Invesco Mortgage Capital Inc.
Form 10-Q
May 14, 2010
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2010

OR

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

For the transition period from ________________ to ________________

Commission file number 001-34385

INVESCO MORTGAGE CAPITAL INC.
(Exact Name of Registrant as Specified in Its Charter)

Maryland (State or Other Jurisdiction of Incorporation or Organization)	26-2749336 (I.R.S. Employer Identification No.)
1555 Peachtree Street, N.E., Suite 1800 Atlanta, Georgia (Address of Principal Executive Offices)	30309 (Zip Code)

(404) 892-0896
(Registrant's Telephone Number, Including Area Code)

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

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

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

Large Accelerated filer ¨	Accelerated filer ¨
Non-Accelerated filer x	Smaller reporting company ¨
(Do not check if a smaller reporting company)	

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

As of May 14, 2010, there were 25,938,046 outstanding shares of common stock of Invesco Mortgage Capital Inc.

INVESCO MORTGAGE CAPITAL INC.
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PART I

ITEM 1. FINANCIAL STATEMENTS

INVESCO MORTGAGE CAPITAL INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

$ in thousands, except per share amounts

ASSETS	March 31, 2010 (Unaudited)	December 31, 2009
Mortgage-backed securities, at fair value	1,436,005	802,592
Cash	9,186	24,041
Restricted cash	30,614	14,432
Principal paydown receivable	12,287	2,737
Investments in unconsolidated limited partnerships, at fair value	28,683	4,128
Accrued interest receivable	6,270	3,518
Derivative asset, at fair value	44	—
Prepaid insurance	335	681
Deferred offering costs	—	288
Other assets	504	983
Total assets	1,523,928	853,400
LIABILITIES AND EQUITY		
Liabilities:		
Repurchase agreements	961,163	545,975
TALF financing	151,819	80,377
Derivative liability, at fair value	9,197	3,782
Dividends and distributions payable	14,323	10,828
Payable for investment securities purchased	12,357	—
Accrued interest payable	977	598
Accounts payable and accrued expenses	820	665
Due to affiliate	1,296	865
Total liabilities	1,151,952	643,090
Equity:		
Preferred Stock: par value $0.01 per share; 50,000,000 shares authorized, 0 shares issued and outstanding	—	—
Common Stock: par value $0.01 per share; 450,000,000 shares authorized, 16,938,046 and 8,887,212 shares issued and outstanding, at March 31, 2010 and December 31, 2009, respectively	170	89
Additional paid in capital	334,904	172,385
Accumulated other comprehensive income	7,533	7,721
Retained earnings (deficit)	(843)	320
Total shareholders' equity	341,764	180,515

Non-controlling interest	30,212	29,795
Total equity	371,976	210,310
Total liabilities and equity	1,523,928	853,400

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

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INVESCO MORTGAGE CAPITAL INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

$ in thousands, except per share data	For the Three Months Ended March 31, 2010	For the Three Months Ended March 31, 2009
Revenues		
Interest income	18,010	—
Interest expense	3,652	—
Net interest income	14,358	—
Other income (loss)		
Gain on sale of investments	733	—
Equity in earnings and fair value change in unconsolidated limited partnerships	446	—
Loss on other-than-temporarily impaired securities	(124)	—
Unrealized loss on interest rate swaps	(25)	—
Total other income	1,030	—
Expenses		
Management fee – related party	1,284	—
General and administrative	182	45
Insurance	346	—
Professional Fees	409	3
Total expenses	2,221	48
Net income (loss)	13,167	(48)
Net income attributable to non-controlling interest	1,118	—
Net income (loss) attributable to common shareholders	12,049	(48)
Earnings per share:		
Net income attributable to common shareholders (basic/diluted)	0.77	NM
Dividends declared per common share	0.78	—
Weighted average number of shares of common stock:		
Basic	15,685	NM
Diluted	17,111	NM

NM = not meaningful

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

INVESCO MORTGAGE CAPITAL INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
For the three months ended March 31, 2010
(Unaudited)

	Attributable to Common Shareholders								
$ in thousands, except per share amounts	Common Stock Shares	Common Stock Amount	Additional Paid in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings (Deficit)	Total Shareholders Equity	Non-Controlling Interest	Total Equity	Comprehensive Income (Loss)
Balance at January 1, 2010	8,887,212	89	172,385	7,721	320	180,515	29,795	210,310	26,470
Net income	—	—	—	—	12,049	12,049	1,118	13,167	13,167
Comprehensive income									
Change in net unrealized gains and losses on available for sale securities	—	—	—	4,531	—	4,531	1,035	5,566	5,566
Change in net unrealized gains and losses on derivatives	—	—	—	(4,719)	—	(4,719)	(627)	(5,346)	(5,346)
Total comprehensive income									39,857
Net proceeds from common stock, net of offering costs	8,050,000	81	162,501	—	—	162,582	—	162,582	
Stock awards to directors	834	—	—	—	—	—	—	—	
Common stock dividends	—	—	—	—	(13,212)	(13,212)	—	(13,212)	
Common unit dividends	—	—	—	—	—	—	(1,112)	(1,112)	
Amortization of equity-based compensation	—	—	18	—	—	18	3	21	
Balance at March 31, 2010	16,938,046	170	334,904	7,533	(843)	341,764	30,212	371,976	

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

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

$ in thousands	Three Months Ended March 31, 2010	Three Months Ended March 31, 2009
Cash Flows from Operating Activities		
Net income (loss)	13,167	(48)
Adjustments to reconcile net income to net cash provided by operating activities		
Amortization of mortgage-backed securities premiums and discounts, net	(1,925)	—
Unrealized loss on derivatives	25	—
Gain on sale of mortgage-backed securities	(733)	—
Loss on other-than-temporarily impaired securities	124	—
Equity in earnings and fair value change in unconsolidated limited partnerships	(446)	—
Amortization of equity-based compensation	21	—
Changes in operating assets and liabilities		
Increase in accrued interest	(2,752)	—
(Increase) decrease in prepaid insurance	346	—
(Increase) decrease in deferred offering costs	20	(235)
Increase in other assets	480	—
Increase in accrued interest payable	379	—
Increase in due to affiliate	529	283
Increase (decrease) in accounts payable and accrued expenses	324	—
Net cash provided by operating activities	9,559	—
Cash Flows from Investing Activities		
Purchase of mortgage-backed securities	(775,561)	—
Investment in PPIP	(11,771)	—
Principal payments of mortgage-backed securities	65,868	—
Proceeds from sale of mortgage-backed securities	74,849	—
Net cash used in investing activities	(646,615)	—
Cash Flows from Financing Activities		
Proceeds from issuance of common stock	162,582	—
Restricted cash	(16,182)	—
Proceeds from repurchase agreements	2,527,880	—
Principal repayments of repurchase agreements	(2,112,692)	—
Proceeds from TALF financing	71,525	—
Principal payments of TALF financing	(84)	—
Payments of dividends and distributions	(10,828)	—
Net cash provided by financing activities	622,201	—
Net change in cash	(14,855)	—
Cash, Beginning of Period	24,041	1

Cash, End of Period	9,186	1
Supplement disclosure of cash flow information		
Interest paid	3,273	—
Non-cash investing and financing activities information		
Net change in unrealized gain (loss) on available-for-sale securities and derivatives	220	—
Net change in investment in PPIP	12,339	—
Dividends and distributions declared not paid	14,323	—

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

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

Note 1 – Organization and Business Operations

Invesco Mortgage Capital Inc. (the “Company”) is a Maryland corporation focused on investing in, financing and managing residential and commercial mortgage-backed securities and mortgage loans. The Company invests in residential mortgage-backed securities (“RMBS”) for which a U.S. Government agency such as the Government National Mortgage Association (“Ginnie Mae”), the Federal National Mortgage Association (“Fannie Mae”) or the Federal Home Loan Mortgage Corporation (“Freddie Mac”) guarantees payments of principal and interest on the securities (collectively “Agency RMBS”). The Company’s Agency RMBS investments include mortgage pass-through securities and collateralized mortgage obligations (“CMOs”). The Company also invests in residential mortgage-backed securities that are not issued or guaranteed by a U.S. government agency (“Non-Agency RMBS”), commercial mortgage-backed securities (“CMBS”), and residential and commercial mortgage loans. The Company is externally managed and advised by Invesco Advisers, Inc. (the “Manager”), a registered investment adviser and an indirect, wholly-owned subsidiary of Invesco Ltd. (“Invesco”), a global investment management company.

The Company conducts its business through IAS Operating Partnership LP (the “Operating Partnership”) as its sole general partner. As of March 31, 2010, the Company owned 92.2% of the Operating Partnership and Invesco Investments (Bermuda) Ltd., a direct, wholly-owned subsidiary of Invesco, owned the remaining 7.8%.

The Company finances its Agency RMBS and Non-Agency RMBS and some of its CMBS investments, through short-term borrowings structured as repurchase agreements. The Manager has secured commitments for the Company with a number of repurchase agreement counterparties. In addition, the Company has financed its CMBS portfolio with financings under the Term Asset-Backed Securities Lending Facility (“TALF”). The Company has also financed, and may do so again in the future, investments in CMBS under private equity sources. The Company also finances its investments in certain Non-Agency RMBS, CMBS and residential and commercial mortgage loans by contributing capital to a partnership that invests in public-private investment funds (“PPIF”) managed by the Company’s Manager. In addition, the Company may use other sources of financing including committed borrowing facilities and other private financing.

The Company intends to elect and qualify to be taxed as a real estate investment trust (“REIT”) for U.S. federal income tax purposes under the provisions of the Internal Revenue Code of 1986, as amended (“Code”), commencing with the Company’s taxable year ended December 31, 2009. To maintain the Company’s REIT qualification, the Company is generally required to distribute at least 90% of its net income (excluding net capital gains) to its shareholders annually.

Note 2 – Summary of Significant Accounting Policies

Basis of Quarterly Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“US GAAP”) for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. In the opinion of management, all adjustments (consisting of normal recurring adjustments) necessary for a fair presentation of the financial position and the results of operations of the Company for the interim periods presented have been included. The interim consolidated financial statements should be read in conjunction with the Company’s consolidated financial statements and related notes thereto included in the Company’s annual report on Form 10-K for the year ended December 31, 2009 which was filed with the Securities and Exchange Commission (the “SEC”) on March 24, 2010 and amended on April 29, 2010. The results of operations for the interim period ended March 31, 2010 are not necessarily indicative of the results to be expected for the full year or any other future period.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its subsidiaries. All intercompany balances and transactions have been eliminated.

Use of Estimates

The accounting and reporting policies of the Company conform to US GAAP. The preparation of consolidated financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Examples of estimates include, but are not limited to, estimates of the fair values of financial instruments, interest income on mortgage-backed securities ("MBS") and other-than-temporary impairment charges. Actual results may differ from those estimates.

Cash and Cash Equivalents

The Company considers all highly liquid investments that have original or remaining maturity dates of three months or less when purchased to be cash equivalents. At March 31, 2010, the Company had cash and cash equivalents, including amounts restricted, in excess of the Federal Deposit Insurance Corporation deposit insurance limit of $250,000 per institution. The Company mitigates its risk by placing cash and cash equivalents with major financial institutions.

Deferred Offering Costs

The Company records costs associated with stock offerings as a reduction in additional paid in capital. At December 31, 2009, deferred offering costs consisted of legal and other costs of approximately $288,000 related to the follow-on public offering completed on January 15, 2010 (the "January Offering").

Underwriting Commissions and Costs

Underwriting commissions and direct costs incurred in connection with the Company's initial public offering ("IPO") and the January Offering are reflected as a reduction of additional paid-in-capital.

Repurchase Agreements

The Company finances its Agency RMBS, Non-Agency RMBS and CMBS investment portfolio through the use of repurchase agreements. Repurchase agreements are treated as collateralized financing transactions and are carried at their contractual amounts, including accrued interest, as specified in the respective agreements.

In instances where the Company acquires Agency RMBS, Non-Agency RMBS or CMBS through repurchase agreements with the same counterparty from whom the Agency RMBS, Non-Agency RMBS or CMBS were purchased, the Company accounts for the purchase commitment and repurchase agreement on a net basis and records a forward commitment to purchase Agency RMBS, Non-Agency RMBS or CMBS as a derivative instrument if the transaction does not comply with the criteria for gross presentation. All of the following criteria must be met for gross presentation in the circumstance where the repurchase assets are financed with the same counterparty as follows:

- the initial transfer of and repurchase financing cannot be contractually contingent;
- the repurchase financing entered into between the parties provides full recourse to the transferee and the repurchase price is fixed;
- the financial asset has an active market and the transfer is executed at market rates; and
- the repurchase agreement and financial asset do not mature simultaneously.

For assets representing available-for-sale investment securities, which are the case with respect to the Company's portfolio of investments, any change in fair value is reported through consolidated other comprehensive income (loss) with the exception of impairment losses, which are recorded in the consolidated statement of operations.

If the transaction complies with the criteria for gross presentation, the Company records the assets and the related financing on a gross basis on its balance sheet, and the corresponding interest income and interest expense in its statements of operations. Such forward commitments are recorded at fair value with subsequent changes in fair value recognized in income. Additionally, the Company records the cash portion of its investment in Agency RMBS and Non-Agency RMBS as a mortgage related receivable from the counterparty on its balance sheet.

Fair Value Measurements

In January 2010, the FASB updated guidance entitled, “Improving Disclosures about Fair Value Measurements.” The guidance required a number of additional disclosures regarding fair value measurements. Specifically, entities should disclose: (1) the amount of significant transfers between Level 1 and Level 2 of the fair value hierarchy and the reasons for these transfers; (2) the reasons for any transfers in or out of Level 3; and (3) information in the reconciliation of recurring Level 3 measurements about purchases, sales, issuances and settlements on a gross basis. Except for the requirement to disclose information about purchases, sales, issuances, and settlements in the reconciliation of recurring Level 3 measurements on a gross basis, all the amendments are effective for interim and annual reporting periods beginning after December 15, 2009. The Company adopted these provisions in preparing the Consolidated Financial Statements for the period ended March 31, 2010. The adoption of these provisions only affected the disclosure requirements for fair value measurements and as a result had no impact on the Company’s consolidated statements of operations and consolidated balance sheets.

The Company discloses the fair value of its financial instruments according to a fair value hierarchy (levels 1, 2, and 3, as defined). In accordance with US GAAP, the Company is required to provide enhanced disclosures regarding instruments in the level 3 category (which require significant management judgment), including a separate reconciliation of the beginning and ending balances for each major category of assets and liabilities.

Additionally, US GAAP permits entities to choose to measure many financial instruments and certain other items at fair value (the “fair value option”). Unrealized gains and losses on items for which the fair value option has been elected are irrevocably recognized in earnings at each subsequent reporting date.

During 2009, the Company elected the fair value option for its investments in unconsolidated limited partnerships. The Company has the one-time option to elect fair value for these financial assets on the election date. The changes in the fair value of these instruments are recorded in equity in earnings and fair value change in unconsolidated limited partnerships in the consolidated statements of operations.

Securities

The Company designates securities as held-to-maturity, available-for-sale, or trading depending on its ability and intent to hold such securities to maturity. Trading and securities available-for-sale are reported at fair value, while securities held-to-maturity are reported at amortized cost. Although the Company generally intends to hold most of its RMBS and CMBS until maturity, the Company may, from time to time, sell any of its RMBS or CMBS as part of its overall management of its investment portfolio and as such will classify its RMBS and CMBS as available-for-sale securities.

All securities classified as available-for-sale are reported at fair value, based on market prices from third-party sources, with unrealized gains and losses excluded from earnings and reported as a separate component of shareholders’ equity. When applicable, included with available-for-sale securities are forward purchase commitments on to be announced securities (“TBA”). The Company records TBA purchases on the trade date and the corresponding payable is recorded as an outstanding liability in payable for investments purchased until the settlement date of the transaction.

The Company evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market conditions warrant such evaluation. The determination of whether a security is other-than-temporarily impaired involves judgments and assumptions based on subjective and objective factors. Consideration is given to (i) the length of time and the extent to which the fair value has been less than cost, (ii) the financial condition and near-term prospects of recovery, in fair value of the security, and (iii) the Company's intent and ability to retain its investment in the security for a period of time sufficient to allow for any anticipated recovery in fair value. For debt securities, the amount of the other-than-temporary impairment related to a credit loss or impairments on securities that the Company has the intent or for which it is more likely than not that the Company will need to sell before recovery are recognized in earnings and reflected as a reduction in the cost basis of the security. The amount of the other-than-temporary impairment on debt securities related to other factors is recorded consistent with changes in the fair value of all other available-for-sale securities as a component of consolidated shareholders' equity in other comprehensive income or loss with no change to the cost basis of the security.

Interest Income Recognition

Interest income on available-for-sale MBS, which includes accretion of discounts and amortization of premiums on such MBS, is recognized over the life of the investment using the effective interest method. Management estimates, at the time of purchase, the future expected cash flows and determines the effective interest rate based on these estimated cash flows and the Company's purchase price. As needed, these estimated cash flows are updated and a revised yield is computed based on the current amortized cost of the investment. In estimating these cash flows, there are a number of assumptions subject to uncertainties and contingencies, including the rate and timing of principal payments (prepayments, repurchases, defaults and liquidations), the pass through or coupon rate and interest rate fluctuations. In addition, interest payment shortfalls due to delinquencies on the underlying mortgage loans have to be judgmentally estimated. These uncertainties and contingencies are difficult to predict and are subject to future events that may impact management's estimates and its interest income. Security transactions are recorded on the trade date. Realized gains and losses from security transactions are determined based upon the specific identification method and recorded as gain (loss) on sale of available-for-sale securities in the consolidated statement of operations.

Investments in Unconsolidated Limited Partnerships

The Company has investments in unconsolidated limited partnerships. In circumstances where the Company has a non-controlling interest but is deemed to be able to exert influence over the affairs of the enterprise the Company utilizes the equity method of accounting. Under the equity method of accounting, the initial investment is increased each period for additional capital contributions and a proportionate share of the entity's earnings and decreased for cash distributions and a proportionate share of the entity's losses.

The Company elected the fair value option for investments in unconsolidated limited partnerships. The election for investments in unconsolidated limited partnerships was made upon their initial recognition in the financial statements. The Company has elected the fair value option for the investments in unconsolidated limited partnerships for the purpose of enhancing the transparency of its financial condition.

The Company measures the fair value of the investments in unconsolidated limited partnerships on the basis of the net asset value per share of the investments as permitted in guidance effective for the interim and annual periods ended after December 15, 2009.

Dividends and Distributions Payable

Dividends and distributions payable represent dividends declared at the balance sheet date which are payable to common shareholders and distributions declared at the balance sheet date which are payable to non-controlling interest common unit holders of the Operating Partnership, respectively.

Earnings per Share

The Company calculates basic earnings per share by dividing net income for the period by weighted-average shares of the Company's common stock outstanding for that period. Diluted income per share takes into account the effect of dilutive instruments, such as units of limited partnership interest in the Operating Partnership ("OP Units"), stock options and unvested restricted stock, but uses the average share price for the period in determining the number of incremental shares that are to be added to the weighted-average number of shares outstanding. For the three months ended March 31, 2009, earnings per share is not presented because it is not a meaningful measure of the Company's performance.

Comprehensive Income

Comprehensive income is comprised of net income, as presented in the consolidated statements of operations, adjusted for changes in unrealized gains or losses on available for sale securities and changes in the fair value of derivatives accounted for as cash flow hedges.

Accounting for Derivative Financial Instruments

US GAAP provides disclosure requirements for derivatives and hedging activities with the intent to provide users of financial statements with an enhanced understanding of: (i) how and why an entity uses derivative instruments; (ii) how derivative instruments and related hedged items are accounted for; and (iii) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. US GAAP requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about the fair value of and gains and losses on derivative instruments, and disclosures about credit-risk-related contingent features in derivative instruments.

The Company records all derivatives on the balance sheet at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative, whether the Company has elected to designate a derivative in a hedging relationship and apply hedge accounting and whether the hedging relationship has satisfied the criteria necessary to apply hedge accounting. Derivatives designated and qualifying as a hedge of the exposure to changes in the fair value of an asset, liability, or firm commitment attributable to a particular risk, such as interest rate risk, are considered fair value hedges. Derivatives designated and qualifying as a hedge of the exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges. Derivatives may also be designated as hedges of the foreign currency exposure of a net investment in a foreign operation. Hedge accounting generally provides for the matching of the timing of gain or loss recognition on the hedging instrument with the recognition of the changes in the fair value of the hedged asset or liability that are attributable to the hedged risk in a fair value hedge or the earnings effect of the hedged forecasted transactions in a cash flow hedge. The Company may enter into derivative contracts that are intended to economically hedge certain of its risk, even though hedge accounting does not apply or the Company elects not to apply hedge accounting under US GAAP.

Income Taxes

The Company intends to elect and qualify to be taxed as a REIT, commencing with the Company's taxable year ended December 31, 2009. Accordingly, the Company will generally not be subject to U.S. federal and applicable state and local corporate income tax to the extent that the Company makes qualifying distributions to its shareholders, and provided the Company satisfies on a continuing basis, through actual investment and operating results, the REIT requirements including certain asset, income, distribution and stock ownership tests. If the Company fails to qualify as a REIT, and does not qualify for certain statutory relief provisions, it will be subject to U.S. federal, state and local income taxes and may be precluded from qualifying as a REIT for the subsequent four taxable years following the year in which the Company lost its REIT qualification. Accordingly, the Company's failure to qualify as a REIT could have a material adverse impact on its results of operations and amounts available for distribution to its shareholders.

A REIT's dividend paid deduction for qualifying dividends to the Company's shareholders is computed using its taxable income as opposed to net income reported on the consolidated financial statements. Taxable income, generally, will differ from net income reported on the consolidated financial statements because the determination of taxable income is based on tax regulations and not financial accounting principles.

The Company may elect to treat certain of its future subsidiaries as taxable REIT subsidiaries ("TRS"). In general, a TRS may hold assets and engage in activities that the Company cannot hold or engage in directly and generally may engage in any real estate or non-real estate-related business. A TRS is subject to U.S. federal, state and local corporate income taxes.

While a TRS will generate net income, a TRS can declare dividends to the Company which will be included in its taxable income and necessitate a distribution to its shareholders. Conversely, if the Company retains earnings at a TRS level, no distribution is required and the Company can increase book equity of the consolidated entity. The Company has no adjustments regarding its tax accounting treatment of any uncertainties. The Company expects to recognize interest and penalties related to uncertain tax positions, if any, as income tax expense, which will be included in general and administrative expense.

Share-Based Compensation

Share-based compensation arrangements include share options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. Compensation cost relating to share-based payment transactions are recognized in the consolidated financial statements, based on the fair value of the equity or liability instruments issued on the date of grant, for awards to the Company's independent directors. Compensation related to stock awards to officers and employees of the Manager are recorded at the estimate fair value of the award during the vesting period. The Company makes an upward or downward adjustment to compensation expense for the difference in the fair value at the date of grant and the date the award was earned.

On July 1, 2009, the Company adopted an equity incentive plan under which its independent directors, as part of their compensation for serving as directors, are eligible to receive quarterly restricted stock awards. In addition, the Company may compensate its officers and employees of the Manager under this plan pursuant to the management agreement.

Note 3 – Mortgage-Backed Securities

All of the Company's MBS are classified as available-for-sale and, as such, are reported at fair value, determined by obtaining valuations from an independent source. If the fair value of a security is not available from a dealer or third-party pricing service, or such data appears unreliable, the Company may estimate the fair value of the security using a variety of methods including other pricing services, repurchase agreement pricing, discounted cash flow analysis, matrix pricing, option adjusted spread models and other fundamental analysis of observable market factors. At March 31, 2010, all of the Company's MBS values were based on third-party values. The following tables present certain information about the Company's investment portfolio at March 31, 2010 and December 31, 2009.

March 31, 2010 $ in thousands	Principal Balance	Unamortized Premium (Discount)	Amortized Cost	Unrealized Gain/ (Loss)	Fair Value	Net Weighted Average Coupon (1)	Average Yield (2)
Agency RMBS:							
15 year fixed-rate	292,729	11,512	304,241	3,276	307,517	4.86%	3.54 %
30 year fixed-rate	342,080	22,672	364,752	870	365,622	5.90%	3.94 %
ARM	9,377	208	9,585	(257)	9,328	3.08%	2.53 %
Hybrid ARM	128,763	6,027	134,790	(353)	134,437	4.98%	2.78 %
Total Agency	772,949	40,419	813,368	3,536	816,904	5.32%	3.58 %
MBS – CMO	23,411	739	24,150	575	24,725	6.33%	4.88 %
Non-Agency MBS	613,798	(241,270)	372,528	6,804	379,332	3.80%	11.58%
CMBS	209,512	(1,861)	207,651	7,393	215,044	5.07%	5.27 %
Total	1,619,670	(201,973)	1,417,697	18,308	1,436,005	4.72%	5.95 %

December 31, 2009 $ in thousands	Principal Balance	Unamortized Premium (Discount)	Amortized Cost	Unrealized Gain/ (Loss)	Fair Value	Net Weighted Average Coupon (1)	Average Yield (2)
Agency RMBS:							
15 year fixed-rate	251,752	9,041	260,793	1,023	261,816	4.82 %	3.80 %
30 year fixed-rate	149,911	10,164	160,075	990	161,065	6.45 %	5.02 %
ARM	10,034	223	10,257	(281)	9,976	2.52 %	1.99 %
Hybrid ARM	117,163	5,767	122,930	597	123,527	5.14 %	3.55 %
Total Agency	528,860	25,195	554,055	2,329	556,384	5.31 %	4.07 %
MBS – CMO	27,819	978	28,797	936	29,733	6.34 %	4.83 %
Non-Agency MBS	186,682	(79,341)	107,341	7,992	115,333	4.11 %	17.10 %
CMBS	104,512	(4,854)	99,658	1,484	101,142	4.93 %	5.97 %
Total	847,873	(58,022)	789,851	12,741	802,592	5.03 %	6.10 %

(1) Net weighted average coupon (“WAC”) is presented net of servicing and other fees.
(2) Average yield incorporates future prepayment and loss assumptions.

The components of the carrying value of the Company's investment portfolio at March 31, 2010 and December 31, 2009 are presented below.

$ in thousands	March 31, 2010	December 31, 2009
Principal balance	1,619,670	847,873
Unamortized premium	43,549	26,174
Unamortized discount	(245,522)	(84,196)
Gross unrealized gains	28,133	14,595
Gross unrealized losses	(9,825)	(1,854)
Fair value	1,436,005	802,592

The following table summarizes certain characteristics of the Company's investment portfolio, at fair value, according to estimated weighted average life classifications as of March 31, 2010:

$ in thousands	March 31, 2010	December 31, 2009
Less than one year	1,382	—
Greater than one year and less than five years	813,500	483,540
Greater than or equal to five years	621,123	319,052
Total	1,436,005	802,592

The Company assesses its investment securities for other-than-temporary impairment on at least a quarterly basis. When the fair value of an investment is less than its amortized cost at the balance sheet date of the reporting period for which impairment is assessed, the impairment is designated as either "temporary" or "other-than-temporary." In deciding on whether or not a security is other than temporarily impaired, the Company considers several factors, including the nature of the investment, the severity and duration of the impairment, the cause of the impairment, and the Company's intent that it is more likely than not that the Company can hold the security until recovery of its cost basis.

During the three months ended March 31, 2010, the trustees of certain non-Agency RMBS notified the Company that due to the deterioration in the credit quality of the underlying collateral in these securitizations, a portion of the principal of these securities had no value. Accordingly, the Company recognized a $124,000 loss on other-than-temporarily impaired securities in the consolidated statement of operations for the three months ended March 31, 2010, which had been included in accumulated other comprehensive income.

The following tables present the gross unrealized losses and estimated fair value of the Company's RMBS by length of time that such securities have been in a continuous unrealized loss position at March 31, 2010 and December 31, 2009, respectively:

March 31, 2010	Less than 12 Months		12 Months or More		Total	
$ in thousands	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses

Agency RMBS:					
15 year fixed-rate	26,814	(70)	—	—	26,814