

ANWORTH MORTGAGE ASSET CORP

Form 10-Q

November 03, 2011

[Table of Contents](#)

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2011

OR

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

For the transition period from to

Commission File Number 001-13709

ANWORTH MORTGAGE ASSET CORPORATION

(Exact name of registrant as specified in its charter)

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MARYLAND
(State or other jurisdiction of
incorporation or organization)

52-2059785
(I.R.S. Employer
Identification No.)

1299 Ocean Avenue, Second Floor,
Santa Monica, California
(Address of principal executive offices)

90401
(Zip Code)

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

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

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

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

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

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

At November 3, 2011, the registrant had 133,968,752 shares of common stock issued and outstanding.

Table of Contents

ANWORTH MORTGAGE ASSET CORPORATION

FORM 10-Q

INDEX

	Page
Part I.	
<u>FINANCIAL INFORMATION</u>	1
Item 1. <u>Consolidated Financial Statements</u>	1
<u>Consolidated Balance Sheets as of September 30, 2011 (unaudited) and December 31, 2010</u>	1
<u>Consolidated Statements of Income for the three and nine months ended September 30, 2011 and 2010 (unaudited)</u>	2
<u>Consolidated Statements of Stockholders' Equity for the three months ended March 31, 2011, June 30, 2011 and September 30, 2011 (unaudited)</u>	3
<u>Consolidated Statements of Cash Flows for the three and nine months ended September 30, 2011 and 2010 (unaudited)</u>	4
<u>Consolidated Statements of Comprehensive Income for the three and nine months ended September 30, 2011 and 2010 (unaudited)</u>	5
<u>Notes to Unaudited Consolidated Financial Statements</u>	6
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	25
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	34
Item 4. <u>Controls and Procedures</u>	38
Part II.	
<u>OTHER INFORMATION</u>	39
Item 1. <u>Legal Proceedings</u>	39
Item 1A. <u>Risk Factors</u>	39
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	42
Item 3. <u>Defaults Upon Senior Securities</u>	43
Item 4. <u>Reserved</u>	43
Item 5. <u>Other Information</u>	43
Item 6. <u>Exhibits</u>	43
<u>Signatures</u>	47

Table of Contents**ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES****Part I. FINANCIAL INFORMATION****Item 1. Consolidated Financial Statements****ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS****(in thousands, except per share amounts)**

	September 30, 2011 (unaudited)	December 31, 2010
ASSETS		
Agency MBS:		
Agency MBS pledged to counterparties at fair value	\$ 7,892,165	\$ 6,762,763
Agency MBS at fair value	800,362	957,316
Paydowns receivable	50,880	14,579
	8,743,407	7,734,658
Non-Agency MBS:		
Non-Agency MBS at fair value	2,186	4,394
Cash and cash equivalents	3,308	10,621
Interest and dividends receivable	28,744	27,097
Derivative instruments at fair value	25	8,828
Prepaid expenses and other	16,003	4,617
Total Assets:	\$ 8,793,673	\$ 7,790,215
LIABILITIES AND STOCKHOLDERS EQUITY		
Liabilities:		
Accrued interest payable	\$ 21,358	\$ 20,585
Repurchase agreements	7,435,000	6,375,000
Junior subordinated notes	37,380	37,380
Derivative instruments at fair value	108,065	70,557
Dividends payable on Series A Preferred Stock	1,011	1,011
Dividends payable on Series B Preferred Stock	450	430
Dividends payable on common stock	30,623	26,574
Payable for securities purchased	155,367	363,820
Accrued expenses and other	6,026	947
Total Liabilities:	\$ 7,795,280	\$ 6,896,304
Series B Cumulative Convertible Preferred Stock: par value \$0.01 per share; liquidating preference \$25.00 per share (\$29,776 and \$27,525, respectively); 1,191 and 1,101 shares issued and outstanding at September 30, 2011 and December 31, 2010, respectively		
	\$ 28,174	\$ 25,630
Stockholders' Equity:		
Series A Cumulative Preferred Stock: par value \$0.01 per share; liquidating preference \$25.00 per share (\$46,888 and \$46,888, respectively); 1,876 and 1,876 shares issued and outstanding at September 30,	\$ 45,397	\$ 45,397

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2011 and December 31, 2010, respectively

Common Stock: par value \$0.01 per share; authorized 200,000 shares, 133,003 and 120,901 issued and outstanding at September 30, 2011 and December 31, 2010, respectively	1,330	1,209
Additional paid-in capital	1,138,610	1,053,959
Accumulated other comprehensive income consisting of unrealized losses and gains	44,134	22,444
Accumulated deficit	(259,252)	(254,728)
Total Stockholders' Equity:	\$ 970,219	\$ 868,281
Total Liabilities and Stockholders' Equity:	\$ 8,793,673	\$ 7,790,215

See accompanying notes to unaudited consolidated financial statements.

Table of Contents**ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF INCOME**

(in thousands, except per share amounts)

(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Interest income:				
Interest on Agency MBS	\$ 54,435	\$ 50,174	\$ 170,315	\$ 165,665
Interest on Non-Agency MBS	33	53	117	161
Other income	14	19	36	47
	54,482	50,246	170,468	165,873
Interest expense:				
Interest expense on repurchase agreements	21,010	22,612	65,849	70,574
Interest expense on junior subordinated notes	320	340	960	968
	21,330	22,952	66,809	71,542
Net interest income	33,152	27,294	103,659	94,331
Recovery on Non-Agency MBS	830	0	1,726	0
Expenses:				
Compensation, incentive compensation and benefits	(2,641)	(2,417)	(8,461)	(8,032)
Write-down of Lehman receivable	0	0	0	(674)
Other expenses	(792)	(538)	(2,437)	(2,227)
Total expenses	(3,433)	(2,955)	(10,898)	(10,933)
Net income	30,549	24,339	94,487	83,398
Dividend on Series A Cumulative Preferred Stock	(1,011)	(1,011)	(3,033)	(3,033)
Dividend on Series B Cumulative Convertible Preferred Stock	(450)	(430)	(1,392)	(1,290)
Net income to common stockholders	\$ 29,088	\$ 22,898	\$ 90,062	\$ 79,075
Basic earnings per common share	\$ 0.22	\$ 0.19	\$ 0.71	\$ 0.67
Diluted earnings per common share	\$ 0.22	\$ 0.19	\$ 0.70	\$ 0.66
Basic weighted average number of shares outstanding	131,886	117,923	126,979	117,412
Diluted weighted average number of shares outstanding	136,099	121,557	131,193	121,046

See accompanying notes to unaudited consolidated financial statements.

Table of Contents**ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY**

(in thousands, except per share amounts)

(unaudited)

	Series A		Series A		Additional Paid-In Capital	Accum. Other Comp. Income		Accum. Other Comp. (Loss)		Accum. (Deficit)	Comp. Income (Loss)	Total
	Preferred Shares	Common Stock	Preferred Stock Par Value	Common Stock Par Value		Agency MBS	Non-Agency MBS	Comp. Derivatives	Comp. (Loss)			
Balance, December 31, 2010	1,876	120,901	\$ 45,397	\$ 1,209	\$ 1,053,959	\$ 80,945	\$ 3,705	\$ (62,206)	\$ (254,728)			\$ 868,281
Issuance of common stock		3,188		32	21,869							21,901
Other comprehensive income (loss), fair value adjustments and reclassifications						(1,074)	79	19,921			18,926	18,926
Net income									31,160		31,160	31,160
Comprehensive income											\$ 50,086	
Amortization of restricted stock					70							70
Dividend declared - \$0.539063 per Series A preferred share									(1,011)			(1,011)
Dividend declared - \$0.390625 per Series B preferred share									(492)			(492)
Dividend declared - \$0.25 per common share									(31,308)			(31,308)
Balance, March 31, 2011	1,876	124,089	\$ 45,397	\$ 1,241	\$ 1,075,898	\$ 79,871	\$ 3,784	\$ (42,285)	\$ (256,379)			\$ 907,527
Issuance of common stock		5,658		56	39,808							39,864
Other comprehensive income (loss), fair value adjustments and reclassifications						45,232	(822)	(25,683)			18,727	18,727
Net income									32,778		32,778	32,778
Comprehensive income											\$ 51,505	
					70							70

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Amortization of restricted stock											
Dividend declared - \$0.539063 per Series A preferred share									(1,011)		(1,011)
Dividend declared - \$0.390625 per Series B preferred share									(450)		(450)
Dividend declared - \$0.25 per common share									(32,692)		(32,692)
Balance, June 30, 2011	1,876	129,747	\$ 45,397	\$ 1,297	\$ 1,115,776	\$ 125,103	\$ 2,962	\$ (67,968)	\$ (257,754)		\$ 964,813
Issuance of common stock		3,256		33	22,764						22,797
Other comprehensive income (loss), fair value adjustments and reclassifications						25,168	(776)	(40,355)		(15,963)	(15,963)
Net income									30,549	30,549	30,549
Comprehensive income										\$ 14,586	
Amortization of restricted stock					70						70
Dividend declared - \$0.539063 per Series A preferred share									(1,011)		(1,011)
Dividend declared - \$0.390625 per Series B preferred share									(450)		(450)
Dividend declared - \$0.23 per common share									(30,586)		(30,586)
Balance, September 30, 2011	1,876	133,003	\$ 45,397	\$ 1,330	\$ 1,138,610	\$ 150,271	\$ 2,186	\$ (108,323)	\$ (259,252)		\$ 970,219

See accompanying notes to unaudited consolidated financial statements.

Table of Contents**ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS****(in thousands)****(unaudited)**

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Operating Activities:				
Net income	\$ 30,549	\$ 24,339	\$ 94,487	\$ 83,398
Adjustments to reconcile net income to net cash provided by (used in) operating activities:				
Amortization of premium and discounts (Agency MBS)	16,482	12,538	41,858	37,318
Amortization of restricted stock	70	70	211	211
Write-down of Lehman receivable	0	0		674
Recovery on Non-Agency MBS	(830)	0	(1,726)	0
Changes in assets and liabilities:				
Decrease (increase) in interest receivable	124	(423)	(1,646)	4,779
(Increase) in prepaid expenses and other	(3,002)	(4,718)	(11,386)	(12,665)
(Decrease) increase in accrued interest payable	(1,138)	(1,038)	966	(84)
Increase (decrease) in accrued expenses and payable for securities purchased	12,843	419,441	(203,374)	431,984
Net cash provided by (used in) operating activities	\$ 55,098	\$ 450,209	\$ (80,610)	\$ 545,615
Investing Activities:				
Available-for-sale Agency MBS:				
Purchases	\$ (930,054)	\$ (1,231,579)	\$ (2,584,367)	\$ (2,454,649)
Principal payments	688,467	592,215	1,603,087	2,113,458
Available-for-sale Non-Agency MBS:				
Principal payments	830	1,031	2,415	3,008
Purchase of reverse repurchase agreements	0	70,500	0	0
Net cash (used in) investing activities	(240,757)	\$ (567,833)	(978,865)	\$ (338,183)
Financing Activities:				
Borrowings from repurchase agreements	\$ 8,659,000	\$ 7,017,350	\$ 25,943,655	\$ 21,244,300
Repayments on repurchase agreements	(8,469,000)	(6,883,350)	(24,883,655)	(21,379,300)
Proceeds from common stock issued, net	20,275	18,369	82,039	48,270
Proceeds from Series B Preferred Stock issued, net	1,039	0	5,065	0
Series A Preferred stock dividends paid	(1,011)	(1,011)	(3,033)	(3,033)
Series B Preferred stock dividends paid	(450)	(430)	(1,372)	(1,291)
Common stock dividends paid	(32,654)	(29,257)	(90,537)	(93,639)
Treasury stock	0	(2,700)	0	(22,731)
Net cash provided by (used in) financing activities	\$ 177,199	\$ 118,971	\$ 1,052,162	\$ (207,424)
Net (decrease) increase in cash and cash equivalents	\$ (8,460)	\$ 1,347	\$ (7,313)	\$ 8
Cash and cash equivalents at beginning of period	11,768	473	10,621	1,812
Cash and cash equivalents at end of period	\$ 3,308	\$ 1,820	\$ 3,308	\$ 1,820

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Supplemental Disclosure of Cash Flow Information:

Cash paid for interest	\$	22,468	\$	24,121	\$	65,843	\$	71,757
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See accompanying notes to unaudited consolidated financial statements.

Table of Contents**ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME****(in thousands)****(unaudited)**

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Net income	\$ 30,549	\$ 24,339	\$ 94,487	\$ 83,398
Available-for-sale Agency MBS, fair value adjustment	25,168	(6,893)	69,326	(21,113)
Available-for-sale Non-Agency MBS, fair value adjustment	(776)	670	(1,519)	2,985
Unrealized (losses) on cash flow hedges	(56,906)	(29,861)	(98,286)	(79,137)
Reclassification adjustment for interest expense included in net income	16,551	18,807	52,169	60,314
	(15,963)	(17,277)	21,690	(36,951)
Comprehensive income	\$ 14,586	\$ 7,062	\$ 116,177	\$ 46,447

See accompanying notes to unaudited consolidated financial statements.

Table of Contents

ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 1. ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

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

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

At our annual stockholders meeting on May 25, 2011, the stockholders approved the execution by us of a Management Agreement, or the Management Agreement (a copy of which is included as Exhibit A to our Definitive Proxy Statement filed with the U.S. Securities and Exchange Commission, or the SEC, on March 31, 2011), between the Company and Anworth Management, LLC, or the Manager, and the concurrent externalization of the Company's management function. We expect to enter into the Management Agreement in the fourth quarter of 2011, effective December 31, 2011. Once effective, our day-to-day operations will be conducted by the Manager through the authority delegated to it under the Management Agreement and pursuant to the policies established by our board of directors. The Manager will at all times be subject to the supervision and direction of our board of directors and will be responsible for (i) the selection, purchase and sale of our investment portfolio; (ii) our financing and hedging activities; and (iii) providing us with management services. The Manager will perform such other services and activities relating to our assets and operations as may be appropriate. In exchange for these services, the Manager will receive a management fee paid monthly in arrears in an amount equal to one-twelfth of 1.20% of our Equity (as defined in the Management Agreement).

BASIS OF PRESENTATION AND CONSOLIDATION

The accompanying unaudited consolidated financial statements are prepared on the accrual basis of accounting in accordance with generally accepted accounting principles utilized in the United States of America, or GAAP. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Material estimates that are susceptible to change relate to the determination of the fair value of securities, amortization of security premiums and accretion of security discounts, accounting for derivatives and hedging activities and accounting for impaired securities. Actual results could materially differ from these estimates. Significant intercompany accounts and transactions have been eliminated. In the opinion of management, all material adjustments, consisting of normal recurring adjustments, considered necessary for a fair presentation have been included. The operating results for the three and nine months ended September 30, 2011 and 2010 are not necessarily indicative of the results that may be expected for the calendar year. The interim financial information in the accompanying unaudited consolidated financial statements and the notes thereto should be read in conjunction with the audited consolidated financial statements included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010.

The following is a summary of our significant accounting policies:

Cash and Cash Equivalents

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

Table of Contents**Reverse Repurchase Agreements**

We use securities purchased under agreements to resell, or reverse repurchase agreements, as a means of investing excess cash. Although legally structured as a purchase and subsequent resale, reverse repurchase agreements are treated as financing transactions under which the counterparty pledges securities (principally U.S. treasury securities) and accrued interest as collateral to secure a loan. The difference between the purchase price that we pay and the resale price that we receive represents interest paid to us and is included in *Other income* on our unaudited consolidated statements of income. It is our policy to generally take possession of securities purchased under reverse repurchase agreements at the time such agreements are made.

Mortgage-Backed Securities (MBS)

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

Non-Agency MBS are securities issued by other companies that are not government-sponsored enterprises and are secured primarily by first-lien residential mortgage loans.

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

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

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

The following table shows our investments' gross unrealized losses and fair value of those individual securities that have been in a continuous unrealized loss position at September 30, 2011 and December 31, 2010, aggregated by investment category and length of time (dollar amounts in thousands):

September 30, 2011

Description of Securities	Less Than 12 Months			12 Months or More			Total		
	Number of Securities	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses
Agency MBS	57	\$ 1,218,013	\$ (6,819)	289	\$ 187,010	\$ (4,892)	346	\$ 1,405,023	\$ (11,711)

Table of Contents*December 31, 2010*

Description of Securities	Less Than 12 Months			12 Months or More			Total		
	Number of Securities	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses
Agency MBS	115	\$ 2,818,632	\$ (37,912)	313	\$ 250,040	\$ (6,498)	428	\$ 3,068,672	\$ (44,410)

We do not consider those Agency MBS that have been in a continuous loss position for 12 months or more to be other-than-temporarily impaired. The unrealized losses on our investments in Agency MBS were caused by fluctuations in interest rates. We purchased the Agency MBS primarily at a premium relative to their face value and the contractual cash flows of those investments are guaranteed by the U.S. government or government-sponsored agencies. Since September 2008, the government-sponsored agencies have been in the conservatorship of the U.S. government. We do not expect to sell the Agency MBS at a price less than the amortized cost basis of our investments. Because the decline in market value of the Agency MBS is attributable to changes in interest rates and not the credit quality of the Agency MBS in our portfolio, and because we do not have the intent to sell these investments nor is it more likely than not that we will be required to sell these investments before recovery of their amortized cost basis, which may be at maturity, we do not consider these investments to be other-than-temporarily impaired at September 30, 2011.

Repurchase Agreements

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

Derivative Financial Instruments*Interest Rate Risk Management*

We primarily use short-term (less than or equal to 12 months) repurchase agreements to finance the purchase of our MBS. These obligations expose us to variability in interest payments due to changes in interest rates. We continuously monitor changes in interest rate exposures and evaluate hedging opportunities.

Our objective is to limit the impact of interest rate changes on earnings and cash flows. We achieve this by entering into interest rate swap agreements, which effectively convert a percentage of our repurchase agreements to fixed-rate obligations over a period of up to five years. Under interest rate swap contracts, we agree to pay an amount equal to a specified fixed rate of interest times a notional principal amount and to receive in return an amount equal to a specified variable-rate of interest times a notional amount, generally based on LIBOR. The notional amounts are not exchanged. We account for these swap agreements as cash flow hedges in accordance with ASC 815-10. We do not issue or hold derivative contracts for speculative purposes.

We are exposed to credit losses in the event of non-performance by counterparties to these interest rate swap agreements. In order to limit credit risk associated with swap agreements, our current practice is to only enter into swap agreements with large financial institution counterparties who are market makers for these types of instruments, limit our exposure on each swap agreement to a single counterparty under our defined guidelines and either pay or receive collateral to or from each counterparty on a periodic basis to cover the net fair market value position of the swap agreements held with that counterparty.

Accounting for Derivatives and Hedging Activities

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

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that the hedge will be highly effective as defined by ASC 815-10.

On the date we enter into a derivative contract, we designate the derivative as a hedge of the variability of cash flows that are to be received or paid in connection with a recognized asset or liability (a cash flow hedge). Changes in the fair value of a derivative that is highly effective and that is designated and qualifies as a cash flow hedge, to the extent that the hedge is

Table of Contents

effective, are recorded in Other comprehensive income and reclassified to income when the forecasted transaction affects income (e.g., when periodic settlement interest payments are due on repurchase agreements). The swap agreements are carried on our consolidated balance sheets at their fair value, based on values obtained from large financial institutions who are market makers for these types of instruments. Hedge ineffectiveness, if any, is recorded in current-period income.

We formally assess, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions have been highly effective in offsetting changes in the cash flows of hedged items and whether those derivatives may be expected to remain highly effective in future periods. If it is determined that a derivative is not (or has ceased to be) highly effective as a hedge, we discontinue hedge accounting.

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

For purposes of the cash flow statement, cash flows from derivative instruments are classified with the cash flows from the hedged item.

For more details on the amounts and other qualitative information on our swap agreements, see Note 12. For more information on the fair value of our swap agreements, see Note 6.

Credit Risk

At September 30, 2011, we have attempted to limit our exposure to credit losses on our MBS by purchasing securities primarily through Freddie Mac and Fannie Mae. The payment of principal and interest on the Freddie Mac and Fannie Mae MBS are guaranteed by those respective enterprises. In September 2008, both Freddie Mac and Fannie Mae were placed in the conservatorship of the U.S. government. While it is the intent that the conservatorship will help stabilize Freddie Mac's and Fannie Mae's losses and overall financial position, there can be no assurance that it will succeed or that, if necessary, Freddie Mac or Fannie Mae will be able to satisfy its guarantees of Agency MBS. In August 2011, Standard & Poor's downgraded each of U.S. sovereign debt and Fannie Mae and Freddie Mac from AAA to AA+. We do not know what effect this will ultimately have on the U.S. economy, the value of our securities and the ability of Fannie Mae and Freddie Mac to satisfy its guarantees of Agency MBS if necessary.

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

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

Income Taxes

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

Table of Contents

We have no unrecognized tax benefits and do not anticipate any increase in unrecognized benefits during 2011 relative to any tax positions taken prior to January 1, 2011. Should the accrual of any interest or penalties relative to unrecognized tax benefits be necessary, it is our policy to record such accruals in our income taxes accounts; and no such accruals existed at September 30, 2011. We file both REIT and taxable REIT subsidiary U.S. federal and California income tax returns. These returns are generally open to examination by the IRS and the California Franchise Tax Board for all years after 2006 and 2005, respectively.

Cumulative Convertible Preferred Stock

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

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

Stock-Based Compensation

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

Restricted stock is expensed over the vesting period (see Note 11).

Earnings Per Share

Basic earnings per share, or EPS, is computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted EPS assumes the conversion, exercise or issuance of all potential common stock equivalents unless the effect is to reduce a loss or increase the income per share.

The computation of EPS for the three and nine months ended September 30, 2011 and 2010 are as follows (amounts in thousands, except per share data):

	Net Income Available to Common Stockholders	Average Shares	Earnings per Share
For the three months ended September 30, 2011			
Basic EPS	\$ 29,088	131,886	\$ 0.22
Effect of dilutive securities(1)	450	4,213	0.00
Diluted EPS	\$ 29,538	136,099	\$ 0.22
For the three months ended September 30, 2010			
Basic EPS	\$ 22,898	117,923	\$ 0.19
Effect of dilutive securities(2)	430	3,634	0.00
Diluted EPS	\$ 23,328	121,557	\$ 0.19
	Net Income Available to Common	Average Shares	Earnings per Share

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	Stockholders		
For the nine months ended September 30, 2011			
Basic EPS	\$ 90,062	126,979	\$ 0.71
Effect of dilutive securities(1)	1,392	4,213	(0.01)
Diluted EPS	\$ 91,454	131,192	\$ 0.70
For the nine months ended September 30, 2010			
Basic EPS	\$ 79,075	117,412	\$ 0.67
Effect of dilutive securities(2)	1,290	3,634	(0.01)
Diluted EPS	\$ 80,365	121,046	\$ 0.66

- (1) During the three and nine months ended September 30, 2011, diluted earnings per common share included the assumed conversion of 1.191 million shares of Series B Preferred Stock at the then-current conversion rate of 3.5374 shares of common stock and the adding back of the Series B Preferred Stock dividend.
- (2) During the three and nine months ended September 30, 2010, diluted earnings per common share included the assumed conversion of 1.101 million shares of Series B Preferred Stock at the then-current conversion rate of 3.2990 shares of common stock and the adding back of the Series B Preferred Stock dividend.

Table of Contents

Accumulated Other Comprehensive Income

In accordance with ASC 220-10-55-2, comprehensive income is divided into net income and other comprehensive income, which includes unrealized gains and losses on marketable securities classified as available-for-sale, and unrealized gains and losses on derivative financial instruments that qualify for cash flow hedge accounting under ASC 815-10.

USE OF ESTIMATES

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

RECENT ACCOUNTING PRONOUNCEMENTS

In April 2011, the FASB issued Accounting Standards Update, or ASU, 2011-03, Reconsideration of Effective Control for Repurchase Agreements. One of the relevant considerations for assessing effective control was the transferor's ability to repurchase or redeem financial assets before maturity. Under this criterion, an entity must consider whether there is an exchange of collateral in sufficient amount so as to reasonably assure the arrangement's completion on substantially the agreed terms. In this ASU, the FASB determined that the criterion pertaining to an exchange of collateral should not be a determining factor in assessing effective control and removed this criterion from the consideration of effective control. The FASB concluded that the assessment of effective control should focus on a transferor's contractual rights and obligations with respect to transferred financial assets, not on whether the transferor has the practical ability to perform in accordance with those rights or obligations. This ASU is effective for our financial statements beginning with the first quarter of 2012. We do not believe that this ASU will have a material impact on our financial statements.

In May 2011, the FASB issued ASU 2011-04, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. ASU 2011-04 supersedes most of the guidance in Accounting Standards Codification Topic 820 (formerly FASB Statement No. 157), although many of the changes are clarifications of existing guidance or wording changes to align with IFRS 13. Additionally, this ASU will require disclosure of any transfers between Level 1 and Level 2 of the fair value hierarchy; disclosure when the highest and best use of a non-financial asset differs from its current use; disclosure of fair value by level for each class of assets and liabilities not measured at fair value in the statement of financial position but for which the fair value is disclosed; and disclosure of information about measurement uncertainty in the form of a sensitivity analysis for recurring fair value measurements categorized in Level 3 of the fair value hierarchy unless another Codification topic specifies that such disclosure is not required. This ASU is effective for our financial statements beginning with the first quarter of 2012. We do not believe that this ASU will have a material impact on our financial statements.

In June 2011, the FASB issued ASU 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income. ASU 2011-05 will supersede some of the guidance in Accounting Standards Codification Topic 220. The main provisions of this ASU provide that an entity that reports items of other comprehensive income has the option to present comprehensive income in either one or two consecutive financial statements: (1) A single statement must present the components of net income and total net income, the components of other comprehensive income and total other comprehensive income, and a total for comprehensive income; (2) In a two-statement approach, an entity must present the components of net income and total net income in the first statement. That statement must be immediately followed by a financial statement that presents the components of other comprehensive income, a total for other comprehensive income, and a total for comprehensive income. The option in current GAAP that permits the presentation of other comprehensive income in the statement of changes in equity has been eliminated. This ASU is effective for our financial statements beginning with the first quarter of 2012. We do not believe that this ASU will have a material impact on our financial statements.

Table of Contents**NOTE 2. REVERSE REPURCHASE AGREEMENTS**

At September 30, 2011, we did not have any reverse repurchase agreements outstanding. During the three months ended September 30, 2011, the maximum amount of reverse repurchase agreements outstanding was \$70 million and the average amount outstanding was \$8.9 million. These investments are used as a means of investing excess cash. The collateral for these loans was U.S. Treasury securities with an aggregate fair value equal to the amount of the loans. At December 31, 2010, there were no reverse repurchase agreements outstanding.

NOTE 3. MORTGAGE-BACKED SECURITIES (MBS)

The following tables summarize our Agency MBS and Non-Agency MBS, classified as available-for-sale, at September 30, 2011 and December 31, 2010, which are carried at their fair value (amounts in thousands):

September 30, 2011

Agency MBS (By Agency)	Ginnie Mae	Freddie Mac	Fannie Mae	Total Agency MBS
Amortized cost	\$ 17,798	\$ 2,754,178	\$ 5,770,279	\$ 8,542,255
Paydowns receivable	0	50,881	0	50,881
Unrealized gains	1	52,092	109,889	161,982
Unrealized losses	(312)	(5,531)	(5,868)	(11,711)
Fair value	\$ 17,487	\$ 2,851,620	\$ 5,874,300	\$ 8,743,407

Agency MBS

(By Security Type)	ARMs	Hybrids	15-Year Fixed-Rate	30-Year Fixed-Rate	Floating-Rate CMOs	Total Agency MBS
Amortized cost	\$ 1,926,317	\$ 4,909,435	\$ 1,196,304	\$ 506,830	\$ 3,369	\$ 8,542,255
Paydowns receivable	7,048	43,833	0	0	0	50,881
Unrealized gains	45,917	58,879	17,156	40,011	19	161,982
Unrealized losses	(5,054)	(6,351)	(306)	0	0	(11,711)
Fair value	\$ 1,974,228	\$ 5,005,796	\$ 1,213,154	\$ 546,841	\$ 3,388	\$ 8,743,407

Non-Agency MBS	Total Non-Agency MBS
Amortized cost	\$ 0
Unrealized gains	2,186
Fair value	\$ 2,186

At September 30, 2011, our Non-Agency MBS portfolio consisted of floating-rate collateralized mortgage obligations, or CMOs, (option-adjusted ARMs based on one-month LIBOR) with an average coupon of 0.48%, which were acquired at par value.

The fair value of our Non-Agency MBS portfolio declined to approximately \$2.2 million at September 30, 2011 from a fair value of approximately \$4.4 million at December 31, 2010. The decrease was due primarily to principal paydowns of approximately \$0.7 million and a decrease in an unrealized gain of approximately \$1.5 million.

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At September 30, 2011, two securities representing the principal balance of our Non-Agency MBS portfolio were rated C by Moody's Investor Service and rated D by Standard & Poor's.

Table of Contents

December 31, 2010

Agency MBS (By Agency)	Ginnie Mae	Freddie Mac	Fannie Mae	Total Agency MBS
Amortized cost	\$ 19,451	\$ 2,129,836	\$ 5,489,848	\$ 7,639,135
Paydowns receivable	0	14,579	0	14,579
Unrealized gains	0	40,455	84,899	125,354
Unrealized losses	(286)	(21,401)	(22,723)	(44,410)
Fair value	\$ 19,165	\$ 2,163,469	\$ 5,552,024	\$ 7,734,658

Agency MBS

(By Security Type)	ARMs	Hybrids	15-Year Fixed-Rate	30-Year Fixed-Rate	Floating-Rate CMOs	Total Agency MBS
Amortized cost	\$ 1,685,741	\$ 4,523,628	\$ 811,687	\$ 613,912	\$ 4,167	\$ 7,639,135
Paydowns receivable	6,069	8,510	0	0	0	14,579
Unrealized gains	26,501	59,149	162	39,519	23	125,354
Unrealized losses	(6,895)	(19,009)	(16,162)	(2,341)	(3)	(44,410)
Fair value	\$ 1,711,416	\$ 4,572,278	\$ 795,687	\$ 651,090	\$ 4,187	\$ 7,734,658

Non-Agency MBS	Total Non-Agency MBS
Amortized cost	\$ 689
Unrealized gains	3,705
Fair value	\$ 4,394

At December 31, 2010, our Non-Agency MBS portfolio consisted of floating-rate CMOs (option-adjusted ARMs based on one-month LIBOR) with an average coupon of 0.51%, which were acquired at par value.

At December 31, 2010, two securities representing the principal balance of our Non-Agency MBS portfolio were rated CC by Standard & Poor's and C by Moody's Investor Service.

NOTE 4. REPURCHASE AGREEMENTS

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

Table of Contents

At September 30, 2011 and December 31, 2010, the repurchase agreements had the following balances (in thousands), weighted average interest rates and remaining weighted average maturities:

	September 30, 2011		December 31, 2010	
	Balance	Weighted Average Interest Rate	Balance	Weighted Average Interest Rate
Overnight	\$ 0	0.00%	\$ 0	0.00%
Less than 30 days	3,420,000	0.24	3,730,000	0.30
30 days to 90 days	4,015,000	0.28	2,645,000	0.30
Over 90 days to less than 1 year	0	0.00	0	0.00
1 year to 2 years	0	0.00	0	0.00
Demand	0	0.00	0	0.00
	\$ 7,435,000	0.26%	\$ 6,375,000	0.30%
Weighted average maturity	38 days		31 days	
Weighted average term to maturity (after accounting for swap agreements)	452 days		418 days	
Weighted average borrowing rate (after accounting for swap agreements)	1.15%		1.43%	
Agency MBS pledged as collateral under the repurchase agreements and swap agreements	\$ 7,892,165		\$ 6,762,763	

NOTE 5. JUNIOR SUBORDINATED NOTES

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

NOTE 6. FAIR VALUES OF FINANCIAL INSTRUMENTS

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

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

Level 2: Observable market based inputs or unobservable inputs that are corroborated by market data. This includes those financial instruments that are valued using models or other valuation methodologies where substantially all of the assumptions are observable in the marketplace, can be derived from observable market data or are supported by observable levels at which transactions are executed in the marketplace. We consider the inputs utilized to fair value our Agency MBS to be Level 2. Management bases the fair value for these investments primarily on third party bid price indications provided by dealers who make markets in these instruments. The Agency MBS market is primarily an over-the-counter market. As such, there are no standard, public market quotations or published trading data for individual MBS securities. As our portfolio consists of hundreds of similar, but distinct, securities that have each been traded with only one broker counterparty, we generally seek to have each Agency MBS security priced by one broker. The prices received are non-binding offers to trade, but are indicative quotations

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of the market value of our securities as of the market close on the last day of each quarter. The brokers receive trading data from several traders that participate in the active markets for these securities and directly observe numerous trades of securities similar to the securities owned by us. Given the volume of market activity for Agency MBS, it is our belief that the broker pricing

Table of Contents

accurately reflects market information for actual, contemporaneous transactions. We do not adjust quotes or prices we obtain from brokers and pricing services. In the limited instances where valuations are received on a security from multiple brokers, we use the median value of the prices received to determine fair value. To validate the prices we obtain, to ensure our fair value determinations are consistent with ASC 820, and to ensure that we properly classify these securities in the fair value hierarchy, we evaluate the pricing information we receive taking into account factors such as coupon, prepayment experience, fixed/adjustable rate, coupon index, time to reset and issuing agency, among other factors. Based on these factors, broker prices are compared to prices of similar securities provided by other brokers. If we determine (based on such a comparison and our market knowledge and expertise) that a security is priced significantly differently than similar securities, the broker is contacted and requested to revisit their valuation of the security. If a broker refuses to reconsider its valuation, we will request pricing from another broker and use the median value of the prices received to determine fair value. If we are unable to receive a valuation from another broker, the price received from an independent third party pricing service will be used, if it is determined (based on our market knowledge and expertise) to be more reliable than the broker pricing. However, the fair value reported may not be indicative of the amounts that could be realized in an actual market exchange.

Our derivative assets and derivative liabilities are comprised of swap agreements, in which we pay a fixed rate of interest and receive a variable rate of interest that is based on LIBOR. The fair value of these instruments is reported to us independently from dealers who are large financial institutions and are market makers for these types of instruments. The LIBOR swap rate is observable at commonly quoted intervals over the full term of the swap agreements and therefore is considered a Level 2 item. The fair value of the derivative instruments' assets and liabilities are the estimated amounts the Company would either receive or pay to terminate these agreements at the reporting date, taking into account current interest rates and the Company's credit worthiness. For more information on our swap agreements, see Note 1 and Note 12.

Level 3: Unobservable inputs that are not corroborated by market data. This is comprised of financial instruments whose fair value is estimated based on internally developed models or methodologies utilizing significant inputs that are generally less readily observable from objective sources. At September 30, 2011 and December 31, 2010, we considered the inputs utilized to fair value the Non-Agency MBS to be Level 3. Historically (prior to December 31, 2008), we had received non-binding indications of value from brokers who make markets in Non-Agency MBS and we also observed market activity in our Non-Agency MBS as well as other similar securities. As the market for Non-Agency MBS became more volatile and less liquid, we received fewer indications of value on these securities. At September 30, 2011 and December 31, 2010, we were unable to get any brokers who made markets in these securities to provide valuation information on our Non-Agency MBS. Instead, we obtained valuations at September 30, 2011 and December 31, 2010 for our Non-Agency MBS from an experienced independent third party pricing service, whose methodologies are based on broker provided pricing information, as well as indirect observation of market activity. Although we continue to monitor market activity for the Non-Agency MBS in our portfolio, as well as for other similar securities, given the lack of trading activity that we are able to observe, we place more weight on the third party pricing service valuations, as they are both independent and specifically determined. As a result of the lack of valuation information from brokers and our own observation of market activity, we determined that the market for our Non-Agency MBS was inactive. We also believe that the valuations obtained from the independent third party pricing service already take into account the illiquidity of the market for Non-Agency MBS and therefore we do not apply our own liquidity discount when determining their fair value. Based on this information, we consider the fair value measurement of the Non-Agency MBS a Level 3 input at September 30, 2011 and December 31, 2010.

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

At September 30, 2011, fair value measurements were as follows (in thousands):

	Level 1	Level 2	Level 3	Total
Assets:				
Agency MBS(1)	\$	\$ 8,743,407	\$	\$ 8,743,407
Non-Agency MBS(2)	\$	\$	\$ 2,186	\$ 2,186
Derivative instruments(3)	\$	\$ 25	\$	\$ 25
Liabilities:				
Derivative instruments(3)	\$	\$ 108,065	\$	\$ 108,065

- (1) For more detail about the fair value of our Agency MBS by agency and type of security, see Note 3.
(2) For more detail about the fair value of our Non-Agency MBS, see Note 3.

- (3) Derivative instruments are hedging instruments under ASC 815-10. For more detail about our derivative instruments, see Notes 1 and 12.

Table of Contents

Cash and cash equivalents, restricted cash, interest receivable, repurchase agreements and interest payable are reflected in our unaudited consolidated financial statements at their costs, which approximate their fair value because of the nature and short term of these instruments.

Junior subordinated notes are variable-rate debt and, as we believe the spread would be consistent with the expectations of market participants as of September 30, 2011 and December 31, 2010, the carrying value approximates fair value.

A reconciliation of the Level 3 Non-Agency MBS fair value measurements is as follows (in thousands):

	Amount
Balance at June 30, 2011	\$ 2,962
Decrease in unrealized gains	(776)
Balance at September 30, 2011	\$ 2,186

NOTE 7. INCOME TAXES

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

NOTE 8. SERIES B CUMULATIVE CONVERTIBLE PREFERRED STOCK

The Series B Preferred Stock has a par value of \$0.01 per share and a liquidation preference of \$25.00 per share plus accrued and unpaid dividends (whether or not declared). The holders of the Series B Preferred Stock must be paid a dividend at a rate of 6.25% per year on the \$25.00 liquidation preference before holders of our common stock are entitled to receive any dividends. The Series B Preferred Stock is senior to our common stock and on parity with our 8.625% Series A Cumulative Preferred Stock, or Series A Preferred Stock, with respect to the payment of distributions and amounts, upon liquidation, dissolution or winding up. So long as any shares of the Series B Preferred Stock remain outstanding, we will not, without the affirmative vote or consent of the holders of at least two-thirds of the shares of the Series B Preferred Stock outstanding at the time, authorize or create, or increase the authorized or issued amount of, any class or series of capital stock ranking senior to the Series B Preferred Stock with respect to payment of dividends or the distribution of assets upon liquidation, dissolution or winding up.

The Series B Preferred Stock has no maturity date and is not redeemable. The Series B Preferred Stock is convertible at the then-current conversion rate into shares of our common stock per \$25.00 liquidation preference. The conversion rate is adjusted in any fiscal quarter in which the cash dividends paid to common stockholders results in an annualized common stock dividend yield that is greater than 6.25%. The conversion ratio is also subject to adjustment upon the occurrence of certain specific events such as a change of control. The Series B Preferred Stock is convertible into shares of our common stock at the option of the holder(s) of Series B Preferred Stock at any time at the then-prevailing conversion rate. On or after January 25, 2012, we may, at our option, under certain circumstances, convert each share of Series B Preferred Stock into a number of shares of our common stock at the then-prevailing conversion rate. We may exercise this conversion option only if our common stock price equals or exceeds 130% of the then-prevailing conversion price of the Series B Preferred Stock for at least twenty (20) trading days in a period of thirty (30) consecutive trading days (including the last trading day of such period) ending on the trading day immediately prior to our issuance of a press release announcing the exercise of the conversion option. The Series B Preferred Stock contains certain fundamental change provisions that allow the holder to redeem the Series B Preferred Stock for cash if certain events occur, such as a change in control. The Series B Preferred Stock generally does not have voting rights, except if dividends on the Series B Preferred Stock are in arrears for six or more quarterly periods (whether or not consecutive). Under such circumstances, the holders of Series B Preferred Stock, together with the holders of Series A Preferred Stock, would be entitled to elect two additional directors to our board of directors to serve until all unpaid dividends have been paid or declared and set aside for payment. In addition, certain material and adverse changes to the terms of the Series B Preferred Stock may not be taken without the affirmative vote of at least two-thirds of the outstanding shares of Series B Preferred Stock and Series A Preferred Stock voting together as a single class. Through September 30, 2011, we have declared and set aside for payment the required dividends for the Series B Preferred Stock.

Table of Contents

During the three months ended September 30, 2011, there were three transactions to convert an aggregate of 105,943 shares of Series B Preferred Stock into an aggregate of 368,448 shares of our common stock (at the then-current conversion rate of 3.4778) and two transactions to convert an aggregate of 500 shares of Series B Preferred Stock into an aggregate of 1,767 shares of our common stock (at the then-current conversion rate of 3.5374). During the three months ended September 30, 2011, we issued 40,000 shares of Series B Preferred Stock, which provided net proceeds to us of approximately \$1.04 million.

NOTE 9. PUBLIC OFFERINGS AND CAPITAL STOCK

At September 30, 2011, our authorized capital included 200 million shares of common stock, of which 133,003,036 shares were issued and outstanding.

At September 30, 2011, our authorized capital included 20 million shares of \$0.01 par value preferred stock, of which 5.15 million shares had been designated 8.625% Series A Cumulative Preferred Stock (liquidation preference \$25.00 per share) and 3.15 million shares had been designated 6.25% Series B Cumulative Convertible Preferred Stock (liquidation preference \$25.00 per share). The undesignated shares of preferred stock may be issued in one or more classes or series, with such distinctive designations, rights and preferences as determined by our board of directors. At September 30, 2011, there were 1,875,500 shares of Series A Preferred Stock issued and outstanding and 1,191,054 shares of Series B Preferred Stock issued and outstanding, respectively.

On May 14, 2008, we entered into a Controlled Equity Offering Sales Agreement, or the 2008 Sales Agreement, with Cantor Fitzgerald & Co., or Cantor, which was amended by Amendment No. 1 to Sales Agreement on February 8, 2011. On May 27, 2011, we entered into a Controlled Equity Offering Sales Agreement, or the 2011 Sales Agreement, with Cantor to sell up to 20,000,000 shares of our common stock, 1,000,000 shares of our Series A Preferred Stock and 1,000,000 shares of our Series B Preferred Stock. During the three months ended September 30, 2011, we issued 129,400 shares of common stock under the amended 2008 Sales Agreement at a price of \$7.65 per share, which provided net proceeds to us of approximately \$970 thousand, net of sales commissions less reimbursement of fees. Cantor, as the sales agent, received approximately \$19.8 thousand, which represents an average commission of approximately 2.0% on the gross sales price per share. This transaction used the remaining number of common shares available under the amended 2008 Sales Agreement, at which point it expired. All future sales of our common stock, Series A Preferred Stock and Series B Preferred Stock will be issued under the 2011 Sales Agreement. During the three months ended September 30, 2011, we issued an aggregate of 590,600 shares of common stock under the 2011 Sales Agreement at a weighted average price of \$7.61 per share, which provided net proceeds to us of approximately \$4.4 million, net of sales commissions less reimbursement of fees. Cantor, as the sales agent, received an aggregate of approximately \$89.9 thousand, which represents an average commission of approximately 2.0% on the gross sales price per share. During the three months ended September 30, 2011, we issued 40,000 shares of our Series B Preferred Stock at a price of \$26.23 per share under the 2011 Sales Agreement, which provided net proceeds to us of approximately \$1.04 million, net of sales commissions less reimbursement of fees. Cantor, as the sales agent, received an aggregate of approximately \$10.5 thousand, which represents an average commission of approximately 1.0% on the gross sales price per share. During the three months ended September 30, 2011, we did not issue any shares of our Series A Preferred Stock under the 2011 Sales Agreement. At September 30, 2011, there were 19,409,400 shares of common stock, 1,000,000 shares of Series A Preferred Stock and 960,000 shares of Series B Preferred Stock, respectively, available under the 2011 Sales Agreement.

Our Dividend Reinvestment and Stock Purchase Plan allows stockholders and non-stockholders to purchase shares of our common stock and to reinvest dividends therefrom to acquire additional shares of our common stock. On December 28, 2009, we filed a shelf registration statement on Form S-3ASR with the SEC, offering up to 20 million shares of our common stock for our 2009 Dividend Reinvestment and Stock Purchase Plan, or the 2009 Plan. During the three months ended September 30, 2011, we issued an aggregate of 2,165,699 shares of common stock at a weighted average price of \$6.88 per share under the 2009 Plan, resulting in proceeds to us of approximately \$14.9 million. At September 30, 2011, there were approximately 5.675 million shares remaining under the 2009 Plan.

On December 28, 2009, we filed a shelf registration statement on Form S-3 with the SEC, and on February 26, 2010 we filed a pre-effective amendment thereto with the SEC, offering up to \$600 million of our capital stock. The registration statement was declared effective on March 26, 2010. At September 30, 2011, approximately \$548.35 million of our capital stock was available for issuance under the registration statement.

On November 7, 2005, we filed a registration statement on Form S-8 with the SEC to register an aggregate of up to 3.5 million shares of our common stock to be issued pursuant to the Anworth Mortgage Asset Corporation 2004 Equity Compensation Plan. To date, we have issued 2.68 million shares of common stock under the plan. This amount includes 1.015 million shares of unexercised stock options and restricted stock.

Table of Contents**NOTE 10. TRANSACTIONS WITH AFFILIATES*****Management Agreement and Externalization***

At our annual stockholders meeting on May 25, 2011, the stockholders approved the execution by us of a Management Agreement, or the Management Agreement (a copy of which is included as Exhibit A to our Definitive Proxy Statement filed with the SEC on March 31, 2011), between the Company and Anworth Management, LLC, or the Manager, and the concurrent externalization of our management function. We expect to enter into the Management Agreement in the fourth quarter of 2011, effective December 31, 2011. Once effective, our day-to-day operations will be conducted by the Manager through the authority delegated to it under the Management Agreement and pursuant to the policies established by our board of directors. The Manager will at all times be subject to the supervision and direction of our board of directors and will be responsible for (i) the selection, purchase and sale of our investment portfolio; (ii) our financing and hedging activities; and (iii) providing us with management services. The Manager will perform such other services and activities relating to our assets and operations as may be appropriate. In exchange for these services, the Manager will receive a management fee paid monthly in arrears in an amount equal to one-twelfth of 1.20% of our Equity, as defined in the Management Agreement.

We expect the Manager to commence performance on December 31, 2011, after which we will become an externally-managed REIT. Following the execution of the Management Agreement and on its effective date, the employment agreements of our executives (discussed later in Note 10) will be terminated and we will operate as an entity with officers and directors, but without employees. In addition, we expect to terminate our 2002 Incentive Compensation Plan, or the 2002 Incentive Plan (discussed later in Note 10), as of the effective date of the Management Agreement. Our employees will become employees of the Manager, and we will take such other actions as are reasonably necessary to implement the Management Agreement and the concurrent externalization.

Our officers and employees have previously been granted restricted stock and other equity incentive awards (see Note 11), including dividend equivalent rights, in connection with their service to us, and certain of our employees have agreements under which they would receive payments if the Company is subject to a change in control (discussed later in Note 10). In connection with the externalization, the agreements under which our officers and employees have been granted equity awards and would be paid payments in the event of a change in control will be modified so that such agreements will continue with respect to our officers and employees after they become officers and employees of the Manager. In addition, as officers of the Company and employees of the Manager, they will continue to be eligible to receive equity incentive awards under equity incentive plans in effect now or in the future.

Currently, the Company leases office space, on a pass-through basis, to Pacific Income Advisers, Inc., or PIA, and pays rent at an annual rate equal to PIA's obligation (discussed later in Note 10). Under an administrative service agreement, PIA provides various administrative services and equipment to us for an annual fee paid quarterly in arrears (discussed later in Note 10). We will continue to pay for both of these obligations.

Anworth 2002 Incentive Compensation Plan

Under our 2002 Incentive Compensation Plan, or the 2002 Incentive Plan, Lloyd McAdams, our Chief Executive Officer, Joseph E. McAdams, our Chief Investment Officer, Heather U. Baines, our Executive Vice President, and other executives are eligible to earn incentive compensation during each fiscal quarter. The 2002 Incentive Plan requires that we pay all amounts earned thereunder each quarter (subject to offset for accrued negative incentive compensation), and we will be required to pay a percentage of such amounts to certain of our executives pursuant to the terms of their employment agreements. Pursuant to their employment agreements, Lloyd McAdams, Joseph E. McAdams and Heather U. Baines are entitled to minimum percentages of all amounts paid under the 2002 Incentive Plan. Those percentages are 45%, 25% and 5%, respectively. The 2002 Incentive Plan is tied directly to our performance and is designed to incentivize key employees to maximize return on equity. The total aggregate amount of compensation that may be earned quarterly by all participants under the 2002 Incentive Plan equals a percentage of net income, before incentive compensation, in excess of the amount that would produce an annualized return on average net worth equal to the ten-year U.S. Treasury Rate plus 1%, or the Threshold Return. At September 30, 2011, the Threshold Return was 3.49%.

Average net worth, as defined in the 2002 Incentive Plan, for any period is (i) the daily average of the cumulative net proceeds to date from all offerings of the Company's equity securities, after deducting any underwriting discounts and commissions and other expenses and costs related to such offerings, plus (ii) the Company's retained earnings computed by taking the average of such values at the end of each month during such period.

Table of Contents

The 2002 Incentive Plan contains a high water-mark provision requiring that in any fiscal quarter in which net income is an amount less than the amount necessary to earn the Threshold Return, the Company will calculate negative incentive compensation for that fiscal quarter which will be carried forward and will offset future incentive compensation earned under the 2002 Incentive Plan with respect to participants who were participants during the fiscal quarter(s) in which negative incentive compensation was generated. At September 30, 2011, the incentive compensation accrual carry forward was a negative \$1.2 million, which was reduced from a negative \$2.9 million at June 30, 2011 and from a negative \$6.4 million at December 31, 2010. This negative carry forward may provide an incentive to management to make higher risk investments in an attempt to generate returns to overcome the negative carry forward.

The percentage of taxable net income in excess of the Threshold Return earned under the 2002 Incentive Plan by all employees is calculated based on our quarterly average net worth as defined in the 2002 Incentive Plan. The percentage rate used in this calculation is based on a blended average of the following tiered percentage rates:

25% for the first \$50 million of average net worth;

15% for the average net worth between \$50 million and \$100 million;

10% for the average net worth between \$100 million and \$200 million; and

5% for the average net worth in excess of \$200 million.

During the three months ended September 30, 2011 and 2010, eligible employees under the 2002 Incentive Plan did not earn any incentive compensation due to the negative incentive carry forward under the Plan.

Following the execution of the Management Agreement as of December 31, 2011 and in connection with the concurrent externalization, we expect to terminate the 2002 Incentive Plan as of the effective date of the Management Agreement.

Employment Agreements

Salary, Incentive and Termination Provisions

Pursuant to the terms of their employment agreements with us, Lloyd McAdams serves as our President, Chairman and Chief Executive Officer, Joseph E. McAdams serves as our Executive Vice President and Chief Investment Officer, and Heather U. Baines serves as our Executive Vice President. Lloyd McAdams receives a \$925 thousand annual base salary, Joseph E. McAdams receives a \$700 thousand annual base salary and Heather U. Baines receives a \$60 thousand annual base salary.

These employment agreements also have the following provisions:

the three executives are entitled to participate in the 2002 Incentive Plan and each of these individuals is provided a minimum percentage of the amounts earned under such plan. Lloyd McAdams is entitled to 45% of all amounts paid under the plan, Joseph E. McAdams is entitled to 25% of all amounts paid under the plan and Heather U. Baines is entitled to 5% of all amounts paid under the plan.

the 2002 Incentive Plan may not be amended without the consent of Messrs. Lloyd McAdams and Joseph E. McAdams;

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in the event any of the three executives is terminated without cause, or if they terminate for good reason, or, in the case of Messrs. Lloyd McAdams or Joseph E. McAdams, their employment agreements are not renewed, then the executives would be entitled to: (1) all base salary due under the employment agreements, (2) all discretionary bonus due under their employment agreements, (3) a lump sum payment of an amount equal to three years of the executive's then-current base salary, (4) payment of COBRA medical coverage for 18 months, (5) immediate vesting of all pension benefits, (6) all incentive compensation under the 2002 Incentive Plan to which the executives would have been entitled to under the employment agreements prorated through the termination date, and (7) all expense reimbursements and benefits due and owing the executives through the termination. In addition, under these circumstances, Messrs. Lloyd McAdams and Joseph E. McAdams would each be entitled to a lump sum payment equal to 150% of the greater of (i) the highest amount paid or that could be payable (in the aggregate) under the 2002 Incentive Plan during any one of the three fiscal years prior to their termination, and (ii) the highest amount paid, or that could be payable (in the aggregate), under the 2002 Incentive Plan during any of the three fiscal years following their termination. Ms. Baines would also be entitled to a lump sum payment equal to all incentive compensation that Ms. Baines would have been entitled to under the 2002 Incentive Plan during the three-year period following her termination;

the equity awards granted to each of the three executives will immediately vest upon the termination of the executive's employment if such termination is in connection with a change in control;

Table of Contents

Messrs. Lloyd McAdams and Joseph E. McAdams are each subject to a one-year non-competition provision following termination of their employment except in the event of a change in control; and

each agreement contains an evergreen provision that permits automatic renewal for one year at the end of each term unless written notice of termination is provided by either party six months prior to the end of the current term.

Performance-Based Bonus Pool Provisions

Under the terms of their employment agreements, a long-term equity incentive structure was established for Messrs. Lloyd McAdams and Joseph E. McAdams. As a result, they are eligible to participate in a performance-based bonus pool that is funded based on our return on average equity, or ROAE. ROAE is calculated as the twelve-month net income available to common stockholders, excluding the effect of depreciation, preferred stock dividends, gains/losses on asset sales and impairment charges, divided by the average stockholder equity less goodwill and preferred stockholder equity. The Compensation Committee of our board of directors, or the Compensation Committee, evaluated various measures and factors of performance in developing this structure and, in its view, ROAE was determined to be the single best indicator of our overall performance and therefore of value creation for our stockholders. This is in part due to the fact that ROAE is a metric of our performance that has been calculated and reported on a consistent basis since our inception in 1998.

As structured by the Compensation Committee, the aggregate amount of this performance-based bonus pool available for distribution can range annually based upon our ROAE in accordance with the following:

if our ROAE is 0% or less, no performance-based bonus is paid.

if our ROAE is greater than 0% but less than 8%, a bonus pool of up to \$500 thousand is available in the aggregate.

if our ROAE is 8% or greater, then the bonus pool available to be paid to both executives in the aggregate equals \$500 thousand plus 10% of the first \$5 million of excess return and 6% of the amount of the excess return greater than \$5 million.

The Compensation Committee has the discretionary right to adjust downward the amount available for distribution from the bonus pool by as much as 10% in any given year, based upon its assessment of factors including our leverage, stability of the book value of our common stock and price per share of our common stock relative to other industry participants. Of the aggregate amount available for distribution from the bonus pool, the Compensation Committee bases annual bonus allocation to each of Messrs. Lloyd McAdams and Joseph E. McAdams on its assessment of the performance of each executive.

In order to further align the performance of Messrs. Lloyd McAdams and Joseph E. McAdams with our long-term financial success and the creation of stockholder value, the Compensation Committee also determined that with respect to 2008 and each year thereafter, 25% of the annual performance-based bonus amount allocated to be distributed to an executive over \$100 thousand would be paid in restricted shares of our common stock, or the Restricted Shares. In addition, neither executive will be permitted to sell or otherwise transfer any Restricted Shares during the executive's employment with us until the value of his respective stock holdings in the Company exceeds a seven and one-half times multiple of his base compensation and, once this threshold is met, only to the extent that the value of such holdings exceeds that multiple.

Prior to the end of any year, the Compensation Committee, at its discretion, may notify an executive that the executive will not participate in the pool during the following year. If this occurs, the sale or transfer restrictions on previously issued pool shares will be eliminated at that time.

The Compensation Committee, in its discretion, may provide additional compensation to each of Messrs. Lloyd McAdams and Joseph E. McAdams beyond the annual performance-based bonus awards earned under the incentive compensation structure in their employment agreements. This additional compensation may be provided in consideration of the execution of our business and strategic plans. During the three months ended September 30, 2011, no additional compensation was paid to Messrs. Lloyd McAdams and Joseph E. McAdams.

Following the execution of the Management Agreement as of December 31, 2011 and in connection with the concurrent externalization, the employment agreements of our executives will be terminated.

Change in Control and Arbitration Agreements

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On June 27, 2006, we entered into Change in Control and Arbitration Agreements with each of Thad M. Brown, our Chief Financial Officer, Charles J. Siegel, our Senior Vice President-Finance, Bistra Pashamova, our Senior Vice President and Portfolio Manager, and Evangelos Karagiannis, our Vice President and Portfolio Manager, as well as certain of our other employees. The Change in Control and Arbitration Agreements grant these officers and employees, in the event that a change in control occurs (as defined therein), a lump sum payment equal to (i) 12 months annual base salary in effect on the date of the change in control, plus (ii) the average annual incentive compensation received for the two complete fiscal years prior to the date

Table of Contents

of the change in control, and plus (iii) the average annual bonus received for the two complete fiscal years prior to the date of the change in control, as well as other benefits. The Change in Control and Arbitration Agreements also provide for accelerated vesting of equity awards granted to these officers and employees upon a change in control.

Following the execution of the Management Agreement as of December 31, 2011 and in connection with the concurrent externalization, we will amend the existing Change in Control and Arbitration Agreements to reflect that these amended Change in Control and Arbitration Agreements with these officers and employees will be on substantially similar terms, as of the effective date of the Management Agreement.

Agreements with Pacific Income Advisers, Inc.

On June 13, 2002, we entered into a sublease with Pacific Income Advisers, Inc., or PIA, a company owned by trusts controlled by certain of our officers. Under the sublease, as amended on July 8, 2003, we lease, on a pass-through basis, 5,500 square feet of office space from PIA and pay rent at an annual rate equal to PIA's obligation, currently \$57.46 per square foot. The sublease runs through June 30, 2012 unless earlier terminated pursuant to the master lease. During the three and nine months ended September 30, 2011, we paid approximately \$85 thousand and \$241 thousand, respectively, in rent and other operating expenses to PIA under the sublease, which is included in Other expenses on the unaudited consolidated statements of income. During the three and nine months ended September 30, 2010, we paid \$84 thousand and \$242 thousand, respectively, in rent and related expenses to PIA under this sublease.

At September 30, 2011, the future minimum lease commitment was as follows (in whole dollars):

Year	2011	2012	Total Commitment
Commitment	\$ 79,007	\$ 158,012	\$ 237,019

On July 25, 2008, we entered into an administrative services agreement with PIA, which was amended and restated on August 20, 2010. Under this agreement, PIA provides administrative services and equipment to us including human resources, operational support and information technology, and we pay an annual fee of 5 basis points on the first \$225 million of stockholders' equity and 1.25 basis points thereafter (paid quarterly in arrears) for those services. The administrative services agreement had an initial term of one year and renews for successive one-year terms thereafter unless either party gives notice of termination no less than 30 days before the expiration of the then-current annual term. We may also terminate the administrative services agreement upon 30 days prior written notice for any reason and immediately if there is a material breach by PIA. Included in Other expenses on the unaudited consolidated statements of income are fees of \$50 thousand and \$148 thousand, respectively, paid to PIA in connection with this agreement during the three and nine months ended September 30, 2011. During the three and nine months ended September 30, 2010, we paid fees of \$48 thousand and \$214 thousand, respectively, to PIA in connection with this agreement.

Deferred Compensation Plan

On January 15, 2003, we adopted the Anworth Mortgage Asset Corporation Deferred Compensation Plan, or the Deferred Compensation Plan. The Deferred Compensation Plan permits our eligible officers to defer the payment of all or a portion of their cash compensation that otherwise would be in excess of the \$1 million annual limitation on deductible compensation imposed by Section 162(m) of the Code (based on the officers' compensation and benefit elections made prior to January 1 of the calendar year in which the compensation will be deferred). Under this limitation, compensation paid to our Chief Executive Officer and our four other highest paid officers is not deductible by us for income tax purposes to the extent the amount paid to any such officer exceeds \$1 million in any calendar year, unless such compensation qualifies as performance-based compensation under Section 162(m). Our board of directors designates the eligible officers who may participate in the Deferred Compensation Plan from among the group consisting of our Chief Executive Officer and our other four highest paid officers. To date, the board has designated all of the executive officers as those who may participate in the Deferred Compensation Plan. Each eligible officer becomes a participant in the Deferred Compensation Plan by making a written election to defer the payment of cash compensation. With certain limited exceptions, the election must be filed with us before January 1 of the calendar year in which the compensation will be deferred. The election is effective for the entire calendar year and may not be terminated or modified for that calendar year. If a participant wishes to defer compensation in a subsequent calendar year, a new deferral election must be made before January 1 of that subsequent year.

Amounts deferred under the Deferred Compensation Plan are not paid to the participant as earned, but are credited to a bookkeeping account maintained by us in the name of the participant. The balance in the participant's account is credited with earnings at a rate of return equal to the annual dividend yield on our common stock. The balance in the participant's account is

Table of Contents

paid to the participant six months after termination of employment or upon the death of the participant or a change in control of the Company. Each participant is a general unsecured creditor of the Company with respect to all amounts deferred under the Deferred Compensation Plan. At September 30, 2011, the aggregate balance of the amounts previously deferred for Mr. Lloyd McAdams was \$415,823.

NOTE 11. EQUITY COMPENSATION PLAN***2004 Equity Compensation Plan***

At our May 27, 2004 annual stockholders meeting, our stockholders adopted the Anworth Mortgage Asset Corporation 2004 Equity Compensation Plan, or the Plan, which amended and restated our 1997 Stock Option and Awards Plan. The Plan authorized the grant of stock options and other stock-based awards, as of December 31, 2005, for an aggregate of up to 3,500,000 shares of our registered common stock. The Plan authorizes our board of directors, or a committee of our Board, to grant incentive stock options, as defined under section 422 of the Code, options not so qualified, restricted stock, dividend equivalent rights (DERs), phantom shares, stock-based awards that qualify as performance-based awards under Section 162(m) of the Code and other stock-based awards. The exercise price for any option granted under the Plan may not be less than 100% of the fair market value of the shares of common stock at the time the option is granted. At September 30, 2011, 816,034 shares remained available for future issuance under the Plan through any combination of stock options or other awards. The Plan does not provide for automatic annual increases in the aggregate share reserve or the number of shares remaining available for grant. We filed a registration statement on Form S-8 on November 7, 2005 to register an aggregate of up to 3,500,000 shares of our common stock to be issued pursuant to the Plan.

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

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

We recognize the compensation expense related to restricted stock over the ten-year vesting period. During the three and nine months ended September 30, 2011, we expensed approximately \$51 thousand and \$152 thousand, respectively, related to these restricted stock grants. During the three and nine months ended September 30, 2010, we expensed approximately \$51 thousand and \$152 thousand, respectively, related to these restricted stock grants.

At our May 24, 2007 annual meeting of stockholders, our stockholders adopted the Anworth Mortgage Asset Corporation 2007 Dividend Equivalent Rights Plan, or the 2007 Dividend Equivalent Rights Plan. A dividend equivalent right, or DER, is a right to receive amounts equal in value to the dividend distributions paid on a share of our common stock. DERs are paid in either cash or shares of our common stock, whichever is specified by our Compensation Committee at the time of grant, at such times as dividends are paid on shares of our common stock during the period between the date a DER is issued and the date the DER expires or earlier terminates. The Compensation Committee may impose such other conditions to the grant of DERs as it may deem appropriate. The maximum term for DERs under the 2007 Dividend Equivalent Rights Plan is ten years from the date of grant. Prior to January 1, 2011, an aggregate of 582 thousand DERs were issued to our officers and employees under the 2007 Dividend Equivalent Rights Plan. These DERs are not attached to any stock and only have the right to receive the same cash distribution per common share distributed to our common stockholders during the term of the grant. All of these grants have a five-year term from the date of the grant. During the three and nine months ended September 30, 2011 we paid or accrued \$134 thousand and \$425 thousand, respectively, as compensation related to DERs granted. During the three and nine months ended September 30, 2010, we paid or accrued approximately \$115 thousand and \$375 thousand, respectively, as compensation related to DERs granted.

Table of Contents

Our officers and employees have previously been granted restricted stock and other equity incentive awards, including dividend equivalent rights, in connection with their service to us. In connection with the externalization, the agreements under which our officers and employees have been granted equity awards will be modified so that such agreements will continue with respect to our officers and employees after they become officers and employees of the Manager. In addition, as officers of the Company and employees of the Manager, they will continue to be eligible to receive equity incentive awards under equity incentive plans in effect now or in the future.

NOTE 12. HEDGING INSTRUMENTS

At September 30, 2011, we were a counterparty to interest rate swap agreements, which are derivative instruments as defined by ASC 815-10, with an aggregate notional amount of \$2.93 billion and a weighted average maturity of 3.0 years. During the three months ended September 30, 2011, no swap agreements matured. During the three months ended September 30, 2011, we entered into three new swap agreements with an aggregate notional amount of \$150 million and terms of up to five years. We utilize swap agreements to manage interest rate risk relating to our repurchase agreements (the hedged item) and do not anticipate entering into derivative transactions for speculative or trading purposes. In accordance with the swap agreements, we will pay a fixed-rate of interest during the term of the swap agreements (ranging from 1.11% to 5.4940%) and receive a payment that varies with the three-month LIBOR rate.

At September 30, 2011 and December 31, 2010, our swap agreements had the following notional amounts (in thousands), weighted average interest rates and remaining terms (in months):

	September 30, 2011			December 31, 2010		
	Notional Amount	Weighted Average Interest Rate	Remaining Term in Months	Notional Amount	Weighted Average Interest Rate	Remaining Term in Months
Less than 12 months	\$ 490,000	3.90%	8	\$ 475,000	4.36%	4
1 year to 2 years	405,000	3.40	17	520,000	3.92	17
2 years to 3 years	325,000	2.31	30	375,000	3.32	26
3 years to 4 years	510,000	2.17	42	410,000	2.07	40
Over 4 years	1,200,000	1.95	54	880,000	2.07	56
	\$ 2,930,000	2.55%	36	\$ 2,660,000	3.02%	33

Swap Agreements by Counterparty

	September 30, 2011	December 31, 2010
	(in thousands)	
Deutsche Bank Securities	\$ 700,000	\$ 725,000
RBS Greenwich Capital	485,000	390,000
Nomura Securities International	450,000	400,000
JPMorgan Securities	400,000	0
Credit Suisse	395,000	545,000
Citigroup	200,000	300,000
Morgan Stanley	150,000	150,000
Bank of New York	100,000	100,000
LBBW Securities, LLC	50,000	50,000
	\$ 2,930,000	\$ 2,660,000

During the nine months ended September 30, 2011, there was an increase in unrealized losses of \$46.1 million, from \$62.2 million in unrealized losses at December 31, 2010 to \$108.3 million in unrealized losses, on our swap agreements included in Other comprehensive income (this increase in unrealized losses consisted of unrealized losses on cash flow hedges of \$98.3 million and a reclassification adjustment for interest

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expense included in net income of \$52.2 million).

At September 30, 2011, we had asset derivatives of \$25 thousand and liability derivatives of \$108.1 million (both shown on our unaudited consolidated balance sheets).

Table of Contents

During the three months ended September 30, 2011, there was no gain or loss recognized in earnings due to hedge ineffectiveness. We have determined that our hedges are still considered highly effective. There were no components of the derivative instruments gain or loss excluded from the assessment of hedge effectiveness. The maximum length of our swap agreements is five years. We do not anticipate any discontinuance of the swap agreements and thus do not expect to recognize any gain or loss into earnings because of this. On September 18, 2008, we terminated all of our interest rate swap agreements with Lehman Brothers Special Finance, or LBSF, as the counterparty. The notional balance of these swap agreements was \$240 million. The fair value of these swap agreements at termination was approximately \$(1.5) million, reflecting a realized loss. This loss is being amortized into interest expense over the remaining term of the related hedged borrowings. During the three and nine months ended September 30, 2011, the amounts amortized into interest expense were approximately \$65 thousand and \$194 thousand, respectively, and the remaining amount at September 30, 2011 to be amortized was approximately \$314 thousand. For the three and nine months ended September 30, 2010, the amounts amortized into interest expense were approximately \$65 thousand and \$189 thousand, respectively.

For more information on our accounting policies, the objectives and risk exposures relating to derivatives and hedging agreements, see the section on Derivative Financial Instruments in Note 1. For more information on the fair value of our swap agreements, see Note 6.

NOTE 13. COMMITMENTS AND CONTINGENCIES

Lease Commitment and Administrative Services Commitment We sublease office space and use administrative services from PIA, as more fully described in Note 10.

NOTE 14. OTHER EXPENSES

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
	(in thousands)			
Legal and accounting fees	\$ 146	\$ 128	\$ 459	\$ 417
Printing and stockholder communications	20	6	204	152
Directors and Officers insurance	107	108	324	326
Software and implementation	64	68	194	209
Administrative service fees	50	48	148	214
Rent and related expenses	85	84	241	242
Stock exchange and filing fees	48	57	149	173
Custodian fees	33	33	98	98
Sarbanes-Oxley consulting fees	41	17	69	56
Board of directors fees and expenses	90	75	242	222
Securities data services	28	27	82	81
Refund of previous Belvedere Trust expenses	0	(170)	0	(170)
Other	80	57	227	207
Total of other expenses:	\$ 792	\$ 538	\$ 2,437	\$ 2,227

NOTE 15. SUBSEQUENT EVENTS

When we pay any cash dividend during any quarterly fiscal period to all or substantially all of our common stockholders in an amount that results in an annualized common stock dividend yield that is greater than 6.25% (the dividend yield on our Series B Preferred Stock), the conversion rate on our Series B Preferred Stock is adjusted based on a formula specified in the Articles Supplementary Establishing and Fixing the Rights and Preferences of the Series B Preferred Stock. This conversion rate increased on October 14, 2011 from 3.5374 shares of our common stock to 3.6075 shares of our common stock using the following information: (1) the average of the closing price of our common stock for the ten (10) consecutive trading day period was \$6.69 and (2) the annualized common stock dividend yield was 13.7560%.

From October 1, 2011 through November 1, 2011, there were two transactions to convert an aggregate of 39,494 shares of Series B Preferred Stock into an aggregate of 139,705 shares of our common stock (at the then-current conversion rate of 3.5374).

Table of Contents

On October 3, 2011, we announced that our board of directors had authorized a share repurchase program, permitting us to acquire up to 2,000,000 shares of our common stock. The shares are expected to be acquired at prevailing prices through open market transactions. The manner, price, number and timing of share repurchases will be subject to market conditions and applicable SEC rules. From October 3, 2011 through November 1, 2011, we had repurchased an aggregate of 357,085 shares at a weighted average price of \$6.40 per share under this program.

The Management Agreement (as described in Note 10) will become effective on December 31, 2011, after which the Company will be an externally-managed REIT.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

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

You should read the following discussion and analysis in conjunction with the unaudited consolidated financial statements and related notes thereto contained in Item 1 of Part I of this Quarterly Report on Form 10-Q. The information contained in this Quarterly Report on Form 10-Q is not a complete description of our business or the risks associated with an investment in our stock. We urge you to carefully review and consider the various disclosures made by us in this Quarterly Report on Form 10-Q and in our other reports filed with the SEC, including our Annual Report on Form 10-K for the fiscal year ended December 31, 2010.

Forward Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the 1933 Act and Section 21E of the Securities Exchange Act of 1934, as amended, and, as such, may involve known and unknown risks, uncertainties and assumptions. Forward-looking statements are those that predict or describe future events or trends and that do not relate solely to historical matters. You can generally identify forward-looking statements as statements containing the words may, will, believe, expect, anticipate, intend, estimate, continue or other similar expressions. You should not rely on our forward-looking statements because the matters they describe are subject to assumptions, known and unknown risks, uncertainties and other unpredictable factors, many of which are beyond our control. Therefore, our actual results could differ materially and adversely from those expressed in any forward-looking statements as a result of various factors, some of which are listed under the section Risk Factors, Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2010.

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

General

The Company

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

We are organized for tax purposes as a real estate investment trust, or REIT. Accordingly, we generally distribute substantially all of our taxable earnings to stockholders without paying federal or state income tax at the corporate level on the distributed earnings. At September 30, 2011, our qualified REIT assets (real estate assets, as defined under the Code, cash and cash items and government securities) were greater than 99% of our total assets, as compared to the Code requirement that at least 75% of our total assets must be qualified REIT assets. Greater than 99% of our

2010 revenue qualified for both the 75%

Table of Contents

source of income test and the 95% source of income test under the REIT rules. At September 30, 2011, we believe we met all REIT requirements regarding the ownership of our common stock and the distributions of our taxable net income. Therefore, we believe that we continue to qualify as a REIT under the provisions of the Code.

At our annual meeting of stockholders held on May 25, 2011, the stockholders approved the execution by us of a Management Agreement (a copy of which is included as Exhibit A to our Definitive Proxy Statement filed with the SEC on March 31, 2011), between the Company and Anworth Management, LLC, and the concurrent externalization of the Company's management function effective on December 31, 2011. We expect to enter into the Management Agreement in the fourth quarter of 2011, effective December 31, 2011. Once effective, our day-to-day operations will be conducted by the Manager through the authority delegated to it under the Management Agreement and pursuant to the policies established by our board of directors. The Manager will at all times be subject to the supervision and direction of our board of directors and will be responsible for (i) the selection, purchase and sale of our investment portfolio; (ii) our financing and hedging activities; and (iii) providing us with management services. The Manager will perform such other services and activities relating to our assets and operations as may be appropriate. In exchange for these services, the Manager will receive a management fee paid monthly in arrears in an amount equal to one-twelfth of 1.20% of our Equity (as defined in the Management Agreement). The term of the Management Agreement will expire December 31, 2013, and will automatically renew for successive one-year renewal terms unless either party elects not to renew. If we terminate the Management Agreement or elect not to renew without cause, then we will be required to pay a termination fee equal to three times the average annual management fee earned during the prior 24-month period.

Although the U.S. government and other foreign governments have taken various actions (including placing Fannie Mae and Freddie Mac in conservatorship) intended to protect financial institutions, their respective economies and their respective housing and mortgage markets, we continue to operate under very difficult market conditions. There can be no assurance that these various actions will have a beneficial impact on the global financial markets and, more specifically, the market for the securities we currently own in our portfolio. We cannot predict what, if any, impact these actions or future actions by either the U.S. government or foreign governments could have on our business, results of operations and financial condition. These events may impact the availability of financing generally in the marketplace and also may impact the market value of MBS generally, including the securities we currently own in our portfolio.

In August 2011, Standard & Poor's downgraded each of U.S. sovereign debt and Fannie Mae and Freddie Mac from AAA to AA+. We do not know what effect this will ultimately have on the U.S. economy, the value of our securities and the ability of Fannie Mae and Freddie Mac to satisfy its guarantees of Agency MBS if necessary. A failure by the U.S. government to meet the conditions of the August 2011 debt ceiling agreement or to reduce its budget deficit or a further downgrade of U.S. sovereign debt and government-sponsored agency debt could have a material adverse effect on the U.S. economy and on the global economy. These events could have a material adverse effect on our borrowing costs, the availability of financing and the liquidity and valuation of securities in general and particularly the securities in our portfolio.

Our Portfolio

Our operations consist of the following portfolios: agency mortgage-backed securities, or Agency MBS, and non-agency mortgage-backed securities, or Non-Agency MBS. Essentially all of our total portfolio is Agency MBS.

At September 30, 2011, we had total assets of \$8.8 billion. Our Agency MBS portfolio, consisting of approximately \$8.74 billion, was allocated as follows: approximately 23% adjustable-rate Agency MBS (less than 1-year reset); approximately 7% adjustable-rate Agency MBS (1-2 year reset); approximately 50% adjustable-rate Agency MBS (2-5 year reset); approximately 14% 15-year fixed-rate Agency MBS, approximately 6% 30-year fixed-rate Agency MBS; and less than 1% agency floating-rate CMOs. Our Non-Agency MBS portfolio consisted of approximately \$2.2 million of floating-rate CMOs. Stockholders' equity available to common stockholders at September 30, 2011 was approximately \$921.7 million, or \$6.93 per share. The \$921.7 million equals total stockholders' equity of \$970.2 million less the Series A Preferred Stock liquidating value of approximately \$46.9 million and less the difference between the Series B Preferred Stock liquidating value of \$29.8 million and the proceeds from its sale of \$28.2 million. For the three months ended September 30, 2011, we reported net income of \$30.6 million. Net income to common stockholders was \$29.1 million, or net income of \$0.22 per diluted share, based on a weighted average of 136.1 million fully diluted shares outstanding, which consisted of net income of \$30.6 million minus payment of preferred dividends of \$1.5 million.

Table of Contents**Results of Operations***Three Months Ended September 30, 2011 Compared to September 30, 2010*

For the three months ended September 30, 2011, our net income was \$30.6 million. Our net income available to common stockholders was \$29.1 million, or \$0.22 per diluted share, based on a weighted average of 136.1 million fully diluted shares outstanding. This includes net income of \$30.6 million minus the payment of preferred dividends of \$1.5 million. For the three months ended September 30, 2010, our net income was \$24.3 million. Our net income available to common stockholders was \$22.9 million, or \$0.19 per diluted share, based on a weighted average of 121.6 million fully diluted shares outstanding. This included net income of \$24.3 million minus the payment of preferred dividends of \$1.4 million.

Net interest income for the three months ended September 30, 2011 totaled \$33.2 million, or 46.7% of gross income, compared to \$27.3 million, or 43% of gross income, for the three months ended September 30, 2010. Net interest income is comprised of the interest income earned on mortgage investments (net of premium amortization expense) less interest expense from borrowings. Interest income (net of premium amortization expense) for the three months ended September 30, 2011 was \$54.5 million, compared to \$50.2 million for the three months ended September 30, 2010, an increase of 8.4%, due primarily to an increase in the weighted average portfolio outstanding from \$5.85 billion at September 30, 2010 to \$8.04 billion at September 30, 2011, partially offset by a decrease in the weighted average yield from 3.44% at September 30, 2010 to 2.71% at September 30, 2011 and an increase in premium amortization of approximately \$3.94 million. Interest expense for the three months ended September 30, 2011 was \$21.3 million, compared to \$23 million for the three months ended September 30, 2010, a decrease of 7.1%, which resulted primarily from a decline in weighted average interest rates after the effect of the swap agreements (from 1.76% at September 30, 2010 to 1.14% at September 30, 2011) and partially offset by an increase in the average borrowings outstanding, from \$5.09 billion at September 30, 2010 to \$7.3 billion at September 30, 2011.

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

During the three months ended September 30, 2011, premium amortization expense increased \$3.94 million, or 31.5%, from \$12.5 million during the three months ended September 30, 2010 to \$16.5 million, due primarily to the increase in the amortization of unearned premium on securities acquired in 2010 and 2011 at higher premiums.

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

Portfolio	2011			2010		
	First Quarter	Second Quarter	Third Quarter	First Quarter	Second Quarter	Third Quarter
Agency MBS and Non-Agency MBS	21%	22%	28%	30%	48%	33%

During the three months ended September 30, 2011 and 2010, there was no gain or loss recognized in earnings due to hedge ineffectiveness. We have determined that our hedges are still considered highly effective. There were no components of the derivative instruments' gain or loss excluded from the assessment of hedge effectiveness.

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During the three months ended September 30, 2011, there was a recovery of \$830 thousand related to a previous write-down on our Non-Agency MBS. For the three months ended September 30, 2010, there was no recovery on our Non-Agency MBS.

Total expenses were \$3.4 million for the three months ended September 30, 2011, compared to \$2.96 million for the three months ended September 30, 2010. Compensation costs increased \$224 thousand (due primarily to an increase in the accrual for bonus and incentive compensation). Other expenses (as detailed in Note 14 to the accompanying unaudited consolidated financial statements) increased \$254 thousand (due primarily to the refund of \$170 thousand of previous Belvedere Trust expenses during the three months ended September 30, 2010).

Table of Contents

Nine Months Ended September 30, 2011 Compared to September 30, 2010

For the nine months ended September 30, 2011, our net income was \$94.5 million. Our net income available to common stockholders was \$90.1 million, or \$0.70 per diluted share, based on a weighted average of 131.2 million fully diluted shares outstanding. This includes net income of \$94.5 million minus the payment of preferred dividends of \$4.4 million. For the nine months ended September 30, 2010, our net income was \$83.4 million. Our net income available to common stockholders was \$79.1 million, or \$0.66 per diluted share, based on a weighted average of 121 million fully diluted shares outstanding. This included net income of \$83.4 million minus the payment of preferred dividends of \$4.3 million.

Net interest income for the nine months ended September 30, 2011 totaled \$103.7 million, or 48.8% of gross income, compared to \$94.3 million, or 46% of gross income, for the nine months ended September 30, 2010. Interest income (net of premium amortization expense) for the nine months ended September 30, 2011 was \$170.5 million, compared to \$165.9 million for the nine months ended September 30, 2010, an increase of 2.8%, due primarily to an increase in the weighted average portfolio outstanding from \$5.93 billion at September 30, 2010 to \$7.75 billion at September 30, 2011, partially offset by a decrease in the weighted average yield from 3.73% at September 30, 2010 to 2.94% at September 30, 2011 and an increase in premium amortization of approximately \$4.54 million. Interest expense for the nine months ended September 30, 2011 was \$66.8 million, compared to \$71.5 million for the nine months ended September 30, 2010, a decrease of 6.6%, which resulted primarily from a decline in interest rates after the effect of the swap agreements (from 1.81% at September 30, 2010 to 1.27% at September 30, 2011) and partially offset by an increase in the average borrowings outstanding, from \$5.2 billion at September 30, 2010 to \$6.96 billion at September 30, 2011.

During the nine months ended September 30, 2011, premium amortization expense increased \$4.54 million, or 12.2%, from \$37.3 million during the nine months ended September 30, 2010 to \$41.9 million, due primarily to the increase in the amortization of unearned premium on securities acquired in 2010 and 2011 at higher premiums.

During the nine months ended September 30, 2011 and 2010, there was no gain or loss recognized in earnings due to hedge ineffectiveness. We have determined that our hedges are still considered highly effective. There were no components of the derivative instruments gain or loss excluded from the assessment of hedge effectiveness.

During the nine months ended September 30, 2011, there was a recovery of approximately \$1.7 million related to a previous write-down on our Non-Agency MBS. During the nine months ended September 30, 2010, there was no recovery on our Non-Agency MBS.

Total expenses were \$10.9 million for the nine months ended September 30, 2011, compared to \$10.9 million for the nine months ended September 30, 2010. Compensation costs increased \$429 thousand (due to an increase in the accrual for bonus and incentive compensation). This was offset primarily by the write-down of \$674 thousand in the three month period ended September 30, 2010 relating to the Lehman receivable. Other expenses (as detailed in Note 14 to the accompanying unaudited consolidated financial statements) increased \$210 thousand (due primarily to the refund of \$170 thousand of previous Belvedere Trust expenses during the nine months ended September 30, 2010).

Financial Condition

Agency MBS Portfolio

At September 30, 2011, we held agency mortgage assets which had an amortized cost of approximately \$8.54 billion, consisting primarily of approximately \$6.84 billion of adjustable-rate Agency MBS, approximately \$1.7 billion of fixed-rate Agency MBS and approximately \$3 million of floating-rate CMOs. This amount represents an approximately 11.8% increase from the \$7.64 billion held at December 31, 2010. Of the adjustable-rate Agency MBS owned by us, 28% were adjustable-rate pass-through certificates which had coupons that reset within one year. The remaining 72% consisted of hybrid adjustable-rate Agency MBS which had coupons that will reset between one year and five years. Hybrid adjustable-rate Agency MBS have an initial interest rate that is fixed for a certain period, usually three to five years, and thereafter adjust annually for the remainder of the term of the asset.

Table of Contents

The following table presents a schedule of the fair value of our Agency MBS owned at September 30, 2011 and December 31, 2010, classified by type of issuer (dollar amounts in thousands):

Agency	September 30, 2011		December 31, 2010	
	Fair Value	Portfolio Percentage	Fair Value	Portfolio Percentage
Fannie Mae (FNM)	\$ 5,874,300	67.2%	\$ 5,552,024	71.8%
Freddie Mac (FHLMC)	2,851,620	32.6	2,163,469	28.0
Ginnie Mae (GNMA)	17,487	0.2	19,165	0.2
Total Agency MBS:	\$ 8,743,407	100.0%	\$ 7,734,658	100.0%

The following table classifies the fair value of our Agency MBS owned at September 30, 2011 and December 31, 2010 by type of interest rate index (dollar amounts in thousands):

Index	September 30, 2011		December 31, 2010	
	Fair Value	Portfolio Percentage	Fair Value	Portfolio Percentage
One-month LIBOR	\$ 3,388	0.0%	\$ 4,187	0.0 %
Six-month LIBOR	75,534	0.9	87,894	1.1
One-year LIBOR	6,535,337	74.8	5,778,465	74.8
Six-month certificate of deposit	1,201	0.0	1,339	0.0
Six-month constant maturity treasury	375	0.0	497	0.0
One-year constant maturity treasury	341,593	3.9	386,332	5.0
Cost of Funds Index	25,984	0.3	29,167	0.4
15-year fixed-rate	1,213,154	13.9	795,687	10.3
30-year fixed-rate	546,841	6.2	651,090	8.4
Total Agency MBS:	\$ 8,743,407	100.0%	\$ 7,734,658	100.0 %

The fair values indicated do not include interest earned but not yet paid. With respect to our hybrid adjustable-rate Agency MBS, the fair value of these securities appears on the line associated with the index based on which the security will eventually reset once the initial fixed interest rate period has expired. The fair value of our Agency MBS is reported to us independently from dealers who are major financial institutions and are considered to be market makers for these types of instruments. For more detail on the fair value of our Agency MBS, see Note 6 to the accompanying unaudited consolidated financial statements.

The weighted average coupons and average amortized costs of our Agency MBS at September 30, 2011 and December 31, 2010 were as follows:

	September 30, 2011	December 31, 2010
<i>Weighted Average Coupon:</i>		
Adjustable-rate	3.36%	3.77%
Hybrid adjustable-rate	3.40	3.83
15-year fixed-rate	3.68	3.68
30-year fixed-rate	5.54	5.56
CMOs	1.02	1.07

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Total Agency MBS:	3.56%	3.94%
<i>Average Amortized Cost:</i>		
Adjustable-rate and hybrid adjustable-rate	102.78%	102.62%
15-year fixed-rate	103.22	103.27
30-year fixed-rate	102.59	100.72
Total Agency MBS:	102.72%	102.53%
Current yield (weighted average coupon divided by average amortized cost)	3.47%	3.84%

Relative to our Agency MBS portfolio at September 30, 2011, the average interest rate on outstanding repurchase agreements was 0.26% and the average days to maturity was 38 days. After adjusting for interest rate swap transactions, the average interest rate on outstanding repurchase agreements was 1.15% and the weighted average term to next rate adjustment was 452 days. Relative to our Agency MBS portfolio at December 31, 2010, the average interest rate on outstanding repurchase agreements was 0.30% and the average days to maturity was 31 days. After adjusting for interest rate swap transactions, the average interest rate on outstanding repurchase agreements was 1.43% and the weighted average term to next rate adjustment was 418 days.

Table of Contents

At September 30, 2011 and December 31, 2010, the unamortized net premium paid for our Agency MBS was approximately \$227 million and \$189 million, respectively.

One of the factors that impact the reported yield on our MBS portfolio is the actual prepayment rate on the underlying mortgages. We analyze our MBS and the extent to which prepayments impact the yield. When the rate of prepayments exceeds expectations, we amortize the premiums paid on mortgage assets over a shorter time period, resulting in a reduced yield to maturity on our mortgage assets. Conversely, if actual prepayments are less than the assumed CPR, the premium would be amortized over a longer time period, resulting in a higher yield to maturity.

Non-Agency MBS Portfolio

Non-Agency MBS are securities not issued by the government or government-sponsored enterprises and that are secured primarily by first-lien residential mortgage loans. At September 30, 2011, our Non-Agency MBS portfolio consisted of a fair value of \$2.2 million of floating-rate CMOs with an average coupon of 0.48%, which were acquired at par value. At December 31, 2010, our Non-Agency MBS portfolio consisted of a fair value of \$4.4 million of floating-rate CMOs with an average coupon of 0.51%, which were acquired at par value. The decrease was due primarily to principal paydowns of approximately \$0.7 million and a decrease in an unrealized gain of approximately \$1.5 million.

At September 30, 2011, the amortized cost of our Non-Agency MBS was \$0. At December 31, 2010, the amortized cost of our Non-Agency MBS was \$689 thousand.

At September 30, 2011, two securities representing the principal balance of our Non-Agency MBS portfolio were rated C by Moody's Investor Service and rated D by Standard & Poor's.

We received valuations at September 30, 2011 and December 31, 2010 for the Non-Agency MBS from an independent third party pricing service whose methodologies are based on broker-provided pricing as well as indirect observation of market activity and we consider the fair value measurement a Level 3 input at September 30, 2011 and December 31, 2010. For more detail on the fair value of our Non-Agency MBS, see Note 6 to the accompanying unaudited consolidated financial statements.

At September 30, 2011, the fair value of our Non-Agency MBS portfolio was approximately \$2.2 million, the principal balance was approximately \$26.8 million and the original principal balance was approximately \$60 million. At December 31, 2010, the fair value of our Non-Agency MBS portfolio was approximately \$4.4 million, the principal balance was approximately \$38.23 million and the original principal balance was approximately \$60 million.

At September 30, 2011, and in connection with the subordination levels of Non-Agency MBS securitizations, the average securitization principal subordinate to Anworth-owned tranches was 0.1%, the average securitization principal of Anworth-owned tranches was 13.4% and the average securitization principal senior to Anworth-owned tranches was 86.5%. At December 31, 2010, the average securitization principal subordinate to Anworth-owned tranches was 0.8%, the average securitization principal of Anworth-owned tranches was 16.8% and the average securitization principal senior to Anworth-owned tranches was 82.4%.

Hedging

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

As part of our asset/liability management policy, we may enter into hedging agreements such as interest rate caps, floors or swaps. These agreements are entered into to try to reduce interest rate risk and are designed to provide us with income and capital appreciation in the event of certain changes in interest rates. We review the need for hedging agreements on a regular basis.

Table of Contents

consistent with our capital investment policy. At September 30, 2011, we were a counter-party to swap agreements, which are derivative instruments as defined by ASC 815-10, with an aggregate notional amount of \$2.93 billion and an average maturity of 3.0 years. We do not anticipate entering into derivative transactions for speculative or trading purposes. In accordance with the swap agreements, we pay a fixed rate of interest during the term of the swap agreements and receive a payment that varies with the three-month LIBOR rate. At September 30, 2011, there were unrealized losses of approximately \$108.3 million on our swap agreements.

For more information on the amounts, policies, objectives and other qualitative data on our hedge agreements, see Notes 1, 6 and 12 to the accompanying unaudited consolidated financial statements.

Liquidity and Capital Resources*Agency MBS and Non-Agency MBS Portfolios*

Our primary source of funds consists of repurchase agreements which totaled approximately \$7.44 billion at September 30, 2011. As collateral for these repurchase agreements, we pledged approximately \$7.9 billion in Agency MBS. Our other significant source of funds for the three months ended September 30, 2011 consisted of payments of principal from our Agency MBS portfolio in the amount of approximately \$688.5 million.

For the three months ended September 30, 2011, there was a net decrease in cash and cash equivalents of approximately \$8.5 million. This consisted of the following components:

Net cash provided by operating activities for the three months ended September 30, 2011 was approximately \$55.1 million. This is comprised of net income of \$30.6 million, adding back the following non-cash items: the amortization of premiums and discounts of approximately \$16.5 million and the amortization of restricted stock of \$70 thousand. Net cash provided by operating activities also included an increase in accrued expenses of approximately \$12.8 million (due primarily to a decrease in payables for securities purchased), a decrease in interest receivable of approximately \$124 thousand, partially offset by an increase in prepaid expenses and other assets of approximately \$3 million, the recovery of \$830 thousand on our Non-Agency MBS and a decrease in accrued interest payable of approximately \$1.1 million;

Net cash used in investing activities for the three months ended September 30, 2011 was approximately \$240.8 million which consisted of purchases of Agency MBS of approximately \$930.1 million, partially offset by \$688.5 million from principal payments on Agency MBS and payments on Non-Agency MBS of approximately \$830 thousand; and

Net cash provided by financing activities for the three months ended September 30, 2011 was approximately \$177.2 million. This consisted of borrowings on repurchase agreements of approximately \$8.66 billion, partially offset by repayments on repurchase agreements of approximately \$8.47 billion. This also included net proceeds from common stock issued of approximately \$20.3 million and net proceeds from Series B Preferred Stock issued of \$1 million less dividends paid of \$32.7 million on common stock and dividends paid of approximately \$1.5 million on preferred stock.

Relative to our Agency MBS portfolio at September 30, 2011, all of our repurchase agreements were fixed-rate term repurchase agreements with original maturities ranging from 18 days to three months. At September 30, 2011, we had borrowed funds under repurchase agreements with 20 different financial institutions. As the repurchase agreements mature, we enter into new repurchase agreements to take their place. Because we borrow money based on the fair value of our MBS and because increases in short-term interest rates or increasing market concern about the liquidity or value of our MBS can negatively impact the valuation of MBS, our borrowing ability could be reduced and lenders may initiate margin calls in the event short-term interest rates increase or the value of our MBS declines for other reasons. We had adequate cash flow, liquid assets and unpledged collateral with which to meet our margin requirements during the three months ended September 30, 2011, but there can be no assurance we will have adequate cash flow, liquid assets and unpledged collateral with which to meet our margin requirements in the future.

Our leverage on capital (including all preferred stock and junior subordinated notes) increased from 6.8x at December 31, 2010 to 7.18x at September 30, 2011.

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

Table of Contents

During the three months ended September 30, 2011, we raised approximately \$14.9 million in capital under our Dividend Reinvestment and Stock Purchase Plan.

During the three months ended September 30, 2011, we issued 129,400 shares of common stock under our amended 2008 Sales Agreement with Cantor (as described in Note 9 to the accompanying unaudited consolidated financial statements) at a price of \$7.65 per share, which provided net proceeds to us of approximately \$970 thousand, net of sales commissions and less reimbursement of fees. Cantor, as the sales agent, received an aggregate commission of approximately \$19.8 thousand, which represents an average commission of approximately 2.0% on the gross sales price per share. This transaction used the remaining number of common shares available under the amended 2008 Sales Agreement, at which point it expired. All future sales of our common stock, Series A Preferred Stock and Series B Preferred Stock will be issued under the 2011 Sales Agreement. During the three months ended September 30, 2011, we issued an aggregate of 590,600 shares of common stock under our 2011 Sales Agreement with Cantor (as described in Note 9 to the accompanying unaudited consolidated financial statements) at a weighted average price of \$7.61 per share, which provided net proceeds to us of approximately \$4.4 million, net of sales commissions and less reimbursement of fees. Cantor, as the sales agent, received an aggregate commission of approximately \$89.9 thousand, which represents an average commission of approximately 2.0% on the gross sales price per share. During the three months ended September 30, 2011, we issued 40,000 shares of Series B Preferred Stock at a price of \$26.23 per share under our 2011 Sales Agreement, which provided net proceeds to us of approximately \$1.04 million, net of sales commissions and less reimbursement of fees. Cantor, as the sales agent, received an aggregate commission of approximately \$10.5 thousand, which represents an average commission of approximately 1.0% on the gross sales price per share. During the three months ended September 30, 2011, we did not issue any shares of Series A Preferred Stock under the 2011 Sales Agreement. At September 30, 2011, there were 19,409,400 shares of common stock, 1,000,000 shares of Series A Preferred Stock and 960,000 shares of Series B Preferred Stock, respectively, available for future issuance under the 2011 Sales Agreement.

Disclosure of Contractual Obligations

There were no material changes outside the normal course of business during the three months ended September 30, 2011 to the contractual obligations identified in our Form 10-K for the fiscal year ended December 31, 2010.

Stockholders Equity

We use available-for-sale treatment for our Agency MBS and Non-Agency MBS, which are carried on our consolidated balance sheets at fair value rather than historical cost. Based upon this treatment, our total equity base at September 30, 2011 was \$970.2 million. Common stockholders equity was approximately \$921.7 million or a book value of \$6.93 per share.

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

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

Unrealized changes in the fair value of MBS have one significant and direct effect on our potential earnings and dividends: positive mark-to-market changes will increase our equity base and allow us to increase our borrowing capacity, while negative changes will tend to reduce borrowing capacity under our capital investment policy. A very large negative change in the net market value of our MBS might reduce our liquidity, requiring us to sell assets with the likely result of realized losses upon sale. Accumulative other comprehensive income, unrealized gain on available-for-sale Agency MBS was approximately \$150.3 million or 1.76% of the amortized cost of our Agency MBS at September 30, 2011. This, along with Accumulative other comprehensive loss, derivatives of approximately \$108.3 million and Accumulated other comprehensive gain, Non-Agency MBS of \$2.2 million, constitutes the total Accumulative other comprehensive income of approximately \$44.1 million.

Critical Accounting Policies

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

Table of Contents

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

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

Revenue Recognition

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

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

Valuation and Classification of Investment Securities

We carry our investment securities on our balance sheet at fair value. The fair values of our Agency MBS are generally based on third party bid price indications provided by certain dealers who make markets in such securities. The fair value of our Non-Agency MBS are obtained from an independent third party pricing service whose methodologies are based on broker-provided pricing as well as indirect observation of market activity. If, in the opinion of management, one or more securities prices reported to us are not reliable or unavailable, management reviews the fair value based on characteristics of the security it receives from the issuer and available market information. The fair values reported reflect estimates and may not necessarily be indicative of the amounts we could realize in a current market exchange. We review various factors (i.e., expected cash flows, changes in interest rates, credit protection, etc.) in determining whether and to what extent an other-than-temporary impairment exists. To the extent that unrealized losses on our Agency MBS and Non-Agency MBS are attributable to changes in interest rates and not credit quality, and because we do not have the intent to sell these investments nor is it not more likely than not that we will be required to sell these investments before recovery of their amortized cost bases, which may be at maturity, we do not consider these investments to be other-than-temporarily impaired. Losses (that are related to credit quality) on securities classified as available-for-sale, which are determined by management to be other-than-temporary in nature, are reclassified from Accumulated other comprehensive income (loss) to current-period income (loss). For more detail on the fair value of our securities, see Note 6 to the accompanying unaudited consolidated financial statements.

Accounting for Derivatives and Hedging Activities

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

On the date we enter into a derivative contract, we designate the derivative as a hedge of the variability of cash flows that are to be received or paid in connection with a recognized asset or liability (a cash flow hedge). Changes in the fair value of a derivative that are highly effective and that are designated and qualify as a cash flow hedge, to the extent that the hedge is effective, are recorded in Other comprehensive income and reclassified to income when the forecasted transaction affects income (e.g., when periodic settlement interest payments are due on repurchase agreements). The swap agreements are carried on our consolidated balance sheets at their fair value based on values obtained from large financial institutions, who are market makers for these types of instruments. Hedge ineffectiveness, if any, is recorded in current-period income.

We formally assess, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions have been highly effective in offsetting changes in the cash flows of hedged items and whether those derivatives may be expected to remain highly effective in future periods. If it is determined that a derivative is not (or has ceased to be) highly effective as a hedge, we discontinue hedge

accounting.

Table of Contents

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

For purposes of the cash flow statement, cash flows from derivative instruments are classified with the cash flows from the hedged item. For more detail on our derivative instruments, see Notes 1, 6 and 12 to the accompanying unaudited consolidated financial statements.

Income Taxes

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

Recent Accounting Pronouncements

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

Subsequent Events

When we pay any cash dividend during any quarterly fiscal period to all or substantially all of our common stockholders in an amount that results in an annualized common stock dividend yield that is greater than 6.25% (the dividend yield on our Series B Preferred Stock), the conversion rate on our Series B Preferred Stock is adjusted based on a formula specified in the Articles Supplementary Establishing and Fixing the Rights and Preferences of the Series B Preferred Stock. This conversion rate increased on October 14, 2011 from 3.5374 shares of our common stock to 3.6075 shares of our common stock using the following information: (1) the average of the closing price of our common stock for the ten (10) consecutive trading day period was \$6.69 and (2) the annualized common stock dividend yield was 13.7560%.

From October 1, 2011 through November 1, 2011, there were two transactions to convert an aggregate of 39,494 shares of Series B Preferred Stock into an aggregate of 139,705 shares of our common stock (at the then-current conversion rate of 3.5374).

On October 3, 2011, we announced that our board of directors had authorized a share repurchase program, permitting us to acquire up to 2,000,000 shares of our common stock. The shares are expected to be acquired at prevailing prices through open market transactions. The manner, price, number and timing of share repurchases will be subject to market conditions and applicable SEC rules. From October 3, 2011 through November 1, 2011, we had repurchased an aggregate of 357,085 shares at a weighted average price of \$6.40 per share under this program.

The Management Agreement (as described in Note 10 to the accompanying unaudited consolidated financial statements) will become effective on December 31, 2011, after which the Company will be an externally-managed REIT.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

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

Interest Rate Risk

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

Table of Contents

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

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

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

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

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

At September 30, 2011, our Agency MBS and Non-Agency MBS and the related borrowings will prospectively reprice based on the following time frames (dollar amounts in thousands):

	Investments(1)(2)		Borrowings	
	Amount	Percentage of Total Investments	Amount	Percentage of Total Borrowings
Investment Type/Rate Reset Dates:				
15-year fixed-rate investments	\$ 1,213,154	13.9%	\$ 0	0.0%
30-year fixed-rate investments	546,841	6.3	0	0.0
Adjustable-Rate Investments/Obligations:				
3 months or less	508,053	5.8	7,435,000	100.0
Greater than 3 months and less than 1 year	1,471,749	16.8	0	0.0
Greater than 1 year and less than 2 years	585,153	6.7	0	0.0
Greater than 2 years and less than 3 years	11,581	0.1	0	0.0
Greater than 3 years and less than 5 years	4,409,062	50.4	0	0.0
Total:	\$ 8,745,593	100.0%	\$ 7,435,000	100.0 %

(1) Based on when they contractually reprice and does not consider the effect of any prepayments.

(2) We assume that if the repricing of the investment is beyond 3 months but less than 4 months, it is included in the 3 months or less category.

Table of Contents

At December 31, 2010, our Agency MBS and Non-Agency MBS and the related borrowings will prospectively reprice based on the following time frames (dollar amounts in thousands):

	Investments(1)(2)		Borrowings	
	Amount	Percentage of Total Investments	Amount	Percentage of Total Borrowings
Investment Type/Rate Reset Dates:				
15-year fixed-rate investments	\$ 795,687	10.3%	\$ 0	0.0%
30-year fixed-rate investments	651,090	8.4	0	0.0
Adjustable-Rate Investments/Obligations:				
3 months or less	441,146	5.7	6,375,000	100.0
Greater than 3 months and less than 1 year	1,278,847	16.5	0	0.0
Greater than 1 year and less than 2 years	880,765	11.4	0	0.0
Greater than 2 years and less than 3 years	503,878	6.5	0	0.0
Greater than 3 years and less than 5 years	3,187,639	41.2	0	0.0
Total:	\$ 7,739,052	100.0%	\$ 6,375,000	100.0%

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

Market Value Risk

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

Liquidity Risk

Our primary liquidity risk arises from financing long-maturity MBS with short-term debt. The interest rates on our borrowings generally adjust more frequently than the interest rates on our adjustable-rate MBS. For example, at September 30, 2011, our Agency MBS and Non-Agency adjustable-rate MBS had a weighted average term to next rate adjustment of approximately 34 months while our borrowings had a weighted average term to next rate adjustment of 38 days. After adjusting for interest rate swap transactions, the weighted average term to next rate adjustment was 452 days. Accordingly, in a period of rising interest rates, our borrowing costs will usually increase faster than our interest earnings from MBS. As a result, we could experience a decrease in net income or a net loss during these periods. Our assets that are pledged to secure short-term borrowings are high-quality liquid assets. As a result, we have been able to roll over our short-term borrowings as they mature. There can be no assurance that we will always be able to roll over our short-term debt.

During the past year, there were continuing liquidity and credit concerns surrounding the mortgage markets and the general global economy. While the U.S. government and other foreign governments have taken various actions to address these concerns, there are also concerns about the ability of the U.S. government to meet the obligations of the August 2011 debt ceiling agreement and to reduce its budget deficit and about possible future rating downgrades of U.S. sovereign debt and government-sponsored agency debt. As a result, there continues to be concerns about the potential impact on product availability, liquidity, interest rates and changes in the yield curve. While we have been able to meet all of our liquidity needs to date, there are still concerns in the mortgage sector about the availability of financing generally.

At September 30, 2011, we had unrestricted cash of \$3.3 million and \$803 million in unpledged Agency MBS and Non-Agency MBS available to meet margin calls on short-term borrowings that could be caused by asset value declines or changes in lender collateralization requirements.

Prepayment Risk

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Prepayments are the full or partial repayment of principal prior to the original term to maturity of a mortgage loan and typically occur due to refinancing of mortgage loans. Prepayment rates on mortgage-related securities and mortgage loans vary from time to time and may cause changes in the amount of our net interest income. Prepayments of ARM loans usually can be expected to increase when mortgage interest rates fall below the then-current interest rates on such loans and decrease when mortgage interest rates exceed the then-current interest rate on such loans, although such effects are not entirely predictable. Prepayment rates may also be affected by the conditions in the housing and financial markets, general economic conditions and

Table of Contents

the relative interest rates on fixed-rate loans and ARM loans underlying MBS. The purchase prices of MBS are generally based upon assumptions regarding the expected amounts and rates of prepayments. Where slow prepayment assumptions are made, we may pay a premium for MBS. To the extent such assumptions differ from the actual amounts of prepayments, we could experience reduced earnings or losses. The total prepayment of any MBS purchased at a premium by us would result in the immediate write-off of any remaining capitalized premium amount and a reduction of our net interest income by such amount. In addition, in the event that we are unable to acquire new MBS to replace the prepaid MBS, our financial condition, cash flows and results of operations could be harmed.

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

General

Many assumptions are made to present the information in the tables below and, as such, there can be no assurance that assumed events will occur, or that other events will not occur, that would affect the outcomes; therefore, the tables below and all related disclosures constitute forward-looking statements. The analyses presented utilize assumptions and estimates based on management's judgment and experience. Furthermore, future sales, acquisitions and restructuring could materially change the interest rate risk profile for us. The tables quantify the potential changes in net income and net asset value should interest rates immediately change (are shocked). The results of interest rate shocks of plus and minus 100 and 200 basis points are presented. The cash flows associated with the portfolio of mortgage-related assets for each shock rate are calculated based on a variety of assumptions including prepayment speeds, time until coupon reset, yield on future acquisitions, slope of the yield curve and size of the portfolio. Assumptions made on the interest rate-sensitive liabilities, which are repurchase agreements, include anticipated interest rates (no negative rates are utilized), collateral requirements as a percent of the repurchase agreement and amount of borrowing. Assumptions made in calculating the impact on net asset value of interest rate shocks include interest rates, prepayment rates and the yield spread of mortgage-related assets relative to prevailing interest rates.

Tabular Presentation

The information presented in the tables below projects the impact of sudden changes in interest rates on Anworth's annual Projected Net Interest Income and Projected Portfolio Value, as more fully discussed below, based on our investments in place at September 30, 2011 and includes all of our interest rate-sensitive assets, liabilities and hedges, such as interest rate swap agreements.

Changes in Projected Net Interest Income equals the change that would occur in the calculated Projected Net Interest Income for the next twelve months relative to the 0% change scenario if interest rates were to instantaneously parallel shift to and remain at the stated level for the next twelve months.

Changes in Projected Portfolio Value equals the change in the value of our assets that we carry at fair value and any change in the value of any derivative instruments or hedges, such as interest rate swap agreements. We acquire interest rate-sensitive assets and fund them with interest rate-sensitive liabilities. We generally plan to retain such assets and the associated interest rate risk to maturity.

Change in Interest Rates	Percentage Change in Projected Net Interest Income	Percentage Change in Projected Portfolio Value
2%	126%	2.5%
1%	78%	0.9%
0%	0%	0%
1%	7%	1.0%
2%	24%	3.3%

When interest rates are shocked, prepayment assumptions are adjusted based on management's best estimate of the effects of changes in interest rates on prepayment speeds. For example, under current market conditions, a 100 basis point instantaneous decline in interest rates from the 0% change scenario is estimated to result in an approximate 52% increase in the prepayment rate of our Agency MBS and Non-Agency MBS portfolios. The base interest rate scenario assumes interest rates at September 30, 2011. Actual results could differ significantly from those estimated in the tables. The above table includes the effect of interest rate swap agreements. At September 30, 2011, the aggregate notional amount of the interest rate swap agreements was \$2.93 billion and the weighted average maturity was 3.0 years.

Table of Contents

The information presented in the table below projects the impact of sudden changes in interest rates on Anworth's annual Projected Net Income and Projected Portfolio Value compared to the base case used in the table above and excludes the effect of the interest rate swap agreements.

Change in Interest Rates	Percentage Change in Projected Net Interest Income	Percentage Change in Projected Portfolio Value
2%	36%	0.4%
1%	12%	0.1%
0%	0%	0%
1%	50%	2.1%
2%	16%	5.4%

Item 4. Controls and Procedures***Disclosure Controls and Procedures***

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

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

Changes in Internal Control Over Financial Reporting

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

Table of Contents

PART II. OTHER INFORMATION

Item 1. Legal Proceedings.

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

Item 1A. Risk Factors.

The following are additional risk factors and changes to the risk factors as previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2010 as modified and supplemented by the risk factors disclosed in our Quarterly Reports on Form 10-Q for the quarterly periods ended March 31, 2011 and June 30, 2011. The materialization of any risks and uncertainties identified below and in our Forward Looking Statements contained in this report together with those previously disclosed in the Form 10-K and our Quarterly Reports on Form 10-Q for the quarterly periods ended March 31, 2011 and June 30, 2011, or those that are presently unforeseen, could result in material and adverse effects on our financial condition, results of operations and cash flows. See Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations - Forward Looking Statements in this Quarterly Report on Form 10-Q.

A failure by the U.S. government to meet the conditions of the August 2011 debt ceiling agreement or to reduce its budget deficit or a further downgrade of U.S. sovereign debt and government-sponsored agency debt could have a material adverse impact on our borrowings and the valuations of our securities and may have a material adverse impact on our financial condition and results of operations.

As widely reported, there continues to be concerns over the ability of the U.S. government to reduce its budget deficit and resolve its debt crisis. The U.S. sovereign debt and government-sponsored agency debt were downgraded from AAA to AA+ in August 2011 and continues to be on review for a downgrade of their respective credit ratings to account for the risk that U.S. lawmakers fail to meet the conditions of the August 2011 debt ceiling agreement and/or reduce its overall debt. Such failures could have a material adverse effect both on the U.S. economy and on the global economy. In particular, this could cause disruption in the capital markets and impact the stability of future U.S. treasury auctions and the trading market for U.S. government securities, resulting in increased interest rates and impaired access to credit. These factors could negatively impact our borrowing costs, our liquidity and the valuation of the securities we currently own in our portfolio, which could have a material adverse impact on our financial condition and our results of operations.

Certain actions taken or that may be taken in the future by the U.S. government to address the financial crisis could negatively affect the availability of financing, the quantity and quality of available products, cause changes in interest rates and the yield curve, any and each of which could materially adversely affect our business, results of operations and financial condition.

The U.S. government, including the Board of Governors of the Federal Reserve System, the Department of Treasury and other governmental and regulatory bodies have taken and are considering taking actions to address the financial crisis. Recently, the Federal Reserve announced that it planned to purchase \$600 billion of U.S. Treasury securities during 2011. In addition, it also announced that it will be reinvesting an additional \$250 billion to \$300 billion from the proceeds of its mortgage portfolio in U.S. Treasury securities over the same time period. In September 2011, the Open Market Committee of the Federal Reserve announced the launching of Operation Twist, in which the Federal Reserve would be buying approximately \$400 billion of longer-term treasury securities financed by the sale of an equal amount of the Federal Reserve's shorter-term treasury securities. These acquisitions are to occur through June 2012. We cannot predict whether or when such other actions may occur or what impact, if any, such actions could have on our business, results of operations and financial condition. While such programs are intended to spur economic activity, there are no assurances that this will occur. In fact, these actions could negatively affect the availability of financing, the quantity and quality of available products, cause changes in interest rates and the yield curve, any and each of which could materially adversely affect our business, results of operations and financial condition, as well as those of the entire mortgage sector in general.

We are subject to the risk that the global credit crisis, despite efforts by global governments to halt that crisis, may affect interest rates and the availability of financing in general, which could adversely affect our financing and our operating results.

During the past several years, several large European banks experienced financial difficulty and were either rescued by government assistance or by other large European banks. Several European governments have coordinated plans to attempt to shore up their financial sectors through loans, credit guarantees, capital infusions, promises of continued liquidity funding and interest rate cuts. Additionally, other governments of the world's largest economic countries also implemented interest rate cuts.

Table of Contents

There is no assurance that these and other plans and programs will be successful in halting the global credit crisis or in preventing other banks from failing. If unsuccessful, this could adversely affect our financing and operations as well as those of the entire mortgage sector in general.

As the European credit crisis continues, with the bailout of Greece, and problems in other countries such as Italy and Spain, there is a growing risk to the financial condition and stability of major European banks. Many of these banks have U.S. banking subsidiaries, which have provided financing to us, particularly repurchase agreement financing for the acquisition of various investments, including MBS investments. Recently, the U.S. government placed many of the U.S. banking subsidiaries of these major European banks on credit watch. If the European credit crisis continues to impact these major European banks, there is the possibility that it will also impact the operations of their U.S. banking subsidiaries. This could adversely affect our financing and operations as well as those of the entire mortgage sector in general.

Failure to maintain an exemption from the Investment Company Act would harm our results of operations.

We believe that we conduct our business in a manner that results in our not being regulated as an investment company under the Investment Company Act of 1940, as amended, or the Investment Company Act. If we fail to continue to qualify for an exemption from registration as an investment company, our ability to use leverage would be substantially reduced and we would be unable to conduct our business as we presently do. The Investment Company Act has an exemption for entities that are primarily engaged in the business of purchasing or otherwise acquiring mortgages and other liens on and interests in real estate. Under the SEC's current interpretation, we qualify for this exemption if we maintain at least 55% of our assets directly in qualifying real estate interests. In meeting the 55% requirement under the Investment Company Act, we treat MBS issued with respect to an underlying pool for which we hold all issued certificates as qualifying interests. If the SEC or its staff adopts a contrary interpretation, we could be required to sell a substantial amount of our MBS under potentially adverse market conditions. Further, in order to maintain our exemption from registration as an investment company by acquiring mortgages and other liens on and interests in real estate, we may be precluded from acquiring MBS whose yield is somewhat higher than the yield on mortgages and other liens on and interests in real estate that could be purchased in a manner consistent with the exemption.

On August 31, 2011, the SEC issued a release soliciting comments on the mortgage REIT exemption under the Investment Company Act. The SEC indicated in its release that it is concerned that some mortgage companies may be subject to the kinds of abuses that the Investment Company Act was intended to address, such as misvaluations of a company's investment portfolio and excessive leveraging. The release asks for comments on whether the exclusion should be narrowed or changed in such a way that these potential abuses can be curtailed. The SEC also asks whether there are existing safeguards in the structure and operations of REITs and other mortgage companies that would address these or similar concerns. The SEC has requested comments on or before November 7, 2011. Although we believe that we have conducted our operations in a manner that would not be of the types of concerns addressed in the SEC's release, we could be subject to any rules or regulations that the SEC could propose in changing or narrowing the current exclusion that mortgage REITs rely on to maintain an exemption from the Investment Company Act. If the SEC or its staff changes or narrows this exemption, we could be required to sell a substantial amount of our MBS under potentially adverse market conditions. Although, at the present time, it is unknown whether the SEC or its staff will make any changes to this exclusion or the nature of any such changes, it is possible that any such changes could impact our leverage, our liquidity, the size of our investment portfolio, our ability to use interest rate swap agreements, our ability to borrow, and could have a material adverse effect on our business and results of operations.

The following additional risk factors have been added since the filing of our 2010 Annual Report on Form 10-K:

We presently are not, nor do we intend to be, regulated as an investment company. Fluctuations in our net income and in our book value will likely be greater than those of investment companies. This may affect investors or potential investors as to the appropriateness of our stock as compared to that of an investment company.

While presently our assets are similar to those owned by some investment companies, we are not regulated as an investment company. Regulation as an investment company entails all investment companies maintaining significantly lower levels of financial leverage than we have employed since our organization in 1998. Because of the differences in our leverage from that of investment companies, this results in the fluctuation in net income and in book value by us to likely be greater than that experienced by investment companies. Therefore, investors and potential investors in our company should, on an ongoing basis, carefully determine if this greater level of income fluctuation and book value fluctuation is appropriate for them as compared to whether the less volatile results of investment companies are more appropriate for them.

Table of Contents

Risks Related to the Management Agreement and the Concurrent Externalization

The Management Agreement was not negotiated on an arm's-length basis and the terms, including fees payable, may not be as favorable to us as if it were negotiated with an unaffiliated third party

The Management Agreement was negotiated between related parties, and we did not have the benefit of arm's-length negotiations of the type normally conducted with an unaffiliated third party. The terms of the Management Agreement, including fees payable, may not reflect the terms we may have received if it was negotiated with an unrelated third party. In addition, as a result of this relationship, we may choose not to enforce, or to enforce less vigorously, our rights under the Management Agreement because of our desire to maintain our ongoing relationship with our Manager.

We will have no employees and the Manager will be responsible for making all of our investment decisions. Certain of our current employees who will become the Manager's employees are not required to devote any specific amount of time to our business, which could result in conflicts of interest.

Upon the effectiveness of the Management Agreement and the concurrent externalization as of December 31, 2011, we will have no employees, and the Manager will be responsible for making all of our investments. Certain of our current employees who will become the Manager's employees are employees of PIA or its affiliates and these persons do not devote their time exclusively to us. The Manager's executive officers are officers of PIA and have significant responsibilities to PIA. Because certain of our and our Manager's employees are also responsible for providing services to PIA, they may not devote sufficient time to the management of our business operations.

We will be completely dependent upon the Manager who will provide services to us through the Management Agreement and we may not find suitable replacements for our Manager if the Management Agreement is terminated or such key personnel are no longer available to us.

Upon the effectiveness of the Management Agreement and the concurrent externalization as of December 31, 2011, because we will have no employees, we will be completely dependent on the Manager to conduct our operations pursuant to the Management Agreement. Our Manager has its own employees, which conduct its day-to-day operations. The Management Agreement does not require the Manager to dedicate specific personnel to our operations.

If we terminate the Management Agreement without cause, we may not, without the consent of the Manager, employ any employee of the Manager or any of its affiliates, or any person who has been employed by our Manager or any of its affiliates at any time within the two year period immediately preceding the date on which the person commences employment with us for two years after such termination of the Management Agreement. We will not have retention agreements with any of our officers. We believe that the successful implementation of our investment and financing strategies will depend upon the experience of certain of the Manager's officers and employees. None of these individuals' continued service is guaranteed. If the Management Agreement is terminated or these individuals leave the Manager, the Manager may be unable to replace them with persons with appropriate experience, or at all, and we may not be able to execute our business plan.

If we elect to not renew the Management Agreement without cause, we would be required to pay the Manager a substantial termination fee. These and other provisions in the Management Agreement make non-renewal of the Management Agreement difficult and costly.

Electing not to renew the Management Agreement without cause would be difficult and costly for us. With the consent of the majority of our independent directors, we may elect not to renew our Management Agreement after the initial term of the Management Agreement, which would expire on December 31, 2013, or upon the expiration of any automatic renewal term, both upon 180-days prior written notice. In addition, if we elect to not renew the agreement because of a decision by our board that the management fee is unfair, the Manager has the right to renegotiate a mutually agreeable management fee. If we elect to not renew the Management Agreement without cause, we are required to pay the Manager a termination fee equal to three times the average annual management fee earned by the Manager during the prior 24-month period immediately preceding the most recently completed month prior to the effective date of termination. These provisions may increase the effective cost to us of electing to not renew the Management Agreement.

The management fee is payable regardless of our performance.

The Manager would be entitled to receive a management fee from us that is based on the amount of our Equity (as defined in our Management Agreement), regardless of the performance of our investment portfolio. For example, we would pay our Manager a management fee for a specific period even if we experienced a net loss during the same period. The Manager's entitlement to substantial nonperformance-based compensation may reduce its incentive to devote sufficient time and effort to seeking investments that provide attractive risk-adjusted returns for our investment portfolio. This in turn could harm our ability to make distributions to our stockholders and the market price of our common

stock.

Table of Contents

The fee structure of the Management Agreement may limit the Manager's ability to retain access to its key personnel.

Under the terms of the Management Agreement, we would be required to pay the Manager a base management fee payable monthly in arrears in amount equal to one twelfth of 1.20% of our Equity. Our Equity is defined as our month-end stockholders' equity, adjusted to exclude the effect of any unrealized gains or losses included in either retained earnings or [other comprehensive income], each as computed in accordance with GAAP. The Management Agreement does not provide the Manager with an incentive management fee that would pay the Manager additional compensation as a result of meeting performance targets. Some of our externally-managed competitors pay their managers an incentive management fee, which could enable the manager to provide additional compensation to its key personnel. Thus, the lack of an incentive fee in the Management Agreement may limit the ability of the Manager to provide key personnel, with additional compensation for strong performance, which could adversely affect the Manager's ability to retain these key personnel. If the Manager were not able to retain any of the key personnel that will be providing services to the Manager, it would have to find replacement personnel to provide those services. Those replacement key personnel may not be able to produce the same operating results as the current key personnel.

Some investors may not view our external management in a positive light, which may affect the market price of our common stock and may make it more difficult for future offerings of our stock.

Although there are currently other mortgage REITs that are externally-managed, there may be times in the future when some investors may have a preference for internally-managed companies. There may also be times, if there are low returns from our portfolio, when our external management is not viewed in a positive light. In either of these cases, there may be a negative effect on the market price of our common stock and this may make it difficult for future offerings of our common stock.

Potential conflicts of interest could arise if the Manager were to take greater risk to increase our equity in order to earn a greater management fee.

The Management Agreement does not contain an incentive fee. The Manager is paid a base management fee payable monthly in arrears in an amount equal to one twelfth of 1.20% of our Equity, as defined in the Management Agreement. As the Management Agreement does not contain an incentive fee, the Manager may take greater risk in our investment portfolio to increase our equity in order to earn a greater management fee.

The Manager's liability is limited under the Management Agreement, and we have agreed to indemnify the Manager against certain liabilities.

Pursuant to the Management Agreement, the Manager does not assume any responsibility other than to render the services called for thereunder and is not responsible for any action of our board of directors in following or declining to follow any advice or recommendation of the Manager. The Manager and its affiliates, and the directors, officers, employees and stockholders of the Manager and its affiliates, are not liable to us, any subsidiary of ours, our board of directors or our stockholders for any acts or omissions by the Manager, its officers, employees or its affiliates, performed in accordance with and pursuant to the Management Agreement, except by reason of acts constituting bad faith, willful misconduct, gross negligence or reckless disregard of their respective duties under this the Management Agreement. We have agreed to indemnify the Manager and its affiliates, its directors, officers, employees and stockholders of the Manager and its affiliates of and from any and all expenses, losses, damages, liabilities, demands, charges and claims of any nature whatsoever (including reasonable attorneys' fees) in respect of or arising from any acts or omissions of such party, not constituting bad faith, willful misconduct, gross negligence or reckless disregard of duties of such party under the Management Agreement.

The Manager has limited resources and may not be able to defend itself in litigation.

The only fee that the Manager will receive from us will be the base management fee, as previously described. It is anticipated that most, if not all, of this fee will be used by the Manager for compensation to its employees and to pay for its other administrative expenses. The Manager has limited resources. If the Manager were to be involved in litigation not related to our operations, it may not be able to defend itself and it may be forced to declare bankruptcy or go out of business and we would have to find another Manager. This could have a material adverse impact on our business and our operations.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

None.

Table of Contents

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Reserved.

Item 5. Other Information.

(a) Additional Disclosures. None.

(b) Stockholder Nominations. There have been no material changes to the procedures by which stockholders may recommend nominees to our board of directors during the quarter ended September 30, 2011. Please see the discussion of our procedures in our most recent proxy statement filed with the SEC on March 31, 2011 on Form DEF 14A.

Item 6. Exhibits.

The following exhibits are either filed herewith or incorporated herein by reference:

Exhibit

Number	Description
1.1	Controlled Equity Offering Sales Agreement dated May 14, 2008 between Anworth Mortgage Asset Corporation and Cantor Fitzgerald & Co. (incorporated by reference from our Current Report on Form 8-K filed with the SEC on May 15, 2008)
1.2	Amendment No. 1 to Sales Agreement dated February 8, 2011 between Anworth Mortgage Asset Corporation and Cantor Fitzgerald & Co. (incorporated by reference from our Current Report on Form 8-K filed with the SEC on February 8, 2011)
1.3	Controlled Equity Offering Sales Agreement dated May 27, 2011 between Anworth Mortgage Asset Corporation and Cantor Fitzgerald & Co. (incorporated by reference from our Current Report on Form 8-K filed with the SEC on May 27, 2011)
3.1	Amended Articles of Incorporation of Anworth (incorporated by reference from our Registration Statement on Form S-11, Registration No. 333-38641, which became effective under the Securities Act of 1933 on March 12, 1998)
3.2	Amended Bylaws of the Company (incorporated by reference from our Current Report on Form 8-K filed with the SEC on March 13, 2009)
3.3	Articles of Amendment to Amended Articles of Incorporation (incorporated by reference from our Definitive Proxy Statement filed pursuant to Section 14(a) of the Securities Exchange Act of 1934, as filed with the SEC on May 14, 2003)
3.4	Articles Supplementary for Series A Cumulative Preferred Stock (incorporated by reference from our Current Report on Form 8-K filed with the SEC on November 3, 2004)
3.5	Articles Supplementary for Series A Cumulative Preferred Stock (incorporated by reference from our Current Report on Form 8-K filed with the SEC on January 21, 2005)
3.6	Articles Supplementary for Series B Cumulative Convertible Preferred Stock (incorporated by reference from our Current Report on Form 8-K filed with the SEC on January 30, 2007)
3.7	Articles Supplementary for Series B Cumulative Convertible Preferred Stock (incorporated by reference from our Current Report on Form 8-K filed with the SEC on May 21, 2007)
3.8	Articles of Amendment to Amended Articles of Incorporation (incorporated by reference from our Current Report on Form 8-K filed with the SEC on May 28, 2008)

Table of Contents

Exhibit

Number	Description
4.1	Specimen Common Stock Certificate (incorporated by reference from our Registration Statement on Form S-11, Registration No. 333-38641, which became effective under the Securities Act of 1933 on March 12, 1998)
4.2	Specimen Series A Cumulative Preferred Stock Certificate (incorporated by reference from our Current Report on Form 8-K filed with the SEC on November 3, 2004)
4.3	Specimen Series B Cumulative Convertible Preferred Stock Certificate (incorporated by reference from our Current Report on Form 8-K filed with the SEC on January 30, 2007)
4.4	Specimen Anworth Capital Trust I Floating Rate Preferred Stock Certificate (liquidation amount \$1,000 per Preferred Security) (incorporated by reference from our Current Report on Form 8-K filed with the SEC on March 16, 2005)
4.5	Specimen Anworth Capital Trust I Floating Rate Common Stock Certificate (liquidation amount \$1,000 per Common Security) (incorporated by reference from our Current Report on Form 8-K filed with the SEC on March 16, 2005)
4.6	Specimen Anworth Floating Rate Junior Subordinated Note Due 2035 (incorporated by reference from our Current Report on Form 8-K filed with the SEC on March 16, 2005)
4.7	Junior Subordinated Indenture dated as of March 15, 2005, between Anworth and JPMorgan Chase Bank (incorporated by reference from our Current Report on Form 8-K filed with the SEC on March 16, 2005)
10.1*	2002 Incentive Compensation Plan (incorporated by reference from our Definitive Proxy Statement filed pursuant to Section 14(a) of the Securities Exchange Act of 1934, as filed with the SEC on May 17, 2002), as amended by Amendment No. 1 to 2002 Incentive Compensation Plan (incorporated by reference from our Current Report on Form 8-K filed with the SEC on October 15, 2009)
10.2*	2004 Equity Compensation Plan (incorporated by reference from our Definitive Proxy Statement filed pursuant to Section 14(a) of the Securities Exchange Act of 1934, as filed with the SEC on April 26, 2004)
10.3*	2007 Dividend Equivalent Rights Plan (incorporated by reference from our Definitive Proxy Statement filed pursuant to Section 14(a) of the Securities Exchange Act of 1934, as filed with the SEC on April 26, 2007)
10.4	2009 Dividend Reinvestment and Stock Purchase Plan (incorporated by reference from our Registration Statement on Form S-3ASR, Registration No. 333-164047, which became effective under the Act on December 28, 2009)
10.5*	Employment Agreement dated January 1, 2002, between the Manager and Lloyd McAdams (incorporated by reference from our Quarterly Report on Form 10-Q for the quarter ended June 30, 2002, as filed with the SEC on August 14, 2002) as amended by Addenda dated April 18, 2002 (incorporated by reference from our Quarterly Report on Form 10-Q for the quarter ended June 30, 2002, as filed with the SEC on August 14, 2002), May 28, 2004 (incorporated by reference from our Quarterly Report on Form 10-Q for the quarter ended June 30, 2004, as filed with the SEC on August 9, 2004), June 27, 2006 (incorporated by reference from our Current Report on Form 8-K filed with the SEC on June 28, 2006), February 22, 2008 (incorporated by reference from our Current Report on Form 8-K filed with the SEC on February 27, 2008), December 30, 2008 (incorporated by reference from our Current Report on Form 8-K filed with the SEC on January 2, 2009) and October 14, 2009 (incorporated by reference from our Current Report on Form 8-K, filed with the SEC on October 15, 2009).
10.6*	Employment Agreement dated January 1, 2002, between the Manager and Heather U. Baines (incorporated by reference from our Quarterly Report on Form 10-Q for the quarter ended June 30, 2002, as filed with the SEC on August 14, 2002) as amended by Addenda dated April 18, 2002 (incorporated by reference from our Quarterly Report on Form 10-Q for the quarter ended June 30, 2002, as filed with the SEC on August 14, 2002), June 27, 2006 (incorporated by reference from our Current Report on Form 8-K filed with the SEC on June 28, 2006) and February 13, 2008 (incorporated by reference from our Current Report on Form 8-K filed with the SEC on February 15, 2008) and October 14, 2009 (incorporated by reference from our Current Report on Form 8-K, filed with the SEC on October 15, 2009).

Table of Contents

Exhibit

Number	Description
10.7*	Employment Agreement dated January 1, 2002, between the Manager and Joseph E. McAdams (incorporated by reference from our Quarterly Report on Form 10-Q for the quarter ended June 30, 2002, as filed with the SEC on August 14, 2002) as amended by Addenda dated April 18, 2002 (incorporated by reference from our Quarterly Report on Form 10-Q for the quarter ended June 30, 2002, as filed with the SEC on August 14, 2002), June 13, 2002 (incorporated by reference from our Quarterly Report on Form 10-Q for the quarter ended June 30, 2002, as filed with the SEC on August 14, 2002), May 28, 2004 (incorporated by reference from our Quarterly Report on Form 10-Q for the quarter ended June 30, 2004, as filed with the SEC on August 9, 2004), June 27, 2006 (incorporated by reference from our Current Report on Form 8-K filed with the SEC on June 28, 2006), February 13, 2008 (incorporated by reference from our Current Report on Form 8-K filed with the SEC on February 15, 2008), February 22, 2008 (incorporated by reference from our Current Report on Form 8-K filed with the SEC on February 27, 2008), December 30, 2008 (incorporated by reference from our Current Report on Form 8-K filed with the SEC on January 2, 2009) and October 14, 2009 (incorporated by reference from our Current Report on Form 8-K, filed with the SEC on October 15, 2009).
10.8	Sublease dated June 13, 2002, between Anworth and PIA (incorporated by reference from our Quarterly Report on Form 10-Q for the quarter ended June 30, 2002, as filed with the SEC on August 14, 2002) as amended by Amendment to Sublease dated July 8, 2003 (incorporated by reference from our Quarterly Report on Form 10-Q for the quarter ended June 30, 2003, as filed with the SEC on August 8, 2003)
10.9*	Deferred Compensation Plan (incorporated by reference from our Annual Report on Form 10-K for the year ended December 31, 2002, as filed with the SEC on March 26, 2003)
10.10	Purchase Agreement dated as of March 15, 2005, by and among Anworth, Anworth Capital Trust I, TABERNA Preferred Funding I, Ltd., and Merrill Lynch International (incorporated by reference from our Current Report on Form 8-K filed with the SEC on March 16, 2005)
10.11	Second Amended and Restated Trust Agreement dated as of September 26, 2005 by and among Anworth, JPMorgan Chase Bank, National Association, Chase Bank USA, National Association, Lloyd McAdams, Joseph McAdams, Thad Brown and the several Holders, as defined therein. (incorporated by reference from our Annual Report on Form 10-K for the fiscal year ended December 31, 2005, as filed with the SEC on March 16, 2006)
10.12*	Change in Control and Arbitration Agreement dated June 27, 2006, between Anworth and Thad M. Brown (incorporated by reference from our Current Report on Form 8-K filed with the SEC on June 28, 2006)
10.13*	Change in Control and Arbitration Agreement dated June 27, 2006, between Anworth and Charles J. Siegel (incorporated by reference from our Current Report on Form 8-K filed with the SEC on June 28, 2006)
10.14*	Change in Control and Arbitration Agreement dated June 27, 2006, between Anworth and Evangelos Karagiannis (incorporated by reference from our Current Report on Form 8-K filed with the SEC on June 28, 2006)
10.15*	Change in Control and Arbitration Agreement dated June 27, 2006, between Anworth and Bistra Pashamova (incorporated by reference from our Current Report on Form 8-K filed with the SEC on June 28, 2006)
10.16	Amended and Restated Administrative Services Agreement dated August 20, 2010, between Anworth and PIA (incorporated by reference from our Current Report on Form 8-K filed with the SEC on August 20, 2010)
31.1	Certification of the Principal Executive Officer, as required by Rule 13a-14(a) of the Securities Exchange Act of 1934
31.2	Certification of the Principal Financial Officer, as required by Rule 13a-14(a) of the Securities Exchange Act of 1934
32.1	Certifications of the Principal Executive Officer provided pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Table of Contents

Exhibit

Number	Description
32.2	Certifications of the Principal Financial Officer provided pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101**	XBRL Instance Document
101**	XBRL Taxonomy Extension Schema Document
101**	XBRL Taxonomy Extension Calculation Linkbase Document
101**	XBRL Taxonomy Definition Linkbase Document
101**	XBRL Taxonomy Extension Labels Linkbase Document
101**	XBRL Taxonomy Extension Presentation Linkbase Document

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

** XBRL (Extensible Business Reporting Language) information is furnished and not filed or a part of a registration statement or prospectus for purposes of Section 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, and otherwise is not subject to liability under these sections.

Table of Contents

SIGNATURES

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

ANWORTH MORTGAGE ASSET CORPORATION

Dated: November 3, 2011

/s/ JOSEPH LLOYD McADAMS
Joseph Lloyd McAdams
Chairman of the Board, President and Chief Executive Officer
(Chief Executive Officer)

Dated: November 3, 2011

/s/ THAD M. BROWN
Thad M. Brown
Chief Financial Officer
(Chief Financial Officer and Principal Accounting Officer)