

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2021

or

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

(State or other jurisdiction of incorporation or organization)

4991 Lake Brook Drive, Suite 100

Glen Allen, Virginia

(Address of principal executive offices)

52-1549373

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

23060-9245

(Zip Code)

(804) 217-5800

(Registrant's telephone number, including area code)

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

<u>Title of each class</u>	<u>Trading Symbol(s)</u>	<u>Name of each exchange on which registered</u>
Common Stock, par value \$0.01 per share	DX	New York Stock Exchange
6.900% Series C Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock, par value \$0.01 per share	DXPRC	New York Stock Exchange

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files).

Yes No

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

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

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

Yes No

On October 29, 2021, the registrant had 36,665,805 shares outstanding of common stock, \$0.01 par value, which is the registrant's only class of common stock.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

DYNEX CAPITAL, INC.
CONSOLIDATED BALANCE SHEETS
(\$s in thousands except per share data)

	September 30, 2021	December 31, 2020
ASSETS	<i>(unaudited)</i>	
Cash	\$ 382,796	\$ 295,602
Cash collateral posted to counterparties	16,639	14,758
Mortgage-backed securities (including pledged of \$2,677,652 and \$2,467,859, respectively), at fair value	2,858,166	2,596,255
Mortgage loans held for investment, at fair value	4,717	6,264
Receivable for sales pending settlement	806	150,432
Derivative assets	70,098	11,342
Accrued interest receivable	13,752	14,388
Other assets, net	7,136	6,394
Total assets	\$ 3,354,110	\$ 3,095,435
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities:		
Repurchase agreements	\$ 2,527,065	\$ 2,437,163
Payable for purchases pending settlement	5,429	5
Derivative liabilities	12,584	1,634
Cash collateral posted by counterparties	22,632	7,681
Accrued interest payable	639	1,410
Accrued dividends payable	6,350	5,814
Other liabilities	5,900	8,275
Total liabilities	2,580,599	2,461,982
Shareholders' equity:		
Preferred stock, par value \$0.01 per share; 50,000,000 shares authorized; 4,460,000 and 7,248,330 shares issued and outstanding, respectively (\$111,500 and \$181,208 aggregate liquidation preference, respectively)	107,843	174,564
Common stock, par value \$0.01 per share, 90,000,000 shares authorized; 35,935,306 and 23,697,970 shares issued and outstanding, respectively	359	237
Additional paid-in capital	1,094,296	869,495
Accumulated other comprehensive income	20,236	80,261
Accumulated deficit	(449,223)	(491,104)
Total shareholders' equity	773,511	633,453
Total liabilities and shareholders' equity	\$ 3,354,110	\$ 3,095,435

See notes to the consolidated financial statements.

DYNEX CAPITAL, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(unaudited)
(\$s in thousands except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2021	2020	2021	2020
Interest income	\$ 15,714	\$ 20,088	\$ 43,000	\$ 79,764
Interest expense	(1,320)	(3,375)	(4,228)	(30,327)
Net interest income	14,394	16,713	38,772	49,437
Realized gain on sale of investments, net	—	20,846	6,705	298,728
Unrealized (loss) gain on investments, net	(3,085)	194	(2,981)	154
Gain (loss) on derivative instruments, net	9,603	7,974	64,463	(196,156)
Other operating expense, net	(330)	(207)	(1,033)	(852)
General and administrative expenses:				
Compensation and benefits	(2,977)	(2,402)	(9,306)	(7,301)
Other general and administrative	(3,572)	(2,393)	(8,417)	(6,926)
Net income	14,033	40,725	88,203	137,084
Preferred stock dividends	(1,923)	(3,252)	(6,405)	(10,346)
Preferred stock redemption charge	—	—	(2,987)	(3,914)
Net income to common shareholders	<u>\$ 12,110</u>	<u>\$ 37,473</u>	<u>\$ 78,811</u>	<u>\$ 122,824</u>
Other comprehensive income:				
Unrealized (loss) gain on available-for-sale investments, net	\$ (9,139)	\$ 27,844	\$ (53,320)	\$ 213,651
Reclassification adjustment for realized gain on available-for-sale investments, net	—	(20,846)	(6,705)	(298,728)
Total other comprehensive (loss) income	(9,139)	6,998	(60,025)	(85,077)
Comprehensive income to common shareholders	<u>\$ 2,971</u>	<u>\$ 44,471</u>	<u>\$ 18,786</u>	<u>\$ 37,747</u>
Weighted average common shares-basic	34,924,449	23,141,270	31,258,711	23,054,042
Weighted average common shares-diluted	35,089,508	23,141,270	31,423,770	23,054,042
Net income per common share-basic	\$ 0.35	\$ 1.62	\$ 2.52	\$ 5.33
Net income per common share-diluted	\$ 0.35	\$ 1.62	\$ 2.51	\$ 5.33
Dividends declared per common share	\$ 0.39	\$ 0.39	\$ 1.17	\$ 1.27

See notes to the consolidated financial statements.

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

	Preferred Stock		Common Stock		Additional Paid-in Capital	AOCI	Accumulated Deficit	Total Shareholders' Equity
	Shares	Amount	Shares	Amount				
Balance as of December 31, 2019	6,788,330	\$ 162,807	22,945,993	\$ 229	\$ 858,347	\$ 173,806	\$ (612,201)	\$ 582,988
Cumulative effect of adopting accounting standard ASU 2019- 05	—	—	—	—	—	—	(548)	(548)
Adjusted Balance, January 1, 2020	6,788,330	\$ 162,807	22,945,993	\$ 229	\$ 858,347	\$ 173,806	\$ (612,749)	\$ 582,440
Stock issuance	4,460,000	107,988	—	—	—	—	—	107,988
Redemption of preferred stock	(4,000,000)	(96,086)	—	—	—	—	(3,914)	(100,000)
Restricted stock granted, net of amortization	—	—	67,511	1	306	—	—	307
Stock repurchase	—	—	(18,782)	—	(206)	—	—	(206)
Adjustments for tax withholding on share-based compensation	—	—	(12,744)	—	(235)	—	—	(235)
Stock issuance costs	—	—	—	—	(9)	—	—	(9)
Net loss	—	—	—	—	—	—	(98,479)	(98,479)
Dividends on preferred stock	—	—	—	—	—	—	(3,841)	(3,841)
Dividends on common stock	—	—	—	—	—	—	(10,330)	(10,330)
Other comprehensive income	—	—	—	—	—	72,972	—	72,972
Balance as of March 31, 2020	7,248,330	\$ 174,709	22,981,978	\$ 230	\$ 858,203	\$ 246,778	\$ (729,313)	\$ 550,607
Restricted stock granted, net of amortization	—	—	172,782	1	422	—	—	423
Stock repurchase	—	—	(14,143)	—	(166)	—	—	(166)
Stock issuance costs	—	—	—	—	(8)	—	—	(8)
Net income	—	—	—	—	—	—	194,838	194,838
Dividends on preferred stock	—	—	—	—	—	—	(3,253)	(3,253)
Dividends on common stock	—	—	—	—	—	—	(9,925)	(9,925)
Other comprehensive loss	—	—	—	—	—	(165,047)	—	(165,047)
Balance as of June 30, 2020	7,248,330	\$ 174,709	23,140,617	\$ 231	\$ 858,451	\$ 81,731	\$ (547,653)	\$ 567,469
Stock issuance	—	—	5,219	—	85	—	—	85
Restricted stock granted, net of amortization	—	—	—	—	568	—	—	568

	Preferred Stock		Common Stock		Additional Paid-in Capital	AOCI	Accumulated Deficit	Total Shareholders' Equity
	Shares	Amount	Shares	Amount				
Adjustments for tax withholding on share-based compensation	—	—	(598)	—	(10)	—	—	(10)
Stock issuance costs	—	—	—	—	(5)	—	—	(5)
Net income	—	—	—	—	—	—	40,725	40,725
Dividends on preferred stock	—	—	—	—	—	—	(3,252)	(3,252)
Dividends on common stock	—	—	—	—	—	—	(9,025)	(9,025)
Other comprehensive income	—	—	—	—	—	6,998	—	6,998
Balance as of September 30, 2020	7,248,330	\$ 174,709	23,145,238	\$ 231	\$ 859,089	\$ 88,729	\$ (519,205)	\$ 603,553
Balance as of December 31, 2020	7,248,330	\$ 174,564	23,697,970	\$ 237	\$ 869,495	\$ 80,261	\$ (491,104)	\$ 633,453
Stock issuance	—	—	7,187,500	72	128,078	—	—	128,150
Redemption of preferred stock	(2,788,330)	(66,721)	—	—	—	—	(2,987)	(69,708)
Restricted stock granted, net of amortization	—	—	16,722	—	451	—	—	451
Adjustments for tax withholding on share-based compensation	—	—	(22,623)	—	(428)	—	—	(428)
Stock issuance costs	—	—	—	—	(270)	—	—	(270)
Net income	—	—	—	—	—	—	117,929	117,929
Dividends on preferred stock	—	—	—	—	—	—	(2,559)	(2,559)
Dividends on common stock	—	—	—	—	—	—	(10,586)	(10,586)
Other comprehensive loss	—	—	—	—	—	(65,156)	—	(65,156)
Balance as of March 31, 2021	4,460,000	\$ 107,843	30,879,569	\$ 309	\$ 997,326	\$ 15,105	\$ (389,307)	\$ 731,276
Stock issuance	—	—	3,463,708	34	68,268	—	—	68,302
Restricted stock granted, net of amortization	—	—	23,305	—	444	—	—	444
Other share-based compensation	—	—	—	—	100	—	—	100
Adjustments for tax withholding on share-based compensation	—	—	(22,016)	—	(425)	—	—	(425)
Stock issuance costs	—	—	—	—	(43)	—	—	(43)
Net loss	—	—	—	—	—	—	(43,759)	(43,759)
Dividends on preferred stock	—	—	—	—	—	—	(1,923)	(1,923)

	Preferred Stock		Common Stock		Additional Paid-in Capital	AOCI	Accumulated Deficit	Total Shareholders' Equity
	Shares	Amount	Shares	Amount				
Dividends on common stock	—	—	—	—	—	—	(12,613)	(12,613)
Other comprehensive income	—	—	—	—	—	14,270	—	14,270
Balance as of June 30, 2021	4,460,000	\$ 107,843	34,344,566	343	1,065,670	29,375	(447,602)	755,629
Stock issuance	—	—	1,590,740	16	27,882	—	—	27,898
Restricted stock granted, net of amortization	—	—	—	—	460	—	—	460
Other share-based compensation	—	—	—	—	300	—	—	300
Stock issuance costs	—	—	—	—	(16)	—	—	(16)
Net income	—	—	—	—	—	—	14,033	14,033
Dividends on preferred stock	—	—	—	—	—	—	(1,923)	(1,923)
Dividends on common stock	—	—	—	—	—	—	(13,731)	(13,731)
Other comprehensive loss	—	—	—	—	—	(9,139)	—	(9,139)
Balance as of September 30, 2021	4,460,000	\$ 107,843	35,935,306	\$ 359	\$ 1,094,296	\$ 20,236	\$ (449,223)	\$ 773,511

See notes to the consolidated financial statements.

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

	Nine Months Ended September 30,	
	2021	2020
Operating activities:		
Net income	\$ 88,203	\$ 137,084
Adjustments to reconcile net income to cash provided by operating activities:		
Realized gain on sale of investments, net	(6,705)	(298,728)
Unrealized loss (gain) on investments, net	2,981	(154)
(Gain) loss on derivative instruments, net	(64,463)	196,156
Amortization of investment premiums, net	90,082	96,018
Other amortization and depreciation, net	1,726	1,428
Share-based compensation expense	1,755	1,299
Decrease in accrued interest receivable	636	10,869
Decrease in accrued interest payable	(771)	(14,526)
Change in other assets and liabilities, net	(4,718)	530
Net cash provided by operating activities	108,726	129,976
Investing activities:		
Purchase of investments	(1,054,928)	(2,436,953)
Principal payments received on investments	321,262	344,055
Proceeds from sales of investments	474,908	4,401,909
Principal payments received on mortgage loans held for investment	1,629	2,170
Net receipts (payments) on derivatives, including terminations	22,082	(197,932)
Increase in cash collateral posted by counterparties	14,951	342
Net cash (used in) provided by investing activities	(220,096)	2,113,591
Financing activities:		
Borrowings under repurchase agreements	11,010,378	28,304,165
Repayments of repurchase agreement borrowings	(10,920,476)	(30,461,830)
Principal payments on non-recourse collateralized financing	(118)	(2,107)
Proceeds from issuance of preferred stock	—	107,988
Proceeds from issuance of common stock	224,350	—
Cash paid for redemption of preferred stock	(69,708)	(100,000)
Cash paid for stock issuance costs	(329)	—
Cash paid for common stock repurchases	—	(372)
Payments related to tax withholding for share-based compensation	(853)	(245)
Dividends paid	(42,799)	(40,151)
Net cash provided by (used in) financing activities	200,445	(2,192,552)
Net increase in cash including cash posted to counterparties	89,075	51,015
Cash including cash posted to counterparties at beginning of period	310,360	136,230
Cash including cash posted to counterparties at end of period	\$ 399,435	\$ 187,245
Supplemental Disclosure of Cash Activity:		
Cash paid for interest	\$ 4,992	\$ 44,216

See notes to the consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DYNEX CAPITAL, INC.

(amounts in thousands except share data)

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 is an internally managed mortgage real estate investment trust, or mortgage REIT, which primarily earns income from investing on a leveraged basis in debt securities, the majority of which are specified pools of Agency mortgage-backed securities (“MBS”) consisting of commercial MBS (“CMBS”), residential MBS (“RMBS”), and CMBS interest-only (“IO”) securities and non-Agency MBS, which consist mainly of CMBS IO. Agency MBS have a guaranty of principal payment by a U.S. government-sponsored entity (“GSE”) such as Fannie Mae and Freddie Mac, which are in conservatorship and are currently supported by a senior preferred stock purchase agreement from the U.S. Treasury. Non-Agency MBS are issued by non-governmental enterprises and do not have a guaranty of principal payment. 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 unaudited consolidated financial statements of the Company and its subsidiaries (together, “Dynex” or, as appropriate, the “Company”) have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) for interim financial information and with the instructions to the Quarterly Report on Form 10-Q and Article 10, Rule 10-01 of Regulation S-X promulgated by the Securities and Exchange Commission (the “SEC”). Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, all significant adjustments, consisting of normal recurring accruals, considered necessary for a fair presentation of the consolidated financial statements have been included. Operating results for the three and nine months ended September 30, 2021 are not necessarily indicative of the results that may be expected for any other interim periods or for the entire year ending December 31, 2021. The unaudited consolidated financial statements included herein should be read in conjunction with the audited financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2020 (the “2020 Form 10-K”) filed with the SEC.

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 and fair value measurements of its investments. These items are discussed further below within this note to the consolidated financial statements.

The Company believes the estimates and assumptions underlying the consolidated financial statements included herein are reasonable and supportable based on the information available as of September 30, 2021; however, the uncertainty over the impact that the COVID-19 pandemic may continue to have on the global economy and on the Company’s business makes any estimates and assumptions inherently less certain than they would be absent the current and potential impacts of COVID-19. The COVID-19 pandemic and resulting emergency measures have led (and may continue to lead) to significant disruptions in the global capital markets and supply chains as well as the economy of the U.S. and other countries impacted by COVID-19. In addition, the nature and timing of any future public policy choices and actions are unpredictable, including the potential impact on MBS prices and prepayment speeds. Though supportive actions taken by the U.S. government and GSEs have helped cushion the economic damage from the disruption of the pandemic to date, the Company can give no assurance as to how, in the long term, these actions will affect the efficiency, liquidity and stability of the financial and mortgage markets.

Reclassifications

Certain items on the Company’s consolidated balance sheet as of December 31, 2020 have been reclassified to conform to the current period’s presentation. In the Company’s 2020 Form 10-K, restricted cash on the consolidated balance

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DYNEX CAPITAL, INC.

(amounts in thousands except share data)

sheet as of December 31, 2020 consisted of the cash collateral posted by the Company to its counterparties to cover initial and variation margin related to its financing and derivative instruments, net of any cash collateral received by the Company from its counterparties. Restricted cash has been renamed “cash collateral posted to counterparties” within total assets, and cash collateral of \$7,681 posted by counterparties as of December 31, 2020 has been reclassified to “cash collateral posted by counterparties” within total liabilities. This change in presentation also impacted the cash flow statement for the nine months ended September 30, 2020, resulting in the addition of “increase in cash collateral posted by counterparties” of \$342 which is the difference in the balances of that line item on the Company’s consolidated balance sheets as of December 31, 2019 and September 30, 2020.

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. 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 to be deemed a primary beneficiary.

The Company consolidates a securitization trust, which has residential mortgage loans included in “mortgage loans held for investment” on its consolidated balance sheet. The Company owns the subordinate class in the trust and has been deemed the primary beneficiary.

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 shareholders 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 and 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 (loss) per common share by dividing net income (loss) to common shareholders for the period by weighted-average shares of common stock outstanding for that period. Please see [Note 2](#) for the calculation of the Company’s basic and diluted net income (loss) per common share for the periods indicated.

The Company currently has unvested restricted stock, service-based restricted stock units (“RSUs”) and performance-based stock units (“PSUs”) issued and outstanding. Upon vesting (or settlement, in the case of units), restrictions on transfer expire on each share of restricted stock, RSU, and PSU, and each such share represents one unrestricted share of common stock. Restricted stock awards are considered participating securities and therefore are included in the computation of basic net income per common share using the two-class method because holders of unvested shares of restricted stock are eligible to receive non-forfeitable dividends. Holders of unvested RSUs and PSUs accrue forfeitable dividend equivalent rights over the vesting period, receiving dividend payments only upon the settlement date if the requisite service-based and performance-based conditions have been achieved. As such, unvested RSUs and PSUs are excluded from

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DYNEX CAPITAL, INC.

(amounts in thousands except share data)

the computation of basic net income per common share, but are included in the computation of diluted net income per common share unless the effect is to reduce a net loss or increase the net income per common share (also known as “anti-dilutive”).

Because the Company’s 6.900% Series C Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock (the “Series C Preferred Stock”) is redeemable at the Company’s option for cash only and convertible into shares of common stock only upon a change of control of the Company (and subject to other circumstances) as described in Article IIIC of the Company’s Restated Articles of Incorporation, the effect of those shares and their related dividends were excluded from the calculation of diluted net income per common share for the periods presented.

Cash

Cash includes unrestricted demand deposits at highly rated financial institutions. The Company’s cash balances fluctuate throughout the year and may exceed Federal Deposit Insurance Corporation (“FDIC”) insured limits from time to time. Although the Company bears risk to amounts in excess of those insured by the FDIC, it does not anticipate any losses as a result due to the financial position and creditworthiness of the depository institutions in which those deposits are held.

Cash Collateral Posted To/By Counterparties

Cash collateral posted to/by counterparties represents amounts pledged/received to cover initial and variation margin related to the Company’s financing and derivative instruments.

The following table provides a reconciliation of “cash” and “cash posted to counterparties” reported on the Company’s consolidated balance sheet as of the period indicated that sum to the total of the same such amounts shown on the Company’s consolidated statement of cash flows for the nine months ended September 30, 2021:

	September 30, 2021
Cash	\$ 382,796
Cash collateral posted to counterparties	16,639
Total cash including cash posted to counterparties shown on consolidated statement of cash flows	\$ 399,435

Mortgage-Backed Securities

The Company’s MBS are recorded at fair value on the Company’s consolidated balance sheet. MBS purchased prior to January 1, 2021 are designated as available-for-sale (“AFS”) with changes in fair value reported in other comprehensive income (“OCI”) as an unrealized gain (loss) until the security is sold or matures. Effective January 1, 2021, the Company elected the fair value option for all MBS purchased on or after that date with changes in fair value reported in net income as “unrealized gain (loss) on investments, net” until the security is sold or matures. Upon the sale of an MBS, any unrealized gain or loss is reclassified to “realized gain (loss) on sale of investments, net” using the specific identification method. Management elected the fair value option so that GAAP net income will reflect the changes in fair value for its future purchases of MBS in a manner consistent with the presentation and timing of the changes in fair value of its derivative instruments. Electing the fair value option is increasing as an industry trend for mortgage REITs who have not elected cash flow hedge accounting. “Unrealized gain (loss) on investments, net”, which was titled “fair value adjustments, net” in prior reporting periods, also includes changes in fair value for mortgage loans held for investment for which the Company elected the fair value option effective January 1, 2020.

Interest Income, Premium Amortization, and Discount Accretion. Interest income on MBS 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 are amortized or accreted into interest income over the projected 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’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

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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 currently hold any non-Agency MBS that were purchased at a discount with credit ratings of less than 'AA' or not rated by any of the nationally recognized credit rating agencies at the time of purchase.

Determination of MBS Fair Value. The Company estimates the fair value of the majority of its MBS based upon prices obtained from 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. Please refer to [Note 6](#) for further discussion of MBS fair value measurements.

Allowance for Credit Losses. On at least a quarterly basis, the Company evaluates any MBS designated as AFS with a fair value less than its amortized cost for credit losses. If the difference between the present value of cash flows expected to be collected on the MBS is less than its amortized cost, the difference is recorded as an allowance for credit loss through net income up to and not exceeding the amount that the amortized cost exceeds current fair value. Subsequent changes in credit loss estimates are recognized in earnings in the period in which they occur. Because the majority of the Company's investments are higher credit quality and most are guaranteed by a GSE, the Company is not likely to have an allowance for credit losses related to its MBS recorded on its consolidated balance sheet.

Repurchase Agreements

The Company's repurchase agreements, which are used to finance its purchases of MBS, 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, which is disclosed parenthetically on the Company's consolidated balance sheets. 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

During the nine months ended September 30, 2021, the Company's derivative instruments have included U.S. Treasury futures, options on U.S. Treasury futures, options on interest rate swaps ("swaptions") and TBA securities, which are forward contracts for the purchase or sale of Agency RMBS on a non-specified pool basis. Derivative instruments are reported at their fair value on the Company's consolidated balance sheet as derivative assets if in a gain position or as derivative liabilities if in a loss position, at the end of the period reported. All income/expenses 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 (loss). 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 currently has short positions in U.S. Treasury futures contracts, which are valued based on exchange pricing with daily margin settlements. The Company realizes gains or losses on these contracts upon expiration at an amount equal to the difference between the current fair value of the underlying asset and the contractual price of the futures contract. Daily margin exchanges for the Company's U.S. Treasury futures are not considered legal settlement of the instrument.

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The Company's options on U.S. Treasury futures provide the Company the right, but not an obligation, to buy U.S. Treasury futures at a predetermined notional amount and stated term in the future. Options on U.S. Treasury futures are valued based on exchange pricing without daily exchanges of margin amounts. The Company records the premium paid for the option contract as a derivative asset on its consolidated balance sheet and adjusts the balance for changes in fair value through "gain (loss) on derivative instruments" until the option is exercised or the contract expires. The Company may also purchase swaptions and defer the premium payment until the effective date. The premium payable and underlying swaption are accounted for as a single unit of account.

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 that the individual TBA transaction will not settle in the shortest time period possible.

Please refer to [Note 5](#) for additional information regarding the Company's derivative instruments as well as [Note 6](#) for information on how the fair value of these instruments is calculated.

Share-Based Compensation

The Company's 2020 Stock and Incentive Plan (the "2020 Plan") reserves for issuance up to 2,300,000 common shares for eligible employees, non-employee directors, consultants, and advisors to the Company to be granted in the form of stock options, restricted stock, restricted stock units, stock appreciation rights, performance units, and performance cash awards (collectively, "awards"). Awards previously granted under the Company's 2018 Stock and Incentive Plan ("2018 Plan") or any other prior equity plan will remain outstanding and valid in accordance with their terms, but no new awards will be granted under the 2018 Plan or any other prior equity plan.

Currently, the Company has shares of restricted stock and RSUs issued and outstanding which are treated as equity awards and recorded at their fair value using the closing stock price on the grant date. The compensation cost is recognized over the vesting period with a corresponding credit to shareholders' equity using the straight-line method.

The Company also has PSUs issued and outstanding which contain either Company performance-based or market performance-based conditions. PSUs subject to Company performance-based conditions are initially recognized as equity at their fair value which is measured using the closing stock price on the grant date multiplied by the number of units expected to vest based on an assessment of the probability of achievement of the Company performance-based conditions as of the grant date. The grant date fair value is amortized as compensation cost on a straight-line basis over the vesting period with adjustments to compensation cost if necessary based on any change in probability of achievement which is re-assessed as of each reporting date and on at least a quarterly basis.

PSUs subject to market performance-based conditions are recognized as equity at their grant date fair value determined through a Monte-Carlo simulation of the Company's common stock total shareholder return ("TSR") relative to the common stock TSR of the group of peer companies specified in the award agreement. Awards subject to market performance-based conditions are not assessed for probability of achievement and are not remeasured subsequent to issuance. The grant date fair value is recognized as compensation cost on a straight-line basis over the vesting period even if the market performance-based conditions are not achieved.

The Company does not estimate forfeitures for any of its share-based compensation awards, but adjusts for actual forfeitures in the periods in which they occur. Because RSUs and PSUs have forfeitable dividend equivalent rights that are paid only upon settlement, any accrued dividend equivalent rights on forfeited units are reversed with a corresponding credit to compensation cost.

Contingencies

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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.

As previously disclosed in the 2020 Form 10-K, the receiver (the "Receiver") for one of the plaintiffs awarded damages in a judgment (the "DCI Judgment") against Dynex Commercial, Inc. ("DCI"), a subsidiary of a former affiliate of the Company, filed a separate claim in May 2018 against the Company seeking payment of the damages awarded in connection with the DCI Judgment, alleging that the Company breached a litigation cost sharing agreement, as amended (the "Agreement"), that was initially entered into by the Company and DCI in December 2000. On November 21, 2019, the U.S. District Court, Northern District of Texas ("Northern District Court") granted in part and denied in part summary judgment on the Receiver's claim and the Company's claim for offset and recoupment. The Northern District Court found that the Company breached the Agreement and therefore must pay damages to the Receiver. The Northern District Court simultaneously granted the Company's motion for summary judgment finding that DCI also breached the Agreement and that the Company can recover amounts due to it from DCI under the Agreement. The Receiver subsequently filed certain objections ("Objections") with the Northern District Court to, among other things, certain amounts the Company included in its recovery claim from DCI. The Company has disputed the Receiver's Objections, arguing, among other things, that the Receiver's Objections are not supportable under Virginia law. At the trial of this matter in the Northern District Court, which occurred in September 2021, and in subsequent briefs, the Receiver set forth damages in a range of \$13,400 to \$13,800. The Company set forth its offsetting claim for damages in amounts ranging from \$14,400 to \$21,300, including interest. On November 1, 2021, the Northern District Court awarded the Company \$14,238, which more than offset the amount the Court awarded to the Receiver, entered a take nothing judgement in the Company's favor against the Receiver, and dismissed the Receiver's claim against the Company. The Receiver has the right to appeal to the United States Court of Appeals for the Fifth Circuit within 30 days. The Company anticipates the final resolution of this matter will not have a material adverse effect on its consolidated financial statements.

Recently Issued Accounting Pronouncements

The Company evaluates Accounting Standards Updates ("ASU") issued by the Financial Accounting Standards Board ("FASB") on at least a quarterly basis to evaluate applicability and significance of any impact on its financial condition and results of operations. There were no accounting pronouncements issued during the nine months ended September 30, 2021 that are expected to have a material impact on the Company's financial condition or results of operations.

NOTE 2 – NET INCOME (LOSS) PER COMMON SHARE

Please refer to [Note 1](#) for information regarding the Company's treatment of its preferred stock and stock awards in the calculation of its basic and diluted net income (loss) per common share and to [Note 7](#) for information regarding the Company's stock award activity for the periods presented. The following table presents the computations of basic and diluted net income (loss) per common share for the periods indicated:

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	Three Months Ended September 30,		Nine Months Ended September 30,	
	2021	2020	2021	2020
Weighted average number of common shares outstanding - basic	34,924,449	23,141,270	31,258,711	23,054,042
Incremental common shares-unvested RSUs	55,019	—	55,019	—
Incremental common shares-unvested PSUs	110,040	—	110,040	—
Weighted average number of common shares outstanding - diluted	35,089,508	23,141,270	31,423,770	23,054,042
Net income to common shareholders	\$ 12,110	\$ 37,473	\$ 78,811	\$ 122,824
Net income per common share-basic	\$ 0.35	\$ 1.62	\$ 2.52	\$ 5.33
Net income per common share-diluted	\$ 0.35	\$ 1.62	\$ 2.51	\$ 5.33

The Company did not have any potentially dilutive instruments outstanding during the three or nine months ended September 30, 2020.

NOTE 3 – MORTGAGE-BACKED SECURITIES

The following tables present the Company's MBS by investment type as of the dates indicated:

	September 30, 2021				
	Agency RMBS	Agency CMBS	CMBS IO ⁽¹⁾	Non-Agency Other	Total
MBS designated as AFS:					
Par value	\$ 1,271,603	\$ 185,603	\$ —	\$ 1,087	\$ 1,458,293
Unamortized premium (discount)	41,604	2,608	300,061	(246)	344,027
Amortized cost	1,313,207	188,211	300,061	841	1,802,320
Gross unrealized gain	10,056	10,230	13,924	107	34,317
Gross unrealized loss	(13,348)	(7)	(684)	(42)	(14,081)
Fair value	1,309,915	198,434	313,301	906	1,822,556
MBS measured at fair value through net income:					
Par value	\$ 1,000,854	\$ —	\$ —	\$ —	\$ 1,000,854
Unamortized premium	33,533	—	4,313	—	37,846
Amortized cost	1,034,387	—	4,313	—	1,038,700
Gross unrealized gain	52	—	17	—	69
Gross unrealized loss	(3,132)	—	(27)	—	(3,159)
Fair value	1,031,307	—	4,303	—	1,035,610
Total as of September 30, 2021	\$ 2,341,222	\$ 198,434	\$ 317,604	\$ 906	\$ 2,858,166

(1) The notional balance for Agency CMBS IO and non-Agency CMBS IO was \$10,508,786 and \$8,865,021 respectively, as of September 30, 2021.

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	December 31, 2020				
	Agency RMBS	Agency CMBS	CMBS IO ⁽¹⁾	Non-Agency Other	Total
MBS designated as AFS:					
Par value	\$ 1,839,046	\$ 235,801	\$ —	\$ 1,499	\$ 2,076,346
Unamortized premium (discount)	57,997	3,152	378,939	(440)	439,648
Amortized cost	1,897,043	238,953	378,939	1,059	2,515,994
Gross unrealized gain	49,348	19,597	12,081	267	81,293
Gross unrealized loss	—	—	(981)	(51)	(1,032)
Fair value	1,946,391	258,550	390,039	1,275	2,596,255
MBS measured at fair value through net income:					
Par value	\$ —	\$ —	\$ —	\$ —	\$ —
Unamortized premium	—	—	—	—	—
Amortized cost	—	—	—	—	—
Gross unrealized gain	—	—	—	—	—
Gross unrealized loss	—	—	—	—	—
Fair value	—	—	—	—	—
Total as of December 31, 2020	\$ 1,946,391	\$ 258,550	\$ 390,039	\$ 1,275	\$ 2,596,255

(1) The notional balance for the Agency CMBS IO and non-Agency CMBS IO was \$11,277,908 and \$9,319,520, respectively, as of December 31, 2020.

The majority of the Company's MBS are pledged as collateral for the Company's repurchase agreements, which are disclosed in [Note 4](#). 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 presents information regarding the "realized gain on sale of investments, net" on the Company's consolidated statements of comprehensive income (loss) for the periods indicated:

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	Three Months Ended September 30,			
	2021		2020	
	Proceeds Received	Realized Gain (Loss)	Proceeds Received	Realized Gain
Agency RMBS-designated as AFS ⁽¹⁾	\$ —	\$ —	\$ —	\$ 1
Agency CMBS-designated as AFS	—	—	403,095	20,845
	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 403,095</u>	<u>\$ 20,846</u>

	Nine Months Ended September 30,			
	2021		2020	
	Proceeds Received	Realized Gain	Proceeds Received	Realized Gain
Agency RMBS-designated as AFS	\$ 287,409	\$ 3,938	\$ 2,187,956	\$ 75,824
Agency CMBS-designated as AFS	37,873	2,767	2,215,098	222,904
	<u>\$ 325,282</u>	<u>\$ 6,705</u>	<u>\$ 4,403,054</u>	<u>\$ 298,728</u>

(1) Additional realized gain for Agency RMBS during the three months ended September 30, 2020 relates to change in effective rate due to paydown that occurred between trade date of sale in second quarter of 2020 and settlement date in third quarter.

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

	September 30, 2021			December 31, 2020		
	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	\$ 1,121,823	\$ (13,738)	23	\$ 19,266	\$ (399)	19
Non-Agency MBS	10,153	(159)	12	33,417	(408)	23
Continuous unrealized loss position for 12 months or longer:						
Agency MBS	\$ 24	\$ (26)	1	\$ 749	\$ (133)	2
Non-Agency MBS	2,771	(159)	7	2,156	(93)	5

The unrealized losses on the Company's MBS were the result of declines in market prices and were not credit related; therefore the Company's allowance for credit losses on its MBS designated as AFS was \$0 as of September 30, 2021 and December 31, 2020. The principal related to Agency MBS is guaranteed by the GSEs Fannie Mae and Freddie Mac. Although the unrealized losses are not credit related, the Company assesses its ability and intent to hold any MBS with an unrealized loss until the recovery in its value. 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. In addition, for its non-Agency MBS, the Company reviews the credit ratings, the credit characteristics of the mortgage loans collateralizing these securities, and the estimated future cash flows including projected collateral losses.

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NOTE 4 – REPURCHASE AGREEMENTS

The Company's repurchase agreements outstanding as of September 30, 2021 and December 31, 2020 are summarized in the following tables:

Collateral Type	September 30, 2021			December 31, 2020		
	Balance	Weighted Average Rate	Fair Value of Collateral Pledged	Balance	Weighted Average Rate	Fair Value of Collateral Pledged ⁽¹⁾
Agency RMBS	\$ 2,069,312	0.13 %	\$ 2,166,848	\$ 1,874,176	0.23 %	\$ 1,973,608
Agency CMBS	186,575	0.13 %	198,487	237,649	0.23 %	255,741
Agency CMBS IO	180,425	0.68 %	203,319	209,393	0.90 %	243,042
Non-Agency CMBS IO	90,753	0.98 %	108,998	115,945	1.28 %	136,684
Total repurchase agreements	\$ 2,527,065	0.20 %	\$ 2,677,652	\$ 2,437,163	0.34 %	\$ 2,609,075

(1) The amounts for fair value of collateral pledged in the table above as of December 31, 2020 include securities with an amortized cost of \$141,215 which were sold but not settled as of that date, and for which the proceeds of \$150,432 are recorded within "receivable for sales pending settlement" on the consolidated balance sheet. These securities collateralized \$140,612 of the Company's repurchase agreement borrowings outstanding as of December 31, 2020.

The Company had \$5,429 and \$5 payable to counterparties as of September 30, 2021 and December 31, 2020, respectively, for TBA transactions pending settlement as of those respective dates. The Company had repurchase agreement borrowings outstanding with 23 different counterparties as of September 30, 2021, and its equity at risk did not exceed 10% with any counterparty as of that date.

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:

Remaining Term to Maturity	September 30, 2021			December 31, 2020		
	Balance	Weighted Average Rate	WAVG Original Term to Maturity	Balance	Weighted Average Rate	WAVG Original Term to Maturity
Less than 30 days	\$ 479,019	0.30 %	110	\$ 1,416,608	0.37 %	53
30 to 90 days	620,085	0.12 %	125	845,394	0.31 %	35
91 to 180 days	1,122,552	0.22 %	168	175,161	0.22 %	13
180 days to 1 year	305,409	0.15 %	318	—	— %	—
Total	\$ 2,527,065	0.20 %	165	\$ 2,437,163	0.34 %	44

The Company has an agreement with Wells Fargo Bank, N.A. for a committed repurchase facility, which has an aggregate maximum borrowing capacity of \$250,000 and a maturity date of June 8, 2023. As of September 30, 2021, the Company had \$95,791 outstanding with this facility at a weighted average borrowing rate of 0.87%. The remaining repurchase facilities available to the Company are uncommitted with no guarantee of renewal or terms of renewal.

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 believes it was in full compliance with all covenants in master repurchase agreements under which there were amounts outstanding as of September 30, 2021.

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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 table presents information regarding the Company's repurchase agreements as if the Company had presented them on a net basis as of September 30, 2021 and December 31, 2020:

	Gross Amount of Recognized Liabilities	Gross Amount Offset in the Balance Sheet	Net Amount of Liabilities Presented in the Balance Sheet	Gross Amount Not Offset in the Balance Sheet ⁽¹⁾		Net Amount
				Financial Instruments Posted as Collateral	Cash Posted as Collateral	
September 30, 2021						
Repurchase agreements	\$ 2,527,065	\$ —	\$ 2,527,065	\$ (2,527,065)	\$ —	\$ —
December 31, 2020						
Repurchase agreements	\$ 2,437,163	\$ —	\$ 2,437,163	\$ (2,437,163)	\$ —	\$ —

(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 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 5](#) for information related to the Company's derivatives, which are also subject to underlying agreements with master netting or similar arrangements.

NOTE 5 – DERIVATIVES

Types and Uses of Derivatives Instruments

Interest Rate Derivatives. During the three and nine months ended September 30, 2021, the Company has been using short positions in U.S. Treasury futures, put options on U.S. Treasury futures, and interest rate swaptions to mitigate the impact of changing interest rates on its book value.

TBA Transactions. The Company purchases TBA securities as a means of investing in non-specified fixed-rate Agency RMBS and may also periodically sell TBA securities as a means of economically hedging its book value exposure to Agency RMBS. The Company holds long and short positions in TBA securities by executing a series of transactions, commonly referred to as “dollar roll” transactions, which effectively delay the settlement of a forward purchase (or sale) of a non-specified Agency RMBS by entering into an offsetting TBA position, net settling the paired-off positions in cash, and simultaneously entering into an identical TBA long (or short) position with a later settlement date. TBA securities purchased (or sold) for a forward settlement date are generally priced at a discount relative to TBA securities settling 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. The Company accounts for all TBAs (whether net long or net short positions, or collectively “TBA dollar roll positions”) as derivative instruments because it 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 that the individual TBA transaction will not settle in the shortest period possible.

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Gain (Loss) on Derivative Instruments, Net

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

Type of Derivative Instrument	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2021	2020	2021	2020
Interest rate swaps	\$ —	\$ 911	\$ —	\$ (182,941)
Interest rate swaptions	3,985	411	42,686	(162)
U.S. Treasury futures	11,209	(6,517)	43,673	(25,140)
Options on U.S. Treasury futures	(3,226)	(5,655)	(2,141)	(23,815)
TBA securities - long positions	(2,365)	18,824	(19,755)	45,943
TBA securities - short positions	—	—	—	(10,041)
Gain (loss) on derivative instruments, net	<u>\$ 9,603</u>	<u>\$ 7,974</u>	<u>\$ 64,463</u>	<u>\$ (196,156)</u>

The table below summarizes information about the carrying 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	September 30, 2021	December 31, 2020
U.S. Treasury futures	Derivative assets	Economic hedging	\$ 60,159	\$ —
Options on U.S. Treasury futures	Derivative assets	Economic hedging	—	1,094
Interest rate swaptions	Derivative assets	Economic hedging	9,939	1,360
TBA securities	Derivative assets	Investing	—	8,888
Total derivatives assets			<u>\$ 70,098</u>	<u>\$ 11,342</u>
Interest rate swaptions	Derivative liabilities	Economic hedging	\$ —	\$ (107)
U.S. Treasury futures	Derivative liabilities	Economic hedging	—	(1,527)
TBA securities	Derivative liabilities	Investing	(12,584)	—
Total derivatives liabilities			<u>\$ (12,584)</u>	<u>\$ (1,634)</u>

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The following table provides details on the Company's interest rate swaptions held as of the dates indicated:

Average Months to Expiration	Option		Underlying Payer Swap		
	Cost	Fair Value	Notional Amount	Average Fixed Pay Rate	Average Term in Years
As of September 30, 2021:					
3 months or less	\$ 3,725	\$ 4,453	\$ 250,000	1.19%	10
9-12 months	9,375	5,486	500,000	1.60%	10
	<u>\$ 13,100</u>	<u>\$ 9,939</u>	<u>\$ 750,000</u>	<u>1.46%</u>	
As of December 31, 2020:					
6 months or less	\$ 6,312	\$ 1,161	\$ 750,000	1.02%	10
6-9 months	6,688	92	500,000	1.16%	10
	<u>\$ 13,000</u>	<u>\$ 1,253</u>	<u>\$ 1,250,000</u>	<u>1.07%</u>	

The following table provides details on the Company's U.S. Treasury futures and options on U.S. Treasury futures held as of the dates indicated:

	September 30, 2021			December 31, 2020:		
	Notional Amount Long (Short)	Fair Value	Average Term to Expiration	Notional Amount Long (Short)	Fair Value	Average Term to Expiration
Options on U.S. Treasury futures	\$ —	\$ —	n/a	\$ 500,000	\$ 1,094	1 month
U.S. Treasury futures	(3,540,000)	60,159	3 months	(825,000)	(1,527)	2 months

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

	September 30, 2021	December 31, 2020
Implied market value ⁽¹⁾	\$ 1,987,906	\$ 1,572,949
Implied cost basis ⁽²⁾	2,000,490	1,564,061
Net carrying value ⁽³⁾	<u>\$ (12,584)</u>	<u>\$ 8,888</u>

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

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

(3) 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DYNEX CAPITAL, INC.

(amounts in thousands except share data)

Volume of Activity

The tables below summarize changes in the Company's derivative instruments for the nine months ended September 30, 2021:

Type of Derivative Instrument	Beginning Notional Amount-Long (Short)	Additions	Settlements, Terminations, or Pair-Offs	Ending Notional Amount-Long (Short)
Interest rate swaptions	1,250,000	500,000	(1,000,000)	750,000
U.S. Treasury futures	(825,000)	(11,640,000)	8,925,000	(3,540,000)
Options on U.S. Treasury futures	500,000	2,350,000	(2,850,000)	—
TBA securities	1,515,000	20,235,000	(19,770,000)	1,980,000

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. Please see [Note 4](#) for information related to the Company's repurchase agreements, which are also subject to underlying agreements with master netting or similar arrangements. 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 September 30, 2021 and December 31, 2020:

	Offsetting of Assets					
	Gross Amount of Recognized Assets	Gross Amount Offset in the Balance Sheet	Net Amount of Assets Presented in the Balance Sheet	Gross Amount Not Offset in the Balance Sheet ⁽¹⁾		Net Amount
				Financial Instruments Received as Collateral	Cash Received as Collateral	
September 30, 2021						
U.S. Treasury futures	\$ 60,159	\$ —	\$ 60,159	\$ —	\$ (12,537)	\$ 47,622
Interest rate swaptions	9,939	—	9,939	—	(9,939)	—
Derivative assets	\$ 70,098	\$ —	\$ 70,098	\$ —	\$ (22,476)	\$ 47,622
December 31, 2020						
Interest rate swaptions	\$ 1,360	\$ —	\$ 1,360	\$ (107)	\$ —	\$ 1,253
Options on U.S. Treasury futures	1,094	—	1,094	—	—	1,094
TBA securities	8,888	—	8,888	—	(7,681)	1,207
Derivative assets	\$ 11,342	\$ —	\$ 11,342	\$ (107)	\$ (7,681)	\$ 3,554

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DYNEX CAPITAL, INC.
(amounts in thousands except share data)

	Offsetting of Liabilities					
	Gross Amount of Recognized Liabilities	Gross Amount Offset in the Balance Sheet	Net Amount of Liabilities Presented in the Balance Sheet	Gross Amount Not Offset in the Balance Sheet ⁽¹⁾		Net Amount
Financial Instruments Posted as Collateral				Cash Posted as Collateral		
September 30, 2021						
TBA securities	\$ (12,584)	—	\$ (12,584)	\$ —	\$ 12,584	\$ —
Derivative liabilities	\$ (12,584)	\$ —	\$ (12,584)	\$ —	\$ 12,584	\$ —
December 31, 2020						
U.S. Treasury futures-short positions	\$ (1,527)	—	\$ (1,527)	\$ —	\$ 1,527	\$ —
Interest rate swaptions	(107)	—	(107)	107	—	—
Derivative liabilities	\$ (1,634)	\$ —	\$ (1,634)	\$ 107	\$ 1,527	\$ —

(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 fair value of financial instruments pledged as collateral for derivatives and repurchase agreements, which is shown parenthetically, and the total cash pledged or received as collateral which is disclosed in "cash collateral posted to/by counterparties."

NOTE 6 – FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value is defined 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. Fair value is based on the assumptions market participants would use when pricing an asset or liability and also considers 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 the Company's consolidated balance sheet by their valuation hierarchy levels as of the dates indicated:

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DYNEX CAPITAL, INC.
(amounts in thousands except share data)

	September 30, 2021				December 31, 2020			
	Fair Value	Level 1	Level 2	Level 3	Fair Value	Level 1	Level 2	Level 3
Assets carried at fair value:								
MBS	\$ 2,858,166	\$ —	\$ 2,857,260	\$ 906	\$ 2,596,255	\$ —	\$ 2,594,980	\$ 1,275
Mortgage loans held for investment	4,717	—	—	4,717	6,264	—	—	6,264
Derivative assets:								
U.S. Treasury futures	\$ 60,159	\$ 60,159	—	—	—	—	—	—
Options on U.S. Treasury futures	—	—	—	—	1,094	1,094	—	—
Interest rate swaptions	9,939	—	9,939	—	1,360	—	1,360	—
TBA securities-long position	—	—	—	—	8,888	—	8,888	—
Total assets carried at fair value	<u>\$ 2,932,981</u>	<u>\$ 60,159</u>	<u>\$ 2,867,199</u>	<u>\$ 5,623</u>	<u>\$ 2,613,861</u>	<u>\$ 1,094</u>	<u>\$ 2,605,228</u>	<u>\$ 7,539</u>
Liabilities carried at fair value:								
U.S. Treasury futures	\$ —	\$ —	\$ —	\$ —	\$ 1,527	\$ 1,527	\$ —	\$ —
Interest rate swaptions	—	—	—	—	107	—	107	—
TBA securities-long position	12,584	—	12,584	—	—	—	—	—
Total liabilities carried at fair value	<u>\$ 12,584</u>	<u>\$ —</u>	<u>\$ 12,584</u>	<u>\$ —</u>	<u>\$ 1,634</u>	<u>\$ 1,527</u>	<u>\$ 107</u>	<u>\$ —</u>

The fair value measurements for the Company's MBS are considered Level 2 when there are substantially similar securities actively trading or for which there has been recent trading activity in their respective markets and are based on prices received from pricing services and quotes from brokers. In valuing a security, the 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 reviews the prices it receives from its pricing sources as well as the assumptions and inputs utilized by its pricing sources for reasonableness. Examples of these observable inputs and assumptions include market interest rates, credit spreads, and projected prepayment speeds, among other things.

The Company owns other non-Agency MBS and mortgage loans that are considered Level 3 assets because there has been no recent trading activity of similar instruments upon which their fair value can be measured. The fair value for these Level 3 assets is measured 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. The Company used a constant prepayment rate assumption of 10%, default rate of 2%, loss severity of 20%, and a discount rate of 7.0% in measuring the fair value of its Level 3 assets as of September 30, 2021. 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DYNEX CAPITAL, INC.

(amounts in thousands except share data)

The activity of the Company's Level 3 assets during the three and nine months ended September 30, 2021 is presented in the following table:

	Three Months Ended		Nine Months Ended	
	September 30, 2021		September 30, 2021	
	Other Non-Agency		Other Non-Agency	
	MBS	Mortgage Loans	MBS	Mortgage Loans
Balance as of beginning of period	\$ 1,002	\$ 5,146	\$ 1,275	\$ 6,264
Change in fair value ⁽¹⁾	(47)	34	(151)	102
Principal payments	(109)	(457)	(412)	(1,629)
Accretion (amortization)	60	(6)	194	(20)
Balance as of end of period	<u>\$ 906</u>	<u>\$ 4,717</u>	<u>\$ 906</u>	<u>\$ 4,717</u>

(1) Change in fair value for mortgage loans is recorded within "unrealized gain (loss) on investments, net" in net income and change in fair value for other non-Agency MBS is recorded as unrealized gain (loss) in "other comprehensive income".

U.S. Treasury futures and options on 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 interest rate swaptions is based on the fair value of the underlying interest rate swap and time remaining until its expiration and is carried on the balance sheet net of any deferred premium to be paid upon expiration. The fair value of TBA securities is estimated using methods similar those used to fair value the Company's Level 2 MBS.

NOTE 7 – SHAREHOLDERS' EQUITY AND SHARE-BASED COMPENSATION

Preferred Stock. The Company's Board of Directors has designated 6,600,000 shares of the Company's preferred stock for issuance as Series C Preferred Stock, of which the Company has 4,460,000 of such shares outstanding as of September 30, 2021. The Series C Preferred Stock has no stated maturity, is not subject to any sinking fund or mandatory redemption, and will remain outstanding indefinitely unless redeemed or otherwise repurchased or converted into common stock pursuant to the terms of the Series C Preferred Stock. Except under certain limited circumstances described in Article IIIC of the Company's Restated Articles of Incorporation, the Company may not redeem the Series C Preferred Stock prior to April 15, 2025. On or after that date, the Series C Preferred Stock may be redeemed 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 Series C 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 C Preferred stock pays a cumulative cash dividend equivalent to 6.900% of the \$25.00 liquidation preference per share each year until April 15, 2025 upon which date and thereafter, the Company will pay cumulative cash dividends at a percentage of the \$25.00 liquidation value per share equal to an annual floating rate of three-month LIBOR plus a spread of 5.461%. The Company paid its regular quarterly dividend of \$0.43125 per share of Series C Preferred Stock on October 15, 2021 to shareholders of record as of October 1, 2021.

During the first quarter of 2021, the Company redeemed the remaining 2,788,330 outstanding shares of its 7.625% Series B Cumulative Redeemable Preferred Stock at an aggregate redemption price of approximately \$25.15 per share, which included accumulated and unpaid dividends declared as of the redemption date February 15, 2021. The excess of the \$25.00 liquidation price per share over the carrying value of the preferred stock redeemed resulted in a charge of \$(2,987) to net income to common shareholders for the nine months ended September 30, 2021.

Common Stock. During the three months ended September 30, 2021, the Company issued 1,590,740 shares of its common stock through its ATM offering ("ATM") program at an aggregate value of \$27,898, net of \$353 in broker commissions and fees.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DYNEX CAPITAL, INC.

(amounts in thousands except share data)

Share-Based Compensation. The Company did not grant any stock awards during the three months ended September 30, 2021. Total share-based compensation expense recognized by the Company for the three and nine months ended September 30, 2021 was \$760 and \$1,755, respectively, compared to \$568 and \$1,299, respectively, for the three and nine months ended September 30, 2020. The following tables present a rollforward of share-based awards for the periods indicated:

Nine Months Ended September 30, 2021						
	Restricted Stock		RSUs		PSUs	
	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
Awards outstanding, beginning of period	281,761	\$ 14.74	—	\$ —	—	\$ —
Granted	40,027	19.02	55,019	19.40	110,040	19.40
Vested	(123,984)	15.28	—	—	—	—
Awards outstanding, end of period	197,804	\$ 15.27	55,019	\$ 19.40	110,040	\$ 19.04

Nine Months Ended September 30, 2020						
	Restricted Stock		RSUs		PSUs	
	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
Awards outstanding, beginning of period	119,213	\$ 18.56	—	\$ —	—	\$ —
Granted	240,293	13.88	—	—	—	—
Vested	(71,431)	18.25	—	—	—	—
Awards outstanding, end of period	288,075	\$ 14.74	—	\$ —	—	\$ —

Actual RSUs awarded will range from 0% if the recipient's time-based vesting condition is not met to 100% if the time-based vesting condition is met. Actual PSUs awarded will range from 0% to 200% based on the achievement of the performance goals defined in the grant award. As of September 30, 2021, the Company expects to award 100% of the 110,040 PSUs outstanding as of September 30, 2021.

The following table discloses the grant date fair value of the Company's remaining unvested awards as of September 30, 2021, which will be amortized into compensation expense over the period disclosed:

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DYNEX CAPITAL, INC.
(amounts in thousands except share data)

	September 30, 2021	
	Remaining Compensation Cost	WAVG Period of Recognition (in Years)
Restricted stock	\$ 2,172	1.5
RSUs	938	2.4
PSUs	1,825	2.3
Total	<u>\$ 4,935</u>	<u>1.9</u>

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

The following discussion should be read in conjunction with our unaudited consolidated financial statements and the accompanying notes included in Part I, Item 1 "Financial Statements" in this Quarterly Report on Form 10-Q and our audited consolidated financial statements and the accompanying notes included in Part II, Item 8 in our 2020 Form 10-K. References herein to "Dynex," the "Company," "we," "us," and "our" include Dynex Capital, Inc. and its consolidated subsidiaries, unless the context otherwise requires. In addition to current and historical information, the following discussion and analysis contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements relate to our future business, financial condition or results of operations. For a description of certain factors that may have a significant impact on our future business, financial condition or results of operations, see "Forward-Looking Statements" at the end of this discussion and analysis.

For more information about our business including our operating policies, investment philosophy and strategy, financing and hedging strategies, and other important information, please refer to Part I, Item 1 of our 2020 Form 10-K.

EXECUTIVE OVERVIEW

Dynex Capital, Inc. is 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.

Market Conditions and Recent Activity

Conditions continued to be volatile during the third quarter of 2021 as the global economy transitioned to a post-pandemic environment. Economic data in the U.S. points to stronger growth, higher inflation and a tighter labor market, but the durability of these trends remains unclear. On the strength of this information, the Federal Reserve has indicated that it plans to taper its purchase of assets, including Agency MBS, in the fourth quarter this year. While most global central bank policy remains highly accommodative, several have begun to raise interest rates and moved to hawkish language as inflation has accelerated. The evolving economic outlook, the uncertainty of the impact of variants of COVID-19 on real economic activity, and the shifting policy of the Federal Reserve and global central banks, contributed to increased volatility in U.S. interest rates during the third quarter of 2021, with the 10-year U.S. Treasury yield touching a low of 1.13% and trading in a range of over 40 basis points before ending the quarter virtually unchanged at 1.49%.

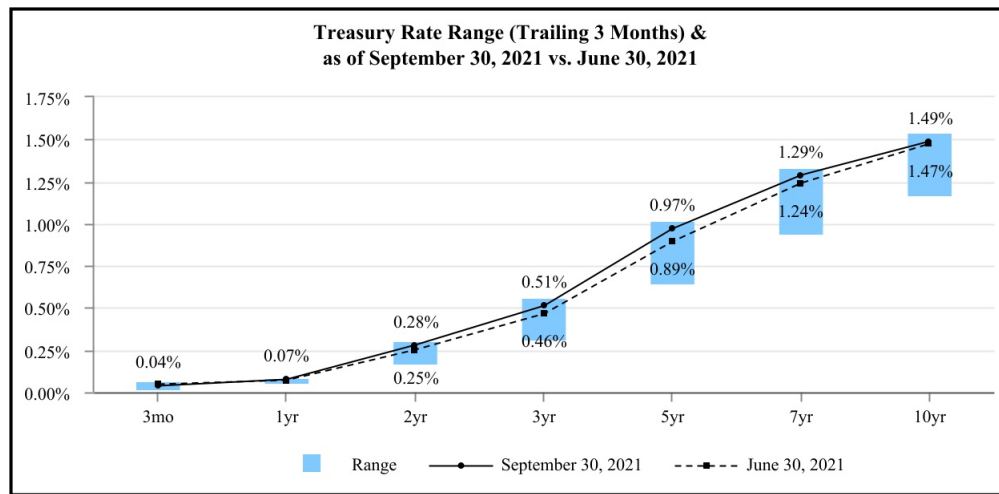
Spreads on risk assets owned by the Company were less volatile for the third quarter compared to the prior quarter, with Agency RMBS ending the quarter slightly tighter and CMBS and CMBS IO modestly wider. The table below shows changes in market spreads in basis points for certain investment types in our MBS portfolio during the three months ended September 30, 2021:

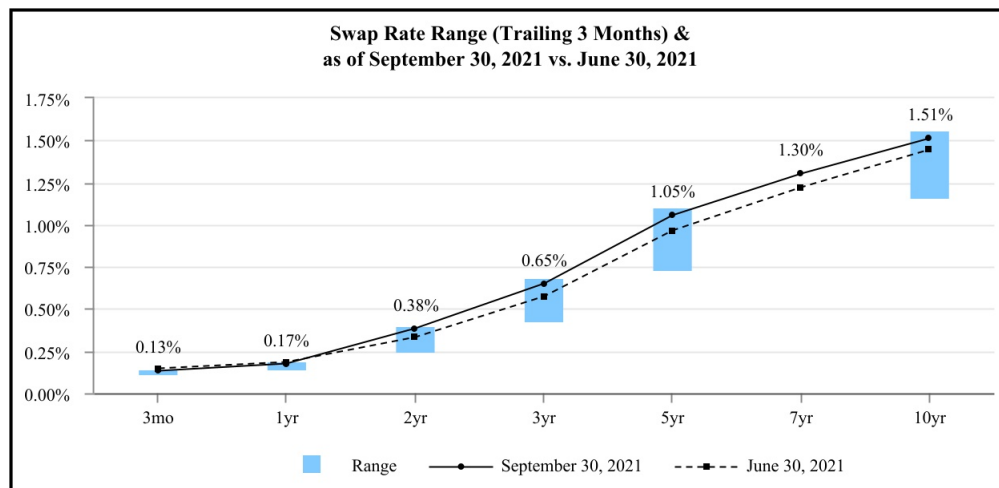
Investment Type:	Third Quarter 2021 Change in Spreads	As of September 30, 2021	As of June 30, 2021
Agency RMBS: ⁽¹⁾			
2.0% coupon	(4)	(10)	(6)
2.5% coupon	(5)	(4)	1
4.0% coupon	(15)	39	54
Agency DUS (Agency CMBS) ⁽²⁾	8	26	18
Freddie K AAA IO (Agency CMBS IO) ⁽²⁾	—	65	65
AAA CMBS IO (Non-Agency CMBS IO) ⁽²⁾	3	108	105

(1) Option adjusted spreads are based on Company estimates using third-party models and market data.

(2) Data represents the spread to swap rate on newly issued securities and is sourced from JP Morgan.

The charts below show the highest and lowest U.S. Treasury and swap rates during the three months ended September 30, 2021 as well as the rates as of September 30, 2021 and June 30, 2021:





Third Quarter 2021 Performance

Comprehensive income to common shareholders was \$3.0 million, or \$0.09 per common share, for the third quarter of 2021 versus a loss of \$(31.4) million, or \$(0.98) per common share in the second quarter of 2021. The Company benefited in the third quarter from maintaining its hedge positioning for a steeper U.S. Treasury yield curve as rates increased in the 5-10 year portion of the curve since the end of the second quarter. As a result, realized and unrealized losses on investments, net of hedges was \$(2.7) million, or \$(0.08) per common share during the third quarter versus a loss of \$(35.6) million, or \$(1.11) per common share for the previous quarter. The Company also benefited from a higher average balance of interest-earning assets due to Agency RMBS purchases late in the second quarter of 2021 which increased net interest income by \$2.3 million, or \$0.03 per common share, for the third quarter. The increase in net interest income was partially offset by an increase in general and administrative expenses of \$0.8 million to \$6.5 million, or \$(0.19) per common share, a portion of which is related to litigation fees as well as expansion of the Company's operating platform used to manage its investment and hedging portfolios as the Company continues to grow.

Earnings available for distribution ("EAD") to common shareholders (a non-GAAP measure formerly referred to as "core net operating income to common shareholders") increased \$0.03 from the prior quarter to \$0.54 per common share for the third quarter of 2021 due to the increase in net interest income discussed above. An increase in average TBA dollar roll transactions during the third quarter of 2021 also drove an increase in drop income of \$1.1 million compared to the prior quarter, but the impact to EAD on a per common share basis was unchanged from \$0.38 per common share due to the higher weighted average common shares outstanding.

Total economic return of \$0.06 per common share, or 0.3%, consisted of \$0.39 in dividends declared per common share offset by a \$(0.33) decline in book value per common share to \$18.42 as of September 30, 2021. The decline in book value was driven by unrealized losses on our assets (excluding drop income from TBAs) exceeding the gains from hedging instruments by \$(0.46) per common share, which was partially offset by earnings available for distribution to common shareholders exceeding dividends declared by \$0.15 per common share. The remaining \$(0.02) per share decline was due to common stock issuances and other equity transactions during the third quarter.

Leverage as of September 30, 2021 was 5.9 times shareholders' equity, down from 6.7 as of June 30, 2021. We lowered leverage during the third quarter by reducing our TBA position in 2.5% coupons in order to protect book value from the potential for additional losses in the fair value of our investments while increasing the flexibility to redeploy capital in

future investments with higher returns. Our leverage was also impacted during the quarter as a result of the increase in our equity due primarily to the \$27.9 million of capital raised through at-the-market offerings of common stock.

Current Outlook

Throughout the third quarter, we maintained our portfolio structure with hedges for the long end of the yield curve and relatively low leverage on our capital, and we continue to hold that position into the fourth quarter. Since September 30, 2021, the yield curve has steepened, and our book value is estimated to have improved to a current range of \$18.80 to \$19.00 per common share. While we expect book value will continue to fluctuate with the level of interest rates and mortgage spreads, we believe it to be cushioned by our low leverage and substantial liquidity. As it relates to credit spreads, in the near-term, fundamentals for Agency RMBS are soft as we see factors that may keep refinancing levels elevated including originator capacity and government policy. Agency RMBS spreads could also widen as much as 20 basis points as the Federal Reserve begins to taper their purchases, assuming demand by banks and other institutions and investors does not materialize. Finally, in our assessment, it is too early to arrive at conclusions on long term trends for inflation, labor market and growth and for this reason, the timing and pace of hikes is less clear. We believe that short-term interest rates will remain low through at least the first half of 2022, providing us with historically cheap financing as a base to generate returns. Given the high degree of uncertainty of economic outcomes, inflation and monetary policy, we will continue to maintain a lower leverage profile with our capital allocated to highly liquid investments.

Non-GAAP Financial Measures

In addition to the Company's operating results presented in accordance with GAAP, the information presented within Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations" of this Quarterly Report on Form 10-Q contains the following non-GAAP financial measures: earnings available for distribution ("EAD") to common shareholders (formerly core net operating income to common shareholders) (including per common share), adjusted net interest income and the related metric 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. Reconciliations of EAD to common shareholders and adjusted net interest income to the related GAAP financial measures are provided below and within "Results of Operations".

Beginning this quarter, the Company has renamed its non-GAAP measure "core net operating income to common shareholders" to "EAD to common shareholders" in order to clarify what the measure represents. The adjustments made to reconcile "comprehensive income to common shareholders" to "EAD to common shareholders" are identical to the adjustments previously used to calculate "core net operating income." EAD to common shareholders is a non-GAAP metric used by the Company as a measure of the investment portfolio's return based on the effective yield of its investments, net of financing costs and other normal recurring operating income/expenses, net. It is one of several factors the Board considers in determining the appropriate level of distributions to common shareholders. In addition to the non-GAAP reconciliation set forth below, which derives EAD to common shareholders from GAAP comprehensive income (loss) to common shareholders, EAD to common shareholders can also be determined by adjusting net interest income to include interest rate swap periodic interest benefit/cost, drop income on TBA securities, general and administrative expenses, preferred dividends, and other normal recurring operating income or expense. Drop income generated by TBA dollar roll positions, which is included in "gain (loss) on derivatives instruments, net" on the Company's consolidated statements of comprehensive income, is included in EAD to common shareholders and in adjusted net interest income because management views drop income as the economic equivalent of net interest income (interest income less implied financing cost) on the underlying Agency security from trade date to settlement date. Management also includes interest rate swap periodic interest benefit/cost, which is also included in "gain (loss) on derivatives instruments, net", 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 therefore represent a 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 the changes in fair value of investments or changes in fair value of and

costs of terminating derivative instruments used by management to economically hedge the impact of changing interest rates on the fair value of the Company's 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.

Reconciliations of GAAP to Non-GAAP Financial Measures:	Three Months Ended	
	September 30, 2021	June 30, 2021
<i>(\$s in thousands except per share data)</i>		
Comprehensive income (loss) to common shareholders	\$ 2,971	\$ (31,412)
Less:		
Change in fair value of investments ⁽¹⁾	12,224	(17,362)
Change in fair value of derivative instruments, net ⁽²⁾	3,716	65,117
EAD to common shareholders	\$ 18,911	\$ 16,343
Average common shares outstanding	34,924,449	31,973,587
Comprehensive income (loss) per common share	\$ 0.09	\$ (0.98)
EAD per common share	\$ 0.54	\$ 0.51
Net interest income	\$ 14,394	\$ 12,118
TBA drop income ⁽³⁾	13,319	12,177
Adjusted net interest income	\$ 27,713	\$ 24,295
Other operating expense, net	(330)	(323)
General and administrative expenses	(6,549)	(5,706)
Preferred stock dividends	(1,923)	(1,923)
EAD to common shareholders	\$ 18,911	\$ 16,343

(1) Amount includes realized and unrealized gains and losses recorded in net income and OCI due to changes in the fair value of the Company's MBS and other investments.

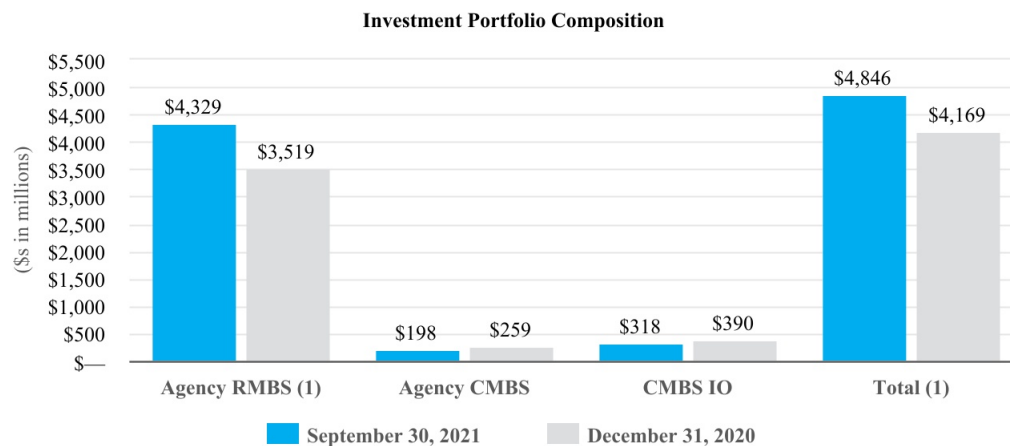
(2) Amount includes unrealized gains and losses from changes in fair value of derivatives and realized gains and losses on terminated derivatives and excludes TBA drop income.

(3) TBA drop income is calculated by multiplying the notional amount of the TBA dollar roll positions by the difference in price between two TBA securities with the same terms but different settlement dates. The impact of TBA drop income on adjusted net interest spread includes the implied average funding cost of TBA dollar roll transactions during the periods indicated.

FINANCIAL CONDITION

Investment Portfolio

The following chart compares the composition of our MBS portfolio including TBA securities as of the dates indicated:



(1) Includes TBA securities at their implied market value, as if settled, of \$2.0 billion and \$1.6 billion, respectively. TBA securities are recorded within "derivative assets (liabilities)" on our consolidated balance sheet at their net carrying value, which represents the difference between the implied market value and the implied cost basis of the TBA security as of the date indicated.

RMBS. As of September 30, 2021, the majority of our investments in RMBS were Agency-issued pass-through securities collateralized primarily by pools of fixed-rate single-family mortgage loans. Monthly payments of principal and interest made by the individual borrowers on the mortgage loans underlying the pools are "passed through" to the security holders, after deducting GSE or U.S. Government agency guarantee and servicer fees. Mortgage pass-through certificates generally distribute cash flows from the underlying collateral on a pro-rata basis among the security holders. Security holders also receive guarantor advances of principal and interest for delinquent loans in the mortgage pools. In addition to specified pools of Agency RMBS, we are also currently investing in TBA securities. Please refer to [Notes 1](#) and [5](#) of the Notes to the Consolidated Financial Statements for a description of these transactions and information regarding their accounting treatment.

As noted in the table below, as of September 30, 2021, we are invested in lower coupon securities to mitigate the risk of loss of premiums due to early prepayment. Our lower coupon investments also have lower premiums relative to higher coupon assets which further protects our earnings when prepayments occur. Our investment in TBA securities has increased relative to prior periods as implied financing rates for dollar roll transactions have been lower than the financing rates for repurchase agreement borrowings we typically use to finance specified pools. Because TBA securities have higher relative liquidity, these transactions allow more flexibility should we decide or find it necessary to reduce leverage.

The following tables compare our fixed-rate Agency RMBS investments including TBA dollar roll positions as of the dates indicated:

September 30, 2021

Coupon	Par/Notional-Long (Short)	Amortized Cost/ Implied Cost Basis ⁽¹⁾⁽³⁾	Fair Value ⁽²⁾⁽³⁾	Weighted Average		
				Loan Age (in months) ⁽⁴⁾	3 Month CPR ⁽⁴⁾⁽⁵⁾	Estimated Duration ⁽⁶⁾
30-year fixed-rate:						
<i>(\$s in thousands)</i>						
2.0%	\$ 880,915	\$ 898,303	\$ 887,089	13	9.0 %	7.09
2.5%	1,209,644	1,261,935	1,256,721	12	8.4 %	6.20
4.0%	181,897	187,356	197,413	42	40.5 %	3.04
TBA 2.0%	1,415,000	1,424,661	1,415,276	n/a	n/a	6.87
TBA 2.5%	190,000	196,591	195,418	n/a	n/a	5.33
15-year fixed-rate:						
TBA 1.5%	375,000	379,238	377,212	n/a	n/a	4.75
Total	\$ 4,252,456	\$ 4,348,084	\$ 4,329,129	15	11.3 %	6.29

December 31, 2020

Coupon	Par/Notional-Long (Short)	Amortized Cost/ Implied Cost Basis ⁽¹⁾⁽³⁾	Fair Value ⁽²⁾⁽³⁾	Weighted Average		
				Loan Age (in months) ⁽⁴⁾	3 Month CPR ⁽⁴⁾⁽⁵⁾	Estimated Duration ⁽⁶⁾
30-year fixed-rate:						
<i>(\$s in thousands)</i>						
TBA 2.0%	\$ 765,000	\$ 789,945	\$ 792,957	n/a	n/a	4.89
2.0%	620,238	635,096	646,744	8	7.7 %	5.31
2.5%	938,334	973,116	995,889	10	13.5 %	3.53
4.0%	280,474	288,831	303,758	33	46.8 %	2.48
15-year fixed-rate:						
TBA 1.5%	250,000	255,068	257,305	n/a	n/a	4.73
TBA 2.0%	500,000	519,047	522,687	n/a	n/a	3.09
Total	\$ 3,354,046	\$ 3,461,103	\$ 3,519,340	13	17.1 %	4.10

(1) Implied cost basis of TBAs represents the forward price to be paid for the underlying Agency MBS.

(2) Fair value of TBAs is the implied market value of the underlying Agency security as of the end of the period.

(3) TBAs are included on the consolidated balance sheet within "derivative assets/liabilities" at their net carrying value which is the difference between their implied market value and implied cost basis. Please refer to [Note 5](#) of the Notes to the Consolidated Financial Statements for additional information.

(4) TBAs 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.

CMBS. Substantially all of our CMBS investments as of September 30, 2021 were fixed-rate Agency-issued securities backed by multifamily housing loans. The loans underlying CMBS are generally fixed-rate with scheduled principal payments generally assuming a 30-year amortization period, but typically requiring balloon payments on average approximately 10 years from origination. 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), which provide us compensation if underlying loans prepay prior to us earning our expected return on our investment. Yield maintenance and prepayment penalty requirements are intended to create an economic disincentive for the loans to prepay, which we believe makes the fair value of CMBS less costly to hedge relative to RMBS.

The following table presents information about our CMBS investments by year of origination as of the dates indicated:

	September 30, 2021				December 31, 2020			
	Par Value	Amortized Cost	Months to Estimated Maturity ⁽¹⁾	WAC ⁽²⁾	Par Value	Amortized Cost	Months to Estimated Maturity ⁽¹⁾	WAC ⁽²⁾
<i>(\$ in thousands)</i>								
Year of Origination:								
Prior to 2009 ⁽³⁾	\$ 5,714	\$ 5,564	15	5.75 %	\$ 9,132	\$ 8,964	36	5.69 %
2009 to 2012	10,789	11,289	31	4.63 %	11,424	12,085	65	5.56 %
2013 to 2014	9,707	9,840	37	3.29 %	9,865	10,033	44	3.61 %
2015	109,613	110,881	60	2.94 %	155,760	157,137	69	2.85 %
2017	30,833	31,175	108	3.18 %	30,907	31,294	91	3.18 %
2019	19,702	19,970	143	3.17 %	19,702	19,988	151	3.12 %
	<u>\$ 186,358</u>	<u>\$ 188,719</u>	<u>72</u>	<u>3.21 %</u>	<u>\$ 236,790</u>	<u>\$ 239,501</u>	<u>77</u>	<u>3.19 %</u>

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

(2) The weighted average coupon ("WAC") is the gross interest rate of the security weighted by the outstanding principal balance.

(3) The Company has one non-Agency CMBS originally issued in 1998 with an amortized cost and fair value of less than \$1.0 million as of September 30, 2021 and December 31, 2020.

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. Agency-issued CMBS IO pools are backed by multifamily housing loans, and our non-Agency issued CMBS IO are backed by loans secured by a number of different property types including office buildings, hospitality, and retail, among others. 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. Yields on CMBS IO securities are dependent upon the performance of the underlying loans. Similar to CMBS described above, the Company receives prepayment compensation as most loans in these securities have some form of prepayment protection from early repayment; however, there are no prepayment protections if the loan defaults and is partially or wholly repaid earlier because of loss mitigation actions taken by the underlying loan servicer. Because Agency CMBS IO generally contain higher credit quality loans, they have a lower risk of default than non-Agency CMBS IO. The majority of 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 following tables present our CMBS IO investments by year of origination as of the dates indicated:

	September 30, 2021					
	Agency			Non-Agency		
	Amortized Cost	Fair Value	Remaining WAL	Amortized Cost	Fair Value	Remaining WAL
<i>(\$s in thousands)</i>						
Year of Origination:						
2010-2012	\$ 4,062	\$ 3,838	4	\$ 928	\$ 877	4
2013	12,544	14,559	8	6,854	6,919	9
2014	18,560	19,393	17	37,684	38,597	15
2015	24,662	25,845	21	42,796	44,216	21
2016	19,372	20,307	25	14,179	14,346	16
2017	23,393	24,589	37	6,560	6,793	29
2018	3,487	3,802	56	—	—	—
2019	82,044	86,223	54	—	—	—
2020	2,936	2,997	47	—	—	—
2021	4,313	4,303	51	—	—	—
	<u>\$ 195,373</u>	<u>\$ 205,856</u>	<u>37</u>	<u>\$ 109,001</u>	<u>\$ 111,748</u>	<u>19</u>

	December 31, 2020					
	Agency			Non-Agency		
	Amortized Cost	Fair Value	Remaining WAL	Amortized Cost	Fair Value	Remaining WAL
<i>(\$s in thousands)</i>						
Year of Origination:						
2010-2012	\$ 12,037	\$ 11,932	9	\$ 3,237	\$ 3,263	8
2013	22,367	24,165	13	10,875	10,912	15
2014	24,841	25,749	22	50,777	51,175	20
2015	31,875	33,404	26	53,176	54,020	27
2016	23,072	24,203	31	16,705	16,906	16
2017	26,493	27,952	42	7,733	7,808	34
2018	3,792	3,983	62	—	—	—
2019	88,757	91,303	60	—	—	—
2020	3,203	3,264	53	—	—	—
	<u>\$ 236,437</u>	<u>\$ 245,955</u>	<u>39</u>	<u>\$ 142,503</u>	<u>\$ 144,084</u>	<u>24</u>

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

The weighted average interest coupon rate for our CMBS IO was 0.70% as of September 30, 2021 and 0.56% as of December 31, 2020. Effective yields on CMBS IO securities are dependent upon the performance of the underlying loans. Our return on these investments may be negatively impacted if the loans default, resulting in foreclosures, or liquidations of the loan collateral. Non-Agency-issued securities are generally expected to have a higher risk of default than Agency CMBS IO. We are mostly invested in senior tranches of these securities where we have evaluated the credit profile of the underlying loan pool and can monitor credit performance in order to mitigate our exposure to losses. The majority of our non-Agency CMBS IO investments are investment grade-rated with the majority rated 'AAA' by at least one of the nationally recognized statistical rating organizations. All of our non-Agency CMBS IO were originated prior to 2017, the majority of which we believe have had underlying property value appreciation.

Since the economic impacts of COVID-19 began in 2020, servicers are reporting an increase in delinquencies on loans underlying our non-Agency CMBS IO and have taken loss mitigation actions including loan forbearance or allowing the borrower to make loan payments using replacement reserve or similar property related funds. Most of the increases in delinquencies thus far have been in the retail and hotel sectors and have nominally impacted cash flows and yields on the securities. Considering the characteristics of our non-Agency CMBS IO and the actions taken by servicers so far to work with borrowers through various relief measures, we have not seen evidence of and do not currently expect a material adverse effect on our future cash flows for non-Agency CMBS IO. However, the ultimate impact of COVID-19 on the global economy and on the loans underlying any of our securities remains uncertain and cannot be predicted at this time.

The property type for the loans securing our non-Agency CMBS IO, which has not changed materially since December 31, 2020, are shown in the table below as of September 30, 2021:

<i>(\$s in thousands)</i>	September 30, 2021	
	Fair Value	Percentage of Portfolio
Property Type:		
Retail	\$ 31,367	28.1 %
Office	24,632	22.0 %
Multifamily	18,133	16.2 %
Hotel	15,134	13.5 %
Mixed use	7,858	7.0 %
Other ⁽¹⁾	14,623	13.2 %
Total non-Agency CMBS IO	\$ 111,747	100.0 %

(1) Other property types collateralizing non-Agency CMBS IO do not comprise more than 5% individually.

Repurchase Agreements

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. 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 based on short-term rate indices that historically closely track LIBOR and are fixed for the term of the borrowing.

Please refer to [Note 4](#) of the Notes to the Consolidated Financial Statements contained within this Quarterly Report on Form 10-Q 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.

Derivative Assets and Liabilities

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. We regularly monitor and frequently adjust our hedging portfolio in response to many factors including, but not limited to, changes in our investment portfolio as well as our expectation of future interest rates, including the absolute level of rates and the slope of the yield curve versus market expectations. As of September 30, 2021, approximately 88% of our MBS portfolio including TBA securities were hedged compared to approximately 62% as of December 31, 2020. Please refer to [Note 5](#) of the Notes to the Consolidated Financial Statements for details on our interest rate derivative instruments as well as “Quantitative and Qualitative Disclosures about Market Risk” in Part I, Item 3 of this Quarterly Report on Form 10-Q.

RESULTS OF OPERATIONS

The discussion below includes both GAAP and non-GAAP financial measures that management utilizes in its internal analysis of financial and operating performance. Please read the section "Non-GAAP Financial Measures" contained in "Executive Overview" of Part I, Item 2 of this Quarterly Report on Form 10-Q for additional important information about these financial measures.

Three Months Ended September 30, 2021 Compared to the Three Months Ended June 30, 2021

The following table summarizes the results of operations for the periods indicated:

<i>\$s in thousands</i>	Three Months Ended	
	September 30, 2021	June 30, 2021
Net interest income	\$ 14,394	\$ 12,118
Realized gain on sale of investments, net	—	2,008
Unrealized (loss) gain on investments, net	(3,085)	1,084
(Loss) gain on derivative instruments, net	9,603	(52,940)
General and administrative expenses	(6,549)	(5,706)
Other operating expenses, net	(330)	(323)
Preferred stock dividends	(1,923)	(1,923)
Net income (loss) to common shareholders	12,110	(45,682)
Other comprehensive (loss) income	(9,139)	14,270
Comprehensive income (loss) to common shareholders	\$ 2,971	\$ (31,412)

Net Interest Income

The increases in net interest income of \$2.3 million and in net interest spread of 6 basis points were driven primarily by purchases of Agency RMBS made in the latter half of the second quarter of 2021, which are fully weighted in the average balance of our interest-earning assets for the third quarter of 2021. In addition, these purchases also earned higher effective yields relative to the remainder of the Agency RMBS portfolio, driving an increase in the effective yield on Agency RMBS by 19 basis points for the three months ended September 30, 2021 compared to the three months ended June 30, 2021. Though we financed a portion of these Agency RMBS purchases using repurchase agreement borrowings, which resulted in a higher average balance of borrowings for the third quarter of 2021, we incurred a nominal increase in interest expense because our borrowing rate declined 3 basis points for the third quarter of 2021 compared to the second quarter of 2021. The weighted average original term to maturity on our borrowings has extended since the second quarter of 2021, allowing us to finance our investments at lower rates.

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

	Three Months Ended					
	September 30, 2021			June 30, 2021		
	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)
<i>(\$s in thousands)</i>						
Interest-earning assets:						
Agency RMBS	\$ 10,336	\$ 2,338,172	1.77 %	\$ 7,373	\$ 1,863,420	1.58 %
Agency CMBS	1,675	189,498	3.02 %	1,959	233,815	2.97 %
CMBS IO (5)	3,572	313,039	4.23 %	3,918	339,288	4.24 %
Non-Agency MBS and other investments	131	5,968	7.11 %	143	6,617	6.94 %
Total:	\$ 15,714	\$ 2,846,677	2.13 %	\$ 13,393	\$ 2,443,140	2.10 %
Interest-bearing liabilities: (6)	(1,320)	2,529,023	(0.20)%	(1,275)	2,155,200	(0.23)%
Net interest income/net interest spread	\$ 14,394		1.93 %	\$ 12,118		1.87 %

(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) Includes Agency and non-Agency issued securities.

(6) Interest-bearing liabilities consist primarily of repurchase agreement borrowings.

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:

	Three Months Ended			
	September 30, 2021 Compared to June 30, 2021			
	Increase (Decrease) Due to Change In			Total Change in Interest Income/Expense
Rate	Volume	Prepayment Adjustments (1)		
<i>(\$s in thousands)</i>				
Interest-earning assets:				
Agency RMBS	\$ 1,085	\$ 1,878	\$ —	\$ 2,963
Agency CMBS	6	(305)	15	(284)
CMBS IO (2)	13	(275)	(84)	(346)
Non-Agency MBS and other investments	(1)	(11)	—	(12)
Change in interest income	1,103	1,287	(69)	2,321
Change in interest expense	(160)	205	—	45
Total net change in net interest income	\$ 1,263	\$ 1,082	\$ (69)	\$ 2,276

(1) Prepayment adjustments represent effective interest amortization adjustments related to changes in actual prepayment speeds and prepayment compensation, net of amortization adjustments for CMBS and CMBS IO.

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

Adjusted Net Interest Income

Please refer to “Non-GAAP Financial Measures” at the end of the “Executive Overview” section of this Quarterly Report on Form 10-Q for additional information about this non-GAAP financial measure used by management to evaluate results of operations.

	Three Months Ended			
	September 30, 2021		June 30, 2021	
	Amount	Rate	Amount	Rate
<i>(\$s in thousands)</i>				
Net interest income	\$ 14,394	1.93 %	\$ 12,118	1.87 %
Add: TBA drop income ^{(1) (2) (3)}	13,319	0.17 %	12,177	0.19 %
Adjusted net interest income ⁽³⁾	\$ 27,713	2.10 %	\$ 24,295	2.06 %

(1) TBA drop income is calculated by multiplying the notional amount of the TBA dollar roll positions by the difference in price between two TBA securities with the same terms but different settlement dates.

(2) The impact of TBA drop income on adjusted net interest spread includes the implied average funding cost of TBA dollar roll transactions during the periods indicated.

(3) Percentages shown for adjusted net interest spread and for the impact from TBA drop income on net interest spread have changed as a result of a correction to the calculation of the average notional balance of TBA dollar roll positions outstanding during the three months ended June 30, 2021. This correction to the calculation of the notional balance did not impact the financial statements as of or for the three months ended June 30, 2021.

Drop income from TBAs for the three months ended September 30, 2021 increased \$1.2 million compared to the three months ended June 30, 2021 as a result of a higher average balance of TBA dollar roll transactions. Though the increase in TBA drop income drove adjusted net interest income higher for the third quarter of 2021 compared to the prior quarter, the lower effective yield for these transactions reduced the impact on adjusted net interest spread by 2 basis points compared to the prior quarter.

We have continued to increase our investment in TBA securities in recent quarters because the financing cost imputed in TBA dollar roll transactions continues to be lower than the average repurchase agreement financing rate. This is commonly referred to in the industry as TBA dollar rolls “trading special” or “dollar roll specialness.” Dollar roll specialness happens primarily as a result of supply/demand imbalances or volatility in market prepayment expectations, and in management’s view, the pace of bank and Federal Reserve purchases is currently resulting in implied financing costs dropping below 0%. The implied financing rate for our TBA long positions was (0.47)% compared to our repurchase agreement financing cost for specified pools of Agency RMBS of 0.13% for the three months ended September 30, 2021, an increase of 11 basis points in dollar roll specialness versus the prior quarter.

Changes in Fair Value of Investments

Changes in the fair value of our investments result in realized and unrealized gains and losses. The fair value of our investments are impacted by a number of factors including, among others, market volatility, changes in credit spreads, spot and forward interest rates, actual and anticipated prepayments, and supply/demand dynamics which are in turn impacted by, among other things, interest rates, capital flows, economic conditions, and government policies and actions, such as purchases and sales by the Federal Reserve Bank of New York.

The following table provides details on unrealized gains and losses on our investments measured and reported at fair value through net income within “unrealized gain (loss) on investments, net” and available-for-sale investments measured and reported at fair value through “other comprehensive income (loss)” for the periods indicated:

	Three Months Ended	
	September 30, 2021	June 30, 2021
<i>(\$s in thousands)</i>		
MBS purchased after December 31, 2020	\$ (3,127)	\$ 997
Mortgage loans held for investment	32	86
Other	10	1
Unrealized (loss) gain on investments, net	(3,085)	1,084
Agency RMBS	(4,894)	12,429
Agency CMBS	(2,069)	(259)
CMBS IO	(2,129)	2,148
Non-Agency other	(47)	(48)
Other comprehensive (loss) income	(9,139)	14,270
Total unrealized (losses) gains	\$ (12,224)	\$ 15,354

Sales of our investments happen in the ordinary course of business as we manage our risk, capital and liquidity profiles, and as we reallocate capital to various investments. We did not sell any investments during the three months ended September 30, 2021. The following table provides information related to our “realized gains (losses) on sales of investments, net” for the periods indicated:

	Three Months Ended			
	September 30, 2021		June 30, 2021	
	Amortized cost sold	Realized Gain	Amortized cost sold	Realized Gain
<i>(\$s in thousands)</i>				
Agency RMBS-designated as AFS	\$ —	\$ —	\$ 213,339	\$ (759)
Agency CMBS-designated as AFS	—	—	35,106	2,767
Total	\$ —	\$ —	\$ 248,445	\$ 2,008

Gain (Loss) on Derivative Instruments, Net

Changes in the fair value of derivative instruments are impacted by changing market interest rates and adjustments that we may make to our hedging 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 yield curve flattened during the three months ended June 30, 2021 when longer-term interest rates declined, which resulted in losses on our interest rate hedges of \$(93.8) million. However, because we maintained our hedge position for a steeper yield curve, we recognized gains of \$12.0 million for the three months ended September 30, 2021 as longer-term interest rates reversed direction from the prior quarter. The following table provides information on our financial instruments accounted for as derivative instruments for the periods indicated:

<i>(\$s in thousands)</i>	Three Months Ended	
	September 30, 2021	June 30, 2021
<i>Change in fair value of interest rate hedges:</i>		
Interest rate swaptions	\$ 3,985	\$ (19,062)
U.S. Treasury futures	11,209	(63,184)
Options on U.S. Treasury futures	(3,226)	(11,531)
Total gain (loss) on interest rate hedges	11,968	(93,777)
<i>TBA dollar roll positions:</i>		
Change in fair value ⁽¹⁾	(15,684)	28,660
TBA drop income ⁽²⁾	13,319	12,177
Total TBA dollar roll gain (loss), net	(2,365)	40,837
Total gain (loss) on derivative instruments, net	\$ 9,603	\$ (52,940)

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

(2) TBA drop income represents a portion of the change in fair value and is calculated by multiplying the notional amount of the net TBA dollar roll positions by the difference in price between two TBA securities with the same terms but different settlement dates.

The following table provides information regarding realized gains (losses) on derivative instruments for the periods indicated:

<i>(\$s in thousands)</i>	Three Months Ended	
	September 30, 2021	June 30, 2021
Interest rate swaptions	\$ 2,828	\$ —
U.S. Treasury futures	(76,089)	36,679
Options on U.S. Treasury futures	(5,578)	(3,633)
TBA long positions	14,880	16,309
Total realized (losses) gains on derivative instruments	\$ (63,959)	\$ 49,355

General and Administrative Expenses

General and administrative expenses increased \$0.8 million for the three months ended September 30, 2021 compared to the three months ended June 30, 2021 due primarily to litigation expenses related to the ongoing legal proceeding discussed in Part II, Item 1 as well as expansion of our operating platform used to manage our investment and hedging portfolios as the Company continues to grow. This increase was partially offset by a \$(0.3) million decrease in compensation and benefits due primarily to adjusting the accrual for annual bonuses which is based on year-to-date performance of the Company.

Nine Months Ended September 30, 2021 Compared to the Nine Months Ended September 30, 2020

Net Interest Income

Net interest income declined \$(10.7) million for the nine months ended September 30, 2021 compared to the nine months ended September 30, 2020 because we held a smaller average balance of lower yielding investments during the nine months ended September 30, 2021 compared to the same period in 2020. Net interest spread increased 26 basis points for the nine months ended September 30, 2021 compared to the nine months ended September 30, 2020 as the decline in our repurchase agreement borrowing costs was higher than the decline in the effective yield earned on our investments. The following table presents information about our interest-earning assets and interest-bearing liabilities and their performance for the periods indicated:

	Nine Months Ended September 30,					
	2021			2020		
<i>(\$ in thousands)</i>	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	\$ 25,090	\$ 2,009,728	1.66 %	\$ 40,734	\$ 2,143,728	2.53 %
Agency CMBS	5,467	220,312	3.17 %	23,319	1,058,847	2.89 %
CMBS IO (5)	12,007	339,212	4.57 %	14,616	448,254	4.18 %
Non-Agency MBS and other investments (6)	436	6,625	7.86 %	1,095	9,516	8.25 %
Total:	\$ 43,000	\$ 2,575,877	2.19 %	\$ 79,764	\$ 3,660,345	2.85 %
Interest-bearing liabilities: (7)	(4,228)	2,282,140	(0.24)%	(30,327)	3,422,287	(1.16)%
Net interest income/net interest spread	\$ 38,772		1.95 %	\$ 49,437		1.69 %

- (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) Includes Agency and non-Agency issued securities.
- (6) Interest income for non-Agency and other investments for the nine months ended September 30, 2020 includes \$0.5 million of interest income from cash and cash equivalents. Average balance and effective yield for non-Agency MBS and other investments excludes cash and cash equivalents.
- (7) Interest-bearing liabilities consist primarily of repurchase agreement borrowings.

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:

**Nine Months Ended
September 30, 2021 Compared to September 30, 2020**

(\$s in thousands)	Increase (Decrease) Due to Change In			Total Change in Interest Income/Expense
	Rate	Volume	Prepayment Adjustments ⁽¹⁾	
Interest-earning assets:				
Agency RMBS	\$ (13,103)	\$ (2,541)	\$ —	\$ (15,644)
Agency CMBS	(21)	(18,330)	499	(17,852)
CMBS IO ⁽²⁾	1,145	(3,020)	(734)	(2,609)
Non-Agency MBS and other investments	(82)	(545)	(32)	(659)
Change in interest income	\$ (12,061)	\$ (24,436)	\$ (267)	\$ (36,764)
Change in interest expense	(16,119)	(9,980)	—	(26,099)
Total net change in net interest income	\$ 4,058	\$ (14,456)	\$ (267)	\$ (10,665)

(1) Prepayment adjustments represent effective interest amortization adjustments related to changes in actual prepayment speeds and prepayment compensation, net of amortization adjustments for CMBS and CMBS IO.

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

Adjusted Net Interest Income

Please refer to “Non-GAAP Financial Measures” at the end of the “Executive Overview” section of this Quarterly Report on Form 10-Q for additional information about this non-GAAP financial measure used by management to evaluate results of operations.

(\$s in thousands)	Nine Months Ended September 30,			
	2021		2020	
	Amount	Rate	Amount	Rate
Net interest income	\$ 38,772	1.95 %	\$ 49,437	1.69 %
Add: TBA drop income ⁽¹⁾⁽²⁾	34,065	0.10 %	8,622	0.02 %
Add: net periodic interest benefit ⁽³⁾	—	— %	1,586	0.06 %
Adjusted net interest income	\$ 72,837	2.05 %	\$ 59,645	1.77 %

(1) TBA drop income is calculated by multiplying the notional amount of the TBA dollar roll positions by the difference in price between two TBA securities with the same terms but different settlement dates.

(2) The impact of TBA drop income on adjusted net interest spread includes the implied average funding cost of TBA dollar roll transactions during the periods indicated.

(3) Amount represents net periodic interest cost/benefit of effective interest rate swaps outstanding during the period and excludes realized and unrealized gains and losses from changes in fair value of derivatives.

The increase of \$13.2 million in adjusted net interest income for the nine months ended September 30, 2021 compared to the nine months ended September 30, 2020 is due to our increased investment in TBA securities at lower implied funding costs relative to the nine months ended September 30, 2020, which resulted in an increase in TBA drop income of \$25.4 million. This increase in TBA drop income offset the decline of \$(10.7) million in net interest income and \$(1.6) million in net periodic interest benefit from interest rate swaps. As discussed previously, we have increased our investment in TBA securities relative to prior periods due to dollar roll specialness, and also given the current market environment. TBA securities allow us more flexibility should we decide or find it necessary to reduce leverage. The decline in net periodic interest benefit from interest rate swaps is because we are not currently using interest rate swaps to hedge our interest rate risk.

Changes in Fair Value of Investments

The following table provides details on unrealized gains or losses on our investments recorded within “unrealized gain (loss) on investments, net” and “other comprehensive income (loss)” for the periods indicated:

	Nine Months Ended	
	September 30, 2021	September 30, 2020
<i>(\$s in thousands)</i>		
MBS purchased after December 31, 2020	\$ (3,090)	\$ —
Mortgage loans held for investment	82	193
Other	27	(39)
Unrealized (loss) gain on investments, net	(2,981)	154
Agency RMBS	(52,640)	(70,262)
Agency CMBS	(9,374)	(11,690)
CMBS IO	2,140	(2,878)
Non-Agency other	(151)	(247)
Other comprehensive loss	(60,025)	(85,077)
Total unrealized losses	\$ (63,006)	\$ (84,923)

The following table provides information related to our realized gains on sales of investments, net for the periods indicated:

	Nine Months Ended			
	September 30, 2021		September 30, 2020	
	Amortized cost sold	Realized Gain	Amortized cost sold	Realized Gain
<i>(\$s in thousands)</i>				
Agency RMBS-designated as AFS	\$ 283,471	\$ 3,938	\$ 2,112,132	\$ 75,824
Agency CMBS-designated as AFS	35,106	2,767	1,992,194	222,904
Total	\$ 318,577	\$ 6,705	\$ 4,104,326	\$ 298,728

Gain (Loss) on Derivative Instruments, Net

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

<i>(\$s in thousands)</i>	Nine Months Ended	
	September 30, 2021	September 30, 2020
<i>Change in fair value of interest rate hedges:</i>		
Interest rate swaps ⁽¹⁾	\$ —	\$ (182,941)
Interest rate swaptions	42,686	(162)
U.S. Treasury futures	43,673	(25,140)
Options on U.S. Treasury futures	(2,141)	(23,815)
Total gain (loss) on interest rate hedges	84,218	(232,058)
<i>TBA dollar roll positions:</i>		
Change in fair value ⁽²⁾	(53,819)	27,280
TBA drop income ⁽³⁾	34,065	8,622
Total TBA dollar roll (loss) gain, net	(19,754)	35,902
Total gain (loss) on derivative instruments, net	\$ 64,464	\$ (196,156)

(1) Amount for interest rate swaps for nine months ended September 30, 2020 is net of periodic interest benefit of \$1.6 million.

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

(3) TBA drop income represents a portion of the change in fair value and is calculated by multiplying the notional amount of the net TBA dollar roll positions by the difference in price between two TBA securities with the same terms but different settlement dates.

The following table provides information regarding realized gains (losses) on derivative instruments for the periods indicated:

<i>(\$s in thousands)</i>	Nine Months Ended	
	September 30, 2021	September 30, 2020
Interest rate swaps	\$ —	\$ (185,985)
Interest rate swaptions	2,828	(1,934)
U.S. Treasury futures	(18,013)	(19,976)
Options on U.S. Treasury futures	(7,339)	(19,724)
TBA long positions	1,717	43,309
TBA short positions	—	(11,016)
Total realized losses on derivative instruments	\$ (20,807)	\$ (195,326)

General and Administrative Expenses

General and administrative expenses increased \$3.5 million for the nine months ended September 30, 2021 compared to the nine months ended September 30, 2020 due primarily to higher bonus accruals and expansion of our operating platform used to manage our investment and hedging portfolios as the Company continues to grow.

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 for 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 meet margin requirements for our repurchase agreements and derivative transactions, including TBA contracts, under the terms of the related agreements. We may also periodically use liquidity to repurchase shares of the Company's stock.

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. Our most liquid assets include unrestricted cash and cash equivalents and unencumbered Agency RMBS, CMBS, and CMBS IO which were \$559.7 million as of September 30, 2021 compared to \$415.3 million as of December 31, 2020. We have increased our available liquidity in recent periods principally to protect against bouts of extreme market volatility, which we believe has a higher potential of occurring given market conditions. Furthermore, there are a number of potential risk events on the horizon including, but not limited to, the fiscal policy debt ceiling resolution, a potential leadership transition at the Federal Reserve, and international risks such as Japanese elections.

We analyze our liquidity under various scenarios based on changes in the fair value of our investments and derivative instruments due to market factors such as changes in the absolute level of interest rates and the shape of the yield curve, credit spreads, lender haircuts, and prepayment speeds. In performing these analyses, 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 analyses is to assess the adequacy of our liquidity to withstand potential adverse events, such as the current COVID-19 pandemic. We may change our leverage targets based on market conditions and our perceptions of the liquidity of our investments. Our leverage, which we calculate using total liabilities plus the cost basis of TBA long positions, was 5.9x shareholders' equity as of September 30, 2021 compared to 6.3x as of December 31, 2020. This decline in leverage since December 31, 2020 is the result of a 22% increase in shareholders' equity, which increased primarily as a result of the \$224.4 million in capital we have raised since December 31, 2020. The impact from the increase in shareholders' equity was partially offset by an increase in our total liabilities including the cost basis of our TBA securities of approximately 14%. We include the cost basis of our TBA securities in evaluating the Company's leverage because it is possible under certain market conditions that it may be uneconomical for us to roll a TBA long position 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. In general, our leverage will increase if we view the risk-reward opportunity of higher leverage is appropriately balanced in our favor.

Our repurchase agreement borrowings are principally uncommitted with terms renewable at the discretion of our lenders and 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. 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 part of our continuous evaluation of counterparty risk, we maintain our highest counterparty exposures with broker dealer subsidiaries of regulated financial institutions or primary dealers whom we believe are better capitalized and more durable counterparties.

The following table presents information regarding the balances of our repurchase agreement borrowings as of and for the periods indicated:

	Repurchase Agreements		
	Balance Outstanding As of Quarter End	Average Balance Outstanding For the Quarter Ended	Maximum Balance Outstanding During the Quarter Ended
<i>(\$s in thousands)</i>			
September 30, 2021	\$ 2,527,065	\$ 2,529,023	\$ 2,590,185
June 30, 2021	2,321,043	2,155,200	2,415,037
March 31, 2021	2,032,089	2,158,121	2,437,163
December 31, 2020	2,437,163	2,500,639	2,594,683
September 30, 2020	2,594,683	2,984,946	3,314,991
June 30, 2020	3,314,991	2,580,296	4,408,106
March 31, 2020	4,408,106	4,701,010	4,917,731
December 31, 2019	4,752,348	4,806,826	4,891,341

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 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. Lenders have the right to change haircut requirements at maturity of the repurchase agreement (if the term is renewed) and may change their haircuts based on market conditions and the perceived riskiness of the collateral pledged. 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”, and if we fail to meet any margin call, our lenders have the right to terminate the repurchase agreement and sell any collateral pledged. Declines in the fair 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, Fannie Mae and Freddie Mac announce principal payments on Agency MBS in advance of their actual remittance of principal payments, and repurchase agreement lenders generally make margin calls 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 from Fannie Mae and Freddie Mac. The weighted average haircut for our borrowings collateralized with Agency RMBS and Agency CMBS typically averages less than 5% while CMBS IO averages between 13-16%.

The collateral we post in excess of our repurchase agreement borrowing with any counterparty is also typically referred to by us as “equity at risk”, which 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. 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. As of September 30, 2021, the Company had repurchase agreement amounts outstanding with 23 of its 37 available repurchase agreement counterparties and did not have more than 5% of equity at risk with any counterparty or group of related counterparties.

We have various financial and operating covenants in certain of our repurchase agreements including, 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), limits on maximum leverage (as a multiple of shareholders' equity), and requirements to maintain our status as a REIT under the Internal Revenue Code of 1986 and the corresponding provisions of state law and to maintain our listing on the New York Stock Exchange. 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. We were in full compliance with our debt covenants as of September 30, 2021, and we are not aware of any circumstances which could potentially result in our non-compliance in the foreseeable future.

Derivative Instruments

We use certain types of financial instruments that are accounted for as derivative instruments, including interest rate swaps, futures, options, 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. 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 September 30, 2021, we had received cash collateral of \$22.6 million from our counterparties under these agreements.

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. As of September 30, 2021, we had cash of \$16.6 million posted as collateral under these agreements. 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 certain deductions. When declaring dividends, the Board of Directors considers the requirements for maintaining our REIT status and maintaining compliance with dividend requirements of the Series C Preferred Stock. In addition, the Board considers, among other things, our total economic return, EAD to common shareholders, taxable income, gains and losses including carryforwards for tax purposes, the Company's long-term outlook for future performance, and trends in the investment and financing markets. 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). Please refer to "Federal Income Tax Considerations" within Part I, Item 1, "Business" as well as Part I, Item 1A, "Risk Factors" of our 2020 Form 10-K for additional important information regarding dividends declared on our taxable income.

Contractual Obligations and Other Matters

As of September 30, 2021, we do not have any material contractual obligations other than the short-term repurchase agreement amounts discussed above, nor do we 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. 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 nine months ended September 30, 2021 that are expected to have a material impact on the Company's financial condition or results of operations. Please refer to [Note 1](#) of the Notes to the Consolidated Financial Statements contained within Part I, Item 1 of this Quarterly Report on Form 10-Q for additional information.

CRITICAL ACCOUNTING ESTIMATES

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 estimates 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. Our critical accounting estimates are discussed in Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and

Results of Operations” of our 2020 Form 10-K under “Critical Accounting Estimates.” There have been no significant changes in our critical accounting estimates during the three months ended September 30, 2021.

FORWARD-LOOKING STATEMENTS

Certain written statements in this Quarterly Report on Form 10-Q that are not historical facts constitute “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). 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, capital management, and dividend policy 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 Quarterly Report on Form 10-Q 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 the macroeconomic environment, monetary and fiscal policy, and conditions in the investment, credit, and derivatives markets;
- Our views on the effect of actual or proposed actions of the 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), the Federal Housing Finance Agency, 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 including TBA dollar roll transaction 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;
- The impact of the COVID-19 pandemic on the economy, as well as certain actions taken by federal, state and local governments in response to the pandemic, and on delinquencies in loans underlying 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;
- The amount, timing, and funding of future dividends;
- Our use of our tax NOL carryforward and other tax loss carryforwards;;
- 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;
- The financial position and credit worthiness of the depository institutions in which the Company’s MBS and cash deposits are held;

- The impact of applicable tax and accounting requirements on the us including our tax treatment of derivative instruments such as TBAs, interest rate swaps, options and futures;
- Our future compliance with covenants in our master repurchase agreements, ISDA agreements, and debt covenants in our other contractual agreements;
- Market interest rates and market spreads; and
- Possible future effects of the COVID-19 pandemic.

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 Quarterly Report on Form 10-Q, especially those incorporated by reference into Part II, Item 1A, “Risk Factors,” and in particular, adverse effects of the ongoing COVID-19 pandemic and any governmental or societal responses thereto, including the efficacy, distribution, availability and adoption rates of vaccines for COVID-19 and variants thereof;
- 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 changes in the Federal Reserve’s policies regarding the purchases of Agency RMBS, Agency CMBS, 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 leverage and 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 underlying MBS that we have purchased, or on loans which 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;
- systems failures or cybersecurity incidents; and
- exposure to current and future claims and litigation.

ITEM 3. 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, credit, liquidity, and reinvestment risks. These risks can and do cause fluctuations in our liquidity, 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 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.

We attempt to manage our exposure to changes in interest rates by entering into interest rate hedging instruments to mitigate the impact of changing interest rates on the market value of our assets. In prior periods, we have also used interest rate hedges to mitigate the impact of changing interest rates on our interest expense from repurchase agreements used to finance our investments. Given current FOMC monetary policy, management anticipates funding costs to remain low and stable in the near-term, and as such, we are not currently hedging our repurchase agreement financing costs.

We manage interest rate risk within tolerances set by our Board of Directors. 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 of 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.

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 as of the dates indicated assuming an instantaneous parallel shift in interest rates and no changes in the composition of our investment portfolio:

	Projected Change in Net Interest Income Due To			
	Decrease in Interest Rates of		Increase in Interest Rates of	
	50 Basis Points	25 Basis Points	25 Basis Points	50 Basis Points
September 30, 2021	(1)	4.0 %	(8.1)%	(17.0)%
December 31, 2020	(1)	0.4 %	(5.9)%	(12.9)%

(1) Because the Company does not assume financing rates will be less than 0%, a parallel downward shift in interest rates of 50 basis points is not presented.

The projected sensitivity to changes in interest rates on our net interest income shown in the table above as of September 30, 2021 has increased compared to December 31, 2020 because the higher interest rates as of September 30, 2021 result in the projected prepayment speed for our Agency RMBS not slowing as much as it did as of December 31, 2020, which decreased the benefit of lower amortization expense compared to December 31, 2020.

The table below shows the projected sensitivity of the market value of our financial instruments and the percentage change in shareholders' equity assuming an instantaneous parallel shift in market interest rates as of the dates indicated:

September 30, 2021

Type of Instrument ⁽¹⁾	Decrease in Interest Rates of				Increase in Interest Rates of			
	100 Basis Points		50 Basis Points		50 Basis Points		100 Basis Points	
	% of Market Value	% of Common Equity	% of Market Value	% of Common Equity	% of Market Value	% of Common Equity	% of Market Value	% of Common Equity
RMBS	1.9 %	14.1 %	1.2 %	9.2 %	(1.6)%	(12.0)%	(3.4)%	(25.3)%
CMBS	0.2 %	1.4 %	0.1 %	0.7 %	(0.1)%	(0.7)%	(0.2)%	(1.4)%
CMBS IO	0.1 %	0.9 %	0.1 %	0.5 %	(0.1)%	(0.6)%	(0.2)%	(1.1)%
TBAAs	1.5 %	11.2 %	1.0 %	7.7 %	(1.4)%	(10.4)%	(3.0)%	(22.0)%
Interest rate hedges	(6.3)%	(46.9)%	(3.3)%	(24.4)%	3.4 %	25.1 %	6.7 %	50.0 %
Total	(2.6)%	(19.3)%	(0.9)%	(6.3)%	0.2 %	1.4 %	(0.1)%	0.2 %

December 31, 2020

Type of Instrument ⁽¹⁾	Decrease in Interest Rates by				Increase in Interest Rates by			
	100 Basis Points		50 Basis Points		50 Basis Points		100 Basis Points	
	% of Market Value	% of Common Equity	% of Market Value	% of Common Equity	% of Market Value	% of Common Equity	% of Market Value	% of Common Equity
RMBS	1.1 %	6.5 %	0.9 %	5.5 %	(1.7)%	(10.1)%	(3.9)%	(22.5)%
CMBS	0.3 %	1.9 %	0.2 %	1.4 %	(0.3)%	(1.5)%	(0.5)%	(3.0)%
CMBS IO	0.2 %	0.9 %	0.1 %	0.8 %	(0.2)%	(1.1)%	(0.4)%	(2.1)%
TBAAs	0.9 %	5.2 %	0.8 %	4.6 %	(1.5)%	(8.9)%	(3.4)%	(19.6)%
Interest rate hedges	(3.4)%	(19.6)%	(1.9)%	(11.0)%	3.4 %	19.9 %	7.5 %	43.4 %
Total	(0.9)%	(5.1)%	0.1 %	1.3 %	(0.3)%	(1.7)%	(0.7)%	(3.8)%

(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.

Relative to December 31, 2020, the table above as of September 30, 2021 shows a projected increase in the market value of our portfolio (including hedges) and common equity for upward parallel shifts in interest rates up to 100 basis points because we held a higher notional balance of hedging instruments as of September 30, 2021 versus December 31, 2020 to better cushion a loss in fair value of our assets in a higher interest rate environment. Conversely, a downward parallel shift in interest rates would result in a decline in the market value of our portfolio and common equity as of September 30, 2021 relative to December 31, 2020. Because we continuously monitor market conditions, economic conditions, interest rates and other market activity and frequently adjust the composition of our investments and hedges throughout any given period, these projections are limited in usefulness because the modeling assumes no changes to the composition of our investment portfolio and hedging instruments as of the dates indicated.

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 (as can be seen by the graphs for U.S. Treasury and swap rates in Item 2, "Executive Overview"). The table below shows the percentage change in projected market value of our financial instruments and in common equity 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:

Basis Point Change in		September 30, 2021		December 31, 2020	
		Percentage Change in		Percentage Change in	
2-year UST	10-year UST	Market Value of Investments ⁽¹⁾	Common Equity	Market Value of Investments ⁽¹⁾	Common Equity
+25	+50	0.1 %	0.5 %	(0.1)%	(0.4)%
+50	+25	0.2 %	1.7 %	(0.5)%	(2.7)%
+50	+100	(0.3)%	(1.9)%	(0.2)%	(1.2)%
0	-25	(0.2)%	(1.2)%	0.1 %	0.8 %
-10	-50	(0.5)%	(3.5)%	0.3 %	1.9 %
-25	-75	(1.1)%	(8.2)%	0.2 %	1.1 %

(1) Includes changes in market value of our investments and derivative instruments, including TBA securities, but excludes changes in market value of our financings which are not carried at fair value on our balance sheet due to their short-term maturities. 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. We do not hedge spread risk given the complexity of hedging credit spreads and in our opinion, 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 Company's exposure to changes to market spreads did not materially shift as of September 30, 2021 versus December 31, 2020. The table below shows the projected sensitivity of the market value of our investments given the indicated change in market spreads as of the dates indicated:

Basis Point Change in Market Spreads	September 30, 2021		December 31, 2020	
	Percentage Change in		Percentage Change in	
	Market Value of Investments ⁽¹⁾	Common Equity	Market Value of Investments ⁽¹⁾	Common Equity
+20/+50 ⁽²⁾	(1.3)%	(9.7)%	(1.6)%	(9.5)%
+10	(0.6)%	(4.7)%	(0.8)%	(4.4)%
-10	0.6 %	4.7 %	0.8 %	4.4 %
-20/-50 ⁽²⁾	1.3 %	9.7 %	1.6 %	9.5 %

(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 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. Our comprehensive income and book value per common share may also be negatively impacted by prepayments if the fair value of the investment materially exceeds the par balance of the underlying security. 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, including GSE policy with respect to loan forbearance and delinquent loan buy-outs.

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). 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 is particularly acute without these prepayment protection provisions. There are no prepayment protections if the loan defaults and is partially or wholly repaid earlier as a result of loss mitigation actions taken by the underlying loan servicer. Loans in non-Agency CMBS IO securities which are collateralized by income producing properties such as retail shopping centers, hotels, multifamily apartments and office buildings are at a higher risk of default as a result of the economic impact of the COVID-19 pandemic. Over the last several years, we have not experienced material defaults on CMBS IO loans in our portfolio; however, the ultimate impact on the economy and commercial real estate performance and market values from the COVID-19 pandemic, and correspondingly loan defaults, is currently unknown. Please refer to Item 2, "Financial Condition-CMBS IO" for additional information on the composition of the Company's investment in CMBS IO.

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, we have invested substantially in lower coupon securities with approximately 85% of our capital in securities with a coupon of 2.5% or lower as of September 30, 2021. We also 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, which we estimate represents approximately 90% of our Agency RMBS investment as of September 30, 2021.

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.

Agency and non-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. This will typically occur when the underlying loan is in default and proceeds from the disposition of the loan collateral are insufficient to pay the prepayment consideration. To mitigate credit risk of investing in CMBS IO, we invest in primarily AAA-rated securities in senior tranches, which means we receive the highest payment priority and are the last to absorb losses in the event of a shortfall in cash flows.

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 and in particular, during the current economic crisis, please refer to "Liquidity and Capital Resources" in Item 2 of this Quarterly Report on Form 10-Q.

Reinvestment Risk

We are 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. Market yields on new investments are substantially lower than the investments we sold in March. As such, we expect new assets that we add at lower yields than the investments sold will lower our interest income in the near future. 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.

ITEM 4. 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 September 30, 2021 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 September 30, 2021 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

With respect to the claim of \$11.3 million against the Company discussed in the Company's 2020 Form 10-K (the "Receiver Litigation") which alleges that the Company breached a litigation cost sharing agreement, at trial in September 2021 and in a subsequent brief, the Receiver set forth damages ranging from \$13.4 million to \$13.8 million, including attorney's fees. The Company set forth and updated its offsetting claim for damages to amounts ranging from \$14.4 million to \$21.3 million, including interest. On November 1, 2021, the Northern District Court awarded the Company \$14.2 million, which more than offset the amount the Court awarded to the Receiver, entered a take nothing judgement in the Company's favor against the Receiver, and dismissed the Receiver's claim against the Company. The Receiver has the right to appeal to the United States Court of Appeals for the Fifth Circuit within 30 days.

The Company believes that the Receiver Litigation will be resolved without a material adverse effect on the Company's consolidated financial statements. The outcome, however, of any legal proceeding, including this matter, cannot be predicted with certainty. As such, no assurances can be given that the Company will ultimately be successful in its defense of this action on the merits or otherwise.

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

ITEM 1A. RISK FACTORS

There have been no material changes from the risk factors discussed in Part I, Item 1A, "Risk Factors" of our 2020 Form 10-K. Risks and uncertainties identified in our forward-looking statements contained in this Quarterly Report on Form 10-Q together with those previously disclosed in the 2020 Form 10-K or those that are presently unforeseen could result in significant adverse effects on our financial condition, results of operations and cash flows. See "Forward-Looking Statements" contained in Part I, Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations" in this Quarterly Report on Form 10-Q as well as Part I, Item 1A, "Risk Factors" in our 2020 Form 10-K.

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

Issuer Purchases of Equity Securities

The Company's Board of Directors has authorized the repurchase of up to \$40 million of the Company's outstanding shares of common stock and up to \$40 million of the Company's Series C Preferred Stock through March 31, 2022. Subject to applicable securities laws and the terms of the Series C Preferred Stock, which are contained in our Restated 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 of its common stock or Series C Preferred Stock during the three months ended September 30, 2021.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

<u>Exhibit No.</u>	<u>Description</u>
3.1	<u>Restated Articles of Incorporation, effective May 14, 2021 (incorporated herein by reference to Exhibit 3.1 to Dynex's Current Report on Form 8-K filed May 18, 2021).</u>
3.2	<u>Amended and Restated Bylaws, effective as of May 11, 2021 (incorporated herein by reference to Exhibit 3.2 to Dynex's Current Report on Form 8-K filed May 12, 2021).</u>
4.1	<u>Specimen of Common Stock Certificate (incorporated herein by reference to Exhibit 4.1 to Dynex's Quarterly Report on Form 10-Q for the quarter ended September 30, 2019).</u>
4.3	<u>Specimen of 6.900% Series C Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock Certificate (incorporated herein by reference to Exhibit 4.4 to Dynex's Registration Statement on Form 8-A12B filed February 18, 2020).</u>
10.1	<u>Amendment No. 2, dated August 3, 2021, to the Distribution Agreement by and among Dynex Capital, Inc., J.P. Morgan Securities LLC, JMP Securities LLC, JonesTrading Institutional Services LLC and BTIG, LLC (incorporated herein by reference to Exhibit 10.1 to Dynex's Current Report on Form 8-K filed August 3, 2021).</u>
31.1	<u>Certification of principal executive officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).</u>
31.2	<u>Certification of principal financial officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).</u>
32.1	<u>Certification of principal executive officer and principal financial officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith).</u>
101	The following materials from Dynex Capital, Inc.'s Quarterly Report on Form 10-Q for the three months ended September 30, 2021, 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 the Consolidated Financial Statements.
104	The cover page from Dynex Capital, Inc.'s Quarterly Report on Form 10-Q for the three months ended September 30, 2021, formatted in iXBRL (Inline Extensible Business Reporting Language) (included with Exhibit 101).

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.

Date: November 2, 2021

/s/ Byron L. Boston
Byron L. Boston
Chief Executive Officer, Co-Chief Investment Officer,
and Director
(Principal Executive Officer)

Date: November 2, 2021

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

CERTIFICATIONS

I, Byron L. Boston, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q 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: November 2, 2021

/s/ Byron L. Boston

Byron L. Boston

Principal Executive Officer

CERTIFICATIONS

I, Stephen J. Benedetti, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q 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: November 2, 2021

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

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

In connection with the Quarterly Report on Form 10-Q of Dynex Capital, Inc. (the "Company") for the three months ended September 30, 2021, 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: November 2, 2021

/s/ Byron L. Boston

Byron L. Boston
Principal Executive Officer

Date: November 2, 2021

/s/ Stephen J. Benedetti

Stephen J. Benedetti
Principal Financial Officer