directors, or as shall be specified in a written waiver signed by all of the directors as provided in Article IV, except that no notice shall be necessary if such meeting is held immediately after the adjournment, and at the site, of the annual meeting of shareholders.

Special meetings of the Board of Directors may be called at any time by two or more directors, by any lead independent director (if one has been designated) or by a majority of the members of the executive committee, if one be constituted, in writing with or without a meeting of such committee or by the Chairman of the Board or the President. The lead independent director (if one has been designated) may also call a separate meeting of the directors of the

Corporation who are not employees of the Corporation. Special meetings may be held at such place or places in or out of the Commonwealth of Virginia as may be designated from time to time by the Board of Directors; in the absence of such designation, such meetings shall be held at such places as may be designated in the notice of meeting.

Notice of the place and time of every meeting of the Board of Directors shall be delivered by the Secretary to each director personally, by first-class mail, or by telephone, which shall also include voice-mail, or by electronic mail to any electronic address of the director or by any other electronic means, or by leaving the same at his residence or usual place of business at least twenty-four hours before the time at which such meeting is to be held, or if by first class mail, at least four days before the day on which such meeting is to be held. If mailed, such notice shall be deemed to be given when deposited in the United States mail addressed to the director at his post office address as it appears on the records of the Corporation, with postage thereon prepaid.

SECTION 3.07 Quorum and Voting. At all meetings of the Board, a majority of the Board of Directors shall constitute a quorum for the transaction of business, and the action of a majority of the directors present at any meeting at which a quorum is present shall be the action of the Board of Directors unless the concurrence of a greater proportion is required for such action by law, the Corporation's Articles of Incorporation or these Bylaws. If a quorum is not present at any meeting of directors, the directors present thereat may, by a majority vote, adjourn the meeting from time to time, without notice other than announcement at the meeting, until a quorum is present.

Notwithstanding the first paragraph of this Section 3.07, and except as provided in the Company's Guidelines (as hereinafter defined) any action pertaining to a transaction involving the Corporation in which any advisor, any director or officer of the Corporation or any affiliate of any of the foregoing persons has an interest shall be approved by a majority of the Independent Directors even if the Independent Directors constitute less than a quorum.

SECTION 3.08 Organization. The Chairman of the Board shall preside at each meeting of the Board of Directors; provided, however, that the lead independent director (if one has been designated) shall preside at any separate meeting of directors of the Corporation who are not employees of the Corporation. In the absence or inability of the Chairman of the Board to preside at a meeting of the Board of Directors, the President, or, in his absence or inability to act, the lead independent director (if one has been designated), or in their absence or inability to act, another director chosen by a majority of the directors present, shall act as chairman of the meeting and preside thereat. The

Secretary (or, in his absence or inability to act, any person appointed by the chairman of the meeting) shall act as secretary of the meeting and keep the minutes thereof.

SECTION 3.09 Meeting by Conference Telephone. Members of the Board of Directors may participate in a meeting by means of a conference telephone or similar communications equipment if all persons participating in the meeting can hear each other at the same time. Participation in a meeting by such means constitutes presence in person at a meeting.

SECTION 3.10 Action Without Meeting. Any action required or permitted to be taken at any meeting of the Board of Directors or of any committee thereof may be taken without a meeting, if a written consent to such action is signed by all members of the Board or of such committee, as the case may be, and such written consent is filed with the minutes of proceedings of the Board or committee.

SECTION 3.11 Compensation of Directors. Non-employee Directors, in consideration of their serving as such, shall be entitled to receive from the Corporation such amount per annum or such fees for attendance at Board and committee meetings, or both, in cash or other property, including securities of the Corporation, as the Board shall from time to time determine, together with reimbursements for the reasonable expenses incurred by them in connection with the performance of their duties. Nothing contained herein shall preclude any director from serving the Corporation, or any subsidiary or affiliated corporation, in any other capacity and receiving proper compensation therefor. If the Board adopts a resolution to that effect, any non-employee Director may elect to defer all or any part of the annual and other fees hereinabove referred to for such period and on such terms and conditions as may be permitted by such resolution.

SECTION 3.12 Investment Policies. It shall be the duty of the Board of Directors to ensure that the purchase, sale, retention and disposal of the Corporation’s assets, and the investment policies of the Corporation and the limitations thereon are at all times in compliance with the restrictions applicable to real estate investment trusts pursuant to the Internal Revenue Code of 1986, as amended.

The Board of Directors, including a majority of the Independent Directors, shall promulgate and approve guidelines governing the investment policies of the Company (the “Guidelines”). The Guidelines and compliance therewith shall be reviewed by the Board of Directors at least annually to determine that the policies then being followed by the Corporation are in the best interest of the shareholders of the Corporation. Each such determination and the basis therefor shall be set forth in the minutes of the meeting of the Board of Directors.

ARTICLE IV

Notice - Waivers - Meetings

SECTION 4.01 What Constitutes Notice. Whenever written notice is required to be given to any person under the provisions of the Articles, these Bylaws, or the Virginia Stock Corporation Act, it may be given to such person, either personally or by sending a copy thereof through the mail, or by telegraph, charges prepaid, to his address appearing on the books of the Corporation, or supplied by him to the Corporation for the purpose of notice. If the notice is sent by mail or by telegraph, it shall be deemed to have been given to the person entitled thereto when deposited in the United States mail or with a telegraph office for transmission to such person. A notice of a meeting shall specify the place, day and hour of the meeting.

SECTION 4.02 Waiver of Notice. Whenever any written notice is required to be given under the provisions of the articles, these Bylaws, or the Virginia Stock Corporation Act, a waiver thereof in writing, signed by the person or persons entitled to such notice, whether before or after the time stated therein, shall be deemed equivalent to the giving of such notice. Except in the case of a special meeting of shareholders, neither the business to be transacted at, nor the purpose of, the meeting need be specified in the waiver of notice of such meeting.

Attendance of a person, either in person or by proxy, or by a telephone conference arrangement which complies with Section 3.09 hereof, at any meeting, shall constitute a waiver of notice of such meeting, except where a person attends a meeting for the express purpose of objecting to the transaction of any business because the meeting was not lawfully called or convened.

ARTICLE V

Officers

SECTION 5.01 Number, Qualifications and Designation. The officers of the Corporation shall be a President, one or more Vice Presidents, a Secretary, a Treasurer, and such other officers as may be elected in accordance with the provisions of Section 5.03 of this Article. One person may hold more than one office. Officers may, but need not be, directors or shareholders of the Corporation. The Board of Directors may elect from among the members of the Board, a Chairman of the Board and Vice Chairman of the Board, neither of whom will be an officer of the Company, unless so designated by the Board.

SECTION 5.02 Election and Term of Office. The officers of the Corporation, except those elected by delegated authority pursuant to Section 5.03 of this Article, shall be elected annually by the Board of Directors, and each officer shall hold his office until the next annual organizational meeting of the Board of Directors and until his successor shall have been duly chosen and qualified, or until his death, resignation, or removal.

SECTION 5.03 Subordinate Officers, Committees and Agents. The Board of Directors may from time to time elect such other officers and appoint such committees, employees or other agents as the business of the Corporation may require, including one or more assistant secretaries, and one or more assistant treasurers, each of whom shall hold office for such period, have such authority, and perform such duties as are provided in these Bylaws, or as the Board of Directors may from time to time determine. The directors may delegate to any officer or committee the power to elect subordinate officers and to retain or appoint employees or other agents.

SECTION 5.04 Resignations. Any officer or agent may resign at any time by giving written notice to the Board of Directors, or to the President or the Secretary of the Corporation. Any such resignation shall take effect at the date of the receipt of such notice or at any later time specified therein and, unless otherwise specified therein, the acceptance of such resignation shall not be necessary to make it effective.

SECTION 5.05 Removal. Any officer, member of a committee, employee or other agent of the Corporation may be removed, either for or without cause, by the Board of Directors or other authority which elected or appointed such officer, member of a committee, employee or other agent whenever in the judgment of such authority the best interests of the Corporation will be served thereby.

SECTION 5.06 Vacancies. A vacancy in any office because of death, resignation, removal, disqualification, or any other cause, shall be filled by the Board of Directors or by the officer or remaining members of the committee to which the power to fill such office has been delegated pursuant to Section 5.03 of this Article, as the case may be, and if the office is one for which these Bylaws prescribe a term, shall be filled for the unexpired portion of the term.

SECTION 5.07 General Powers. All officers of the Corporation as between themselves and the Corporation, shall, respectively, have such authority and perform such duties in the management of the property and affairs of the Corporation as may be determined by resolution of the Board of Directors, or in the absence of controlling provisions in a resolution of the Board of Directors, as may be provided in these Bylaws.

SECTION 5.08 The Chairman and Vice Chairman of the Board. The Chairman of the Board or in his absence, the Vice Chairman of the Board, shall preside at all meetings of the Board of Directors, and shall perform such other duties as may from time to time be requested of him by the Board of Directors.

SECTION 5.09 The President. The President shall be the chief executive officer of the Corporation and shall have general supervision over the business and operation of the Corporation, subject, to the control of the Board of Directors. He shall sign, execute, and acknowledge, in the name of the Corporation, deeds, mortgages, bonds, contracts or other instruments, authorized by the Board of Directors, except in cases where the signing and execution thereof shall be expressly delegated by the Board of Directors, or by these Bylaws, to some other officer or agent of the Corporation, and, in general, shall perform all duties incident to the office of President, and such other duties as from time to time may be assigned to him by the Board of Directors.

SECTION 5.10 The Vice Presidents. The Vice Presidents shall perform the duties of the President in his absence and such other duties as may from time to time be assigned to them by the Board of Directors or by the President.

SECTION 5.11 The Secretary. The Secretary or an assistant secretary shall attend all meetings of the shareholders and of the Board of Directors and shall record all the votes of the shareholders and of the directors and the minutes of the meetings of the shareholders and of the Board of Directors and of committees of the Board in a book or books to be kept for that purpose; shall see that notices are given and records and reports properly kept and filed by the Corporation as required by law; shall be the custodian of the seal of the Corporation and see that it is affixed to all documents to be executed on behalf of the Corporation under its seal; and, in general, shall perform all duties incident to the office of Secretary, and such other duties as may from time to time be assigned to him by the Board of Directors or the President.

SECTION 5.12 The Treasurer. The Treasurer or an assistant treasurer shall have or provide for the custody of the funds or other property of the corporation and shall keep a separate book account of the same to his credit as Treasurer; shall collect and receive or provide for the collection and receipts of monies earned by or in any manner due to or received by the Corporation; shall deposit all funds in his custody as Treasurer in such banks or other places of deposit as the Board of Directors may from time to time designate; shall, whenever so required by the Board of Directors, render an account showing his transactions as Treasurer and the financial condition of the Corporation; and, in general, shall discharge such other duties as may from time to time be assigned to him by the Board of Directors or the President.

SECTION 5.13 Officers' Bonds. Any officer shall give a bond for the faithful discharge of his duties in such sum, if any, and with such surety or sureties as the Board of Directors shall require.

SECTION 5.14 Salaries. The salaries of the officers elected by the Board of Directors shall be fixed from time to time by the Board of Directors or by such officer as may be designated by resolution of the Board. The salaries or other compensation of any other officers, employees and other agents shall be fixed from time to time by the officer or committee to which the power to elect such officers or to retain or appoint such employees or other agents has been delegated pursuant to Section 5.03 of this Article. No officer shall be prevented from receiving such salary or other compensation by reason of the fact that he is also a director of the Corporation.

ARTICLE VI

Capital Stock

SECTION 6.01 Shares of Stock. The shares of all classes and series of stock of the Corporation may be certificated or uncertificated as provided under Virginia law, and shall be entered in the share transfer books of the Corporation and registered as they are issued.

When shares of stock of the Corporation are represented by certificates, such certificates shall represent and certify the number and kind and class of shares owned by the shareholder in the Corporation and shall be in such form as may be required by law and approved by the Board of Directors. Each certificate shall be signed by the Chairman of the Board or the President or a Vice President and countersigned by the Secretary or an assistant secretary or the Treasurer or an assistant treasurer and may be sealed with the corporate seal or a facsimile thereof. The signatures of the officers upon a share certificate may be facsimiles if the certificate is countersigned by a transfer agent, or registered by a registrar, other than the Corporation itself or an employee of the Corporation. In case any officer who has signed any certificate ceases to be an officer of the Corporation before the certificate is issued, the certificate may nevertheless be issued by the Corporation with the same effect as if the officer had not ceased to be such officer as of the date of its issue. All certificates for the Corporation's shares shall be consecutively numbered or otherwise identified.

Each stock certificate shall include on its face (i) the name of the Corporation, (ii) that the Corporation is organized under the laws of the Commonwealth of Virginia, (iii) the name of the shareholder, (iv) the number and class or series, if any, of the shares represented by the certificate, and (v) any additional information required by the Virginia Stock Corporation Act to be included on certificates. If the Corporation has authority to issue stock of more than one class, or of more than one series within a class, the stock certificate shall contain on its face or back a full statement or summary of the designations and any preferences, conversion and other rights, voting powers, restrictions, limitations as to dividends, qualifications, and terms and conditions of redemption of the stock of each class which the Corporation is authorized to issue and if the Corporation is authorized to issue any preferred or special class in series, the differences in the relative rights, preferences and limitations between the shares of each series to the extent they have been set, and the authority of the Board of Directors to set the relative rights and preferences of subsequent series. In lieu of such full statement or summary, there may be set forth upon the face or back of the certificate a statement that the Corporation will furnish to any shareholder upon request and without charge, a full statement of such information. A summary of such information included in a registration statement permitted to become effective under the federal Securities Act of 1933, as amended, shall be an acceptable summary for the purposes of this section. Every stock certificate representing shares of stock which are restricted as to transferability by the Corporation shall contain a full statement of the restriction or state that the Corporation will furnish information about the restriction to the shareholder on request and without charge. A stock certificate may not be issued until the stock represented by it is fully paid, except in the case of stock purchased under an option plan as permitted by law.

When shares of stock of the Corporation are not represented by certificates, then within a reasonable time after the issuance or transfer of such shares, the Corporation shall send, or cause to be sent, to the shareholder to whom such shares have been issued or transferred a written notice that shall set forth (i) the name of the Corporation, (ii) that the Corporation is organized under the laws of the Commonwealth of Virginia, (iii) the name of the shareholder, (iv) the number and class or series, if any, of the shares so held, and (v) any additional information required by the Virginia Stock Corporation Act to be included on certificates. If the Corporation has authority to issue stock of more than one class, or of more than one series within a class, the written notice shall contain the information required by the previous paragraph with respect to each class or series, or shall contain a statement that the Corporation will furnish such information to any shareholder upon request and without charge. In the event the shares are restricted as to transferability by the Corporation, then the written notice shall contain a full statement of the restriction or state that the Corporation will furnish information about the restriction to the shareholder on request and without charge.

Blank share certificates shall be kept by the Secretary or by a transfer agent or by a registrar or by any other officer or agent designated by the Board of Directors.

SECTION 6.02 Stolen, Lost or Destroyed Certificates. The Board of Directors may direct that a new certificate or certificates be issued, or evidence of the holder's ownership of shares in uncertificated form be delivered, in place of any certificate or certificates theretofore issued by the Corporation alleged to have been stolen, lost or destroyed, upon the making of an affidavit of that fact by the person claiming the certificate of stock to be stolen, lost or destroyed. When authorizing such issuance of a new certificate or certificates or delivery of evidence of the holder's ownership of such shares in uncertificated form, the Board of Directors may, in its discretion and as a condition precedent to the issuance or delivery thereof, require the owner of such stolen, lost or destroyed certificate or certificates, or his legal representative, to advertise the same in such manner as it shall require, to give the Corporation a bond, with sufficient surety, to the Corporation to indemnify it against any loss or claim which may arise by reason of the issuance of a new certificate or delivery of evidence of the holder's ownership of such shares in uncertificated form, and to comply with any other terms the Board of Directors may lawfully prescribe.

SECTION 6.03 Transfer Agents and Registrars. The Board of Directors shall appoint one or more transfer agents and/or registrars of the shares of stock of the Corporation; and, upon such appointments being made, no certificate representing shares shall be valid until countersigned by one of such transfer agents and registered by one of such registrars.

SECTION 6.04 Transfer of Stock. The Corporation, or its designated transfer agent or other agent, shall keep a book or set of books to be known as the share transfer books of the Corporation, containing the name of each shareholder of record, together with such shareholder's address and the number and class or series of shares held by such shareholder. Such information may be stored or retained on discs, tapes, cards or any other approved storage device relating to data processing equipment; provided that such device is capable of reproducing all information contained therein in legible and understandable form, for inspection by shareholders or for any other corporate purpose.

No transfers of shares of stock of the Corporation shall be made if (i) void ab initio pursuant to any Article of the Corporation's Articles of Incorporation, (ii) the Board of Directors, pursuant to such Article, shall have refused to tender such shares, or (iii) the transferee is a nonresident alien individual or foreign entity. A permitted transfer of shares shall be made and recorded on the share transfer books of the Corporation upon the receipt of proper transfer instructions as prescribed by the Board of Directors, the payment of all taxes thereon, and, in the case of transfers of shares which are represented by one or more certificates, only upon receipt of such certificate(s) with proper endorsement or duly executed stock transfer power, from the registered holder of record or from such holder's attorney thereunto authorized by power of attorney duly executed and filed with the Secretary or with a transfer agent or transfer clerk. In the event a certificate representing shares to be transferred cannot be surrendered because it has been stolen, lost, or destroyed, the transferor shall comply with the requirements imposed by the Board of Directors as set forth in Section 6.02 of these Bylaws in lieu of surrendering a properly endorsed certificate. Upon satisfactory completion by the transferor of the requirements set forth in this Section 6.04, as to any transfer not prohibited by the Articles of Incorporation or by action of the Board of Directors thereunder, all certificates for the transferred shares shall be cancelled, new certificates representing the transferred shares (or evidence of the transferee's ownership of the transferred shares in uncertificated form) shall be delivered to the transferee, and the transaction shall be recorded on the share transfer books of the Corporation. Except as otherwise provided by law, no transfer of shares shall be valid as against the Corporation, its shareholders or creditors, for any purpose, until it shall have been entered in the share transfer books of the Corporation by an entry showing from and to whom transferred.

SECTION 6.05 Registered Shareholders. The Corporation shall be entitled to recognize the exclusive right of a person registered on its share transfer books as the owner of shares (whether or not such shares are represented by certificates) to receive dividends, and to vote as such owner, and to hold liable for calls and assessments, if any, a person registered on its share transfer books as the owner of shares, and shall not be bound to recognize any equitable or other claim to or interest in such share or shares on the part of any other person, whether or not it shall have express or other notice thereof, except as otherwise provided by law.

SECTION 6.06 Regulations. The Board of Directors may make such additional rules and regulations, not inconsistent with these Bylaws, as it may deem expedient concerning the issue, transfer and registration of shares of stock of the Corporation (whether or not such shares are represented by certificates).

ARTICLE VII

Miscellaneous

SECTION 7.01 Corporate Seal. The Corporation shall have a corporate seal in the form of a circle containing the name of the Corporation and such other details as may be required by the Board of Directors.

SECTION 7.02 Checks. All checks, notes, bills of exchange or other orders in writing shall be signed by such person or persons as the Board of Directors may from time to time designate.

SECTION 7.03 Contracts. Except as otherwise provided in these Bylaws, the Board of Directors may authorize any officer or officers, agent or agents, to enter into any contract or to execute or deliver any instrument on behalf of the Corporation, and such authority may be general or confined to specific instances.

SECTION 7.04 Deposits. All funds of the Corporation shall be deposited from time to time to the credit of the Corporation in such banks, trust companies, or other depositories as the Board of Directors may approve or designate, and all such funds shall be withdrawn only upon checks signed by such one or more officers or employees as the Board of Directors shall from time to time determine.

SECTION 7.05 Corporate Records. There shall be kept at the principal office of the Corporation an original or duplicate record of the proceedings of the shareholders and of the directors, and the original or a copy of the Bylaws including all amendments or alterations thereto to date, certified by the Secretary. An original or duplicate share transfer book shall also be kept at the registered office or principal place of business of the Corporation, or at the office of a transfer agent or registrar, giving the names of the shareholders, their respective addresses and the number and class of shares held by each. The Corporation shall also keep appropriate, complete and accurate books or records of account, which may be kept at its registered office or at its principal place of business.

SECTION 7.06 Amendment of Bylaws. These Bylaws may be amended or replaced, or new Bylaws may be adopted, either (1) by the vote of the shareholders entitled to cast at least a majority of the votes which all shareholders are entitled to cast thereon at any duly organized annual or special meeting of shareholders, or (2), with respect to those matters which are not by statute reserved exclusively to the shareholders, by vote of a majority of the Board of Directors, including a majority of the Independent Directors of the Corporation in office at any regular or special meeting of directors. It shall not be necessary to set forth such proposed amendment, repeal or new Bylaws, or a summary thereof, in any notice of such meeting, whether annual, regular or special.

SECTION 7.07 Exclusive Forum. Unless the Corporation consents in writing to the selection of an alternative forum, the United States District Court for the Eastern District of Virginia, Richmond Division, or in the event that court lacks jurisdiction to hear such action, the Circuit Court of the City of Richmond, Virginia, shall be the sole and exclusive forum for (i) any derivative action or proceeding brought on behalf of the Corporation, (ii) any action asserting a claim of breach of a legal duty owed by any current or former director, officer or other employee or agent of the Corporation to the Corporation or the Corporation’s shareholders, (iii) any action asserting a claim against the Corporation or any director or officer or other employee of the Corporation arising pursuant to any provision of the Virginia Stock Corporation Act or the Articles of Incorporation or these Bylaws (as any may be amended from time to time), or (iv) any action asserting a claim against the Corporation or any current or former director or officer or other employee or agent of the Corporation governed by the internal affairs doctrine.

Exhibit 21.1

DYNEX CAPITAL, INC.
LIST OF SIGNIFICANT CONSOLIDATED ENTITIES
As of December 31, 2018

Name	State of Organization
Issued Holdings Capital Corporation	Virginia

Exhibit 23.1

Consent of Independent Registered Public Accounting Firm

Dynex Capital, Inc.
Glen Allen, Virginia

We hereby consent to the incorporation by reference in the Registration Statements on Form S3 (No. 333-222354) and Form S-8 (Nos. 333-159427, 333-198796, and 333-224967) of our reports dated February 27, 2019, relating to the consolidated financial statements, and the effectiveness of Dynex Capital, Inc.'s internal control over financial reporting appearing in the Company's Annual Report on Form 10-K for the year ended December 31, 2018.

/s/ BDO USA, LLP
Richmond, Virginia

February 27, 2019

Exhibit 31.1

CERTIFICATIONS

I, Byron L. Boston, certify that:

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

Date: February 27, 2019

/s/ Byron L. Boston

Byron L. Boston
Principal Executive Officer

Exhibit 31.2

CERTIFICATIONS

I, Stephen J. Benedetti, certify that:

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

Date: February 27, 2019

/s/ Stephen J. Benedetti

Stephen J. Benedetti
Principal Financial Officer

Exhibit 32.1

CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER AND PRINCIPAL FINANCIAL OFFICER PURSUANT TO SECTION 906

In connection with the Annual Report on Form 10-K of Dynex Capital, Inc. (the "Company") for the year ended December 31, 2018, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned, as the Principal Executive Officer of the Company and the Principal Financial Officer of the Company, respectively, certify, pursuant to and for purposes of 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to their knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: February 27, 2019

/s/ Byron L. Boston
Byron L. Boston
Principal Executive Officer

Date: February 27, 2019

/s/ Stephen J. Benedetti
Stephen J. Benedetti
Principal Financial Officer