

Invesco Mortgage Capital Inc.
Form 10-Q
November 07, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2018

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 001-34385

(Exact Name of Registrant as Specified in Its Charter)

| | |
|--|--------------------------------------|
| Maryland | 26-2749336 |
| (State or Other Jurisdiction of Incorporation or Organization) | (I.R.S. Employer Identification No.) |

1555 Peachtree Street, N.E., Suite 1800
Atlanta, Georgia 30309
(Address of Principal Executive Offices) (Zip Code)
(404) 892-0896
(Registrant's Telephone Number, Including Area Code)

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

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

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

Large Accelerated filer Accelerated filer
Non-Accelerated filer Smaller reporting company
Emerging growth company

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

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

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As of October 31, 2018, there were 111,652,661 outstanding shares of common stock of Invesco Mortgage Capital Inc.

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PART I

ITEM 1. FINANCIAL STATEMENTS

INVESCO MORTGAGE CAPITAL INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

| \$ in thousands except share amounts | As of September 30, 2018 | December 31, 2017 |
|---|--------------------------------|----------------------|
| ASSETS | | |
| Mortgage-backed and credit risk transfer securities, at fair value (including pledged securities of \$17,473,413 and \$17,560,811, respectively) | 18,336,825 | 18,190,754 |
| Commercial loans, held-for-investment | 31,707 | 191,808 |
| Cash and cash equivalents | 108,223 | 88,381 |
| Restricted cash | 300 | 620 |
| Due from counterparties | 26,380 | — |
| Investment related receivable (including pledged securities of \$449,289 and \$0, respectively) | 528,223 | 73,217 |
| Derivative assets, at fair value | 46,214 | 6,896 |
| Other assets | 145,015 | 105,580 |
| Total assets | 19,222,887 | 18,657,256 |
| LIABILITIES AND EQUITY | | |
| Liabilities: | | |
| Repurchase agreements | 14,378,518 | 14,080,801 |
| Secured loans | 1,650,000 | 1,650,000 |
| Exchangeable senior notes, net | — | 143,231 |
| Derivative liabilities, at fair value | 13,982 | 32,765 |
| Dividends and distributions payable | 50,205 | 50,193 |
| Investment related payable | 559,398 | 5,191 |
| Accrued interest payable | 25,624 | 17,845 |
| Collateral held payable | 47,687 | 7,327 |
| Accounts payable and accrued expenses | 1,620 | 2,200 |
| Due to affiliate | 10,430 | 10,825 |
| Total liabilities | 16,737,464 | 16,000,378 |
| Commitments and contingencies (See Note 16): | | |
| Equity: | | |
| Preferred Stock, par value \$0.01 per share; 50,000,000 shares authorized: | | |
| 7.75% Series A Cumulative Redeemable Preferred Stock: 5,600,000 shares issued and outstanding (\$140,000 aggregate liquidation preference) | 135,356 | 135,356 |
| 7.75% Fixed-to-Floating Series B Cumulative Redeemable Preferred Stock: 6,200,000 shares issued and outstanding (\$155,000 aggregate liquidation preference) | 149,860 | 149,860 |
| 7.50% Fixed-to-Floating Series C Cumulative Redeemable Preferred Stock: 11,500,000 shares issued and outstanding (\$287,500 aggregate liquidation preference) | 278,108 | 278,108 |
| Common Stock, par value \$0.01 per share; 450,000,000 shares authorized; 111,652,661 and 111,624,159 shares issued and outstanding, respectively | 1,116 | 1,116 |
| Additional paid in capital | 2,385,218 | 2,384,356 |
| Accumulated other comprehensive income | 174,553 | 261,029 |
| Retained earnings (distributions in excess of earnings) | (663,007) | (579,334) |
| Total stockholders' equity | 2,461,204 | 2,630,491 |

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| | | |
|------------------------------|------------|------------|
| Non-controlling interest | 24,219 | 26,387 |
| Total equity | 2,485,423 | 2,656,878 |
| Total liabilities and equity | 19,222,887 | 18,657,256 |

The accompanying notes are an integral part of these condensed consolidated financial statements.

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INVESCO MORTGAGE CAPITAL INC. AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
 (Unaudited)

| | Three Months | | Nine Months | |
|---|-----------------|-----------|-----------------|-----------|
| | Ended September | | Ended September | |
| | 30, | | 30, | |
| \$ in thousands, except share amounts | 2018 | 2017 | 2018 | 2017 |
| Interest Income | | | | |
| Mortgage-backed and credit risk transfer securities | 160,416 | 134,138 | 456,967 | 374,038 |
| Commercial and other loans | 1,672 | 6,251 | 9,945 | 18,036 |
| Total interest income | 162,088 | 140,389 | 466,912 | 392,074 |
| Interest Expense | | | | |
| Repurchase agreements | 81,763 | 45,907 | 210,737 | 111,926 |
| Secured loans | 9,490 | 5,544 | 24,888 | 13,492 |
| Exchangeable senior notes | — | 2,724 | 1,621 | 11,236 |
| Total interest expense | 91,253 | 54,175 | 237,246 | 136,654 |
| Net interest income | 70,835 | 86,214 | 229,666 | 255,420 |
| Other Income (loss) | | | | |
| Gain (loss) on investments, net | (207,910) | (11,873) | (404,657) | (2,551) |
| Equity in earnings (losses) of unconsolidated ventures | 1,084 | 408 | 2,778 | (1,280) |
| Gain (loss) on derivative instruments, net | 87,672 | 1,955 | 288,208 | (46,096) |
| Realized and unrealized credit derivative income (loss), net | 4,975 | (2,930) | 8,875 | 38,428 |
| Net loss on extinguishment of debt | — | (1,344) | (26) | (6,581) |
| Other investment income (loss), net | 1,068 | 2,313 | 2,010 | 6,175 |
| Total other income (loss) | (113,111) | (11,471) | (102,812) | (11,905) |
| Expenses | | | | |
| Management fee – related party | 10,105 | 9,557 | 30,428 | 27,385 |
| General and administrative | 1,673 | 1,697 | 4,954 | 5,389 |
| Total expenses | 11,778 | 11,254 | 35,382 | 32,774 |
| Net income (loss) | (54,054) | 63,489 | 91,472 | 210,741 |
| Net income (loss) attributable to non-controlling interest | (681) | 800 | 1,153 | 2,656 |
| Net income (loss) attributable to Invesco Mortgage Capital Inc. | (53,373) | 62,689 | 90,319 | 208,085 |
| Dividends to preferred stockholders | 11,107 | 13,562 | 33,320 | 24,994 |
| Net income (loss) attributable to common stockholders | (64,480) | 49,127 | 56,999 | 183,091 |
| Earnings per share: | | | | |
| Net income (loss) attributable to common stockholders | | | | |
| Basic | (0.58) | 0.44 | 0.51 | 1.64 |
| Diluted | (0.58) | 0.43 | 0.51 | 1.59 |

The accompanying notes are an integral part of these condensed consolidated financial statements.

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INVESCO MORTGAGE CAPITAL INC. AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
 (Unaudited)

| | Three Months | | Nine Months | |
|--|-----------------|-----------|-----------------|-----------|
| | Ended September | | Ended September | |
| | 30, | 30, | 30, | 30, |
| \$ in thousands | 2018 | 2017 | 2018 | 2017 |
| Net income (loss) | (54,054) | 63,489 | 91,472 | 210,741 |
| Other comprehensive income (loss): | | | | |
| Unrealized gain (loss) on mortgage-backed and credit risk transfer securities, net | (40,554) | 19,089 | (220,800) | 75,011 |
| Reclassification of unrealized (gain) loss on sale of mortgage-backed and credit risk transfer securities to gain (loss) on investments, net | 134,280 | 7 | 153,406 | 1,508 |
| Reclassification of amortization of net deferred (gain) loss on de-designated interest rate swaps to repurchase agreements interest expense | (6,422) | (6,438) | (19,859) | (19,105) |
| Currency translation adjustments on investment in unconsolidated venture | (1,126) | 807 | (328) | 331 |
| Total other comprehensive income (loss) | 86,178 | 13,465 | (87,581) | 57,745 |
| Comprehensive income (loss) | 32,124 | 76,954 | 3,891 | 268,486 |
| Less: Comprehensive (income) loss attributable to non-controlling interest | (405) | (970) | (48) | (3,384) |
| Less: Dividends to preferred stockholders | (11,107) | (13,562) | (33,320) | (24,994) |
| Comprehensive income (loss) attributable to common stockholders | 20,612 | 62,422 | (29,477) | 240,108 |

The accompanying notes are an integral part of these condensed consolidated financial statements.

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CONDENSED CONSOLIDATED STATEMENT OF EQUITY

For the nine months ended September 30, 2018

(Unaudited)

| \$ in thousands except share amounts | Series A Preferred Stock | | Series B Preferred Stock | | Series C Preferred Stock | | Common Stock | | Attributable to Common Stockholders | | Accumulated Other Comprehensive Income (Loss) | Retained Earnings (Distributions in excess of earnings) |
|---|-----------------------------|---------|-----------------------------|---------|-----------------------------|---------|--------------|--------|-------------------------------------|----------|---|---|
| | Shares | Amount | Shares | Amount | Shares | Amount | Shares | Amount | Additional Paid in Capital | | | |
| Balance at December 31, 2017 | 5,600,000 | 135,356 | 6,200,000 | 149,860 | 11,500,000 | 278,108 | 111,624,159 | 1,116 | 2,384,356 | 261,029 | (579,330) | |
| Net income | — | — | — | — | — | — | — | — | — | — | 90,319 | |
| Other comprehensive loss | — | — | — | — | — | — | — | — | — | (86,476) | — | |
| Stock awards | — | — | — | — | — | — | 28,502 | — | — | — | — | |
| Common stock dividends | — | — | — | — | — | — | — | — | — | — | (140,600) | |
| Common unit dividends | — | — | — | — | — | — | — | — | — | — | — | |
| Preferred stock dividends | — | — | — | — | — | — | — | — | — | — | (33,320) | |
| Amortization of equity-based compensation | — | — | — | — | — | — | — | — | 436 | — | — | |
| Rebalancing of ownership percentage of non-controlling interest | — | — | — | — | — | — | — | — | 426 | — | — | |
| Balance at September 30, 2018 | 5,600,000 | 135,356 | 6,200,000 | 149,860 | 11,500,000 | 278,108 | 111,652,661 | 1,116 | 2,385,218 | 174,553 | (663,000) | |

The accompanying notes are an integral part of this condensed consolidated financial statement.

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INVESCO MORTGAGE CAPITAL INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

| | Nine Months Ended September 30, | |
|---|------------------------------------|---------------|
| \$ in thousands | 2018 | 2017 |
| Cash Flows from Operating Activities | | |
| Net income | 91,472 | 210,741 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Amortization of mortgage-backed and credit risk transfer securities premiums and (discounts), net | 37,263 | 53,612 |
| Realized and unrealized (gain) loss on derivative instruments, net | (307,594) | (14,217) |
| Realized and unrealized (gain) loss on credit derivatives, net | 8,034 | (20,904) |
| (Gain) loss on investments, net | 404,657 | 2,551 |
| Loss from investments in unconsolidated ventures in excess of distributions received | 320 | 1,925 |
| Other amortization | (19,332) | (17,702) |
| Net loss on extinguishment of debt | 26 | 6,581 |
| (Gain) loss on foreign currency transactions, net | 1,038 | (3,715) |
| Changes in operating assets and liabilities: | | |
| Increase in operating assets | (1,140) | (9,713) |
| Decrease (increase) in operating liabilities | 6,974 | (4,985) |
| Net cash provided by operating activities | 221,718 | 204,174 |
| Cash Flows from Investing Activities | | |
| Purchase of mortgage-backed and credit risk transfer securities | (4,996,460) | (5,480,222) |
| (Contributions to) distributions from investments in unconsolidated ventures, net | 1,107 | 9,023 |
| Change in other assets | (41,094) | (3,457) |
| Principal payments from mortgage-backed and credit risk transfer securities | 1,597,052 | 1,758,781 |
| Proceeds from sale of mortgage-backed and credit risk transfer securities | 2,836,065 | 625,540 |
| Proceeds from/ (payments for) settlement or termination of forwards, swaps, futures and TBAs, net | 249,492 | (5,808) |
| Net change in due from counterparties and collateral held payable | 13,980 | 1,255 |
| Principal payments from commercial loans held-for-investment | 160,809 | — |
| Origination and advances of commercial loans, net of origination fees | (1,677) | (3,754) |
| Net cash used in investing activities | (180,726) | (3,098,642) |
| Cash Flows from Financing Activities | | |
| Proceeds from issuance of preferred stock, net of issuance cost | — | 278,411 |
| Due from counterparties - secured loans | — | (1,550) |
| Proceeds from repurchase agreements | 108,342,902 | 107,218,532 |
| Principal repayments of repurchase agreements | (108,044,996) | (104,288,947) |
| Extinguishment of exchangeable senior notes | (143,433) | (247,454) |
| Payments of deferred costs | (167) | — |
| Payments of dividends and distributions | (175,776) | (152,782) |
| Net cash (used in) provided by financing activities | (21,470) | 2,806,210 |
| Net change in cash, cash equivalents and restricted cash | 19,522 | (88,258) |
| Cash, cash equivalents and restricted cash, beginning of period | 89,001 | 161,788 |
| Cash, cash equivalents and restricted cash, end of period | 108,523 | 73,530 |
| Supplement Disclosure of Cash Flow Information | | |
| Interest paid | 248,824 | 159,982 |

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Non-cash Investing and Financing Activities Information

| | | |
|---|----------|--------------|
| Net change in unrealized gain (loss) on mortgage-backed and credit risk transfer securities | (67,394 |) 76,519 |
| Dividends and distributions declared not paid | 50,205 | 59,909 |
| Net change in investment related payable (receivable) | (100,061 |) (141,085) |
| Net change in repurchase agreements, not settled | (189 |) (1,416) |
| Change in due from counterparties and collateral held payable | — | 86,450 |

The accompanying notes are an integral part of these condensed consolidated financial statements.

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INVESCO MORTGAGE CAPITAL INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1 – Organization and Business Operations

Invesco Mortgage Capital Inc. (the "Company", "we") is a Maryland corporation primarily focused on investing in, financing and managing residential and commercial mortgage-backed securities and mortgage loans. We are externally managed and advised by Invesco Advisers, Inc. (our "Manager"), a registered investment adviser and an indirect, wholly-owned subsidiary of Invesco Ltd. ("Invesco"), a leading independent global investment management firm. We conduct our business through IAS Operating Partnership LP (the "Operating Partnership"), as its sole general partner. As of September 30, 2018, we owned 98.7% of the Operating Partnership, and a wholly-owned subsidiary of Invesco owned the remaining 1.3%. We have one operating segment.

We primarily invest in:

- Residential mortgage-backed securities ("RMBS") that are guaranteed by a U.S. government agency such as the Government National Mortgage Association, or a federally chartered corporation such as the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation (collectively "Agency RMBS");
- Commercial mortgage-backed securities ("CMBS") that are guaranteed by a U.S. government agency such as the Government National Mortgage Association or a federally chartered corporation such as the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation (collectively "Agency CMBS");
- RMBS that are not guaranteed by a U.S. government agency ("non-Agency RMBS");
- CMBS that are not guaranteed by a U.S. government agency ("non-Agency CMBS");
- Credit risk transfer securities that are unsecured obligations issued by government-sponsored enterprises ("GSE CRT");
- Residential and commercial mortgage loans; and
- Other real estate-related financing agreements.

We elected to be taxed as a real estate investment trust ("REIT") for U.S. federal income tax purposes under the provisions of the Internal Revenue Code of 1986 commencing with our taxable year ended December 31, 2009. To maintain our REIT qualification, we are generally required to distribute at least 90% of our REIT taxable income to our stockholders annually. We operate our business in a manner that permits exclusion from the "Investment Company" definition under the Investment Company Act of 1940.

Note 2 – Summary of Significant Accounting Policies

Basis of Presentation and Consolidation

Certain disclosures included in our Annual Report on Form 10-K are not required to be included on an interim basis in our quarterly reports on Form 10-Q. We have condensed or omitted these disclosures. Therefore, this Form 10-Q should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2017.

The condensed consolidated financial statements have been prepared in accordance with U.S. GAAP and consolidate the financial statements of the Company and our controlled subsidiaries. All significant intercompany transactions, balances, revenues and expenses are eliminated upon consolidation. In the opinion of management, the condensed consolidated financial statements reflect all adjustments, consisting of normal recurring accruals, which are necessary for a fair statement of our financial condition and results of operations for the periods presented.

Use of Estimates

The preparation of condensed consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. Examples of estimates include, but are not limited to, estimates of the fair values of financial instruments, interest income on mortgage-backed and credit risk transfer securities, allowance for loan losses and other-than-temporary impairment charges. Actual results may differ from those estimates.

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Significant Accounting Policies

There have been no changes to our accounting policies included in Note 2 to the consolidated financial statements of our Annual Report on Form 10-K for the year ended December 31, 2017, other than the significant accounting policy disclosed below.

Restricted Cash

Restricted cash represents cash posted with the Federal Home Loan Bank of Indianapolis ("FHLBI") as collateral for secured loans and cash posted with counterparties as collateral for various derivative instruments. Cash held by counterparties as collateral is legally restricted and is not available for general corporate purposes.

Accounting Pronouncements Recently Adopted

Effective January 1, 2018, we adopted the accounting guidance that amends certain aspects of recognition, measurement, presentation, and disclosure of financial assets and liabilities. The standard requires that all equity investments, other than those accounted for as equity method investments, be measured at fair value with changes recognized in income. As of January 1, 2018, we had three types of equity investments: investments in unconsolidated ventures, an investment in an exchange traded fund, and an investment in FHLBI stock. Our investments in unconsolidated ventures are accounted for as equity method investments, and our investment in an exchange-traded fund is measured at fair value with changes recognized in income. While the standard eliminates the cost method for equity investments without readily determinable fair values, it does allow an election to record equity investments without readily determinable fair values at cost, less impairment, and plus or minus adjustments for observable price changes. We have elected to record our investment in FHLBI stock at cost, less impairment. As such, the adoption of this accounting guidance did not impact our financial condition or results of operations. The standard also amends certain disclosure requirements for financial instruments. Refer to Note 4 - "Mortgage-Backed and Credit Risk Transfer Securities" for a tabular summary of the fair value of our available-for-sale securities and securities accounted for under the fair value option by asset type.

Effective January 1, 2018, we adopted the accounting guidance intended to reduce diversity in how restricted cash and certain transactions are classified in the statement of cash flows. The new guidance requires that the statement of cash flows explains the difference during the period in the total of cash, cash equivalents and amounts generally described as restricted cash or restricted cash equivalents. We adopted the accounting standard on a retrospective basis, which required us to restate our statement of cash flows for the nine months ended September 30, 2017. The adoption resulted in a \$21.7 million decrease in net cash provided by operating activities, \$22.9 million decrease in net cash used in investing activities and \$1.3 million decrease in net cash provided by financing activities. We included restricted cash of \$300,000 as of September 30, 2018 and \$620,000 as of December 31, 2017 in our reconciliation of cash, cash equivalents and restricted cash on the condensed consolidated statements of cash flows.

Pending Accounting Pronouncements

In June 2016, new accounting guidance was issued for reporting credit losses for assets measured at amortized cost and available-for-sale securities. The new guidance significantly changes how entities will measure credit losses for most financial assets, including loans, that are not measured at fair value through net income. The guidance replaces the existing "incurred loss" model with an "expected loss" model for instruments measured at amortized cost, and requires entities to record allowances for available-for-sale debt securities rather than reduce the carrying amount, as they do today under the other-than-temporary impairment model. The new guidance also simplifies the accounting model for purchased credit-impaired debt securities and loans. We are required to adopt the new guidance in the first quarter of 2020 by recording a cumulative effect adjustment to retained earnings as of January 1, 2020. We are currently evaluating the potential impacts of the new guidance on our consolidated financial statements.

In June 2018, new accounting guidance was issued that aligns the measurement and classification for stock-based payments to non-employees with the guidance for stock-based payments to employees. Under the new guidance, the measurement of equity-classified non-employee awards will be fixed at the grant date. We are required to adopt the new guidance in the first quarter of 2019 by recording a cumulative effect adjustment to retained earnings as of January 1, 2019. We are currently evaluating the potential impacts of the new guidance on our consolidated financial

statements.

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Note 3 - Variable Interest Entities ("VIEs")

Our maximum risk of loss in VIEs in which we are not the primary beneficiary at September 30, 2018 is presented in the table below.

| \$ in thousands | Carrying Amount | Company's Maximum Risk of Loss |
|--|--------------------|---|
| Non-Agency CMBS | 3,270,768 | 3,270,768 |
| Non-Agency RMBS | 1,158,712 | 1,158,712 |
| Investments in unconsolidated ventures | 24,217 | 24,217 |
| Total | 4,453,697 | 4,453,697 |

Refer to Note 4 - "Mortgage-Backed and Credit Risk Transfer Securities" and Note 6 - "Other Assets" for additional details regarding these investments.

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Note 4 – Mortgage-Backed and Credit Risk Transfer Securities

The following tables summarize our mortgage-backed securities ("MBS") and GSE CRT portfolio by asset type as of September 30, 2018 and December 31, 2017.

September 30, 2018

| \$ in thousands | Principal/ Notional Balance | Unamortized Premium (Discount) | Amortized Cost | Unrealized Gain/ (Loss), net | Fair Value | Period- end Weighted Average Yield ⁽¹⁾ |
|--------------------------------------|-----------------------------------|--------------------------------------|-------------------|------------------------------------|---------------|---|
| Agency RMBS: | | | | | | |
| 15 year fixed-rate | 594,301 | 11,144 | 605,445 | (3,286) | 602,159 | 3.08 % |
| 30 year fixed-rate | 10,444,475 | 339,322 | 10,783,797 | (284,747) | 10,499,050 | 3.46 % |
| ARM* | 146,287 | 467 | 146,754 | (1,676) | 145,078 | 2.69 % |
| Hybrid ARM* | 1,011,695 | 19,333 | 1,031,028 | (21,005) | 1,010,023 | 2.68 % |
| Total Agency RMBS pass-through | 12,196,758 | 370,266 | 12,567,024 | (310,714) | 12,256,310 | 3.37 % |
| Agency-CMO ⁽²⁾ | 922,228 | (684,283) | 237,945 | (13,795) | 224,150 | 3.25 % |
| Agency CMBS | 578,952 | 11,995 | 590,947 | (6,259) | 584,688 | 3.39 % |
| Non-Agency CMBS ⁽³⁾ | 3,995,236 | (715,867) | 3,279,369 | (8,601) | 3,270,768 | 5.05 % |
| Non-Agency RMBS ⁽⁴⁾⁽⁵⁾⁽⁶⁾ | 2,832,999 | (1,796,118) | 1,036,881 | 121,831 | 1,158,712 | 7.26 % |
| GSE CRT ⁽⁷⁾ | 737,487 | 22,182 | 759,669 | 82,528 | 842,197 | 2.91 % |
| Total | 21,263,660 | (2,791,825) | 18,471,835 | (135,010) | 18,336,825 | 3.76 % |

* Adjustable-rate mortgage ("ARM")

(1) Period-end weighted average yield is based on amortized cost as of September 30, 2018 and incorporates future prepayment and loss assumptions.

(2) Agency collateralized mortgage obligation ("Agency-CMO") includes interest-only securities ("Agency IO"), which represent 78.7% of principal/notional balance, 16.6% of amortized cost and 15.5% of fair value.

(3) Non-Agency CMBS includes interest-only securities which represent 15.2% of principal/notional balance, 0.4% of amortized cost and 0.5% of fair value.

(4) Non-Agency RMBS held by us is 46.6% variable rate, 47.1% fixed rate and 6.3% floating rate based on fair value.

(5) Of the total discount in non-Agency RMBS, \$198.5 million is non-accretable calculated using the principal/notional balance and based on estimated future cash flows of the securities.

(6) Non-Agency RMBS includes interest-only securities ("non-Agency IO") which represent 56.2% of principal/notional balance, 2.5% of amortized cost and 2.5% of fair value.

(7) GSE CRT weighted average yield excludes coupon interest associated with embedded derivatives not accounted for under the fair value option that is recorded as realized and unrealized credit derivative income (loss), net.

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December 31, 2017

| \$ in thousands | Principal/Notional Balance | Unamortized Premium (Discount) | Amortized Cost | Unrealized Gain/ (Loss), net | Fair Value | Period-end Weighted Average Yield ⁽¹⁾ |
|--------------------------------------|----------------------------|--------------------------------|----------------|------------------------------|------------|--|
| Agency RMBS: | | | | | | |
| 15 year fixed-rate | 2,917,307 | 119,120 | 3,036,427 | (61,645) | 2,974,782 | 2.17 % |
| 30 year fixed-rate | 7,354,211 | 295,977 | 7,650,188 | (9,648) | 7,640,540 | 3.09 % |
| ARM | 238,486 | 1,609 | 240,095 | 1,105 | 241,200 | 2.60 % |
| Hybrid ARM | 1,696,148 | 26,066 | 1,722,214 | (2,829) | 1,719,385 | 2.54 % |
| Total Agency RMBS pass-through | 12,206,152 | 442,772 | 12,648,924 | (73,017) | 12,575,907 | 2.79 % |
| Agency-CMO ⁽²⁾ | 1,226,539 | (942,290) | 284,249 | (10,306) | 273,943 | 2.91 % |
| Non-Agency CMBS ⁽³⁾ | 3,879,775 | (704,097) | 3,175,678 | 40,739 | 3,216,417 | 4.92 % |
| Non-Agency RMBS ⁽⁴⁾⁽⁵⁾⁽⁶⁾ | 2,785,704 | (1,661,683) | 1,124,021 | 133,587 | 1,257,608 | 7.19 % |
| GSE CRT ⁽⁷⁾ | 757,183 | 24,306 | 781,489 | 85,390 | 866,879 | 2.45 % |
| Total | 20,855,353 | (2,840,992) | 18,014,361 | 176,393 | 18,190,754 | 3.42 % |

- (1) Period-end weighted average yield is based on amortized cost as of December 31, 2017 and incorporates future prepayment and loss assumptions.
- (2) Agency collateralized mortgage obligation ("Agency-CMO") includes interest-only securities ("Agency IO"), which represent 81.8% of principal (notional) balance, 20.9% of amortized cost and 18.7% of fair value.
- (3) Non-Agency CMBS includes interest-only securities which represent 15.8% of principal/notional balance, 0.5% of amortized cost and 0.6% of fair value.
- (4) Non-Agency RMBS held by us is 52.2% variable rate, 37.8% fixed rate, and 10.0% floating rate based on fair value.
- (5) Of the total discount in non-Agency RMBS, \$195.3 million is non-accretable calculated using the principal/notional balance and based on estimated future cash flows of the securities.
- (6) Non-Agency RMBS includes interest-only securities, which represent 51.5% of principal/notional balance, 2.0% of amortized cost and 1.8% of fair value.
- (7) GSE CRT weighted average yield excludes coupon interest associated with embedded derivatives not accounted for under the fair value option that is recorded as realized and unrealized credit derivative income (loss), net.

The following table presents the fair value of our available-for-sale securities and securities accounted for under the fair value option by asset type as of September 30, 2018 and December 31, 2017. We have elected the fair value option for all of our RMBS IOs, our MBS purchased on or after September 1, 2016 and our GSE CRTs purchased on or after August 24, 2015. As of September 30, 2018 and December 31, 2017, approximately 61% and 36%, respectively, of our MBS and GSE CRTs are accounted for under the fair value option.

| \$ in thousands | September 30, 2018 | | | December 31, 2017 | | |
|--------------------|-------------------------------|------------------------------------|------------------|-------------------------------|------------------------------------|------------------|
| | Available-for-sale Securities | Securities under Fair Value Option | Total Fair Value | Available-for-sale Securities | Securities under Fair Value Option | Total Fair Value |
| Agency RMBS: | | | | | | |
| 15 year fixed-rate | 369,459 | 232,700 | 602,159 | 2,842,440 | 132,342 | 2,974,782 |
| 30 year fixed-rate | 1,569,998 | 8,929,052 | 10,499,050 | 2,467,871 | 5,172,669 | 7,640,540 |
| ARM | 145,078 | — | 145,078 | 241,200 | — | 241,200 |
| Hybrid ARM | 979,057 | 30,966 | 1,010,023 | 1,719,385 | — | 1,719,385 |

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| | | | | | | |
|--------------------------------|-----------|------------|------------|------------|-----------|------------|
| Total RMBS Agency pass-through | 3,063,592 | 9,192,718 | 12,256,310 | 7,270,896 | 5,305,011 | 12,575,907 |
| Agency-CMO | 171,954 | 52,196 | 224,150 | 203,351 | 70,592 | 273,943 |
| Agency CMBS | — | 584,688 | 584,688 | — | — | — |
| Non-Agency CMBS | 2,241,109 | 1,029,659 | 3,270,768 | 2,376,413 | 840,004 | 3,216,417 |
| Non-Agency RMBS | 1,015,963 | 142,749 | 1,158,712 | 1,236,178 | 21,430 | 1,257,608 |
| GSE CRT | 611,163 | 231,034 | 842,197 | 635,537 | 231,342 | 866,879 |
| Total | 7,103,781 | 11,233,044 | 18,336,825 | 11,722,375 | 6,468,379 | 18,190,754 |

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The components of the carrying value of our MBS and GSE CRT portfolio at September 30, 2018 and December 31, 2017 are presented below.

| | September 30, 2018 | | |
|--|----------------------------------|-----------------------------|--------------|
| \$ in thousands | MBS and GSE CRT Securities | Interest-Only Securities | Total |
| Principal/ notional balance | 18,495,706 | 2,767,954 | 21,263,660 |
| Unamortized premium | 449,797 | — | 449,797 |
| Unamortized discount | (551,097) | (2,690,525) | (3,241,622) |
| Gross unrealized gains ⁽¹⁾ | 243,555 | 7,682 | 251,237 |
| Gross unrealized losses ⁽¹⁾ | (379,122) | (7,125) | (386,247) |
| Fair value | 18,258,839 | 77,986 | 18,336,825 |
| | December 31, 2017 | | |
| \$ in thousands | MBS and GSE CRT Securities | Interest-Only Securities | Total |
| Principal/ notional balance | 17,974,390 | 2,880,963 | 20,855,353 |
| Unamortized premium | 521,626 | — | 521,626 |
| Unamortized discount | (577,344) | (2,785,274) | (3,362,618) |
| Gross unrealized gains ⁽¹⁾ | 336,543 | 5,113 | 341,656 |
| Gross unrealized losses ⁽¹⁾ | (155,146) | (10,117) | (165,263) |
| Fair value | 18,100,069 | 90,685 | 18,190,754 |

Gross unrealized gains and losses includes gains (losses) recognized in net income for securities accounted for as derivatives or under the fair value option as well as gains (losses) for available-for-sale securities which are (1) recognized as adjustments to other comprehensive income. Realization occurs upon sale or settlement of such securities. Further detail on the components of our total gains (losses) on investments, net for the three and nine months ended September 30, 2018 and 2017 is provided below within this Note 4.

The following table summarizes our MBS and GSE CRT portfolio according to estimated weighted average life classifications as of September 30, 2018 and December 31, 2017.

| \$ in thousands | September 30, 2018 | December 31, 2017 |
|--|-----------------------|----------------------|
| Less than one year | 135,685 | 135,559 |
| Greater than one year and less than five years | 4,097,807 | 7,934,836 |
| Greater than or equal to five years | 14,103,333 | 10,120,359 |
| Total | 18,336,825 | 18,190,754 |

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The following tables present the estimated fair value and gross unrealized losses of our MBS and GSE CRTs by length of time that such securities have been in a continuous unrealized loss position at September 30, 2018 and December 31, 2017.

September 30, 2018

| \$ in thousands | Less than 12 Months | | | 12 Months or More | | | Total | | |
|--|---------------------|-------------------|----------------------|-------------------|-------------------|----------------------|-------------------|-------------------|----------------------|
| | Fair Value | Unrealized Losses | Number of Securities | Fair Value | Unrealized Losses | Number of Securities | Fair Value | Unrealized Losses | Number of Securities |
| Agency RMBS: | | | | | | | | | |
| 15 year fixed-rate | 442,294 | (4,202) | 75 | 13,153 | (311) | 23 | 455,447 | (4,513) | 98 |
| 30 year fixed-rate | 7,109,826 | (156,950) | 248 | 2,538,629 | (134,979) | 84 | 9,648,455 | (291,929) | 332 |
| ARM | 76,597 | (688) | 6 | 45,981 | (1,197) | 9 | 122,578 | (1,885) | 15 |
| Hybrid ARM | 491,065 | (8,070) | 52 | 459,728 | (13,770) | 66 | 950,793 | (21,840) | 118 |
| Total Agency RMBS pass-through ⁽¹⁾ | 8,119,782 | (169,910) | 381 | 3,057,491 | (150,257) | 182 | 11,177,273 | (320,167) | 563 |
| Agency-CMO ⁽²⁾ | 116,495 | (7,696) | 31 | 93,933 | (8,179) | 20 | 210,428 | (15,875) | 51 |
| Agency CMBS ⁽³⁾ | 584,688 | (6,259) | 12 | — | — | — | 584,688 | (6,259) | 12 |
| Non-Agency CMBS ⁽⁴⁾ | 1,569,147 | (21,167) | 108 | 513,211 | (19,198) | 39 | 2,082,358 | (40,365) | 147 |
| Non-Agency RMBS ⁽⁵⁾ | 247,068 | (2,981) | 26 | 57,666 | (600) | 11 | 304,734 | (3,581) | 37 |
| Total | 10,637,180 | (208,013) | 558 | 3,722,301 | (178,234) | 252 | 14,359,481 | (386,247) | 810 |

(1) Amounts disclosed includes Agency RMBS with a fair value of \$8.7 billion for which the fair value option has been elected. Such securities have unrealized losses of \$250.2 million.

(2) Amounts disclosed includes Agency IO and Agency-CMO with fair value of \$22.6 million and \$17.4 million, respectively, for which the fair value option has been elected. These Agency IO and Agency-CMO securities have unrealized losses of \$6.8 million and \$1.2 million, respectively.

(3) Fair value option has been elected for all Agency CMBS.

(4) Amounts disclosed includes non-Agency CMBS with a fair value of \$652.5 million for which the fair value option has been elected. Such securities have unrealized losses of \$13.8 million.

(5) Amounts disclosed includes non-Agency RMBS and non-Agency IO with a fair value of \$115.1 million and \$8.4 million, respectively for which the fair value option has been elected. Such securities have unrealized losses of \$1.1 million and \$368,000, respectively.

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December 31, 2017

| \$ in thousands | Less than 12 Months | | | 12 Months or More | | | Total | | |
|---|---------------------|-------------------|----------------------|-------------------|-------------------|----------------------|------------|-------------------|----------------------|
| | Fair Value | Unrealized Losses | Number of Securities | Fair Value | Unrealized Losses | Number of Securities | Fair Value | Unrealized Losses | Number of Securities |
| Agency RMBS: | | | | | | | | | |
| 15 year fixed-rate | 111,020 | (321) | 26 | 2,406,021 | (67,285) | 133 | 2,517,041 | (67,606) | 159 |
| 30 year fixed-rate | 3,677,576 | (20,730) | 107 | 963,547 | (27,158) | 56 | 4,641,123 | (47,888) | 163 |
| ARM | 101,173 | (902) | 12 | — | — | — | 101,173 | (902) | 12 |
| Hybrid ARM | 614,321 | (4,189) | 73 | 517,642 | (8,091) | 47 | 1,131,963 | (12,280) | 120 |
| Total Agency RMBS pass-through ⁽¹⁾ | 4,504,090 | (26,142) | 218 | 3,887,210 | (102,534) | 236 | 8,391,300 | (128,676) | 454 |
| Agency-CMO ⁽²⁾ | 75,299 | (10,433) | 44 | 81,988 | (2,309) | 5 | 157,287 | (12,742) | 49 |
| Non-Agency CMBS ⁽³⁾ | 892,553 | (17,612) | 81 | 135,139 | (3,792) | 12 | 1,027,692 | (21,404) | 93 |
| Non-Agency RMBS ⁽⁴⁾ | 84,439 | (709) | 15 | 96,263 | (1,732) | 11 | 180,702 | (2,441) | 26 |
| Total | 5,556,381 | (54,896) | 358 | 4,200,600 | (110,367) | 264 | 9,756,981 | (165,263) | 622 |

(1) Amounts disclosed includes Agency RMBS with a fair value of \$3.4 billion for which the fair value option has been elected. Such securities have unrealized losses of \$22.8 million.

(2) Amounts disclosed includes Agency IO and Agency-CMO with fair value of \$36.5 million and \$9.5 million, respectively, for which the fair value option has been elected. These Agency IO and Agency-CMO securities have unrealized losses of \$10.1 million and \$88,000, respectively.

(3) Amounts disclosed includes non-Agency CMBS with a fair value of \$596.0 million for which the fair value option has been elected. Such securities have unrealized losses of \$8.9 million.

(4) Amounts disclosed includes non-Agency IO with a fair value of \$530,000 for which the fair value option has been elected. Such securities have unrealized losses of \$39,000.

Gross unrealized losses on our Agency RMBS, Agency CMBS and CMO were \$335.5 million at September 30, 2018 (December 31, 2017: \$131.3 million). Due to the inherent credit quality of Agency RMBS, Agency CMBS and Agency-CMO, we determined that at September 30, 2018 and December 31, 2017, any unrealized losses on these securities are not other than temporary.

Gross unrealized losses on our Agency IO, non-Agency RMBS and non-Agency CMBS were \$50.7 million at September 30, 2018 (December 31, 2017: \$33.9 million). We did not consider these unrealized losses to be credit related, but rather due to non-credit related factors such as interest rates, prepayment speeds, and market fluctuations. These investment securities are included in our assessment for other-than-temporary impairment ("OTTI") on a quarterly basis.

We assess our investment securities for OTTI on a quarterly basis. When the fair value of an investment is less than its amortized cost at the balance sheet date of the reporting period for which impairment is assessed, the impairment is designated as either "temporary" or "other-than-temporary." This analysis includes a determination of estimated future cash flows through an evaluation of the characteristics of the underlying loans and the structural features of the investment. Underlying loan characteristics reviewed include, but are not limited to, delinquency status, loan-to-value ratios, borrower credit scores, occupancy status and geographic concentration.

The following table summarizes OTTI included in earnings for the three and nine months ended September 30, 2018 and 2017:

| \$ in thousands | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|-----------------|----------------------------------|------|---------------------------------|------|
| | 2018 | 2017 | 2018 | 2017 |
| | | | | |

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| | | | | |
|--------------------------------|-----|-------|-------|-------|
| RMBS interest-only securities | 702 | 4,959 | 7,100 | 8,835 |
| Non-Agency RMBS ⁽¹⁾ | 35 | — | 85 | 754 |
| Total | 737 | 4,959 | 7,185 | 9,589 |

(1) Amounts disclosed relate to credit losses on debt securities for which a portion of an other-than-temporary impairment was recognized in other comprehensive income.

OTTI on RMBS interest-only securities was recorded as a reclassification from an unrealized to realized loss within gain (loss) on investments, net on the condensed consolidated statements of operations because we account for these securities under

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the fair value option. As of September 30, 2018, we did not intend to sell the securities and determined that it was not more likely than not that we will be required to sell the securities.

The following table summarizes the components of our total gain (loss) on investments, net for the three and nine months ended September 30, 2018 and 2017.

| \$ in thousands | Three Months | | Nine Months | |
|--|--------------------------|----------|--------------------------|---------|
| | Ended September 30, 2018 | 2017 | Ended September 30, 2018 | 2017 |
| Gross realized gains on sale of investments | 739 | — | 774 | 2,208 |
| Gross realized losses on sale of investments | (141,454) | (7) | (162,251) | (3,873) |
| Other-than-temporary impairment losses | (737) | (4,959) | (7,185) | (9,589) |
| Net unrealized gains and losses on MBS accounted for under the fair value option | (66,831) | (5,301) | (236,967) | (1,188) |
| Net unrealized gains and losses on GSE CRT accounted for under the fair value option | 377 | (1,608) | 993 | 9,866 |
| Net unrealized gains and losses on trading securities | (4) | 2 | (21) | 25 |
| Total gain (loss) on investments, net | (207,910) | (11,873) | (404,657) | (2,551) |

The following tables present components of interest income recognized on our MBS and GSE CRT portfolio for the three and nine months ended September 30, 2018 and 2017. GSE CRT interest income excludes coupon interest associated with embedded derivatives not accounted for under the fair value option that is recorded as realized and unrealized credit derivative income (loss), net.

For the three months ended September 30, 2018

| \$ in thousands | Coupon Interest | Net (Premium Amortization)/Discount Accretion | Interest Income |
|----------------------|-----------------|---|-----------------|
| Agency RMBS and CMBS | 115,829 | (20,850) | 94,979 |
| Non-Agency CMBS | 37,938 | 1,470 | 39,408 |
| Non-Agency RMBS | 14,106 | 4,831 | 18,937 |
| GSE CRT | 7,513 | (731) | 6,782 |
| Other | 310 | — | 310 |
| Total | 175,696 | (15,280) | 160,416 |

For the three months ended September 30, 2017

| \$ in thousands | Coupon Interest | Net (Premium Amortization)/Discount Accretion | Interest Income |
|----------------------|-----------------|---|-----------------|
| Agency RMBS and CMBS | 99,748 | (26,155) | 73,593 |
| Non-Agency CMBS | 33,613 | (591) | 33,022 |
| Non-Agency RMBS | 17,109 | 4,846 | 21,955 |
| GSE CRT | 6,021 | (597) | 5,424 |
| Other | 144 | — | 144 |
| Total | 156,635 | (22,497) | 134,138 |

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For the nine months ended September 30, 2018

| \$ in thousands | Coupon Interest | Net (Premium Amortization)/Discount Accretion | Interest Income |
|----------------------|-----------------|---|-----------------|
| Agency RMBS and CMBS | 329,576 | (66,347) | 263,229 |
| Non-Agency CMBS | 113,332 | 4,091 | 117,423 |
| Non-Agency RMBS | 41,313 | 15,167 | 56,480 |
| GSE CRT | 21,218 | (2,124) | 19,094 |
| Other | 741 | — | 741 |
| Total | 506,180 | (49,213) | 456,967 |

For the nine months ended September 30, 2017

| \$ in thousands | Coupon Interest | Net (Premium Amortization)/Discount Accretion | Interest Income |
|----------------------|-----------------|---|-----------------|
| Agency RMBS and CMBS | 282,958 | (82,508) | 200,450 |
| Non-Agency CMBS | 94,795 | (5,077) | 89,718 |
| Non-Agency RMBS | 55,854 | 12,967 | 68,821 |
| GSE CRT | 16,064 | (1,315) | 14,749 |
| Other | 300 | — | 300 |
| Total | 449,971 | (75,933) | 374,038 |

Note 5 – Commercial Loans Held-for-Investment

The following table summarizes purchased or originated commercial mezzanine loans held-for-investment as of September 30, 2018 and December 31, 2017.

| \$ in thousands | Number of loans | Principal Balance | Unamortized (fees)/ costs, net | Carrying value | Weighted Average Coupon | Weighted Average Years to Maturity ⁽¹⁾ |
|--------------------|-----------------|-------------------|--------------------------------|----------------|-------------------------|---|
| September 30, 2018 | 2 | 31,707 | — | 31,707 | 10.44 % | 2.0 |
| December 31, 2017 | 8 | 191,894 | (86) | 191,808 | 8.52 % | 1.2 |

Weighted average years to maturity is based on the contractual maturity date. Certain loans may contain either an (1) option to prepay or an option to extend beyond their contractual maturity dates as specified in the respective loan agreements.

These loans were not impaired, and no allowance for loan loss has been recorded as of September 30, 2018 and December 31, 2017 based on our analysis of credit quality factors as described in Note 2 - "Summary of Significant Accounting Policies" included in the consolidated financial statements of our Annual Report on Form 10-K for the year ended December 31, 2017.

Note 6 – Other Assets

The following table summarizes our other assets as of September 30, 2018 and December 31, 2017.

| \$ in thousands | September 30, 2018 | December 31, 2017 |
|--|--------------------|-------------------|
| FHLBI stock | 74,250 | 74,250 |
| Loan participation interest | 45,058 | — |
| Investments in unconsolidated ventures | 24,217 | 25,972 |
| Investment in exchange-traded fund | — | 3,979 |
| Prepaid expenses and other assets | 1,490 | 1,379 |
| Total | 145,015 | 105,580 |

IAS Services LLC, our wholly-owned subsidiary, is required to purchase and hold FHLBI stock as a condition of membership in the FHLBI. The stock is recorded at cost.

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In August 2018, we acquired a participation interest in a secured loan collateralized by mortgage servicing rights. The loan has a two year term subject to a one year extension option. The participation interest bears interest at a floating rate based on LIBOR plus a spread. The weighted average asset yield for the participation interest was 5.97% as of September 30, 2018. We elected to account for the investment using the fair value option. Refer to Note 16- "Commitments and Contingencies" for additional details regarding our unfunded commitment on this loan participation interest.

We have invested in unconsolidated ventures that are managed by an affiliate of our Manager. The unconsolidated ventures invest in our target assets. Refer to Note 16 - "Commitments and Contingencies" for additional details regarding our commitments to these unconsolidated ventures.

We redeemed our investment in an exchange-traded fund that is managed by an affiliate of our Manager in the third quarter of 2018.

Note 7 – Borrowings

We have financed the majority of our investment portfolio through repurchase agreements, secured loans and exchangeable senior notes. The following tables summarize certain characteristics of our borrowings at September 30, 2018 and December 31, 2017. Refer to Note 8 - "Collateral Positions" for collateral pledged under our repurchase agreements and secured loans.

| \$ in thousands | September 30, 2018 | | | |
|-------------------------------|--------------------|--------------------------------|--|-----------------|
| | Amount Outstanding | Weighted Average Interest Rate | Weighted Average Remaining Maturity (days) | |
| | | | Interest Rate | Maturity (days) |
| Repurchase Agreements: | | | | |
| Agency RMBS | 10,693,221 | 2.29 % | 42 | |
| Agency CMBS | 559,258 | 2.28 % | 61 | |
| Non-Agency CMBS | 1,525,347 | 3.31 % | 20 | |
| Non-Agency RMBS | 876,406 | 3.36 % | 26 | |
| GSE CRT | 690,493 | 3.30 % | 23 | |
| Loan participation interest | 33,793 | 3.93 % | 697 | |
| Total Repurchase Agreements | 14,378,518 | 2.52 % | 40 | |
| Secured Loans | 1,650,000 | 2.38 % | 2,044 | |
| Total Borrowings | 16,028,518 | 2.50 % | 246 | |

| \$ in thousands | December 31, 2017 | | | |
|--|--------------------|--------------------------------|--|-----------------|
| | Amount Outstanding | Weighted Average Interest Rate | Weighted Average Remaining Maturity (days) | |
| | | | Interest Rate | Maturity (days) |
| Repurchase Agreements: | | | | |
| Agency RMBS | 11,111,755 | 1.58 % | 25 | |
| Non-Agency CMBS | 1,396,330 | 2.61 % | 9 | |
| Non-Agency RMBS | 915,225 | 2.77 % | 31 | |
| GSE CRT | 657,491 | 2.78 % | 24 | |
| Total Repurchase Agreements | 14,080,801 | 1.82 % | 25 | |
| Secured Loans | 1,650,000 | 1.52 % | 2,317 | |
| Exchangeable Senior Notes ⁽¹⁾ | 143,410 | 5.00 % | 74 | |
| Total Borrowings | 15,874,211 | 1.82 % | 263 | |

(1)

The carrying value of exchangeable senior notes was \$143.2 million as of December 31, 2017. The carrying value was net of unamortized debt issuance costs of \$179,000 as of December 31, 2017.

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The following table shows the aggregate amount of maturities of our outstanding borrowings:

| \$ in thousands | As of |
|-----------------------------|--------------------|
| Borrowings maturing within: | September 30, 2018 |
| 10/1/2018 - 9/30/2019 | 14,344,725 |
| 10/1/2019 - 9/30/2020 | 333,793 |
| 10/1/2020 - 9/30/2021 | 100,000 |
| 10/1/2021 - 9/30/2022 | — |
| 10/1/2022 - 9/30/2023 | — |
| Thereafter | 1,250,000 |
| Total | 16,028,518 |

The following tables summarize certain characteristics of our repurchase agreements and secured loans at September 30, 2018 and December 31, 2017.

September 30, 2018

| \$ in thousands | Amount Outstanding | Percent of | |
|---|--------------------|--------------------------|-----------------------------------|
| | | Total Amount Outstanding | Collateral Pledged ⁽¹⁾ |
| Repurchase Agreement Counterparties: | | | |
| HSBC | 1,516,849 | 9.5 % | 1,615,248 |
| Mirae Asset Securities | 1,461,790 | 9.1 % | 1,544,998 |
| ING Financial Market | 1,421,007 | 8.9 % | 1,519,860 |
| E D & F Man Capital Markets | 1,229,333 | 7.7 % | 1,300,892 |
| Royal Bank of Canada | 1,162,208 | 7.1 % | 1,374,230 |
| Industrial and Commercial Bank of China | 1,069,894 | 6.7 % | 1,141,135 |
| South Street Securities | 740,686 | 4.6 % | 780,219 |
| Citigroup | 737,250 | 4.6 % | 859,223 |
| MUFJ Securities | 520,086 | 3.2 % | 581,079 |
| Amherst Pierpont Securities | 476,763 | 3.0 % | 511,652 |
| Federal Home Loan Mortgage Corp | 448,893 | 2.8 % | 476,023 |
| Societe Generale | 403,911 | 2.5 % | 506,541 |
| JP Morgan | 342,608 | 2.1 % | 408,518 |
| Wells Fargo Securities | 318,432 | 2.0 % | 364,723 |
| Goldman Sachs | 316,714 | 2.0 % | 413,391 |
| BNP Paribas Securities | 268,540 | 1.7 % | 304,177 |
| Guggenheim Liquidity Services | 260,650 | 1.6 % | 278,794 |
| Mizuho Securities | 258,112 | 1.6 % | 281,012 |
| Scotia Capital | 204,958 | 1.3 % | 213,515 |
| Natixis Securities | 201,715 | 1.3 % | 235,189 |
| All other counterparties ⁽²⁾ | 1,018,119 | 6.4 % | 1,172,737 |
| Total Repurchase Agreement Counterparties | 14,378,518 | 89.7 % | 15,883,156 |
| Secured Loans Counterparty: | | | |
| FHLBI | 1,650,000 | 10.3 % | 1,898,258 |
| Total | 16,028,518 | 100.0 % | 17,781,414 |

Amount pledged as collateral is measured at fair value as described in Note 2 - "Summary of Significant Accounting Policies" included in the consolidated financial statements of our Annual Report on Form 10-K for the year ended December 31, 2017. See Note 8 - "Collateral Positions" of this Form 10-Q for additional details regarding collateral pledged.

(2) Represents amounts outstanding with nine counterparties.

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December 31, 2017

| \$ in thousands | Amount Outstanding | Percent of | |
|---|-----------------------|--------------------------------|--------------------------------------|
| | | Total Amount Outstanding | Collateral Pledged ⁽¹⁾ |
| Repurchase Agreement Counterparties: | | | |
| HSBC | 1,745,684 | 11.2 | % 1,839,411 |
| ING Financial Markets | 1,482,603 | 9.4 | % 1,571,061 |
| Royal Bank of Canada | 1,144,856 | 7.3 | % 1,375,285 |
| Industrial and Commercial Bank of China | 1,038,844 | 6.6 | % 1,102,543 |
| E D & F Man Capital Markets | 1,028,437 | 6.5 | % 1,085,429 |
| Mirae Asset Securities | 958,756 | 6.1 | % 1,018,664 |
| MUFG Securities | 865,201 | 5.5 | % 936,071 |
| Citigroup | 724,094 | 4.6 | % 841,977 |
| Amherst Pierpont Securities | 722,080 | 4.6 | % 764,713 |
| KGS-Alpha Capital Markets | 461,098 | 2.9 | % 491,313 |
| JP Morgan | 451,941 | 2.9 | % 523,590 |
| Societe Generale | 386,737 | 2.5 | % 495,093 |
| BNP Paribas Securities | 348,340 | 2.2 | % 388,091 |
| South Street Securities | 332,623 | 2.1 | % 354,689 |
| Goldman Sachs | 324,152 | 2.1 | % 419,713 |
| Mizuho Securities | 310,835 | 2.0 | % 330,555 |
| Guggenheim Liquidity Services | 306,081 | 1.9 | % 322,452 |
| Bank of Nova Scotia | 289,705 | 1.8 | % 301,715 |
| Natixis Securities | 275,764 | 1.8 | % 302,291 |
| All other counterparties ⁽²⁾ | 882,970 | 5.5 | % 1,058,759 |
| Total Repurchase Agreement Counterparties | 14,080,801 | 89.5 | % 15,523,415 |
| Secured Loans Counterparty: | | | |
| FHLBI | 1,650,000 | 10.5 | % 1,927,496 |
| Total | 15,730,801 | 100.0 | % 17,450,911 |

Amount pledged as collateral is measured at fair value as described in Note 2 - "Summary of Significant

(1) Accounting Policies" included in the consolidated financial statements of our Annual Report on Form 10-K for the year ended December 31, 2017. See Note 8 - "Collateral Positions" of this Form 10-Q for additional details regarding collateral pledged.

(2) Represents amounts outstanding with seven counterparties.

Repurchase Agreements

Our repurchase agreements generally bear interest at a contractually agreed upon rate and have maturities ranging from one month to twelve months. Our repurchase agreement that is collateralized by a loan participation interest bears interest at a floating rate based on LIBOR plus a spread. Repurchase agreements are accounted for as secured borrowings since we maintain effective control of the financed assets. Repurchase agreements are subject to certain financial covenants. We were in compliance with these covenants at September 30, 2018.

Our repurchase agreement collateral ratio (MBS, GSE CRTs and a loan participation interest) pledged as collateral/Amount Outstanding) was 110% as of September 30, 2018 (December 31, 2017: 110%).

Secured Loans

Our wholly-owned captive insurance subsidiary, IAS Services LLC, is a member of the FHLBI. As a member of the FHLBI, IAS Services LLC has borrowed funds from the FHLBI in the form of secured loans.

As of September 30, 2018, IAS Services LLC had \$1.65 billion in outstanding secured loans from the FHLBI. These secured loans have floating rates that are based on the three-month FHLB swap rate plus a spread. For the nine months

ended

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September 30, 2018, IAS Services LLC had weighted average borrowings of \$1.65 billion with a weighted average borrowing rate of 2.01% and a weighted average maturity of 5.6 years.

The Federal Housing Finance Agency's ("FHFA") final rule governing Federal Home Loan Bank membership (the "FHFA Rule") became effective on February 19, 2016. The FHFA Rule permits existing captive insurance companies, such as IAS Services LLC, to remain members until February 2021. New advances or renewals that mature after February 2021 are prohibited. The FHLBI has indicated it will honor the contractual maturity dates of existing advances to IAS Services LLC that were made prior to February 19, 2016 and extend beyond February 2021. We do not expect there to be any impact to our existing FHLBI borrowings under the FHFA rule. The ability to borrow from the FHLBI is subject to our continued creditworthiness, pledging of sufficient eligible collateral to secure advances, and compliance with certain agreements with FHLBI and FHFA rules.

As discussed in Note 6 - "Other Assets," IAS Services LLC is required to purchase and hold a certain amount of FHLBI stock, which is based, in part, upon the outstanding principal balance of secured loans from the FHLBI.

Exchangeable Senior Notes

In 2013, our wholly-owned subsidiary, IAS Operating Partnership LP, issued \$400 million in aggregate principal amount of Exchangeable Senior Notes (the "Notes") due March 15, 2018. We retired a portion of the Notes prior to their maturity and fully retired the Notes upon their maturity on March 15, 2018. In the three months ended September 30, 2017, we retired \$60.9 million of the Notes for a repurchase price of \$62.1 million and realized a net loss on extinguishment of debt of \$209,000. In the nine months ended September 30, 2018, we retired \$143.4 million (2017: \$242.2 million) of the Notes for a repurchase price of \$143.4 million (2017: \$247.5 million). We realized a net loss on extinguishment of debt of \$26,000 and \$6.6 million, respectively in the nine months ended September 30, 2018 and 2017. Accrued interest payable on the Notes was approximately \$2.1 million as of December 31, 2017.

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Note 8 - Collateral Positions

The following table summarizes the fair value of collateral that we have pledged and held under our repurchase agreements, secured loans, interest rate swaps, futures contracts and currency forward contracts as of September 30, 2018 and December 31, 2017. Refer to Note 2 - "Summary of Significant Accounting Policies - Fair Value Measurements" of our consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2017 for a description of how we determine fair value. RMBS, CMBS and GSE CRT collateral pledged is included in mortgage-backed and credit risk transfer securities on our condensed consolidated balance sheets. Loan participation interest collateral pledged is included in other assets on our condensed consolidated balance sheets. Cash collateral pledged on secured loans, bilateral interest rate swaps and currency forward contracts is classified as restricted cash on our condensed consolidated balance sheets. Cash collateral pledged on futures contracts is classified as due from counterparties on our condensed consolidated balance sheets.

Cash collateral held on bilateral swaps that is not restricted for use is included in cash and cash equivalents on our condensed consolidated balance sheets and the liability to return the collateral is included in collateral held payable. Non-cash collateral held is only recognized if the counterparty defaults or if we sell the pledged collateral. As of September 30, 2018 and December 31, 2017, we did not recognize any non-cash collateral held.

| \$ in thousands | As of | |
|--|-----------------------|----------------------|
| Collateral Pledged | September 30, 2018 | December 31, 2017 |
| Repurchase Agreements: | | |
| Agency RMBS ⁽¹⁾ | 11,425,714 | 11,788,765 |
| Agency CMBS | 584,688 | — |
| Non-Agency CMBS | 1,908,538 | 853,446 |
| Non-Agency RMBS | 1,076,961 | 1,737,831 |
| GSE CRT | 842,197 | 1,143,373 |
| Loan participation interest | 45,058 | — |
| Total repurchase agreements collateral pledged | 15,883,156 | 15,523,415 |
| Secured Loans: | | |
| Agency RMBS | 636,506 | 623,181 |
| Non-Agency CMBS | 1,261,752 | 1,304,315 |
| Total secured loans collateral pledged | 1,898,258 | 1,927,496 |
| Interest Rate Swaps, Futures Contracts and Currency Forward Contracts: | | |
| Agency RMBS ⁽²⁾ | 186,346 | 109,900 |
| Cash | 26,680 | 620 |
| Total interest rate swaps, futures contracts and currency forward contracts collateral pledged | 213,026 | 110,520 |
| Total collateral pledged: | | |
| Mortgage-backed and credit risk transfer securities | 17,922,702 | 17,560,811 |
| Loan participation interest | 45,058 | — |
| Cash | 26,680 | 620 |
| Total collateral pledged | 17,994,440 | 17,561,431 |
| Collateral Held | | |
| Interest Rate Swaps: | | |
| Cash | 47,687 | 7,327 |
| Total collateral held | 47,687 | 7,327 |
| (1) | | |

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Includes pledged securities of \$449.3 million sold but not settled as of September 30, 2018 that are recorded as investment related receivable on our condensed consolidated balance sheet. Securities associated with unsettled trades remain legally pledged until the

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related repurchase agreement is repaid. There were no securities pledged as collateral associated with unsettled trades as of December 31, 2017.

During the first quarter of 2018, we determined that the amount disclosed as Agency RMBS collateral pledged on our interest rate swaps was understated by \$86.2 million in our report on Form 10-K as of December 31, 2017. We (2) concluded that the error in the amount disclosed was immaterial. We have revised the total amount of pledged securities disclosed parenthetically on our condensed consolidated balance sheet as of December 31, 2017 presented in this report on Form 10-Q and within the table above.

Repurchase Agreements

Collateral pledged with our repurchase agreement counterparties is segregated in our books and records. The repurchase agreement counterparties have the right to resell and repledge the collateral posted but have the obligation to return the pledged collateral, or substantially the same collateral if agreed to by us, upon maturity of the repurchase agreement. Under the repurchase agreements, the respective lender retains the contractual right to mark the underlying collateral to fair value as determined by a pricing service agreed to by the respective lender and us. We would be required to provide additional collateral or fund margin calls if the value of pledged assets declined. We intend to maintain a level of liquidity that will enable us to meet margin calls.

Secured Loans

The ability to borrow from the FHLBI is subject to our continued creditworthiness, pledging of sufficient eligible collateral to secure advances, and compliance with certain agreements with FHLBI and FHFA rules. Collateral pledged with the FHLBI is held in trust for the benefit of the FHLBI and is not commingled with our other assets. The FHLBI does not have the right to resell or repledge collateral posted unless an event of default occurs. The FHLBI retains the right to mark the underlying collateral for FHLBI advances to fair value as determined by the FHLBI in its sole discretion. IAS Services LLC would be required to provide additional collateral or fund margin calls if the value of pledged assets declines.

Interest Rate Swaps

Collateral pledged with our interest rate swap counterparties is segregated in our books and records. We have two types of interest rate swap agreements: bilateral interest rate swaps that are governed by an International Swaps and Derivatives Association ("ISDA") agreement and interest rate swaps that are centrally cleared by a registered clearing organization such as the Chicago Mercantile Exchange ("CME") and LCH. Clearnet Limited ("LCH") through a Futures Commission Merchant ("FCM"). Interest rate swaps that are governed by an ISDA agreement provide for bilateral collateral pledging based on the counterparties' market value. The counterparties have the right to repledge the collateral posted, but have the obligation to return the pledged collateral, or substantially the same collateral, if agreed to by us, as the market value of the interest rate swaps change.

We are required to pledge initial margin and daily variation margin for our interest rate swaps that are centrally cleared. The FCM determines the fair value of our centrally cleared swaps, including daily variation margin. The daily variation margin payment for centrally cleared interest rate swaps is characterized as settlement of the derivative itself rather than collateral. Accordingly, cash collateral pledged on our centrally cleared interest rate swaps is settled against the fair value of these swaps.

Futures Contracts

We are required to pledge initial margin and daily variation margin for our futures contracts that is based on the fair value of our contracts as determined by our FCM. The daily variation margin payment for our futures contracts is characterized as settlement of the futures contract itself rather than collateral. Accordingly, cash collateral pledged on our futures contracts is settled against the fair value of these contracts.

Currency Forward Contracts

Collateral pledged with our currency forward counterparty is segregated in our books and records. Eligible collateral to be pledged can be in the form of cash or securities. Our currency forward contract provides for bilateral collateral pledging based on the counterparties' market value. The counterparties have the right to repledge the collateral posted,

but have the obligation to return the pledged collateral, or substantially the same collateral, if agreed to by us, as the market value of the currency forward contracts change.

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Note 9 – Derivatives and Hedging Activities

The following table summarizes changes in the notional amount of our derivative instruments during 2018:

| \$ in thousands | Notional Amount as of December 31, 2017 | Additions | Settlement, Termination, Expiration or Exercise | Notional Amount as of September 30, 2018 |
|--|---|------------|--|--|
| Interest Rate Swaps ^{(1) (2)} | 8,620,000 | 2,700,000 | (1,450,000) | 9,870,000 |
| Futures Contracts | — | 2,489,400 | (1,040,000) | 1,449,400 |
| Currency Forward Contracts | 76,859 | 185,578 | (233,613) | 28,824 |
| Credit Derivatives | 553,493 | — | (18,259) | 535,234 |
| TBA Purchase Contracts ⁽³⁾ | — | 283,100 | (283,100) | — |
| TBA Sale Contracts | — | (283,100) | 283,100 | — |
| Total | 9,250,352 | 5,374,978 | (2,741,872) | 11,883,458 |

(1) Notional amount as of September 30, 2018 excludes \$1.4 billion of interest rate swaps with forward start dates.

(2) Notional amount as of December 31, 2017 excludes \$500.0 million of interest rate swaps with forward start dates.

(3) To Be Announced Securities ("TBAs")

Interest Rate Swaps

Our repurchase agreements are usually settled on a short-term basis ranging from one to twelve months. At each settlement date, we typically refinance each repurchase agreement at the market interest rate at that time. In addition, our secured loans have floating interest rates. As such, we are exposed to changing interest rates. Our objectives in using interest rate derivatives are to add stability to interest expense and to manage our exposures to interest rate movements. To accomplish these objectives, we primarily use interest rate swaps as part of our interest rate risk management strategy. Interest rate swaps involve making fixed-rate payments to a counterparty in exchange for the receipt of variable-rate amounts over the life of the agreements without exchange of the underlying notional amount. Amounts recorded in accumulated other comprehensive income ("AOCI") before we discontinued cash flow hedge accounting for our interest rate swaps are reclassified to interest expense on repurchase agreements on the condensed consolidated statements of operations as interest is accrued and paid on the related repurchase agreements over the remaining life of the interest rate swap agreements. We reclassified \$6.4 million as a decrease (September 30, 2017: \$6.4 million as a decrease) and \$19.9 million as a decrease (September 30, 2017: \$19.1 million as a decrease) to interest expense for the three and nine months ended September 30, 2018, respectively. During the next 12 months, we estimate that \$23.7 million will be reclassified as a decrease to interest expense, repurchase agreements. As of September 30, 2018, \$104.3 million (December 31, 2017: \$123.9 million) of unrealized gains on discontinued cash flow hedges, net are still included in accumulated other comprehensive income and will be reclassified to interest expense over a period of time through December 15, 2023.

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As of September 30, 2018, we had the following interest rate swaps outstanding:

| \$ in thousands Counterparty | Index | Notional | Maturity Date | Fixed Interest Rate in Contract | |
|-------------------------------------|---------------|-----------|---------------|------------------------------------|---|
| LCH Central Clearing | 1-month LIBOR | 400,000 | 7/30/2020 | 2.69 | % |
| CME Central Clearing | 1-month LIBOR | 200,000 | 9/20/2020 | 2.79 | % |
| CME Central Clearing | 1-month LIBOR | 400,000 | 9/28/2020 | 2.72 | % |
| CME Central Clearing | 1-month LIBOR | 300,000 | 2/5/2021 | 2.69 | % |
| CME Central Clearing | 1-month LIBOR | 300,000 | 2/5/2021 | 2.50 | % |
| CME Central Clearing | 3-month LIBOR | 500,000 | 5/24/2021 | 2.25 | % |
| Citibank, N.A. | 1-month LIBOR | 200,000 | 5/25/2021 | 2.83 | % |
| CME Central Clearing | 3-month LIBOR | 500,000 | 6/24/2021 | 2.44 | % |
| HSBC Bank USA, National Association | 1-month LIBOR | 550,000 | 2/24/2022 | 2.45 | % |
| CME Central Clearing | 3-month LIBOR | 1,000,000 | 6/9/2022 | 2.21 | % |
| CME Central Clearing | 3-month LIBOR | 1,000,000 | 8/14/2022 | 1.87 | % |
| The Royal Bank of Scotland Plc | 1-month LIBOR | 500,000 | 8/15/2023 | 1.98 | % |
| CME Central Clearing | 1-month LIBOR | 600,000 | 8/24/2023 | 2.88 | % |
| HSBC Bank USA, National Association | 1-month LIBOR | 500,000 | 12/15/2023 | 2.20 | % |
| CME Central Clearing | 3-month LIBOR | 450,000 | 1/12/2024 | 2.10 | % |
| CME Central Clearing | 3-month LIBOR | 450,000 | 1/25/2024 | 2.15 | % |
| LCH Central Clearing | 3-month LIBOR | 1,000,000 | 2/6/2025 | 2.77 | % |
| CME Central Clearing | 3-month LIBOR | 100,000 | 4/2/2025 | 2.04 | % |
| LCH Central Clearing | 3-month LIBOR | 220,000 | 8/31/2027 | 2.12 | % |
| CME Central Clearing | 3-month LIBOR | 250,000 | 5/24/2028 | 2.78 | % |
| CME Central Clearing | 3-month LIBOR | 250,000 | 5/24/2028 | 2.39 | % |
| LCH Central Clearing | 1-month LIBOR | 200,000 | 7/3/2028 | 2.78 | % |
| Total | | 9,870,000 | | 2.39 | % |

As of September 30, 2018, we had the following additional interest rate swaps outstanding with forward start dates:

| \$ in thousands Counterparty | Index | Notional | Maturity Date | Fixed Interest Rate in Contract | |
|---------------------------------|---------------|-----------|---------------|------------------------------------|---|
| LCH Central Clearing (1) | 3-month LIBOR | 600,000 | 2/5/2026 | 2.64 | % |
| LCH Central Clearing (2) | 3-month LIBOR | 200,000 | 3/17/2031 | 2.74 | % |
| LCH Central Clearing (3) | 1-month LIBOR | 600,000 | 8/24/2033 | 3.18 | % |
| Total | | 1,400,000 | | 2.88 | % |

(1) Forward start date of 2/5/2021

(2) Forward start date of 3/15/2021

(3) Forward start date of 8/24/2023

Refer to Note 8 - "Collateral Positions" for further information regarding our collateral pledged to and received from our interest rate swap counterparties.

TBAs, Futures and Currency Forward Contracts

We purchase or sell certain TBAs and U.S. Treasury futures contracts to help mitigate the potential impact of changes in interest rates on the performance of our investment portfolio. We recognize realized and unrealized gains and losses associated with the purchases or sales of TBAs and U.S. Treasury futures contracts in gain (loss) on derivative instruments, net in our condensed consolidated statements of operations.

We use currency forward contracts to help mitigate the potential impact of changes in foreign currency exchange rates on our investments denominated in foreign currencies. We recognize realized and unrealized gains and losses associated with the purchases or sales of currency forward contracts in gain (loss) on derivative instruments, net in our condensed consolidated statements of operations. As of September 30, 2018, we did not have any forward contracts denominated in Pound Sterling (December 31, 2017: \$49.7 million of notional amount of forward contracts

denominated in Pound Sterling). As of September 30, 2018, we had \$28.8 million (December 31, 2017: \$27.2 million) of notional amount of forward contracts denominated in Euro.

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Credit Derivatives

Our GSE CRTs purchased prior to August 24, 2015 are accounted for as hybrid financial instruments consisting of a debt host contract and an embedded credit derivative. Embedded derivatives associated with GSE CRTs are recorded within mortgage-backed and credit risk transfer securities, at fair value, on the condensed consolidated balance sheets. At September 30, 2018 and December 31, 2017, terms of the GSE CRT embedded derivatives are:

| \$ in thousands | September | December |
|--|-----------|----------|
| | 30, 2018 | 31, 2017 |
| Fair value amount | 37,366 | 45,400 |
| Notional amount | 535,234 | 553,493 |
| Maximum potential amount of future undiscounted payments | 535,234 | 553,493 |

Tabular Disclosure of the Effect of Derivative Instruments on the Balance Sheet

The table below presents the fair value of our derivative financial instruments, as well as their classification on the condensed consolidated balance sheets as of September 30, 2018 and December 31, 2017.

| \$ in thousands | Derivative Assets | | Derivative Liabilities | |
|----------------------------|--------------------------------|-------------------------------|--------------------------------|-------------------------------|
| | As of September 30, 2018 | As of December 31, 2017 | As of September 30, 2018 | As of December 31, 2017 |
| | Fair Value | Fair Value | Balance Sheet | Fair Value |
| Balance Sheet | | | | Fair Value |
| Interest Rate Swaps Asset | 46,212 | 6,896 | Interest Rate Swaps Liability | 5,683 |
| Currency Forward Contracts | 2 | — | Currency Forward Contracts | 95 |
| | | | Futures Contracts | 8,204 |
| | | | | — |

Tabular Disclosure of the Effect of Derivative Instruments on the Income Statement

The tables below present the effect of our credit derivatives on the condensed consolidated statements of operations for the three and nine months ended September 30, 2018 and 2017.

| \$ in thousands | Three months ended September 30, 2018 | | |
|---|---|-----------------------------------|--|
| | Realized GSE CRT embedded derivative (loss), coupon net interest | Unrealized gain (loss), net | Realized and unrealized credit derivative income (loss), net |
| Derivative not designated as hedging instrument | | | |
| GSE CRT Embedded Derivatives | −5,638 | (663) | 4,975 |

| \$ in thousands | Three months ended September 30, 2017 | | |
|---|---|-----------------------------------|--|
| | Realized GSE CRT embedded derivative (loss), coupon net interest | Unrealized gain (loss), net | Realized and unrealized credit derivative income (loss), net |
| Derivative not designated as hedging instrument | | | |
| GSE CRT Embedded Derivatives | −5,873 | (8,803) | (2,930) |

| \$ in thousands | Nine months ended September 30, 2018 | | |
|-----------------|--------------------------------------|--|--|
|-----------------|--------------------------------------|--|--|

| Derivative not designated as hedging instrument | GSE CRT Realized embedded gain. derivative (loss), coupon net interest | Unrealized gain (loss), net | Realized and unrealized credit derivative income (loss), net |
|---|--|-----------------------------------|--|
| GSE CRT Embedded Derivatives | -16,909 | (8,034) | 8,875 |

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| | | | | |
|---|--------------------------------------|---|-----------------------------|--|
| \$ in thousands | Nine months ended September 30, 2017 | | | |
| Derivative not designated as hedging instrument | Realized gain (loss), net | GSE CRT embedded derivative coupon interest | Unrealized gain (loss), net | Realized and unrealized credit derivative income (loss), net |
| GSE CRT Embedded Derivatives | -17,524 | 20,904 | 38,428 | |

The following table summarizes the effect of interest rate swaps, futures contracts, currency forward contracts, and TBAs reported in gain (loss) on derivative instruments, net on the condensed consolidated statements of operations for the three and nine months ended September 30, 2018 and 2017:

| | | | | |
|---|---|----------------------------------|-----------------------------|--|
| \$ in thousands | Three Months Ended September 30, 2018 | | | |
| Derivative not designated as hedging instrument | Realized gain (loss) on derivative instruments, net | Contractual net interest expense | Unrealized gain (loss), net | Gain (loss) on derivative instruments, net |
| Interest Rate Swaps | 68,953 | (2,763) | (178) | 66,012 |
| Futures Contracts | 27,136 | — | (5,548) | 21,588 |
| Currency Forward Contracts | 3,569 | — | (3,480) | 89 |
| TBAs | (17) | — | — | (17) |
| Total | 99,641 | (2,763) | (9,206) | 87,672 |

| | | | | |
|---|---|----------------------------------|-----------------------------|--|
| \$ in thousands | Three Months Ended September 30, 2017 | | | |
| Derivative not designated as hedging instrument | Realized gain (loss) on derivative instruments, net | Contractual net interest expense | Unrealized gain (loss), net | Gain (loss) on derivative instruments, net |
| Interest Rate Swaps | 21,126 | (17,453) | 144 | 3,817 |
| Currency Forward Contracts | (1,623) | — | (239) | (1,862) |
| Total | 19,503 | (17,453) | (95) | 1,955 |

| | | | | |
|---|---|----------------------------------|-----------------------------|--|
| \$ in thousands | Nine Months Ended September 30, 2018 | | | |
| Derivative not designated as hedging instrument | Realized gain (loss) on derivative instruments, net | Contractual net interest expense | Unrealized gain (loss), net | Gain (loss) on derivative instruments, net |
| Interest Rate Swaps | 225,499 | (19,386) | 65,181 | 271,294 |
| Futures Contracts | 22,499 | — | (8,204) | 14,295 |
| Currency Forward Contracts | 1,512 | — | 1,124 | 2,636 |

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| | | | | |
|----------------------------|--------------------------------------|--------------|-------------|---------------|
| TBA's | (17) | — | — | (17) |
| Total | 249,493 | (19,386) | 58,101 | 288,208 |
| \$ in thousands | Nine Months Ended September 30, 2017 | | | |
| | Realized | | | |
| | gain | | | |
| Derivative | (loss) | Contractual | Unrealized | Gain (loss) |
| not designated as | on | net interest | gain | on derivative |
| hedging instrument | derivative | expense | (loss), net | instruments, |
| | instruments, | | | net |
| | net | | | |
| Interest Rate Swaps | (1,392) | (60,313) | 21,069 | (40,636) |
| Currency Forward Contracts | (4,416) | — | (1,044) | (5,460) |
| Total | (5,808) | (60,313) | 20,025 | (46,096) |

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Credit-risk-related Contingent Features

We have agreements with each of our bilateral derivative counterparties. Some of those agreements contain a provision whereby if we default on any of our indebtedness, including default whereby repayment of the indebtedness has not been accelerated by the lender, we could be declared in default on our derivative obligations.

We have minimum collateral posting thresholds with certain of our bilateral derivative counterparties and were not required to pledge collateral with these counterparties as of September 30, 2018 because our bilateral interest rate swaps were in a net asset position. If we had breached any of these provisions at September 30, 2018, we could have been required to settle our obligations under these agreements at their termination value.

We also have an agreement with a clearing counterparty for our interest rate swaps that includes cross default provisions. The fair value of our centrally cleared interest rate derivative contracts, which includes accrued interest and variation margin but excludes any adjustment for non-performance risk, was a net liability of \$5.7 million as of September 30, 2018.

We were in compliance with all of the financial provisions of these counterparty agreements as of September 30, 2018.

Note 10 – Offsetting Assets and Liabilities

Certain of our repurchase agreements and derivative transactions are governed by underlying agreements that generally provide for a right of offset under master netting arrangements (or similar agreements) in the event of default or in the event of bankruptcy of either party to the transactions. Assets and liabilities subject to such arrangements are presented on a gross basis in the condensed consolidated balance sheets.

The following tables present information about the assets and liabilities that are subject to master netting agreements (or similar agreements) and can potentially be offset on our condensed consolidated balance sheets at September 30, 2018 and December 31, 2017. The daily variation margin payment for centrally cleared interest rate swaps is characterized as settlement of the derivative itself rather than collateral. As of September 30, 2018, our derivative liability of \$5.7 million (December 31, 2017: derivative liability of \$10.3 million) related to centrally cleared interest rate swaps is not included in the table below as a result of this characterization of daily variation margin.

Offsetting of Derivative Assets

As of September 30, 2018

| \$ in thousands Description | Gross Amounts of Recognized Assets | Gross Amounts Offset in the Condensed Consolidated Balance Sheets | Net Amounts of Assets presented in the Condensed Consolidated Balance Sheets | Gross Amounts Not Offset in the Condensed Consolidated Balance Sheets | | Net Amount |
|---|---|---|---|---|-----------------------------|---------------|
| | | | | Financial Instrument | Cash Collateral Received | |
| Derivatives ⁽¹⁾ ⁽³⁾ | 46,214 | — | 46,214 | (2) | (46,089) | 123 |

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As of September 30, 2018

| \$ in thousands Description | Gross Amounts of Recognized Liabilities | Gross Amounts Offset in the Condensed Consolidated Balance Sheets | Net Amounts of Liabilities presented in the Condensed Consolidated Balance Sheets | Gross Amounts Not Offset in the Condensed Consolidated Balance Sheets | | |
|--------------------------------------|--|---|--|---|-------------------------------|---------------|
| | | | | Financial Instruments ⁽²⁾ | Cash Collateral Pledged | Net Amount |
| Derivatives ⁽³⁾ | 8,299 | — | 8,299 | (2) | (8,297) | — |
| Repurchase Agreements ⁽⁴⁾ | 14,378,518 | — | 14,378,518 | (14,378,518) | — | — |
| Secured Loans ⁽⁵⁾ | 1,650,000 | — | 1,650,000 | (1,650,000) | — | — |
| Total | 16,036,817 | — | 16,036,817 | (16,028,520) | (8,297) | — |

Offsetting of Derivative Assets
As of December 31, 2017

| \$ in thousands Description | Gross Amounts of Recognized Assets | Gross Amounts Offset in the Condensed Consolidated Balance Sheets | Net Amounts of Assets presented in the Condensed Consolidated Balance Sheets | Gross Amounts Not Offset in the Condensed Consolidated Balance Sheets | | |
|--------------------------------|---|---|---|---|-------------------------------|---------------|
| | | | | Financial Instruments | Cash Collateral Pledged | Net Amount |
| Derivatives ⁽¹⁾⁽³⁾ | 6,896 | — | 6,896 | (6,896) | — | — |

Offsetting of Derivative Liabilities and Repurchase Agreements
As of December 31, 2017

| \$ in thousands Description | Gross Amounts of Recognized Liabilities | Gross Amounts Offset in the Condensed Consolidated Balance Sheets | Net Amounts of Liabilities presented in the Condensed Consolidated Balance Sheets | Gross Amounts Not Offset in the Condensed Consolidated Balance Sheets | | |
|--------------------------------------|--|---|--|---|-------------------------------|---------------|
| | | | | Financial Instruments ⁽²⁾ | Cash Collateral Pledged | Net Amount |
| Derivatives ⁽³⁾ | 22,445 | — | 22,445 | (21,169) | (620) | 656 |
| Repurchase Agreements ⁽⁴⁾ | 14,080,801 | — | 14,080,801 | (14,080,801) | — | — |
| Secured Loans ⁽⁵⁾ | 1,650,000 | — | 1,650,000 | (1,650,000) | — | — |
| Total | 15,753,246 | — | 15,753,246 | (15,751,970) | (620) | 656 |

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- (1) Amounts represent derivatives in an asset position which could potentially be offset against derivatives in a liability position at September 30, 2018 and December 31, 2017, subject to a netting arrangement.
- (2) Amounts represent collateral pledged that is available to be offset against liability balances associated with repurchase agreements, secured loans and derivatives.
The fair value of securities pledged against our derivatives was \$186.3 million (December 31, 2017: \$109.9 million) at September 30, 2018, of which \$186.3 million (December 31, 2017: \$86.2 million) relates to initial margin pledged on centrally cleared interest rate swaps. Centrally cleared interest rate swaps are excluded from the tables above. Cash collateral received on our derivatives was \$47.7 million and \$7.3 million at September 30, 2018 and December 31, 2017, respectively. Cash collateral pledged by us on our futures contracts and currency forward contracts were \$26.7 million and \$620,000 at September 30, 2018 and December 31, 2017, respectively. Cash collateral pledged on our centrally cleared interest rate swaps is settled against the fair value of these swaps and therefore excluded from the tables above at September 30, 2018 and December 31, 2017, respectively.
- (3) The fair value of securities pledged against our borrowing under repurchase agreements was \$15.9 billion and \$15.5 billion at September 30, 2018 and December 31, 2017, respectively.
- (4) The fair value of securities pledged against IAS Services LLC's borrowings under secured loans was \$1.9 billion at September 30, 2018 and December 31, 2017, respectively.
- (5)

Note 11 – Fair Value of Financial Instruments

A three-level valuation hierarchy exists for disclosure of fair value measurements based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. Observable inputs reflect readily obtainable data from independent sources, while unobservable inputs reflect our market assumptions. The three levels are defined as follows:

Level 1 Inputs – Quoted prices for identical instruments in active markets.

Level 2 Inputs – Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose inputs are observable or whose significant value drivers are observable.

Level 3 Inputs – Instruments with primarily unobservable value drivers.

The following tables present our assets and liabilities measured at fair value on a recurring basis.

| \$ in thousands | September 30, 2018 | | | | Total at Fair Value |
|---|--------------------|------------|---------|---|------------------------|
| | Level 1 | Level 2 | Level 3 | NAV as a practical expedient (3) | |
| Assets: | | | | | |
| Mortgage-backed and credit risk transfer securities ⁽¹⁾⁽²⁾ | — | 18,299,459 | 37,366 | — | 18,336,825 |
| Derivative assets | — | 46,214 | — | — | 46,214 |
| Other assets ⁽⁴⁾⁽⁵⁾ | — | — | 45,058 | 24,217 | 69,275 |
| Total assets | — | 18,345,673 | 82,424 | 24,217 | 18,452,314 |
| Liabilities: | | | | | |
| Derivative liabilities | 8,204 | 5,778 | — | — | 13,982 |
| Total liabilities | 8,204 | 5,778 | — | — | 13,982 |

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| \$ in thousands | December 31, 2017 | | | | |
|---|--------------------------------|------------|---------|---|------------------------|
| | Fair Value Measurements Using: | | | | Total at Fair Value |
| | Level 1 | Level 2 | Level 3 | NAV as a practical expedient (3) | |
| Assets: | | | | | |
| Mortgage-backed and credit risk transfer securities ⁽¹⁾⁽²⁾ | — | 18,145,354 | 45,400 | — | 18,190,754 |
| Derivative assets | — | 6,896 | — | — | 6,896 |
| Other assets ⁽⁵⁾ | 3,979 | — | — | 25,972 | 29,951 |
| Total assets | 3,979 | 18,152,250 | 45,400 | 25,972 | 18,227,601 |
| Liabilities: | | | | | |
| Derivative liabilities | — | 32,765 | — | — | 32,765 |
| Total liabilities | — | 32,765 | — | — | 32,765 |

(1) For more detail about the fair value of our MBS and GSE CRTs, refer to Note 4 - "Mortgage-Backed and Credit Risk Transfer Securities."

Our GSE CRTs purchased prior to August 24, 2015 are accounted for as hybrid financial instruments with an embedded derivative. The hybrid financial instruments consist of debt host contracts classified as Level 2 and embedded derivatives classified as Level 3. As of September 30, 2018, the net embedded derivative asset position (2) of \$37.4 million includes \$39.4 million of embedded derivatives in an asset position and \$2.0 million of embedded derivatives in a liability position. As of December 31, 2017, the net embedded derivative asset position of \$45.4 million includes \$46.5 million of embedded derivatives in an asset position and \$1.1 million of embedded derivatives in a liability position.

Investments in unconsolidated ventures are valued using the net asset value ("NAV") as a practical expedient and are not subject to redemption, although investors may sell or transfer their interest at the approval of the general partner of the underlying funds. As of September 30, 2018 and December 31, 2017, the weighted average remaining term of investments in unconsolidated ventures is 2.4 and 1.9 years, respectively.

(4) Includes \$45.1 million of a loan participation interest as of September 30, 2018. The loan participation interest is transferable and bears interest at a variable rate based on LIBOR plus a spread and resets daily. As a result, the cost of the loan participation interest approximates its fair value.

(5) Includes \$4.0 million of an investment in an exchange-traded fund as of December 31, 2017. We sold this investment during the three months ended September 30, 2018.

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The following table shows a reconciliation of the beginning and ending fair value measurements of our GSE CRT embedded derivatives, which we have valued utilizing Level 3 inputs:

| | Three Months | | Nine Months | |
|--|--------------------------------|----------|--------------------------------|--------|
| | Ended September 30, 2018 | 2017 | Ended September 30, 2018 | 2017 |
| \$ in thousands | | | | |
| Beginning balance | 38,029 | 46,802 | 45,400 | 17,095 |
| Unrealized credit derivative gains (losses), net | (663) | (8,803) | (8,034) | 20,904 |
| Ending balance | 37,366 | 37,999 | 37,366 | 37,999 |

The following table shows a reconciliation of the beginning and ending fair value measurements of our loan participation interest, which we have valued utilizing Level 3 inputs:

| | Three Months | | Nine Months | |
|-------------------|--------------------------------|------|-----------------------------|------|
| | Ended September 30, 2018 | 2017 | Ended September 30, 2018 | 2017 |
| \$ in thousands | | | | |
| Beginning balance | — | — | — | — |
| Purchases | 45,058 | — | 45,058 | — |
| Ending balance | 45,058 | — | 45,058 | — |

The following tables summarize significant unobservable inputs used in the fair value measurement of our GSE CRT embedded derivatives:

| \$ in thousands | Fair Value at September 30, 2018 | Valuation Technique | Unobservable Input | Range | Weighted |
|------------------------------|-------------------------------------|------------------------------------|-----------------------|-----------------|---------------------|
| | | | | | Average |
| GSE CRT Embedded Derivatives | 37,366 | Market Comparables, Vendor Pricing | Weighted average life | 2.9 - 6.2 years | 4.4 years |
| \$ in thousands | Fair Value at December 31, 2017 | Valuation Technique | Unobservable Input | Range | Weighted Average |
| GSE CRT Embedded Derivatives | 45,400 | Market Comparables, Vendor Pricing | Weighted average life | 2.6 - 6.8 years | 4.8 years |

These significant unobservable inputs change according to market conditions and security performance. We estimate the weighted average life of GSE CRTs in order to identify GSE corporate debt with a similar maturity. We obtain our weighted average life estimates from a third party provider. Although weighted average life is a significant input, changes in weighted average life may not have an explicit directional impact on the fair value measurement.

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The following table presents the carrying value and estimated fair value of our financial instruments that are not carried at fair value on the condensed consolidated balance sheets at September 30, 2018 and December 31, 2017:

| \$ in thousands | September 30, 2018 | | December 31, 2017 | |
|---------------------------------------|--------------------|----------------------|-------------------|----------------------|
| | Carrying Value | Estimated Fair Value | Carrying Value | Estimated Fair Value |
| Financial Assets | | | | |
| Commercial loans, held-for-investment | 31,707 | 31,114 | 191,808 | 191,930 |
| Other assets | 74,250 | 74,250 | 74,250 | 74,250 |
| Total | 105,957 | 105,364 | 266,058 | 266,180 |
| Financial Liabilities | | | | |
| Repurchase agreements | 14,378,518 | 14,377,381 | 14,080,801 | 14,080,460 |
| Secured loans | 1,650,000 | 1,650,000 | 1,650,000 | 1,650,000 |
| Exchangeable senior notes | — | — | 143,231 | 143,948 |
| Total | 16,028,518 | 16,027,381 | 15,874,032 | 15,874,408 |

The following describes our methods for estimating the fair value for financial instruments not carried at fair value on the condensed consolidated balance sheets.

The estimated fair value of commercial loans held-for-investment is a Level 3 fair value measurement. Subsequent to the origination or purchase, commercial loan investments are valued on a monthly basis by an independent third party valuation agent using a discounted cash flow technique.

The estimated fair value of FHLBI stock, included in "Other assets," is a Level 3 fair value measurement. FHLBI stock may only be sold back to the FHLBI at its discretion at cost. As a result, the cost of the FHLBI stock approximates its fair value.

The estimated fair value of repurchase agreements is a Level 3 fair value measurement based on an expected present value technique. This method discounts future estimated cash flows using rates we determined best reflect current market interest rates that would be offered for repurchase agreements with similar characteristics and credit quality.

The estimated fair value of secured loans is a Level 3 fair value measurement. The secured loans have floating rates based on an index plus a spread and the spread is typically consistent with those demanded in the market.

Accordingly, the interest rates on these secured loans are at market, and thus the carrying amount approximates fair value.

The estimated fair value of exchangeable senior notes is a Level 2 fair value measurement based on a valuation obtained from a third-party pricing service.

Note 12 – Related Party Transactions

Under the terms of our management agreement, our Manager and its affiliates provide us with our management team, including our officers and appropriate support personnel. Each of our officers is an employee of our Manager or one of its affiliates. We do not have any employees. Our Manager is not obligated to dedicate any of its employees exclusively to us, nor is our Manager obligated to dedicate any specific portion of time to our business. During the three and nine months ended September 30, 2018, we reimbursed our Manager \$168,000 (September 30, 2017: \$202,000) and \$599,000 (September 30, 2017: \$589,000), respectively, for costs of support personnel that are fully dedicated to our business.

We have invested \$41.2 million as of September 30, 2018 (December 31, 2017: \$74.4 million) in money market or mutual funds managed by affiliates of our Manager. The investments are reported as cash and cash equivalents on our condensed consolidated balance sheets.

Management Fee Expense

We pay our Manager a management fee equal to 1.50% of our stockholders' equity per annum. The fee is calculated and payable quarterly in arrears. For purposes of calculating the management fee, stockholders' equity is equal to the sum of the net proceeds from all issuances of equity securities since inception including proceeds from the issuance of operating partnership units to an affiliate of our Manager, plus retained earnings at the end of the most recently completed calendar quarter (without taking into account any non-cash equity compensation expense incurred in

current or prior periods), less any amount paid to repurchase common stock since inception. Stockholder's equity excludes (i) any unrealized gains, losses or other items that do not affect realized net income (regardless of whether such items are included in other comprehensive income or loss, or in net income); (ii) cumulative net realized losses that are not attributable to permanently impaired investments and that relate to the investments for which market movement is accounted for in other comprehensive income; provided, however, that such

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adjustment shall not exceed cumulative unrealized net gains in other comprehensive income; (iii) one-time events pursuant to changes in U.S. GAAP; and (iv) certain non-cash items after discussions between our Manager and our independent directors and approval by a majority of our independent directors.

We do not pay any management fees on our investments in unconsolidated ventures that are managed by an affiliate of our Manager.

Expense Reimbursement

We are required to reimburse our Manager for our operating expenses incurred on our behalf, including directors and officers insurance, accounting services, auditing and tax services, filing fees, and miscellaneous general and administrative costs. Our reimbursement obligation is not subject to any dollar limitation.

The following table summarizes the costs incurred on our behalf by our Manager for the three and nine months ended September 30, 2018 and 2017.

| | Three Months Ended September 30, 2018 | | Nine Months Ended September 30, 2017 | |
|---|--|-------|---|-------|
| \$ in thousands | 2018 | 2017 | 2018 | 2017 |
| Incurred costs, prepaid or expensed | 2,133 | 2,378 | 4,925 | 5,172 |
| Incurred costs, charged against equity as a cost of raising capital | — | — | 167 | — |
| Total incurred costs, originally paid by our Manager | 2,133 | 2,378 | 5,092 | 5,172 |

Termination Fee

If we terminate our management agreement, we owe our Manager a termination fee equal to three times the sum of our average annual management fee during the 24-month period before termination, calculated as of the end of the most recently completed fiscal quarter.

Note 13 – Stockholders' Equity**Preferred Stock**

Holders of our Series A Preferred Stock are entitled to receive dividends at an annual rate of 7.75% of the liquidation preference of \$25.00 per share or \$1.9375 per share per annum. Dividends are cumulative and payable quarterly in arrears.

Holders of our Series B Preferred Stock are entitled to receive dividends at an annual rate of 7.75% of the liquidation preference of \$25.00 per share or \$1.9375 per share per annum until December 27, 2024. After December 27, 2024, holders are entitled to receive dividends at a floating rate equal to three-month LIBOR plus a spread of 5.18% of the \$25.00 liquidation preference per annum. Dividends are cumulative and payable quarterly in arrears.

In August 2017, we completed a public offering of 11,500,000 shares of 7.50% Fixed-to-Floating Series C Cumulative Redeemable Preferred Stock at the price of \$25.00 per share. Holders of our Series C Preferred Stock are entitled to receive dividends at an annual rate of 7.50% of the liquidation preference of \$25.00 per share or \$1.875 per share per annum until September 27, 2027. After September 27, 2027, holders are entitled to receive dividends at a floating rate equal to three-month LIBOR plus a spread of 5.289% of the \$25.00 liquidation preference per annum. Dividends are cumulative and payable quarterly in arrears.

As of July 27, 2017, we had the option to redeem shares of Series A Preferred Stock for \$25.00 per share, plus any accumulated and unpaid dividends through the date of redemption. We have the option to redeem shares of Series B Preferred Stock after December 27, 2024 and shares of Series C Preferred Stock after September 27, 2027 for \$25.00 per share, plus any accumulated and unpaid dividends through the date of the redemption. Shares of Series B and Series C Preferred Stock are not redeemable, convertible into or exchangeable for any other property or any other securities of the Company prior to those times, except under circumstances intended to preserve our qualification as a REIT or upon the occurrence of a change in control.

Common Stock

In December 2017, we entered into an equity distribution agreement with a placement agent under which we may sell up to 17,000,000 shares of our common stock from time to time in at-the-market or privately negotiated transactions. These shares are registered with the SEC under our automatic shelf registration statement (as amended and/or supplemented). As of September 30, 2018, we have not sold any shares of common stock under the equity distribution agreement.

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Securities Convertible into Shares of Common Stock

The non-controlling interest holder of the Operating Partnership units, a wholly-owned Invesco subsidiary, has the right to cause the Operating Partnership to redeem their operating partnership units ("OP Units") for cash equal to the market value of an equivalent number of shares of common stock, or at our option, we may purchase their OP Units by issuing one share of common stock for each OP Unit redeemed. We also have an equity incentive plan which allows us to grant securities convertible into our common stock to our independent directors and employees of our Manager and its affiliates.

Share Repurchase Program

During the three and nine months ended September 30, 2018 and 2017, we did not repurchase any shares of our common stock. As of September 30, 2018, we had authority to purchase 18,239,082 shares of our common stock through our share repurchase program. The share repurchase program has no stated expiration date.

Share-Based Compensation

We established the 2009 Equity Incentive Plan for grants of common stock and other equity based awards to our independent directors and officers and employees of our Manager and its affiliates (the "Incentive Plan"). Under the Incentive Plan, a total of 1,000,000 shares of common stock are authorized for issuance. Unless terminated earlier, the Incentive Plan will terminate in 2019, but will continue to govern the unexpired awards. As of September 30, 2018, 769,181 shares of common stock remain available for future issuance under the Incentive Plan.

We recognized compensation expense of approximately \$107,000 (September 30, 2017: \$129,000) and approximately \$306,000 (September 30, 2017: \$326,000) for shares issued to our independent directors under the Incentive Plan for the three and nine months ended September 30, 2018. During the three months ended September 30, 2018 and 2017, we issued 6,620 shares and 6,650 shares of common stock, respectively, to our independent directors. During the nine months ended September 30, 2018 and 2017, we issued 20,262 shares and 17,398 shares of common stock, respectively, to our independent directors. The fair market value of the shares granted was determined by the closing stock market price on the date of the grant. The grants vested immediately.

We recognized compensation expense of approximately \$71,000 (September 30, 2017: \$33,000) and approximately \$115,000 (September 30, 2017: \$99,000) for the three and nine months ended September 30, 2018 for restricted stock units awarded to employees of our Manager and its affiliates under the Incentive Plan. Our Manager reimburses us for the cost of these restricted stock awards under the terms of our management agreement. At September 30, 2018, there was approximately \$131,000 of total unrecognized compensation cost related to restricted stock unit awards that is expected to be recognized over a period of up to 42 months, with a weighted-average remaining vesting period of 16 months.

The following table summarizes the activity related to restricted stock units awarded to employees of our Manager and its affiliates for the three and nine months ended September 30, 2018.

| | Three Months Ended September 30, 2018 | | Nine Months Ended September 30, 2018 | |
|---|--|---|---|---|
| | Restricted Stock Units | Weighted Average Grant Date Fair Value ⁽¹⁾ | Restricted Stock Units | Weighted Average Grant Date Fair Value ⁽¹⁾ |
| Unvested at the beginning of the period | 19,185 | \$ 14.56 | 19,827 | \$ 14.35 |
| Shares granted during the period | — | — | 7,055 | 15.37 |
| Shares forfeited during the period | (3,967) | 14.56 | (3,967) | 14.56 |
| Shares vested during the period | (4,167) | 14.62 | (11,864) | 14.71 |
| Unvested at the end of the period | 11,051 | \$ 14.55 | 11,051 | \$ 14.55 |

(1)

The grant date fair value of restricted stock awards is based on the closing market price of our common stock at the grant date.

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Accumulated Other Comprehensive Income

The following tables present the components of total other comprehensive income (loss), net and accumulated other comprehensive income ("AOCI") for the three and nine months ended September 30, 2018 and 2017. The tables exclude gains and losses on MBS and GSE CRTs that are accounted for under the fair value option.

| \$ in thousands | Three Months Ended September 30, 2018 | | | |
|--|---------------------------------------|----------------------------------|-------------------------------|-----------|
| | Equity method investments | Available-for-sale securities | Derivatives and hedging | Total |
| Total other comprehensive income/(loss) | | | | |
| Unrealized gain (loss) on mortgage-backed and credit risk transfer securities, net | — | (40,554) | — | (40,554) |
| Reclassification of unrealized (gain) loss on sale of mortgage-backed and credit risk transfer securities to gain (loss) on investments, net | — | 134,280 | — | 134,280 |
| Reclassification of amortization of net deferred (gain) loss on de-designated interest rate swaps to repurchase agreements interest expense | — | — | (6,422) | (6,422) |
| Currency translation adjustments on investment in unconsolidated venture | (1,126) | — | — | (1,126) |
| Total other comprehensive income/(loss) | (1,126) | 93,726 | (6,422) | 86,178 |
| AOCI balance at beginning of period | 1,736 | (22,901) | 110,626 | 89,461 |
| Total other comprehensive income/(loss) | (1,126) | 93,726 | (6,422) | 86,178 |
| Other comprehensive income/(loss) attributable to non-controlling interest | 13 | (1,181) | 82 | (1,086) |
| AOCI balance at end of period | 623 | 69,644 | 104,286 | 174,553 |
| \$ in thousands | Three Months Ended September 30, 2017 | | | |
| | Equity method investments | Available-for-sale securities | Derivatives and hedging | Total |
| Total other comprehensive income/(loss) | | | | |
| Unrealized gain (loss) on mortgage-backed and credit risk transfer securities, net | — | 19,089 | — | 19,089 |
| Reclassification of unrealized (gain) loss on sale of mortgage-backed and credit risk transfer securities to gain (loss) on investments, net | — | 7 | — | 7 |
| Reclassification of amortization of net deferred (gain) loss on de-designated interest rate swaps to repurchase agreements interest expense | — | — | (6,438) | (6,438) |
| Currency translation adjustments on investment in unconsolidated venture | 807 | — | — | 807 |
| Total other comprehensive income/(loss) | 807 | 19,096 | (6,438) | 13,465 |
| AOCI balance at beginning of period | (375) | 201,158 | 136,608 | 337,391 |
| Total other comprehensive income/(loss) | 807 | 19,096 | (6,438) | 13,465 |
| Other comprehensive income/(loss) attributable to non-controlling interest | (10) | (241) | 81 | (170) |
| Rebalancing of ownership percentage of non-controlling interest | — | — | — | — |
| AOCI balance at end of period | 422 | 220,013 | 130,251 | 350,686 |

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| \$ in thousands | Nine Months Ended September 30, 2018 | | | |
|--|--------------------------------------|----------------------------------|-------------------------------|------------|
| | Equity method investments | Available-for-sale securities | Derivatives and hedging | Total |
| Total other comprehensive income/(loss) | | | | |
| Unrealized gain (loss) on mortgage-backed and credit risk transfer securities, net | — | (220,800) | — | (220,800) |
| Reclassification of unrealized (gain) loss on sale of mortgage-backed and credit risk transfer securities to gain (loss) on investments, net | — | 153,406 | — | 153,406 |
| Reclassification of amortization of net deferred (gain) loss on de-designated interest rate swaps to repurchase agreements interest expense | — | — | (19,859) | (19,859) |
| Currency translation adjustments on investment in unconsolidated venture | (328) | — | — | (328) |
| Total other comprehensive income/(loss) | (328) | (67,394) | (19,859) | (87,581) |
| AOCI balance at beginning of period | 947 | 136,188 | 123,894 | 261,029 |
| Total other comprehensive income/(loss) | (328) | (67,394) | (19,859) | (87,581) |
| Other comprehensive income/(loss) attributable to non-controlling interest | 4 | 850 | 251 | 1,105 |
| AOCI balance at end of period | 623 | 69,644 | 104,286 | 174,553 |
| \$ in thousands | Nine Months Ended September 30, 2017 | | | |
| | Equity method investments | Available-for-sale securities | Derivatives and hedging | Total |
| Total other comprehensive income/(loss) | | | | |
| Unrealized gain (loss) on mortgage-backed and credit risk transfer securities, net | — | 75,011 | — | 75,011 |
| Reclassification of unrealized (gain) loss on sale of mortgage-backed and credit risk transfer securities to gain (loss) on investments, net | — | 1,508 | — | 1,508 |
| Reclassification of amortization of net deferred (gain) loss on de-designated interest rate swaps to repurchase agreements interest expense | — | — | (19,105) | (19,105) |
| Currency translation adjustments on investment in unconsolidated venture | 331 | — | — | 331 |
| Total other comprehensive income/(loss) | 331 | 76,519 | (19,105) | 57,745 |
| AOCI balance at beginning of period | 95 | 144,458 | 149,115 | 293,668 |
| Total other comprehensive income/(loss) | 331 | 76,519 | (19,105) | 57,745 |
| Other comprehensive income/(loss) attributable to non-controlling interest | (4) | (965) | 241 | (728) |
| Rebalancing of ownership percentage of non-controlling interest | — | 1 | — | 1 |
| AOCI balance at end of period | 422 | 220,013 | 130,251 | 350,686 |

Amounts recorded in AOCI before we discontinued cash flow hedge accounting for our interest rate swaps are reclassified to interest expense on repurchase agreements on the condensed consolidated statements of operations as interest is accrued and paid on the related repurchase agreements over the remaining original life of the interest rate swap agreements.

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Dividends

We declared the following dividends during the nine months ended September 30, 2018 and 2017:

| Series A Preferred Stock | Dividends Declared Per Share | |
|--------------------------|------------------------------|--------------------|
| | Amount | Date of Payment |
| 2018 | | |
| September 14, 2018 | \$0.4844 | October 25, 2018 |
| June 15, 2018 | \$0.4844 | July 25, 2018 |
| March 15, 2018 | \$0.4844 | April 25, 2018 |
| 2017 | | |
| September 14, 2017 | \$0.4844 | October 25, 2017 |
| June 15, 2017 | \$0.4844 | July 25, 2017 |
| March 15, 2017 | \$0.4844 | April 25, 2017 |
| | | |
| Series B Preferred Stock | Dividends Declared Per Share | |
| | Amount | Date of Payment |
| 2018 | | |
| August 2, 2018 | \$0.4844 | September 27, 2018 |
| May 2, 2018 | \$0.4844 | June 27, 2018 |
| February 15, 2018 | \$0.4844 | March 27, 2018 |
| 2017 | | |
| September 14, 2017 | \$0.4844 | December 27, 2017 |
| June 15, 2017 | \$0.4844 | September 27, 2017 |
| March 15, 2017 | \$0.48 | June 27, 2017 |
| | | |
| Series C Preferred Stock | Dividends Declared Per Share | |
| | Amount | Date of Payment |
| 2018 | | |
| August 2, 2018 | \$0.4688 | September 27, 2018 |
| May 2, 2018 | \$0.4688 | June 27, 2018 |
| February 15, 2018 | \$0.4688 | March 27, 2018 |
| 2017 | | |
| September 14, 2017 | \$0.6823 | December 27, 2017 |
| | | |
| Common Stock | Dividends Declared Per Share | |
| | Amount | Date of Payment |
| 2018 | | |
| September 14, 2018 | \$0.42 | October 26, 2018 |
| June 15, 2018 | \$0.42 | July 26, 2018 |
| March 15, 2018 | \$0.42 | April 26, 2018 |
| 2017 | | |
| September 14, 2017 | \$0.41 | October 26, 2017 |
| June 15, 2017 | \$0.40 | July 26, 2017 |
| March 15, 2017 | \$0.40 | April 26, 2017 |

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Note 14 – Earnings per Common Share

Earnings per share for the three and nine months ended September 30, 2018 and 2017 is computed as follows:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|--|---------|---------------------------------------|---------|
| In thousands except per share amounts | 2018 | 2017 | 2018 | 2017 |
| Numerator (Income) | | | | |
| Basic Earnings: | | | | |
| Net income (loss) available to common stockholders | (64,480) | 49,127 | 56,999 | 183,091 |
| Effect of dilutive securities: | | | | |
| Income allocated to exchangeable senior notes | — | 2,724 | — | 11,236 |
| Income (loss) allocated to non-controlling interest | (681) | 800 | 1,153 | 2,656 |
| Dilutive net income (loss) available to stockholders | (65,161) | 52,651 | 58,152 | 196,983 |
| Denominator (Weighted Average Shares) | | | | |
| Basic Earnings: | | | | |
| Shares available to common stockholders | 111,647 | 111,614 | 111,639 | 111,607 |
| Effect of dilutive securities: | | | | |
| Restricted stock awards | — | 20 | 16 | 20 |
| Non-controlling interest OP units | 1,425 | 1,425 | 1,425 | 1,425 |
| Exchangeable senior notes | — | 8,166 | — | 11,226 |
| Dilutive Shares | 113,072 | 121,225 | 113,080 | 124,278 |
| Earnings per share: | | | | |
| Net income (loss) attributable to common stockholders | | | | |
| Basic | (0.58) | 0.44 | 0.51 | 1.64 |
| Diluted | (0.58) | 0.43 | 0.51 | 1.59 |

The following potential common shares were excluded from our diluted earnings per share calculation as the effect would be anti-dilutive: 14,766 for restricted stock awards for the three months ended September 30, 2018 and 1,583,503 for the exchangeable senior notes for the nine months ended September 30, 2018.

Note 15 – Non-controlling Interest - Operating Partnership

Non-controlling interest represents the aggregate ownership interest of a wholly-owned Invesco subsidiary in our Operating Partnership. The ownership percentage is determined by dividing the number of OP Units held by the Unit Holders by the total number of dilutive shares of common stock. The issuance or repurchase of common stock ("Share" or "Shares") or OP Units changes the percentage ownership of both the Unit Holders and the common stockholders. Since an OP unit is generally redeemable for cash or Shares at our option, it is deemed to be a Share equivalent. Therefore, such transactions are treated as capital transactions and result in a reallocation between stockholders' equity and non-controlling interest in the accompanying condensed consolidated balance sheets. As of September 30, 2018 and December 31, 2017, non-controlling interest related to the outstanding 1,425,000 OP Units represented a 1.3% interest in the Operating Partnership.

Income allocated to the non-controlling interest is based on the Unit Holders' ownership percentage of the Operating Partnership. The following table presents the net income (loss) allocated and distributions paid to the Operating Partnership non-controlling interest for the three and nine months ended September 30, 2018 and 2017.

| | Three Months Ended September | Nine Months Ended September 30, |
|--|---------------------------------------|---------------------------------------|
|--|---------------------------------------|---------------------------------------|

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| | 30, | | | |
|-----------------------------|--------|------|-------|-------|
| \$ in thousands | 2018 | 2017 | 2018 | 2017 |
| Net income (loss) allocated | (681) | 800 | 1,153 | 2,656 |
| Distributions paid | 599 | 570 | 1,796 | 1,710 |

As of September 30, 2018 and December 31, 2017, distributions payable to the non-controlling interest were \$598,500 and \$598,500, respectively.

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Note 16 – Commitments and Contingencies
Commitments and Contingencies

Commitments and contingencies may arise in the ordinary course of business. Our material off-balance sheet commitments as of September 30, 2018 are discussed below.

As discussed in Note 6 - "Other Assets", we have invested in unconsolidated ventures that are sponsored by an affiliate of our Manager. The unconsolidated ventures are structured as partnerships, and we invest in the partnerships as a limited partner. The entities are structured such that capital commitments are to be drawn down over the life of the partnership as investment opportunities are identified. As of September 30, 2018 and December 31, 2017, our undrawn capital and purchase commitments were \$10.1 million and \$10.2 million, respectively.

As discussed in Note 6 - "Other Assets", we have funded our portion of a commitment in a loan participation. The remainder of our commitment under the agreement will be funded over the two year term of the loan based upon the financing needs of the borrower. As of September 30, 2018, we have an unfunded commitment of \$29.9 million.

As discussed in Note 5 - "Commercial Loans Held-for-Investment", we purchase and originate commercial loans. As of September 30, 2018, we have no unfunded commitments on commercial loans held for investment (December 31, 2017: \$4.8 million).

We have entered into agreements with financial institutions to guarantee certain obligations of our subsidiaries. We would be required to perform under these guarantees in the event of certain defaults. We have not had prior claims or losses pursuant to these contracts and expect the risk of loss to be remote.

Note 17 – Subsequent Events

We have reviewed subsequent events occurring through the date that these condensed consolidated financial statements were issued and determined that no subsequent events occurred that would require accrual or additional disclosure.

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

In this quarterly report on Form 10-Q, or this “Report,” we refer to Invesco Mortgage Capital Inc. and its consolidated subsidiaries as “we,” “us,” “our Company,” or “our,” unless we specifically state otherwise or the context indicates otherwise. We refer to our external manager, Invesco Advisers, Inc., as our “Manager,” and we refer to the indirect parent company of our Manager, Invesco Ltd. together with its consolidated subsidiaries (which does not include us), as “Invesco.” The following discussion should be read in conjunction with our condensed consolidated financial statements and the accompanying notes to our condensed consolidated financial statements, which are included in Item 1 of this Report, as well as the information contained in our most recent Form 10-K filed with the Securities and Exchange Commission (the “SEC”).

Forward-Looking Statements

We make forward-looking statements in this Report and other filings we make with the SEC within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), and such statements are intended to be covered by the safe harbor provided by the same. Forward-looking statements are subject to substantial risks and uncertainties, many of which are difficult to predict and are generally beyond our control. These forward-looking statements include information about possible or assumed future results of our business, investment strategies, financial condition, liquidity, results of operations, plans and objectives. When we use the words “believe,” “expect,” “anticipate,” “estimate,” “plan,” “continue,” “intend,” “should,” “may,” “will,” “could,” “would,” and any other similar expressions and future or conditional verbs such as “will,” “may,” “could,” “should,” and “would,” and any other statement that necessarily depends on future events, we intend to identify forward-looking statements. Factors that could cause actual results to differ from those expressed in our forward-looking statements include, but are not limited to:

- our business and investment strategy;
- our investment portfolio;
- our projected operating results;
- general volatility of financial markets and effects of governmental responses, including actions and initiatives of the U.S. governmental agencies and changes to U.S. government policies, including the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”), mortgage loan modification programs, actions and initiatives of foreign governmental agencies and central banks, monetary policy actions of the Federal Reserve, including actions relating to its agency mortgage-backed securities portfolio and the continuation of re-investment of principal payments, and our ability to respond to and comply with such actions, initiatives and changes;
- the availability of financing sources, including our ability to obtain additional financing arrangements and the terms of such arrangements;
- financing and advance rates for our target assets;
- changes to our expected leverage;
- our expected investments;
- our expected book value per diluted common share;
- interest rate mismatches between our target assets and our borrowings used to fund such investments;
- the adequacy of our cash flow from operations and borrowings to meet our short-term liquidity needs;
- our ability to maintain sufficient liquidity to meet any margin calls;
- changes in the credit rating of the U.S. government;
- changes in interest rates and interest rate spreads and the market value of our target assets;
- changes in prepayment rates on our target assets;
- the impact of any deficiencies in foreclosure practices of third parties and related uncertainty in the timing of collateral disposition;
- our reliance on third parties in connection with services related to our target assets;
- effects of hedging instruments on our target assets;

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rates of default or decreased recovery rates on our target assets;
 modifications to whole loans or loans underlying securities;
 the degree to which our hedging strategies may or may not protect us from interest rate volatility;
 the degree to which derivative contracts expose us to contingent liabilities;
 counterparty defaults;
 compliance with financial covenants in our financing arrangements;
 changes in governmental regulations, zoning, insurance, eminent domain and tax law and rates, and similar matters and our ability to respond to such changes;
 our ability to maintain our qualification as a real estate investment trust for U.S. federal income tax purposes;
 our ability to maintain our exception from the definition of “investment company” under the Investment Company Act of 1940, as amended (the “1940 Act”);
 availability of investment opportunities in mortgage-related, real estate-related and other securities;
 availability of U.S. Government Agency guarantees with regard to payments of principal and interest on securities;
 the market price and trading volume of our capital stock;
 availability of qualified personnel of our Manager;
 the relationship with our Manager;
 estimates relating to taxable income and our ability to continue to make distributions to our stockholders in the future;
 estimates relating to fair value of our target assets and loan loss reserves;
 our understanding of our competition;
 changes to generally accepted accounting principles in the United States of America (“U.S. GAAP”);
 the adequacy of our disclosure controls and procedures and internal controls over financial reporting; and
 market trends in our industry, interest rates, real estate values, the debt securities markets or the general economy.

The forward-looking statements are based on our beliefs, assumptions and expectations of our future performance, taking into account all information currently available to us. You should not place undue reliance on these forward-looking statements. These beliefs, assumptions and expectations can change as a result of many possible events or factors, not all of which are known to us. Some of these factors are described under the headings “Risk Factors,” “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and “Business.” If a change occurs, our business, financial condition, liquidity and results of operations may vary materially from those expressed in our forward-looking statements. Any forward-looking statement speaks only as of the date on which it is made. New risks and uncertainties arise over time, and it is not possible for us to predict those events or how they may affect us. Except as required by law, we are not obligated to, and do not intend to, update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

The following discussion should be read in conjunction with our condensed consolidated financial statements and the accompanying notes to our condensed consolidated financial statements, which are included in this Report.

Overview

We are a Maryland corporation primarily focused on investing in, financing and managing residential and commercial mortgage-backed securities (“MBS”) and mortgage loans. Our objective is to provide attractive risk-adjusted returns to our investors, primarily through dividends and secondarily through capital appreciation. To achieve this objective, we primarily invest in the following:

- Residential mortgage-backed securities (“RMBS”) that are guaranteed by a U.S. government agency such as the Government National Mortgage Association or a federally chartered corporation such as the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation (collectively “Agency RMBS”);
- Commercial mortgage-backed securities (“CMBS”) that are guaranteed by a U.S. government agency such as the Government National Mortgage Association or a federally chartered corporation such as the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation (collectively “Agency CMBS”);

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RMBS that are not guaranteed by a U.S. government agency (“non-Agency RMBS”);
CMBS that are not guaranteed by a U.S. government agency (“non-Agency CMBS”);
Credit risk transfer securities that are unsecured obligations issued by government-sponsored enterprises (“GSE CRT”);
Residential and commercial mortgage loans; and
Other real estate-related financing arrangements.

We elected to be taxed as a real estate investment trust (“REIT”) for U.S. federal income tax purposes under the provisions of the Internal Revenue Code of 1986. To maintain our REIT qualification, we are generally required to distribute at least 90% of our REIT taxable income to our stockholders annually. We operate our business in a manner that permits our exclusion from the definition of “Investment Company” under the 1940 Act. We are externally managed and advised by Invesco Advisers, Inc., our Manager, which is an indirect, wholly-owned subsidiary of Invesco Ltd.

Capital Activities

On September 14, 2018, we declared the following dividends:

a dividend of \$0.42 per share of common stock to be paid on October 26, 2018 to stockholders of record as of the close of business on September 25, 2018; and

a dividend of \$0.4844 per share of Series A Preferred Stock to be paid on October 25, 2018 to stockholders of record as of the close of business on October 1, 2018.

On August 2, 2018, we declared the following dividends:

a dividend of \$0.4844 per share of Series B Preferred Stock payable on September 27, 2018 to stockholders of record as of the close of business on September 5, 2018; and

a dividend of \$0.46875 per share of Series C Preferred Stock payable on September 27, 2018 to stockholders of record as of the close of business on September 5, 2018.

During the nine months ended September 30, 2018, we did not repurchase any shares of our common stock.

Factors Impacting Our Operating Results

Our operating results can be affected by a number of factors and primarily depend on the level of our net interest income and the market value of our assets. Our net interest income, which includes the amortization of purchase premiums and accretion of purchase discounts, varies primarily as a result of changes in market interest rates and prepayment speeds, as measured by the constant prepayment rate (“CPR”) on our target assets. Interest rates and prepayment speeds 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. The market value of our assets can be impacted by credit spread premiums (yield advantage over U.S. Treasury notes) and the supply of, and demand for, target assets in which we invest.

Market Conditions

Macroeconomic factors that affect our business include credit spread premiums, market interest rates, governmental policy initiatives, residential and commercial real estate prices, credit availability, consumer personal income, corporate earnings, employment conditions, financial conditions and inflation.

Financial conditions improved during the third quarter of 2018, reflecting strength in the equity markets, tighter credit spreads and low volatility. The total return on the S&P 500 Index was 7.2% for the second quarter while the CBOE SPX Volatility Index (VIX) decreased by 24.7%. Interest rates on U.S. Treasuries were higher across the maturity spectrum, with short term rates increasing more than long term rates. U.S. Treasury two year, five year and 10 year rates were higher by 29, 22 and 21 basis points, respectively. Investors continued to be encouraged by the positive impacts that tax reform and easing of banking regulatory burdens are having on the economy. This optimism is tempered by concerns that strained foreign relations and escalating trade disputes could lead to a broader trade war. The labor market showed continued strength during the third quarter, with increases in non-farm payrolls averaging over 189,000 jobs per month, down slightly from an average of 217,000 jobs the previous quarter. The strength in the labor market continues to boost consumer confidence, as the University of Michigan Consumer Sentiment Index

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remains near multi-year highs. The consensus forecast for full-year 2018 gross domestic product (“GDP”) is 2.9%, while the Federal Reserve’s forecast is at 3.1%.

While the overall inflation picture remains relatively subdued, some indicators have begun to increase. The U.S. Personal Consumption Expenditure Core (“PCE”) Price Index is at 1.96%, just below the Federal Reserve’s inflation target of 2%. The consensus forecast for Core PCE in 2018 and 2019 remains at 1.9% and 2.2%, respectively. Energy prices were higher during the third quarter, with the price of WTI Crude up over 5%, while the broader Commodity Research Bureau (“CRB”) Commodity Price Index decreased by 2.6%. Given the strength of the overall economy, the Federal Reserve’s Open Market Committee raised the federal funds rate to a range of 2.00% to 2.25% during their September meeting, which caused short-term interest rates to increase. The inflation outlook continues to have meaningful implications for future Federal Reserve monetary policy. We expect the interest rate environment to remain relatively volatile, as the Federal Reserve continues to signal a willingness to increase the federal funds rate. During the third quarter, the performance of Agency RMBS was mixed: 30 year fixed-rate Agency RMBS slightly outperformed similar duration Treasuries, 15 year fixed rate Agency MBS were flat to Treasuries and Hybrid ARM Agency RMBS underperformed similar duration Treasuries. The outlook for Agency RMBS remains mixed, as the potential for increased interest rate volatility and the end of reinvestment activity by the Federal Reserve weighs on the market. On the positive side, a higher interest rate environment has the potential to spur investment demand on the part of both foreign and domestic banks, while at the same time keeping refinancing activity muted.

During the third quarter, credit spreads (defined as the yield in excess of risk-free rates) on non-Agency CMBS and GSE CRT securities tightened, reflecting strong real estate fundamentals and robust investor demand. Financing markets remained steady during the quarter, though repurchase agreement rates moved higher in line with increases in the federal funds rate.

As we move into the fourth quarter of 2018, we expect that the U.S. will continue to experience moderate economic growth which should allow the Federal Reserve to continue its efforts to tighten monetary policy despite core inflation at or below the Federal Reserve’s policy objective of 2%. Investor concerns include historically high valuations across both the equity and fixed income markets, the potential for additional protectionist trade policies, and the prospect of further increases in interest rates and price volatility.

Investment Activities

The table below shows the allocation of our equity as of September 30, 2018, December 31, 2017 and September 30, 2017:

| \$ in thousands | As of | | | |
|-----------------------------------|--------------------|-------------------|--------------------|---|
| | September 30, 2018 | December 31, 2017 | September 30, 2017 | |
| Agency RMBS and Agency CMBS | 51 % | 45 % | 41 % | % |
| Commercial Credit ⁽¹⁾ | 31 % | 35 % | 38 % | % |
| Residential Credit ⁽²⁾ | 18 % | 20 % | 21 % | % |
| Total | 100 % | 100 % | 100 % | % |

(1) Non-Agency CMBS, commercial loans and investments in unconsolidated ventures (which are included in Other Assets on our condensed consolidated balance sheet) are considered commercial credit.

(2) Non-Agency RMBS, GSE CRTs and a loan participation interest (which is included in Other Assets on our condensed consolidated balance sheet) are considered residential credit.

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The table below shows the breakdown of our investment portfolio as of September 30, 2018, December 31, 2017 and September 30, 2017:

| \$ in thousands | As of | | |
|--|--------------------|-------------------|--------------------|
| | September 30, 2018 | December 31, 2017 | September 30, 2017 |
| Agency RMBS: | | | |
| 30 year fixed-rate, at fair value | 10,499,050 | 7,640,540 | 7,386,544 |
| 15 year fixed-rate, at fair value | 602,159 | 2,974,782 | 3,134,880 |
| Hybrid ARM, at fair value | 1,010,023 | 1,719,385 | 1,819,513 |
| ARM, at fair value | 145,078 | 241,200 | 254,766 |
| Agency CMO, at fair value | 224,150 | 273,943 | 274,139 |
| Agency CMBS, at fair value | 584,688 | — | — |
| Non-Agency CMBS, at fair value | 3,270,768 | 3,216,417 | 3,108,797 |
| Non-Agency RMBS, at fair value | 1,158,712 | 1,257,608 | 1,420,333 |
| GSE CRT, at fair value | 842,197 | 866,879 | 860,580 |
| Loan participation interest, at fair value | 45,058 | — | — |
| Commercial loans, at amortized cost | 31,707 | 191,808 | 280,989 |
| Investments in unconsolidated ventures | 24,217 | 25,972 | 22,684 |
| Total Investment portfolio | 18,437,807 | 18,408,534 | 18,563,225 |

During the nine months ended September 30, 2018, we purchased \$5.2 billion of Agency RMBS and CMBS, \$207.4 million of non-Agency CMBS and \$123.4 million of non-Agency RMBS. As of September 30, 2018 our holdings of 30 year fixed-rate Agency RMBS represent approximately 57% of our total investment portfolio versus 42% as of December 31, 2017 and 40% as of September 30, 2017. We have continued to increase our holdings of 30 year fixed-rate Agency RMBS over the past 12 months as the return on equity profile for these securities remains attractive. Despite yield curve flattening and wider spreads due to the unwinding of the Federal Reserve's balance sheet, 30 year fixed-rate Agency RMBS presents an attractive opportunity in the sector. Our purchases are focused on current coupon 30 year specified pools priced at modest payups to generic Agency MBS given characteristics that reduce prepayment risk.

During the nine months ended September 30, 2018, we purchased \$584.7 million of Agency CMBS structured pass-through certificates issued by Freddie Mac through its K program. Freddie Mac sources these loans from a network of approved multi-family sellers/servicers and guarantees the timely payment of interest on these investments. We purchased these securities because they offer targeted exposure to multi-family loans, and have an attractive return on equity profile and offer underlying loan prepayment protection. We have continued to hold 15 year fixed-rate Agency RMBS and commercial real estate loans that have relatively low interest rate risk, which reduces our book value per diluted common share volatility. Additionally, we hold Hybrid ARM Agency RMBS and ARM Agency RMBS that we believe have lower durations and better cash flow certainty relative to current coupon 30 year fixed-rate Agency RMBS. Further, we own Agency collateralized mortgage obligations ("CMOs"), some of which are interest-only securities ("IOs"). Our portfolio of investments that have credit exposure includes non-Agency CMBS, non-Agency RMBS, GSE CRTs, commercial real estate loans, and a loan participation interest. Rather than relying on the rating agencies, we utilize proprietary models as well as third party applications to quantify and monitor the credit risk associated with our portfolio holdings. Our analysis generally begins at the underlying asset level, where we gather detailed information on loan, borrower, and property characteristics that inform our expectations for future performance. In addition to base case cash flow projections, we perform a range of scenario stresses to gauge the sensitivity of returns to potential deviations in underlying asset behavior. We perform this detailed credit analysis at the time of initial purchase and regularly throughout the holding period of each investment.

Our non-Agency CMBS portfolio generally consists of assets originated during and after 2010. These assets continue to benefit from rating agency upgrades, property price appreciation and limited supply. Non-Agency CMBS investments represent approximately 18% of our total investment portfolio as of September 30, 2018.

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With respect to our non-Agency RMBS portfolio, we primarily invest in securities collateralized by prime and Alt-A loans. In addition, we have invested in re-securitizations of real estate mortgage investment conduit ("Re-REMIC") RMBS and securitizations of reperforming mortgage loans ("RPL") that we expect to provide attractive risk adjusted returns. We also invest in GSE CRTs, which have the added benefit of paying a floating rate coupon, reducing our need to hedge interest rate risk. The majority of our GSE CRT holdings are concentrated in 2013 and 2014 vintages, where reference loans have significant embedded home price appreciation. From a fundamental perspective, we continue to view GSE CRT as an attractive asset class based on our positive outlook for U.S. home prices and the strong performance of reference mortgage loans to date.

During the third quarter of 2018, we acquired a participation interest in a secured loan collateralized by mortgage servicing rights associated with Fannie Mae, Freddie Mac, and Ginnie Mae loans. The loan has a two year term subject to a one year extension option. We funded \$45.1 million of the loan during the quarter and have committed to fund up to an additional \$29.9 million.

As of September 30, 2018, our commercial real estate loan portfolio includes two mezzanine loans that we either purchased or originated with a weighted average maturity of two years. Our floating rate commercial real estate loan portfolio had a weighted average yield of 10.05% during the three months ended September 30, 2018 and continues to benefit from favorable fundamentals and increasing LIBOR. The commercial real estate loan portfolio's weighted average loan-to-value ratio is approximately 77% based on the most recently attained independent property appraisals and the relevant loan amounts. For further details on our commercial loan portfolio, see Note 5 - "Commercial Loans Held-for-Investment" of our condensed consolidated financial statements. We evaluate the collectibility of our commercial loans held-for investment using the factors described in Note 2 - "Summary of Significant Accounting Policies" of our consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2017. We determined that no allowance for loan losses for our commercial loans was required as of September 30, 2018.

Portfolio Characteristics

The table below illustrates the vintage distribution of our non-Agency RMBS, GSE CRT and non-Agency CMBS portfolio as of September 30, 2018 as a percentage of the fair value:

| | 2003-2007 | 2008-2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | Total |
|-------------------------|-----------|-----------|--------|--------|--------|--------|-------|--------|-------|--------|---------|
| Prime | 20.7 % | 2.4 % | — % | — % | 13.1 % | 10.7 % | 2.4 % | 0.3 % | — % | 10.4 % | 60.0 % |
| Alt-A | 29.4 % | — % | — % | — % | — % | — % | — % | — % | — % | — % | 29.4 % |
| Re-REMIC ⁽¹⁾ | 0.7 % | 4.9 % | 2.2 % | 1.7 % | 0.9 % | — % | — % | — % | — % | — % | 10.4 % |
| Subprime/RPL | 0.2 % | — % | — % | — % | — % | — % | — % | — % | — % | — % | 0.2 % |
| Total Non-Agency | 51.0 % | 7.3 % | 2.2 % | 1.7 % | 14.0 % | 10.7 % | 2.4 % | 0.3 % | — % | 10.4 % | 100.0 % |
| GSE CRT | — % | — % | — % | — % | 31.4 % | 35.7 % | 6.7 % | 22.5 % | 3.7 % | — % | 100.0 % |
| Non-Agency CMBS | — % | 3.6 % | 17.9 % | 11.5 % | 14.2 % | 33.7 % | 7.4 % | 2.1 % | 8.3 % | 1.3 % | 100.0 % |

⁽¹⁾ Reflects the year in which the re-securitizations were issued. The vintage distribution of the securities that collateralize our Re-REMIC investments is 5.8% for 2005, 3.5% for 2006, and 90.7% for 2007.

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The following table summarizes the credit enhancement provided to our Re-REMIC holdings as of September 30, 2018 and December 31, 2017.

| Re-REMIC Subordination ⁽¹⁾ | Percentage of Re-REMIC Holdings at Fair Value | | | |
|---------------------------------------|---|---|-------------------|---|
| | September 30, 2018 | | December 31, 2017 | |
| 0% - 10% | 46.3 | % | 34.5 | % |
| 10% - 20% | 3.4 | % | 3.7 | % |
| 20% - 30% | 15.5 | % | 12.3 | % |
| 30% - 40% | 15.6 | % | 18.4 | % |
| 40% - 50% | 2.6 | % | 9.6 | % |
| 50% - 60% | 15.6 | % | 19.7 | % |
| 60% - 70% | 1.0 | % | 1.8 | % |
| Total | 100.0 | % | 100.0 | % |

Subordination refers to the credit enhancement provided to the Re-REMIC tranche held by us by any junior Re-REMIC tranche or tranches in a securitization. This figure reflects the percentage of the balance of the underlying securities represented by any junior tranche or tranches at the time of securitization. Generally, (1) principal losses on the underlying securities in excess of the subordination amount would result in principal losses on the Re-REMIC tranche held by us. As of September 30, 2018, 66.9% of our Re-REMIC holdings are not senior tranches.

The tables below represent the geographic concentration of the underlying collateral for our non-Agency RMBS, GSE CRT and non-Agency CMBS portfolio as of September 30, 2018:

| Non-Agency RMBS | | GSE CRT | | Non-Agency CMBS | |
|-----------------|------------|---------------|------------|-----------------|------------|
| State | Percentage | State | Percentage | State | Percentage |
| California | 43.8 % | California | 19.0 % | California | 14.8 % |
| New York | 8.8 % | Texas | 6.0 % | New York | 14.6 % |
| Florida | 6.5 % | New York | 4.6 % | Texas | 9.3 % |
| New Jersey | 4.0 % | Virginia | 4.3 % | Florida | 6.2 % |
| Massachusetts | 3.3 % | Florida | 4.2 % | Illinois | 4.3 % |
| Virginia | 3.3 % | Illinois | 3.9 % | Pennsylvania | 4.1 % |
| Maryland | 2.9 % | Massachusetts | 3.4 % | New Jersey | 3.5 % |
| Washington | 2.5 % | New Jersey | 3.3 % | Michigan | 3.1 % |
| Texas | 2.4 % | Washington | 3.3 % | Ohio | 3.0 % |
| Illinois | 2.4 % | Pennsylvania | 3.2 % | Virginia | 2.9 % |
| Other | 20.1 % | Other | 44.8 % | Other | 34.2 % |
| Total | 100.0 % | Total | 100.0 % | Total | 100.0 % |

Financing and Other Liabilities

We enter into repurchase agreements to finance the majority of our target assets. These agreements are secured by our mortgage-backed and credit risk transfer securities and an investment in a loan participation interest. Repurchase agreements are generally settled on a short-term basis, usually from one to twelve months, and bear interest at rates that have historically moved in close relationship to LIBOR. At each settlement date, we refinance each repurchase agreement at the market interest rate at that time. As of September 30, 2018, we had entered into repurchase agreements totaling \$14.4 billion (December 31, 2017: \$14.1 billion).

Our wholly-owned captive insurance subsidiary, IAS Services, is a member of the Federal Home Loan Bank of Indianapolis ("FHLBI"). As a member of the FHLBI, IAS Services has borrowed funds from the FHLBI in the form of secured loans. As of September 30, 2018, IAS Services had \$1.65 billion in outstanding secured loans. For the nine

months ended September 30, 2018, IAS Services had weighted average borrowings of \$1.65 billion with a weighted average borrowing rate of 2.01% and a weighted average maturity of 5.6 years.

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The following table presents the amount of collateralized borrowings outstanding under repurchase agreements and secured loans as of the end of each quarter, the average amount outstanding during the quarter and the maximum balance outstanding during the quarter:

| Quarter Ended | Collateralized borrowings under repurchase agreements and secured loans | | |
|--------------------|---|---------------------------------|---|
| | Quarter-end balance | Average quarterly balance | Maximum balance of any quarter-end |
| September 30, 2017 | 15,738,838 | 15,010,514 | 15,738,838 |
| December 31, 2017 | 15,730,801 | 15,762,094 | 15,815,972 |
| March 31, 2018 | 15,561,137 | 15,536,093 | 15,561,137 |
| June 30, 2018 | 15,352,321 | 15,275,972 | 15,352,321 |
| September 30, 2018 | 16,028,518 | 15,973,428 | 16,078,388 |

In 2013, our wholly-owned subsidiary, IAS Operating Partnership LP, issued \$400.0 million in aggregate principal amount of Exchangeable Senior Notes (the "Notes"). We retired a portion of the Notes prior to their maturity and fully retired the Notes upon their maturity on March 15, 2018. We utilized proceeds from repurchase agreement borrowings to retire the Notes.

We have also committed to invest up to \$122.8 million in unconsolidated ventures that are sponsored by an affiliate of our Manager. As of September 30, 2018, \$112.7 million of our commitment to these unconsolidated ventures has been called. We are committed to fund \$10.1 million in additional capital to fund future investments and cover future expenses should they occur.

Hedging Instruments.

As of September 30, 2018, we have entered into interest rate swap agreements designed to mitigate the effects of increases in interest rates for a portion of our borrowings. Under these swap agreements, we pay fixed interest rates and receive floating interest rates indexed off of one- or three-month LIBOR, effectively fixing the floating interest rates on \$9.9 billion (December 31, 2017: \$8.6 billion) of borrowings. As of September 30, 2018 we received interest based on one-month LIBOR on \$4.2 billion of our swaps and interest based on three-month LIBOR on \$5.7 billion of our swaps.

During the nine months ended September 30, 2018, existing swaps with a notional amount of \$1.45 billion expired and we entered into new swaps with a notional amount of \$2.7 billion. In addition, we entered into forward starting swaps with a notional amount of \$1.4 billion that effectively extend the maturities of existing interest rate swaps at September 30, 2018.

As of September 30, 2018, we have entered into U.S. Treasury futures contracts that are designed to help mitigate the potential impact of changes in interest rates on the performance of our investment portfolio. During the nine months ended September 30, 2018, we entered into contracts with a notional amount of \$2.5 billion and realized a net gain of \$22.5 million. As of September 30, 2018 we held \$1.4 billion in notional amount of futures contracts as a liability with a fair value of \$8.2 million. As of December 31, 2017, we had no outstanding futures contracts.

As of September 30, 2018, we have entered into currency forward contracts to help mitigate the potential impact of changes in foreign currency exchange rates on our investments denominated in foreign currencies. During the nine months ended September 30, 2018, we settled currency forward contracts of \$233.6 million (September 30, 2017: \$200.4 million) in notional amount and realized a net gain of \$1.5 million (September 30, 2017: \$4.4 million net loss). As of December 31, 2017, we had \$49.7 million of notional amount of forward contracts denominated in Pound Sterling. We did not have any forward contracts denominated in Pound Sterling as of September 30, 2018 because the commercial loan investment that we were hedging was repaid in the third quarter of 2018. As of September 30, 2018, we had \$28.8 million (December 31, 2017: \$27.2 million) of notional amount of forward contracts denominated in Euro related to our investment in an unconsolidated venture.

During the three months ended September 30, 2018, we entered into and settled TBA purchase and sale contracts with a notional value of \$283.1 million and realized a net loss of \$17,000. TBAs are a method for hedging interest rate exposure through entering into a contract to purchase or sell, for future delivery, an Agency MBS with a specified issuer, term and coupon. We periodically purchase or sell certain TBAs to help mitigate the potential impact of changes in interest rates on the performance of our portfolio.

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Book Value per Diluted Common Share

We calculate book value per diluted common share as follows:

| In thousands except per share amounts | As of | |
|--|-----------------------|----------------------|
| | September 30, 2018 | December 31, 2017 |
| Numerator (adjusted equity): | | |
| Total equity | 2,485,423 | 2,656,878 |
| Less: Liquidation preference of Series A Preferred Stock | (140,000) | (140,000) |
| Less: Liquidation preference of Series B Preferred Stock | (155,000) | (155,000) |
| Less: Liquidation preference of Series C Preferred Stock | (287,500) | (287,500) |
| Total adjusted equity | 1,902,923 | 2,074,378 |
| Denominator (number of shares - diluted): | | |
| Common stock outstanding | 111,653 | 111,624 |
| Non-controlling interest OP units | 1,425 | 1,425 |
| Number of shares - diluted | 113,078 | 113,049 |
| Book value per diluted common share | 16.83 | 18.35 |

Our book value per diluted common share decreased 8.3% as of September 30, 2018 compared to December 31, 2017 primarily due to rising interest rates driving a decrease in the valuations of our mortgage-backed securities portfolio that exceeded the increase in the valuations of our interest rate hedges. Refer to Item 3. "Quantitative and Qualitative Disclosures About Market Risk" for interest rate risk and its impact on fair value.

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Critical Accounting Policies

Our condensed consolidated financial statements are prepared in accordance with U.S. GAAP, which requires the use of estimates and assumptions that involve the exercise of judgment and use of assumptions as to future uncertainties. Accounting estimates and assumptions discussed in this section are those that we consider to be the most critical to an understanding of our financial statements because they involve significant judgments and uncertainties. All of these estimates reflect our best judgment about current, and for some estimates, future economic and market conditions and their effects based on information available as of the date of these financial statements. If conditions change from those expected, it is possible that the judgments and estimates described below could change, which may result in a change in valuation of our investment portfolio, future impairments of our MBS and GSE CRTs, change in our interest income recognition, allowance for loan losses, and a change in our tax liability among other effects.

There have been no significant changes to our critical accounting policies that are disclosed in our most recent Form 10-K for the year ended December 31, 2017, other than the significant accounting policy disclosed below.

Restricted Cash

Restricted cash represents cash posted with the FHLBI as collateral for secured loans and cash posted with counterparties as collateral for various derivative instruments. Cash held by counterparties as collateral is legally restricted and is not available for general corporate purposes.

Recent Accounting Standards

See Part I, Item 1, Financial Statements Note 2 - "Accounting Pronouncements Recently Adopted" and "Pending Accounting Pronouncements".

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Results of Operations

The table below presents certain information from our condensed consolidated statements of operations for the three and nine months ended September 30, 2018 and 2017.

| \$ in thousands, except share data | Three Months Ended | | Nine Months | |
|---|--------------------|-------------|---------------------|-------------|
| | September 30, | | Ended September 30, | |
| | 2018 | 2017 | 2018 | 2017 |
| Interest Income | | | | |
| Mortgage-backed and credit risk transfer securities | 160,416 | 134,138 | 456,967 | 374,038 |
| Commercial and other loans | 1,672 | 6,251 | 9,945 | 18,036 |
| Total interest income | 162,088 | 140,389 | 466,912 | 392,074 |
| Interest Expense | | | | |
| Repurchase agreements | 81,763 | 45,907 | 210,737 | 111,926 |
| Secured loans | 9,490 | 5,544 | 24,888 | 13,492 |
| Exchangeable senior notes | — | 2,724 | 1,621 | 11,236 |
| Total interest expense | 91,253 | 54,175 | 237,246 | 136,654 |
| Net interest income | 70,835 | 86,214 | 229,666 | 255,420 |
| Other Income (loss) | | | | |
| Gain (loss) on investments, net | (207,910 |) (11,873 |) (404,657 |) (2,551 |
| Equity in earnings (losses) of unconsolidated ventures | 1,084 | 408 | 2,778 | (1,280 |
| Gain (loss) on derivative instruments, net | 87,672 | 1,955 | 288,208 | (46,096 |
| Realized and unrealized credit derivative income (loss), net | 4,975 | (2,930 |) 8,875 | 38,428 |
| Net loss on extinguishment of debt | — | (1,344 |) (26 |) (6,581 |
| Other investment income (loss), net | 1,068 | 2,313 | 2,010 | 6,175 |
| Total other income (loss) | (113,111 |) (11,471 |) (102,812 |) (11,905 |
| Expenses | | | | |
| Management fee – related party | 10,105 | 9,557 | 30,428 | 27,385 |
| General and administrative | 1,673 | 1,697 | 4,954 | 5,389 |
| Total expenses | 11,778 | 11,254 | 35,382 | 32,774 |
| Net income (loss) | (54,054 |) 63,489 | 91,472 | 210,741 |
| Net income (loss) attributable to non-controlling interest | (681 |) 800 | 1,153 | 2,656 |
| Net income (loss) attributable to Invesco Mortgage Capital Inc. | (53,373 |) 62,689 | 90,319 | 208,085 |
| Dividends to preferred stockholders | 11,107 | 13,562 | 33,320 | 24,994 |
| Net income (loss) attributable to common stockholders | (64,480 |) 49,127 | 56,999 | 183,091 |
| Earnings per share: | | | | |
| Net income (loss) attributable to common stockholders | | | | |
| Basic | (0.58 |) 0.44 | 0.51 | 1.64 |
| Diluted | (0.58 |) 0.43 | 0.51 | 1.59 |
| Weighted average number of shares of common stock: | | | | |
| Basic | 111,647,456 | 111,613,804 | 111,639,132 | 111,606,784 |
| Diluted | 113,072,456 | 121,225,215 | 113,079,666 | 124,278,215 |

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Interest Income and Average Earning Asset Yields

The table below presents information related to our average earning assets and earning asset yields for the three and nine months ended September 30, 2018 and 2017.

| \$ in thousands | Three Months Ended | | Nine Months | | |
|---|--------------------|------------|---------------------|------------|---|
| | September 30, | | Ended September 30, | | |
| | 2018 | 2017 | 2018 | 2017 | |
| Average Balances ⁽¹⁾ : | | | | | |
| Agency RMBS: | | | | | |
| 15 year fixed-rate, at amortized cost | 1,613,967 | 3,223,684 | 2,376,050 | 3,370,401 | |
| 30 year fixed-rate, at amortized cost | 9,362,170 | 6,486,613 | 8,338,593 | 5,274,103 | |
| ARM, at amortized cost | 181,721 | 258,304 | 211,147 | 275,010 | |
| Hybrid ARM, at amortized cost | 1,303,070 | 1,847,709 | 1,520,365 | 2,043,497 | |
| Agency - CMO, at amortized cost | 242,133 | 287,364 | 256,770 | 308,159 | |
| Agency CMBS, at amortized cost | 516,992 | — | 190,951 | — | |
| Non-Agency CMBS, at amortized cost | 3,236,226 | 2,920,587 | 3,202,556 | 2,721,306 | |
| Non-Agency RMBS, at amortized cost | 1,055,671 | 1,339,639 | 1,056,962 | 1,537,013 | |
| GSE CRT, at amortized cost | 762,235 | 790,886 | 769,546 | 784,301 | |
| Commercial loans, at amortized cost | 55,607 | 279,840 | 137,028 | 277,642 | |
| Loan participation interest | 29,875 | — | 10,068 | — | |
| Average earning assets | 18,359,667 | 17,434,626 | 18,070,036 | 16,591,432 | |
| Average Earning Asset Yields ⁽²⁾ : | | | | | |
| Agency RMBS: | | | | | |
| 15 year fixed-rate | 2.59 | % 1.95 | % 2.15 | % 1.99 | % |
| 30 year fixed-rate | 2.96 | % 2.73 | % 2.96 | % 2.73 | % |
| ARM | 2.49 | % 2.35 | % 2.41 | % 2.31 | % |
| Hybrid ARM | 2.57 | % 2.19 | % 2.35 | % 2.26 | % |
| Agency - CMO | 3.20 | % 2.71 | % 2.90 | % 1.16 | % |
| Agency CMBS | 2.85 | % — | % 3.34 | % — | % |
| Non-Agency CMBS | 4.88 | % 4.52 | % 4.89 | % 4.40 | % |
| Non-Agency RMBS | 7.17 | % 6.56 | % 7.12 | % 5.97 | % |
| GSE CRT ⁽³⁾ | 3.56 | % 2.74 | % 3.31 | % 2.51 | % |
| Commercial loans | 10.05 | % 8.86 | % 9.45 | % 8.69 | % |
| Loan participation interest | 5.87 | % — | % 5.87 | % — | % |
| Average earning asset yields | 3.53 | % 3.22 | % 3.45 | % 3.15 | % |

(1) Average balances for each period are based on weighted month-end average earning assets.

Average earning asset yields for the period were calculated by dividing interest income, including amortization of (2) premiums and discounts, by the average month-end earning assets based on the amortized cost of the investments.

All yields are annualized.

GSE CRT average earning asset yields exclude coupon interest associated with embedded derivatives on securities (3) not accounted for under the fair value option that is recorded as realized and unrealized credit derivative income (loss), net under U.S. GAAP.

Our primary source of income is interest earned on our investment portfolio. We had average earning assets of approximately \$18.4 billion for the three months ended September 30, 2018 (September 30, 2017: \$17.4 billion). We had average earning assets of approximately \$18.1 billion for the nine months ended September 30, 2018 (September 30, 2017: \$16.6 billion). Average earning assets increased for the three and nine months ended September 30, 2018 primarily because we issued \$287.5 million of Series C Preferred Stock in August 2017 and invested the proceeds in 30 year fixed-rate Agency RMBS and CMBS.

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We earned total interest income of \$162.1 million (September 30, 2017: \$140.4 million) and \$466.9 million (September 30, 2017: \$392.1 million) for the three and nine months ended September 30, 2018. Our interest income includes coupon interest and net premium amortization on MBS and GSE CRTs as well as interest income on commercial loans and an investment in a loan participation interest as shown in the table below.

| | Three Months | | Nine Months | |
|--|--------------------------|----------|--------------------------|----------|
| | Ended September 30, 2018 | 2017 | Ended September 30, 2018 | 2017 |
| \$ in thousands | | | | |
| Interest Income | | | | |
| MBS and GSE CRT - coupon interest | 175,696 | 156,635 | 506,180 | 449,971 |
| MBS and GSE CRT - net premium amortization | (15,280) | (22,497) | (49,213) | (75,933) |
| MBS and GSE CRT - interest income | 160,416 | 134,138 | 456,967 | 374,038 |
| Commercial and other loans | 1,672 | 6,251 | 9,945 | 18,036 |
| Total interest income | 162,088 | 140,389 | 466,912 | 392,074 |

MBS and GSE CRT interest income increased \$26.3 million and \$82.9 million, respectively, for the three and nine months ended September 30, 2018 compared to 2017 primarily due to the purchase of 30 year Agency RMBS and non-Agency CMBS with the proceeds from our August 2017 Series C Preferred Stock offering and lower net premium amortization. Net premium amortization decreased \$7.2 million and \$26.7 million, respectively, for the three and nine months ended September 30, 2018 compared to 2017 primarily due to slower prepayment speeds on 30 year fixed-rate Agency RMBS and purchases of non-Agency CMBS securities at a discount over the last 12 months.

Interest income on our floating rate commercial real estate and other loans decreased \$4.6 million and \$8.1 million, respectively, during the three and nine months ended September 30, 2018 primarily due to commercial loan payoffs. The balance of our commercial loans held-for-investment decreased to \$31.7 million as of September 30, 2018 compared to \$281.0 million as of September 30, 2017.

Our average earning asset yields increased 31 and 30 basis points, respectively, during the three and nine months ended September 30, 2018 compared to 2017 due to purchases of new securities at higher yields, slower prepayment speeds and higher index rates on floating and adjustable assets.

Prepayment Speeds

Our RMBS and GSE CRT portfolio is subject to inherent prepayment risk primarily driven by changes in interest rates, which impacts the amount of premium and discount on the purchase of these securities that is recognized into interest income. Expected future prepayment speeds on our RMBS and GSE CRT portfolio are estimated on a quarterly basis. Generally, in an environment of falling interest rates, prepayment speeds will increase as homeowners are more likely to prepay their existing mortgage and refinance into a lower borrowing rate. If the actual prepayment speed during the period is faster than estimated, the amortization on securities purchased at a premium to par value will be accelerated, resulting in lower interest income recognized. Conversely, for securities purchased at a discount to par value, interest income will be reduced in periods where prepayment speeds were slower than expected. The standard measure of prepayment speeds is the constant prepayment rate, also known as the conditional prepayment rate or "CPR". CPR measures prepayments as a percentage of the current outstanding loan balance and is expressed as a compound annual rate. The table below provides the three month constant prepayment rate for our RMBS and GSE CRTs as of September 30, 2018, June 30, 2018, September 30, 2017 and June 30, 2017.

| | As of | | | |
|--------------------------------|--------------------|--------------------|--------------------|---------------|
| | September 30, 2018 | September 30, 2018 | September 30, 2017 | June 30, 2017 |
| 15 year fixed-rate Agency RMBS | 10.9 | 10.6 | 10.2 | 9.5 |
| 30 year fixed-rate Agency RMBS | 7.4 | 8.2 | 9.3 | 9.2 |
| ARM/ Hybrid ARM Agency RMBS | 16.6 | 15.7 | 18.6 | 16.3 |
| Non-Agency RMBS | 10.5 | 12.0 | 15.3 | 12.6 |

| | | | | |
|----------------------|------|------|------|------|
| GSE CRT | 10.9 | 9.8 | 12.4 | 9.7 |
| Weighted average CPR | 8.9 | 10.2 | 12.2 | 11.2 |

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The following table presents net premium amortization recognized on our MBS and GSE CRT portfolio for the three and nine months ended September 30, 2018 and 2017.

| | Three Months | | Nine Months | |
|---|---------------------|----------|---------------------|----------|
| | Ended September 30, | | Ended September 30, | |
| \$ in thousands, except share data | 2018 | 2017 | 2018 | 2017 |
| Agency RMBS and CMBS | (20,850) | (26,155) | (66,347) | (82,508) |
| Non-Agency CMBS | 1,470 | (591) | 4,091 | (5,077) |
| Non-Agency RMBS | 4,831 | 4,846 | 15,167 | 12,967 |
| GSE CRT | (731) | (597) | (2,124) | (1,315) |
| Net (premium amortization) discount accretion | (15,280) | (22,497) | (49,213) | (75,933) |

Net premium amortization decreased compared to the same periods in 2017 primarily due to slower prepayment speeds on 30 year fixed-rate Agency RMBS in the three and nine months ended September 30, 2018 and purchases of non-Agency CMBS securities at a discount over the last 12 months.

Our interest income is subject to interest rate risk. Refer to Item 3. "Quantitative and Qualitative Disclosures about Market Risk" for more information relating to interest rate risk and its impact on our operating results.

Interest Expense and the Cost of Funds

The table below presents the components of interest expense for the three and nine months ended September 30, 2018 and 2017:

| \$ in thousands | Three Months | | Nine Months | |
|---|---------------------|---------|---------------------|----------|
| | Ended September 30, | | Ended September 30, | |
| | 2018 | 2017 | 2018 | 2017 |
| Interest Expense | | | | |
| Interest expense on repurchase agreement borrowings | 88,185 | 52,345 | 230,596 | 131,031 |
| Amortization of net deferred (gain) loss on de-designated interest rate swaps | (6,422) | (6,438) | (19,859) | (19,105) |
| Repurchase agreements interest expense | 81,763 | 45,907 | 210,737 | 111,926 |
| Secured loans | 9,490 | 5,544 | 24,888 | 13,492 |
| Exchangeable senior notes | — | 2,724 | 1,621 | 11,236 |
| Total interest expense | 91,253 | 54,175 | 237,246 | 136,654 |

We enter into repurchase agreements to finance the majority of our target assets. These agreements are secured by our mortgage-backed and credit risk transfer securities. These agreements are generally settled on a short-term basis, usually from one to twelve months, and bear interest at rates that have historically moved in close relationship to LIBOR. At each settlement date, we typically refinance each repurchase agreement at the market interest rate at that time.

Our interest expense on repurchase agreement borrowings rose \$35.8 million and \$99.6 million, respectively, for the three and nine months ended September 30, 2018 compared to 2017 due to high average borrowings and increases in the federal funds rate over the past 12 months. We increased our average borrowings in the second half of 2017 after investing the proceeds of our August 2017 offering of Series C Preferred Stock.

Our repurchase agreement interest expense as reported in our condensed consolidated statement of operations includes amortization of net deferred gains and losses on de-designated interest rate swaps as summarized in the table above. Amortization of net deferred gains on de-designated interest rate swaps decreased our total interest expense by \$6.4 million and \$19.9 million, respectively, during the three and nine months ended September 30, 2018 and \$6.4 million and \$19.1 million, respectively, during the three and nine months ended September 30, 2017. Amounts recorded in AOCI before we discontinued cash flow hedge accounting for our interest rate swaps are reclassified to interest expense on repurchase agreements on the condensed consolidated statements of operations as interest is accrued and paid on the related repurchase agreements over the remaining life of the interest rate swap agreements. During the next twelve months, we estimate that \$23.7 million of net deferred gains on de-designated interest rate swaps will be

reclassified from other comprehensive income and recorded as a decrease to interest expense.

During the three and nine months ended September 30, 2018, interest expense for our secured loans increased \$3.9 million and \$11.4 million, respectively, compared to the same periods in 2017 due to higher borrowing rates.

Borrowing rates

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on our secured loans are based on the three-month FHLB swap rate plus a spread. For the nine months ended September 30, 2018, the weighted average borrowing rate on our secured loans was 2.01% as compared to 1.09% for the nine months ended September 30, 2017.

During the three and nine months ended September 30, 2018, interest expense on exchangeable senior notes decreased \$2.7 million and \$9.6 million, respectively, compared to the same periods in 2017 because we retired \$256.6 million of the Notes during 2017 and the remaining balance of the Notes when they matured on March 15, 2018.

Our total interest expense during the three months ended September 30, 2018 increased \$37.1 million from the same period in 2017 primarily due to the \$39.8 million increase in interest expense on repurchase agreements borrowings and secured loans in the 2018 period offset by a \$2.7 million decrease in interest expense on the Notes as discussed above.

Our total interest expense during the nine months ended September 30, 2018 increased \$100.6 million from the same period in 2017 primarily due to a \$111.0 million increase in interest expense on repurchase agreements borrowings and secured loans in the 2018 period that was partially offset by a \$9.6 million decrease in interest expense on the Notes as discussed above.

The table below presents information related to our borrowings and cost of funds for the three and nine months ended September 30, 2018 and 2017:

| \$ in thousands | Three Months Ended | | Nine Months | | |
|---|-----------------------|------------|-----------------------------|------------|---|
| | September 30, 2018 | 2017 | Ended September 30, 2018 | 2017 | |
| Average Borrowings ⁽¹⁾ : | | | | | |
| Agency RMBS ⁽²⁾ | 11,326,323 | 10,919,243 | 11,299,625 | 10,105,277 | |
| Agency CMBS | 472,011 | — | 173,727 | — | |
| Non-Agency CMBS ⁽²⁾ | 2,575,504 | 2,367,648 | 2,558,317 | 2,260,356 | |
| Non-Agency RMBS | 895,504 | 1,062,528 | 882,784 | 1,208,702 | |
| GSE CRT | 681,079 | 661,095 | 674,560 | 639,234 | |
| Exchangeable senior notes | — | 185,930 | 38,300 | 256,261 | |
| Loan participation interest | 22,406 | — | 7,551 | — | |
| Total average borrowings | 15,972,827 | 15,196,444 | 15,634,864 | 14,469,830 | |
| Maximum borrowings during the period ⁽³⁾ | 16,078,387 | 15,896,218 | 16,078,387 | 15,896,218 | |
| Average Cost of Funds ⁽⁴⁾ : | | | | | |
| Agency RMBS ⁽²⁾ | 2.24 | % 1.28 | % 1.96 | % 1.09 | % |
| Agency CMBS | 2.26 | % — | % 2.22 | % — | % |
| Non-Agency CMBS ⁽²⁾ | 2.88 | % 1.91 | % 2.61 | % 1.63 | % |
| Non-Agency RMBS | 3.40 | % 2.67 | % 3.17 | % 2.42 | % |
| GSE CRT | 3.26 | % 2.69 | % 3.10 | % 2.50 | % |
| Exchangeable senior notes | — | % 5.86 | % 5.58 | % 5.85 | % |
| Loan participation interest | 3.83 | % — | % 3.83 | % — | % |
| Cost of funds | 2.29 | % 1.43 | % 2.02 | % 1.26 | % |
| Effective cost of funds (non-GAAP measure) ⁽⁵⁾ | 2.52 | % 2.06 | % 2.36 | % 2.00 | % |

(1) Average borrowings for each period are based on weighted month-end balances.

(2) Agency RMBS and non-Agency CMBS average borrowings and average cost of funds include borrowings under repurchase agreements and secured loans.

(3) Amount represents the maximum borrowings at month-end during each of the respective periods.

(4) Average cost of funds is calculated by dividing annualized interest expense excluding amortization of net deferred gain (loss) on de-designated interest rate swaps by our average borrowings.

(5) For a reconciliation of cost of funds to effective cost of funds, see "Non-GAAP Financial Measures."

Total average borrowings rose \$776.4 million and \$1.2 billion, respectively, in the three and nine months ended September 30, 2018 compared to 2017 primarily because we entered into repurchase agreements to finance our

increased holdings of 30 year fixed-rate Agency RMBS, Agency CMBS and non-Agency CMBS. The increase in our average cost of funds for three and nine months ended September 30, 2018 versus 2017 was primarily due to increases in the federal funds rate over the past twelve months.

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Net Interest Income

The table below presents the components of net interest income for the three and nine months ended September 30, 2018 and 2017:

| \$ in thousands | Three Months Ended | | Nine Months | |
|---|-----------------------|----------|-----------------------------|-----------|
| | September 30, 2018 | 2017 | Ended September 30, 2018 | 2017 |
| Interest Income | | | | |
| Mortgage-backed and credit risk transfer securities | 160,416 | 134,138 | 456,967 | 374,038 |
| Commercial and other loans | 1,672 | 6,251 | 9,945 | 18,036 |
| Total interest income | 162,088 | 140,389 | 466,912 | 392,074 |
| Interest Expense | | | | |
| Interest expense on repurchase agreement borrowings | 88,185 | 52,345 | 230,596 | 131,031 |
| Amortization of net deferred (gain) loss on de-designated interest rate swaps | (6,422) | (6,438) | (19,859) | (19,105) |
| Repurchase agreements interest expense | 81,763 | 45,907 | 210,737 | 111,926 |
| Secured loans | 9,490 | 5,544 | 24,888 | 13,492 |
| Exchangeable senior notes | — | 2,724 | 1,621 | 11,236 |
| Total interest expense | 91,253 | 54,175 | 237,246 | 136,654 |
| Net interest income | 70,835 | 86,214 | 229,666 | 255,420 |
| Net interest rate margin | 1.24 | % 1.79 | % 1.43 | % 1.89 |

Our net interest income, which equals interest income less interest expense, totaled \$70.8 million (September 30, 2017: \$86.2 million) and \$229.7 million (September 30, 2017: \$255.4 million) for the three and nine months ended September 30, 2018, respectively. The decrease in net interest income for the three and nine months ended September 30, 2018 was primarily due to an increase in interest expense driven by higher average borrowings and borrowing rates exceeding the increase in interest income on higher average earning assets.

Our net interest rate margin, which equals the yield on our average assets for the period less the average cost of funds for the period, was 1.24% (September 30, 2017: 1.79%) and 1.43% (September 30, 2017: 1.89%) for the three and nine months ended September 30, 2018, respectively. The decrease in net interest rate margin for the three and nine months ended September 30, 2018 compared to the same periods in 2017 was primarily due to increases in the federal funds rate in 2017 and 2018 that had a greater impact on our average cost of funds than on our average earning asset yields.

Gain (Loss) on Investments, net

The table below summarizes the components of gain (loss) on investments, net for the three and nine months ended September 30, 2018 and 2017:

| \$ in thousands | Three Months | | Nine Months | |
|--|--------------------------------|----------|--------------------------------|---------|
| | Ended September 30, 2018 | 2017 | Ended September 30, 2018 | 2017 |
| Realized gains and losses on sale of investments | (140,715) | (7) | (161,477) | (1,665) |
| Other-than-temporary impairment losses | (737) | (4,959) | (7,185) | (9,589) |
| Net unrealized gains and losses on MBS accounted for under the fair value option | (66,831) | (5,301) | (236,967) | (1,188) |
| Net unrealized gains and losses on GSE CRT accounted for under the fair value option | 377 | (1,608) | 993 | 9,866 |
| Net unrealized gains and losses on trading securities | (4) | 2 | (21) | 25 |
| Total gain (loss) on investments, net | (207,910) | (11,873) | (404,657) | (2,551) |

As part of our investment process, our mortgage-backed and credit risk transfer securities are continuously reviewed to determine if they continue to meet our risk and return targets. This process involves looking at changing market

assumptions and the impact those assumptions will have on the individual securities. Given the sharp rise in interest rates during the first half of 2018, as well as reduced purchases by the Federal Reserve, valuations and potential equity returns on newly issued 30-

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year Agency MBS were attractive during the third quarter, creating accretive opportunities in the sector. During the three months ended September 30, 2018, we repositioned our Agency portfolio by rotating out of seasoned Agency RMBS and into newly issued 30 year Agency RMBS and Agency CMBS to take advantage of those accretive opportunities. We sold \$3.0 billion of mortgage-backed securities during the three months ended September 30, 2018 (September 30, 2017: \$182.0 million) and realized losses of \$140.7 million (September 30, 2017: net losses of \$7,000). During the nine months ended September 30, 2018, we sold \$3.5 billion of mortgage-backed securities (September 30, 2017: \$627.6 million) and realized losses of \$161.5 million (September 30, 2017: net losses of \$1.7 million).

We assess our investment securities for other-than-temporary impairment on a quarterly basis. Our determination of whether a security is other-than-temporarily impaired involves judgment and assumptions based on subjective and objective factors. We consider (i) whether we intend to sell the security and whether it is more likely than not that we will be required to sell the security before recovery of its amortized cost and (ii) the financial condition and near-term prospects of recovery in fair value of the security. This includes a determination of estimated future cash flows through an evaluation of the characteristics of the underlying loans and the structural features of the investment. When the fair value of an investment is less than its amortized cost at the balance sheet date of the reporting period for which impairment is assessed, the impairment is designated as either "temporary" or "other-than-temporary." For additional information regarding our assessment analysis of other-than temporary impairment on our investment securities, refer to Note 4 – "Mortgage-Backed and Credit Risk Transfer Securities" of our condensed consolidated financial statements. We have elected the fair value option for all of our RMBS IOs, our MBS purchased on or after September 1, 2016 and our GSE CRTs purchased on or after August 24, 2015. Under the fair value option, changes in fair value are recognized in income in the condensed consolidated statements of operations and are reported as a component of gain (loss) on investments, net. As of September 30, 2018, \$11.2 billion (December 31, 2017: \$6.5 billion) or 61.3% (December 31, 2017: 35.6%) of our MBS and GSE CRT are accounted for under the fair value option.

Equity in Earnings (Losses) of Unconsolidated Ventures

For the three months ended September 30, 2018, we recorded equity in earnings of unconsolidated ventures of \$1.1 million (September 30, 2017: equity in earnings of \$408,000). For the nine months ended September 30, 2018, we recorded equity in earnings of unconsolidated ventures of \$2.8 million (September 30, 2017: equity in losses of \$1.3 million). We recorded equity in earnings for the three and nine months ended September 30, 2018 primarily due to realized and unrealized gains on the underlying portfolio investments. We recorded losses for the nine months ended September 30, 2017 primarily due to unrealized losses on the underlying portfolio investments.

Gain (Loss) on Derivative Instruments, net

Our objectives in using interest rate derivatives are to add stability to interest expense and to manage our exposure to interest rate movements on our floating rate repurchase agreements and secured loans. To accomplish these objectives, we primarily use interest rate derivative instruments, including interest rate swaps, interest rate swaptions, U.S.

Treasury futures contracts and TBAs as part of our interest rate risk management strategy.

We also use currency forward contracts to help mitigate the potential impact of changes in foreign currency exchange rates on our investments denominated in foreign currencies.

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The tables below summarize our realized and unrealized gain (loss) on derivative instruments, net for the following periods:

| | | | | |
|---|--|----------------------------------|-----------------------------|--|
| \$ in thousands | Three months ended September 30, 2018 | | | |
| | Realized | | | |
| Derivative not designated as hedging instrument | gain (loss) on derivative instruments, net | Contractual net interest expense | Unrealized gain (loss), net | Gain (loss) on derivative instruments, net |
| Interest Rate Swaps | 68,953 | (2,763) | (178) | 66,012 |
| Futures Contracts | 27,136 | — | (5,548) | 21,588 |
| Currency Forward Contracts | 3,569 | — | (3,480) | 89 |
| TBAs | (17) | — | — | (17) |
| Total | 99,641 | (2,763) | (9,206) | 87,672 |
| \$ in thousands | Three months ended September 30, 2017 | | | |
| | Realized | | | |
| Derivative not designated as hedging instrument | gain (loss) on derivative instruments, net | Contractual net interest expense | Unrealized gain (loss), net | Gain (loss) on derivative instruments, net |
| Interest Rate Swaps | 21,126 | (17,453) | 144 | 3,817 |
| Currency Forward Contracts | (1,623) | — | (239) | (1,862) |
| Total | 19,503 | (17,453) | (95) | 1,955 |
| \$ in thousands | Nine Months Ended September 30, 2018 | | | |
| | Realized | | | |
| Derivative not designated as hedging instrument | gain (loss) on derivative instruments, net | Contractual net interest expense | Unrealized gain (loss), net | Gain (loss) on derivative instruments, net |
| Interest Rate Swaps | 225,499 | (19,386) | 65,181 | 271,294 |
| Futures Contracts | 22,499 | — | (8,204) | 14,295 |
| Currency Forward Contracts | 1,512 | — | 1,124 | 2,636 |
| TBAs | (17) | — | — | (17) |
| Total | 249,493 | (19,386) | 58,101 | 288,208 |
| \$ in thousands | Nine Months Ended September 30, 2017 | | | |
| | Realized | | | |
| Derivative not designated as hedging instrument | gain (loss) on derivative instruments, net | Contractual net interest expense | Unrealized gain (loss), net | Gain (loss) on derivative instruments, net |
| Interest Rate Swaps | (1,392) | (60,313) | 21,069 | (40,636) |
| Currency Forward Contracts | (4,416) | — | (1,044) | (5,460) |

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Total (5,808) (60,313) 20,025 (46,096)

As of September 30, 2018 and December 31, 2017, we held the following interest rate swaps whereby we receive interest at a one-month and three-month LIBOR rate:

| Derivative instrument | As of September 30, 2018 | | | | As of December 31, 2017 | | | |
|-----------------------|--------------------------|------------------------|----------------------|--------------------------|-------------------------|------------------------|----------------------|--------------------------|
| | Notional Amounts (1) | Average Fixed Pay Rate | Average Receive Rate | Average Maturity (Years) | Notional Amounts (2) | Average Fixed Pay Rate | Average Receive Rate | Average Maturity (Years) |
| Interest Rate Swaps | 9,870,000 | 2.39 % | 2.13 % | 4.5 | 8,620,000 | 2.11 % | 1.48 % | 4.2 |

(1) Excludes \$1.4 billion of notional amount for interest rate swaps with forward start dates.

(2) Excludes \$500.0 million of notional amount for interest rate swaps with forward start dates.

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Realized and Unrealized Credit Derivative Income (Loss), net

The table below summarizes the components of realized and unrealized credit derivative income (loss), net for the three and nine months ended September 30, 2018 and 2017.

| | Three Months Ended September 30, 2018 | | Nine Months Ended September 30, 2017 | |
|--|--|----------|---|--------|
| \$ in thousands | | | | |
| GSE CRT embedded derivative coupon interest | 5,638 | 5,873 | 16,909 | 17,524 |
| Change in fair value of GSE CRT embedded derivatives | (663) | (8,803) | (8,034) | 20,904 |
| Total realized and unrealized credit derivative income (loss), net | 4,975 | (2,930) | 8,875 | 38,428 |

In the three months ended September 30, 2018, we recorded an increase of \$7.9 million in realized and unrealized credit derivative income (loss), net compared to the same period in 2017 because the decreases in valuation of the debt host contracts exceeded the decreases in valuation of the hybrid financial instruments.

In the nine months ended September 30, 2018, we recorded a decrease of \$29.6 million in realized and unrealized credit derivative income (loss), net compared to the same period in 2017 because the increases in valuation of the debt host contracts exceeded the increases in valuation of the hybrid financial instruments.

Net Loss on Extinguishment of Debt

We retired a portion of our Exchangeable Senior Notes (the "Notes") prior to their maturity and fully retired the Notes upon their maturity on March 15, 2018.

In the three months ended September 30, 2017, we retired \$60.9 million of the Notes for a repurchase price of \$62.1 million and realized a net loss on extinguishment of debt of \$209,000. In the nine months ended September 30, 2018, we retired \$143.4 million (2017: \$242.2 million) of the Notes for a repurchase price of \$143.4 million (2017: \$247.5 million). We realized a net loss on extinguishment of debt of \$26,000 and \$6.6 million, respectively in the nine months ended September 30, 2018 and 2017.

Other Investment Income (Loss), net

Other investment income (loss), net consists of (i) quarterly dividends from FHLBI stock and an investment in an exchange-traded fund and (ii) foreign exchange rate gains and losses related to a commercial loan investment denominated in a foreign currency. The table below summarizes the components of other investment income (loss), net for the three and nine months ended September 30, 2018 and 2017.

| | Three Months Ended September 30, 2018 | | Nine Months Ended September 30, 2017 | |
|---|--|-------|---|-------|
| \$ in thousands | | | | |
| Dividend income | 853 | 809 | 2,947 | 2,427 |
| Gain (loss) on foreign currency transactions, net | 215 | 1,504 | (937) | 3,748 |
| Total | 1,068 | 2,313 | 2,010 | 6,175 |

We are required to purchase and hold a certain amount of FHLBI stock, which is based, in part, upon the outstanding principal balance of secured advances from the FHLBI. We earn dividend income on our investment in FHLBI stock, and the amount of our dividend income varies based upon the number of shares that we are required to own and the dividend declared per share.

We incurred foreign exchange gains (losses) on the revaluation of a commercial loan investment (notional amount of £34.5 million) for the three and nine months ended September 30, 2018 and 2017 due to the fluctuation in the Pound Sterling/ U.S. Dollar foreign exchange rate. The loan was repaid in the third quarter of 2018. We enter into currency forward contracts as an economic hedge against our foreign currency exposure. Changes in the fair value of our currency forward contracts are recognized in gain (loss) derivative instruments, net in the condensed consolidated statements of operations. During the three and nine months ended September 30, 2018, we recognized net gains of

\$89,000 (September 30, 2017: net losses of \$1.9 million) and \$2.6 million (September 30, 2017: net losses of \$5.5 million), respectively, on our currency forward contracts.

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Expenses

We incurred management fees of \$10.1 million (September 30, 2017: \$9.6 million) for the three months ended September 30, 2018 and \$30.4 million (September 30, 2017: \$27.4 million) for the nine months ended September 30, 2018. Management fees increased for the three and nine months ended September 30, 2018 compared to the same periods in 2017 primarily because the Company issued preferred stock in August 2017. Refer to Note 12 – "Related Party Transactions" of our condensed consolidated financial statements for a discussion of our relationship with our Manager and a description of how our fees are calculated.

Our general and administrative expenses not covered under our management agreement amounted to \$1.7 million (September 30, 2017: \$1.7 million) for the three months ended September 30, 2018 and \$5.0 million (September 30, 2017: \$5.4 million) for the nine months ended September 30, 2018. General and administrative expenses not covered under our management agreement primarily consist of directors and officers insurance, legal costs, accounting, auditing and tax services, filing fees, and miscellaneous general and administrative costs. General and administrative costs were lower for the nine months ended September 30, 2018 versus 2017 primarily due to higher professional fees in the 2017 period.

Net Income (Loss) attributable to Common Stockholders

For the three months ended September 30, 2018, our net loss attributable to common stockholders was \$64.5 million (September 30, 2017: \$49.1 million net income attributable to common stockholders) or \$0.58 basic and diluted net loss per average share available to common stockholders (September 30, 2017: \$0.44 basic and \$0.43 diluted net income per average share available to common stockholders). The change in net income (loss) attributable to common stockholders was primarily due to (i) net loss on investments of \$207.9 million in the 2018 period compared to net loss on investments of \$11.9 million in the 2017 period, (ii) net gain on derivative instruments of \$87.7 million in the 2018 period compared to net gain on derivative instruments of \$2.0 million in the 2017 period, (iii) credit derivative net income of \$5.0 million in the 2018 period compared to credit derivative net loss of \$2.9 million in the 2017 period and (iv) a \$15.4 million decrease in net interest income.

For the nine months ended September 30, 2018, our net income attributable to common stockholders was \$57.0 million (September 30, 2017: \$183.1 million) or \$0.51 basic and \$0.51 diluted net income per average share available to common stockholders (September 30, 2017: \$1.64 basic and \$1.59 diluted net income per average share available to common stockholders). The decrease in net income attributable to common stockholders was primarily due to (i) net loss on investments of \$404.7 million compared to net loss of \$2.6 million in the 2017 period, (ii) net gain on derivative instruments of \$288.2 million in the 2018 period compared to net loss on derivative instruments of \$46.1 million in the 2017 period, (iii) net credit derivative income of \$8.9 million in the 2018 period compared to net credit derivative income of \$38.4 million in the 2017 period and (iv) a \$25.8 million decrease in net interest income.

For further information on the changes in net gain (loss) on investments, net gains (loss) on derivative instruments, realized and unrealized credit derivative income (loss), net and net interest income, see preceding discussion under "Gain (Loss) on Investments, net," "Gain (Loss) on Derivative Instruments, net," "Realized and Unrealized Credit Derivative Income (Loss), net," and "Net Interest Income."

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Non-GAAP Financial Measures

We use the following non-GAAP financial measures to analyze the Company's operating results and believe these financial measures are useful to investors in assessing our performance as further discussed below:

- core earnings (and by calculation, core earnings per common share),
- effective interest income (and by calculation, effective yield),
- effective interest expense (and by calculation, effective cost of funds),
- effective net interest income (and by calculation, effective interest rate margin), and
- repurchase agreement debt-to-equity ratio.

The most directly comparable U.S. GAAP measures are:

- net income (loss) attributable to common stockholders (and by calculation, basic earnings (loss) per common share),
- total interest income (and by calculation, earning asset yields),
- total interest expense (and by calculation, cost of funds),
- net interest income (and by calculation, net interest rate margin), and
- debt-to-equity ratio.

The non-GAAP financial measures used by management should be analyzed in conjunction with U.S. GAAP financial measures and should not be considered substitutes for U.S. GAAP financial measures. In addition, the non-GAAP financial measures may not be comparable to similarly titled non-GAAP financial measures of our peer companies.

Core Earnings

We calculate core earnings as U.S. GAAP net income (loss) attributable to common stockholders adjusted for (gain) loss on investments, net; realized (gain) loss on derivative instruments, net; unrealized (gain) loss on derivative instruments, net; realized and unrealized (gain) loss on GSE CRT embedded derivatives, net; (gain) loss on foreign currency transactions, net; amortization of net deferred (gain) loss on de-designated interest rate swaps; net loss on extinguishment of debt; and cumulative adjustments attributable to non-controlling interest. We may add and have added additional reconciling items to our core earnings calculation as appropriate.

We believe the presentation of core earnings provides a consistent measure of operating performance by excluding the impact of gains and losses described above from operating results. We exclude the impact of gains and losses because gains and losses are not accounted for consistently under U.S. GAAP. Under U.S. GAAP, certain gains and losses are reflected in net income whereas other gains and losses are reflected in other comprehensive income. For example, a portion of our mortgage-backed securities are classified as available-for-sale securities, and we record changes in the valuation of these securities in other comprehensive income on our condensed consolidated balance sheets. We elected the fair value option for our mortgage-backed securities purchased on or after September 1, 2016, and changes in the valuation of these securities are recorded in other income (loss) in our condensed consolidated statements of operations. In addition, certain gains and losses represent one-time events.

We believe that providing transparency into core earnings enables our investors to consistently measure, evaluate and compare our operating performance to that of our peers over multiple reporting periods. However, we caution that core earnings should not be considered as an alternative to net income (determined in accordance with U.S. GAAP), or as an indication of our cash flow from operating activities (determined in accordance with U.S. GAAP), a measure of our liquidity, or as an indication of amounts available to fund our cash needs, including our ability to make cash distributions.

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The table below provides a reconciliation of U.S. GAAP net income (loss) attributable to common stockholders to core earnings for the following periods:

| | Three Months | | Nine Months | |
|--|---------------------|----------|---------------------|-----------|
| | Ended September 30, | | Ended September 30, | |
| \$ in thousands, except per share data | 2018 | 2017 | 2018 | 2017 |
| Net income (loss) attributable to common stockholders | (64,480) | 49,127 | 56,999 | 183,091 |
| Adjustments: | | | | |
| (Gain) loss on investments, net | 207,910 | 11,873 | 404,657 | 2,551 |
| Realized (gain) loss on derivative instruments, net ⁽¹⁾ | (99,641) | (19,503) | (249,493) | 5,808 |
| Unrealized (gain) loss on derivative instruments, net ⁽¹⁾ | 9,206 | 95 | (58,101) | (20,025) |
| Realized and unrealized (gain) loss on GSE CRT embedded derivatives, net ⁽²⁾ | 663 | 8,803 | 8,034 | (20,904) |
| (Gain) loss on foreign currency transactions, net ⁽³⁾ | (215) | (1,504) | 937 | (3,748) |
| Amortization of net deferred (gain) loss on de-designated interest rate swaps ⁽⁴⁾ | (6,422) | (6,438) | (19,859) | (19,105) |
| Net loss on extinguishment of debt | — | 1,344 | 26 | 6,581 |
| Subtotal | 111,501 | (5,330) | 86,201 | (48,842) |
| Cumulative adjustments attributable to non-controlling interest | (1,405) | 67 | (1,087) | 616 |
| Preferred stock dividend declared but not accumulated ⁽⁵⁾ | — | 5,211 | — | 5,211 |
| Core earnings attributable to common stockholders | 45,616 | 49,075 | 142,113 | 140,076 |
| Basic income (loss) per common share | (0.58) | 0.44 | 0.51 | 1.64 |
| Core earnings per share attributable to common stockholders ⁽⁶⁾ | 0.41 | 0.44 | 1.27 | 1.26 |

⁽¹⁾ U.S. GAAP gain (loss) on derivative instruments, net on the condensed consolidated statements of operations includes the following components:

| | Three Months | | Nine Months | |
|---|---------------------|----------|---------------------|----------|
| | Ended September 30, | | Ended September 30, | |
| \$ in thousands | 2018 | 2017 | 2018 | 2017 |
| Realized gain (loss) on derivative instruments, net | 99,641 | 19,503 | 249,493 | (5,808) |
| Unrealized gain (loss) on derivative instruments, net | (9,206) | (95) | 58,101 | 20,025 |
| Contractual net interest expense on interest rate swaps | (2,763) | (17,453) | (19,386) | (60,313) |
| Gain (loss) on derivative instruments, net | 87,672 | 1,955 | 288,208 | (46,096) |

⁽²⁾ U.S. GAAP realized and unrealized credit derivative income (loss), net on the condensed consolidated statements of operations includes the following components:

| | Three Months | | Nine Months | |
|--|---------------------|---------|---------------------|--------|
| | Ended September 30, | | Ended September 30, | |
| \$ in thousands | 2018 | 2017 | 2018 | 2017 |
| Realized and unrealized gain (loss) on GSE CRT embedded derivatives, net | (663) | (8,803) | (8,034) | 20,904 |
| GSE CRT embedded derivative coupon interest | 5,638 | 5,873 | 16,909 | 17,524 |
| Realized and unrealized credit derivative income (loss), net | 4,975 | (2,930) | 8,875 | 38,428 |

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- (3) U.S. GAAP other investment income (loss) net on the condensed consolidated statements of operations includes the following components:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|--|-------|---------------------------------------|-------|
| \$ in thousands | 2018 | 2017 | 2018 | 2017 |
| Dividend income | 853 | 809 | 2,947 | 2,427 |
| Gain (loss) on foreign currency transactions, net | 215 | 1,504 | (937) | 3,748 |
| Other investment income (loss), net | 1,068 | 2,313 | 2,010 | 6,175 |

- (4) U.S. GAAP repurchase agreements interest expense on the condensed consolidated statements of operations includes the following components:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|--|----------|---------------------------------------|-----------|
| \$ in thousands | 2018 | 2017 | 2018 | 2017 |
| Interest expense on repurchase agreements borrowings | 88,185 | 52,345 | 230,596 | 131,031 |
| Amortization of net deferred (gain) loss on de-designated interest rate swaps | (6,422) | (6,438) | (19,859) | (19,105) |
| Repurchase agreements interest expense | 81,763 | 45,907 | 210,737 | 111,926 |

- Preferred stock dividend declared but not accumulated is a timing adjustment related to the first dividend declaration on Series C Preferred Stock. On September 14, 2017, we declared a dividend on Series C Preferred Stock that covered the period from the date of issuance, August 16, 2017, to but not including the dividend payment date, December 27, 2017. We adjusted core earnings for the period ended September 30, 2017 to exclude the portion of the dividend declared for the period from October 1, 2017 through December 26, 2017 because we did not consider the future unaccumulated portion of the dividend a current component of our capital costs.

- (5) Core earnings per share attributable to common stockholders is equal to core earnings divided by the basic weighted average number of common shares outstanding.

Core earnings for the three months ended September 30, 2018 decreased \$3.5 million from the same period in 2017 primarily due to (i) a \$2.8 million increase in dividends accumulated for Series C Preferred Stock issued in August 2017 and a \$908,000 decrease in effective net interest income. See tables below for a discussion of the decrease in effective net interest income.

Core earnings for the nine months ended September 30, 2018 increased \$2.0 million from the same period in 2017 primarily due to (i) a \$13.8 million increase in effective net interest income and (ii) equity in earnings of unconsolidated ventures of \$2.8 million for the nine months ended September 30, 2018 compared to equity in losses of \$1.3 million for the same period in 2017, that was partially offset by an \$13.5 million increase in dividends accumulated for Series C Preferred stock and a \$3.0 million increase in management fees. Higher effective net interest income, preferred stock dividends and management fees were driven by investment of the proceeds of our \$287.5 million Series C Preferred Stock offering in August 2017.

Table of Contents**Effective Interest Income / Effective Yield / Effective Interest Expense / Effective Cost of Funds / Effective Net Interest Income / Effective Interest Rate Margin**

We calculate effective interest income (and by calculation, effective yield) as U.S. GAAP total interest income adjusted for GSE CRT embedded derivative coupon interest that is recorded as realized and unrealized credit derivative income (loss), net. We include our GSE CRT embedded derivative coupon interest in effective interest income because GSE CRT coupon interest is not accounted for consistently under U.S. GAAP. We account for GSE CRTs purchased prior to August 24, 2015 as hybrid financial instruments, but we have elected the fair value option for GSE CRTs purchased on or after August 24, 2015. Under U.S. GAAP, coupon interest on GSE CRTs accounted for using the fair value option is recorded as interest income, whereas coupon interest on GSE CRTs accounted for as hybrid financial instruments is recorded as realized and unrealized credit derivative income (loss). We add back GSE CRT embedded derivative coupon interest to our total interest income because we consider GSE CRT embedded derivative coupon interest a current component of our total interest income irrespective of whether we elected the fair value option for the GSE CRT or accounted for the GSE CRT as a hybrid financial instrument.

We calculate effective interest expense (and by calculation, effective cost of funds) as U.S. GAAP total interest expense adjusted for contractual net interest expense on our interest rate swaps that is recorded as gain (loss) on derivative instruments, net and the amortization of net deferred gains (losses) on de-designated interest rate swaps that is recorded as repurchase agreements interest expense. We view our interest rate swaps as an economic hedge against increases in future market interest rates on our floating rate borrowings. We add back the net payments we make on our interest rate swap agreements to our total U.S. GAAP interest expense because we use interest rate swaps to add stability to interest expense. We exclude the amortization of net deferred gains (losses) on de-designated interest rate swaps from our calculation of effective interest expense because we do not consider the amortization a current component of our borrowing costs.

We calculate effective net interest income (and by calculation, effective interest rate margin) as U.S. GAAP net interest income adjusted for net interest expense on our interest rate swaps that is recorded as gain (loss) on derivative instruments, amortization of net deferred gains (losses) on de-designated interest rate swaps that is recorded as repurchase agreements interest expense and GSE CRT embedded derivative coupon interest that is recorded as realized and unrealized credit derivative income (loss), net.

We believe the presentation of effective interest income, effective yield, effective interest expense, effective cost of funds, effective net interest income and effective interest rate margin measures, when considered together with U.S. GAAP financial measures, provide information that is useful to investors in understanding our borrowing costs and operating performance.

The following tables reconcile total interest income to effective interest income and yield to effective yield for the following periods:

| | Three Months Ended September 30, | | | | | |
|---|----------------------------------|--------------------------|---|----------------|--------------------------|---|
| | 2018 | | | 2017 | | |
| \$ in thousands | Reconciliation | Yield/Effective Yield | % | Reconciliation | Yield/Effective Yield | % |
| Total interest income | 162,088 | 3.53 | % | 140,389 | 3.22 | % |
| Add: GSE CRT embedded derivative coupon interest recorded as realized and unrealized credit derivative income (loss), net | 5,638 | 0.12 | % | 5,873 | 0.14 | % |
| Effective interest income | 167,726 | 3.65 | % | 146,262 | 3.36 | % |
| | Nine Months Ended September 30, | | | | | |
| | 2018 | | | 2017 | | |
| \$ in thousands | Reconciliation | Yield/Effective Yield | % | Reconciliation | Yield/Effective Yield | % |
| Total interest income | 466,912 | 3.45 | % | 392,074 | 3.15 | % |
| Add: GSE CRT embedded derivative coupon interest recorded as realized and unrealized credit derivative income (loss), net | 16,909 | 0.13 | % | 17,524 | 0.14 | % |

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| | | | | | | |
|---------------------------|---------|------|---|---------|------|---|
| Effective interest income | 483,821 | 3.58 | % | 409,598 | 3.29 | % |
|---------------------------|---------|------|---|---------|------|---|

Our effective interest income increased in the three and nine months ended September 30, 2018 versus the same periods in 2017 primarily due to higher average earning assets. The increase in effective yield for the three and nine months ended

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September 30, 2018 versus the same periods in 2017 was primarily due to slower prepayment speeds and higher index rates on floating and adjustable rate assets.

The following tables reconcile total interest expense to effective interest expense and cost of funds to effective cost of funds for the following periods.

| | Three Months Ended September 30, | | | | | |
|---|----------------------------------|---------------|----------------|-----------------|---------------|----------------|
| | 2018 | | | 2017 | | |
| \$ in thousands | Cost of Funds / | | Reconciliation | Cost of Funds / | | Reconciliation |
| | Effective | Cost of Funds | | Effective | Cost of Funds | |
| Total interest expense | 91,253 | 2.29 % | | 54,175 | 1.43 % | |
| Add (Less): Amortization of net deferred gain (loss) on de-designated interest rate swaps | 6,422 | 0.16 % | | 6,438 | 0.17 % | |
| Add: Contractual net interest expense on interest rate swaps recorded as gain (loss) on derivative instruments, net | 2,763 | 0.07 % | | 17,453 | 0.46 % | |
| Effective interest expense | 100,438 | 2.52 % | | 78,066 | 2.06 % | |
| | Nine Months Ended September 30, | | | | | |
| | 2018 | | | 2017 | | |
| \$ in thousands | Cost of Funds / | | Reconciliation | Cost of Funds / | | Reconciliation |
| | Effective | Cost of Funds | | Effective | Cost of Funds | |
| Total interest expense | 237,246 | 2.02 % | | 136,654 | 1.26 % | |
| Add (Less): Amortization of net deferred gain (loss) on de-designated interest rate swaps | 19,859 | 0.17 % | | 19,105 | 0.18 % | |
| Add: Contractual net interest expense on interest rate swaps recorded as gain (loss) on derivative instruments, net | 19,386 | 0.17 % | | 60,313 | 0.56 % | |
| Effective interest expense | 276,491 | 2.36 % | | 216,072 | 2.00 % | |

Our effective interest expense and effective cost of funds increased during the three and nine months ended September 30, 2018 compared to the same period in 2017 primarily due to increased borrowings and higher interest rates. See the preceding caption "Interest Expense and Cost of Funds" for further discussion of these variances.

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The following tables reconcile net interest income to effective net interest income and net interest rate margin to effective interest rate margin for the following periods.

| | Three Months Ended September 30, | | 2018 | | 2017 | |
|---|---|----------------|--------------------------|----------------|--------------------------|----------------|
| | Net Interest Rate Margin / Effective Interest Rate Margin | Reconciliation | Net Interest Rate Margin | Reconciliation | Net Interest Rate Margin | Reconciliation |
| \$ in thousands | | | | | | |
| Net interest income | 70,835 | 1.24 % | 86,214 | 1.79 % | | |
| Add (Less): Amortization of net deferred (gain) loss on de-designated interest rate swaps | (6,422) | (0.16)% | (6,438) | (0.17)% | | |
| Add: GSE CRT embedded derivative coupon interest recorded as realized and unrealized credit derivative income (loss), net | 5,638 | 0.12 % | 5,873 | 0.14 % | | |
| Less: Contractual net interest expense on interest rate swaps recorded as gain (loss) on derivative instruments, net | (2,763) | (0.07)% | (17,453) | (0.46)% | | |
| Effective net interest income | 67,288 | 1.13 % | 68,196 | 1.30 % | | |

| | Nine Months Ended September 30, | | 2018 | | 2017 | |
|---|---------------------------------|----------------|--------------------------|----------------|--------------------------|----------------|
| | Net Interest Rate Margin | Reconciliation | Net Interest Rate Margin | Reconciliation | Net Interest Rate Margin | Reconciliation |
| \$ in thousands | | | | | | |
| Net interest income | 229,666 | 1.43 % | 255,420 | 1.89 % | | |
| Add (Less): Amortization of net deferred (gain) loss on de-designated interest rate swaps | (19,859) | (0.17)% | (19,105) | (0.18)% | | |
| Add: GSE CRT embedded derivative coupon interest recorded as realized and unrealized credit derivative income (loss), net | 16,909 | 0.13 % | 17,524 | 0.14 % | | |
| Less: Contractual net interest expense on interest rate swaps recorded as gain (loss) on derivative instruments, net | (19,386) | (0.17)% | (60,313) | (0.56)% | | |
| Effective net interest income | 207,330 | 1.22 % | 193,526 | 1.29 % | | |

Effective net interest income for the three months ended September 30, 2018 decreased primarily due to higher effective net interest expense as discussed above. Effective net interest income for the nine months ended September 30, 2018 increased from the same period in 2017 primarily due to lower contractual net interest expense on interest rate swaps. Contractual net interest expense on interest rate swaps decreased from \$60.3 million for the nine months ended September 30, 2017 to \$19.4 million for the nine months ended September 30, 2018 primarily as a result of higher LIBOR rates in 2018.

Effective interest rate margin decreased for the three and nine months ended September 30, 2018 compared to the same periods in 2017 primarily due to increases in the federal funds rate over the past twelve months that had a greater impact on our average cost of funds than on our average earning asset yields.

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Repurchase Agreement Debt-to-Equity Ratio

The tables below show the allocation of our equity to our target assets, our debt-to-equity ratio, and our repurchase agreement debt-to-equity ratio as of September 30, 2018 and December 31, 2017. Our debt-to-equity ratio is calculated in accordance with U.S. GAAP and is the ratio of total debt (sum of repurchase agreements, secured loans and exchangeable senior notes) to total equity. We present a repurchase agreement debt-to-equity ratio, a non-GAAP financial measure of leverage, because the mortgage REIT industry primarily uses repurchase agreements, which typically mature within one year, to finance investments. We believe that presenting our repurchase agreement debt-to-equity ratio, when considered together with our U.S. GAAP financial measure of debt-to-equity ratio, provides information that is useful to investors in understanding our refinancing risks, and gives investors a comparable statistic to those other mortgage REITs who almost exclusively borrow using short-term repurchase agreements that are subject to refinancing risk.

September 30, 2018

| \$ in thousands | Agency RMBS and CMBS | Commercial Credit ⁽¹⁾ | Residential Credit ⁽²⁾ | Total |
|---|----------------------------|-------------------------------------|--------------------------------------|-------------|
| Investments | 13,065,148 | 3,302,475 | 2,000,909 | 18,368,532 |
| Cash and cash equivalents ⁽³⁾ | 55,295 | 34,480 | 18,448 | 108,223 |
| Restricted cash | — | 300 | — | 300 |
| Derivative assets, at fair value ⁽⁴⁾ | 46,212 | 2 | — | 46,214 |
| Other assets | 556,914 | 91,814 | 50,890 | 699,618 |
| Total assets | 13,723,569 | 3,429,071 | 2,070,247 | 19,222,887 |
| Repurchase agreements | 11,252,479 | 1,525,347 | 1,600,692 | 14,378,518 |
| Secured loans ⁽⁵⁾ | 553,262 | 1,096,738 | — | 1,650,000 |
| Derivative liabilities, at fair value ⁽⁴⁾ | 13,887 | 95 | — | 13,982 |
| Other liabilities | 646,954 | 34,576 | 13,434 | 694,964 |
| Total liabilities | 12,466,582 | 2,656,756 | 1,614,126 | 16,737,464 |
| Total equity (allocated) | 1,256,987 | 772,315 | 456,121 | 2,485,423 |
| Adjustments to calculate repurchase agreement debt-to-equity ratio: | | | | |
| Net equity in unsecured assets ⁽⁶⁾ | — | (55,924) | — | (55,924) |
| Collateral pledged against secured loans | (636,506) | (1,261,752) | — | (1,898,258) |
| Secured loans | 553,262 | 1,096,738 | — | 1,650,000 |
| Equity related to repurchase agreement debt | 1,173,743 | 551,377 | 456,121 | 2,181,241 |
| Debt-to-equity ratio ⁽⁷⁾ | 9.4 | 3.4 | 3.5 | 6.4 |
| Repurchase agreement debt-to-equity ratio ⁽⁸⁾ | 9.6 | 2.8 | 3.5 | 6.6 |

(1) Investments in non-Agency CMBS, commercial loans and investments in unconsolidated joint ventures are included in commercial credit.

(2) Investments in non-Agency RMBS, GSE CRT and a loan participation interest are included in residential credit.

(3) Cash and cash equivalents are allocated based on a percentage of equity for each asset class.

(4) Derivative assets and liabilities are allocated based on the hedging strategy for each asset class.

(5) Secured loans are allocated based on amount of collateral pledged.

(6) Net equity in unsecured assets includes commercial loans, investments in unconsolidated joint ventures and other.

(7) Debt-to-equity ratio is calculated as the ratio of total debt (sum of repurchase agreements and secured loans) to total equity.

(8) Repurchase agreement debt-to-equity ratio is calculated as the ratio of repurchase agreements to equity related to repurchase agreement debt.

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December 31, 2017

| \$ in thousands | Agency RMBS | Commercial Credit ⁽¹⁾ | Residential Credit ⁽²⁾ | Exchangeable Senior Notes and Other | Total |
|---|----------------|-------------------------------------|--------------------------------------|---|-------------|
| Investments | 12,849,851 | 3,434,196 | 2,124,487 | — | 18,408,534 |
| Cash and cash equivalents ⁽³⁾ | 39,630 | 31,069 | 17,682 | — | 88,381 |
| Restricted cash | — | 620 | — | — | 620 |
| Derivative assets, at fair value ⁽⁴⁾ | 6,896 | — | — | — | 6,896 |
| Other assets | 77,893 | 64,284 | 6,669 | 3,979 | 152,825 |
| Total assets | 12,974,270 | 3,530,169 | 2,148,838 | 3,979 | 18,657,256 |
| Repurchase agreements | 11,111,755 | 1,396,330 | 1,572,716 | — | 14,080,801 |
| Secured loans ⁽⁵⁾ | 533,463 | 1,116,537 | — | — | 1,650,000 |
| Exchangeable senior notes | — | — | — | 143,231 | 143,231 |
| Derivative liabilities, at fair value ⁽⁴⁾ | 31,548 | 1,217 | — | — | 32,765 |
| Other liabilities | 51,840 | 24,742 | 14,888 | 2,111 | 93,581 |
| Total liabilities | 11,728,606 | 2,538,826 | 1,587,604 | 145,342 | 16,000,378 |
| Total equity (allocated) | 1,245,664 | 991,343 | 561,234 | (141,363) | 2,656,878 |
| Adjustments to calculate repurchase agreement debt-to-equity ratio: | | | | | |
| Net equity in unsecured assets and exchangeable senior notes ⁽⁶⁾ | — | (217,780) | — | 141,363 | (76,417) |
| Collateral pledged against secured loans | (623,181) | (1,304,315) | — | — | (1,927,496) |
| Secured loans | 533,463 | 1,116,537 | — | — | 1,650,000 |
| Equity related to repurchase agreement debt | 1,155,946 | 585,785 | 561,234 | — | 2,302,965 |
| Debt-to-equity ratio ⁽⁷⁾ | 9.3 | 2.5 | 2.8 | NA | 6.0 |
| Repurchase agreement debt-to-equity ratio ⁽⁸⁾ | 9.6 | 2.4 | 2.8 | NA | 6.1 |

(1) Investments in non-Agency CMBS, commercial loans and investments in unconsolidated joint ventures are included in commercial credit.

(2) Investments in non-Agency RMBS and GSE CRT are included in residential credit.

(3) Cash and cash equivalents are allocated based on a percentage of equity for each asset class.

(4) Derivative assets and liabilities are allocated based on the hedging strategy for each asset class.

(5) Secured loans are allocated based on amount of collateral pledged.

(6) Net equity in unsecured assets and exchangeable senior notes includes commercial loans, investments in unconsolidated joint ventures, exchangeable senior notes and other.

(7) Debt-to-equity ratio is calculated as the ratio of total debt (sum of repurchase agreements, secured loans and exchangeable senior notes) to total equity.

(8) Repurchase agreement debt-to-equity ratio is calculated as the ratio of repurchase agreements to equity related to repurchase agreement debt.

Liquidity and Capital Resources

Liquidity is a measurement of our ability to meet potential cash requirements, including ongoing commitments to pay dividends, fund investments, repayment of borrowings and other general business needs. Our primary sources of funds for liquidity consist of the net proceeds from our common and preferred equity offerings, net cash provided by operating activities, proceeds from repurchase agreements and other financing arrangements and future issuances of equity and/or debt securities.

We currently believe that we have sufficient liquidity and capital resources available for the acquisition of additional investments, repayments on borrowings, margin requirements and the payment of cash dividends as required for continued qualification as a REIT. We generally maintain liquidity to pay down borrowings under repurchase arrangements to reduce borrowing costs and otherwise efficiently manage our long-term investment capital. Because the level of these borrowings can be adjusted on a daily basis, the level of cash and cash equivalents carried on our condensed consolidated balance sheets is

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significantly less important than our potential liquidity available under borrowing arrangements. However, there can be no assurance that we will maintain sufficient levels of liquidity to meet any margin calls.

We held cash, cash equivalents and restricted cash of \$108.5 million at September 30, 2018 (September 30, 2017: \$73.5 million). Our cash, cash equivalents and restricted cash increased due to normal fluctuations in cash balances related to the timing of principal and interest payments, repayments of debt, and asset purchases and sales. Our operating activities provided net cash of \$221.7 million for the nine months ended September 30, 2018 (September 30, 2017: \$204.2 million).

Our investing activities used net cash of \$180.7 million in the nine months ended September 30, 2018 compared to net cash used in investing activities of \$3.1 billion in the nine months ended September 30, 2017. We invested \$5.0 billion in mortgage-backed and credit risk transfer securities during the nine months ended September 30, 2018 compared to investments of \$5.5 billion in mortgage-backed and credit risk transfer securities in the nine months ended September 30, 2017. We generated \$1.6 billion from principal payments of mortgage-backed and credit risk transfer securities during the nine months ended September 30, 2018 (September 30, 2017: \$1.8 billion) and \$2.8 billion (September 30, 2017: \$625.5 million) from the sales of mortgage-backed and credit risk transfer securities. We also generated \$160.8 million in proceeds from commercial loan repayments in the nine months ended September 30, 2018.

Our financing activities used net cash of \$21.5 million for the nine months ended September 30, 2018 compared to net cash provided by financing activities of \$2.8 billion in the nine months ended September 30, 2017. We used cash of \$297.9 million to make net principal repayments on repurchase agreements (September 30, 2017: net proceeds of \$2.9 billion). We also used cash of \$143.4 million (September 30, 2017: \$247.5 million) to extinguish our exchangeable senior notes and to pay dividends of \$175.8 million (September 30, 2017: \$152.8 million).

As of September 30, 2018, our wholly-owned subsidiary, IAS Services, had \$1.65 billion in outstanding secured loans from the FHLBI. As of September 30, 2018, the FHLBI secured loans were collateralized by non-Agency CMBS and Agency RMBS with a fair value of \$1.3 billion and \$636.5 million, respectively.

As of September 30, 2018, the average margin requirement (weighted by borrowing amount), or the percentage amount by which the collateral value must exceed the loan amount (also refer to as the "haircut") under our repurchase agreements was 5.0% for Agency RMBS, 5.0% for Agency CMBS, 19.5% for non-Agency RMBS, 18.3% for GSE CRT and 19.3% for non-Agency CMBS. Across our repurchase agreement facilities, the haircuts range from a low of 3.0% to a high of 20.0% for Agency RMBS, a low of 5% to a high of 5% for Agency CMBS, a low of 10.0% to a high of 35.0% for non-Agency RMBS, a low of 15% to a high of 25% for GSE CRT, a low of 10.0% to a high of 30.0% for non-Agency CMBS. Declines in the value of our securities portfolio can trigger margin calls by our lenders under our repurchase agreements. An event of default or termination event would give some of our counterparties the option to terminate all repurchase transactions existing with us and require any amount due by us to the counterparties to be payable immediately.

Effects of Margin Requirements, Leverage and Credit Spreads

Our securities have values that fluctuate according to market conditions and, as discussed above, the market value of our securities will decrease as prevailing interest rates or credit spreads increase. When the value of the securities pledged to secure a repurchase loan or a secured loan decreases to the point where the positive difference between the collateral value and the loan amount is less than the haircut, our lenders may issue a margin call, which means that the lender will require us to pay the margin call in cash or pledge additional collateral to meet that margin call. Under our repurchase facilities and secured loans, our lenders have full discretion to determine the value of the securities we pledge to them. Most of our lenders will value securities based on recent trades in the market. Lenders also issue margin calls as the published current principal balance factors change on the pool of mortgages underlying the securities pledged as collateral when scheduled and unscheduled paydowns are announced monthly.

We experience margin calls and increased collateral requirements in the ordinary course of our business. In seeking to effectively manage the margin requirements established by our lenders, we maintain a position of cash and unpledged securities. We refer to this position as our liquidity. The level of liquidity we have available to meet margin calls is directly affected by our leverage levels, our haircuts and the price changes on our securities. If interest rates increase

as a result of a yield curve shift or for another reason or if credit spreads widen, then the prices of our collateral (and our unpledged assets that constitute our liquidity) will decline, we will experience margin calls, and we will use our liquidity to meet the margin calls. There can be no assurance that we will maintain sufficient levels of liquidity to meet any margin calls or increased collateral requirements. If our haircuts increase, our liquidity will proportionately decrease. In addition, if we increase our borrowings, our liquidity will decrease by the amount of additional haircut on the increased level of indebtedness.

We intend to maintain a level of liquidity in relation to our assets that enables us to meet reasonably anticipated margin calls and increased collateral requirements but that also allows us to be substantially invested in securities. We may misjudge the appropriate amount of our liquidity by maintaining excessive liquidity, which would lower our investment returns, or by

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maintaining insufficient liquidity, which would force us to liquidate assets into unfavorable market conditions and harm our results of operations and financial condition.

We are subject to financial covenants in connection with our lending, derivatives and other agreements we enter into in the normal course of our business. We intend to continue to operate in a manner which complies with all of our financial covenants. Our lending and derivative agreements provide that we may be declared in default of our obligations if our leverage ratio exceeds certain thresholds and we fail to maintain stockholders' equity or market value above certain thresholds over specified time periods.

Forward-Looking Statements Regarding Liquidity

Based upon our current portfolio, leverage rate and available borrowing arrangements, we believe that cash flow from operations and available borrowing capacity will be sufficient to enable us to meet anticipated short-term (one year or less) liquidity requirements to fund our investment activities, pay fees under our management agreement, fund our distributions to stockholders and for other general corporate expenses.

Our ability to meet our long-term (greater than one year) liquidity and capital resource requirements will be subject to obtaining additional debt financing. We may increase our capital resources by obtaining long-term credit facilities or through public or private offerings of equity or debt securities, possibly including classes of preferred stock, common stock, and senior or subordinated notes. Such financing will depend on market conditions for capital raises and our ability to invest such offering proceeds. If we are unable to renew, replace or expand our sources of financing on substantially similar terms, it may have an adverse effect on our business and results of operations.

Contractual Obligations

We have entered into an agreement with our Manager pursuant to which our Manager is entitled to receive a management fee and the reimbursement of certain expenses. The management fee is calculated and payable quarterly in arrears in an amount equal to 1.50% of our stockholders' equity, per annum. Refer to Note 12 - "Related Party Transactions" of our condensed consolidated financial statements for a description of adjustments made to our stockholders' equity for purposes of calculating our management fee. Our Manager uses the proceeds from its management fee in part to pay compensation to its officers and personnel who, notwithstanding that certain of those individuals are also our officers, receive no cash compensation directly from us. We are required to reimburse our Manager for operating expenses related to us incurred by our Manager, including certain salary expenses and other expenses relating to legal, accounting, due diligence and other services. Our reimbursement obligation is not subject to any dollar limitation. Refer to Note 12 - "Related Party Transactions" of our condensed consolidated financial statements for details of our reimbursements to our Manager.

As of September 30, 2018, we had the following contractual obligations:

| \$ in thousands | Total | Payments Due by Period | | | |
|-----------------------|------------|------------------------|-----------|-----------|---------------|
| | | Less than 1 year | 1-3 years | 3-5 years | After 5 years |
| Repurchase agreements | 14,378,518 | 14,344,725 | 33,793 | — | — |
| Secured loans | 1,650,000 | — | 400,000 | — | 1,250,000 |
| Total ⁽¹⁾ | 16,028,518 | 14,344,725 | 433,793 | — | 1,250,000 |

⁽¹⁾ Excluded from total contractual obligations are the amounts due to our Manager under the management agreement, as those obligations do not have fixed and determinable payments.

As of September 30, 2018, we have approximately \$64.2 million and \$222.3 million in contractual interest payments related to our repurchase agreements and secured loans, respectively.

Off-Balance Sheet Arrangements

We have committed to invest up to \$122.8 million in unconsolidated ventures that are sponsored by an affiliate of our Manager. As of September 30, 2018, \$112.7 million of our commitment to these unconsolidated ventures has been called. We are committed to fund \$10.1 million in additional capital to fund future investments and cover future expenses should they occur.

As of September 30, 2018, we have an unfunded commitment on a loan participation interest of \$29.9 million.

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Share-Based Compensation

We established the 2009 Equity Incentive Plan for grants of common stock and other equity based awards to our independent directors and officers and employees of our Manager and its affiliates (the "Incentive Plan"). Under the Incentive Plan, a total of 1,000,000 shares of common stock are authorized for issuance. Unless terminated earlier, the Incentive Plan will terminate in 2019, but will continue to govern the unexpired awards. As of September 30, 2018, 769,181 shares of common stock remain available for future issuance under the Incentive Plan.

We recognized compensation expense of approximately \$107,000 (September 30, 2017: \$129,000) and approximately \$306,000 (September 30, 2017: \$326,000) for shares issued to our independent directors under the Incentive Plan for the three and nine months ended September 30, 2018, respectively. During the three months ended September 30, 2018 and 2017, we issued 6,620 shares and 6,650 shares of common stock, respectively, to our independent directors. During the nine months ended September 30, 2018 and 2017, we issued 20,262 shares and 17,398 shares of common stock, respectively, to our independent directors. The fair market value of the shares granted was determined by the closing stock market price on the date of the grant. The grants vested immediately.

We recognized compensation expense of approximately \$71,000 (September 30, 2017: \$33,000) and approximately \$115,000 (September 30, 2017: \$99,000) for the three and nine months ended September 30, 2018, respectively, for restricted stock units awarded to employees of our Manager and its affiliates under the Incentive Plan. Our Manager reimburses us for the cost of these restricted stock awards under the terms of our management agreement. At September 30, 2018 there was approximately \$131,000 of total unrecognized compensation cost related to restricted stock unit awards that is expected to be recognized over a period of up to 42 months, with a weighted-average remaining vesting period of 16 months.

The following table summarizes the activity related to restricted stock units awarded to employees of our Manager and its affiliates for the three and nine months ended September 30, 2018.

| | Three Months Ended September 30, 2018 | | Nine Months Ended September 30, 2018 | |
|---|--|---|---|---|
| | Restricted Stock Units | Weighted Average Grant Date Fair Value ⁽¹⁾ | Restricted Stock Units | Weighted Average Grant Date Fair Value ⁽¹⁾ |
| Unvested at the beginning of the period | 19,185 | \$ 14.56 | 19,827 | \$ 14.35 |
| Shares granted during the period | — | — | 7,055 | 15.37 |
| Shares forfeited during the period | (3,967) | 14.56 | (3,967) | 14.56 |
| Shares vested during the period | (4,167) | 14.62 | (11,864) | 14.71 |
| Unvested at the end of the period | 11,051 | \$ 14.55 | 11,051 | \$ 14.55 |

(1) The grant date fair value of restricted stock awards is based on the closing market price of our common stock at the grant date.

Dividends

We intend to continue to make regular quarterly distributions to holders of our common stock and preferred stock. U.S. federal income tax law generally requires that a REIT distribute at least 90% of its REIT taxable income annually, determined without regard to the deduction for dividends paid and excluding net capital gains, and that it pay tax at regular corporate rates to the extent that it annually distributes less than 100% of its taxable income. Before we pay any dividend, whether for U.S. federal income tax purposes or otherwise, we must first meet both our operating requirements and debt service on our repurchase agreements and other debt payable. If our cash available for distribution is less than our taxable income, we could be required to sell assets or borrow funds to make cash distributions, or we may make a portion of the required distribution in the form of a taxable stock distribution or distribution of debt securities.

Inflation

Virtually all of our assets and liabilities are sensitive to interest rates. As a result, interest rates and other factors influence our performance far more than inflation. Changes in interest rates do not necessarily correlate with inflation rates or changes in inflation rates.

Unrelated Business Taxable Income

We have not engaged in transactions that would result in a portion of our income being treated as unrelated business taxable income.

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Other Matters

We believe that we satisfied each of the asset tests in Section 856(c)(4) of the Internal Revenue Code of 1986, as amended (the "Code") for the period ended September 30, 2018, and that our proposed method of operation will permit us to satisfy the asset tests, gross income tests, and distribution and stock ownership requirements for our taxable year that will end on December 31, 2018.

At all times, we intend to conduct our business so that neither we nor our Operating Partnership nor the subsidiaries of our Operating Partnership are required to register as an investment company under the 1940 Act. If we were required to register as an investment company, then our use of leverage would be substantially reduced. Because we are a holding company that conducts our business through our Operating Partnership and the Operating Partnership's wholly-owned or majority-owned subsidiaries, the securities issued by these subsidiaries that are excepted from the definition of "investment company" under Section 3(c)(1) or Section 3(c)(7) of the 1940 Act, together with any other investment securities the Operating Partnership may own, may not have a combined value in excess of 40% of the value of the Operating Partnership's total assets (exclusive of U.S. government securities and cash items) on an unconsolidated basis, which we refer to as the 40% test. This requirement limits the types of businesses in which we are permitted to engage in through our subsidiaries. In addition, we believe neither we nor the Operating Partnership are considered an investment company under Section 3(a)(1)(A) of the 1940 Act because they do not engage primarily or hold themselves out as being engaged primarily in the business of investing, reinvesting or trading in securities. Rather, through the Operating Partnership's wholly-owned or majority-owned subsidiaries, we and the Operating Partnership are primarily engaged in the non-investment company businesses of these subsidiaries. IAS Asset I LLC and certain of the Operating Partnership's other subsidiaries that we may form in the future rely upon the exclusion from the definition of "investment company" under the 1940 Act provided by Section 3(c)(5)(C) of the 1940 Act, which is available for entities "primarily engaged in the business of purchasing or otherwise acquiring mortgages and other liens on and interests in real estate." This exclusion generally requires that at least 55% of each subsidiary's portfolio be comprised of qualifying assets and at least 80% be comprised of qualifying assets and real estate-related assets (and no more than 20% comprised of miscellaneous assets). We calculate that as of September 30, 2018, we conducted our business so as not to be regulated as an investment company under the 1940 Act.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

The primary components of our market risk are related to interest rate, principal prepayment and market value. While we do not seek to avoid risk completely, we believe the risk can be quantified from historical experience and we seek to actively manage that risk, to earn sufficient compensation to justify taking those risks and to maintain capital levels consistent with the risks we undertake.

Interest Rate Risk

Interest rate risk is highly sensitive to many factors, including governmental, monetary and tax policies, domestic and international economic and political considerations, and other factors beyond our control. We are subject to interest rate risk in connection with our investments and our repurchase agreements. Our repurchase agreements are typically of limited duration and will be periodically refinanced at current market rates. We mitigate this risk through utilization of derivative contracts, primarily interest rate swap agreements, TBAs and futures contracts.

Interest Rate Effect on Net Interest Income

Our operating results depend in large part upon differences between the yields earned on our investments and our cost of borrowing and interest rate hedging activities. Most of our repurchase agreements provide financing based on a floating rate of interest calculated on a fixed spread over LIBOR. The fixed spread will vary depending on the type of underlying asset which collateralizes the financing. Accordingly, the portion of our portfolio which consists of floating interest rate assets are match-funded utilizing our expected sources of short-term financing, while our fixed interest rate assets are not match-funded. During periods of rising interest rates, the borrowing costs associated with our investments tend to increase while the income earned on our fixed interest rate investments may remain substantially unchanged. This increase in borrowing costs results in the narrowing of the net interest spread between the related assets and borrowings and may even result in losses. Further, during this portion of the interest rate and

credit cycles, defaults could increase and result in credit losses to us, which could adversely affect our liquidity and operating results. Such delinquencies or defaults could also have an adverse effect on the spread between interest-earning assets and interest-bearing liabilities.

Hedging techniques are partly based on assumed levels of prepayments of our RMBS. If prepayments are slower or faster than assumed, the life of the RMBS will be longer or shorter, which would reduce the effectiveness of any hedging strategies we may use and may cause losses on such transactions. Hedging strategies involving the use of derivative securities are highly complex and may produce volatile returns.

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Interest Rate Effects on Fair Value

Another component of interest rate risk is the effect that changes in interest rates will have on the market value of the assets that we acquire. We face the risk that the market value of our assets will increase or decrease at different rates than those of our liabilities, including our hedging instruments.

We primarily assess our interest rate risk by estimating the duration of our assets and the duration of our liabilities. Duration measures the market price volatility of financial instruments as interest rates change. We generally calculate duration using various financial models and empirical data. Different models and methodologies can produce different duration numbers for the same securities.

The impact of changing interest rates on fair value can change significantly when interest rates change materially. Therefore, the volatility in the fair value of our assets could increase significantly in the event interest rates change materially. In addition, other factors impact the fair value of our interest rate-sensitive investments and hedging instruments, such as the shape of the yield curve, market expectations as to future interest rate changes and other market conditions. Accordingly, changes in actual interest rates may have a material adverse effect on us.

Spread Risk

We employ a variety of spread risk management techniques that seek to mitigate the influences of spread changes on our book value and our liquidity to help us achieve our investment objectives. We refer to the difference between interest rates on our investments and interest rates on risk free instruments as spreads. The yield on our investments changes over time due to the level of risk free interest rates, the creditworthiness of the security, and the price of the perceived risk. The change in the market yield of our interest rate hedges also changes primarily with the level of risk free interest rates. We manage spread risk through careful asset selection, sector allocation, regulating our portfolio value-at-risk, and maintaining adequate liquidity. Changes in spreads impact our book value and our liquidity and could cause us to sell assets and to change our investment strategy in order to maintain liquidity and preserve book value.

Prepayment Risk

As we receive prepayments of principal on our investments, premiums paid on these investments are amortized against interest income. In general, an increase in prepayment rates will accelerate the amortization of purchase premiums, thereby reducing the interest income earned on the investments. Conversely, discounts on such investments are accreted into interest income. In general, an increase in prepayment rates will accelerate the accretion of purchase discounts, thereby increasing the interest income earned on the investments.

Extension Risk

We compute the projected weighted average life of our investments based upon assumptions regarding the rate at which the borrowers will prepay the underlying mortgages. In general, when a fixed-rate or hybrid adjustable-rate security is acquired with borrowings, we may, but are not required to, enter into an interest rate swap agreement or other hedging instrument that effectively fixes our borrowing costs for a period close to the anticipated average life of the fixed-rate portion of the related assets. This strategy is designed to protect us from rising interest rates, because the borrowing costs are fixed for the duration of the fixed-rate portion of the related target asset.

However, if prepayment rates decrease in a rising interest rate environment, then the life of the fixed-rate portion of the related assets could extend beyond the term of the swap agreement or other hedging instrument. This could have a negative impact on our results from operations, as borrowing costs would no longer be fixed after the end of the hedging instrument, while the income earned on the hybrid adjustable-rate assets would remain fixed. This situation may also cause the market value of our hybrid adjustable-rate assets to decline, with little or no offsetting gain from the related hedging transactions. In extreme situations, we may be forced to sell assets to maintain adequate liquidity, which could cause us to incur losses.

Market Risk

Market Value Risk

Our available-for-sale securities are reflected at their estimated fair value with unrealized gains and losses excluded from earnings and reported in other comprehensive income pursuant to ASC Topic 320. The estimated fair value of these securities fluctuates primarily due to changes in interest rates and other factors. Generally, in a rising interest

rate environment, the estimated fair value of these securities would be expected to decrease; conversely, in a decreasing interest rate environment, the estimated fair value of these securities would be expected to increase.

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The sensitivity analysis table presented below shows the estimated impact of an instantaneous parallel shift in the yield curve, up and down 50 and 100 basis points, on the market value of our interest rate-sensitive investments and net interest income, including net interest paid or received under interest rate swaps, at September 30, 2018, assuming a static portfolio. When evaluating the impact of changes in interest rates, prepayment assumptions and principal reinvestment rates are adjusted based on our Manager's expectations. The analysis presented utilized assumptions, models and estimates of our Manager based on our Manager's judgment and experience.

| Change in Interest Rates | Percentage Change in Projected Net Interest Income | | Percentage Change in Projected Portfolio Value | |
|--------------------------|--|----|--|----|
| | | | | |
| +1.00% | (16.80 |)% | (1.29 |)% |
| +0.50% | (6.69 |)% | (0.56 |)% |
| -0.50% | 2.64 | % | 0.23 | % |
| -1.00% | (2.96 |)% | 0.10 | % |

Certain assumptions have been made in connection with the calculation of the information set forth in the foregoing interest rate sensitivity table and, as such, there can be no assurance that assumed events will occur or that other events will not occur that would affect the outcomes. The base interest rate scenario assumes interest rates at September 30, 2018. Furthermore, while we generally expect to retain such assets and the associated interest rate risk to maturity, future purchases and sales of assets could materially change our interest rate risk profile.

Given the low interest rates at September 30, 2018, we applied a floor of 0% for all anticipated interest rates included in our assumptions. Because of this floor, we anticipate that any hypothetical interest rate shock decrease would have a limited positive impact on our funding costs; however, because prepayment speeds are unaffected by this floor, we expect that any increase in our prepayment speeds (occurring as a result of any interest rate decrease or otherwise) could result in an acceleration of our premium amortization on securities purchased at a premium, and accretion of discount on our securities purchased at a discount. As a result, because this floor limits the positive impact of any interest rate decrease on our funding costs, hypothetical interest rate decreases could cause the fair value of our financial instruments and our net interest income to decline.

The information set forth in the interest rate sensitivity table above and all related disclosures constitutes forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act. Actual results could differ significantly from those estimated in the foregoing interest rate sensitivity table.

Real Estate Risk

Residential and commercial property values are subject to volatility and may be adversely affected by a number of factors, including, but not limited to: national, regional and local economic conditions (which may be adversely affected by industry slowdowns and other factors); local real estate conditions (such as the supply of housing stock); changes or continued weakness in specific industry segments; construction quality, age and design; demographic factors; and retroactive changes to building or similar codes. In addition, decreases in property values reduce the value of the collateral and the potential proceeds available to a borrower to repay our loans, which could also cause us to suffer losses.

Credit Risk

We believe that our investment strategy will generally keep our credit losses and financing costs low. However, we retain the risk of potential credit losses on all of our residential and commercial mortgage investments. We seek to manage this risk through our pre-acquisition due diligence process. In addition, we re-evaluate the credit risk inherent in our investments on a regular basis pursuant to fundamental considerations such as GDP, unemployment, interest rates, retail sales, store closings/openings, corporate earnings, housing inventory, affordability and regional home price trends. We also review key loan credit metrics including, but not limited to, payment status, current loan-to-value ratios, current borrower credit scores and debt yields. These characteristics assist in determining the likelihood and severity of loan loss as well as prepayment and extension expectations. We then perform structural analysis under multiple scenarios to establish likely cash flow profiles and credit enhancement levels relative to collateral performance projections. This analysis allows us to quantify our opinions of credit quality and fundamental value, which are key drivers of portfolio management decisions.

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Foreign Exchange Rate Risk

We have an investment in a commercial loan denominated in foreign currency and an investment in an unconsolidated joint venture whose net assets and results of operations are exposed to foreign currency translation risk when translated in U.S. dollars upon consolidation. We seek to hedge our foreign currency exposures by purchasing currency forward contracts.

Risk Management

To the extent consistent with maintaining our REIT qualification, we seek to manage risk exposure to protect our investment portfolio against the effects of major interest rate changes. We generally seek to manage this risk by:

- monitoring and adjusting, if necessary, the reset index and interest rate related to our target assets and our financings;
- attempting to structure our financing agreements to have a range of different maturities, terms, amortizations and interest rate adjustment periods;
- using hedging instruments, primarily interest rate swap agreements but also financial futures, options, interest rate cap agreements, floors and forward sales to adjust the interest rate sensitivity of our target assets and our borrowings; and
- actively managing, on an aggregate basis, the interest rate indices, interest rate adjustment periods, and gross reset margins of our target assets and the interest rate indices and adjustment periods of our financings.

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ITEM 4. CONTROLS AND PROCEDURES.

Our management is responsible for establishing and maintaining disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act.

We have evaluated, with the participation of our principal executive officer and principal financial officer, the effectiveness of our disclosure controls and procedures as of September 30, 2018. Based upon our evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective to provide reasonable assurance 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 applicable rules and forms, and that it is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives.

Changes in Internal Control over Financial Reporting

There has been no change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act) during the quarter ended September 30, 2018 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II – OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

From time to time, we may be involved in various claims and legal actions arising in the ordinary course of business. As of September 30, 2018, we were not involved in any such legal proceedings.

ITEM 1A. RISK FACTORS.

There were no material changes during the period covered by this Report to the risk factors previously disclosed in our annual report on Form 10-K for the year ended December 31, 2017, as filed with the SEC on February 20, 2018, other than as set forth below. Additional risks not presently known, or that we currently deem immaterial, also may have a material adverse effect on our business, financial condition and results of operations.

It may be uneconomical to "roll" our Agency MBS TBA holdings or we may be unable to meet margin calls on our TBA contracts, which could negatively affect our financial condition and results of operations.

Investing in Agency MBS TBA securities is an alternate method for gaining exposure to the Agency MBS market by entering into a contract to purchase or sell, for future delivery, an Agency MBS with a specified issuer, term and coupon. A dollar roll represents a transaction where two TBA contracts with the same terms but different settlement dates are simultaneously bought and sold. The price difference between those two contracts is commonly referred to as the "drop", and is a reflection of the expected net interest income from an investment in similar Agency mortgage-backed securities, net of an implied financing cost, which would be foregone as a result of settling the contract in the later month rather than in the earlier month. Accordingly, TBA dollar roll income generally represents the economic equivalent of the net interest income earned on the underlying Agency mortgage-backed security less an implied financing cost. Consequently, dollar roll transactions and such forward purchases of Agency securities represent a form of off-balance sheet financing and increase our "at risk" leverage.

The economic return of a TBA dollar roll generally equates to interest income on a generic TBA-eligible security less an implied financing cost, and there may be situations in which the implied financing cost exceeds the interest income, resulting in a negative carry on the position. If we roll our TBA dollar roll positions when they have a negative carry, the positions would decrease net income and amounts available for distributions to shareholders.

There may be situations in which we are unable or unwilling to roll our TBA dollar roll positions. The TBA transaction could have a negative carry or otherwise be uneconomical, we may be unable to find counterparties with whom to trade in sufficient volume, or we may be required to collateralize the TBA positions in a way that is uneconomical. Because TBA dollar rolls represent implied financing, an inability or unwillingness to roll has effects similar to any other loss of financing. If we do not roll our TBA positions prior to the settlement date, we would have to take physical delivery of the underlying securities and settle our obligations for cash. We may not have sufficient funds or alternative financing sources available to settle such obligations. Counterparties may also make margin calls as the value of a generic TBA-eligible security (and therefore the value of the TBA contract) declines. Margin calls on TBA positions or failure to roll TBA positions could have the effects described in the liquidity risks described above.

Uncertainty exists with respect to the treatment of our TBAs for purposes of the REIT asset and income tests. There is no direct authority with respect to the qualifications of income or gains from dispositions of TBAs as gains from the sale of real property (including interests in real property and interests in mortgages on real property) or other qualifying income for purposes of the 75% gross income test. In the event that such income were determined not to be qualifying for the 75% gross income test, we could be subject to a penalty tax or we could fail to qualify as a REIT if such income when added to any other non-qualifying income exceeded 25% of our gross income.

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

During the three months ended September 30, 2018, we did not repurchase any shares of our common stock.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None.

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ITEM 4. MINE SAFETY DISCLOSURES.

Not applicable.

ITEM 5. OTHER INFORMATION.

None.

ITEM 6. EXHIBITS.

A list of exhibits to this Form 10-Q is set forth on the Exhibit Index and is incorporated herein by reference.

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SIGNATURES

Pursuant to the requirements 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.

INVESCO MORTGAGE
CAPITAL INC.

November 7, 2018 By: /s/ John M. Anzalone
John M. Anzalone
Chief Executive Officer

November 7, 2018 By: /s/ R. Lee Phegley, Jr.
R. Lee Phegley, Jr.
Chief Financial Officer

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EXHIBIT INDEX

Item 6. Exhibits

| Exhibit No. | Description |
|----------------|-------------|
|----------------|-------------|

| | |
|-----|--|
| 3.1 | <u>Articles of Amendment and Restatement of Invesco Mortgage Capital Inc. (incorporated by reference to Exhibit 3.1 to our Quarterly Report on Form 10-Q, filed with the Securities and Exchange Commission on August 12, 2009).</u> |
|-----|--|

| | |
|-----|---|
| 3.2 | <u>Articles Supplementary of 7.75% Series A Cumulative Redeemable Preferred Stock (incorporated by reference to Exhibit 3.3 to the Registrant’s Registration Statement on Form 8-A, filed with the SEC on July 23, 2012).</u> |
|-----|---|

| | |
|-----|---|
| 3.3 | <u>Articles Supplementary of 7.75% Fixed-to-Floating Series B Cumulative Redeemable Preferred Stock (incorporated by reference to Exhibit 3.3 to the Registrant’s Registration Statement on Form 8-A, filed with the SEC on September 8, 2014).</u> |
|-----|---|

| | |
|-----|---|
| 3.4 | <u>Articles Supplementary of 7.50% Fixed-to-Floating Series C Cumulative Redeemable Preferred Stock (incorporated by reference to Exhibit 3.4 to the Registrant’s Registration Statement on Form 8-A, filed with the SEC on August 11, 2017).</u> |
|-----|---|

| | |
|-----|---|
| 3.5 | <u>Amended and Restated Bylaws of Invesco Mortgage Capital Inc., incorporated by reference to Exhibit 3.1 to the Current Report on Form 8-K, filed with the SEC on February 17, 2017.</u> |
|-----|---|

| | |
|------|--|
| 31.1 | <u>Certification of John M. Anzalone pursuant to Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u> |
|------|--|

| | |
|------|---|
| 31.2 | <u>Certification of R. Lee Phegley, Jr. pursuant to Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u> |
|------|---|

| | |
|------|---|
| 32.1 | <u>Certification of John M. Anzalone pursuant to Rule 13a-14(b) and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u> |
|------|---|

| | |
|------|--|
| 32.2 | <u>Certification of R. Lee Phegley, Jr. pursuant to Rule 13a-14(b) and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u> |
|------|--|

| | |
|-----|---|
| 101 | The following series of unaudited XBRL-formatted documents are collectively included herewith as Exhibit 101. The financial information is extracted from Invesco Mortgage Capital Inc.’s unaudited condensed consolidated interim financial statements and notes that are included in this Form 10-Q Report. |
|-----|---|

101.INS XBRL Instance Document

101.SCH XBRL Taxonomy Extension Schema Document

101.CAL XBRL Taxonomy Calculation Linkbase Document

101.LAB XBRL Taxonomy Label Linkbase Document

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101.PRE XBRL Taxonomy Presentation Linkbase Document

101.DEF XBRL Taxonomy Definition Linkbase Document