OFS Capital Corp
Form 8-K
March 21, 2019

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 8-K

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

Date of Report (Date of earliest event reported): March 15, 2019

OFS Capital Corporation
(Exact name of Registrant as specified in its charter)

Delaware	814-00813	46-1339639
(State or other jurisdiction of incorporation)	(Commission File Number)	(I.R.S. Employer Identification No.)

10 S. Wacker Drive, Suite 2500 Chicago, Illinois	60606
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (847) 734-2000

Not applicable
(Former name or former address, if changed since last report)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions (see General Instruction A.2. below):

¨Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)
¨ Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)
¨Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))
¨ Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

Indicate by check mark whether the registrant is an emerging growth company as defined in Rule 405 of the Securities Act of 1933 or Rule 12b-2 of the Securities Exchange Act of 1934.

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. ¨

Item 4.01. Changes in Registrant's Certifying Accountant.

(a) Dismissal of independent registered public accounting firm

On March 15, 2019, the board of directors (the "Board") of OFS Capital Corporation (the "Company") dismissed BDO USA, LLP ("BDO") as the Company's independent registered public accounting firm. The Board's decision to dismiss BDO was recommended by the audit committee of the Board.

BDO served as the Company's independent registered public accounting firm for the fiscal years ended December 31, 2018 and 2017. The audit reports of BDO on the Company's consolidated financial statements as of and for the years ended December 31, 2018 and 2017 did not contain an adverse opinion or disclaimer of opinion and were not qualified or modified as to uncertainty, audit scope or accounting principles.

The audit report of BDO on the effectiveness of internal control over financial reporting as of December 31, 2018 did not contain any adverse opinion or disclaimer of opinion, nor was it qualified or modified as to uncertainty, audit scope, or accounting principles. The audit report of BDO on the effectiveness of internal control over financial reporting as of December 31, 2017 was an adverse opinion due to the material weakness identified regarding the Company's internal controls related to the reliability of financial information reported by portfolio companies that is used as financial inputs in the Company's investment valuations as disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2017 as filed with the U.S. Securities Exchange Commission ("SEC") on March 12, 2018.

During the Company's two most recent fiscal years and the subsequent period preceding March 15, 2019, there were no disagreements with BDO on any matter of accounting principles or practices, financial statement disclosure or auditing scope or procedure, which disagreements, if not resolved to the satisfaction of BDO, would have caused it to make reference to the subject matter of such disagreements in connection with its reports, nor were there any "reportable events", as such term is described in Item 304(a)(1)(v) of Regulation S-K promulgated under the Securities Exchange Act of 1934, as amended (the "Exchange Act").

The Company provided BDO with a copy of this Form 8-K prior to its filing with the SEC and requested that BDO provide the Company with a letter addressed to the SEC stating whether it agrees with the above statements. A copy of BDO's letter dated March 21, 2019 is filed as an exhibit to this Form 8-K.

(b) Engagement of new independent registered public accounting firm

On March 15, 2019, upon the recommendation of the audit committee, the Board approved the engagement of KPMG LLP ("KPMG") to serve as the Company's independent registered accounting firm to audit the Company's consolidated financial statements for the fiscal year ending December 31, 2019.

During the two most recent fiscal years and through March 15, 2019, the date of the engagement of KPMG, neither the Company nor any person on its behalf has consulted with KPMG with respect to either (i) the application of accounting principles to a specified transaction, either completed or proposed, or the type of audit opinion that might be rendered on the Company's consolidated financial statements or (ii) any matter that was either the subject of a "disagreement" or a "reportable event" as such terms are described in Items 304(a)(1)(iv) or 304(a)(1)(v), respectively, of Regulation S-K promulgated under the Exchange Act.

Item 9.01. Financial Statements and Exhibits

Exhibit No.	Description
16.1	Letter of BDO USA, LLP

* * * * *

SIGNATURE

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 hereunto duly authorized.

OFS CAPITAL CORPORATION

Date: March 21, 2019

By: /s/ Bilal Rashid
Chief Executive Officer

rowth in net asset value, to share-based LTIP expenses based on growth in book value per share and to higher other operating expenses. The increase in other operating expenses was primarily related to costs associated with our dedicated employees hired in 2009 that we did not have in 2008 and increased professional costs.

For the years ended December 31, 2009 and 2008, we incurred expenses for base management fees payable to our Manager of $4.2 million and $3.7 million, respectively. Our Manager is also entitled to a quarterly incentive fee if, and in proportion to the extent that, our performance (as measured by adjusted net income, as defined in the management agreement) over the relevant calculation period exceeds a defined return hurdle for the period. During each of the years ended December 31, 2009 and 2008, our performance exceeded the return hurdle for one or more of the relevant quarterly calculation periods, and therefore our Manager earned incentive fees. For each of the quarterly calculation periods included in the years ended December 31, 2009 and 2008, the return hurdle was based on a 9% annual rate. Total incentive fees earned for the years ended December 31, 2009 and 2008 were $18.9 million and $1.8 million, respectively.

Effective July 1, 2009, our Management Agreement was amended. The incentive fees earned by our Manager for the period prior to July 1, 2009, were calculated based on the provisions in our management agreement that were in effect prior to the July 1, 2009 amendment. See Note 4 to our consolidated financial statements for a description of the changes to our management agreement.

Net Realized and Unrealized Gains and Losses on Investments and Financial Derivatives

During the year ended December 31, 2009, we had net realized and unrealized gains on investments of $70.1 million as compared to net realized and unrealized losses on investments of $(84.3) million for the year ended December 31, 2008. This increase of $154.4 million is principally attributable to a net increase in the value of investments, primarily our non-Agency RMBS, for the year ended December 31, 2009 as compared to the year ended December 31, 2008 when the net value of our non-Agency RMBS declined. Our net realized gains on investments during the year ended December 31, 2009 includes proceeds, in the amount of approximately $5.3 million, from the sale of a claim against Lehman Brothers Special Financing, Inc., or LBSF, a wholly-owned subsidiary of Lehman Brothers Holdings Inc., or Lehman. In September 2008, Lehman filed with the United States Bankruptcy Court in the Southern District of New York for protection under Chapter 11 of the United States Bankruptcy Code. At that time, we were a party to a number of interest rate swap and credit default swap contracts with LBSF and the Chapter 11 filing by Lehman constituted an event of default under the ISDA Master Agreement between us and LBSF. See Note 8 to our consolidated financial statements for a full description of the events leading up to the sale of this claim in 2009.

During the year ended December 31, 2009, we had net realized and unrealized gains on our financial derivatives of $4.9 million as compared to net realized and unrealized gains on financial derivatives of $69.0 million for the year ended December 31, 2008. The decline of $64.1 million is principally attributable to our swaps, where for the year ended December 31, 2008, we realized substantially more gains relative to 2009. Net realized gains on our swaps for the year ended December 31, 2009, was $6.8 million as compared to $63.6 million for the year ended December 31, 2008.

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Results of Operations for the Year Ended December 31, 2008 and the Period from August 17, 2007 (commencement of operations) through December 31, 2007

Summary of Net Increase (Decrease) in Shareholders Equity from Operations

Our shareholders equity decreased by $2.4 million from operations during the year ended December 31, 2008 as compared to an increase of $3.3 million during the period from August 17, 2007 (commencement of operations) through December 31, 2007. We attribute a majority of the net decrease in 2008 to increases in unrealized losses on RMBS. We attribute a majority of the net increase in the partial 2007 year to interest income and net realized gains on our RMBS. Total return for our common shares for the year ended December 31, 2008 based on change in book value per share was (0.41)% as compared to 0.94% for the period from August 17, 2007 (commencement of operations) through December 31, 2007.

Net Investment Income

Net investment income was $12.8 million for the year ended December 31, 2008 as compared to $2.4 million for the period from August 17, 2007 (commencement of operations) through December 31, 2007. Net investment income consists of interest income less expenses. The increase was due primarily to our being more fully invested in 2008 than in 2007 and the fact that we operated for a full fiscal year in 2008.

Interest Income

Interest income was $29.9 million for the year ended December 31, 2008 as compared to $5.9 million for the period from August 17, 2007 (commencement of operations) through December 31, 2007. Our interest income increased due to our being more fully invested in 2008 than in 2007 and the fact that we operated for a full fiscal year in 2008.

Interest Expense

Interest expense includes interest on funds borrowed under reverse repos and interest on our counterparties cash collateral held by us. We had average borrowed funds of $165.6 million and $0 for the year ended December 31, 2008 and the period from August 17, 2007 (commencement of operations) through December 31, 2007, respectively. Interest expense increased $6.2 million for the year ended December 31, 2008 from $0 for the period from August 17, 2007 (commencement of operations) through December 31, 2007. The increase in interest expense is related to an increase in total borrowings.

The table below shows our average borrowed funds, interest expense, average cost of funds, average one-month LIBOR and average six-month LIBOR under our reverse repos for the year ended December 31, 2008.

	Average Borrowed Funds	Interest Expense	Average Cost of Funds	Average One-Month LIBOR	Average Six-Month LIBOR
For the year ended December 31, 2008	$ 165,616,083	$ 4,363,685	2.63%	2.68%	3.06%

There were no borrowings as of and for the period ended December 31, 2007.

Other Expenses

Other expenses consist of base management fees and incentive fees payable to our Manager pursuant to our management agreement, share-based LTIP expense and other operating expenses. Other expenses exclude interest expense. Other operating expenses include professional fees, insurance expense, agency and administrative fees, organizational costs and other expenses necessary to operate the business. Our other expenses were $10.9 million for the year ended December 31, 2008 as compared to $3.5 million for the period from August 17, 2007 (commencement of operations) through December 31, 2007. This increase was mainly due to the fact that (i) we operated for a full year in 2008 as compared to only a partial year in 2007 and (ii) we paid an incentive fee to our Manager in 2008 and did not pay an incentive fee to our Manager in 2007.

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Net Realized and Unrealized Gains and Losses on Investments and Financial Derivatives

During the year ended December 31, 2008, we had net realized and unrealized losses on investments of $(84.3) million as compared to net realized and unrealized gains on investments of $1.1 million during the period from August 17, 2007 (commencement of operations) through December 31, 2007. This change of $(85.4) million was mainly the result of unrealized losses on our RMBS during 2008. During the year ended December 31, 2008, we had net realized and unrealized gains on financial derivatives of $69.0 million as compared to net realized and unrealized losses on financial derivatives of $(0.1) million during the period from August 17, 2007 (commencement of operations) through December 31, 2007. This change of $69.1 million was mainly the result of our exiting certain derivative contracts at net realized gains during the year ended December 31, 2008.

Liquidity and Capital Resources

Liquidity refers to our ability to meet our cash needs, including repaying our borrowings, funding and maintaining RMBS and other assets, making distributions and other general business needs. Our short-term (one year or less) and long-term liquidity requirements include acquisition costs for assets we acquire, payment of our base management fee and incentive fee, compliance with margin requirements under our repo, reverse repo, TBA and derivative contracts, repayment of reverse repo borrowings to the extent we are unable or unwilling to extend our reverse repos, and payment of our general operating expenses. Our capital resources primarily include cash on hand, cash flow from our investments (including monthly principal and interest payments received on our RMBS and proceeds from the sale of securities), borrowings under reverse repos and proceeds from equity offerings. We expect that these sources of funds will be sufficient to meet our short-term and long-term liquidity needs.

We expect to continue to borrow funds in the form of reverse repos and we may increase the level of borrowings in the future. The terms of these borrowings under our master repurchase agreements generally conform to the terms in the standard master repurchase agreement as published by SIFMA as to repayment and margin requirements. In addition, each lender typically requires that we include supplemental terms and conditions to the standard master repurchase agreement. Typical supplemental terms and conditions include the addition of or changes to provisions relating to margin calls, requirements that all controversies related to the repurchase agreement be litigated in a particular jurisdiction and cross default provisions. These provisions may differ for each of our lenders.

We have repurchased some of our own common shares in privately negotiated unsolicited transactions. To date, these share repurchases have occurred at prices which represented a material discount to our book value per common share at the time of repurchase. As a result, the share repurchases were each accretive to our book value and, in our Manager s opinion, the effective expected return on the capital used to repurchase the shares was attractive compared to alternative opportunities available in the market at those times. However, we currently do not have a systematic plan to buy back our common shares.

We held cash and cash equivalents of approximately $109.3 million, $102.9 million and $61.4 million as of June 30, 2010, December 31, 2009 and December 31, 2008, respectively.

We may declare dividends based on, among other things, our earnings, our financial condition, our working capital needs and new opportunities. The declaration of dividends to our shareholders and the amount of such dividends are at the discretion of our board of directors. During the six month period ended June 30, 2010, we paid total dividends in the amount of $18.5 million. No dividends were paid during the six month period ended June 30, 2009.

For the six month period ended June 30, 2010, our operating activities (including net sales of investments throughout the period) provided net cash in the amount of $157.1 million, but our reverse repo activity used to finance many of our investments (including repayments, in conjunction with the sales of investments, of amounts borrowed under our reverse repo agreements) used net cash of $131.8 million. Thus our operating activities,

when combined with our reverse repo financing activities, provided net cash of $25.3 million. Of this $25.3 million, we used $18.5 million to pay dividends, $0.3 million for other non-operating-activity-related uses, with the remaining $6.5 million serving to increase our cash holdings from $102.9 million as of December 31, 2009 to $109.3 million as of June 30, 2010.

For the year ended December 31, 2009, our operating activities (including net purchases of investments throughout the year) used net cash of $215.4 million, but our reverse repo activity used to finance many of our investments (including many of those purchased throughout the year) provided net cash of $299.4 million. Thus our operating activities, when combined with our reverse repo financing activities, provided net cash of $84.0 million. Of this $84.0 million, we used $30.8 million to pay dividends and we used an additional $11.7 million for other non-operating-activity-related uses, with the remaining $41.5 million serving to increase our cash holdings from $61.4 million as of December 31, 2008 to $102.9 million as of December 31, 2009.

For the year ended December 31, 2008, our operating activities used net cash of $259.7 million, primarily through the acquisition of assets and payments made in respect of financial derivatives. No dividends were paid in 2008.

Based on our current portfolio, amount of free cash on hand, debt-to-equity ratio and current and anticipated availability of credit, we believe that our capital resources will be sufficient to enable us to meet anticipated short-term and long-term liquidity requirements. However, the unexpected inability to finance our Agency RMBS portfolio would create a serious short-term strain on our liquidity and would require us to liquidate much of that portfolio, which in turn would require us to restructure our portfolio to maintain our exclusion from regulation as an investment company under the Investment Company Act. Steep declines in the values of our RMBS assets financed using reverse repos, or in the values of our derivative contracts, would result in margin calls that would significantly reduce our free cash position. Furthermore, a substantial increase in prepayment rates on our assets financed by reverse repos could cause a temporary liquidity shortfall, because we are generally required to post margin on such assets in proportion to the amount of the announced principal paydowns before the actual receipt of the cash from such principal paydowns. If our cash resources are at any time insufficient to satisfy our liquidity requirements, we may have to sell assets or issue debt or additional equity securities.

While our net borrowings under our reverse repos declined during the six month period ended June 30, 2010, we expect to continue to borrow funds in the form of reverse repos as well as other types of financing. As of June 30, 2010, December 31, 2009 and December 31, 2008, we had $428.2 million, $560.0 million and $260.5 million, respectively of borrowings outstanding under our reverse repos with a weighted average borrowing rate of 0.77%, 0.58% and 2.07%, respectively, most of which were collateralized by our Agency RMBS. As of June 30, 2010, our reverse repos had interest rates ranging from 0.25% to 2.50%. As of December 31, 2009, our reverse repos had interest rates ranging from (0.01)% to 2.75%. The negative borrowing rate relates to a single Treasury holding which we financed using a reverse repo arrangement. As of December 31, 2009, market demand for this security was such that the lender was willing to pay interest to us in order to access the security as collateral under the reverse repo arrangement. As of December 31, 2008, our reverse repos had interest rates ranging from 1.20% to 4.50%. As of June 30, 2010, the remaining terms on our reverse repos ranged from 1 to 91 days, as of December 31, 2009, the remaining terms on our reverse repos ranged from 4 to 236 days and as of December 31, 2008, the remaining terms on our reverse repos ranged from 6 to 26 days. The RMBS and Treasury security pledged as collateral under the reverse repos had an aggregate estimated fair value of $501.6 million and $627.4 million as of June 30, 2010 and December 31, 2009, respectively. RMBS pledged as collateral under our reverse repos had an estimated fair value of $299.0 million as of December 31, 2008. The interest rates of the reverse repos are generally indexed to the one-month LIBOR rate and reset accordingly. It is expected that amounts due upon maturity of our reverse repos will be funded primarily through the roll over/re-initiation of reverse repos and, if we are unable or unwilling to roll over/re-initiate our reverse repos, through free cash and proceeds from the sale of securities.

We are not required by our investment guidelines to maintain any specific debt-to-equity ratio, and we believe that the appropriate leverage for the particular assets we hold depends on the credit quality and risk of those assets, as well as the general availability and terms of stable and reliable financing for those assets.

Contractual Obligations and Commitments

We are a party to a management agreement with our Manager. Pursuant to that agreement, our Manager is entitled to receive a base management fee, an incentive fee, reimbursement of certain expenses and, in certain circumstances, a termination fee. Such fees and expenses do not have fixed and determinable payments. For a description of the management agreement provisions, see Management Management Agreement.

We enter into reverse repos with third-party broker-dealers whereby we sell securities to such broker-dealers at agreed-upon purchase prices at the initiation of the reverse repos and agree to repurchase such securities at predetermined repurchase prices and termination dates, thus providing the broker-dealers with an implied interest rate on the funds initially transferred to us by the broker-dealers. When we enter into a reverse repo, the lender establishes and maintains an account containing cash and securities having a value not less than the repurchase price, including accrued interest, of the reverse repo. We enter into repos with third-party broker-dealers whereby we purchase securities under agreements to resell at an agreed-upon price and date. In general, we most often enter into repo transactions in order to effectively borrow securities that we can then deliver to counterparties to whom we have made short sales of the same securities. The implied interest rates on the repos and reverse repos we enter into are based upon market rates at the time of initiation. Repos and reverse repos that are conducted with the same counterparty may be reported on a net basis if they meet the requirements of ASC 210-20, Balance Sheet, Offsetting.

As of June 30, 2010, we had an aggregate amount at risk under our reverse repos with seven counterparties of approximately $81.1 million, as of December 31, 2009, we had an aggregate amount at risk under our reverse repos with six counterparties of approximately $74.5 million and as of December 31, 2008, we had an aggregate amount at risk under our reverse repos with four counterparties of approximately $38.4 million. Amounts at risk represent the aggregate excess, if any, for each counterparty of the fair value of collateral held by such counterparty over the amounts outstanding under repos and reverse repos. If the amounts outstanding under repos and reverse repos with a particular counterparty are greater than the collateral held by the counterparty, there is no amount at risk for the particular counterparty. Amounts at risk as of June 30, 2010, December 31, 2009 and December 31, 2008 do not include approximately $1.3 million, $2.0 million and $1.0 million, respectively, of net accrued interest, defined as accrued interest on securities held as collateral less interest payable on cash borrowed.

Our swap and futures contracts are governed by trading agreements, which are separately negotiated agreements with dealer counterparties. Changes in the relative value of the swap and futures transactions may require us or the counterparty to post or receive collateral. Typically, a collateral payment or receipt is triggered based on the net change in the value of all contracts governed by a particular trading agreement. Entering into swap and futures contracts involves market risk in excess of amounts recorded on our balance sheet.

As of June 30, 2010, we had an aggregate amount at risk under our derivative contracts with nine counterparties of approximately $13.9 million, including $0.8 million with one futures counterparty. As of December 31, 2009, we had an aggregate amount at risk under our derivatives contracts with six counterparties of approximately $10.5 million, including $1.8 million with one futures counterparty. As of December 31, 2008, we had an aggregate amount at risk under our derivatives contracts with four counterparties of approximately $8.8 million. Amounts at risk under our derivatives contracts represent the aggregate excess, if any, for each counterparty of the fair value of our derivative contracts plus our collateral held directly by the counterparty less the counterparty s collateral held by us. If a particular counterparty s collateral held by us is greater than the aggregate fair value of the financial derivatives plus our collateral held directly by the counterparty, there is no amount at risk for the particular counterparty. Amounts at risk as of June 30, 2010, December 31, 2009 and December 31, 2008 do not include approximately $0.6 million, $0 and $0.5 million, respectively, of trade receivables on unsettled swap transactions.

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We are party to a tri-party collateral arrangement under one of our ISDA trading agreements whereby a third party holds collateral posted by us. Pursuant to the terms of the arrangement, the third party must follow certain pre-defined actions prior to the release of the collateral to the counterparty or to us. Deposits with Dealers Held as Collateral on the Consolidated Statement of Assets, Liabilities and Shareholders Equity includes, at June 30, 2010, December 31, 2009 and December 31, 2008 collateral posted by the Company and held by a third party custodian in the amount of approximately $6.3 million, $11.3 million and $14.3 million, respectively.

We purchase and sell certain non-derivative securities, including TBAs, on a when-issued or delayed delivery basis. Since delivery for these securities extends beyond the typical settlement dates for most non-derivative investments, these transactions are more prone to market fluctuations between the trade date and the ultimate settlement date, and thereby are more vulnerable, especially in the absence of margining arrangements with respect to these transactions, to increasing amounts at risk with the applicable counterparties.

As of June 30, 2010, in connection with our TBAs, we had an aggregate amount at risk with twelve counterparties in the aggregate amount of approximately $7.9 million. As of December 31, 2009, in connection with our TBAs, we had an aggregate amount at risk with six counterparties in the aggregate amount of approximately $6.6 million. No amounts were at risk as of December 31, 2008. Amounts at risk in connection with our TBAs represent the aggregate excess, if any, for each counterparty of the net fair value of our TBAs plus our collateral held directly by the counterparty less the counterparty s collateral held by us. If a particular counterparty s collateral held by us is greater than the aggregate fair value of the TBAs plus our collateral held directly by the counterparty, there is no amount at risk for the particular counterparty.

Off-Balance Sheet Arrangements

As of June 30, 2010, December 31, 2009 and December 31, 2008, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. Further, we have not guaranteed any obligations of unconsolidated entities nor do we have any commitment or intent to provide funding to any such entities. As such, we are not materially exposed to any market, credit, liquidity or financing risk that could arise if we had engaged in such relationships.

Inflation

Virtually all of our assets and liabilities are interest rate sensitive in nature. As a result, interest rates and other factors influence our performance far more so than does inflation. Changes in interest rates do not necessarily correlate with inflation rates or changes in inflation rates. Our activities and balance sheet are measured with reference to historical cost and/or fair market value without considering inflation.

Quantitative and Qualitative Disclosures About Market Risk

The primary components of our market risk are related to credit risk, prepayment risk and interest rate risk. We seek to actively manage these and other risks and to acquire and hold assets that we believe justify bearing those risks, and to maintain capital levels consistent with those risks.

Credit Risk

We are subject to credit risk in connection with our assets, especially our non-Agency RMBS. Credit losses on real estate loans can occur for many reasons, including, but not limited to, poor origination practices, fraud, faulty appraisals, documentation errors, poor underwriting, legal errors, poor servicing practices, weak economic conditions, decline in the value of homes, businesses or commercial properties, special hazards, earthquakes and other natural events, over-leveraging of the borrower on the property, reduction in market rents and occupancies and

poor property management services, changes in legal protections for lenders, reduction in personal income, job loss

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and personal events such as divorce or health problems. Property values are subject to volatility and may be affected adversely 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 an oversupply of housing), changes or continued weakness in specific industry segments, construction quality, age and design, demographic factors and retroactive changes to building or similar codes. For mortgage-related instruments, the two primary components of credit risk are default risk and severity risk. Market conditions since August 2007 have demonstrated substantial increase in both of these risks which has had a negative impact on the value of non-Agency RMBS. The second half of 2009 and the first half of 2010 experienced some perceived stabilization in default risk and severity risk which has led to an increase in values of certain non-Agency RMBS. Should these factors resume their negative trend, some or all of the increase in value of these non-Agency RMBS may be reversed, although to the extent there is an increase in write-downs of principal balances by servicers positive trends could continue.

Default Risk

Default risk is the risk that borrowers will fail to make principal and interest payments on their mortgage loans. We may attempt to mitigate our default risk by, among other things, opportunistically entering into credit default swaps on individual RMBS or RMBS indices, whereby we would receive payments upon the occurrence of a credit event on the underlying reference asset or assets. We also rely on third-party mortgage servicers to mitigate our default risk, but such third-party mortgage servicers may have little or no economic incentive to mitigate loan default rates. Default risk in the RMBS market, as measured by mortgage loans which are sixty days or greater delinquent, has stabilized recently, but remains at elevated levels.

Severity Risk

Severity risk is the risk of loss upon a borrower default on a mortgage loan underlying our RMBS. Severity risk includes the risk of loss of value of the property underlying the mortgage loan as well as the risk of loss associated with taking over the property, including foreclosure costs. We rely on third-party mortgage servicers to mitigate our severity risk, but such third-party mortgage servicers may have little or no economic incentive to mitigate loan loss severities. Such mitigation efforts may include loan modification programs and prompt foreclosure and property liquidation following a default. Severity risk increased consistently throughout the first half of 2009 due to, among other things, increased servicing costs, delays in loan foreclosure, continuing home price declines and lack of incentive for mortgage servicers to minimize costs. Loss severities stabilized in the second half of 2009 and the first half of 2010 and, while such stabilization may prove temporary should the pace of property liquidations increase in the coming months, such stabilization may prove more permanent to the extent there is an increase in write-downs of principal balances by servicers. In order to stem heightened foreclosure activity, recent government action encourages principal forgiveness on defaulted mortgage loans. This is potentially a positive step in alleviating risk of foreclosure, but its success relies on effective implementation by mortgage loan servicers.

Prepayment Risk

Prepayment risk is the risk of change, whether an increase or a decrease, in the rate at which principal is returned in respect of mortgage loans underlying RMBS, including both through voluntary prepayments and through liquidations due to defaults and foreclosures. This rate of prepayment is affected by a variety of factors, including the prevailing level of interest rates as well as economic, demographic, tax, social, legal and other factors. Changes in prepayment rates will have varying effects on the different types of securities in our portfolio. We attempt to take these effects into account in making asset management decisions with respect to our assets. Additionally, increases in prepayment rates may cause us to experience losses on our IOs and IIOs, as those securities are extremely sensitive to prepayment rates. Prepayment risk was at elevated levels throughout the second half of 2008 and the first half of 2009. Prepayment rates, besides being subject to interest rates and borrower behavior, are also substantially affected by government policy and regulation. Legislation directed at

high loan-to-value borrowers increased prepayments over several classes of mortgage loans in the second half of 2009; however, we believe heightened prepayment levels are unlikely to continue as many borrowers who are eligible to refinance have already done so. A return of principal similar to an increase in prepayment rates has occurred with respect to our Agency RMBS guaranteed by Fannie Mae and Freddie Mac given the repurchase by them of delinquent mortgage loans from the mortgage pools backing such Agency RMBS.

Interest Rate Risk

Interest rates are 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 certain of our assets and liabilities. For some securities in our portfolio, the coupon yields on, and therefore also the values of, such securities are highly sensitive to interest rate movements, such as inverse floating rate RMBS, which benefit from falling interest rates, or certain deep discount floating rate RMBS, which benefit from rising interest rates. We selectively hedge our interest rate risk by entering into interest rate swaps, Eurodollar futures, and other instruments. In general, such hedging instruments are used to offset the large majority of the interest rate risk we estimate to arise from our Agency RMBS positions. Hedging instruments may also be used to offset a portion of the interest rate risk arising from certain non-Agency RMBS positions.

The following sensitivity analysis table shows the estimated impact on the fair value of our portfolio segregated by certain identified categories as of June 30, 2010, assuming a static portfolio and immediate shifts in interest rates from current levels as indicated below.

	Estimated Change in Fair Value for a Decrease in Interest Rates by		Estimated Change in Fair Value for an Increase in Interest Rates by	
Category of Instruments	**50 Basis Points**	**100 Basis Points**	**50 Basis Points**	**100 Basis Points**
Non-Agency RMBS	$ 3,880,729	$ 7,830,170	$ 3,812,017	$ (7,555,323)
U.S. Treasury Securities and Interest Rate Swaps and Futures	(2,313,494)	(4,652,772)	2,287,710	4,549,636
Agency RMBS	87,678	1,853,424	1,590,389	4,858,845
Total	$ 1,654,913	$ 5,030,822	$ 66,082	$ 1,853,158

The preceding analysis does not show sensitivity to changes in interest rates for our reverse repo liabilities, our credit default swaps on MBS or MBS indices, or our derivatives on corporate securities (whether debt or equity-related). We believe that the effect of a change in interest rates on such categories of instruments in our portfolio cannot be accurately estimated and/or is not material to the value of the overall portfolio.

Our analysis of interest rate risk is derived from Ellington s proprietary models as well as third party information and analytics. The estimated changes in fair value for our Agency and non-Agency RMBS are calculated assuming that changes in interest rates affect: (i) the related securitization s variable-rate bond and variable-rate collateral coupons; (ii) the prepayment rates of the underlying collateral; and (iii) the market discount rates applied to the projected cash flows of such RMBS. Changes in fair value for a given shift in interest rates are estimated by averaging over a wide range of possible future interest rate scenarios consistent with such shift.

Our portfolio is subject to many risks other than interest rate risks. Furthermore, many simplifying assumptions have been made in connection with the calculations set forth in the table above 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. For example, for each hypothetical immediate shift in interest rates, simplifying assumptions have been made concerning the shape of the yield curve and market volatilities of interest rates, each of which can significantly and adversely affect the fair value of our interest rate-sensitive instruments.

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The above analysis utilizes assumptions and estimates based on management s judgment and experience, and relies on financial models, which are inherently imperfect; in fact different models can produce different results for the same securities. While the table above reflects the estimated impacts of immediate interest rate increases and decreases on specific categories of instruments in our portfolio, we actively trade many of the instruments in our portfolio, and therefore our current or future portfolios may have risks that differ significantly from those of our June 30, 2010 portfolio estimated above. Furthermore, the impact of changing interest rates on fair value can change significantly when interest rates change by a greater amount than the hypothetical shifts assumed above. For all of the foregoing reasons and others, the table above is for illustrative purposes only and actual changes in interest rates would likely cause changes in the actual fair value of our portfolio that would differ from those presented above, and such differences might be significant and adverse. See Special Note Regarding Forward-Looking Statements.

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BUSINESS

Our Company

Ellington Financial LLC is a specialty finance company formed in August 2007 to specialize in acquiring and managing mortgage-related assets. Our primary objective is to generate attractive, risk-adjusted total returns for our shareholders by making investments that we believe compensate us appropriately for the risks associated with them. We seek to attain this objective by utilizing an opportunistic strategy. Our targeted assets currently include non-Agency RMBS, Agency RMBS, mortgage-related derivatives, corporate debt and equity securities and derivatives. We also may opportunistically acquire and manage other types of mortgage-related assets and financial assets, such as residential whole mortgage loans, CMBS and commercial mortgages or other commercial real estate debt, ABS backed by consumer and commercial assets and non-mortgage-related derivatives. As of June 30, 2010, we had an aggregate portfolio of RMBS with a net value of approximately $157.2 million, derivatives contracts with a net value of approximately $128.1 million and total shareholders equity of approximately $294.4 million. Our net RMBS portfolio value of $157.2 million as of June 30, 2010, represents long investments in Agency and non-Agency RMBS valued at $885.3 million offset by Agency RMBS sold short valued at $728.1 million.

The members of our management team are Michael Vranos, founder and Chief Executive Officer of Ellington, who serves as our Co-Chief Investment Officer, Laurence Penn, Vice Chairman of Ellington, who serves as our Chief Executive Officer and President, Mark Tecotzky, a Managing Director of Ellington, who serves as our Co-Chief Investment Officer, Lisa Mumford, who serves as our dedicated Chief Financial Officer, and Daniel Margolis, General Counsel of Ellington, who serves as our Secretary. Each of these individuals is an officer of our Manager. We currently do not have any employees.

Our Manager and Ellington

We are externally managed and advised by our Manager, an affiliate of Ellington, pursuant to a management agreement. Our Manager was formed solely to serve as our Manager and does not have any other clients. In addition, our Manager currently does not have any employees and instead relies on the employees of Ellington to perform its obligations to us. Ellington is a private investment management firm and registered investment advisor with a 15-year history of investing in a broad spectrum of MBS and related derivatives.

Our Manager is responsible for administering our business activities and day-to-day operations and, pursuant to a services agreement between our Manager and Ellington, relies on the resources of Ellington to support our operations. See Certain Relationships and Related Party Transactions Services Agreement for a description of the terms of the services agreement between our Manager and Ellington. Ellington has established portfolio management resources for each of our targeted asset classes and an established infrastructure supporting those resources. Through our relationship with our Manager, we benefit from Ellington s highly analytical investment processes, broad-based deal flow, extensive relationships in the financial community, financial and capital structuring skills, investment surveillance database and operational expertise. Ellington s analytic approach to the investment process involves collection of substantial amounts of data regarding historical performance of MBS collateral and MBS market transactions. Ellington analyzes this data to identify possible trends and develops financial models used to support the investment and risk management process. In addition, throughout Ellington s 15-year history of investing in MBS and related derivatives, it has developed strong relationships with a wide range of dealers and other market participants that provide Ellington access to a broad range of trading opportunities and market information. In addition, our Manager provides us with access to a wide variety of asset acquisition and disposition opportunities and information that assist us in making asset management decisions across our targeted asset classes, which we believe provides us with a significant competitive advantage. We also benefit from Ellington s finance, accounting, operational, legal, compliance and administrative functions.

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As of June 30, 2010, Ellington employed over 100 employees, and, including our company, various hedge funds, and various private accounts, had net assets under management of approximately $2.8 billion. In addition, Ellington, through its affiliates, manages CDOs collateralized by MBS or ABS, as well as a traditional managed account.

Our Manager has an investment and risk management committee that advises and consults with our senior management team with respect to, among other things, our investment policies, portfolio holdings, financing and hedging strategies and investment guidelines. The members of the investment and risk management committee include Messrs. Vranos, Penn and Tecotzky.

Our Strategy

We utilize an opportunistic strategy to seek to provide investors with attractive, risk-adjusted total returns by:

- taking advantage of opportunities in the residential mortgage market by purchasing investment grade and non-investment grade non-Agency RMBS, including senior and subordinated securities;

- acquiring Agency RMBS on a more leveraged basis in order to take advantage of opportunities in that market sector and assist us in maintaining our exclusion from regulation as an investment company under the Investment Company Act;

- opportunistically entering into and managing a portfolio of mortgage-related derivatives;

- opportunistically acquiring and managing other mortgage-related and financial assets, such as residential whole mortgage loans, CMBS, commercial mortgages or other commercial real estate debt, ABS backed by consumer and commercial assets and non-mortgage-related derivatives; and

- opportunistically mitigating our credit and interest rate risk by using a variety of hedging instruments.

Our strategy is adaptable to changing market environments, subject to compliance with the income and other tests that will allow us to continue to be treated as a partnership for U.S. federal income tax purposes and to maintain our exclusion from regulation as an investment company under the Investment Company Act. As a result, although we focus on the assets described above, our acquisition and management decisions depend on prevailing market conditions and our targeted asset classes may vary over time in response to market conditions. To effect our strategy, we may engage in a high degree of trading volume. Our Manager is authorized to follow very broad investment guidelines and, as a result, we cannot predict our portfolio composition. We may change our strategy and policies without a vote of our shareholders. Moreover, although our independent directors periodically review our investment guidelines and our portfolio, they generally do not review our proposed asset acquisitions or asset management decisions.

Ellington s investment philosophy revolves around the pursuit of value across various types of MBS and related assets. Ellington seeks investments across a wide range of MBS sectors without any restriction as to ratings, structure or position in the capital structure. Over time and through market cycles, opportunities will present themselves in varying sectors and in varying forms. In current markets, for example, the liquidation of portfolios of MBS from structured vehicles and from distressed financial institutions have been significant sources of asset acquisition opportunities. By rotating between sectors of the MBS markets and adjusting the extent to which it hedges, Ellington believes that it is able to capitalize on the disparities between these sectors as well as on overall trends in the marketplace, and therefore provide better and more consistent returns for its investors. Disparities between MBS sectors vary from time to time and are driven by a combination of factors. For example, as various MBS sectors fall in and out of favor, the relative yields that the market demands for those sectors may vary. In addition, Ellington s performance projections for certain sectors may differ from those of other market participants and such disparities will naturally cause us, from time to time, to gravitate towards certain sectors and away from others. Disparities between MBS sectors may also be driven by differences in collateral performance (for example, seasoned subprime collateral may perform better than more recent subprime collateral) and in the structure of particular investments (for example, in the timing of cash flow or the level of

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credit enhancement), and our Manager may believe that other market participants are overestimating or underestimating the value of these differences. Furthermore, we believe that risk management, including opportunistic portfolio hedging and prudent financing and liquidity management, is essential for consistent generation of attractive, risk-adjusted total returns across market cycles.

Ellington s continued emphasis on and development of proprietary MBS credit, interest rate and prepayment models, as well as other proprietary research and analytics, underscores the importance it places on a disciplined and often analytical approach to fixed income investing, especially in MBS. Our Manager uses Ellington s proprietary models to identify attractive assets, value these assets, monitor and forecast the performance of these assets, and opportunistically hedge our credit and interest rate risk. We leverage these skills and resources to seek to meet our objectives.

We believe that our Manager is uniquely qualified to implement our strategy. Our strategy is consistent with Ellington s investment approach, which is based on its distinctive strengths in sourcing, analyzing, trading and hedging complex MBS. Furthermore, we believe that Ellington s extensive experience in buying, selling, analyzing and structuring fixed income securities, coupled with its broad access to market information and trading flows, provides us with a steady flow of opportunities to acquire assets with favorable trade executions.

We also employ a wide variety of hedging instruments and derivative contracts. See Risk Management.

Our Targeted Asset Classes

Our targeted asset classes currently include:

Asset Class	Principal Assets
Non-Agency RMBS	RMBS backed by prime jumbo, Alt-A and subprime mortgages
	RMBS backed by fixed rate mortgages, ARMs, Option-ARMs and Hybrid ARMs
	RMBS backed by first lien and second lien mortgages
	Investment grade and non-investment grade securities
	Senior and subordinated securities
	IOs, POs, IIOs and inverse floaters
Agency RMBS	Whole pool pass-through certificates
	TBAs
Mortgage-Related Derivatives	Credit default swaps on individual RMBS, on the ABX, CMBX and PrimeX indices and on other mortgage-related indices
	Other mortgage-related derivatives
Corporate Debt and Equity Securities and Derivatives	Credit default swaps on corporations or on corporate indices
	Corporate debt or equity securities
	Options or total return swaps on corporate equity or on corporate equity indices

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Asset Class	Principal Assets
Other	Residential whole mortgage loans CMBS Commercial mortgages and other commercial real estate debt ABS Other non-mortgage-related derivatives

The following briefly discusses the principal types of assets we purchase.

Non-Agency RMBS

We acquire non-Agency RMBS backed by prime jumbo, Alt-A and subprime residential mortgage loans.

Non-Agency RMBS are debt obligations issued by private originators of or investors in residential mortgage loans. Non-Agency RMBS generally are issued as CMOs, and are backed by pools of whole mortgage loans or by mortgage pass-through certificates. Non-Agency RMBS generally are securitized in senior/subordinated structures, or in excess spread/over-collateralization structures. In senior/subordinated structures, the subordinated tranches generally absorb all losses on the underlying mortgage loans before any losses are borne by the senior tranches. In excess spread/over-collateralization structures, losses are first absorbed by any existing over-collateralization, then borne by subordinated tranches and excess spread, which represents the difference between the interest payments received on the mortgage loans backing the RMBS and the interest due on the RMBS debt tranches, and finally by senior tranches and any remaining excess spread.

We currently acquire and may continue to acquire IOs, POs, IIOs and inverse floaters. IOs are RMBS that entitle the holder to receive interest payments, but not any principal payments, from either a collection of mortgage loans or a particular RMBS debt tranche. IIOs are IOs that entitle the holder to interest payments from an inverse floater. POs are RMBS that entitle the holder to receive principal payments, but not any interest payments, from either a collection of mortgage loans or a particular RMBS debt tranche. POs sell at a discount to par value and are in many respects similar to zero coupon bonds. Inverse floaters are RMBS that have coupon rates that move in the opposite direction of a designated reference interest rate.

Prime jumbo mortgage loans are mortgage loans that generally conform to Fannie Mae or Freddie Mac underwriting guidelines except that the mortgage balance exceeds the maximum amount permitted by Fannie Mae or Freddie Mac underwriting guidelines.

Alt-A mortgage loans generally have income verification and/or employment verification standards that are weaker than those standards employed in prime underwriting. Additionally, Alt-A mortgage loans are more frequently collateralized by non-primary residences than prime loans. The credit quality of Alt-A borrowers generally exceeds the credit quality of subprime borrowers.

Subprime mortgage loans are loans that are originated using underwriting standards that are less restrictive than those used for other first and junior lien mortgage loan origination programs, such as the programs of Fannie Mae and Freddie Mac. These lower standards permit loans to be made to borrowers having low credit scores and/ or imperfect or impaired credit histories (including outstanding judgments or prior bankruptcies), loans with no income disclosure or verification, and loans with high loan-to-value ratios.

The residential mortgage loans securing our RMBS are either fixed-rate mortgages, ARMs, option-ARMs or hybrid ARMs. ARMs have interest rates that reset periodically, typically every six or twelve months. Because the interest rates on ARMs adjust periodically based on market conditions, ARMs tend to have interest rates that do not significantly deviate from current market rates. This, in turn, can cause ARMs to have less price sensitivity to interest rates.

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A second lien mortgage loan is a mortgage loan that is subordinate to the primary mortgage loan on a property. The second lien mortgage loan can be in the form of a revolving home equity line of credit or in a closed-end non-revolving loan. In the event of a default or a bankruptcy of the borrower, the second lien mortgage loan will not be paid off until the first lien mortgage loan is paid off. The subordination inherent in the second lien mortgage loan and the resulting difficulty in asset recovery following a bankruptcy makes this type of loan a greater risk to lenders, and consequently carries higher interest rates and has high costs associated with it.

Manufactured homes are housing units that are largely assembled in factories and then transported to sites of use. Manufactured housing loans include both manufactured housing installment sales contracts secured by security interests in manufactured homes (and, in some cases, by liens on the real estate on which the manufactured homes are located) and mortgage loans secured by first liens on the real estate on which manufactured homes are permanently affixed.

An option ARM is a mortgage loan that initially offers the borrower a variety of monthly payment options, typically including a specified minimum payment that may be less than the full interest payment, an interest-only payment, a 30-year fully amortizing payment and a 15-year fully amortizing payment. Such mortgage loans typically allow unpaid accrued interest to be capitalized monthly and added back to the loan s outstanding principal balance. This negative amortization only occurs in loans where the monthly payment does not cover the amount of interest due for that period. Such mortgage loans typically employ (i) a recast date before which the outstanding principal loan balance is permitted to negatively amortize but after which it is not, and (ii) a principal balance cap based on federal and state legislation. Option ARMs are typically made to borrowers in high-cost areas because monthly mortgage payments are relatively low for these loans, and are made for the purposes of cash management and increased payment flexibility.

Hybrid ARMs have interest rates that have an initial fixed period (typically two, three, five, seven or ten years) and thereafter reset at regular intervals in a manner similar to traditional ARMs.

The characteristics of RMBS differ from those of traditional fixed-income securities. The major differences include the monthly payment of interest and principal on the RMBS and the possibility that principal may be prepaid on the RMBS at any time due to prepayments on the underlying mortgage loans. These differences can result in significantly greater price and yield volatility than is the case with traditional fixed-income securities.

Our non-Agency RMBS portfolio has significant quantities of RMBS collateralized by prime jumbo, Alt-A and subprime residential mortgage loans and generally consists of securities which ranked in the more senior classes of their respective securitizations, benefiting from the subordination provided by those securitization structures. Our portfolio also includes significant quantities of RMBS collateralized by manufactured housing loans. However, because we actively trade our portfolio and consider a wide range of potential investments without restriction as to ratings, structure or position in the capital structure, no assurance can be given that, in the future, our non-Agency RMBS will or will not be concentrated in these or other sectors, or consist of securities which rank lower in the capital structure or have lower ratings.

Agency RMBS

Our assets in this asset class consist primarily of whole-pool, pass-through certificates, the principal and interest of which are guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae and which are backed by ARMs, hybrid ARMs or fixed-rate mortgages. Pass-through certificates are securities representing undivided interests in pools of mortgage loans secured by residential real property where payments of both interest and principal, plus pre-paid principal, on the securities are made monthly to holders of the security, in effect passing through monthly payments made by the individual borrowers on the mortgage loans that underlie the securities, net of fees paid to the issuer/guarantor and servicers of the securities. Whole pool pass-through certificates are pass-through certificates that represent the entire ownership of (as opposed to merely a partial undivided interest in) a pool of mortgage loans.

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TBAs

In addition to investing in specific pools of Agency RMBS, we utilize forward-settling purchases and sales of Agency RMBS where the underlying pools of mortgage loans are To-Be-Announced, or TBAs. Pursuant to these TBA transactions, we agree to purchase or sell, for future delivery, Agency RMBS with certain principal and interest terms and certain types of underlying collateral, but the particular Agency RMBS to be delivered is not identified until shortly before the TBA settlement date. TBAs are liquid and have quoted market prices and represent the most actively traded class of MBS. We use TBAs primarily for hedging purposes. TBA trading is based on the assumption that the specific mortgage pools that will be delivered at settlement are fungible and thus do not need to be explicitly known at the time a trade is initiated. As a general matter, one mortgage pool is considered to be interchangeable with another mortgage pool for these purposes.

We primarily engage in TBA transactions for purposes of managing certain risks associated with our long Agency RMBS and, to a lesser extent, our non-Agency RMBS. The principal risks that we use TBAs to mitigate are interest rate and yield spread risks. For example, we may hedge the interest rate and/or yield spread risk inherent in our long Agency RMBS by taking short positions in TBAs that are similar in character. Alternatively, we may engage in TBA transactions because we find them attractive on their own, from a relative value perspective or otherwise.

We generally do not settle our purchases and sales of TBAs. If, for example, we wish to maintain a short position in a particular TBA as a hedge, we may roll the short TBA transaction. In a hypothetical roll transaction, we might have previously entered into a contract to sell a specified amount of 30-year FNMA 4.5% TBA pass-throughs to a particular counterparty for a specified settlement date. As this settlement date approaches, because we generally do not intend to settle the sale transaction, but we wish to maintain the short position, we enter into a roll transaction whereby we purchase the same amount of 30-year FNMA 4.5% TBA pass-throughs (but not necessarily from the same counterparty) for the same specified settlement date, and we sell the same amount of 30-year FNMA 4.5% TBA pass-throughs (potentially to yet another counterparty) for a later settlement date. In this way, we have essentially flattened out our 30-year FNMA 4.5% TBA pass-through position for the earlier settlement date (i.e., offset the original sale with a corresponding purchase), and established a new short position for the later settlement date, hence maintaining our short position. By rolling our transaction, we maintain our desired short position in 30 year FNMA 4.5% securities without actually settling the original sale transaction.

In the case where the counterparty from whom we purchase (or to whom we sell) for the earlier settlement date is the same as the counterparty to whom we sell (or from whom we purchase) for the later settlement date, and when these purchases/sales are transacted simultaneously, this pair of simultaneous purchases or sales is often referred to as a TBA roll transaction.

In some instances, to avoid taking or making delivery of TBA securities, we will pair-off an open purchase or sale transaction with an offsetting sale or purchase with the same counterparty. Alternatively, we will assign open transactions from counterparties from whom we have purchased to other counterparties to whom we have sold. In either case, no securities are actually delivered, but instead the net difference in trade proceeds of the offsetting transactions is calculated, and a money wire representing such difference is sent to the appropriate party.

Mortgage-Related Derivatives

We take long and short positions in various mortgage-related derivative instruments, including credit default swaps. A credit default swap is a credit derivative contract in which one party (protection buyer) pays an ongoing periodic premium (and often an upfront payment as well) to another party (protection seller) in return for compensation for default (or similar credit event) by a reference entity. In this case, the reference entity can be an asset-backed security or an index of several ABS, such as an ABX Index, PrimeX or a CMBX Index. Payments from protection seller to protection buyer typically occur if a credit event takes place; a credit event may be triggered by, among other things, the reference entity s failure to pay its principal obligations or a severe ratings downgrade of the reference entity.

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Legislators and market regulators are currently considering additional regulations pertaining to derivative transactions, including credit derivatives. Given the variety of potential regulations that have been proposed and the preliminary nature of most of the proposals, we are not able at this time to predict the impact any final regulations might have on our business. Proposed regulations could have positive, adverse or mixed consequences for our business. For example, some measures being considered would require that derivatives be traded on regulated exchanges or through clearinghouses. While such changes could benefit us by substantially reducing our derivatives counterparty-related risks, they might also reduce some of the market inefficiencies that we believe create opportunities for us. Such changes might also impact the amount of collateral that we are required to post against our derivatives positions, which could affect our liquidity and the amount of capital that we have available for our non-derivative investment activities. Such changes may lead us to re-evaluate our derivatives strategy in particular and our investment strategy overall. No assurance can be given that any final regulations will not impact our business in a material and adverse way.

Corporate Debt and Equity Securities and Derivatives

For hedging purposes, we take short positions in corporate debt and equity (including indices on corporate debt and equity) by entering into derivative contracts such as credit default swaps, total return swaps and options. These are generally not hedges against risks that are directly related to specific corporate entities. Rather, these hedges reference corporations or indices whose performance we believe may have a reasonable degree of correlation with the performance of our portfolio. Given this correlation, a short position with respect to such corporations or indices provides a hedge to our portfolio of RMBS as a whole.

A credit default swap is a derivative contract in which one party (protection buyer) pays an ongoing periodic premium (and often an upfront payment as well) to another party (protection seller) in return for compensation upon the occurrence of a credit event with respect to the corporation or index referenced by such derivative contract. A credit event relating to a credit default swap on an individual corporation or an index of corporate names would typically be triggered by a corporation s bankruptcy or failure to make scheduled payments in respect of debt obligations. A total return swap is a derivative whereby one party makes payments to the other representing the total return on a reference debt or equity security (or index of debt or equity securities) in exchange for an agreed upon ongoing periodic premium. An equity option is a derivative that gives the holder the option to buy or sell an equity security or index of securities at a predetermined price within a certain time period. The option may reference the equity of a publicly traded company or an equity index. In addition to general market risk, our derivatives on corporate debt and equity securities are subject to risks related to the underlying corporate entities.

Other Assets

We also may from time to time opportunistically acquire other mortgage-related and financial assets that may include, among others: residential whole mortgage loans, CMBS, commercial mortgages or other commercial real estate debt and ABS backed by consumer and commercial assets.

Our Portfolio

As of June 30, 2010, our RMBS portfolio consisted of the following assets:

Asset Class	**Cost**	**Estimated Fair Value**	**Estimated Fair Value as a Percentage of Total Shareholders Equity**
Non-Agency RMBS	$ 244,750,275	$ 245,518,617	83.41%
Agency RMBS			
Agency RMBS-Whole pool pass-through certificates	420,639,387	427,220,689	145.14%
Agency RMBS-TBAs	211,590,090	212,536,525	72.21%
Agency RMBS-TBAs Sold Short	(721,847,422)	(728,063,164)	(247.35)%
Total	$ 155,132,330	$ 157,212,667	53.41%

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As of June 30, 2010, our derivatives portfolio consisted of the following derivatives:

Asset Class	Notional Amount	Estimated Fair Value	Value as a Percentage of Total Shareholders Equity
Long positions using credit default swaps on RMBS and CMBS Indices[1]	$ 58,125,334	$ (13,331,050)	(4.53)%
Short positions using credit default swaps on RMBS[2]	(138,101,934)	113,425,291	38.53%
Short positions using credit default swaps on RMBS and CMBS Indices[2]	(124,942,637)	31,489,932	10.70%
Short positions using credit default swaps on corporate bond indices[2]	(19,700,000)	171,597	0.06%
Short positions in interest rate swaps[3]	(48,000,000)	(1,214,536)	(0.41)%
Depreciated futures	N/A	(2,421,139)	(0.82)%
Total		$ 128,120,095	43.53%

(1) Long positions using credit default swaps represent transactions where we sold credit protection to a counterparty.
(2) Short positions using credit default swaps represent transactions where we purchased credit protection from a counterparty.
(3) For short positions in interest rate swaps, a fixed rate is being paid and a floating rate is being received.

The table below shows the credit rating categories from Moody s, Standard & Poor s or Fitch Ratings Ltd., respectively, for our long RMBS portfolio, including TBAs but excluding IOs, as of June 30, 2010; as well as our long investments that were unrated but affiliated with Fannie Mae, Freddie Mac or Ginnie Mae. Ratings tend to be a lagging credit indicator; as a result, the credit quality of our long investment holdings may be lower than the credit quality implied based on the ratings listed below. In situations where an investment has a split rating, the lowest provided rating is used.

Ratings Description	Current Principal	Estimated Fair Value	Average Price	Estimated Fair Value as a Percentage of Shareholders Equity
Unrated but Agency Affiliated	$ 602,936,447	$ 639,757,214	$ 106.11	217.35%
Aaa/AAA/AAA	30,797,630	23,795,893	77.27	8.08%
Aa/AA/AA	65,824,883	49,920,606	75.84	16.96%
A/A/A	26,323,376	18,804,707	71.44	6.39%
Baa/BBB/BBB	20,928,354	16,125,397	77.05	5.48%
Ba/BB/BB and below	228,738,424	128,185,495	56.04	43.55%
Unrated	241,277,990			0.00%

Investment Process

Our investment process benefits from the resources and professionals of our Manager and Ellington. The process is managed by an investment and risk management committee, which includes the following three officers of our Manager: Messrs. Vranos, Penn, and Tecotzky. These officers of our Manager also serve as our Co-Chief Investment Officer; Chief Executive Officer; and Co-Chief Investment Officer, respectively. The investment and risk management committee operates under investment guidelines and meets periodically to develop a set of preferences for sectors and sub-sectors. The primary focus of the investment and risk management committee is to review and approve our investment policies and our portfolio holdings and related compliance with our investment policies and guidelines. Our investment and risk management committee has authority delegated by our board to authorize transactions consistent with our investment guidelines. Any transactions deviating in a material way from these guidelines must be approved by our board.

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Ellington has a focused investment team for each of our targeted asset classes. Each team evaluates acquisition opportunities consistent with the guidelines developed and maintained by our Manager s investment and risk management committee. Our asset acquisition process includes sourcing and screening of asset acquisition opportunities, credit analysis, due diligence, structuring, financing and hedging, each as appropriate, to seek attractive total returns commensurate with our risk tolerance. We also screen and monitor all potential assets to determine their impact on maintaining our exclusion from regulation as an investment company under the Investment Company Act and our qualification as a partnership for U.S. federal income tax purposes.

Asset Surveillance

Our asset surveillance process benefits from the resources and professionals of our Manager and Ellington. Ellington performs security- and loan-level analysis of its holdings on a periodic and on-going basis by assessing collateral performance data, evaluating future expected performance, and observing market expectations. Such surveillance capabilities help identify securities or sectors that are performing anomalously. In addition, Ellington analyzes the collateral performance of a broad range of securities that it does not hold in order to monitor emerging trends across asset classes. For instance, Ellington performs surveillance on representative samples of actively traded securities, covering most residential MBS sectors and vintages. On a monthly basis, Ellington gathers data on each such representative sample from its third-party data providers, and produces detailed reports based on loan level information, including analyses of prepayment rates, flow rates, severities, delinquencies and loan modification effects. This process offers Ellington s trading and surveillance personnel additional insight into the Company s portfolio and potential asset acquisition opportunities. We believe that Ellington s surveillance capabilities provide it with a substantial advantage over most other market participants, and present a formidable barrier to entry for potential competitors.

Valuation of Assets

The value of our assets as used and reported in our financial statements is generally determined as follows:

If an asset is listed on a recognized exchange, such asset will be valued at its last available public sale price, or at the bid price for long positions and the offer price for short positions, as applicable. It is anticipated that only a small portion of our holdings may be so listed.

If a security is not listed on a recognized exchange, then such security will generally be valued using methodologies that include (i) the use of proprietary models that require the use of a significant amount of judgment and the application of various assumptions including, but not limited to, prepayment assumptions and default rate assumptions, and (ii) the solicitation of valuations from third parties (typically, broker-dealers). Third party valuation providers often utilize proprietary models that are highly subjective and also require the use of a significant amount of judgment and the application of various assumptions including, but not limited to, prepayment assumptions and default rate assumptions. Our Manager utilizes such information to assign a good faith valuation (the estimated price that would be received to sell an asset or paid to transfer a liability in an orderly transaction at the valuation date) to such financial instruments. Our Manager has been able to obtain third party valuations on the vast majority of our assets and expects to continue to solicit third party valuations on substantially all of our assets in the future to the extent practical. Our Manager uses its judgment, based on its own models, the assessments of its portfolio managers, and third party valuations it obtains, to determine and assign fair values to our Level 3 assets. We believe that third party valuations play an important role in ensuring that our Manager s valuation determinations are fair and reasonable. Our Manager s valuation process is subject to the oversight of the Manager s investment and risk management committee as well as the oversight of the independent members of our board of directors. Because of the inherent uncertainty of valuation, those estimated values may differ significantly from the values that would have been used had a ready market for the financial instruments existed, and the differences could be material to the consolidated financial statements. See Management s Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies Valuation.

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Risk Management

Risk management is a cornerstone of Ellington s portfolio management process. Ellington s risk management infrastructure system includes ELLiN, a proprietary trading and portfolio management system that Ellington uses for all of its accounts, which provides real time and batch reporting to all departments at Ellington, including trading, research, finance, operations, and accounting. We benefit from Ellington s comprehensive risk management infrastructure and ongoing assessment of both portfolio and operational risks. In addition, we utilize derivatives and other hedging instruments to opportunistically hedge our credit and interest rate risk.

Credit Risk Hedging

We enter into short positions using credit default swaps to protect against adverse credit events with respect to our non-Agency RMBS. We may use credit default swaps to hedge non-Agency RMBS credit risk by buying protection on a single non-Agency RMBS or by buying protection on a basket of non-Agency RMBS assets. We may also enter into credit default swaps on the ABX index, PrimeX or CMBX index. We also enter into derivative contracts for hedging purposes referencing the unsecured corporate credit, or the equity of, certain corporations.

Interest Rate Hedging

We opportunistically hedge our interest rate risk by using various hedging strategies to mitigate such risks. The interest rate hedging instruments that we use and may use in the future include, without limitation:

- Treasury securities;
- TBAs;
- interest rate swaps (floating-to-fixed, fixed-to-floating, or more complex swaps such as floating-to-inverse floating, callable or non-callable);
- swaptions, caps, floors and other derivatives on interest rates;
- futures and forward contracts; and
- options on any of the foregoing.

In particular, from time to time we enter into short positions in interest rate swaps to offset the potential adverse effects that changes in interest rates will have on the value of certain of our assets and our financing costs. An interest rate swap is an agreement to exchange interest rate cash flows, calculated on a notional principal amount, at specified payment dates during the life of the agreement. Typically one party pays a fixed interest rate and receives floating interest rate and the other party pays a floating interest rate and receives a fixed interest rate. Each party s payment obligation is computed using a different interest rate. In an interest rate swap, the notional principal is never exchanged.

Liquidity Management

As part of the risk management and liquidity management functions that our Manager performs for us, our Manager computes a cash buffer which at any given point in time represents the amount of our free cash in excess of what our Manager estimates would conservatively be required, especially in times of market dislocation, to support our particular assets and liabilities at such time. Thus, rather than focusing solely on our leverage, our Manager typically seeks to maintain a positive cash buffer.

Our Financing Strategies and Use of Leverage

We finance our assets with what we believe to be a prudent amount of leverage, the level of which varies from time to time based upon the particular characteristics of our portfolio, availability of financing and market

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conditions. Our borrowings currently consist solely of reverse repos. Currently, the majority of our reverse repo borrowings are collateralized by Agency RMBS; however, should the prospects for stable and reliable reverse repo financing for non-Agency RMBS continue to improve, we would expect to increase our reverse repo borrowings that are collateralized by non-Agency RMBS. In a reverse repo, we sell an asset to a counterparty at a discounted value, or the loan amount, and simultaneously agree to repurchase the same asset from such counterparty at a price equal to the loan amount plus an interest factor. Despite being legally structured as sales and subsequent repurchases, reverse repos are generally accounted for as debt secured by the underlying assets. During the term of a reverse repo, we generally receive the income and other payments distributed with respect to the underlying assets, and pay interest to the counterparty. While the proceeds of our reverse repo financings are often used to purchase the assets subject to the repo, our financing arrangements do not restrict our ability to use proceeds from these arrangements to support our other liquidity needs. Our reverse repo arrangements are typically documented under SIFMA s standard form Master Repurchase Agreement, with the ability for both parties to request margin. Given daily market volatility, we and our repo counterparties are required to post additional margin collateral to each other from time to time as part of the normal course of our business. Our reverse repo financing counterparties generally have the right to determine the value of the underlying collateral for margining purposes, subject to the terms and conditions of our agreement with the counterparty, including in certain cases our right to dispute the counterparty s valuation determination. As of June 30, 2010, we had approximately $428.2 million outstanding on reverse repos with seven counterparties. These borrowings were the only debt financings we had outstanding as of June 30, 2010, and, given that we had approximately $294.4 million of shareholders equity as of June 30, 2010, our debt-to-equity ratio was 1.45 to 1. Our debt-to-equity ratio does not account for liabilities other than debt financings.

The following table summarizes our reverse repos:

	Reverse Repurchase Agreements	
	Average Borrowed Funds During Period	**Borrowed Funds Outstanding at End of Period**
June 30, 2010	$ 481,025,553	$ 428,169,799
December 31, 2009	$ 368,176,286	$ 559,978,100
December 31, 2008	$ 165,616,083	$ 260,534,000

The difference between average amounts borrowed during the years ended December 31, 2009 and 2008, and the respective amounts outstanding at the end of each period reflect our increased investment holdings as well as our increased use of leverage to acquire investments in Agency and non-Agency RMBS. During the six month period ended June 30, 2010, we slightly decreased our investment holdings as well as our use of leverage.

The following table summarizes our reverse repos by counterparty as of June 30, 2010:

Counterparty	**Outstanding Borrowings**	**Range of Borrowing Rates**	**Range of Maturity Dates**	**Estimated Fair Value of Collateral**
Bank of America	$ 108,969,000	0.27% to 2.46%	14 to 84 days	$ 121,450,273
Barclays	22,563,000	1.54% to 2.29%	6 to 85 days	33,835,076
Credit Suisse Group	96,043,000	0.25% to 1.75%	1 to 55 days	107,661,428
Deutsche Bank AG	47,456,000	0.29% to 2.10%	7 to 43 days	53,555,316
Jefferies Group	16,063,000	2.35% to 2.35%	12 days	23,719,424
Morgan Stanley	120,577,799	0.27% to 2.50%	1 to 71 days	138,428,211
Royal Bank of Scotland	16,498,000	1.53% to 2.31%	13 to 91 days	22,916,628
	$ 428,169,799			$ 501,566,356

We may utilize other types of borrowings in the future, including term facilities or other more complex financing structures. Additionally, we may also take advantage of available borrowings, if any, under new programs established by the Federal Government to finance our assets. We also may raise capital by issuing unsecured debt, preferred or common shares, or trust preferred securities.

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Our use of leverage, especially in order to increase the amount of assets supported by our capital base, may have the effect of increasing losses when these assets underperform. Our investment policies require no minimum or maximum leverage and our Manager s investment and risk management committee will have the discretion, without the need for further approval by our board of directors, to change both our overall leverage and the leverage used for individual asset classes. Because our strategy is flexible, dynamic and opportunistic, our overall leverage will vary over time. As a result, we do not have a targeted debt-to-equity ratio.

Conflicts of Interest; Equitable Allocation of Opportunities

Ellington manages, and expects to continue to manage, other funds, accounts and vehicles that have strategies that are similar to, or that overlap with, our strategy. As of June 30, 2010, Ellington managed various funds, accounts and other vehicles that have strategies that are similar to, or that overlap with, our strategy, that have aggregate net assets of approximately $2.5 billion (excluding our assets). Ellington makes available to our Manager all opportunities to acquire assets that it determines, in its reasonable and good faith judgment, based on our objectives, policies and strategies, and other relevant factors, are appropriate for us in accordance with Ellington s written investment allocation procedures and policies, subject to the exception that we might not participate in each such opportunity, but will on an overall basis equitably participate with Ellington s other accounts in all such opportunities. Ellington s investment and risk management committee and its compliance committee (headed by its Chief Compliance Officer) are responsible for monitoring the administration of, and facilitating compliance with, Ellington s investment allocation procedures and policies.

Because many of our targeted assets are typically available only in specified quantities and because many of our targeted assets are also targeted assets for other Ellington accounts, Ellington often is not able to buy as much of any given asset as required to satisfy the needs of all its accounts. In these cases, Ellington s investment allocation procedures and policies typically allocate such assets to multiple accounts in proportion to their needs and available capital. As a result, accounts in start-up mode are given priority. The policies permit departure from such proportional allocation when such allocation would result in an inefficiently small amount of the security being purchased for an account. In that case, the policy allows for a protocol of allocating assets so that, on an overall basis, each account is treated equitably.

Other policies of Ellington that our Manager will apply to the management of our company include controls for:

Cross Transactions defined as transactions between us or one of our subsidiaries, on the one hand, and an account (other than us or one of our subsidiaries) managed by Ellington or our Manager, on the other hand. It is Ellington s policy to engage in a cross transaction only when the transaction is in the best interests of, and is consistent with the objectives and policies of, both accounts involved in the transaction. Ellington or our Manager may enter into cross transactions where it acts both on our behalf and on behalf of the other party to the transaction. Upon written notice to our Manager, we may at any time revoke our consent to our Manager s executing cross transactions. Additionally, unless approved in advance by a majority of our independent directors or pursuant to and in accordance with a policy that has been approved by a majority of our independent directors, all cross transactions must be effected at the then-prevailing market prices. Pursuant to our Manager s current policies and procedures, assets for which there are no readily observable market prices may be purchased or sold in cross transactions (i) at prices based upon third party bids received through auction, (ii) at the average of the highest bid and lowest offer quoted by third party dealers, or (iii) according to another pricing methodology approved by our Manager s chief compliance officer.

Principal Transactions defined as transactions between Ellington or our Manager (or any related party of Ellington or our Manager, which includes employees of Ellington and our Manager and their families), on the one hand, and us or one of our subsidiaries, on the other hand. Certain cross transactions may also be considered principal transactions whenever our Manager, Ellington (or any related party of Ellington or our Manager, which includes employees of Ellington and our Manager and their families) have a substantial ownership interest in one of the transacting parties. Our Manager is only authorized to execute

principal transactions with the prior approval of a majority of our independent directors and in accordance with applicable law. Such prior approval includes approval of the pricing methodology to be used, including with respect to assets for which there are no readily observable market prices.

Investment in other Ellington accounts pursuant to our management agreement, although we have not done so to date, if we invest at issuance in the equity of any CDO that is managed, structured or originated by Ellington or one of its affiliates, or if we invest in any other investment fund or other investment for which Ellington or one of its affiliates receives management, origination or structuring fees, the base management and incentive fees payable by us to our Manager will be reduced by an amount equal to the applicable portion (as described in the management agreement) of any related management fees, origination fees or structuring fees payable to our Manager.

Split price executions pursuant to our management agreement, our Manager is authorized to combine purchase or sale orders on our behalf together with orders for other accounts managed by Ellington, our Manager or their affiliates and allocate the securities or other assets so purchased or sold, on an average price basis or other fair and consistent basis, among such accounts.

To date, we have not entered into any cross transactions with other Ellington-managed accounts, principal transactions with Ellington or invested in other Ellington accounts.

Our Manager is authorized to follow very broad investment guidelines. Our independent directors will periodically review our investment guidelines and our portfolio. However, our independent directors generally will not review our proposed asset acquisitions, dispositions or other management decisions. In addition, in conducting periodic reviews, the independent directors will rely primarily on information provided to them by our Manager. Furthermore, our Manager may arrange for us to use complex strategies or to enter into complex transactions that may be difficult or impossible to unwind by the time they are reviewed by our board of directors. Our Manager has great latitude within our broad investment guidelines to determine the types of assets it may decide are proper for purchase by us. The management agreement with our Manager does not restrict the ability of its officers and employees from engaging in other business ventures of any nature, whether or not such ventures are competitive with our business. We may acquire assets from entities affiliated with our Manager, even where the assets were originated by such entities. Affiliates of our Manager may also provide services to entities in which we have invested.

Our executive officers and the officers and employees of our Manager are also officers and employees of Ellington, and, with the exception of those officers that are dedicated to us, we compete with other Ellington accounts for access to these individuals. We have not adopted a policy that expressly prohibits our directors, officers, security holders or affiliates from having a direct or indirect pecuniary interest in any asset to be acquired or disposed of by us or any of our subsidiaries or in any transaction to which we or any of our subsidiaries is a party or has an interest, nor do we have a policy that expressly prohibits any such persons from engaging for their own account in business activities of the types conducted by us. However, our code of business conduct and ethics contains a conflicts of interest policy that prohibits our directors, officers and employees, as well as employees of our Manager who provide services to us, from engaging in any transaction that involves an actual or apparent conflict of interest with us, absent approval by the board of directors or except as expressly set forth above or as provided in the management agreement between us and our Manager. In addition, nothing in the management agreement binds or restricts our Manager or any of its affiliates, officers or employees from buying, selling or trading any securities or commodities for their own accounts or for the accounts of others for whom our Manager or any of its affiliates, officers or employees may be acting.

Policies with Respect to Certain Other Activities

If our board of directors determines that additional funding is required, we may raise such funds through additional offerings of equity or debt securities, the retention of cash flow and other funds from debt financing, including reverse repos, or a combination of these methods. In the event that our board of directors determines to

raise additional equity capital, it has the authority, without shareholder approval, to issue additional common shares or preferred shares in any manner and on such terms and for such consideration as it deems appropriate, at any time.

We have not in the past, but may in the future, offer equity or debt securities in exchange for assets.

We have not invested in the past in the securities of other issuers for the purpose of exercising control over such entities, but we may do so in the future.

We engage in the purchase and sale of assets. We have in limited circumstances in the past, and may in the future, make loans to third parties. We have not in the past and will not in the future underwrite the securities of other issuers.

We have furnished and intend to continue to furnish our shareholders with annual reports containing consolidated financial statements audited by our independent certified public accountants and with quarterly reports containing unaudited consolidated financial statements for each of the first three quarters of each fiscal year.

Our board of directors may change any of these policies without prior notice to you or a vote of our shareholders.

Competition

In acquiring our assets, we compete with mortgage REITs, specialty finance companies, savings and loan associations, banks, mortgage bankers, insurance companies, mutual funds, institutional investors, investment banking firms, financial institutions, governmental bodies and other entities. Many of our competitors are significantly larger than us, have greater access to capital and other resources and may have other advantages over us. In addition to existing companies, other companies may be organized for similar purposes, including companies focused on purchasing mortgage assets. A proliferation of such companies may increase the competition for equity capital and thereby adversely affect the market value of our common shares. In addition, some of our competitors may have higher risk tolerances or different risk assessments, which could allow them to consider a wider variety of assets and establish more relationships than us.

Additionally, we may also compete with (i) the Federal Reserve and the Treasury to the extent they purchase assets meeting our objectives pursuant to various purchase programs and (ii) companies that partner with and/or receive financing from the Federal Government, including TALF and PPIP participants. See Management s Discussion and Analysis of Financial Condition and Results of Operations Trends and Recent Market Developments.

In the face of this competition, we have access to our Manager s and Ellington s professionals and their industry expertise, which may provide us with a competitive advantage and help us assess risks and determine appropriate pricing for certain potential assets. In addition, we believe that these relationships enable us to compete more effectively for attractive asset acquisition opportunities. However, we may not be able to achieve our business goals or expectations due to the competitive risks that we face.

Operating and Regulatory Structure

Tax Requirements

We believe that we have been organized and have operated so that we have qualified, and will continue to qualify, to be treated for U.S. federal income tax purposes as a partnership and not as an association or a publicly traded partnership taxable as a corporation. In general, an entity that is treated as a partnership for U.S. federal income tax purposes is not subject to U.S. federal income tax at the entity level. Consequently, as a holder of our common shares, you will be required to take into account your allocable share of items of our income, gain, loss, deduction and credit for our taxable year ending within or with your taxable year, regardless of whether we make

cash distributions on a current basis with which to pay any resulting tax. We believe that we are treated, and will continue to be treated, as a publicly traded partnership. Publicly traded partnerships are generally treated as partnerships for U.S. federal income tax purposes as long as they satisfy certain income and other tests on an ongoing basis. We believe that we have satisfied and will continue to satisfy those requirements and that we have been and will continue to be treated as a partnership for U.S. federal income tax purposes. See Material U.S. Federal Income Tax Considerations.

Investment Company Act Exclusions

Most of our business is conducted through various wholly-owned and majority-owned subsidiaries in a manner such that neither we nor our subsidiaries are subject to regulation under the Investment Company Act. Under Section 3(a)(1) of the Investment Company Act, a company is deemed to be an investment company if:

- it is, or holds itself out as being, engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting or trading in securities (Section 3(a)(1)(A)); or
- it is engaged or proposes to engage in the business of investing, reinvesting, owning, holding or trading in securities and does own or proposes to acquire investment securities having a value exceeding 40% of the value of its total assets (excluding U.S. Government securities and cash) on an unconsolidated basis, or the 40% Test. Investment securities excludes U.S. Government securities and securities of majority-owned subsidiaries that are not themselves investment companies and are not relying on the exception from the definition of investment company for private funds under Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act.

We believe we will not be considered an investment company under Section 3(a)(1)(A) of the Investment Company Act because we will not engage primarily or hold ourself out as being engaged primarily in the business of investing, reinvesting or trading in securities. Rather, through wholly-owned or majority-owned subsidiaries, we will be primarily engaged in the non-investment company businesses of these subsidiaries.

The 40% Test limits the types of businesses in which we may engage either directly or through our subsidiaries. Our wholly-owned subsidiary, EF Mortgage LLC, relies on the exclusion provided by Section 3(c)(5)(C) under the Investment Company Act. It, in turn, has a wholly-owned subsidiary, EF CMO LLC, which invests in mortgage-related securities and relies on Section 3(c)(7) of the Investment Company Act. EF Mortgage LLC treats its investment in EF CMO LLC as a real estate-related asset for purposes of its own exclusion under Section 3(c)(5)(C). Our other wholly-owned subsidiary, EF Securities LLC, owns securities, including various kinds of mortgage-related securities and relies on the exemption provided by Section 3(c)(7) of the Investment Company Act; therefore, we treat securities that we own and that were issued by EF Securities LLC as investment securities and are required to keep the value of these securities, together with any other investment securities we own, below 40% of our total assets (excluding U.S. Government securities and cash) on an unconsolidated basis. Any subsidiaries we may form in the future may not be majority-owned or wholly-owned by us or might rely on the exemption provided by Section 3(c)(1) or 3(c)(7) of the Investment Company Act, in which case we would treat securities that we own and that were issued by these types of subsidiaries as investment securities and be required to keep the value of these securities, together with the value of our investment in EF Securities LLC and any other investment securities we own, below 40% of our total assets (excluding U.S. Government securities and cash) on an unconsolidated basis.

Section 3(c)(5)(C), the Investment Company Act exclusion upon which EF Mortgage LLC relies, is designed 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 the entity s assets consist of qualifying real estate assets and at least 80% of the entity s assets consist of either qualifying real estate assets or real estate-related assets. Qualifying real estate assets for this purpose include mortgage loans, whole pool Agency pass-through certificates and other assets that the SEC staff has determined in various no-action letters are the functional equivalent of mortgage loans for the purposes of the Investment Company Act. We intend to treat as real estate-related assets RMBS that do not satisfy the conditions set forth in those SEC

staff no-action letters. In classifying the assets held by EF Mortgage LLC as qualifying real estate assets or real estate-related assets, we also will rely on any other guidance published by the SEC staff or on our analyses (in consultation with outside counsel) of guidance published with respect to other types of assets to determine which assets are qualifying real estate assets and real estate-related assets.

Both the 40% Test and the requirements of the Section 3(c)(5)(C) exclusion limit the types of businesses in which we may engage and the types of assets we may hold, as well as the timing of sales and purchases of assets.

There can be no assurance that the laws and regulations governing the Investment Company Act status of companies similar to ours, or the guidance from the Division of Investment Management of the SEC regarding the treatment of assets as qualifying real estate assets or real estate-related assets, will not change in a manner that adversely affects our operations. To the extent that the SEC staff provides more specific guidance regarding any of the matters bearing upon our exclusion from the need to register under the Investment Company Act, we may be required to adjust our strategy accordingly. Any additional guidance from the SEC staff could provide additional flexibility to us, or it could further inhibit our ability to pursue the strategies that we have chosen. Furthermore, although we intend to monitor the assets of EF Mortgage LLC regularly, there can be no assurance that EF Mortgage LLC will be able to maintain this exclusion from registration. In that case, our investment in EF Mortgage LLC would be classified as an investment security, and we might not be able to maintain our overall exclusion from registering as an investment company under the Investment Company Act.

If we or our subsidiaries were required to register as an investment company under the Investment Company Act, we would become subject to substantial regulation with respect to our capital structure (including our ability to use leverage), management, operations, transactions with affiliated persons (as defined in the Investment Company Act), and portfolio composition, including restrictions with respect to diversification and industry concentration and other matters. Compliance with the restrictions imposed by the Investment Company Act would require us to make material changes to our strategy which could materially adversely affect our business, financial condition and results of operations and our ability to make distributions to our shareholders. Accordingly, to avoid that result, we may be required to adjust our strategy, which could limit our ability to make certain investments or require us to sell assets in a manner, at a price or at a time that we otherwise would not have chosen. This could negatively affect the value of our common shares, the sustainability of our business model and our ability to make distributions.

Investment Advisers Act of 1940

Both Ellington and our Manager are registered as investment advisers under the Advisers Act and are subject to the regulatory oversight of the Investment Management Division of the SEC.

Staffing

All of our executive officers, including our dedicated Chief Financial Officer and our dedicated controller, and a dedicated in-house counsel, if our Manager elects to provide such officer, are or will be employees of Ellington or one or more of its affiliates. See Management Management Agreement.

Legal Proceedings

Neither we nor our Manager is currently subject to any legal proceedings that we or our Manager considers to be material. Nevertheless, we, our Manager and Ellington operate in highly regulated markets that currently are under intense regulatory scrutiny, and Ellington and its affiliates have received, and we expect in the future may receive, inquiries and requests for documents and information from various federal, state and foreign regulators. In the past these have included:

In June 2007, Ellington received an informal inquiry from the SEC requesting documents and other information relating to trading in credit default swaps on the ABX indices. Ellington provided documents to the SEC staff in August 2007 and Ellington has had no communication with the SEC on the matter since that time.

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In November 2006, Ellington received a request from the SEC that it produce documents relating to trading of collateralized mortgage obligations, or CMOs, between Ellington and a third party broker-dealer as well as individuals associated with that broker-dealer, and Ellington produced documents to the SEC consistent with that request. In July 2007, Ellington received a subpoena from the SEC requesting documents relating to trading in CMOs by these individuals and firms they were affiliated with, including that broker-dealer. Ellington responded to that subpoena in August 2007, and has had no communication with the SEC on the matter since that time. The SEC filed complaints in May 2009 and December 2009 against, respectively, certain former employees of the broker-dealer, and the broker-dealer and its CEO, alleging fraud in their marketing of CMOs to their clients.

In August 2007, Ellington received a subpoena from the New York Attorney General, or the NYAG, requesting documents and other information from Ellington about its and its affiliates mortgage loan servicing activities. Ellington informed the NYAG that it did not engage in mortgage loan servicing. Ellington subsequently received subpoenas for documents and information relating to Ellington s residual or equity interests in mortgage securitization trusts; communications with and information received from mortgage servicers relating to these trusts and their underlying mortgage loans; and trading in bonds of these trusts and related credit default swaps, and for documents and other information relating to communications with and information received from one of its vendors, which had performed asset surveillance for Ellington on these trusts. Ellington completed its response to the NYAG subpoenas in June 2008 and has had no communication with the NYAG since that time.

In March 2008, Ellington received a subpoena from the SEC requesting documents and other information relating primarily to CDOs underwritten during 2007 and 2008 by a particular investment bank and for which Ellington acted as collateral manager. Ellington provided an initial response to the subpoena in April 2008 and finished its production in May 2009. Ellington has had no communication with the SEC on the matter since that time.

In August 2009, Ellington and one of its affiliates received subpoenas from the SEC seeking documents and information regarding certain structuring, sales and marketing practices in the CDO market. The subpoenas seek documents and details regarding CDOs in which Ellington or its affiliates participated during 2006 and 2007. Ellington finished its production in response to the subpoenas in November 2009, responded to subsequent requests by the SEC for clarifications with respect to some of the information that Ellington produced to the SEC and intends to cooperate with any further requests.

In May 2010, Ellington received a request for documents and responses to interrogatories from the Financial Crisis Inquiry Commission, or the FCIC, a commission recently formed to examine the causes of the current financial and economic crisis in the United States and report thereon to the Congress and the President, relating to Ellington s CDO business during the period from January 2000 through the present. Ellington produced documents on May 28, 2010 in response to the FCIC s request and intends to cooperate with any further requests.

Ellington has advised us that, at the present time, it is not aware that any material legal proceeding against Ellington and its affiliates is contemplated in connection with any of the foregoing inquiries or requests. However, we believe that scrutiny of CDO market participants (including large CDO collateral managers such as Ellington) has intensified recently. We believe this intensified scrutiny increases the risk of additional inquiries and requests from regulatory or enforcement agencies. Ellington and we cannot provide any assurance that these inquiries and requests will not result in further investigation of or the initiation of a proceeding against Ellington or its affiliates or that, if any such investigation or proceeding were to arise, it would not materially adversely affect our company.

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OUR MANAGER

Overview

Our Manager is an affiliate of Ellington. Ellington is a private investment management firm and registered investment advisor specializing in fixed income strategies, with an emphasis on the RMBS market.

Our Manager is responsible for administering our business activities and day-to-day operations and, pursuant to a services agreement between our Manager and Ellington, relies on the resources of Ellington to support our operations. Ellington has established portfolio management resources for each of our targeted asset classes and an established infrastructure supporting those resources. Through our relationship with our Manager, we benefit from Ellington s highly analytical investment process, broad-based deal flow, extensive relationships in the financial community, financial and capital structuring skills, investment surveillance database, and operational expertise. Ellington s analytic approach to the investment process involves collection of substantial amounts of data regarding historical performance of MBS collateral and MBS market transactions. Ellington analyzes this data to identify possible trends and develops financial models used to support the investment and risk management process. In addition, throughout Ellington s 15-year history of investing in MBS and related derivatives it has developed strong relationships with a wide range of dealers and other market participants that provide Ellington access to a broad range of trading opportunities and market information. In addition, our Manager provides us with access to a wide variety of asset acquisition and disposition opportunities and information that assists us in making asset management decisions across our targeted asset classes, which we believe provides us with a significant competitive advantage. We also benefit from Ellington s finance, accounting, operational, legal, compliance and administrative functions.

As of June 30, 2010, Ellington employed over 100 employees, and, including our company, various hedge funds, and various private accounts, had net assets under management of approximately $2.8 billion. In addition, Ellington, through its affiliates, manages CDOs collateralized by MBS or ABS, as well as a traditional managed account.

Throughout its 15-year history, Ellington has participated in virtually all sectors of the MBS and ABS markets. Early on in its history, Ellington invested primarily in CMO prepayment and interest rate derivatives such as IOs, IIOs, POs and inverse floaters. Since then, Ellington has dramatically broadened its investment scope and strategies to include a wide spectrum of asset-backed sectors, including RMBS and CMBS, and, within RMBS:

- RMBS representing all parts of the credit spectrum, from AAA securities down to unrated, first-loss securities;
- RMBS backed by fixed rate mortgages, ARMs and hybrid ARMs indexed to a wide variety of indices;
- Agency RMBS and non-Agency RMBS backed by prime jumbo, Alt-A and subprime mortgage loans; and
- credit default swaps on debt tranches of RMBS.

Ellington has extensive experience in, and actively seeks investment opportunities in, all of these sectors. By establishing and maintaining expertise in a wide variety of MBS sectors, Ellington believes that it can identify those sectors in which the greatest opportunities exists, and therefore be able to adapt and rotate its strategies over time to produce more consistent performance across market cycles.

Ellington s investment strategies, which we believe are applicable to us, rely on two key components:

- the ability to identify and purchase securities that are either fundamentally undervalued or provide relative value versus other fixed income instruments; and

an intensive analytical approach to risk management.

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Our Manager has an investment and risk management committee that advises and consults with our senior management team with respect to, among other things, our investment policies, portfolio holdings, financing and hedging strategies and investment guidelines. The members of the investment and risk management committee include Messrs. Vranos, Penn, and Tecotzky.

Our Manager s and Ellington s Employees

Through 15 years of operational experience as an investment advisor, Ellington has built significant portfolio management and infrastructure resources to support its numerous funds and large asset base. Therefore, we believe that Ellington s portfolio management resources and infrastructure are scalable to service our activities.

Ellington s 14 principals have an average of over 21 years of industry experience; its Chief Executive Officer and three Vice Chairmen have an average of over 25 years of industry experience. One of the strengths of the Ellington portfolio management team is the strength of its senior management team; summary biographies of certain of these individuals are as follows:

Name/position at Ellington	Age	Background summary
Michael W. Vranos *Founder & Chief Executive Officer*	49	Mr. Vranos is the founder and Chief Executive Officer of Ellington. Mr. Vranos is also the Chief Executive Officer and President of our Manager and serves on our Manager s investment and risk management committee. Mr. Vranos has been our Co-Chief Investment Officer since June 2009. Mr. Vranos has served as a member of our board of directors since August 2007, and from August 2007 until October 2009 Mr. Vranos served as our Chairman. Mr. Vranos founded Ellington in December of 1994 to capitalize on distressed conditions in the MBS derivatives market. Until December 1994, Mr. Vranos was a Senior Managing Director at Kidder Peabody in charge of RMBS trading. Mr. Vranos graduated magna cum laude, Phi Beta Kappa with a B.A. in Mathematics from Harvard University.
Laurence Penn *Vice Chairman*	48	Mr. Penn is a Vice Chairman of Ellington, where he helps oversee many functions of the firm, including trading, risk management, and new business. Mr. Penn is also the Executive Vice President of our Manager and serves on our Manager s investment and risk management committee. Mr. Penn has been our Chief Executive Officer and has served as a member of our board of directors since August 2007. In Ellington s earlier years, Mr. Penn was the senior portfolio manager primarily responsible for investments in Agency RMBS and was also responsible for monitoring and updating the risk measures associated with all MBS assets in the funds. Prior to joining Ellington in 1995 shortly after its inception, Mr. Penn was at Lehman Brothers where he was a Managing Director and co-head of CMO origination and trading. Mr. Penn specialized in the trading and risk-management of CMO derivatives. Prior to trading CMOs and CMO derivatives, Mr. Penn was in charge of Lehman Brothers structured transaction modeling group from 1987 to 1990, where he was responsible for the structuring, modeling and computer system design for MBS and ABS. Mr. Penn began his career at Lehman Brothers in 1984, after receiving a Certificate of Advance Study in Mathematics from Cambridge University, where he studied as both a National Science Foundation and Winston Churchill Fellow. Mr. Penn graduated summa cum laude, Phi Beta Kappa with a B.A. in Mathematics from Harvard University.

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Name/position at Ellington	Age	Background summary
Richard Brounstein *Vice Chairman*	50	Mr. Brounstein is a Vice Chairman and the Director of Investor Relations at Ellington. Prior to joining Ellington in 2000, Mr. Brounstein was the Managing Director responsible for the Fixed Income Securities division at Société Générale Securities Corporation, later renamed S.G. Cowen Securities Corporation. In this capacity, Mr. Brounstein was responsible for supervising all aspects of risk management, market making, proprietary trading, distribution and finance related activities. In addition to his direct responsibilities for the Fixed Income Division, Mr. Brounstein was a member of the Risk Management committee at Société Générale Securities Corporation. Prior to joining Société Générale Securities Corporation, Mr. Brounstein was the Managing Director responsible for the Mortgage-Backed Securities Division at the Union Bank of Switzerland. Later he was given responsibilities for the supervision of distribution/placement of all Fixed Income Securities. Prior to joining the Union Bank of Switzerland, Mr. Brounstein worked with Messrs. Vranos and other Ellington employees at Kidder Peabody. Mr. Brounstein received a M.A. from Columbia University and a B.A. from Fairleigh Dickinson University.
John Geanakoplos *Managing Director*	55	Professor Geanakoplos is a Managing Director at Ellington, where he is the Head of Research and Development and is responsible for the design of computer models to evaluate and hedge the firm s portfolio. Professor Geanakoplos is largely responsible for the theoretical framework of Ellington s proprietary prepayment model and interest rate model. From 1992 until joining Ellington in 1995, Professor Geanakoplos was a Managing Director of Kidder Peabody, where he was head of the Fixed Income Research Department. In this capacity, he led the design of the firm s proprietary MBS analytical systems. He became a full Professor at Yale University in 1986, at the age of 30, and is currently the James Tobin Professor of Economics and Director of the Cowles Foundation for Research in Economics. He was elected a fellow of the Econometric Society in 1990 and of the American Academy of Arts and Sciences in 1999. He was awarded the Samuelson Prize in 1999, and was awarded the first Bodossaki Prize in economics in 1995. In 1990 and again in 2000, he directed the economics program at the Santa Fe Institute, where he remains an external professor. Professor Geanakoplos graduated summa cum laude, Phi Beta Kappa with a B.A. in Mathematics from Yale University and received a M.A. in Mathematics and a Ph.D. in economics from Harvard University.
Robert Kinderman *Managing Director*	34	Mr. Kinderman is a Managing Director at Ellington where he is responsible for trading credit-sensitive securities, including CMBS, ABS, and subordinated RMBS. Mr. Kinderman also serves on our Manager s investment and risk management committee. He started full-time with Ellington in 1998, developing credit models as well as pieces of Ellington s proprietary portfolio management systems, and is currently the head trader for all credit-sensitive mortgage-backed and asset-backed investments at Ellington. He also helps direct the development of research, modeling and systems for credit-sensitive products. Mr. Kinderman earned a B.A. from Yale with distinction in Economics and in Mathematics.

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Name/position at Ellington	Age	Background summary
Peter Green	31	Mr. Green is a Managing Director at Ellington where he heads the Risk Management department, which helps monitor, measure, and manage liquidity, market, credit, operational, and other risks. Mr. Green also serves on our Manager s investment and risk management committee. At Ellington, Mr. Green oversees the development of the firm s many risk management tools adapted to the particular needs of Ellington s investment strategies. Over his career at Ellington, Mr. Green has performed a wide variety of roles at the firm, including assisting in the development of Ellington s interest rate and RMBS credit models, formulating hedging strategies, supporting new business initiatives, and helping design many of the computer systems that support the firm s specific portfolio management and operational needs. Mr. Green holds a Ph.D. in Pure Mathematics from Harvard University and a B.Sc. from McGill University.
Thomas Larkin *Chief Operating Officer &* *Managing Director*	46	Mr. Larkin is the Chief Operating Officer of Ellington, where he oversees most of the operational and financial functions of the firm. He has over 20 years of experience in the investment management industry with a primary focus in hedge funds and private equity funds. From 1997 until joining Ellington in 2004, Mr. Larkin served as Chief Financial Officer of Resurgence Asset Management, or Resurgence, a SEC-registered investment advisory firm specializing in securities of financially distressed companies. At Resurgence, Mr. Larkin oversaw accounting, reporting, taxation, operations, human resources and information systems. Prior to joining Resurgence, he was the Controller of Concord International Investments Group, a multinational investment management firm. Mr. Larkin started his career at Ernst & Young, where he provided auditing and consulting services to companies in a variety of industries, including private investment funds, commodity trading advisors, mutual funds, and oil and gas concerns. Mr. Larkin received a B.S. in Accounting from Boston College. He became a CPA in 1989.
Daniel Margolis *General Counsel*	37	Mr. Margolis is Ellington s General Counsel. Mr. Margolis has been our Secretary since July 2010. As General Counsel for Ellington, he is responsible for advising Ellington on all legal, regulatory, compliance, documentation and litigation matters. Prior to joining Ellington, Mr. Margolis was a Partner at Pillsbury, Winthrop, Shaw, Pittman LLP and before that was a Junior Partner at Wilmer, Cutler, Pickering, Hale and Dorr LLP. In both positions, Mr. Margolis represented corporations and individuals, including financial services organizations, in criminal and regulatory investigations and in complex civil litigation. From 2000 to 2004, he served as an Assistant United States Attorney in the United States Attorney s Office for the Southern District of New York where he prosecuted a variety of white collar crimes including securities fraud, investment fraud, tax fraud and money laundering. In 2004, he received the John Marshall Award, the Department of Justice s highest award for excellence in legal performance. He has a J.D. from New York University Law School, where he graduated cum laude, and a B.A. from Binghamton University where he graduated magna cum laude with highest honors in Political Science and was a member of Phi Beta Kappa.

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Name/position at Ellington	Age	Background summary
Vassilios Nikos Nicopoulos *Managing Director*	49	Mr. Nicopoulos is a Managing Director at Ellington and is responsible for the mathematical modeling and computer implementation of Ellington s interest rate and hedging models, and their use in valuing, hedging and managing the risk of MBS. Mr. Nicopoulos joined Ellington from Oxford University in England, where he was an Assistant Professor in Theoretical Condensed Matter Physics. His work focused on the complex behavior of interacting electronic systems. He has had extensive experience in the simulation and analysis of complex stochastic systems on workstations and supercomputers and has built an international reputation for research relevant to real-world physics problems. Mr. Nicopoulos graduated magna cum laude, Phi Beta Kappa with a B.A. in Physics from Harvard University, and also holds M.A. and Ph.D. degrees in Theoretical Physics from Princeton University. Prior to his position at Oxford, he was a researcher and consultant at Los Alamos National Laboratory.
David Rice *Chief Compliance Officer*	41	Mr. Rice is Ellington s Chief Compliance Officer and chairs the firm s Compliance Committee. He is responsible for implementation of Ellington s compliance program. Prior to joining Ellington, he served as Associate General Counsel, Compliance at GSC Group. From 2002-2007 he served in the Division of Enforcement at the Securities and Exchange Commission in Washington, D.C., where he worked on investigations involving hedge funds, broker-dealers, investment companies, and public and private companies. He has a J.D. from Yale Law School, a Ph.D. in English from the University of California, Irvine, and graduated Phi Beta Kappa, summa cum laude, with a B.A. in English and Philosophy from the University of Southern California.
Mark Tecotzky *Managing Director*	48	Mr. Tecotzky is a Managing Director of Ellington, and head manager for all MBS/ABS credit, reporting directly to Mr. Vranos. Mr. Tecotzky also serves as the Chief Investment Officer of Ellington Global Asset Management LLC and our Manager and serves on our Manager s investment and risk management committee. Mr. Tecotzky has been our Co-Chief Investment Officer since March 2008. Prior to joining Ellington in July 2006, Mr. Tecotzky was the senior trader in the mortgage department at Credit Suisse. He developed and launched several of its securitization vehicles, including hybrid ARMs and second liens, and subsequently ran its hybrid ARM business, including conduit pricing, servicing sales, monthly securitization, trading of Agency/non-Agency hybrids of all ratings categories and managing and hedging the residual portfolio. Prior to joining Credit Suisse, Mr. Tecotzky worked with Mr. Vranos and many of the other Ellington principals at Kidder Peabody, where he traded Agency and non-Agency pass-throughs and structured CMOs as a Managing Director. Mr. Tecotzky holds a B.S. from Yale University, and received a National Science Foundation fellowship to study at MIT.

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Name/position at Ellington	Age	Background summary
Lisa Mumford *Chief Financial Officer of the Company*	47	Ms. Mumford has served as the Chief Financial Officer of our Manager and as our Chief Financial Officer since October 2009. Prior to joining our Manager, and since August 2008, Ms. Mumford was Chief Financial Officer of ACA Financial Guaranty Corporation, or ACA FG, where she oversaw all aspects of the finance and accounting operations. Prior to August 2008, ACA FG was an operating subsidiary of ACA Capital Holdings, Inc., or ACA, and from 2003 until this period, Ms. Mumford served as the Chief Accounting Officer. While at ACA, Ms. Mumford oversaw all aspects of the accounting, internal control, and financial reporting process. Prior to joining ACA, and beginning in 1988, Ms. Mumford was with ACE Guaranty Corp., where over her tenure, she held the positions of Chief Financial Officer and Controller. She began her career as a staff accountant with Coopers & Lybrand in 1984, culminating in the role of Audit Supervisor at the time of her departure in 1988. Ms. Mumford is a member of the American Institute of Certified Public Accountants and holds a B.B.A. in Accounting from Hofstra University.

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MANAGEMENT

Directors and Executive Officers

Our board of directors consists of five directors. Of these five directors, three are considered independent in accordance with the requirements of the New York Stock Exchange, Inc., or NYSE. See Corporate Governance Board of Directors and Committees.

Each member of our board of directors serves for a term that commenced at our 2010 Annual Meeting of Shareholders and expires at the 2011 Annual Meeting of Shareholders or at such time as their respective successors are elected and qualified. All of our executive officers, including our dedicated Chief Financial Officer, dedicated controller and, if provided by our Manager, dedicated in-house counsel are or will be employees of Ellington or one or more of its affiliates. The following table sets forth certain information about our directors and executive officers.

Name	Age	Position With Us
Michael W. Vranos	49	Co-Chief Investment Officer and Director
Laurence Penn	48	Chief Executive Officer, President and Director
Daniel Margolis	37	Secretary
Lisa Mumford	47	Chief Financial Officer
Mark Tecotzky	48	Co-Chief Investment Officer
Edward Resendez	54	Director*
Thomas F. Robards	64	Chairman of the Board of Directors*
Ronald I. Simon, Ph.D.	71	Director*

* Independent director

For biographical information relating to our executive officers, see Our Manager Our Manager s and Ellington s Employees. Information for each of our directors is set forth below.

Edward Resendez Mr. Resendez has served as a member of our board of directors since August 2007. From 2007 to September 2009 Mr. Resendez was Senior Vice President-Chief Lending Officer of Kinecta Federal Credit Union and President of Kinecta Alternative Financial Solutions, Inc. From 2002 to 2007 Mr. Resendez was Chief Executive Officer, Board Member and Co-Founder of ResMAE Financial Corporation and its wholly-owned subsidiary ResMAE Mortgage Corporation, or ResMAE. In February 2007, ResMAE filed for bankruptcy protection under Chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court, District of Delaware. From 1995 through 2000, Mr. Resendez was the President of Long Beach Mortgage Company. During that timeframe he was also appointed as President and a Management Member of the board of directors for both Long Beach Financial Corporation, when that company went public in 1997 (formerly NASDAQ symbol: LBFC), and its wholly-owned operating subsidiary, Long Beach Mortgage Company, a subprime mortgage company, or, collectively with Long Beach Financial Corporation, Long Beach. Long Beach was an originator, purchaser, seller and servicer of subprime mortgages. From 1987 to 1995, Mr. Resendez held various management positions at Long Beach, including Executive Vice President Loan Administration, First Vice President Risk Management, Vice President REO Loan Servicing, and Vice President Retail Origination. Prior to joining Long Beach in 1987, Mr. Resendez held several managerial positions with Transamerica Financial Services from 1977 to 1987. Mr. Resendez earned a B.B.A. from Loyola Marymount University in Los Angeles in 1978, and is a licensed real estate broker in California.

Thomas F. Robards Mr. Robards has served as a member of our board of directors since August 2007 and as our Chairman since October 2009. Mr. Robards is a principal in Robards & Co, LLC, a private investment and advisory company. He currently serves as a Trustee and is Audit Committee Chair for the HSBC Investor Funds, a mutual fund complex. He is a Director and is Audit Committee Chair of Overseas Shipholding Group, Inc., and until December of 2006 was a Director and on the Audit Committee of Financial Federal Corporation, both NYSE-listed companies. From 2003 to 2004, he was the Senior Vice President and Chief Financial Officer of the

American Museum of Natural History in New York, New York. He was the Chief Financial Officer for Datek Online Holding Corporation from 2000 until its acquisition by Ameritrade in 2002. Prior to that, Mr. Robards was employed at Republic New York Corporation for 24 years, including as Chief Financial Officer and Executive Vice President, and from 1997-1999 served on its board of directors. During his tenure his responsibilities at Republic included leading its Asset/Liability Committee as well as managing Republic National Bank treasury and investment portfolio activities. He currently serves on the Board of Trustees and is Chairman of the Finance Committee of the Big Apple Circus. Mr. Robards earned his B.A. from Brown University and an M.B.A. from Harvard Business School.

Ronald I. Simon, Ph.D. Dr. Simon has served as a member of our board of directors since August 2007. Dr. Simon is a private investor and financial consultant to businesses. From March 2003 through February 2006, when it was acquired by Wachovia Corp., Dr. Simon was a Director of WFS Financial Inc., a publicly-traded financial services company specializing in automobile finance. He was a director of Collateral Therapeutics from 1998 until its acquisition by Schering A.G. in 2002. From January 2006 to January 2009, he was a director of Cardium Therapeutics, a company formed to acquire and carry on the research and development of gene therapy to treat heart disease, which was originally developed by Collateral Therapeutics and then continued by Schering. From 1995 through 2002, Dr. Simon was a director of SoftNet Systems, Inc., and since 2002, has been a director of its successor company, American Independence Corp., a holding company engaged principally in the health insurance and reinsurance business. He was a director of BDI Investment Corporation, a closely held regulated investment company, from February 2003 until its liquidation in early 2005, and served as Chief Financial Officer for Wingcast, LLC, a developer of automotive telematics from 2001 to 2002. During 2001, Dr. Simon served as Acting Chairman, Chief Executive Officer and Chief Financial Officer for SoftNet Systems, Inc. He also served as Executive Vice President and Chief Financial Officer of Western Water Company from 1997 to 2000, and a director of Western Water Company from 1999 through 2001. Dr. Simon earned a B.A. from Harvard University, an M.A. from Columbia University, and a Ph.D. from Columbia University Graduate School of Business.

Qualifications and Skills of our Board of Directors

Our board of directors believes its members collectively have the experience, qualifications, attributes and skills to effectively oversee the management of our company, including a high degree of personal and professional integrity, an ability to exercise sound business judgment on a broad range of issues, sufficient experience and background to have an appreciation of the issues facing our company, a willingness to devote the necessary time to board duties, a commitment to representing the best interests of the company and its shareholders and a dedication to enhancing shareholder value. Set forth below is a brief description of the particular experience and skills of each director that led our board of directors to conclude that such individual is qualified to serve as a director of our company in light of our business and structure.

Michael W. Vranos Our board believes that Mr. Vranos operational experience as Co-Chief Investment Officer of our company, trading and market expertise and, in particular, his extensive experience in the mortgage securities business, give him the qualifications and skills to serve as a director. Additional information regarding Mr. Vranos experience is set forth under Our Manager Our Manager s and Ellington s Employees.

Laurence Penn Our board believes that Mr. Penn s operational experience as President and Chief Executive Officer of our company, risk management and trading expertise and, in particular, his extensive experience in the mortgage securities business, give him the qualifications and skills to serve as a director. Additional information regarding Mr. Penn s experience is set forth under Our Manager Our Manager s and Ellington s Employees.

Edward Resendez Our board believes that Mr. Resendez extensive operational experience in and knowledge of the mortgage lending business give him the qualifications and skills to serve as a director. Additional information regarding Mr. Resendez experience is set forth above.

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Thomas F. Robards Our board believes that Mr. Robards expertise in finance and accounting, including knowledge of financial institutions, public accounting, internal controls, audit committee performance and governance matters, and experience amassed from past and current service on the audit committees of NYSE-listed companies, give him the qualifications and skills to serve as a director. Additional information regarding Mr. Robards experience is set forth above.

Ronald I. Simon, Ph.D Our board believes that Mr. Simon s expertise in finance and his extensive service in senior officer positions and directorships of public companies in a variety of industries give him the qualifications and skills to serve as a director. Additional information regarding Mr. Simon s experience is set forth above.

Promoters

We consider Mr. Vranos, our Co-Chief Investment Officer, and Mr. Penn, our Chief Executive Officer and President, as our promoters, which means that they have taken initiative in funding and organizing our business.

Corporate Governance Board of Directors and Committees

Our business is managed through the oversight and direction of our board of directors, which has established investment guidelines for our Manager to follow in its day-to-day management of our business. At least a majority of our board of directors is independent, as defined by the rules of the NYSE. Our independent directors are nominated by our nominating and corporate governance committee.

Our board consists of five directors, two of whom are affiliated with our Manager and three of whom are independent directors (Messrs. Resendez, Robards and Simon). The directors are informed about our business at meetings of our board and its committees and through supplemental reports and communications. Our independent directors meet regularly in executive sessions without the presence of our corporate officers.

Our board has established three committees consisting solely of independent directors, the principal functions of which are briefly described below. Matters put to a vote at any one of our three committees must be approved by a majority of the directors on the committee who are present at a meeting at which there is a quorum or by unanimous written consent of the directors on that committee.

Audit Committee

Our board of directors has established an audit committee, which is composed of Messrs. Robards, Simon and Resendez. Mr. Robards chairs the committee. Our audit committee assists the board in overseeing (i) our accounting and financial reporting processes; (ii) the integrity and audits of our consolidated financial statements; (iii) our compliance with legal and regulatory requirements; (iv) the qualifications and independence of our independent auditors; (v) the performance of our independent auditors; and (vi) the performance of the Company s internal audit function.

Compensation Committee

Our board of directors has established a compensation committee, which is composed of Messrs. Resendez, Robards and Simon. Mr. Resendez chairs the committee. The compensation committee s principal functions are to (i) evaluate the performance of our officers, (ii) review the compensation payable to our dedicated Chief Financial Officer, dedicated controller and, if provided by our Manager, dedicated in-house counsel, (iii) evaluate the performance of our Manager, (iv) review the compensation and fees payable to our Manager under our management agreement and (v) administer the issuance of any LTIP units and other share-based awards issued to our officers, our Manager or the employees of our Manager who provide services to us.

Nominating and Corporate Governance Committee

Our board of directors has established nominating and corporate governance committee, which is comprised of Messrs. Simon, Robards and Resendez. Mr. Simon chairs the committee. The nominating and corporate governance committee is responsible for seeking, considering and recommending to the board qualified candidates for election as directors and recommending a slate of nominees for election as directors at the annual meeting. It also periodically prepares and submits to the board for adoption the committee s selection criteria for director nominees. It reviews and makes recommendations on matters involving general operation of the board and our corporate governance, and annually recommends to the board nominees for each committee of the board. In addition, the committee annually facilitates the assessment of the board of directors performance as a whole and of the individual directors and reports thereon to the board.

Compensation Committee Interlocks and Insider Participation

None of the members of our compensation committee is or has been employed by us. None of our executive officers currently serves, or in the past three years has served, as a member of the board of directors or compensation committee of another entity that has one or more executive officers serving on our board of directors or compensation committee.

Compensation of Directors

Any member of our board of directors who is also an employee of our Manager or Ellington or their respective affiliates does not receive additional compensation for serving on our board of directors. Each independent director currently receives an annual cash retainer of $40,000 and a fee of $1,000 for each board and committee meeting attended ($500 if the meeting is attended telephonically). The chairman of each of our board of directors, the audit committee, the compensation committee and the nominating and corporate governance committee also receives an additional annual cash retainer of $25,000, $15,000, $7,500 and $7,500, respectively. We also reimburse our directors for their travel expenses incurred in connection with their attendance at full board and committee meetings.

Our independent directors currently receive annual awards of 1,250 LTIP units and are eligible to receive LTIP units and other share-based awards under our individual incentive plan. On October 1, 2009, we granted 1,250 LTIP units to each of our independent directors in connection with the 2009 annual award of LTIP units to our independent directors. Our board of directors has approved the issuance of 1,250 LTIP units on October 1, 2010 to each of our independent directors in connection with the 2010 annual awards. See 2007 Long-Term Incentive Plans.

Compensation of Our Directors in 2009

The table below describes the compensation earned by our independent directors in 2009. We compensated only those directors who are independent under the NYSE listing standards.

Name	Fees Earned or Paid in Cash	Share-Based Awards[1]	All other Compensation	Total Compensation
Thomas F. Robards	$ 65,000	$ 31,163[2]		$ 96,163
Ronald I. Simon	$ 57,500	$ 31,163[3]		$ 88,663
Edward Resendez	$ 57,500	$ 31,163[4]		$ 88,663

(1) All share-based awards were granted pursuant to the Ellington Incentive Plan for Individuals.

(2) Mr. Robards received 1,250 LTIP units with a grant date fair value of $31,163. These LTIP units were granted on October 1, 2009, and will vest on October 1, 2010. As of December 31, 2009, Mr. Robards had outstanding an aggregate of 2,500 LTIP units.

(3) Mr. Simon received 1,250 LTIP units with a grant date fair value of $31,163. These LTIP units were granted on October 1, 2009, and will vest on October 1, 2010. As of December 31, 2009, Mr. Simon had outstanding an aggregate of 1,250 LTIP units.

(4) Mr. Resendez received 1,250 LTIP units with a grant date fair value of $31,163. These LTIP units were granted on October 1, 2009, and will vest on October 1, 2010. As of December 31, 2009, Mr. Resendez had outstanding an aggregate of 3,750 LTIP units.

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Executive Compensation

We do not pay any annual cash compensation to our executive officers, although we are required to reimburse the costs of the wages, salaries and benefits incurred by our Manager or Ellington with respect to our dedicated Chief Financial Officer, our dedicated controller and, if provided by our Manager, our dedicated in-house counsel, subject to the approval of these reimbursements by the compensation committee of our board of directors. Our Manager currently provides us with a dedicated Chief Financial Officer and a dedicated controller. The annual base salary of our dedicated Chief Financial Officer is $250,000. Her cash bonus for 2009 was $85,000. For calendar year 2010 and thereafter, she is eligible to receive an annual bonus at the discretion of and in an amount determined by our compensation committee. It is our understanding that the compensation paid to our executive officers by our Manager or Ellington, other than to our dedicated Chief Financial Officer, our dedicated controller and, if provided by our Manager, our dedicated in-house counsel, is not allocated in a manner that would allow us to determine that portion of their compensation that is related to the services performed for us and that portion that is related to services performed for other entities.

2007 Long-Term Incentive Plans

In connection with our August 2007 private offering, our board adopted the Ellington Incentive Plan for Individuals, or the individual incentive plan, and the Ellington Incentive Plan for Entities, or the entity incentive plan, referred to collectively in this prospectus as the incentive plans, to provide incentives to attract and retain the highest qualified directors, officers, employees, advisors, consultants and other personnel. Our Manager s directors, officers, employees and affiliates who provide services to us and our officers, directors, employees, consultants and advisors who are natural persons are eligible to receive awards under the individual incentive plan. Our Manager, consultants and advisors who are not natural persons are eligible to receive awards under the entity incentive plan.

The incentive plans are administered by our compensation committee. The incentive plans each have a term of ten years from the date of adoption.

Currently, under the incentive plans, a combined total of 363,750 LTIP units remain available for issuance. Upon vesting, LTIP units are transferable on a one-for-one basis into common shares. In each subsequent calendar year, the maximum limit on the number of common shares and LTIP units issuable under both incentive plans shall increase by an amount equal to six percent (6%) of the difference, if any (but not less than zero) between (i) the number of common shares that are outstanding as of the last day of such calendar year and (ii) the number of common shares that are outstanding as of the last day of the immediately preceding calendar year. The individual incentive plan requires that of the number of common shares and LTIP units available for awards under both plans, 62,500 common shares be reserved for awards to be made to our independent directors. As of June 30, 2010, 11,250 LTIP units had been issued to our independent directors. In no event shall the number of common shares and LTIP units issued pursuant to both incentive plans exceed 10,000,000. In the event that an award expires, or is forfeited, cancelled or otherwise terminates without the issuance of shares, such common shares subject to such award will again be available for subsequent awards, except as prohibited by law. In addition, common shares that we withhold in satisfaction of the holder s obligation to remit an exercise price or withholding taxes will be available for future awards.

Upon the occurrence of any event that affects our common shares in such a way that an adjustment of outstanding awards is appropriate in order to prevent the dilution or enlargement of rights under the awards (including, without limitation, any extraordinary dividend or other distribution (whether in cash or in kind), recapitalization, stock split, reverse split, reorganization, merger, consolidation, spin-off, combination, repurchase, or share exchange, or other similar corporate transaction or event), the compensation committee shall make appropriate equitable adjustments, which may include, without limitation, adjustments to any or all of the number and kind of common shares (or other securities) which may thereafter be issued in connection with such outstanding awards and adjustments to any exercise price specified in the outstanding awards and shall also make appropriate equitable adjustments to the number and kind of common shares (or other securities) authorized by or

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to be granted under the incentive plans. Such other substitutions or adjustments shall be made respecting awards granted under the incentive plans as may be determined by the compensation committee, in its sole discretion. In connection with any event described in this paragraph, the compensation committee may provide, in its discretion, for the cancellation of any outstanding award and payment in cash or other property in exchange therefor, equal to the difference, if any, between the fair market value of our common shares or other property subject to the award, and the exercise price, if any.

The compensation committee has the authority under the incentive plans to determine the terms and conditions of any awards thereunder, including the terms of any LTIP units. In general, LTIP units will comprise a separate class or classes of our limited liability company interests. Each LTIP unit awarded will typically be deemed to be the equivalent of one common share under the incentive plans. In connection with each grant of LTIP units, the compensation committee sets the relevant terms of such grant, including the number, vesting schedule (including any performance-based vesting conditions) and forfeiture provisions, rights to distributions, allocations of income and capital accounts, required capital contributions, if any, voting rights and conversion features, among other things. As equity interests, the LTIP units are also subject to the terms of our operating agreement. LTIP units may be granted either as free-standing awards or in tandem with other awards under our incentive plans.

In addition to LTIP units, the incentive plans also permit awards of restricted common shares. A restricted common share award is an award of our common shares that may be subject to forfeiture (vesting), restrictions on transferability and such other restrictions, if any, as the compensation committee may impose at the date of grant. The restrictions may lapse at such times and under such circumstances, including, without limitation, a specified period of employment or the satisfaction of pre-established criteria, in such installments or otherwise, as our compensation committee may determine. Except to the extent restricted under an award agreement, the holder of a restricted common share has all of the rights of a shareholder, including, without limitation, the right to vote and the right to receive distributions on the restricted common shares. Although distributions are paid on all restricted common shares, whether or not vested, at the same rate and on the same date as common shares, the award agreement may prohibit holders of restricted common shares from transferring such restricted common shares until they vest. All restrictions on restricted common shares granted under the incentive plans will be removed immediately and fully upon a change of control of us.

The compensation committee may also grant share appreciation rights, performance awards and other share and non-share-based awards under the incentive plans. These awards may be subject to such conditions and restrictions as the compensation committee may determine, including, but not limited to, the achievement of certain performance goals or continued employment with us through a specific period.

Generally, holders are not permitted to sell, transfer, pledge or assign any award, and all awards shall be exercisable, during the holder s lifetime, only by the holder; provided, however, that the compensation committee may, in its sole discretion, provide that certain awards may be transferable subject to certain restrictions.

Our compensation committee may at any time amend, alter, suspend or discontinue the incentive plans, but cannot, without a participant s consent, take any action that would impair the rights of such participant under any award granted under the plans. To the extent required by law, the compensation committee will obtain approval of the shareholders for any amendment that would:

- increase the total number of common shares reserved for issuance under the incentive plans (other than through adjustment as provided in the incentive plan);
- change the class of eligible participants under the incentive plans; or
- otherwise require such approval.

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Outstanding Awards

In connection with our August 2007 private offering, we issued 375,000 LTIP units to our Manager under our entity incentive plan, which are convertible into 375,000 common shares. As of August 17, 2010, all of these LTIP units have vested. As of June 30, 2010, our independent directors have, in the aggregate, been issued 11,250 LTIP units under our individual incentive plan, 7,500 of which have vested and 6,250 of which have been converted into common shares. We will issue 1,250 LTIP units to each of our independent directors on October 1, 2010 in connection with the 2010 annual award of LTIP units to our independent directors.

These LTIP units comprise a separate non-voting class of our limited liability company interests. They are structured as profits interests that do not require any capital contribution by the grantee, and, unlike common shares, they initially had no associated capital account. Each of the LTIP units is generally entitled to distributions, and to allocations of our income, in amounts that correspond to distributions and allocations for one common share.

The LTIP units issued to our Manager are subject to forfeiture restrictions that began lapsing in three equal annual installments beginning on the first anniversary of the closing date of our August 2007 private offering, while the LTIP units issued to our independent directors will be subject to forfeiture restrictions that lapse one year after the date of grant. To the extent that distributions are received in respect of an LTIP unit that is subsequently forfeited, the recipient of the distribution will have no obligation to repay us the amount distributed. However, upon forfeiture, the former holder of the LTIP unit will lose the right to any future distributions or allocations of income in respect of such LTIP unit, and will forfeit any capital account that is associated with such LTIP unit at the time of forfeiture.

A holder of an LTIP unit has a right, which will generally be exercisable by the holder at any time after vesting, to convert the LTIP unit into one common share. Prior to the effectiveness of the conversion, and upon the occurrence of certain other specified events, our income will be specially allocated to the holder of the LTIP unit in an amount necessary to equalize the capital account associated with the LTIP units with that of common shares, such that the LTIP Unit is economically identical to, and fungible with, the common shares.

The grant, vesting and conversion of LTIP units, and the payment of distributions with respect thereto, will not give rise to a tax deduction to us or the holders of common shares. Allocations of income to holders of LTIP units, however, reduces the amount of our income that would otherwise be allocable and taxable to the holders of our common shares.

Management Agreement

We entered into a management agreement with our Manager upon our inception in August 2007, pursuant to which our Manager provides for the day-to-day management of our operations.

The management agreement, which was amended and restated effective July 1, 2009, requires our Manager to manage our assets, operations and affairs in conformity with the policies and the investment guidelines that are approved and monitored by our board of directors. Our Manager is under the supervision and direction of our board of directors. Our Manager is responsible for:

- the selection, purchase and sale of assets in our portfolio;
- our financing activities; and
- providing us with advisory services.

Our Manager is responsible for our day-to-day operations and performs (or causes to be performed) such services and activities relating to the management, operation and administration of our assets and liabilities and business as may be appropriate, which may include, without limitation, the following:

serving as our consultant with respect to the periodic review of our investment guidelines and other policies and criteria for our other borrowings and operations for the approval of our board of directors;

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investigating, analyzing and selecting possible asset acquisition opportunities and originating, acquiring, structuring, financing, retaining, selling, negotiating for prepayment, restructuring or disposing of our assets in a manner consistent with our investment guidelines;

with respect to any of our prospective asset acquisitions and any sale, exchange or other disposition of any investment by us, conducting negotiations on our behalf with sellers and purchasers and their respective agents, representatives and investment bankers and owners of privately and publicly held real estate companies;

engaging and supervising, on our behalf and at our sole cost and expense, third-party service providers that are not affiliated with Ellington who provide, among other services, investment banking, mortgage brokerage, securities brokerage, legal, accounting, due diligence and such other services as may be required relating to our assets or potential assets and to our other business and operations;

coordinating and managing operations of any joint venture or co-investment interests held by us and conducting all matters with any joint venture or co-investment partners;

coordinating and supervising, on our behalf and at our sole cost and expense, other third-party service providers;

providing executive and administrative personnel, office space and office services required in rendering services to us;

administering our day-to-day operations and performing and supervising the performance of such other administrative functions necessary for our management as may be agreed upon by our Manager and our board of directors, including, without limitation, the collection of revenues and the payment of our debts and obligations and maintenance of appropriate computer services to perform such administrative functions;

engaging and supervising, on our behalf and at our sole cost and expense, consultants and other service providers that are not affiliated with Ellington, to assist us in complying with the requirements of Sarbanes Oxley and the Exchange Act;

communicating on our behalf with the holders of any of our equity or debt securities as required to satisfy the reporting and other requirements of any governmental bodies or agencies or trading markets and to maintain effective relations with such holders;

counseling us in connection with policy decisions to be made by our board of directors;

counseling us, and when appropriate, evaluating and recommending to our board of directors hedging, financing and securitization strategies, and engaging in hedging, financing, borrowing and securitization activities on our behalf, consistent with the investment guidelines;

counseling us regarding the maintenance of our exclusion from regulation as an investment company under the Investment Company Act and monitoring compliance with the requirements for maintaining such exclusion and using commercially reasonable efforts to cause us to maintain such exclusion from regulation as an investment company under the Investment Company Act;

assisting us in developing criteria for asset purchase or commitments that are specifically tailored to our objectives and making available to us its knowledge and experience with respect to mortgage loans, real estate, real estate related securities, other real estate-related assets, ABS, non-real estate-related assets and real estate operating companies;

furnishing such reports to us or our board of directors that our Manager reasonably determines to be responsive to reasonable requests for information from us or our board of directors regarding our activities and services performed for us or any of our subsidiaries by our Manager;

monitoring the operating performance of our assets and providing periodic reports with respect thereto to our board of directors, including comparative information with respect to such operating performance and budgeted or projected operating results;

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purchasing assets (including short-term investments pending the purchase of other assets, payment of fees, costs and expenses, or distributions to our shareholders), and advising us as to our capital structure and capital raising;

causing us, at our sole cost and expense, to retain qualified independent accountants and legal counsel, as applicable, to assist in developing appropriate accounting procedures, compliance procedures and testing systems with respect to financial reporting obligations including soliciting shareholders for required information to the extent provided by the provision of the Code and the Treasury Regulations applicable to us and to conduct quarterly compliance reviews with respect thereto;

causing us to qualify to do business in all applicable jurisdictions and to obtain and maintain all appropriate licenses;

assisting us in complying with all regulatory requirements applicable to us in respect of our business activities, including preparing or causing to be prepared all financial statements required under applicable regulations and contractual undertakings and all reports and documents, if any, required under the Exchange Act and the Securities Act;

taking all necessary actions to enable us to make required tax filings and reports and compliance with the Code and the Treasury Regulations applicable to us, including, without limitation, the provisions applicable to the treatment of us as a partnership, and not an association or publicly traded partnership taxable as a corporation, for U.S. federal income tax purposes;

handling and resolving all claims, disputes or controversies (including all litigation, arbitration, settlement or other proceedings or negotiations) in which we may be involved or to which we may be subject arising out of our day-to-day operations, subject to such limitations or parameters as may be imposed from time to time by our board of directors;

using commercially reasonable efforts to cause expenses incurred by or on our behalf to be commercially reasonable or commercially customary and within any budgeted parameters or expense guidelines set by our board of directors from time to time;

advising on, and obtaining on our behalf, appropriate credit facilities or other financings for our assets consistent with our investment guidelines;

advising us with respect to and structuring long-term financing vehicles for our portfolio of assets, and offering and selling securities publicly or privately in connection with any such structured financing;

performing such other services as may be required from time to time for management and other activities relating to our assets as our board of directors shall reasonably request or our Manager shall deem appropriate under the particular circumstances; and

using commercially reasonable efforts to cause us to comply with all applicable laws.

Pursuant to the management agreement, our Manager will not assume any responsibility other than to render the services called for thereunder in good faith and will not be responsible for any action of our board of directors in following or declining to follow our Manager s advice or recommendations.

Our Manager, Ellington, EMG Holdings, L.P. and their affiliates who provide services to us under the management agreement or the services agreement, their directors, officers, members, shareholders, managers, investment and risk management committee members, employees, agents, successors and assigns are not liable to us, any subsidiary of ours, any of our or our subsidiaries directors, officers, shareholders, managers, owners or partners for acts or omissions performed in accordance with and pursuant to the management agreement, except by reason of acts or omissions constituting bad faith, willful misconduct, gross negligence, or reckless disregard of our Manager s duties under the management

agreement, as determined by a final non-appealable order of a court of competent jurisdiction. We have agreed to indemnify our Manager, Ellington, EMG Holdings, L.P. and their affiliates, directors, officers, members, shareholders, managers, investment and risk management committee members, employees, agents, successors and assigns with respect to all liabilities, judgments, costs, charges,

losses, expenses and claims, including attorney s fees, charges and expenses and expert witness fees, of any nature, kind or description, arising from claims by third parties caused by acts or omissions of our Manager, Ellington, EMG Holdings, L.P. or their affiliates not constituting bad faith, willful misconduct, gross negligence, or reckless disregard of our Manager s duties under the management agreement or claims by our Manager s employees relating to the terms and conditions of their employment. Our Manager and its affiliates will not be liable for acts or omissions made or taken in accordance with written advice of professional advisors that are engaged by our Manager with commercially reasonable care, absent bad faith, gross negligence, willful misconduct or fraud by our Manager, Ellington, EMG Holdings, L.P. or their affiliates or their personnel.

Our Manager has agreed to indemnify us and our directors and officers with respect to all liabilities, judgments, costs, charges, losses, expenses and claims, including attorney s fees, charges and expenses and expert witness fees, of any nature, kind or description, arising out of (i) claims by third parties based on acts or omissions of our Manager constituting bad faith, willful misconduct, gross negligence or reckless disregard of our Manager s duties under the management agreement, as determined pursuant to a final, non-appealable order of a court of competent jurisdiction or (ii) claims by our Manager s employees relating to the terms and conditions of their employment with our Manager. Our Manager intends to obtain errors and omissions and other insurance which is customarily carried by property and investment managers.

Pursuant to the terms of the management agreement, our Manager is required through Ellington and its affiliates to provide a management team (including, without limitation, a Chief Executive Officer and President, Chief Operating Officer, a Chief Investment Officer and a Chief Financial Officer) along with appropriate support personnel, to deliver the management services to us, with the members of such management team, other than those that are dedicated to us, devoting such of their time to the management of us as our Manager deems reasonably necessary and appropriate for the proper performance of all of our Manager s duties, commensurate with the level of our activity from time to time. Our Manager currently provides us with a dedicated Chief Financial Officer and a dedicated controller, who devote all or substantially all of their time to the management of us and the performance of their duties as our Chief Financial Officer and controller. We are responsible for the entire cost of the dedicated Chief Financial Officer and controller and reimburse our Manager or Ellington for such costs. Our management agreement also permits our Manager to appoint a dedicated in-house counsel to our company and to be reimbursed by us for the entire cost incurred by our Manager or Ellington to employ such individual. The dedicated in-house counsel will be required by our Manager to dedicate all or substantially all of his or her business time and efforts to us. We have the benefit of our Manager s reasonable judgment and effort in rendering services and, in furtherance of the foregoing, our Manager shall not undertake activities which, in its reasonable judgment, will materially adversely affect the performance of its obligations under the management agreement.

Term and Termination

The management agreement has a current term that expires on December 31, 2011, and will be automatically renewed for a one year term each anniversary date thereafter unless notice of non-renewal is delivered by either party to the other party at least 180 days prior to the expiration of the then current term. Our independent directors will review our Manager s performance annually and the management agreement may be terminated annually upon the affirmative vote of at least two-thirds of our independent directors, or by the affirmative vote of the holders of at least a majority of the outstanding common shares, based upon unsatisfactory performance that is materially detrimental to us or a determination by our independent directors that the base management and incentive fees payable to our Manager are not fair, subject to our Manager s right to prevent such a compensation termination by accepting a mutually acceptable reduction of management fees. In the event we terminate the management agreement without cause or elect not to renew the management agreement, we will be required to pay our Manager a termination fee equal to the amount of three times the sum of (i) the average annual base management fee earned by our Manager during the 24-month period immediately preceding the date of termination, calculated as of the end of the most recently completed fiscal quarter prior to the date of termination and (ii) the average annual incentive fee earned by our Manager during the 24-month period immediately preceding the date of termination, calculated as of the end of the most recently completed fiscal quarter prior to the date of termination.

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We may also terminate the management agreement without payment of the termination fee with 30 days prior written notice from our board of directors for cause, which is defined as:

- our Manager s continued material breach of any provision of the management agreement following a period of 30 days after written notice of such breach;
- our Manager s fraud, misappropriation of funds, or embezzlement against us;
- our Manager s gross negligence in performance of its duties under the management agreement;
- the occurrence of certain events with respect to the bankruptcy or insolvency of our Manager, including, but not limited to, an order for relief in an involuntary bankruptcy case or our Manager authorizing or filing a voluntary bankruptcy petition;
- the dissolution of our Manager; and
- certain changes of control of our Manager, including but not limited to the departure of Mr. Vranos from senior management of Ellington, whether through resignation, retirement, withdrawal, long-term disability, death or termination of employment with or without cause or for any other reason.

Our Manager may terminate the management agreement effective upon 60 days prior written notice of termination to us in the event that we default in the performance or observance of any material term, condition or covenant in the management agreement and the default continues for a period of 30 days after written notice to us specifying the default and requesting that the default be remedied in such 30-day period. In the event our Manager terminates the management agreement due to our default in the performance or observance of any material term, condition or covenant in the management agreement, we will be required to pay our Manager the termination fee.

Our Manager may also terminate the management agreement in the event we become regulated as an investment company under the Investment Company Act, with such termination deemed to occur immediately prior to such event; provided, however, that in the case of such termination, if our Manager was not at fault for our becoming regulated as an investment company under the Investment Company Act, we will be required to pay a termination fee.

Our Manager may generally only assign the management agreement with the written approval of a majority of our independent directors. However, our Manager may assign to one or more of its affiliates the performance of any of its responsibilities under the management agreement without the approval of our independent directors so long as our Manager remains liable for any such affiliates performance and such assignment does not require our approval under the Advisers Act.

License to use the Name Ellington

Pursuant to the management agreement, our Manager has granted us a non-exclusive, royalty-free license to use the name Ellington. We have a right to use the Ellington name for so long as our Manager remains our manager. In the event the management agreement is terminated, we would be required to change our name to eliminate the use of the word Ellington.

Base Management Fees, Incentive Fees and Reimbursement of Expenses

We do not maintain an office or employ personnel. Instead we rely on the facilities and resources of our Manager to conduct our operations. Expense reimbursements to our Manager are made within 60 days following delivery of the expense statement by our Manager.

Base Management Fees

Under the management agreement, we pay our Manager a base management fee quarterly in arrears in an amount equal to 1.50% per annum of our shareholders equity (calculated in accordance with GAAP) as of the

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end of each fiscal quarter (before deductions for base management fees and incentive fees payable with respect to such fiscal quarter), provided that shareholders equity will be adjusted to exclude one-time events pursuant to changes in GAAP, as well as non-cash charges after discussion between our Manager and our independent directors and approval by a majority of our independent directors in the case of non-cash charges.

In the event that our Manager, Ellington or any of their affiliates receives any management fees, origination fees or structuring fees from any CDO, investment fund, issuer of debt or other investment in which our company has invested or participated, then the quarterly base management fees and any incentive fees payable by us to our Manager will be reduced by, or our Manager will otherwise rebate to us, an amount equal to the portion of such fees payable to our Manager, Ellington or their affiliates that is allocable to our investment or participating interest in such CDO, investment fund, other investment or debt securities during the same period.

Our Manager calculates the base management fee within 45 days after the end of each fiscal quarter and such calculation is promptly delivered to us. We are obligated to pay the base management fee within 15 business days after receipt of the calculation from our Manager.

Our Manager will earn a larger base management fee as a result of this offering to the extent our shareholders equity increases.

As stated above, we and our Manager amended and restated the management agreement between us and our Manager effective July 1, 2009. Under the amended and restated management agreement, among other things, we reduced the base management fee rate from 1.75% of shareholders equity per annum to 1.50% of shareholders equity per annum, and we eliminated a provision pursuant to which, with respect to our common shares held by our Manager, our Manager was paid a special distribution in lieu of being paid base management fees. For the three month periods ended June 30, 2010 and 2009, we paid actual base management fees to our Manager of $1.1 million and $1.0 million, respectively, and we paid special distributions in lieu of base management fees to our Manager for these periods of $0 and $0.2 million, respectively, resulting in a total amount of base management fees and special distributions in lieu of base management fees for these periods of $1.1 million and $1.2 million, respectively. For the six month periods ended June 30, 2010 and 2009, we paid actual base management fees to our Manager of $2.2 million and $2.0 million, respectively, and we paid special distributions in lieu of base management fees to our Manager for these periods of $0 and $0.3 million, respectively, resulting in a total amount of base management fees and special distributions in lieu of base management fees for these periods of $2.2 million and $2.3 million, respectively. For the years ended December 31, 2009 and 2008, we paid actual base management fees to our Manager of $4.2 million and $3.7 million, respectively, and we paid special distributions in lieu of base management fees to our Manager for these periods of $0.3 million and $0.6 million, respectively, resulting in a total amount of base management fees and special distributions in lieu of base management fees for these periods of $4.5 million and $4.3 million, respectively. For the periods prior to July 1, 2009, such base management fees and special distributions were calculated pursuant to the management agreement that was in effect prior to the July 1, 2009 effective date of the amendments. Had the amendments that became effective on July 1, 2009 been in effect since our inception, we would have paid our Manager base management fees for the three month periods ended June 30, 2010 and 2009 and the six month periods ended June 30, 2010 and 2009 of $1.1 million, $1.1 million, $2.3 million and $2.1 million, respectively, and we would not have paid any special distributions in lieu of base management fees to our Manager. For the years ended December 31, 2009 and 2008, had the amendments been in effect, we would have paid our Manager base management fees of $4.4 million and $3.7 million, respectively, and we would not have paid any special distributions in lieu of base management fees to our Manager.

Incentive Fees

In addition to the base management fee, with respect to each fiscal quarter we pay our Manager an incentive fee equal to the excess, if any, of (i) the product of (A) 25% and (B) the excess of (1) our Adjusted Net Income (described below) for the Incentive Calculation Period (which means such fiscal quarter and the immediately preceding three fiscal quarters (but excluding any fiscal quarters prior to July 1, 2009)) over (2) the sum of the Hurdle Amounts (described below) for the Incentive Calculation Period, over (ii) the sum of the incentive fees already paid or payable for each fiscal quarter in the Incentive Calculation Period preceding such fiscal quarter.

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For purposes of calculating the incentive fee, Adjusted Net Income for the Incentive Calculation Period means our net increase in shareholders equity from operations (or such equivalent GAAP measure based on the basis of presentation of our consolidated financial statements), after all base management fees but before any incentives fees for such period, and excluding any non-cash equity compensation expenses for such period, as reduced by any Loss Carryforward (as described below) as of the end of the fiscal quarter preceding the Incentive Calculation Period. Adjusted Net Income will be adjusted to exclude one-time events pursuant to changes in GAAP, as well as non-cash charges after discussion between our Manager and our independent directors and approval by a majority of our independent directors in the case of non-cash charges. For the avoidance of doubt, Adjusted Net Income includes both net investment income and net realized and unrealized gains and losses.

For purposes of calculating the incentive fee, the Loss Carryforward as of the end of any fiscal quarter is calculated by determining the excess, if any, of (1) the Loss Carryforward as of the end of the immediately preceding fiscal quarter over (2) our net increase in shareholders equity from operations (expressed as a positive number) or net decrease in shareholders equity from operations (expressed as a negative number) for such fiscal quarter (or such equivalent GAAP measures as may be appropriate depending on the basis of presentation of our consolidated financial statements), as the case may be, calculated in accordance with GAAP, adjusted to exclude one-time events pursuant to changes in GAAP, as well as non-cash charges after discussion between our Manager and our independent directors and approval by a majority of our independent directors in the case of non-cash charges.

For purposes of calculating the incentive fee, the Hurdle Amount means, with respect to any fiscal quarter, the product of (i) one-fourth of the greater of (A) 9% and (B) 3% plus the ten-year Treasury rate for such fiscal quarter, (ii) the sum of (A) the weighted average gross proceeds per share of all our common share issuances (excluding issuances of our common shares (a) as equity incentive awards, (b) to our Manager as part of its base management fee or incentive fee and (c) to our Manager or any of its Affiliates in privately negotiated transactions) up to the end of such fiscal quarter (with each such issuance weighted by both the number of shares issued in such issuance and the number of days that such issued shares were outstanding during such fiscal quarter) and (B) the result obtained by dividing (I) retained earnings attributable to our common shares at the beginning of such fiscal quarter by (II) the average number of our common shares outstanding for each day during such fiscal quarter, and (iii) the average number of our common shares and LTIP units outstanding for each day during such fiscal quarter.

Set forth below are various hypothetical examples of how our incentive fee relates to our Adjusted Net Income, calculated in accordance with the amended management agreement that became effective on July 1, 2009. The following hypothetical examples are made by applying a rolling four-quarter calculation and show results for a full four-quarter period.

Example	Adjusted Net Income (expressed as % of shareholders equity)(1)	Excess Adjusted Net Income over Hurdle Rate (expressed as % of shareholders equity)(2)(3)	Incentive Fee (expressed as % of shareholders equity)	Incentive Fee (expressed as % of Adjusted Net Income)
1	9.00%	0.00%	0.00%	0.00%
2	12.00%	3.00%	0.75%	6.25%
3	15.00%	6.00%	1.50%	10.00%
4	25.00%	16.00%	4.00%	16.00%
5	35.00%	26.00%	6.50%	18.57%

(1) Adjusted Net Income is net of any Loss Carryforwards and of all expenses incurred and base management fees paid during the calculation period.

(2) For these hypothetical examples, we have assumed that the total Hurdle Amounts (as defined earlier) for the rolling four-quarter period, expressed as a percentage of shareholders equity, is 9.00%. When we calculate the actual incentive fees payable to our Manager, the total Hurdle Amounts during a four-quarter period, expressed as a percentage of the shareholders equity as of the beginning of such period, will not generally be the same as the annual hurdle rate.

(3) For these hypothetical examples, we have assumed that there is a non-negative excess of (i) the product of (A) 25% and (B) the excess of (1) the Adjusted Net Income for the rolling four quarter period over (2) the sum of the Hurdle Amounts for the rolling four quarter period, over (ii) the sum of the incentive fees already paid or payable for each of the first three quarters in the rolling four quarter period.

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The following table shows the calculation of the actual incentive fee for the three month period ended June 30, 2010.

(Dollars in thousands except per share amounts)		**Three Month Period Ended September 30, 2009**	**Three Month Period Ended December 31, 2009**	**Three Month Period Ended March 31, 2010**	**Three Month Period Ended June 30, 2010**
Calculation of Hurdle Amount for Incentive Calculation Period (1):					
(A)	Annual hurdle rate (the greater of (i) 9% and (ii) 3% plus the ten year Treasury rate)	9%	9%	9%	9%
(B)	Hurdle price per share (the sum of (i) the weighted average gross proceeds per share of all common share issuances (adjusted as discussed in the definitions above); and (ii) the result obtained by dividing (x) retained earnings attributable to our common shares at the beginning of each period by (y) the average number of common shares outstanding for each day during each period)	$ 23.69	$ 24.73	$ 24.71	$ 24.07
(C)	Average number of our common shares and LTIPs outstanding for each day during each period (in thousands)	12,299	12,342	12,359	12,365
(D)	Quarterly Hurdle Amount = 1/4 x A x B x C (2)	$ 6,555	$ 6,868	$ 6,872	$ 6,698
(E)	Cumulative Hurdle Amount for the Incentive Calculation Period (1)				$ 26,993
Calculation of Adjusted Net Income for Incentive Calculation Period (1):					
(F)	Net increase in shareholders equity from operations, after all base management fees, and excluding any non-cash equity compensation expenses during such period	$ 39,322	$ 15,966	$ 8,804	$ 4,505
(G)	Loss Carryforward				
(H)	Quarterly Adjusted Net Income = F G:	$ 39,322	$ 15,966	$ 8,804	$ 4,505
(I)	Cumulative Adjusted Net Income for Incentive Calculation Period (1)				$ 68,597
Calculation of Incentive Fee for Incentive Calculation Period (1):					
(J)	Cumulative Hurdle Amount for the Incentive Calculation Period (same as (E) above)				$ 26,993
(K)	Cumulative Adjusted Net Income for Incentive Calculation Period Less Cumulative Hurdle Amount = I - J (if positive)				$ 41,604
(L)	Incentive fee rate				25%
(M)	Incentive fee for the Incentive Calculation Period = K x L (if positive)				$ 10,401
(N)	Incentive fee incurred for prior quarters included in Incentive Calculation Period (3)	$ 8,192	$ 2,275	$ 482	
(O)	Cumulative Incentive fee incurred for prior quarters included in Incentive Calculation Period (1)				$ 10,949

Incentive fee for the three month period ended June 30, 2010 = M O (if positive)	$

(1) Incentive Calculation Period comprises the current fiscal quarter and the immediately preceding three fiscal quarters.
(2) Recalculation of the Hurdle Amount in (D) and the incentive fee based on the figures in the table may not match the actual figures, due to rounding.
(3) Amount represents the incentive fee for the three month periods ended September 30, 2009, December 31, 2009 and March 31, 2010, which were the first three quarters of the Incentive Fee Calculation Period.

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Our manager calculates the incentive fee within 45 days after the end of each fiscal quarter, and we pay the incentive fee with respect to such fiscal quarter within 15 business days following the delivery to us of our Manager s written statement setting forth the computation of the incentive fee for such fiscal quarter.

The management agreement provides that a minimum of 10% of each incentive fee payable to our Manager is to be paid in common shares, with the balance paid in cash. Our Manager may, in its sole discretion, elect to receive a greater percentage of any incentive fee in the form of common shares. Our management agreement further provides that our Manager may not elect to receive common shares as payment of its incentive fee, other than in accordance with all applicable securities exchange rules and securities laws (including prohibitions on insider trading). The number of our common shares to be received by our Manager is based on the fair market value of those common shares. Common shares delivered as payment of the incentive fee are immediately vested, provided that our Manager has agreed not to sell the common shares prior to one year after the date they are issued to our Manager. These common shares are subject to the registration rights as described elsewhere in this prospectus. Our manager s transfer restriction will lapse if the management agreement is terminated.

As stated above, we and our Manager amended and restated the management agreement between us and our Manager effective July 1, 2009. Under the amended and restated management agreement, among other things, we modified the incentive fee calculation so that performance is measured against the applicable hurdle rate based on a rolling four quarter basis rather than on a individual quarter-by-quarter basis, and we eliminated a provision pursuant to which, with respect to our common shares held by our Manager, our Manager was paid a special distribution in lieu of being paid incentive fees. For the three month periods ended June 30, 2010 and 2009, we paid actual incentive fees to our Manager of $0 and $8.4 million, respectively, and we paid special distributions in lieu of incentive fees to our Manager for these periods of $0 and $1.5 million, respectively, resulting in a total amount of incentive fees and special distributions in lieu of incentive fees for these periods of $0 million and $9.9 million, respectively. For the six month periods ended June 30, 2010 and 2009, we paid actual incentive fees to our Manager for these periods of $0.5 million and $8.4 million, and we paid special distributions in lieu of incentive fees to our Manager for these periods of $0 and $1.5 million, respectively, resulting in a total amount of incentive fees and special distributions in lieu of incentive fees for these periods of $0.5 million and $9.9 million, respectively. For the years ended December 31, 2009 and 2008, we paid actual incentive fees to our Manager of $18.9 million and $1.8 million, respectively, and we paid special distributions in lieu of incentive fees to our Manager for these periods of $1.5 million and $0.3 million, respectively, resulting in a total amount of incentive fees and special distributions in lieu of incentive fees for these periods of $20.4 million and $2.1 million, respectively. For periods prior to July 1, 2009 such incentive fees and special distributions were calculated pursuant to the management agreement that was in effect prior to the July 1, 2009 effective date of the amendments. Had the amendments that became effective on July 1, 2009 been in effect since our inception, we would have paid our Manager incentive fees for the three month periods ended June 30, 2010 and 2009 and the six month periods ended June 30, 2010 and 2009, $0 million, $6.1 million, $1.8 million and $6.1 million, respectively, and we would not have paid any special distributions in lieu of incentive fees to our Manager. For the years ended December 31, 2009 and 2008, had the amendments been in effect, we would have paid our Manager incentive fees of $19.0 million and $0, respectively, and we would not have paid any special distributions in lieu of incentive fees to our Manager.

Reimbursement of Expenses

We pay all of our direct operating expenses, except those specifically required to be borne by our Manager under the management agreement. Our Manager is responsible for all costs incident to the performance of its duties under the management agreement, including compensation of our Manager s employees and other related expenses, other than the costs incurred by our Manager for a dedicated Chief Financial Officer and controller and, if provided by our Manager, a dedicated in-house counsel. The expenses required to be paid by us include, but are not limited to:

- issuance and transaction costs incident to the acquisition, disposition and financing of our assets;
- legal, regulatory, compliance, tax, accounting, consulting, auditing and administrative fees and expenses and fees and expenses for other similar services rendered by third-party service providers;

the compensation and expenses of our directors and the cost of liability insurance to indemnify our directors and officers;

the costs associated with the establishment and maintenance of any credit facilities and our other indebtedness (including commitment fees, accounting fees, legal fees, closing costs, etc.);

expenses associated with our other securities offerings;

expenses relating to the payment of dividends;

expenses connected with communications to holders of our securities and in complying with the continuous reporting and other requirements of the Exchange Act, the SEC and other governmental bodies;

transfer agent, registrar and exchange listing fees;

the costs of printing and mailing proxies, reports and other materials to our shareholders;

costs associated with any computer software or hardware, electronic equipment, or purchased information technology services from third-party vendors that is used solely by us;

costs and out-of-pocket expenses incurred by directors, officers, employees or other agents of our Manager for travel on our behalf;

costs associated with the dedicated Chief Financial Officer and controller and, if provided by our Manager, a dedicated in-house counsel;

the portion of any costs and expenses incurred by our Manager or its affiliates with respect to market information systems and publications, research publications and materials that are allocable to us in accordance with the expense allocation policies of Ellington;

settlement, clearing, and custodial fees and expenses;

all taxes and license fees;

all insurance costs incurred with respect to insurance policies obtained in connection with the operation of our business including, but not limited to, insurance covering activities of our Manager and its employees relating to the performance of our Manager s duties and obligations under the management agreement;

costs and expenses incurred in contracting third parties for the servicing and special servicing of our assets;

all other actual out of pocket costs and expenses relating to our business and operations, including, without limitation, the costs and expenses of acquiring, owning, protecting, maintaining, developing and disposing of investments, including appraisal, reporting, audit and legal fees;

any judgment or settlement of pending or threatened proceedings (whether civil, criminal or otherwise) against us or any subsidiary, or against any of our trustees, directors or officers in his capacity as such or of any subsidiary for which we or any subsidiary are required to indemnify such trustee, director or officer by any court or governmental agency, or settlement of pending or threatened proceedings;

the costs of maintaining compliance with all federal, state and local rules and regulations, including securities regulations, or any other regulatory agency, all taxes and license fees and all insurance costs incurred on our behalf;

expenses relating to any office or office facilities, including disaster backup recovery sites and facilities, maintained expressly for us and separate from offices of our Manager

the costs of the wages, salaries and benefits incurred by our Manager with respect to our dedicated officers; and

all other costs and expenses approved by the board of directors.

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In addition, other than as expressly described above, we are not required to pay any portion of rent, telephone, utilities, office furniture, equipment, machinery and other office, internal and overhead expenses of our Manager and its affiliates.

Since our inception and through June 30, 2010, we have not been invoiced for and we have not reimbursed our Manager or Ellington for any expenses other than direct third-party expenses of our company (including in certain situations our allocable share of such third-party expenses) that our Manager or Ellington advanced on our behalf.

Distributions to Manager

Prior to July 1, 2009, the management agreement contained provisions requiring that we reduce the base management and incentive fees payable to our Manager by an amount equal to the portion of those fees attributable to our common shares held by our Manager and that we pay those amounts to our Manager as a distribution instead.

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CERTAIN RELATIONSHIPS AND RELATED PARTY TRANSACTIONS

Transactions Effected by Ellington and its Affiliates in Respect of Our Portfolio

We may from time to time enter into certain related party transactions with Ellington and its affiliates including, subject to certain conditions and limitations, cross transactions, principal transactions and the purchase of securities in other Ellington accounts. See Business Conflicts of Interest; Equitable Allocation of Opportunities for a description of theses types of transactions.

Management Agreement

We have entered into a management agreement with our Manager, pursuant to which our Manager provides for the day-to-day management of our operations. The management agreement requires our Manager to manage our business affairs in conformity with the policies and the investment guidelines that are approved and monitored by our board of directors. All of our officers also serve as officers, employees and/or directors of Ellington, our Manager or one of their other affiliates. As a result, the management agreement between us and our Manager was negotiated between related parties, and the terms, including fees payable, may not be as favorable to us as if it had been negotiated with an unaffiliated third party. See Management Management Agreement Base Management Fees, Incentive Fees and Reimbursement of Expenses, Business Conflicts of Interest; Equitable Allocation of Opportunities and Risk Factors Risks Related to our Relationship with our Manager and Ellington.

Services Agreement

Our Manager has entered into a services agreement with Ellington Management Group, L.L.C. pursuant to which Ellington Management Group, L.L.C. and its affiliates provide to our Manager the personnel, services and resources as needed by our Manager to enable our Manager to carry out its obligations and responsibilities under the management agreement, including due diligence, asset management and credit risk management. We are a named third-party beneficiary to the service agreement and, as a result, have, as a non-exclusive remedy, a direct right of action against Ellington in the event of any breach by the Manager of any of its duties, obligations or agreements under the management agreement that arise out of or result from any breach by Ellington of its obligations under the services agreement. The services agreement will terminate upon the termination of the management agreement. Pursuant to the services agreement, our Manager makes certain payments to Ellington in connection with the services provided. However, as described under Summary Our Formation and Structure, our Manager and Ellington are under common ownership and control. As a result, all management fee compensation earned by our Manager and all service agreement fees earned by Ellington accrue to the common benefit of the owners of our Manager and Ellington, namely EMG Holdings, L.P. and VC Investments L.L.C.

Compensation of Directors

Our non-independent directors do not receive additional compensation for serving on our board of directors. Each independent director currently receives an annual cash retainer of $40,000 and a fee of $1,000 for each board and committee meeting attended ($500 if the meeting is attended telephonically). The chairman of each of our board of directors, the audit committee, the compensation committee and the nominating and corporate governance committee also receives an additional annual cash retainer of $25,000, $15,000, $7,500 and $7,500, respectively. We also reimburse our directors for their travel expenses incurred in connection with their attendance at full board and committee meetings.

We currently award our independent directors annual grants of 1,250 LTIP units under our individual incentive plan and they are eligible to receive LTIP units and other share-based awards under our individual incentive plan. On October 1, 2009, we issued 1,250 LTIP units to each of our independent directors in connection with the 2009 annual award of LTIP units to our independent directors. We will issue 1,250 LTIP units to each of our independent directors on October 1, 2010 in connection with the 2010 annual award of LTIP units to our independent directors. See Management 2007 Long-Term Incentive Plans.

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Registration Rights

Our and our Manager s executive officers, directors, partners, members and other affiliates (as such term is defined in the Exchange Act), including but not limited to Ellington-managed funds, and any of their permitted transferees and including (i) any executive officer, director, trustee, or general partner of such affiliate and (ii) any legal entity for which such affiliate acts as an executive officer, director, trustee or general partner, or the Covered Persons, are entitled to the benefits of a registration rights agreement with respect to the common shares they purchased in our August 2007 private offering and, in the case of our Manager, any common shares issued to our Manager as part of its incentive fee. Pursuant to such registration rights agreement, we are required to file within 60 days after the closing of this offering a resale shelf registration statement providing for the registered resale of these shares. In addition, to the extent any of these shares are no longer eligible for the treatment in the preceding sentence, the registration rights agreement provides the Covered Persons with (i) customary piggy-back registration rights with respect to any registration statement we file with the SEC (subject to underwriter cut-back rights with respect to underwritten offerings) and (ii) upon the request of Covered Persons holding a certain percentage of common shares covered under the registration rights agreement, the right to require us to file up to three registration statements on Form S-3 once we become eligible to use such form or, if we have been subject to regulation under the Exchange Act and have filed all material required to be filed pursuant to Section 13, 14 or 15(d) of the Exchange Act for at least 12 months and are not then eligible to use Form S-3, a single registration on such other form that we are eligible to use.

Indemnification Agreements

We have entered into indemnification agreements with our directors and officers that obligate us to indemnify them to the maximum extent permitted by Delaware law and pay such persons expenses in defending any civil or criminal proceedings in advance of final disposition of such proceeding.

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PRINCIPAL SHAREHOLDERS

The following table sets forth, as of August 23, 2010 and before giving effect to this offering, certain ownership information with respect to our common shares for those persons known to us who directly or indirectly own, control or hold with the power to vote 5% or more of our outstanding common shares and all of our executive officers and directors, individually and as a group. In accordance with SEC rules, each listed person s beneficial ownership includes:

all shares the investor actually owns beneficially or of record;

all shares over which the investor has or shares voting or dispositive control (such as in the capacity as a general partner of a fund); and

all shares the investor has the right to acquire within 60 days (such as upon exercise of options that are currently vested or which are scheduled to vest within 60 days).

	Shares Beneficially Owned	
Name and Address	**Number**	**Percent**
5% Shareholders:		
EMG Holdings, L.P.[1]	3,462,920	28.0%
American Financial Group, Inc.[2]		%
FBR Capital Markets Corporation[3]		%
Legg Mason Opportunity Trust[4]		%
Reservoir Capital Group, L.L.C.[5]		%
Summit Capital Group LLC[6]		%
Zweig-DiMenna Partners, L.P.[7]		%
Directors and Executive Officers:[8]		
Michael W. Vranos[9][10]	3,462,920	28.0%
Laurence Penn[10]	3,462,920	28.0%
Mark Tecotzky[10]	3,462,920	28.0%
Lisa Mumford		
Thomas Robards[11]	3,750	*
Ronald I. Simon, Ph.D[12]	7,500	*
Edward Resendez[13]	3,750	*
All officers and directors as a group	3,477,920	28.1%

* Less than 1%.

(1) Includes (a) 1,294,004 shares and 375,000 LTIP units held by EMG Holdings, L.P., 1,250,000 shares held by three hedge funds that are controlled by Ellington and are part of the Manager Group, (b) 500,000 shares held by a trust as to which Mr. Vranos is the settlor, and (c) 43,916 shares held by our Manager. LTIP units are convertible into common shares on a one-for-one basis, subject to certain conditions. The members of our Manager are VC Investments L.L.C. and EMG Holdings, L.P. VC Investments L.L.C. is the managing member of our manager and the general partner of EMG Holdings, L.P. VC Investments L.L.C. and EMG Holdings, L.P. collectively own the beneficial interest in the common shares held by our Manager and 100% of the voting interest in our Manager. Mr. Vranos beneficially owns a controlling interest in VC Investments L.L.C. Accordingly, Mr. Vranos, VC Investments L.L.C. and EMG Holdings L.P. may be deemed to beneficially own common shares owned by our Manager. The address for EMG Holdings, L.P. is 53 Forest Avenue, Old Greenwich, CT 06870.

(2) The address for American Financial Group, Inc. is One East Fourth Street, Cincinnati, OH 45202.

(3) The address for FBR Capital Markets Corporation is 1001 Nineteenth Street North, 18th Floor, Arlington, VA 22209.

(4) The address for Legg Mason Opportunity Trust, a series of Legg Mason Investment Trust, Inc., is 100 Light Street, Baltimore, MD 21202.

(5) The address for Reservoir Capital Group, L.L.C. is 650 Madison Avenue, 26th Floor, New York, NY 10022.

(6) The address for Summit Capital Group LLC is One Union Square, Suite 2304, 600 University Street, Seattle, WA 98101.

(7) The address for Zweig-DiMenna Associates, Inc. is 900 3rd Avenue, 31st Floor, New York, NY 10022.

(8) The address for all officers and directors is Ellington Financial LLC, 53 Forest Avenue, Old Greenwich, CT 06870.

(9) Mr. Vranos is the settlor of a trust that owns 500,000 of our common shares. Mr. Vranos disclaims beneficial ownership of our common shares held by this trust.

(10) Each of Messrs. Vranos, Penn and Tecotzky is a beneficial owner of our Manager and EMG Holdings, L.P. Accordingly, such individuals may be deemed to beneficially own common shares and LTIP units owned by our Manager and EMG Holdings, L.P. Each such individual member disclaims beneficial ownership of any such common shares and LTIP units in which they do not have a pecuniary interest.
(11) Includes 2,500 LTIP units which are convertible into common shares on a one-for-one basis, subject to certain conditions.
(12) Mr. Simon and his spouse are beneficiaries of a trust that holds all of Mr. Simon s common shares.
(13) Includes 1,250 LTIP units which are convertible into common shares on a one-for-one basis, subject to certain conditions.

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DESCRIPTION OF SHARES

The following is a summary of some of the terms of the common shares representing limited liability company interests in our company. Our operating agreement provides for the issuance of our common shares, as well as certain terms of our common shares. The following is a summary of some of the terms of our common shares, our operating agreement and the Delaware LLC Act, and is not complete and is subject to, and qualified in its entirety by reference to, all of the provisions of our operating agreement and the Delaware LLC Act.

Authorized Shares

Each of our common shares represents a limited liability company interest in Ellington Financial LLC. We are authorized to issue, pursuant to action by our board of directors and without action by our shareholders, up to 100,000,000 common shares, up to 100,000,000 preferred shares and up to 10,000,000 LTIP units. Upon consummation of this offering, there will be   common shares and 380,000 LTIP Units outstanding.

Common shares

Upon payment in full of the consideration payable with respect to the common shares, as determined by our board of directors, such shareholders shall not be liable to us to make any additional capital contributions with respect to such shares (except as otherwise required by Sections 18-607 and 18-804 of the Delaware LLC Act). No holder of common shares is entitled to preemptive, redemption or conversion rights.

Voting Rights

The holders of common shares are entitled to one vote per share held of record on all matters submitted to a vote of our shareholders. Generally, all matters to be voted on by our shareholders must be approved by a majority (or, in the case of election of directors, by a plurality) of the votes entitled to be cast by all common shares present in person or represented by proxy, voting together as a group.

Distribution Rights

In general, holders of common shares will share ratably (based on the number of common shares held) in any distribution declared by our board of directors out of funds legally available, therefore, subject to any statutory or contractual restrictions on the payment of distributions and to any restrictions on the payment of distributions imposed by the terms of any outstanding preferred shares. Distributions consisting of common shares may be paid only as follows: (i) common shares may be paid only to holders of common shares; and (ii) shares shall be paid proportionally with respect to each outstanding common share.

Manager s Shares

Prior to July 1, 2009, the amount of base management fees and incentive fees that we paid to our Manager was reduced to exclude from the calculation amounts that was otherwise payable in respect of equity and net income that was attributable to common shares and LTIP units owned by our Manager. Pursuant to our operating agreement, the base management fee and incentive fee was reduced in the manner described in the preceding sentence, was specially allocated to holders of common shares other than our Manager, and an amount of cash equal to such reduction was distributed to our Manager. The amounts paid to our Manager as distributions in lieu of base management and incentive fees that were otherwise payable in respect of common shares held by our Manager were approximately $0.2 million for the period from August 17, 2007 (commencement of operations) through December 31, 2007, approximately $0.9 million for the year ended December 31, 2008 and $1.8 million for the year ended December 31, 2009.

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Liquidation Rights

Upon our dissolution, liquidation or winding up, after payment in full of all amounts required to be paid to creditors and to the holders of preferred shares having liquidation preferences, if any, the holders of our common shares will be entitled to receive our remaining assets available for distribution (only to the extent such assets are converted to cash) in accordance with and to the extent of positive balances in the respective capital accounts after taking into account certain adjustments. If our assets remaining after payment or discharge of our debts or liabilities are insufficient to return their capital contributions, the holders of our common shares shall have no recourse against us or any other holder of our common shares or our Manager.

Other Matters

In the event of our merger or consolidation with or into another entity in connection with which our common shares are converted into or exchangeable for shares of stock, other securities or property (including cash), all holders of common shares will thereafter be entitled to receive the same kind and amount of shares of stock and other securities and property (including cash). Under our operating agreement, in the event of an inadvertent termination of partnership status in which the IRS has granted us limited relief each holder of our common shares also is obligated to make such adjustments as are required by the IRS to maintain our status as a partnership for U.S. federal (and applicable state) income tax purposes.

Preferred Shares

Our operating agreement authorizes our board of directors to establish one or more series of preferred shares. Unless required by law or by any stock exchange, the authorized preferred shares will be available for issuance without further action by common shareholders. Our board of directors is able to determine, with respect to any series of preferred shares, the holders of terms and rights of that series, including:

- the designation of the series;
- the amount of preferred shares of the series, which our board may, except where otherwise provided in the preferred shares designation, increase or decrease, but not below the number of preferred shares of the series then outstanding;
- whether distributions, if any, will be cumulative or non-cumulative and the dividend rate of the series;
- the dates at which distributions, if any, will be payable;
- the redemption rights and price or prices, if any, for preferred shares of the series;
- the terms and amounts of any sinking fund provided for the purchase or redemption of the preferred shares of the series;
- the amounts payable on preferred shares of the series in the event of any voluntary or involuntary liquidation, dissolution or winding-up of the affairs of our company;
- whether the preferred shares of the series will be convertible into or exchangeable for interests of any other class or series, or any other security, of our company or any other entity, and, if so, the specification of the other class or series or other security, the conversion or exchange price or prices or rate or rates, any rate adjustments, the date or dates on which, the period or periods during which, the shares will be convertible or exchangeable and all other terms and conditions upon which the conversion or exchange may be made;

restrictions on the issuance of preferred shares of the series or of any shares of any other class or series; and

the voting rights, if any, of the holders of the preferred shares of the series.

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We could issue a series of preferred shares that could, depending on the terms of the series, impede or discourage an acquisition attempt or other transaction that some, or a majority, of holders of common shares might believe to be in their best interests or in which holders of common shares might receive a premium for their common shares over the market value of the common shares.

LTIP Units

For a description of our LTIP units see Management 2007 Long-Term Incentive Plans.

Operating Agreement

Organization and Duration

We were formed in Delaware in July 2007, and will remain in existence until dissolved in accordance with our operating agreement.

Purpose

Under our operating agreement, we are permitted to engage in any business activity that lawfully may be conducted by a limited liability company organized under Delaware law and, in connection therewith, to exercise all of the rights and powers conferred upon us pursuant to the agreements relating to such business activity; provided, however, that, except if our board of directors determines that it is no longer in our best interests, our management shall not cause us to engage, directly or indirectly, in any business activity that our board of directors determines would require us to register as an investment company under the Investment Company Act or cause us to be treated as an association or publicly traded partnership taxable as a corporation or otherwise taxable at the entity level for federal income tax purposes.

Agreement to be Bound by our Operating Agreement; Power of Attorney

By purchasing a common share, you will be admitted as a member of our limited liability company and will be deemed to have agreed to be bound by the terms of our operating agreement. Pursuant to this agreement, each shareholder and each person who acquires a common share from a shareholder grants to certain of our officers (and, if appointed, a liquidator) a power of attorney to, among other things, execute and file documents required for our qualification, continuance or dissolution. The power of attorney also grants certain of our officers the authority to make certain amendments to, and to make consents under and in accordance with, our operating agreement.

Duties of Officers and Directors

Our operating agreement provides that our business and affairs shall be managed under the direction of our board of directors, which shall have the power to appoint our officers. Our operating agreement further provides that the authority and function of our board of directors and officers shall be identical to the authority and functions of a board of directors and officers of a corporation organized under the Delaware General Corporation Law, or DGCL, except as expressly modified by the terms of the operating agreement. Finally, our operating agreement provides that except as specifically provided therein, the fiduciary duties and obligations of our board of directors owed to us and to our members shall be the same as the respective duties and obligations owed by officers and directors of a corporation organized under the DGCL to their corporation and stockholders, respectively.

Our operating agreement does not expressly modify the duties and obligations owed by officers and directors under the DGCL. However, there are certain provisions in our operating agreement regarding exculpation and indemnification of our officers and directors that differ from the DGCL. First, our operating

agreement provides that to the fullest extent permitted by applicable law our directors will not be liable to us. Under the DGCL, a director or officer would be liable to us for (i) breach of duty of loyalty to us or our shareholders; (ii) intentional misconduct or knowing violations of the law that are not done in good faith; (iii) improper redemption of stock or declaration of a dividend; or (iv) a transaction from which the director derived an improper personal benefit.

Second, our operating agreement provides that we indemnify our directors and officers for acts or omissions to the fullest extent permitted by law. Under the DGCL, a corporation can only indemnify directors and officers for acts or omissions if the director or officer acted in good faith, in a manner he reasonably believed to be in the best interests of the corporation, and, in a criminal action, if the officer or director had no reasonable cause to believe his conduct was unlawful.

Third, our operating agreement provides that in the event a potential conflict of interest exists or arises between any of our principals, our directors or their respective affiliates, on the one hand, and us, any of our subsidiaries or any of our shareholders, on the other hand, a resolution or course of action by our board of directors shall be deemed approved by all of our shareholders, and shall not constitute a breach of the fiduciary duties of members of the board to us or our shareholders, if such resolution or course of action is (i) approved by our nominating and corporate governance committee, which is composed of independent directors, (ii) approved by shareholders holding a majority of our shares that are disinterested parties, (iii) on terms no less favorable than those generally provided to or available from unrelated third parties, or (iv) fair and reasonable to us. Under the DGCL, a corporation is not permitted to automatically exempt board members from claims of breach of fiduciary duty under such circumstances.

In addition, our operating agreement provides that all conflicts of interest described in this prospectus are deemed to have been specifically approved by all of our shareholders.

Election of Members of Our Board of Directors

Since our first annual meeting of shareholders, members of our board of directors have been elected by a plurality of our shareholders. Each member of our board of directors currently serves until such director s successor is duly elected or appointed and qualified.

Removal of Members of Our Board of Directors

Any director or the entire board of directors may be removed, only for cause (as defined in the operating agreement) and then only by a vote of at least two-thirds of the votes entitled to be cast in the election of directors. The vacancy in the board of directors caused by any such removal will be filled by a vote of the majority of directors then in office even if the remaining directors do not constitute a quorum.

Shareholder Meetings

Under our operating agreement, we are required to hold an annual meeting of shareholders for the election of directors and other business during the month of May of each year on a date and time to be set by the board of directors. In addition, our operating agreement provides that a special meeting of shareholders may be called by our board of directors and certain of our officers. Our operating agreement further provides that, subject to the satisfaction of certain procedural and information requirements, a special meeting of shareholders shall be called by the Secretary of the company upon written request of shareholders entitled to cast not less than a majority of all of the votes entitled to be cast at such meeting.

Advance Notice of Nominations and Shareholder Business

Our operating agreement establishes advance notice procedures with respect to shareholder proposals and the nomination of persons for election as directors at annual meeting of our shareholders.

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Limited Liability

The Delaware LLC Act provides that a member who receives a distribution from a Delaware limited liability company and knew at the time of the distribution that the distribution was in violation of the Delaware LLC Act shall be liable to the company for the amount of the distribution for three years. Under the Delaware LLC Act, a limited liability company may not make a distribution to a member if, after the distribution, all liabilities of the company, other than liabilities to members on account of their shares and liabilities for which the recourse of creditors is limited to specific property of the company, would exceed the fair value of the assets of the company. For the purpose of determining the fair value of the assets of a company, the Delaware LLC Act provides that the fair value of property subject to liability for which recourse of creditors is limited shall be included in the assets of the company only to the extent that the fair value of that property exceeds the nonrecourse liability. Under the Delaware LLC Act, an assignee who becomes a substituted member of a company is liable for the obligations of his assignor to make contributions to the company, except the assignee is not obligated for liabilities unknown to him at the time the assignee became a member and that could not be ascertained from the operating agreement.

Limitations on Liability and Indemnification of Our Directors and Officers

Our operating agreement provides that our directors will not be liable to us, or any subsidiary of ours, or any holder of shares, for monetary damages for any acts or omissions arising from the performance of any of such director s obligations or duties in connection with us, including breach of fiduciary duty, except as follows: (i) for any breach of the director s duty of loyalty to us or the holders of the shares; (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law; or (iii) for any transaction from which the director derived an improper personal benefit. The operating agreement provides that, to the fullest extent permitted by law, we will indemnify our directors and officers or any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative (other than an action by or in the right of us) by reason of the fact that the person is or was our director, officer, employee, tax matters member or agent, or is or was serving at our request as a director, officer, employee or agent of another company, to the fullest extent permitted by law against expenses (including attorneys fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by the person in connection with such action, suit or proceeding if the person acted in good faith and in a manner the person reasonably believed to be in or not opposed to our best interests, and, with respect to any criminal action or proceeding, had no reasonable cause to believe the person s conduct was unlawful.

Each of the persons entitled to be indemnified for expenses and liabilities as contemplated above may, in the performance of his, her or its duties, consult with legal counsel and accountants, and any act or omission by such person on our behalf in furtherance of our interests in good faith in reliance upon, and in accordance with, the advice of such legal counsel or accountants will be full justification for any such act or omission, and such person will be fully protected for such acts and omissions; provided that such legal counsel or accountants were selected with reasonable care by or on our behalf.

Amendment of Our Operating Agreement

Amendments to our operating agreement may be proposed only by or with the consent of our board of directors. To adopt a proposed amendment, our board of directors is required to seek written approval of the holders of the number of shares required to approve the amendment or call a meeting of our shareholders to consider and vote upon the proposed amendment. Except as set forth below, an amendment must be approved by holders of a majority of the total voting power of our outstanding common shares and, to the extent that such amendment would have a material adverse effect on the holders of any class or series of shares, by the holders of a majority of the holders of such class or series.

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Prohibited Amendments. No amendment may be made that would:

- enlarge the obligations of any shareholder without such shareholder s consent, unless approved by at least a majority of the type or class of shares so affected;

- provide that we are not dissolved upon an election to dissolve our limited liability company by our board of directors that is approved by holders of a majority of the total voting power of our outstanding common shares;