

ANWORTH MORTGAGE ASSET CORP
Form 10-Q
August 06, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF
1934
FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2014

OR

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

For the transition period from to

Commission File Number 001-13709

ANWORTH MORTGAGE ASSET CORPORATION

(Exact name of registrant as specified in its charter)

MARYLAND	52-2059785
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1299 Ocean Avenue, Second Floor, Santa Monica, California	90401
(Address of principal executive offices)	(Zip Code)

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

Edgar Filing: ANWORTH MORTGAGE ASSET CORP - Form 10-Q

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 August 4, 2014, the registrant had 121,582,996 shares of common stock issued and outstanding.

ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES

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 June 30, 2014 (unaudited) and December 31, 2013</u>	1
<u>Consolidated Statements of Income for the three and six months ended June 30, 2014 and 2013 (unaudited)</u>	2
<u>Consolidated Statements of Comprehensive Income (Loss) for the three and six months ended June 30, 2014 and 2013 (unaudited)</u>	3
<u>Consolidated Statements of Stockholders' Equity for the three months ended March 31, 2014 and June 30, 2014 (unaudited)</u>	4
<u>Consolidated Statements of Cash Flows for the three and six months ended June 30, 2014 and 2013 (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>	36
Item 4. <u>Controls and Procedures</u>	40
Part II. <u>OTHER INFORMATION</u>	41
Item 1. <u>Legal Proceedings</u>	41
Item 1A. <u>Risk Factors</u>	41
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	42
Item 3. <u>Defaults Upon Senior Securities</u>	42
Item 4. <u>Mine Safety Disclosures</u>	42
Item 5. <u>Other Information</u>	42
Item 6. <u>Exhibits</u>	42
<u>Signatures</u>	45

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)

	June 30, 2014 (unaudited)	December 31, 2013
ASSETS		
Agency MBS:		
Agency MBS pledged to counterparties at fair value	\$7,598,607	\$8,060,567
Agency MBS at fair value	431,597	462,478
Paydowns receivable	39,160	33,401
	\$8,069,364	\$8,556,446
Residential properties	10,421	-
Cash and cash equivalents	1,184	7,368
Interest and dividends receivable	21,742	23,310
Derivative instruments at fair value	432,649	22,551
Prepaid expenses and other	19,428	9,816
Total Assets:	\$8,554,788	\$8,619,491
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Accrued interest payable	\$28,160	\$30,117
Repurchase agreements	7,118,500	7,580,000
Junior subordinated notes	37,380	37,380
Derivative instruments at fair value	465,639	55,914
Interest rate swaps at fair value	34,831	-
Dividends payable on Series A Preferred Stock	1,035	1,035
Dividends payable on Series B Preferred Stock	394	394
Dividends payable on common stock	17,332	11,097
Accrued expenses and other	3,355	1,368
Total Liabilities:	\$7,706,626	\$7,717,305
Series B Cumulative Convertible Preferred Stock: par value \$0.01 per share; liquidating	\$23,924	\$23,924
preference \$25.00 per share (\$25,241 and \$25,241, respectively); 1,010 and 1,010		
shares issued and outstanding at June 30, 2014 and December 31, 2013,		

respectively		
Stockholders' Equity:		
Series A Cumulative Preferred Stock: par value \$0.01 per share; liquidating preference \$25.00 per share (\$47,984 and \$47,984, respectively); 1,919 and 1,919 shares issued and outstanding at June 30, 2014 and December 31, 2013, respectively	\$46,537	\$46,537
Common Stock: par value \$0.01 per share; authorized 200,000 shares, 123,798 and 138,717 issued and outstanding at June 30, 2014 and December 31, 2013, respectively	1,238	1,387
Additional paid-in capital	1,107,796	1,185,369
Accumulated other comprehensive (loss) consisting of unrealized gains and losses	(52,830)	(92,008)
Accumulated deficit	(278,503)	(263,023)
Total Stockholders' Equity:	\$824,238	\$878,262
Total Liabilities and Stockholders' Equity:	\$8,554,788	\$8,619,491

See accompanying notes to unaudited consolidated financial statements.

ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(in thousands, except per share amounts)

(unaudited)

	Three Months Ended		Six Months Ended	
	June 30, 2014	2013	June 30, 2014	2013
Interest income:				
Interest on Agency MBS	\$41,400	\$45,231	\$85,796	\$88,680
Other income	16	13	27	31
	41,416	45,244	85,823	88,711
Interest expense:				
Interest expense on repurchase agreements	25,807	20,046	53,213	40,948
Interest expense on junior subordinated notes	315	320	629	640
	26,122	20,366	53,842	41,588
Net interest income	15,294	24,878	31,981	47,123
Gain on sales of Agency MBS	1,594	2,076	1,594	7,246
Loss on interest rate swaps, net	(2,006)	-	(1,378)	-
Gain on derivatives-TBA securities	1,578	-	1,578	-
Recovery on Non-Agency MBS	33	103	70	232
Expenses:				
Management fee to related party	(2,724)	(3,029)	(5,640)	(6,027)
Other expenses	(3,722)	(1,030)	(4,786)	(1,952)
Total expenses	(6,446)	(4,059)	(10,426)	(7,979)
Net income	\$10,047	\$22,998	\$23,419	\$46,622
Dividend on Series A Cumulative Preferred Stock	(1,035)	(1,035)	(2,070)	(2,072)
Dividend on Series B Cumulative Convertible Preferred Stock	(394)	(394)	(788)	(806)
Net income to common stockholders	\$8,618	\$21,569	\$20,561	\$43,744
Basic earnings per common share	\$0.07	\$0.15	\$0.16	\$0.30
Diluted earnings per common share	\$0.07	\$0.15	\$0.16	\$0.30
Basic weighted average number of shares outstanding	126,787	144,252	131,790	143,581
Diluted weighted average number of shares outstanding	130,867	148,126	135,843	147,539

See accompanying notes to unaudited consolidated financial statements.

ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(in thousands)

(unaudited)

	Three Month Ended		Six Month Ended	
	June 30,		June 30,	
	2014	2013	2014	2013
Net income	\$10,047	\$22,998	\$23,419	\$46,622
Available-for-sale Agency MBS, fair value adjustment	46,006	(188,986)	75,728	(209,129)
Reclassification adjustment for gain on sales of Agency MBS included in net income	(1,594)	(2,076)	(1,594)	(7,246)
Unrealized (losses) gains on derivatives	(45,291)	29,616	(74,946)	30,148
Reclassification adjustment for interest expense on swap agreements included in net income	19,535	11,640	39,990	23,793
Other comprehensive income (loss)	18,656	(149,806)	39,178	(162,434)
Comprehensive income (loss)	\$28,703	\$(126,808)	\$62,597	\$(115,812)

See accompanying notes to unaudited consolidated financial statements.

ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(in thousands, except per share amounts)

(unaudited)

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

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

See accompanying notes to unaudited consolidated financial statements.

ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Three Months Ended		Six Months Ended	
	June 30, 2014	2013	June 30, 2014	2013
Operating Activities:				
Net income	\$10,047	\$22,998	\$23,419	\$46,622
Adjustments to reconcile net income to net cash provided by operating activities:				
Amortization of premium and discounts (Agency MBS)	11,791	15,981	21,678	35,003
(Gain) on sales of Agency MBS	(1,594)	(2,076)	(1,594)	(7,246)
Amortization of restricted stock	24	50	48	101
Recovery on Non-Agency MBS	(33)	(103)	(70)	(232)
Amortization related to interest rate swaps	(756)	-	(1,001)	-
Loss on interest rate swaps, net	2,006	-	1,378	-
(Gain) on derivatives - TBA Securities	(1,578)	-	(1,578)	-
Changes in assets and liabilities:				
Decrease (increase) in interest receivable	1,345	(635)	1,568	(15)
(Increase) decrease in prepaid expenses and other	(4,459)	7,042	(9,612)	7,225
Increase (decrease) in accrued interest payable	2,423	(2,748)	(1,926)	(3,060)
Increase in accrued expenses	552	128	1,955	1,562
Net cash provided by operating activities	\$19,768	\$40,637	\$34,265	\$79,960
Investing Activities:				
Available-for-sale Agency MBS:				
Proceeds from sale	\$197,703	\$92,111	\$197,703	\$294,328
Purchases	(99,228)	(1,131,487)	(337,976)	(2,021,159)
Principal payments	351,078	658,916	681,538	1,309,008
Residential properties purchases	(9,792)	-	(10,485)	-
Net cash provided by (used in) investing activities	\$439,761	\$(380,460)	\$530,780	\$(417,823)
Financing Activities:				
Borrowings from repurchase agreements	\$8,976,965	\$10,975,727	\$17,710,065	\$22,547,073
Repayments on repurchase agreements	(9,368,465)	(10,595,727)	(18,171,565)	(22,162,073)
Net settlement on TBA commitments	704	-	704	-
Proceeds from common stock issued, net of common stock repurchased				
	(49,705)	(11,154)	(77,770)	526
Proceeds on Series B Preferred Stock issued	-	-	-	1,335
Proceeds on Series A Preferred Stock issued	-	-	-	1,090
Series A Preferred stock dividends paid	(1,035)	(1,035)	(2,070)	(2,047)
Series B Preferred stock dividends paid	(394)	(411)	(788)	(827)
Common stock dividends paid	(18,689)	(21,653)	(29,805)	(42,955)

Edgar Filing: ANWORTH MORTGAGE ASSET CORP - Form 10-Q

Net cash (used in) provided by financing activities	\$(460,619)	\$345,747	\$(571,229)	\$342,122
Net (decrease) increase in cash and cash equivalents	\$(1,090)	\$5,924	\$(6,184)	\$4,259
Cash and cash equivalents at beginning of period	2,274	1,245	7,368	2,910
Cash and cash equivalents at end of period	\$1,184	\$7,169	\$1,184	\$7,169
Supplemental Disclosure of Cash Flow Information:				
Cash paid for interest	\$24,455	\$23,114	\$56,799	\$44,648
Conversions of Series B Preferred Stock into common stock	\$-	\$1,044	\$-	\$2,633
Common stock repurchased	\$50,094	\$17,591	\$78,417	\$18,170
Change in payable for securities purchased	\$(100,064)	\$238,899	\$-	\$35,673

See accompanying notes to unaudited consolidated financial statements.

ANWORTH MORTGAGE ASSET CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 1. ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

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

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

In February 2014, the Company incorporated its wholly-owned Qualified REIT Subsidiary (“QRS”), Anworth Properties, Inc., which commenced operations in March 2014. The Company also incorporated Anworth Property Services, Inc., a Taxable REIT Subsidiary (“TRS”) that is wholly-owned by the Company. The Company’s QRS will provide the entity through which the Company may own REIT-qualified real estate assets such as: (1) other types of mortgage assets, from which the Company would receive interest income; and (2) real estate assets, from which the Company would receive rental income and potential price appreciation. The Company’s TRS will provide the entity through which the Company may participate in various real estate-related activities which would earn profits that the IRS considers to be taxable income. Unlike a REIT, a TRS pays standard corporate taxes on its income earned from these activities in the mortgage and real estate markets. These other activities include almost everything other than receiving rent on properties owned and collecting interest on real estate mortgages owned. Examples of these other activities include: the securitization of mortgage loans; mortgage origination; leasing and managing rental properties; and owning properties acquired through the foreclosure process.

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

BASIS OF PRESENTATION

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

The following is a summary of our significant accounting policies:

6

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.

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 instruments under which the counterparty pledges securities (U.S. treasury securities or Agency MBS) 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) guaranteed by the U.S. government, such as Ginnie Mae, or guaranteed by federally sponsored enterprises, such as Fannie Mae or Freddie Mac. Our investment-grade Agency MBS portfolio is invested primarily in fixed-rate and adjustable-rate mortgage-backed pass-through certificates and hybrid adjustable-rate MBS. Hybrid adjustable-rate MBS have an initial interest rate that is fixed for a certain period, usually three to ten years, and then adjusts annually for the remainder of the term of the asset. We structure our investment portfolio to be diversified with a variety of prepayment characteristics, investing in mortgage assets with prepayment penalties, investing in certain mortgage security structures that have prepayment protections and purchasing mortgage assets at a premium and at a discount. Our portfolio also includes a small amount of Non-Agency MBS (approximately \$21 thousand) and this is included with the Agency MBS. Prior year balances have been presented consistent with this treatment.

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

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

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

Edgar Filing: ANWORTH MORTGAGE ASSET CORP - Form 10-Q

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 June 30, 2014 and December 31, 2013, aggregated by investment category and length of time (dollar amounts in thousands):

June 30, 2014

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	131	\$1,745,928	\$ (33,185)	314	\$2,460,702	\$ (43,200)	445	\$4,206,630	\$ (76,385)

7

December 31, 2013

Description	Less Than 12 Months			12 Months or More			Total		
	Number	Fair Value	Unrealized Losses	Number	Fair Value	Unrealized Losses	Number	Fair Value	Unrealized Losses

Agency MBS	202	\$4,262,712	\$(122,890)	230	\$763,911	\$(23,089)	432	\$5,026,623	\$(145,979)
------------	-----	-------------	-------------	-----	-----------	------------	-----	-------------	-------------

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 June 30, 2014.

Residential Properties

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

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

Repurchase Agreements

We finance the acquisition of MBS primarily through the use of repurchase agreements. Under these repurchase agreements, we sell securities to a lender and agree to repurchase the same securities in the future for a price that is higher than the original sales price. The difference between the sale price that we receive and the repurchase price that

we pay represents interest paid to the lender. Although structured as a sale and repurchase obligation, a repurchase agreement operates as a financing under which we pledge our securities and accrued interest as collateral to secure a loan which is equal in value to a specified percentage of the estimated fair value of the pledged collateral. We retain beneficial ownership of the pledged collateral. Upon the maturity of a repurchase agreement, we are required to repay the loan and concurrently receive back our pledged collateral from the lender or, with the consent of the lender, we may renew such agreement at the then-prevailing financing rate. These repurchase agreements may require us to pledge additional assets to the lender in the event the estimated fair value of the existing pledged collateral declines.

Derivative Financial Instruments

Interest Rate Risk Management

We primarily use short-term (less than or equal to 12 months) repurchase agreements to finance the purchase of MBS. These obligations expose us to variability in interest payments due to changes in interest rates. We continuously monitor changes in interest rate exposures and evaluate 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 swaps, which effectively convert a percentage of our repurchase agreements to fixed-rate obligations over a period of up to ten 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 the London Interbank Offered Rate, or LIBOR. The notional amounts are not exchanged. We generally account for these swaps as cash flow hedges in accordance with ASC 815-10. We do not issue or hold derivative contracts for speculative purposes.

For all interest rate swaps entered into prior to September 9, 2013, we are exposed to credit losses in the event of non-performance by counterparties to interest rate swap agreements. In order to limit credit risk associated with swaps, our practice was to only enter into swaps with large financial institution counterparties who are market makers for these types of instruments, limit our exposure on each swap to a single counterparty under our defined guidelines and either pay or receive collateral to or from each counterparty on a periodic basis to cover the net fair market value position of the swaps held with that counterparty.

For all interest rate swaps entered into on or after September 9, 2013, all swap participants are required by rules of the Commodities Futures Trading Commission, or CFTC, under authority granted to it pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act, or the Dodd-Frank Act, to clear swaps through a registered derivatives clearing organization, or “swap execution facility,” through standardized documents under which each swap counterparty transfers its position to another entity whereby a central clearinghouse effectively becomes the counterparty on each side of the swap. Both the swap execution facility and the central clearing house could require greater initial and periodic margin (collateral) requirements and additional transaction fees. It is the intent of the Dodd-Frank Act that the clearing of swaps in this manner is designed to avoid concentration of risk in any single entity by spreading and centralizing the risk in the clearinghouse and its members.

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 is highly effective and that is designated and qualifies 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 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. All of our swaps have historically been accounted for as cash flow hedges under ASC 815. However, on March 17, 2014, we discontinued hedge accounting on certain of our swaps totaling approximately \$1.685 billion in notional amounts by de-designating

these swaps as cash flow hedges. No swaps were terminated in conjunction with this action and our risk management and hedging practices were not impacted. As a result of discontinuing hedge accounting, beginning March 18, 2014, changes in the fair value of our swaps are recorded in “Gain on interest rate swaps, net” in our consolidated statements of income rather than in other comprehensive income (loss). Also, net interest paid or received under these swaps which, up through March 17, 2014, was recognized in “interest expense,” is instead recognized in “Gain on interest rate swaps, net.” These continue to be reported as assets or liabilities on our consolidated balance sheets at their fair value.

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

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 13. For more information on the fair value of our swap agreements, see Note 7.

To-Be-Announced (TBA) Securities

We may also enter into TBA contracts, where we agree to purchase or sell, for future delivery, agency securities with certain principal and interest terms and certain types of collateral, but the particular agency securities to be delivered are not identified until shortly before the TBA settlement date. We may also do TBA dollar roll transactions, which involve moving the settlement of a TBA contract out to a later date by entering into an offsetting short position (referred to as a “pair off”), net settling the paired off positions for cash and simultaneously purchasing a similar TBA contract for a later settlement date. The agency securities purchased at the forward settlement date are typically priced at a discount to securities for settlement in the current month. This difference is referred to as the “price drop”. The price drop represents compensation to us for foregoing net interest margin (interest income less repurchase agreement financing cost) and is referred to as “dollar roll income”.

We account for TBA securities as derivative instruments since we do not meet the exemption allowed as a “regular-way” security trade under ASC 815, as either the TBA contracts do not settle in the shortest period of time possible or we cannot assess that it is probable at inception that we will take physical delivery of the security or that we will not settle on a net basis. Gains, losses and dollar roll income associated with the TBA securities are recognized in our consolidated financial statements of income as “gains (losses) on derivatives – TBA securities.”

We estimate the fair value of TBA securities based on similar methods used to value our agency securities.

Credit Risk

At June 30, 2014, we have attempted to limit our exposure to credit losses on our MBS by purchasing securities primarily through Freddie Mac and Fannie Mae. The payment of principal and interest on the Freddie Mac and Fannie Mae MBS are guaranteed by those respective enterprises. In September 2008, both Freddie Mac and Fannie Mae were placed in the conservatorship of the U.S. government. While it is the intent that the conservatorship will help stabilize Freddie Mac’s and Fannie Mae’s losses and overall financial position, there can be no assurance that it will succeed or that, if necessary, Freddie Mac or Fannie Mae will be able to satisfy its guarantees of Agency MBS. In August 2011, the ratings of each of U.S. sovereign debt, Fannie Mae and Freddie Mac were downgraded from AAA to AA+ by Standard & Poor’s, and affirmed at Aaa by Moody’s Investors Service, or Moody’s, with each of Standard & Poor’s and Moody’s revising the outlook on U.S. sovereign debt, Fannie Mae and Freddie Mac to negative. Each of Standard & Poor’s and Moody’s has indicated that it would likely change its ratings on Fannie Mae and Freddie Mac if it was to change its rating on the U.S. government. In June 2013, Standard & Poor’s affirmed its AA+ long-term sovereign credit rating on the United States and revised the outlook from negative to stable, and in July 2013, Moody’s affirmed its Aaa government bond rating of the United States and revised the outlook from negative to stable. These ratings have remained unchanged through June 30, 2014. We do not know what effect any changes in the ratings of U.S. sovereign debt, Fannie Mae and Freddie Mac will ultimately have on the U.S. economy, the value of our securities, or 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, or OTTI, involves judgments and assumptions based on both subjective and objective factors. When a security is impaired, an OTTI is considered to have occurred if (i) we intend to sell the security, (ii) it is more likely than not that we will be required to sell the security before recovery of its

amortized cost basis or (iii) we do not expect to recover its amortized cost basis (i.e., there is a credit-related loss). The following are among, but not all of, the factors considered in determining whether and to what extent an OTTI exists and the portion that is related to credit loss: (i) the expected cash flow from the investment; (ii) whether there has been an other-than-temporary deterioration of the credit quality of the underlying mortgages; (iii) the credit protection available to the related mortgage pool for MBS; (iv) any other market information available, including analysts' assessments and statements, public statements and filings made by the debtor or counterparty; (v) management's internal analysis of the security, considering all known relevant information at the time of assessment; and (vi) the magnitude and duration of historical decline in market prices. Because management's assessments are based on factual information as well as subjective information available at the time of assessment, the determination as to whether an other-than-temporary decline exists and, if so, the amount considered impaired, is also subjective and therefore constitutes material estimates that are susceptible to significant change.

Income Taxes

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

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

Cumulative Convertible Preferred Stock

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

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

Stock-Based Expense

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

Restricted stock is expensed over the vesting period (see Note 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 (which includes stock options and convertible preferred stock) and the adding back of the Series B Preferred Stock dividends unless the effect is to reduce a loss or increase the income per share.

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

Net Income	Average	Earnings
Available to	Shares	per
Common		Share

Edgar Filing: ANWORTH MORTGAGE ASSET CORP - Form 10-Q

	Stockholders		
For the three months ended June 30, 2014			
Basic EPS	\$ 8,618	126,787	\$ 0.07
Effect of dilutive securities	394	4,080	-
Diluted EPS	\$ 9,012	130,867	\$ 0.07
For the three months ended June 30, 2013			
Basic EPS	\$ 21,569	144,252	\$ 0.15
Effect of dilutive securities	394	3,874	-
Diluted EPS	\$ 21,963	148,126	\$ 0.15

	Net Income		
	Available to	Earnings	
	Common	Average	per
	Stockholders	Shares	Share
For the six months ended June 30, 2014			
Basic EPS	\$ 20,561	131,790	\$ 0.16
Effect of dilutive securities	788	4,053	-
Diluted EPS	\$ 21,349	135,843	\$ 0.16
For the six months ended June 30, 2013			
Basic EPS	\$ 43,744	143,581	\$ 0.30
Effect of dilutive securities	806	3,958	-
Diluted EPS	\$ 44,550	147,539	\$ 0.30

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

Accumulated Other Comprehensive Income

In accordance with ASC 220-10-55-2, total comprehensive income is divided into net income and other comprehensive income, which includes unrealized gains and losses on marketable securities classified as available-for-sale, and unrealized gains and losses on derivative financial instruments that qualify for cash flow hedge accounting under ASC 815-10. In accordance with ASU 2013-02, we have identified, in our Statements of Comprehensive Income, items that are reclassified and included in our Statements of Income.

USE OF ESTIMATES

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

RECENT ACCOUNTING PRONOUNCEMENTS

In the first quarter of 2013, the FASB issued ASU 2013-04, "Liabilities (Topic 405): Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation Is Fixed at the Reporting Date." This ASU requires an entity to measure obligations resulting from joint and several liability arrangements for which the total amount of the obligation within the scope of this ASU is fixed at the reporting date, as the sum of the following: (a) the amount the reporting entity agreed to pay on the basis of its arrangement among its co-obligors; and (b) any additional amount the reporting entity expects to pay on behalf of its co-obligors. This ASU also requires an entity to disclose the nature and amount of the obligation as well as other information about the obligations including the terms and conditions of the arrangement. Examples of obligations within the scope of this ASU include debt arrangements, other contractual obligations, and settled litigation and judicial rulings. This ASU was effective for our

financial statements beginning with the quarter ended March 31, 2014. We have adopted this ASU and it did not have a material impact on our financial statements.

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

In June 2014, the FASB issued a new standard on repurchase agreements, ASU No. 2014-11, "Transfers and Servicing: Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures (Topic 860)." This new standard introduces two major changes to the existing accounting guidance: (1) it requires transferors and transferees to account for repurchase-to-maturity

transactions as secured borrowings, where the transferor maintains control over the transferred asset instead of accounting for these as a sale; and (2) it requires separate accounting for a transfer of a financial asset executed contemporaneously with a repurchase agreement with the same counterparty, causing the repurchase agreement to be accounted for as a secured borrowing. For these types of transactions, there is additional disclosure about the nature of the transaction. This ASU also requires the following disclosures for all repurchase agreements, securities lending transactions and repurchase-to-maturity transactions that are accounted for as secured borrowings: (i) a disaggregation of the gross obligation by the class of collateral pledged; (ii) the remaining contractual tenor of the agreements; and (iii) a discussion of the potential risks associated with the agreements and the related collateral pledged, including obligations arising from a decline in the fair value of the collateral pledged and how those risks are managed. This ASU is effective for a public entity for the financial statements beginning with the quarter ending March 31, 2015. We do not believe that this ASU will have a material impact on our financial statements.

NOTE 2. REVERSE REPURCHASE AGREEMENTS

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

NOTE 3. MORTGAGE-BACKED SECURITIES (MBS)

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

June 30, 2014

By Agency	Ginnie	Freddie	Fannie	Non-Agency	Total
	Mae	Mac	Mae	MBS	MBS
Amortized cost	\$ 12,622	\$ 3,421,387	\$ 4,580,707	\$ -	\$ 8,014,716
Paydowns receivable ⁽¹⁾	-	39,160	-	-	39,160
Unrealized gains	6	21,219	70,627	21	91,873
Unrealized losses	(136)	(46,071)	(30,178)	-	(76,385)
Fair value	\$ 12,492	\$ 3,435,695	\$ 4,621,156	\$ 21	\$ 8,069,364

By Security Type	ARMs	Hybrids	15-Year	20-Year	Floating-Rate	Total
			Fixed-Rate	and	CMOs ⁽²⁾	MBS
				30-Year		

Fixed-Rate

Amortized cost	\$ 1,775,135	\$ 4,577,991	\$ 1,514,126	\$ 146,203	\$ 1,261	\$ 8,014,716
Paydowns receivable ⁽¹⁾	2,695	36,465	-	-	-	39,160
Unrealized gains	54,317	23,338	4,937	9,254	27	91,873
Unrealized losses	(3,901)	(53,137)	(19,344)	-	(3)	(76,385)
Fair value	\$ 1,828,246	\$ 4,584,657	\$ 1,499,719	\$ 155,457	\$ 1,285	\$ 8,069,364

(1) Paydowns receivable are generated when the Company receives notice from Freddie Mac of prepayments but does not receive the actual cash with respect to such prepayments until the 15th day of the following month.

(2) Non-Agency MBS are included in the Floating-Rate CMOs category.

During the three months ended June 30, 2014, we received proceeds of approximately \$198 million from the sales of Agency MBS and recognized a gain on sales of approximately \$1.6 million. During the three months ended June 30, 2013, we received proceeds of approximately \$92 million from the sales of Agency MBS and recognized a gain on sales of approximately \$2.1 million.

December 31, 2013

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

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

(1) Paydowns receivable are generated when the Company receives notice from Freddie Mac of prepayments but does not receive the actual cash with respect to such prepayments until the 15th day of the following month.

(2) Non-Agency MBS are included in the Floating-Rate CMOs category.

NOTE 4. RESIDENTIAL PROPERTIES

As of June 30, 2014, we owned 77 single-family residential properties which are all located in Southeastern Florida and were acquired at a total cost of approximately \$10.4 million. As we did not start this operation until March 2014, we did not own any single-family residential properties as of December 31, 2013.

NOTE 5. REPURCHASE AGREEMENTS

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

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

Edgar Filing: ANWORTH MORTGAGE ASSET CORP - Form 10-Q

	June 30, 2014			December 31, 2013		
	Balance	Weighted Average Interest Rate		Balance	Weighted Average Interest Rate	
Overnight	\$3,500	0.25 %		\$-	0.00 %	
Less than 30 days	3,000,000	0.33		3,105,000	0.39	
30 days to 90 days	4,115,000	0.32		4,475,000	0.39	
Over 90 days to less than 1 year	-	-		-	-	
1 year to 2 years	-	-		-	-	
Demand	-	-		-	-	
	\$7,118,500	0.32 %		\$7,580,000	0.39 %	
Weighted average maturity	37 days			38 days		
Weighted average interest rate after adjusting for interest rate swap hedges	1.07	%		1.50	%	
Weighted average maturity after adjusting for interest rate swap hedges	889 days			1,010 days		
Weighted average interest rate after adjusting for all interest rate swaps	1.47	%		1.50	%	
Weighted average maturity after adjusting for all interest rate swaps	992 days			1,010 days		
Agency MBS pledged as collateral under the repurchase agreements and swap agreements	\$7,598,607			\$8,060,567		

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

June 30, 2014	Gross Amounts of Recognized Assets or	Gross Amounts Offset in the	Net Amounts of		
			Assets or Liabilities Presented in the Balance	Gross Amounts Not Offset in the Balance Sheets ⁽¹⁾ Financial	Cash Collateral Net

Edgar Filing: ANWORTH MORTGAGE ASSET CORP - Form 10-Q

(in thousands)	Liabilities	Balance Sheets	Sheets	Instruments	Received	Amounts
Derivative assets at fair value ⁽²⁾	\$ 432,649	\$ -	\$ 432,649	\$ (432,649)	\$ -	\$ -
Total	\$ 432,649	\$ -	\$ 432,649	\$ (432,649)	\$ -	\$ -
Repurchase Agreements ⁽³⁾	\$ 7,118,500	\$ -	\$ 7,118,500	\$ (7,118,500)	\$ -	\$ -
Derivative liabilities at fair value ⁽²⁾	465,639	-	465,639	(465,639)	-	-
Interest rate swaps at fair value ⁽²⁾	34,831	-	34,831	(34,831)	-	-
Total	\$ 7,618,970	\$ -	\$ 7,618,970	\$ (7,618,970)	\$ -	\$ -

15

December 31, 2013 (in thousands)	Gross Amounts		Net Amounts of Assets or Liabilities		Gross Amounts Not Offset in the Balance Sheets ⁽¹⁾		
	of Recognized Assets or Liabilities	Gross Amounts Offset in the Balance Sheets	Presented in the Balance Sheets		Financial Instruments	Cash Collateral Received	Net Amounts
Derivative assets at fair value ⁽²⁾	\$ 22,551	\$ -	\$ 22,551	\$ (22,551)	\$ -	\$ -	\$ -
Total	\$ 22,551	\$ -	\$ 22,551	\$ (22,551)	\$ -	\$ -	\$ -
Repurchase Agreements ⁽³⁾	\$ 7,580,000	\$ -	\$ 7,580,000	\$ (7,580,000)	\$ -	\$ -	\$ -
Derivative liabilities at fair value	55,914	-	55,914	(55,914)	-	-	-
Total	\$ 7,635,914	\$ -	\$ 7,635,914	\$ (7,635,914)	\$ -	\$ -	\$ -

(1) Amounts presented are limited to collateral pledged sufficient to reduce the related net amount to zero in accordance with ASU No. 2011-11, as amended by ASU No. 2013-01.

(2) At June 30, 2014, we had pledged approximately \$86.3 million in Agency MBS as collateral and paid another approximately \$16.2 million on swap margin calls on our derivatives. At December 31, 2013, we had pledged approximately \$84.2 million in Agency MBS as collateral and paid another approximately \$7.1 million on swap margin calls on our derivatives.

(3) At June 30, 2014, we had pledged approximately \$7.51 billion in Agency MBS as collateral on our repurchase agreements. At December 31, 2013, we had pledged approximately \$7.98 billion in Agency MBS as collateral on our repurchase agreements.

NOTE 6. JUNIOR SUBORDINATED NOTES

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

NOTE 7. FAIR VALUES OF FINANCIAL INSTRUMENTS

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

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

Level 2: Observable market based inputs or unobservable inputs that are corroborated by market data. This includes those financial instruments that are valued using models or other valuation methodologies where substantially all of the assumptions are observable in the marketplace, can be derived from observable market data or are supported by observable levels at which transactions are executed in the marketplace. We consider the inputs utilized to fair value our Agency MBS to be Level 2. Management bases the fair value for these investments primarily on third party bid price indications provided by dealers who make markets in these instruments. The Agency MBS market is primarily an over-the-counter market. As such, there are no standard, public market quotations or published trading data for individual MBS securities. As our portfolio consists of hundreds of similar, but distinct, securities that have each been traded with only one broker counterparty, we generally seek to have each Agency MBS security priced by one broker. The prices received are non-binding offers to trade, but are indicative quotations of the market value of our securities as of the market close on the last day of each quarter. The brokers receive trading data from several traders that participate in the active markets for these securities and directly observe numerous trades of securities similar to the securities owned by us. Given the volume of market activity for Agency MBS, it is our belief that the broker pricing accurately reflects market information for actual, contemporaneous transactions. We do not adjust quotes or prices we obtain from brokers and pricing services. In the limited instances where valuations are received on a security from multiple brokers, we use the median value of the prices received to determine fair value. To validate the prices we obtain, to ensure our fair value determinations are consistent with ASC 820, and to ensure that we

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

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

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

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

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

	Level 1	Level 2	Level 3	Total
Assets				
Agency MBS ⁽¹⁾	\$ -	\$8,069,364	\$ -	\$8,069,364
Derivative instruments ⁽²⁾	\$ -	\$432,649	\$ -	\$432,649
Liabilities				
Derivative instruments ⁽²⁾	\$ -	\$465,639	\$ -	\$465,639
Interest rate swaps ⁽³⁾	\$ -	\$34,831	\$ -	\$34,831

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

(2)Derivative instruments include hedging instruments under ASC 815-10. For more detail about our derivative instruments, see Notes 1 and 13.

(3) Interest rate swaps shown in the above table are swaps that are no longer treated for accounting purposes as hedging instruments. For more information about these swaps, see Note 1 and Note 13 regarding discontinuing hedge accounting.

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

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

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

(2) Derivative instruments are hedging instruments under ASC 815-10. For more detail about our derivative instruments, see Notes 1 and 13.

17

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

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

NOTE 8. INCOME TAXES

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

NOTE 9. SERIES B CUMULATIVE CONVERTIBLE PREFERRED STOCK

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

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

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

NOTE 10. PUBLIC OFFERINGS AND CAPITAL STOCK

At June 30, 2014, our authorized capital included 200,000,000 shares of common stock, of which 123,799,073 shares were issued and outstanding.

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

On May 27, 2011, we entered into a Controlled Equity Offering Sales Agreement, or the 2011 Sales Agreement, with Cantor Fitzgerald & Co., or 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 June 30, 2014, we did not issue any shares of our common stock, our Series A Preferred Stock or our Series B Preferred Stock under the 2011 Sales Agreement. The Series A Preferred Stock has no maturity date, and we are not required to redeem it at any time. We may redeem the Series A Preferred Stock for cash at our option, in whole or from time to time in part, at a redemption price of \$25.00 per share, plus accrued and unpaid dividends, if any, to the redemption date. To date, we have not redeemed any shares of our Series A Preferred Stock. At June 30, 2014, there were 19,409,400 shares of common stock, 956,122 shares of Series A Preferred Stock and 894,518 shares of Series B Preferred Stock, respectively, available for sale and issuance under the 2011 Sales Agreement.

On October 3, 2011, we announced that our board of directors had authorized a share repurchase program which permits us to acquire up to 2,000,000 shares of our common stock. The shares are expected to be acquired at prevailing prices through open market transactions. The manner, price, number and timing of share repurchases will be subject to market conditions and applicable SEC rules. Our board of directors also authorized the Company to purchase an amount of our common stock up to the amount of common stock sold through our 2012 Dividend Reinvestment and Stock Purchase Plan. On December 13, 2013, we announced that our board of directors had authorized us to acquire up to an additional 5,000,000 shares of our common stock; on March 14, 2014, we announced that our board of directors had authorized the Company to acquire up to an additional 10,000,000 shares of our common stock; and on May 22, 2014, we announced that our board of directors had authorized the Company to acquire up to an additional 10,000,000 shares of our common stock, in each case through our share repurchase program. During the three months ended June 30, 2014, we repurchased an aggregate of 9,522,441 shares at a weighted average price of \$5.30 per share under our share repurchase program.

Our Dividend Reinvestment and Stock Purchase Plan allows stockholders and non-stockholders to purchase shares of our common stock and to reinvest dividends therefrom to acquire additional shares of our common stock. On March 14, 2012, we filed a shelf registration statement on Form S-3 with the U.S. Securities and Exchange Commission, or the SEC, registering up to 27,000,000 shares of our common stock for our 2012 Dividend Reinvestment and Stock Purchase Plan, or the 2012 Plan. During the three months ended June 30, 2014, we issued an aggregate of 72,268 shares of our common stock at a weighted average price of \$5.40 per share under the 2012 Plan, resulting in proceeds to us of approximately \$390 thousand. At June 30, 2014, there were approximately 16.635 million shares remaining under the 2012 Plan.

On March 20, 2013, we filed a shelf registration statement on Form S-3 with the SEC and on April 5, 2013 we filed a pre-effective amendment thereto with the SEC, offering up to \$544,727,778 of our capital stock. The registration statement was declared effective on April 8, 2013. At June 30, 2014, approximately \$544.7 million of our capital stock was available for future 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 3,500,000 shares of our common stock to be issued pursuant to the Anworth Mortgage Asset Corporation 2004 Equity Compensation Plan, or the 2004 Equity Plan. As of June 30, 2014, we had issued 2,840,000 shares of common stock under the 2004 Equity Plan. This amount includes 263,469 shares of unexercised stock options, restricted stock and restricted stock units. At our 2014 annual meeting of stockholders held on May 22, 2014, our stockholders approved the adoption of the Anworth Mortgage Asset Corporation 2014 Equity Compensation Plan, or the 2014 Equity Plan, which replaced the 2004 Equity Plan due to its expiration. The 2014 Equity Plan decreases the aggregate share reserve from 3,500,000 shares available under the 2004 Equity Plan to 2,000,000 shares available under the 2014 Equity Plan. Unlike the 2004 Equity Plan, however, the 2014 Equity Plan does not provide for automatic increases in the aggregate share reserve or the number of shares remaining available for grant and only provides for the granting of dividend equivalent rights, or DERs, and phantom shares.

NOTE 11. TRANSACTIONS WITH AFFILIATES

Management Agreement and Externalization

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

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

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

Nothing in the Management Agreement prevents the Manager or any of its affiliates from engaging in other businesses or from rendering services of any kind to any other person or entity, including investment in or advisory service to others investing in any type of real estate investment, other than advising other REITs that invest more than 75% of their assets in U.S. agency residential MBS. Directors, officers and employees of the Manager may serve as our directors and officers.

The terms of the Management Agreement, including the management fee payable, were not negotiated on an arm's-length basis, and its terms may not be as favorable to us as if it was negotiated with an unaffiliated party. The management fee that we pay to the Manager is not tied to our performance. The management fee is paid regardless of our performance and it may not provide sufficient incentive to the Manager to seek to achieve risk-adjusted returns for our investment portfolio.

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

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

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

Change in Control and Arbitration Agreements

On June 27, 2006, we entered into Change in Control and Arbitration Agreements with each of Mr. Thad M. Brown, our Chief Financial Officer, Mr. Charles J. Siegel, our then Senior Vice President-Finance, Ms. Bistra Pashamova, our

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

Agreements with Pacific Income Advisers, Inc.

On January 26, 2012, we entered into a sublease agreement that became effective on July 1, 2012 with PIA. Under the sublease agreement, we lease, on a pass-through basis, 7,300 square feet of office space from PIA at the same location and pay rent at an annual rate equal to PIA's obligation, which is currently \$59.87 per square foot. The base monthly rental for us is \$36,426.47, which will be increased by 3% per annum beginning on July 1, 2014. The sublease agreement runs through June 30, 2022 unless earlier terminated pursuant to the master lease. During the three and six months ended June 30, 2014, we expensed \$127 thousand and \$251 thousand,

respectively, in rent and related expenses to PIA under this sublease agreement. During the three and six months ended June 30, 2013, we expensed \$121 thousand and \$243 thousand, respectively, in rent and related expenses to PIA under this sublease agreement.

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

Year	2014	2015	2016	2017	2018	Thereafter	Total Commitment
Commitment	\$225,110	\$456,987	\$470,720	\$484,852	\$499,398	\$1,866,753	\$4,003,820

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. During the three and six months ended June 30, 2014, we paid fees of \$51 thousand and \$103 thousand, respectively, to PIA in connection with this agreement. During the three and six months ended June 30, 2013, we paid fees of \$53 thousand and \$106 thousand, respectively, to PIA in connection with this agreement.

NOTE 12. EQUITY COMPENSATION PLAN

2014 Equity Compensation Plan

We filed a registration statement on Form S-8 on November 7, 2005 to register up to an aggregate of 3,500,000 shares of our common stock to be issued pursuant to the 2004 Equity Compensation Plan, or the 2004 Equity Plan. At our 2014 annual meeting of stockholders held on May 22, 2014, our stockholders approved the adoption of the Anworth Mortgage Asset Corporation 2014 Equity Compensation Plan, or the 2014 Equity Plan, which replaced the 2004 Equity Plan due to its expiration. The 2014 Equity Plan decreases the aggregate share reserve from 3,500,000 shares available under the 2004 Equity Plan to 2,000,000 shares of our registered common stock available under the 2014 Equity Plan. The 2014 Equity Plan authorizes our board of directors, or a committee of our Board, to grant DERs or phantom shares, which qualify as performance-based awards under Section 162(m) of the Code. Unlike the 2004 Equity Plan, however, the 2014 Equity Plan does not provide for automatic increases in the aggregate share reserve or the number of shares remaining available for grant and only provides for the granting of DERs or phantom shares. As of June 30, 2014, we did not issue any shares of common stock or other equity awards under the 2014 Equity Plan.

In October 2005, our board of directors approved the grant of an aggregate of 200,780 shares of restricted stock to various officers under the 2004 Equity Compensation Plan. The stock price on the grant date was \$7.72. The restricted stock vests 10% per year on each anniversary date for a ten-year period and shall also vest immediately upon the death of the grantee or upon the grantee reaching age 65. Each grantee shall have the right to sell 40% of the restricted stock

any time after such shares have vested. The remaining 60% of such vested restricted stock may not be sold until after termination of employment with us. We amortize the restricted stock over the vesting period, which is the lesser of ten years or the remaining number of years to age 65.

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

We recognize the expense related to restricted stock over the ten-year vesting period. During the three and six months ended June 30, 2014, we expensed approximately \$24 thousand and \$48 thousand, respectively, related to these restricted stock grants. During the three and six months ended June 30, 2013, we expensed approximately \$51 thousand and \$101 thousand, respectively, related to these restricted stock grants.

At our May 24, 2007 annual meeting of stockholders, our stockholders adopted the Anworth Mortgage Asset Corporation 2007 Dividend Equivalent Rights Plan, or the 2007 Dividend Equivalent Rights Plan. A dividend equivalent right, or DER, is a right to receive amounts equal in value to the dividend distributions paid on a share of our common stock. DERs are paid in either cash or shares of our common stock, whichever is specified by our Compensation Committee at the time of grant, at such times as dividends are paid on shares of our common stock during the period between the date a DER is issued and the date the DER expires or earlier terminates. The Compensation Committee may impose such other conditions to the grant of DERs as it may deem appropriate. The maximum term for DERs under the 2007 Dividend Equivalent Rights Plan is ten years from the date of grant. Prior to January 1, 2012, an aggregate of 582,000 DERs were issued to our officers under the 2007 Dividend Equivalent Rights Plan. These DERs are not attached to any stock and only have the right to receive the same cash distribution per common share distributed to our common stockholders during the term of the grant. All of these grants have a five-year term from the date of the grant. During the three and six months ended June 30, 2014, we paid or accrued \$81 thousand and \$163 thousand, respectively, related to DERs granted. During the three and six months ended June 30, 2013, we paid or accrued \$87 thousand and \$175 thousand, respectively, related to DERs granted.

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

NOTE 13. DERIVATIVE INSTRUMENTS

At June 30, 2014, we were a counterparty to interest rate swaps, which are derivative instruments as defined by ASC 815-10, with an aggregate notional amount of \$5.265 billion and a weighted average maturity of approximately 3.7 years. During the three months ended June 30, 2014, two swap agreements with a notional amount of \$175 million matured. We utilize interest rate swaps 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 0.578% to 3.06%) and receive a payment that varies with the three-month LIBOR rate.

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

June 30, 2014			December 31, 2013		
Notional	Weighted	Remaining	Notional	Weighted	Remaining
Amount	Average	Term in	Amount	Average	Term in

Edgar Filing: ANWORTH MORTGAGE ASSET CORP - Form 10-Q

		Fixed		Months		Fixed		Months
		Rate				Rate		
Less than 12 months	\$460,000	2.16	%	8	\$410,000	2.07	%	4
1 year to 2 years	1,200,000	1.92		20	680,000	2.07		18
2 years to 3 years	775,000	1.11		32	1,145,000	1.82		29
3 years to 5 years	1,330,000	1.25		46	1,715,000	1.18		48
5 years to 7 years	1,000,000	2.12		70	925,000	2.11		76
7 years to 10 years	500,000	2.84		101	500,000	2.84		107
	\$5,265,000	1.78	%	44	\$5,375,000	1.81	%	47

Swap Agreements by Counterparty

	June 30,	December 31,
	2014	2013
	(in thousands)	
JPMorgan Securities	\$1,175,000	\$1,175,000
Deutsche Bank Securities	1,165,000	1,165,000
RBS Greenwich Capital	800,000	800,000
ING Financial Markets LLC	650,000	650,000
Chicago Mercantile Exchange ⁽¹⁾	615,000	400,000
Nomura Securities International	550,000	650,000
Bank of New York	160,000	260,000
Morgan Stanley	75,000	150,000
Credit Suisse	75,000	75,000
LBBW Securities, LLC	-	50,000
	\$5,265,000	\$5,375,000

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

During the six months ended June 30, 2014, there was an increase in unrealized losses of approximately \$35 million, from approximately \$33.3 million in unrealized losses at December 31, 2013 to approximately \$68.3 million in unrealized losses, on our swap agreements included in “Other comprehensive income” (this increase in unrealized losses consisted of unrealized losses on derivatives of \$75 million and a reclassification adjustment for interest expense included in net income of \$40 million).

At June 30, 2014, we had asset and liability interest rate swap derivatives of approximately \$8.8 million and \$42.7 million, respectively (included in our assets and liabilities, respectively, in “Derivative instruments at fair value” on our unaudited consolidated balance sheets). At June 30, 2014, we also had interest rate swap liabilities (shown on our unaudited consolidated balance sheets as “Interest rate swaps at fair value”) of approximately \$34.8 million on which the accounting treatment as hedges has been discontinued.

During the three and six months ended June 30, 2014, 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 ten 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 March 17, 2014, we decided to discontinue hedge accounting on certain swaps which totaled approximately \$1.685 billion in notional amounts and was approximately \$1.51 billion at June 30, 2014. These swaps carry a remaining average fixed rate of 1.89% and an average maturity of September 2015. These swaps will not be closed out or terminated and no realized loss will be recognized. As of the date we decided to discontinue hedge accounting for these swaps, there was a related liability of approximately \$42 million. At June 30, 2014, this liability was

approximately \$34.8 million. During the three and six months ended June 30, 2014, the net loss on these interest rate swaps was approximately \$2 million and \$1.4 million, respectively. During the three and six months ended June 30, 2014, the net payments accrued relating to these swaps was approximately \$7.2 million and \$15.2 million, respectively.

TBA Securities

We may also enter TBA contracts and recognize a gain or loss on the sale of the contracts or dollar roll income. See the section in Note 1 on “Derivative Financial Instruments – TBA Securities” for more information on TBA securities. For the three and six months ended June 30, 2014, we recognized a gain on derivatives-TBA securities of approximately \$1.6 million. For the three and six months ended June 30, 2013, we did not enter into any TBA contracts. At June 30, 2014, included in these assets under “Derivative instruments at fair value” in our unaudited consolidated balance sheets is a receivable of approximately \$212.2 million for TBA securities sold. Also included in these assets is approximately \$211.7 million for TBA securities commitments, which represents our open position at June 30, 2014. Also included in the liabilities under “Derivative instruments at fair value” is a payable of approximately \$423 million for TBA securities commitments. The types of securities involved in these TBA contracts are Fannie Mae 15-year fixed-rate securities at a 3.5% coupon.

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

NOTE 14. COMMITMENTS AND CONTINGENCIES

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

NOTE 15. OTHER EXPENSES

	Three Months Ended		Six Months Ended	
	June 30, 2014	2013	June 30, 2014	2013
	(in thousands)		(in thousands)	
Legal and professional fees	\$2,392	\$123	\$2,640	\$265
Printing and stockholder communications	537	139	569	177
Directors and Officers insurance	129	118	245	230
DERs expense	81	87	163	175
Amortization of restricted stock	24	51	48	101
Software implementation and maintenance	77	74	154	145
Administrative service fees	51	53	103	106
Rent	127	121	251	243
Stock exchange and filing fees	44	55	90	108
Custodian and clearing fees	70	35	145	69
Sarbanes-Oxley consulting fees	5	32	51	57
Board of directors fees and expenses	89	75	160	154
Securities data services	33	33	66	66
Other	63	34	101	56
Total of other expenses:	\$3,722	\$1,030	\$4,786	\$1,952

NOTE 16. 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 July 1, 2014 from 4.0411 shares of our common stock to 4.0919 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 \$5.30 and (2) the annualized common stock dividend yield was 10.5621%.

From July 1, 2014 through August 4, 2014, we issued an aggregate of 67,972 shares of common stock at a weighted average price of \$5.19 per share under the 2012 Dividend Reinvestment and Stock Purchase Plan, resulting in proceeds to us of approximately \$353 thousand.

Edgar Filing: ANWORTH MORTGAGE ASSET CORP - Form 10-Q

From July 1, 2014 through August 4, 2014, we had repurchased an aggregate of 2,333,590 shares of our common stock at a weighted average price of \$5.17 per share under our share repurchase program.

From July 1, 2014 through August 4, 2014, we acquired two single-family residential rental properties in Southeastern Florida for approximately \$218 thousand.

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

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

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

Forward-Looking Statements

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

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

General

The Company

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

In February of 2014, the Company incorporated its wholly-owned Qualified REIT Subsidiary (“QRS”), Anworth Properties, which commenced operations in March 2014. The Company incorporated Anworth Property Services, Inc., a Taxable REIT Subsidiary (“TRS”) that is wholly-owned by the Company. The Company’s QRS will provide the entity through which the Company may own REIT-qualified real estate assets such as: (1) other types of mortgage assets, from which the Company would receive interest income; and (2) real estate assets, from which the Company would receive rental income and potential price appreciation. The Company’s TRS will provide the entity through which the Company may participate in various real estate-related activities which would earn profits that the IRS considers to be taxable income. Unlike a REIT, a TRS pays standard corporate taxes on its income earned from these activities in the mortgage and real estate markets. These other activities include almost everything other than receiving rent on properties owned and collecting interest on real estate mortgages owned. Examples of these other activities include: the securitization of mortgage loans; mortgage origination; leasing and managing rental properties; and owning properties acquired through the foreclosure process.

We have elected to be taxed as a REIT under the Code and are organized for tax purposes as a REIT. Accordingly, we generally distribute substantially all of our taxable earnings to stockholders without paying federal or state income tax at the corporate level on the distributed earnings. At June 30, 2014, 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 2013 revenue qualified for both the 75% source of income test and the 95% source of income test under the REIT rules. At June 30, 2014, we believe we met all REIT requirements regarding the ownership of our common stock and the distributions of our taxable net income. Therefore, we believe that we continue to qualify as a REIT under the provisions of the Code.

Pursuant to a Management Agreement, or the Management Agreement, between us and Anworth Management, LLC, or the Manager, effective as of December 31, 2011, our day-to-day operations are being conducted by the Manager. The Manager is supervised and directed by our board of directors and is responsible for (i) the selection, purchase and sale of our investment portfolio; (ii) our financing and hedging activities; and (iii) providing us with management services. The Manager will also perform such other services and activities relating to our assets and operations as may be appropriate. In exchange for these services, the Manager receives a management fee paid monthly in arrears in an amount equal to one-twelfth of 1.20% of our Equity (as defined in the Management Agreement). The term of the Management Agreement expired on December 31, 2013 and automatically renews for successive one-year renewal terms unless either party elects not to renew. If we terminate the Management Agreement, or elect not to renew without cause, then we will be required to pay a termination fee equal to three times the average annual management fee earned during the prior 24-month period. At June 30, 2014, if this hypothetical event were to occur, the termination fee would be approximately \$35 million.

Government Activity

Developments Concerning Fannie Mae and Freddie Mac

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

Actions of the Federal Reserve

In September 2012, the Fed Open Market Committee of the Federal Reserve, or FOMC, announced an open-ended program to purchase an additional \$40 billion of Agency MBS per month until economic conditions (primarily the unemployment rate) improved. This program, combined with the then-existing Fed bond-buying program of Treasury securities, was to increase the Federal Reserve's holdings by \$85 billion per month. The Federal Reserve also

announced its projection that the federal funds rate would likely remain at exceptionally low levels until at least mid-2015. In May and June 2013, then Federal Reserve Chairman Ben Bernanke commented that if there was continued improvement in the U.S. economy, the pace of purchases could be slowed down or tapered. These comments had a great effect on the bond market, as longer-term interest rates rose while short-term interest rates remained constant. The resulting steepened yield curve caused a decline in the value of MBS. At the FOMC meeting on December 18, 2013, the Federal Reserve announced that it would begin the tapering of its bond-buying program down from the \$85 billion per month and would continue to re-evaluate this at subsequent FOMC meetings. Through its recent meeting in June 2014, the Federal Reserve has reduced its monthly purchases of Agency MBS and Treasury securities by \$50 billion per month down to \$35 billion per month and Federal Reserve officials announced at the June policy meeting that they would end the bond buying program in October 2014. Most Federal Reserve officials announced that they expect the first hike in interest rates to come sometime in 2015.

Other Recent Activity

On January 2, 2013, the U.S. Congress passed the American Taxpayer Relief Act of 2012, or the Taxpayer Relief Act, which extended, for most Americans, tax cuts implemented under President George W. Bush's administration. However, the Taxpayer Relief Act also delayed the implementation of the budget sequestration provisions of the Budget Control Act of 2011, which provided for

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

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

During 2012 and 2013, U.S. and British banking authorities assessed fines on several major financial institutions for LIBOR manipulation. LIBOR is an unregulated rate based on estimates that lenders submitted to the British Bankers' Association, or BBA, a trade group that compiled the information and published daily the LIBOR rate. In September 2013, oversight of LIBOR was transferred over to United Kingdom regulators, the Financial Conduct Authority. The administration of LIBOR was to be transferred to the NYSE Euronext Rate Administration Limited but was renamed to the ICE Benchmark Administration Limited upon the successful completion of the acquisition of NYSE Euronext by the Intercontinental Exchange in November 2013. On February 1, 2014, the administration of LIBOR was transferred from the BBA to the ICE Benchmark Administration Limited following authorization by the Financial Conduct Authority. The calculation of LIBOR under the ICE Benchmark Administration Limited is the average of the interest rates that some of the world's leading banks charge each other for short-term loans. It is unclear at this time how this change will affect the interest rates that repurchase agreement counterparties charge on borrowings in general and how they could specifically affect our borrowing agreements.

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

Our Portfolio

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

	June 30, 2014 (dollar amounts in thousands)	December 31, 2013		
Total assets	\$8,554,788	\$8,619,491		
Fair value of Agency MBS	\$8,281,038	\$8,556,446		
Adjustable-rate Agency MBS (less than 1 year reset)	22	% 19	%	
Adjustable-rate Agency MBS (1-2 year reset)	11	% 9	%	
Adjustable-rate Agency MBS (2-3 year reset)	14	% 15	%	
Adjustable-rate Agency MBS (3-4 year reset)	3	% 10	%	
Adjustable-rate Agency MBS (4-5 year reset)	4	% 3	%	
Adjustable-rate Agency MBS (5-7 year reset)	15	% 15	%	
Adjustable-rate Agency MBS (>7 year reset)	8	% 8	%	
15-year fixed-rate Agency MBS	18	% 20	%	
15-year fixed-rate TBA Agency securities	3	% 0	%	
20-year and 30-year fixed-rate Agency MBS	2	% 1	%	
	100	% 100	%	

As of June 30, 2014, we also owned 77 single-family residential properties which are all located in Southeastern Florida and were acquired at a total cost of approximately \$10.4 million. As we did not start this operation until March 2014, we did not own any single-family residential properties as of December 31, 2013.

Stockholders' equity available to common stockholders at June 30, 2014 was approximately \$774.9 million, or \$6.26 per share. The \$774.9 million equals total stockholders' equity of \$824.2 million less the Series A Preferred Stock liquidating value of approximately \$48 million and less the difference between the Series B Preferred Stock liquidating value of approximately \$25.2 million and the proceeds from its sale of approximately \$23.9 million.

Results of Operations

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

For the three months ended June 30, 2014, our net income available to common stockholders was \$8.6 million, or \$0.07 per diluted share, based on a weighted average of 130.9 million fully diluted shares outstanding. This includes net income of \$10 million minus the payment of preferred dividends of \$1.4 million. For the three months ended June 30, 2013, our net income available to common stockholders was \$21.6 million, or \$0.15 per diluted share, based on a weighted average of 148.1 million fully diluted shares outstanding. This included net income of \$23 million minus the payment of preferred dividends of \$1.4 million.

Net interest income for the three months ended June 30, 2014 was approximately \$15.3 million, or 28.7% of gross income, compared to approximately \$24.9 million, or 40.6% of gross income, for the three months ended June 30,

2013. Net interest income is comprised of the interest income earned on mortgage investments (net of premium amortization expense) less interest expense from borrowings. Interest income (net of premium amortization expense) for the three months ended June 30, 2014 was approximately \$41.4 million, compared to approximately \$45.2 million for the three months ended June 30, 2013, a decrease of 8.5% due primarily to a decrease in the coupons on our MBS (from 2.67% during the three months ended June 30, 2013 to 2.51% during the three months ended June 30, 2014), and by a decrease in the average MBS outstanding (from \$9.16 billion during the three months ended June 30, 2013 to \$8.46 billion during the three months ended June 30, 2014), partially offset by a decrease in the premium amortization of approximately \$4.3 million. Interest expense for the three months ended June 30, 2014 was approximately \$26.1 million, compared to approximately \$20.4 million for the three months ended June 30, 2013, an increase of 28.3%, which resulted primarily from an increase in weighted average interest rates after the effect of the swap agreements (from 0.97% at June 30, 2013 to 1.39% at June 30, 2014), partially offset by a decrease in the average repurchase agreement borrowings outstanding, from \$8.31 billion at June 30, 2013 to \$7.43 billion at June 30, 2014.

The results of our operations are affected by a number of factors, many of which are beyond our control, and primarily depend on, among other things, the level of our net interest income, the market value of our MBS, the supply of, and demand for, MBS in the marketplace, and the terms and availability of financing. Our net interest income varies primarily as a result of changes in interest rates, the slope of the yield curve (the differential between long-term and short-term interest rates), borrowing costs (our interest

expense) and prepayment speeds on our MBS portfolios, the behavior of which involves various risks and uncertainties. Interest rates and prepayment speeds, as measured by the constant prepayment rate, or CPR, vary according to the type of investment, conditions in the financial markets, competition and other factors, none of which can be predicted with any certainty. With respect to our business operations, increases in interest rates, in general, may, over time, cause: (i) the interest expense associated with our borrowings, which are primarily comprised of repurchase agreements, to increase; (ii) the value of our MBS portfolios and, correspondingly, our stockholders' equity to decline; (iii) coupons on our MBS to reset, although on a delayed basis, to higher interest rates; (iv) prepayments on our MBS portfolios to slow, thereby slowing the amortization of our MBS purchase premiums; and (v) the value of our interest rate swap agreements and, correspondingly, our stockholders' equity to increase. Conversely, decreases in interest rates, in general, may, over time, cause: (i) prepayments on our MBS portfolios to increase, thereby accelerating the amortization of our MBS purchase premiums; (ii) the interest expense associated with our borrowings to decrease; (iii) the value of our MBS portfolios and, correspondingly, our stockholders' equity to increase; (iv) the value of our interest rate swap agreements and, correspondingly, our stockholders' equity to decrease; and (v) coupons on our MBS to reset, although on a delayed basis, to lower interest rates. In addition, our borrowing costs and credit lines are further affected by the type of collateral pledged and general conditions in the credit markets.

During the three months ended June 30, 2014, premium amortization expense decreased \$4.3 million, or 26.6%, from \$16 million during the three months ended June 30, 2013 to \$11.7 million, due primarily to lower future CPR projections.

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

Portfolio	2014		2013	
	First	Second	First	Second
Agency MBS	12%	14%	24%	24%

During the three months ended June 30, 2014 and 2013, 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 three months ended June 30, 2014, we received proceeds of approximately \$198 million from the sales of Agency MBS and recognized a gain of approximately \$1.6 million. During the three months ended June 30, 2013, we received proceeds of approximately \$92 million from the sales of Agency MBS and recognized a gain of approximately \$2.1 million. During the three months ended June 30, 2014, we sold approximately \$422 million of TBA securities and recognized a gain of approximately \$1.6 million. During the three months ended June 30, 2013, we did not enter into any TBA securities contracts.

Total expenses were approximately \$6.4 million for the three months ended June 30, 2014, compared to approximately \$4.1 million for the three months ended June 30, 2013. For the three months ended June 30, 2014, we incurred management fees of approximately \$2.7 million, as compared to management fees of approximately \$3 million for the three months ended June 30, 2013, due primarily to management fees being calculated as a percentage of stockholders' equity (excluding accumulated other comprehensive income), which decreased from the three months ended June 30, 2013. "Other expenses," as detailed in Note 15 to our unaudited consolidated financial statements, increased approximately \$2.7 million due primarily to an increase in legal and other professional fees and also printing fees related to the Company's proxy solicitation contest.

Six Months Ended June 30, 2014 Compared to June 30, 2013

For the six months ended June 30, 2014, our net income available to common stockholders was \$20.6 million, or \$0.16 per diluted share, based on a weighted average of 135.8 million fully diluted shares outstanding. This includes net income of \$23.4 million minus the payment of preferred dividends of \$2.8 million. For the six months ended June 30, 2013, our net income available to common stockholders was \$43.7 million, or \$0.30 per diluted share, based on a weighted average of 147.5 million fully diluted shares outstanding. This included net income of \$46.6 million minus the payment of preferred dividends of \$2.9 million.

Net interest income for the six months ended June 30, 2014 was approximately \$32 million, or 29.7% of gross income, compared to approximately \$47.1 million, or 38.1% of gross income, for the six months ended June 30, 2013. Interest income (net of premium amortization expense) for the six months ended June 30, 2014 was approximately \$85.8 million, compared to approximately \$88.7 million for the six months ended June 30, 2013, a decrease of 3.3% due primarily to a decrease in the coupons on our MBS (from 2.74% during the three months ended June 30, 2013 to 2.54% during the three months ended June 30, 2014), and by a decrease in the average MBS outstanding (from \$9.03 billion during the six months ended June 30, 2013 to \$8.47 billion during the six months ended June 30, 2014), partially offset by a decrease in the premium amortization of approximately \$13.4 million. Interest expense for the six months ended June 30, 2014 was approximately \$53.8 million, compared to approximately \$41.6 million for the three months ended June 30, 2013, an increase of 29.5%, which resulted primarily from an increase in weighted average interest rates after the

effect of the swap agreements (from 1.01% at June 30, 2013 to 1.43% at June 30, 2014), partially offset by a decrease in the average repurchase agreement borrowings outstanding, from \$8.18 billion at June 30, 2013 to \$7.5 billion at June 30, 2014.

During the six months ended June 30, 2014, premium amortization expense decreased \$13.4 million, or 38.2%, from \$35 million during the six months ended June 30, 2013 to \$21.6 million, due primarily to lower future CPR projections.

During the six months ended June 30, 2014 and 2013, 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 six months ended June 30, 2014, we received proceeds of approximately \$198 million from the sales of Agency MBS and recognized a gain of approximately \$1.6 million. During the six months ended June 30, 2013, we received proceeds of approximately \$294 million from the sales of Agency MBS and recognized a gain of approximately \$7.2 million.

During the six months ended June 30, 2014, we sold approximately \$422 million of TBA securities (face amount plus premium) and recognized a gain of approximately \$1.6 million. During the six months ended June 30, 2013, we did not enter into any TBA securities contracts.

Total expenses were approximately \$10.43 million for the six months ended June 30, 2014, compared to approximately \$7.98 million for the six months ended June 30, 2013. For the six months ended June 30, 2014, we incurred management fees of approximately \$5.6 million, as compared to management fees of approximately \$6 million for the six months ended June 30, 2013, due primarily to management fees being calculated as a percentage of stockholders’ equity (excluding accumulated other comprehensive income), which decreased from the six months ended June 30, 2013. “Other expenses” (as detailed in Note 15 to our unaudited consolidated financial statements) increased approximately \$2.8 million due primarily to an increase in legal and other professional fees and also printing fees related to the Company’s proxy solicitation contest.

Financial Condition

Agency MBS Portfolio

At June 30, 2014, we held agency mortgage assets which had an amortized cost of approximately \$8.01 billion, consisting primarily of approximately \$6.3 billion of adjustable-rate Agency MBS and approximately \$1.7 billion of fixed-rate Agency MBS. This amount represents an approximately 6.6% decrease from the \$8.58 billion held at December 31, 2013. Of the adjustable-rate Agency MBS owned by us, approximately 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 ten years. Hybrid adjustable-rate Agency MBS have an initial interest rate that is fixed for a certain period, usually three to ten years, and thereafter adjust annually for the remainder of the term of the loan.

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

June 30, 2014

December 31, 2013

Edgar Filing: ANWORTH MORTGAGE ASSET CORP - Form 10-Q

Agency	Fair	Portfolio	Fair	Portfolio
	Value	Percentage	Value	Percentage
Fannie Mae (FNM)	\$4,621,156	57.3	% \$4,962,273	58.0
Freddie Mac (FHLMC)	3,435,695	42.6	3,580,834	41.8
Ginnie Mae (GNMA)	12,492	0.1	13,260	0.2
Non-Agency MBS	21	-	79	-
Total MBS:	\$8,069,364	100.0	% \$8,556,446	100.0

30

Edgar Filing: ANWORTH MORTGAGE ASSET CORP - Form 10-Q

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

Agency	June 30, 2014		December 31, 2013	
	Fair Value	Portfolio Percentage	Fair Value	Portfolio Percentage
One-month LIBOR	\$1,285	- %	\$1,532	- %
Six-month LIBOR	47,351	0.6	51,301	0.6
One-year LIBOR	6,137,912	76.1	6,488,980	75.8
Six-month certificate of deposit	948	-	992	-
Six-month constant maturity treasury	198	-	227	-
One-year constant maturity treasury	211,818	2.6	227,805	2.7
Cost of Funds Index	14,676	0.2	16,223	0.2
15-year fixed-rate	1,499,719	18.6	1,658,348	19.4
20-year and 30-year fixed-rate	155,457	1.9	111,038	1.3
Total MBS:	\$8,069,364	100.0 %	\$8,556,446	100.0 %

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

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

	June 30, 2014	March 31, 2014	December 31, 2013	September 30, 2013
Weighted Average Coupon				
Adjustable-rate Agency MBS	2.60 %	2.57 %	2.52 %	2.52 %
Hybrid adjustable-rate Agency MBS	2.57	2.59	2.62	2.66
15-year fixed-rate Agency MBS	2.65	2.68	2.66	2.64
20-year and 30-year fixed-rate Agency MBS	5.01	5.04	5.71	5.74
Total Agency MBS:	2.63 %	2.65 %	2.65 %	2.67 %
Average Amortized Cost				
Adjustable-rate Agency MBS	102.65 %	102.56 %	102.46 %	102.51 %
Hybrid adjustable-rate Agency MBS	103.58	103.55	103.45	103.47
15-year fixed-rate Agency MBS	103.16	103.10	103.39	103.47
20-year and 30-year fixed-rate Agency MBS	102.86	102.91	101.31	101.28
Total Agency MBS:	103.28 %	103.24 %	103.23 %	103.26 %
	2.55 %	2.57 %	2.57 %	2.59 %

Current yield (weighted average coupon divided by average
amortized cost)

31

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

	June 30, 2014	March 31, 2014	December 31, 2013	September 30, 2013
Repurchase agreements outstanding	\$7,118,500	\$7,510,000	\$7,580,000	\$7,575,000
Average repurchase agreements outstanding	\$7,434,984	\$7,565,029	\$7,644,822	\$8,052,629
Average interest rate on outstanding repurchase agreements	0.32	% 0.35	% 0.39	% 0.37
Average days to maturity	37 days	37 days	38 days	38 days
Average interest rate after adjusting for interest rate swap hedges	1.07	% 1.05	% 1.50	% 1.44
Average maturity after adjusting for interest rate swap hedges	889 days	892 days	1,010 days	1,024 days
Average interest rate after adjusting for all interest rate swaps	1.47	% 1.48	% 1.50	% 1.44
Weighted average maturity after adjusting for all interest rate swaps	992 days	1,008 days	1,010 days	1,024 days
Weighted average haircuts ⁽¹⁾	4.98	% 5.03	% 5.05	% 4.92

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

At June 30, 2014 and December 31, 2013, the unamortized net premium paid for our Agency MBS was approximately \$254.5 million and \$268.1 million, respectively.

At June 30, 2014, the current yield of 2.55% declined by 2 basis points from March 31, 2014. For the three months ended June 30, 2014, the weighted average coupon for our total Agency MBS declined by 2 basis points from March 31, 2014. One of the factors that also impacts the reported yield on our MBS portfolio is the actual prepayment rate on the underlying mortgages. We analyze our MBS and the extent to which prepayments impact the yield. When the rate of prepayments exceeds expectations, we amortize the premiums paid on mortgage assets over a shorter time period, resulting in a reduced yield to maturity on our mortgage assets. Conversely, if actual prepayments are less than the assumed CPR, the premium would be amortized over a longer time period, resulting in a higher yield to maturity.

The average interest rate on outstanding repurchase agreements, after adjusting for all interest rate swaps, decreased from 1.50% at December 31, 2013 to 1.47% at June 30, 2014. The weighted average term to next rate adjustment after adjusting for all interest rate swaps decreased from 1,010 days at December 31, 2013 to 992 days at June 30, 2014. The weighted average interest rate after adjusting for only hedged swaps was 1.07%. The weighted average maturity after adjusting for only hedged swaps was 889 days at June 30, 2014.

Residential Properties Portfolio

As of June 30, 2014, we owned 77 single-family residential properties which are all located in Southeastern Florida and were acquired at a total cost of approximately \$10.4 million. As we did not start this operation until March 2014, we did not own any single-family residential properties as of December 31, 2013.

Hedging

We periodically enter into derivative transactions, in the form of forward purchase commitments and interest rate swaps, which are intended to hedge our exposure to rising interest rates on funds borrowed to finance our investments in securities. We designate interest rate swaps 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 consistent with our capital investment policy. Swaps are derivative instruments as defined by ASC 815-10. We do not anticipate entering into derivative transactions for speculative or trading purposes. In accordance with the swap agreements, we pay a fixed rate of interest during the term of the swaps and receive a payment that varies with the three-month LIBOR rate.

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

	June 30, 2014	March 31, 2014	December 31, 2013	September 30, 2013
Aggregate notional amount of swap agreements	\$5.265 billion	\$5.44 billion	\$5.375 billion	\$5.185 billion
Average maturity of swap agreements	3.7 years	3.8 years	3.9 years	4.1 years
Weighted average fixed rate paid on swap agreements	1.78 %	1.79 %	1.81 %	1.82 %
Swap agreements as a percentage of outstanding repurchase agreements	74 %	72 %	71 %	68 %

At June 30, 2014, there were unrealized losses of approximately \$68.3 million on all of our swaps.

On March 17, 2014, we decided to discontinue hedge accounting on certain swaps which totaled approximately \$1.685 billion in notional amounts and was approximately \$1.51 billion at June 30, 2014. These swaps carry a remaining average fixed rate of 1.89% and an average maturity of September 2015. These swaps will not be closed out or terminated and no realized loss will be recognized. As of the date we decided to discontinue hedge accounting for these swaps, there was a related liability of approximately \$42 million. At June 30, 2014, this liability was approximately \$34.8 million. During the three and six months ended June 30, 2014, the net loss on interest rate swaps was approximately \$2 million and \$1.4 million, respectively, and the net payments accrued relating to these swaps was approximately \$7.2 million and \$15.2 million, respectively.

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

Liquidity and Capital Resources

MBS Portfolio

Our primary source of funds consists of repurchase agreements which totaled approximately \$7.1 billion at June 30, 2014. As collateral for our repurchase agreements and interest rate swaps, we pledged approximately \$7.6 billion in MBS. Our other significant source of funds for the three months ended June 30, 2014 consisted of payments of principal from our MBS portfolio in the amount of approximately \$351.1 million.

For the three months ended June 30, 2014, there was a net decrease in cash and cash equivalents of approximately \$1.1 million. This consisted of the following components:

- Net cash provided by operating activities for the three months ended June 30, 2014 was approximately \$19.8 million. This is comprised of net income of approximately \$10 million and adding back the following non-cash items: the amortization of premiums and discounts of approximately \$11.8 million, the amortization of restricted stock of \$24 thousand and net loss on interest rate swaps of approximately \$2 million, partially offset by recoveries on Non-Agency MBS of approximately \$33 thousand, amortization related to interest rate swaps of approximately \$756 thousand, gain on derivatives-TBA securities of approximately \$1.6 million and gain on sale of Agency MBS of approximately \$1.6 million. Net cash provided by operating activities also included an increase in accrued expenses of approximately \$552 thousand and a decrease in accrued interest receivable of approximately \$1.3 million and an increase in interest payable of approximately \$2.4 million, partially offset by an increase in prepaid expenses and other of approximately \$4.5 million;
- Net cash provided by investing activities for the three months ended June 30, 2014 was approximately \$439.8 million, which consisted of \$351.1 million from principal payments on Agency MBS and proceeds from the sales of Agency MBS of approximately \$197.7 million, partially offset by purchases of Agency MBS of approximately \$99.2 million and purchases of residential properties of approximately \$9.8 million; and
- Net cash used in financing activities for the three months ended June 30, 2014 was approximately \$460.6 million. This consisted of borrowings on repurchase agreements of approximately \$8.977 billion, partially offset by repayments on repurchase agreements of approximately \$9.368 billion. This also included net proceeds from common stock issued net of

common stock repurchased of approximately \$49.7 million and dividends paid of approximately \$18.7 million on common stock and dividends paid of approximately \$1.4 million on preferred stock, partially offset by net settlements of TBA commitments of approximately \$0.7 million.

Relative to our MBS portfolio at June 30, 2014, all of our repurchase agreements were fixed-rate term repurchase agreements with original maturities ranging from one day to three months. At June 30, 2014, we had borrowed funds under repurchase agreements with 24 different financial institutions. As the repurchase agreements mature, we enter into new repurchase agreements to take their place. Because we borrow money based on the fair value of our MBS and because increases in short-term interest rates or increasing market concern about the liquidity or value of our MBS can negatively impact the valuation of MBS, our borrowing ability could be reduced and lenders may initiate margin calls in the event short-term interest rates increase or the value of our MBS declines for other reasons. Typically, most margin calls by lenders arise each month due to prepayments. The value of the MBS pledged is reduced by an amount equal to any prepaid principal in order to reestablish the required ratio of borrowing to collateral value. The pledging of additional collateral is usually done on the same day or the following day. We had adequate cash flow, liquid assets and unpledged collateral with which to meet our margin requirements during the three months ended June 30, 2014, but there can be no assurance we will have adequate cash flow, liquid assets and unpledged collateral with which to meet our margin requirements in the future.

At June 30, 2014, our leverage on capital (including all preferred stock and junior subordinated notes) was 8.04x, which declined slightly from our leverage multiple of 8.1x at December 31, 2013.

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

During the three months ended June 30, 2014, we raised approximately \$390 thousand in capital under our 2012 Dividend Reinvestment and Stock Purchase Plan.

During the three months ended June 30, 2014, we did not issue any shares of our Common Stock, our Series A Preferred Stock or our Series B Preferred Stock under our 2011 Sales Agreement with Cantor (as described in Note 10 to the accompanying unaudited consolidated financial statements). At June 30, 2014, there were 19,409,400 shares of common stock, 956,122 shares of Series A Preferred Stock and 894,518 shares of Series B Preferred Stock, respectively, available for sale and future issuance under the 2011 Sales Agreement.

Disclosure of Contractual Obligations

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

Stockholders' Equity

We use available-for-sale treatment for our MBS, which are carried on our balance sheets at fair value rather than historical cost. Based upon this treatment, our total equity base at June 30, 2014 was approximately \$824.2 million. Common stockholders' equity was approximately \$774.9 million, or a book value of \$6.26 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 balance sheets by

changing the carrying value of the assets and reflecting the change in stockholders' equity under "Accumulated other comprehensive income, unrealized gain (loss) on available-for-sale securities."

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

Unrealized changes in the fair value of MBS have one significant and direct effect on our potential earnings and dividends: positive mark-to-market changes will increase our equity base and allow us to increase our borrowing capacity, while negative changes will tend to reduce borrowing capacity under our capital investment policy. A very large negative change in the net market value of our MBS might reduce our liquidity, requiring us to sell assets with the likely result of realized losses upon sale. "Accumulated other comprehensive income" on available-for-sale Agency MBS was approximately \$15.5 million, or 0.19% of the

amortized cost of our Agency MBS, at June 30, 2014. This, along with “Accumulated other comprehensive loss, derivatives” of approximately \$68.3 million, constitutes the total “Accumulated other comprehensive loss” of approximately \$52.8 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.

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

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

Revenue Recognition

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

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

Valuation and Classification of Investment Securities

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

securities classified as available-for-sale, which are determined by management to be other-than-temporary in nature, are reclassified from “Accumulated other comprehensive income (loss)” to current-period income (loss). For more detail on the fair value of our securities, see Note 7 to the accompanying unaudited consolidated financial statements.

Accounting for Derivatives and Hedging Activities

In accordance with ASC 815-10, 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 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 (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, 7 and 13 to the accompanying unaudited consolidated financial statements.

Income Taxes

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

Recent Accounting Pronouncements

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

Subsequent Events

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 July 1, 2014 from 4.0411 shares of our common stock to 4.0919 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 \$5.30 and (2) the annualized common stock dividend yield was 10.5621%.

From July 1, 2014 through August 4, 2014, we issued an aggregate of 67,972 shares of common stock at a weighted average price of \$5.19 per share under the 2012 Dividend Reinvestment and Stock Purchase Plan, resulting in proceeds to us of approximately \$353 thousand.

From July 1, 2014 through August 4, 2014, we had repurchased an aggregate of 2,333,590 shares of our common stock at a weighted average price of \$5.17 per share under our share repurchase program.

From July 1, 2014 through August 4, 2014, we acquired two single-family residential rental properties in Southeastern Florida for approximately \$218 thousand.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

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

Interest Rate Risk

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

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

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

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

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

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

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

Investment Type/Rate Reset Dates	Investments ⁽¹⁾⁽²⁾		Borrowings	
	Amount	Percentage of Total Investments	Amount	Percentage of Total Borrowings
15-year fixed-rate investments	\$1,499,719	18.1	% \$-	-
15-year fixed-rate TBA Agency securities	211,674	2.6	-	-
20-year and 30-year fixed-rate investments	155,457	1.9	-	-
Adjustable-Rate Investments/Obligations				
Less than 3 months	347,610	4.2	7,118,500	100.0

Edgar Filing: ANWORTH MORTGAGE ASSET CORP - Form 10-Q

Greater than 3 months and less than 1 year	1,481,919	17.9	-	-		
Greater than 1 year and less than 2 years	906,730	10.9	-	-		
Greater than 2 years and less than 3 years	1,208,906	14.6	-	-		
Greater than 3 years and less than 4 years	289,703	3.5	-	-		
Greater than 4 years and less than 5 years	295,419	3.6	-	-		
Greater than 5 years and less than 7 years	1,228,714	14.8	-	-		
Greater than 7 years	655,187	7.9	-	-		
Total:	\$8,281,038	100.0	%	\$7,118,500	100.0	%

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

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

37

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

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

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

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

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 June 30, 2014, our Agency MBS had a weighted average term to next rate adjustment of approximately 39 months while our borrowings had a weighted average term to next rate adjustment of 37 days. After adjusting for all interest rate swaps, the weighted average term to next rate adjustment was 992 days. Accordingly, in a period of rising interest rates, our borrowing costs will usually increase faster than our interest earnings from MBS. As a result, we could experience a decrease in net income or a net loss during these periods. Our assets that are pledged to secure short-term borrowings are high-quality liquid assets. As a result, we have been able to roll over our short-term borrowings as they mature. There can be no assurance that we will always be able to roll over our short-term debt.

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

At June 30, 2014, we had unrestricted cash of approximately \$1.2 million and approximately \$431.6 million in unpledged MBS available to meet margin calls on short-term borrowings that could be caused by asset value declines or changes in lender collateralization requirements.

Prepayment Risk

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

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

General

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

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

Tabular Presentation

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

Change in Interest Rates	Percentage Change in Projected Net Interest Income	Percentage Change in Projected Portfolio Value
-2%	-107%	-2.8%
-1%	-33%	-0.4%
0%	0%	0%
1%	-13%	-0.8%
2%	-31%	-3.0%

The information presented in the table below projects the impact of the same sudden changes in interest rates on our annual projected net income and projected portfolio value compared to the base case used in the table above, and the only difference is that it

excludes the effect of the interest rate swap agreements on both net interest income and portfolio value. As of June 30, 2014, the aggregate notional amount of our interest rate swap agreements was \$5.265 billion and the weighted average maturity was 3.7 years.

Change in Interest Rates	Percentage Change in Projected Net Interest Income	Percentage Change in Projected Portfolio Value
-2%	166%	1.8%
-1%	240%	1.9%
0%	0%	0%
1%	86%	-3.1%
2%	-87%	-7.5%

Item 4. Controls and Procedures

Disclosure Controls and Procedures

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

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

Changes in Internal Control Over Financial Reporting

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

PART II. OTHER INFORMATION

Item 1. Legal Proceedings.

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

Item 1A. Risk Factors.

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

Risk Factors for Residential Properties Business

We are entering into a relatively new industry that has significant competition, and we have no operating history in this sector, which makes this business difficult to evaluate and may affect our ability to operate this business in a profitable manner.

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

In addition, although we have several employees who have previously personally engaged in this business on a small scale, we have no operating history as a company in this business, and will be contracting with various third-party professionals to assist us in acquiring and managing our properties and providing services to tenants. If these professionals do a poor job or don't perform to our expectations, it could affect the prices we pay to acquire properties, our relationships with our tenants, the operation of our properties, and our reputation in this business. These factors make this business difficult to evaluate, and may affect our ability to operate this business in a profitable manner.

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

The success of our business model will depend upon many factors including, but not limited to: the availability of properties that meet our investment criteria and our ability to acquire such properties at favorable prices; real estate appreciation or depreciation in our target markets; the condition of our properties; our ability to contain renovation, maintenance, marketing and other operating costs for our properties; our ability to maintain high occupancy rates and target rent levels; general economic conditions in our target markets, such as changes in employment and household earnings and expenses; the effects of rent controls, stabilization laws and other laws or regulations regarding rental rates and tenant rights; and changes in, and changes in enforcement of, laws, regulations and government policies

including health, safety, environmental, property, zoning and tax laws. We will have no control over many of these factors, which could adversely affect the profitability of this business. Our success will also depend, in part, on our assumptions about our target properties, our target renters, our renovation, maintenance and other operating costs, and our rental rates and occupancy levels and, if our assumptions prove to be inaccurate, this may adversely affect the profitability of this business.

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

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

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

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

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

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

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

None.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Mine Safety Disclosures.

Not applicable.

Item 5. Other Information.

(a) Additional Disclosures. None.

(b) Stockholder Nominations. There have been no material changes to the procedures by which stockholders may recommend nominees to our board of directors during the quarter ended June 30, 2014. Please see the discussion of our procedures in our most recent proxy statement filed with the SEC on April 14, 2014 as DEFC 14A.

Item 6. Exhibits.

Edgar Filing: ANWORTH MORTGAGE ASSET CORP - Form 10-Q

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

Exhibit

Number Description

- 1.1 Controlled Equity Offering Sales Agreement dated May 27, 2011 between Anworth Mortgage Asset Corporation and Cantor Fitzgerald & Co. (incorporated by reference from our Current Report on Form 8-K filed with the SEC on May 27, 2011)
- 3.1 Amended Articles of Incorporation of Anworth (incorporated by reference from our Registration Statement on Form S-11, Registration No. 333-38641, which became effective under the Securities Act of 1933, as amended, on March 12, 1998)
- 3.2 Articles of Amendment to Amended Articles of Incorporation (incorporated by reference from our Definitive Proxy Statement filed, pursuant to Section 14(a) of the Securities Exchange Act of 1934, as amended, with the SEC on May 14, 2003)
- 3.3 Articles of Amendment to Amended Articles of Incorporation (incorporated by reference from our Current Report on Form 8-K filed with the SEC on May 28, 2008)

42

Exhibit

Number Description

- 3.4 Amended Bylaws of the Company (incorporated by reference from our Current Report on Form 8-K filed with the SEC on March 13, 2009)
- 3.5 Amendment of Bylaws to Amended Bylaws of the Company (incorporated by reference from our Current Report on Form 8-K filed with the SEC on April 1, 2014)
- 3.6 Articles Supplementary for Series A Cumulative Preferred Stock (incorporated by reference from our Current Report on Form 8-K filed with the SEC on November 3, 2004)
- 3.7 Articles Supplementary for Series A Cumulative Preferred Stock (incorporated by reference from our Current Report on Form 8-K filed with the SEC on January 21, 2005)
- 3.8 Articles Supplementary for Series B Cumulative Convertible Preferred Stock (incorporated by reference from our Current Report on Form 8-K filed with the SEC on January 30, 2007)
- 3.9 Articles Supplementary for Series B Cumulative Convertible Preferred Stock (incorporated by reference from our Current Report on Form 8-K filed with the SEC on May 21, 2007)
- 4.1 Specimen Common Stock Certificate (incorporated by reference from our Registration Statement on Form S-11, Registration No. 333-38641, which became effective under the Securities Act of 1933, as amended, on March 12, 1998)
- 4.2 Specimen Series A Cumulative Preferred Stock Certificate (incorporated by reference from our Current Report on Form 8-K filed with the SEC on November 3, 2004)
- 4.3 Specimen Series B Cumulative Convertible Preferred Stock Certificate (incorporated by reference from our Current Report on Form 8-K filed with the SEC on January 30, 2007)
- 4.4 Specimen Anworth Capital Trust I Floating Rate Preferred Stock Certificate (liquidation amount \$1,000 per Preferred Security) (incorporated by reference from our Current Report on Form 8-K filed with the SEC on March 16, 2005)
- 4.5 Specimen Anworth Capital Trust I Floating Rate Common Stock Certificate (liquidation amount \$1,000 per Common Security) (incorporated by reference from our Current Report on Form 8-K filed with the SEC on

March 16, 2005)

- 4.6 Specimen Anworth Floating Rate Junior Subordinated Note Due 2035 (incorporated by reference from our Current Report on Form 8-K filed with the SEC on March 16, 2005)
- 4.7 Junior Subordinated Indenture dated as of March 15, 2005, between Anworth and JPMorgan Chase Bank (incorporated by reference from our Current Report on Form 8-K filed with the SEC on March 16, 2005)
- 10.1* 2014 Equity Compensation Plan (incorporated by reference from our Registration Statement on Form S-8 filed with the SEC on August 5, 2014)
- 10.2* 2007 Dividend Equivalent Rights Plan (incorporated by reference from our Definitive Proxy Statement filed, pursuant to Section 14(a) of the Securities Exchange Act of 1934, as amended, with the SEC on April 26, 2007)
- 10.3* 2012 Dividend Reinvestment and Stock Purchase Plan (incorporated by reference from our Registration Statement on Form S-3, Registration No. 333-180093, which became effective under the Securities Act of 1933, as amended, on March 14, 2012)
- 10.4 Termination Agreement, dated as of December 31, 2011, between Anworth and Lloyd McAdams, with respect to the Employment Agreement, dated as of January 1, 2002, between Anworth and Lloyd McAdams, as amended (incorporated by reference from our Current Report on Form 8-K filed with the SEC on January 3, 2012)
- 10.5 Termination Agreement, dated as of December 31, 2011, between Anworth and Heather U. Baines, with respect to the Employment Agreement, dated as of January 1, 2002, between Anworth and Heather U. Baines, as amended (incorporated by reference from our Current Report on Form 8-K filed with the SEC on January 3, 2012)
- 10.6 Termination Agreement, dated as of December 31, 2011, between Anworth and Joseph E. McAdams, with respect to the Employment Agreement, dated as of January 1, 2002, between Anworth and Joseph E. McAdams, as amended (incorporated by reference from our Current Report on Form 8-K filed with the SEC on January 3, 2012)
- 10.7 Purchase Agreement dated as of March 15, 2005, by and among Anworth, Anworth Capital Trust I, TABERNA Preferred Funding I, Ltd., and Merrill Lynch International (incorporated by reference from our Current Report on Form 8-K filed with the SEC on March 16, 2005)

Exhibit

Number Description

- 10.8 Second Amended and Restated Trust Agreement dated as of September 26, 2005 by and among Anworth, JPMorgan Chase Bank, National Association, Chase Bank USA, National Association, Lloyd McAdams, Joseph McAdams, Thad Brown and the several Holders, as defined therein (incorporated by reference from our Annual Report on Form 10-K for the fiscal year ended December 31, 2005, as filed with the SEC on March 16, 2006)
- 10.9* Change in Control and Arbitration Agreement, dated June 27, 2006, between Anworth and Thad M. Brown (incorporated by reference from our Current Report on Form 8-K filed with the SEC on June 28, 2006), as amended by Amendment to Anworth Mortgage Asset Corporation Change in Control and Arbitration Agreement, effective December 31, 2011, between Anworth and Thad M. Brown (incorporated by reference from our Current Report on Form 8-K filed with the SEC on January 3, 2012)
- 10.10 Amended and Restated Administrative Services Agreement dated August 20, 2010, between Anworth and PIA (incorporated by reference from our Current Report on Form 8-K filed with the SEC on August 20, 2010)
- 10.11 Management Agreement dated as of December 31, 2011 by and between Anworth and Anworth Management, LLC (incorporated by reference from our Current Report on Form 8-K filed with the SEC on January 3, 2012)
- 10.12 Sublease dated as of January 26, 2012, between Anworth and PIA (incorporated by reference from our Quarterly Report on Form 10-Q for the quarter ended June 30, 2012, as filed with the SEC on August 6, 2012)
- 31.1 Certification of the Principal Executive Officer, as required by Rule 13a-14(a) of the Securities Exchange Act of 1934
- 31.2 Certification of the Principal Financial Officer, as required by Rule 13a-14(a) of the Securities Exchange Act of 1934
- 32.1 Certifications of the Principal Executive Officer provided pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certifications of the Principal Financial Officer provided pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

- 101 XBRL Instance Document
- 101 XBRL Taxonomy Extension Schema Document
- 101 XBRL Taxonomy Extension Calculation Linkbase Document
- 101 XBRL Taxonomy Definition Linkbase Document
- 101 XBRL Taxonomy Extension Labels Linkbase Document
- 101 XBRL Taxonomy Extension Presentation Linkbase Document

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

SIGNATURES

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

ANWORTH MORTGAGE ASSET CORPORATION

Dated: August 6, 2014 /S/ JOSEPH LLOYD MCADAMS

Joseph Lloyd McAdams
Chairman of the Board, President and Chief Executive Officer
(Chief Executive Officer)

Dated: August 6, 2014 /s/ THAD M. BROWN

Thad M. Brown
Chief Financial Officer
(Chief Financial Officer and Principal Accounting Officer)