

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

FORM 10-K

☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2019
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: 001-35543

WESTERN ASSET MORTGAGE CAPITAL CORPORATION
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of incorporation or organization)

27-0298092
(I.R.S. Employer Identification No.)



Western Asset Mortgage Capital Corporation
385 East Colorado Boulevard
Pasadena, California 91101
(Address of principal executive offices)
(626) 844-9400
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, \$0.01 par value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: **None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes ☐ No ☒

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

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

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

Large accelerated filer	<input type="checkbox"/>	Accelerated filer	<input checked="" type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>
		Emerging growth company	<input type="checkbox"/>

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

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

The aggregate market value of the registrant's common stock held by non-affiliates was \$514,733,789 based on the closing sales price on the New York Stock Exchange on June 30, 2019.

On March 3, 2020, the registrant had a total of 53,523,876 shares of common stock outstanding.

TABLE OF CONTENTS

	Page
PART I	
<u>ITEM 1. Business</u>	<u>2</u>
<u>ITEM 1A. Risk Factors</u>	<u>8</u>
<u>ITEM 1B. Unresolved Staff Comments</u>	<u>28</u>
<u>ITEM 2. Properties</u>	<u>28</u>
<u>ITEM 3. Legal Proceedings</u>	<u>28</u>
<u>ITEM 4. Mine Safety Disclosures</u>	<u>28</u>
PART II	
<u>ITEM 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	<u>29</u>
<u>ITEM 6. Selected Financial Data</u>	<u>31</u>
<u>ITEM 7. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>32</u>
<u>ITEM 7A. Quantitative and Qualitative Disclosures About Market Risk</u>	<u>68</u>
<u>ITEM 8. Financial Statements and Supplementary Data</u>	<u>73</u>
<u>ITEM 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	<u>141</u>
<u>ITEM 9A. Controls and Procedures</u>	<u>141</u>
<u>ITEM 9B. Other Information</u>	<u>141</u>
PART III	
<u>ITEM 10. Directors, Executive Officers and Corporate Governance</u>	<u>142</u>
<u>ITEM 11. Executive Compensation</u>	<u>142</u>
<u>ITEM 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	<u>142</u>
<u>ITEM 13. Certain Relationships and Related Transactions and Director Independence</u>	<u>142</u>
<u>ITEM 14. Principal Accountant Fees and Services</u>	<u>142</u>
PART IV	
<u>ITEM 15. Exhibits and Financial Statement Schedule</u>	<u>142</u>
<u>SIGNATURES</u>	<u>145</u>

FORWARD-LOOKING INFORMATION

The Company makes forward-looking statements herein and will make forward-looking statements in future filings with the Securities and Exchange Commission (the “SEC”), press releases or other written or oral communications within the meaning of Section 27A of the Securities Act of 1933, as amended (the “Securities Act”), and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). For these statements, the Company claims the protections of the safe harbor for forward-looking statements contained in such sections. Forward-looking statements are subject to substantial risks and uncertainties, many of which are difficult to predict and are generally beyond the Company’s control. These forward-looking statements include information about possible or assumed future results of the Company’s business, financial condition, liquidity, results of operations, plans and objectives. When the Company uses the words “believe,” “expect,” “anticipate,” “estimate,” “plan,” “continue,” “intend,” “should,” “may” or similar expressions, the Company intends to identify forward-looking statements. Statements regarding the following subjects, among others, may be forward-looking: market trends in the Company’s industry, interest rates, real estate values, the debt securities markets, the U.S. housing and the U.S. and foreign commercial real estate markets or the general economy or the market for residential and/or commercial mortgage loans; the Company’s business and investment strategy; the Company’s projected operating results; changes in interest rates and the market value of the Company’s target assets; credit risks; servicing -related risks, including those associated with foreclosure and liquidation; the state of the U.S. and to a lesser extent, international economy generally or in specific geographic regions; economic trends and economic recoveries; the Company’s ability to obtain and maintain financing arrangements, including under the Company’s repurchase agreements, a form of secured financing, and securitizations; the current potential return dynamics available in residential mortgage-backed securities (“RMBS”), and commercial mortgage-backed securities (“CMBS” and collectively with RMBS, “MBS”); the level of government involvement in the U.S. mortgage market; the anticipated default rates on CMBS and Commercial Loans; the loss severity on Non-Agency MBS the general volatility of the securities markets in which the Company participates; changes in the value of the Company’s assets; the Company’s expected portfolio of assets; the Company’s expected investment and underwriting process; interest rate mismatches between the Company’s target assets and any borrowings used to fund such assets; changes in prepayment rates on the Company’s target assets; effects of hedging instruments on the Company’s target assets; rates of default or decreased recovery rates on the Company’s target assets; the degree to which the Company’s hedging strategies may or may not protect the Company from interest rate volatility; the impact of and changes in governmental regulations, tax law and rates, accounting guidance and similar matters; the Company’s ability to maintain the Company’s qualification as a real estate investment trust for U.S. federal income tax purposes; the Company’s ability to maintain its exemption from registration under the Investment Company Act of 1940, as amended (the “1940 Act”); the availability of opportunities to acquire Agency RMBS, Non-Agency RMBS, CMBS, Residential and Commercial Whole Loans, Residential and Commercial Bridge Loans and other mortgage assets; the availability of qualified personnel; estimates relating to the Company’s ability to make distributions to its stockholders in the future; and the Company’s understanding of its competition.

The forward-looking statements are based on the Company’s beliefs, assumptions and expectations of its future performance, taking into account all information currently available to it. Forward-looking statements are not predictions of future events. These beliefs, assumptions and expectations can change as a result of many possible events or factors, not all of which are known to the Company. Some of these factors, are described in “Risk Factors” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” of this annual report on Form 10-K. These and other risks, uncertainties and factors, including those described in the annual, quarterly and current reports that the Company files with the SEC, could cause its actual results to differ materially from those included in any forward-looking statements the Company makes. All forward-looking statements speak only as of the date they are made. New risks and uncertainties arise over time and it is not possible to predict those events or how they may affect the Company. Except as required by law, the Company is not obligated to, and does not intend to, update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Part I

Item 1. Business

Our Company

Western Asset Mortgage Capital Corporation, a Delaware corporation, and Subsidiaries (the “Company” unless otherwise indicated or except where the context otherwise requires “we,” “us” or “our”) commenced operations in May 2012, focused on investing in, financing and managing a diversified portfolio of real estate related securities, whole loans and other financial assets, which we collectively refer to as our target assets. We are externally managed by Western Asset Management Company, LLC (our “Manager”) pursuant to the terms of a management agreement. We conduct our operations to qualify and be taxed as a real estate investment trust, or REIT, for U.S. federal income tax purposes. Accordingly, we generally will not be subject to U.S. federal income taxes on our taxable income that we distribute currently to our stockholders as long as we maintain our intended qualification as a REIT. However, certain activities that we may perform may cause us to earn income which will not be qualifying income for REIT purposes. We have designated a subsidiary as a taxable REIT subsidiary, or TRS, to engage in such activities. We also intend to operate our business in a manner that permits us to maintain our exemption from registration under the 1940 Act, as amended, or the Investment Company Act. Our common stock is traded on the New York Stock Exchange, or the NYSE, under the symbol “WMC.”

Our objective is to provide attractive risk adjusted returns to our stockholders primarily through an attractive dividend, we intend to support with sustainable core earnings, as well as the potential for higher returns through capital appreciation. Our investment strategy is based on our Manager's perspective of which mix of our target assets it believes provides us with the best risk-reward opportunities at any given time. We also deploy leverage as part of our investment strategy to increase potential returns.

Our Manager

We are externally managed and advised by our Manager, an SEC-registered investment advisor and a wholly-owned subsidiary of Legg Mason, Inc. (“Legg Mason”), headquartered in Pasadena, California, that specializes in fixed-income asset management. From offices in Pasadena, Hong Kong, London, Melbourne, New York, São Paulo, Singapore, Tokyo and Zurich, our Manager's 835 employees provide investment services for a wide variety of global clients, including mutual funds, corporate, public, insurance, health care, union organizations and charitable foundations. In addition, two of our directors, James W. Hirschmann III and Jennifer W. Murphy, are also employees of our Manager. Our Manager is responsible for, among other duties: (i) performing all of our day-to-day functions; (ii) determining investment criteria in conjunction with our Board of Directors; (iii) sourcing, analyzing and executing investments, asset sales and financings; (iv) performing asset management duties; and (v) performing financial and accounting management.

On February 18, 2020, Franklin Resources, Inc. (“Franklin”) and Legg Mason, announced that they had entered into an agreement under which Franklin would acquire Legg Mason and its affiliates, including our Manager. The transaction is expected to close in the third quarter of 2020 and is subject to customary closing conditions. Upon completion of the transaction our Manager would become a wholly owned subsidiary of Franklin.

Our Competitive Advantages

Our competitive advantages in the marketplace stems from our relationship with our Manager. As of December 31, 2019, our Manager had approximately \$460.1 billion in assets under management. Our Manager's scale makes it an important trading partner for many of the largest broker-dealers and banks, which provides our investment team the ability to source real estate related opportunities directly from originators as well as access attractive financing.

Our Investment Strategy

Our Manager's investment philosophy, which developed from a singular focus in fixed-income asset management over a variety of credit cycles and conditions, is to provide clients with a diversified, long-term value-oriented portfolio. We benefit from the breadth and depth of our Manager's overall investment philosophy, which focuses on a macroeconomic analysis as well as an in-depth analysis of individual assets and their relative value. In making investment decisions on our behalf, our Manager seeks to identify assets across the broad mortgage universe with attractive risk adjusted returns, which incorporates its view on the outlook for the mortgage markets, including relative valuation, supply and demand trends, the level of interest rates, the shape of the yield curve, prepayment rates, financing and liquidity, commercial and residential real estate prices, delinquencies, default rates, recovery of various segments of the economy and vintage of collateral, subject to maintaining our REIT qualification and our exemption from registration under the 1940 Act.

Our Target Assets

Agency RMBS. — Agency RMBS, which are RMBS for which the principal and interest payments are guaranteed by a U.S. Government agency, such as the Government National Mortgage Association (“GNMA” or “Ginnie Mae”), or a U.S. Government-sponsored entity (“GSE”), such as the Federal National Mortgage Association (“FNMA” or “Fannie Mae”) or the Federal Home Loan Mortgage Corporation (“FHLMC” or “Freddie Mac”). The Agency RMBS we acquire can be secured by fixed-rate mortgages, adjustable-rate mortgages or hybrid adjustable-rate mortgages. Fixed-rate mortgages have interest rates that are fixed for the term of the loan and do not adjust. The interest rates on adjustable-rate mortgages generally adjust annually (although some may adjust more frequently) to an increment over a specified interest rate index. Hybrid adjustable-rate mortgages have interest rates that are fixed for a specified period of time (typically three, five, seven or ten years) and, thereafter, adjust to an increment over a specified interest rate index. Adjustable-rate mortgages and hybrid adjustable-rate mortgages generally have periodic and lifetime constraints on the amount by which the loan interest rate can change on any predetermined interest rate reset date.

Agency CMBS. — Fixed and floating rate CMBS, for which the principal and interest payments are guaranteed by a U.S. Government agency or U.S. Government-sponsored entity, but for which the underlying mortgage loans are secured by real property other than single family residences. These may include, but are not limited to Fannie Mae DUS (Delegated Underwriting and Servicing) MBS, Freddie Mac Multifamily Mortgage Participation Certificates, Ginnie Mae project loan pools, and/or CMOs structured from such collateral. These securities generally have prepayment protection in the form of defeasance, yield maintenance or points.

Non-Agency RMBS. — RMBS that are not guaranteed by a U.S. Government agency or U.S. Government-sponsored entity. The mortgage loan collateral for Non-Agency RMBS consists of residential mortgage loans that do not generally conform to underwriting guidelines issued by a U.S. Government agency or U.S. Government-sponsored entity due to certain factors, including mortgage balances in excess of Agency underwriting guidelines, borrower characteristics, loan characteristics and/or level of documentation, and therefore are not issued or guaranteed by a U.S. Government agency or U.S. Government-sponsored entity. The mortgage loan collateral may be classified as subprime, Alternative-A or prime depending on the borrower’s credit rating and the underlying level of documentation. Non-Agency RMBS collateral may also include reperforming loans, which are conventional mortgage loans that were current at the time of the securitization, but had been delinquent in the past. Non-Agency RMBS may be secured by fixed-rate mortgages, adjustable-rate mortgages or hybrid adjustable-rate mortgages.

Non-Agency CMBS. — Fixed and floating rate CMBS for which the principal and interest payments are not guaranteed by a U.S. Government agency or U.S. Government-sponsored entity. We do not have an established minimum current rating requirement for such investments.

Non U.S. CMBS. — CMBS which is not guaranteed by a U.S. Government agency or U.S. Government-sponsored entity and which is secured by commercial real estate located outside of the U.S. Although our Manager believes that these investments can provide attractive risk-reward opportunities and offer additional asset diversification, investing in international real estate has a number of additional risks, including, but not limited to, currency risk, political risk and the legal risk of investing in jurisdictions with varying laws and regulations and potential tax implications.

GSE Risk Sharing Securities Issued by Fannie Mae and Freddie Mac. — From time to time we have and may in the future continue to invest in risk sharing securities issued by Fannie Mae and Freddie Mac. Principal and interest payments on these securities are based on the performance of a specified pool of Agency residential mortgages. The payments due on these securities, however, are not secured by the referenced mortgages. The payments due are full faith and credit obligations of Fannie Mae or Freddie Mac respectively, but neither agency guarantees full payment of the underlying mortgages. Investments in these securities generally are not qualifying assets for purposes of the 75% real estate asset test applicable to REITs and generally do not generate qualifying income for purposes of the 75% real estate income test applicable to REITs. As a result, we may be limited in our ability to invest in such assets.

TBAs. — We may utilize TBAs, in order to invest in Agency RMBS. Pursuant to these TBAs, we agree to purchase (or deliver), for future settlement, Agency RMBS with certain principal and interest terms and certain underlying collateral, but the particular Agency RMBS to be delivered is not identified until shortly before the TBA settlement date. Our ability to invest in Agency RMBS through TBAs may be limited by the 75% real estate income and asset tests applicable to REITs.

Mortgage pass-through certificates. — Mortgage pass-through certificates are securities representing interests in “pools” of mortgage loans secured by residential real property where payments of both interest and scheduled principal, plus pre-paid principal, on the underlying loan pools are made monthly to holders of the securities, 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 of the securities and servicers of the underlying mortgages.

Interest-Only Strips or IOs. — This type of security entitles the holder only to payments of interest based on a notional principal balance. The yield to maturity of Interest-Only Strips is extremely sensitive to the rate of principal payments (particularly prepayments) on the underlying pool of mortgages. We invest in these types of securities primarily to take advantage of particularly attractive prepayment-related or structural opportunities in the MBS markets, as well as to help manage the duration of our overall portfolio.

Inverse Interest-Only Strips or IIOs. — This type of security has a coupon with an inverse relationship to its index and is subject to caps and floors. Inverse Interest-Only MBS entitles the holder to interest only payments based on a notional principal balance, which is typically equal to a fixed rate of interest on the notional principal balance less a floating rate of interest on the notional principal balance that adjusts according to an index subject to set minimum and maximum rates. The current yield of Inverse Interest-Only MBS will generally decrease when its related index rate increases and increase when its related index rate decreases.

Agency and Non-Agency CMBS IO and IIO Securities. — Interest-Only and Inverse Interest-Only securities for which the underlying collateral is commercial mortgages the principal and interest on which may or may not be guaranteed by a U.S. Government agency or U.S. Government-sponsored entity. Unlike single family residential mortgages in which the borrower, generally, can prepay at any time, commercial mortgages frequently limit the ability of the borrower to prepay, thereby providing a certain level of prepayment protection. Common restrictions include yield maintenance and prepayment penalties, the proceeds of which are generally at least partially allocable to these securities, as well as, defeasance.

Principal-Only Strips or POs. — This type of security generally only entitles the holder to receive cash flows that are derived from principal repayments of an underlying loan pool, but in the case of Non-Agency Principal-Only Strips will also include cash flows from default recoveries and excess interest. The yield to maturity of Principal-Only Strips is extremely sensitive to the rate of principal payments (particularly prepayments) on the underlying pool of mortgages. We invest in these types of securities primarily to take advantage of structural opportunities in the MBS markets.

Residential Whole Loans. — Residential Whole Loans are mortgages secured by single family residences held directly by us or through consolidated trusts with us holding the beneficial interest in the trusts. Our Residential Whole Loans include conforming fixed rate mortgages and adjustable rate mortgages that do not qualify for the Consumer Finance Protection Bureau’s (or CFPB) safe harbor provision for “qualified mortgages” (“Non QM” mortgages). Our Manager’s review, relating to Non QM mortgages, includes an analysis of the loan originator’s procedures and documentation for compliance with Ability-to-Repay requirements. As discussed in Note 7 “Financing,” we have and may continue to securitize whole-loan interests, selling more senior interests in the pool of loans and retaining residual portions. The characteristics of our Residential Whole Loans may vary going forward.

Residential Bridge Loans. — Residential Bridge Loans are mortgages secured by non owner occupied single family and multi-family residences, typically short-term, held directly by us or through structured Non-Agency RMBS programs crafted specifically for us and other clients of our Manager. These loans are held in a consolidated trust with us holding the beneficial interest in the trust.

Commercial Whole Loans. — Commercial Whole Loans are generally loans ranging from, \$5.0 million to \$125.0 million, secured by commercial real estate typically short-term loans. The collateral types may include hospitality, senior care living facilities, multifamily, office, retail and industrial properties. These loans may be held directly by us or through consolidated trusts with us holding the beneficial interest in the trust.

Commercial Mezzanine Loans. — Commercial mezzanine loans are generally structured to represent a senior position in the borrower’s equity in, and subordinate to a first mortgage loan, on a property. These loans are generally secured by pledges of ownership interests, in whole or in part, in entities that directly or indirectly own the real property. At times, mezzanine loans may be secured by additional collateral, including letters of credit, personal guarantees, or collateral unrelated to the property. Mezzanine loans may be structured to carry either fixed or floating interest rates as well as carry a right to participate in a percentage of gross revenues and a percentage of the increase in the fair market value of the property securing the loan. Mezzanine loans may also contain prepayment lockouts, penalties, minimum profit hurdles and other mechanisms to protect and enhance returns to the lender. Mezzanine loans usually have maturities that match the maturity of the related mortgage loan but may have shorter

or longer terms. Depending on the structure of a transaction, Commercial Mezzanine loans may or may not qualify as "qualifying real estate interests" for purposes of the 1940 Act.

Collateralized Mortgage Obligations or CMOs. — These are securities, which can be Agency or Non-Agency, that are structured from residential and/or commercial pass-through certificates, which receive monthly payments of principal and interest. CMOs divide the cash flows which come from the underlying mortgage pass-through certificates into different classes of securities that may have different maturities and different weighted average lives than the underlying pass-through certificates.

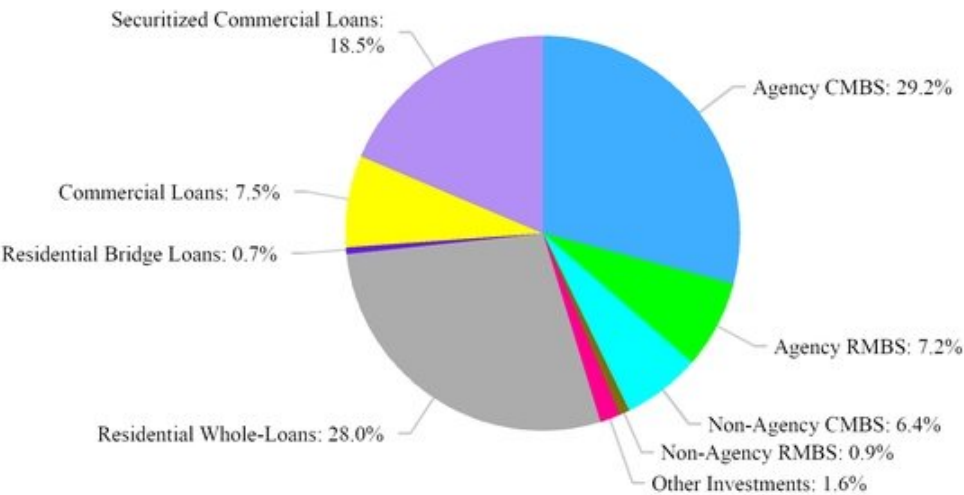
ABS. — Debt and/or equity tranches of securitizations backed by various asset classes, including, but not limited to, automobiles, credit cards, equipment, franchises, recreational vehicles and student loans. Investments in ABS generally are not qualifying assets for purposes of the 75% real estate asset test applicable to REITs and generally do not generate qualifying income for purposes of the 75% real estate income test applicable to REITs. As a result, we may be limited in our ability to invest in such assets.

Other investments. — In addition to MBS, our principal investment, and ABS from time to time, we may also make other investments in securities, which our Manager believes will assist us in meeting our investment objective and are consistent with our overall investment policies. These investments will normally be limited by the REIT requirements that 75% our assets be real estate assets and that 75% of our income be generated from real estate, thereby limiting our ability to invest in such assets.

Our Investment Portfolio

Our investment portfolio composition at December 31, 2019.

Investment Portfolio



Our Financing Strategy

We deploy leverage to increase potential returns to our stockholders and to fund the acquisition of our target assets. While we are not required to maintain any particular leverage ratio, we expect to maintain a debt-to-equity ratio of three to ten times the amount of our stockholders' equity, depending on our investment composition. The amount of leverage we use for our portfolio depends upon a variety of factors, such as, general economic, political and financial market conditions, the anticipated liquidity and price volatility of our assets, the availability and cost of financing the assets, the credit worthiness of financing counterparties and the health of the U.S. residential and commercial mortgage markets. At December 31, 2019, our aggregate debt-to-equity

ratio was approximately 5.4 to 1 excluding our non-recourse debt and 8.0 to 1 including our non-recourse debt. The debt-to-equity ratio is not a comprehensive statement of overall investment portfolio leverage which is affected by any leverage embedded in TBAs and derivative instruments.

Repurchase Agreements

We primarily finance our investments through repurchase agreements for which we pledge our assets. Our repurchase agreements have maturities generally ranging from one to twelve months, but in some cases longer. Repurchase agreements involve the transfer of the pledged collateral to a counterparty at an agreed upon price in exchange for such counterparty's simultaneous agreement to return the same security back to the borrower at a future date (i.e., the maturity of the borrowing). Under our repurchase agreements, we retain beneficial ownership of the pledged collateral, while the counterparty maintains custody of such collateral. At the maturity of a repurchase financing, unless the repurchase financing is renewed with the same counterparty, we are required to repay the loan, including any accrued interest, and concurrently reacquire custody of the pledged collateral or, with the consent of the counterparty, we may renew the repurchase financing at the then prevailing market interest rate and terms. The amount borrowed under our repurchase agreements is a specified percentage of the asset's applicable fair value, which is dependent on the collateral type. Our repurchase agreement counterparties generally require collateral in excess of the loan amount, or haircuts. As of December 31, 2019, the ranges of the haircuts on our investments were as follow:

	Minimum	Maximum (excluding IOs and IIOs)	Maximum (including IOs and IIOs)
Agency RMBS	3.0%	5.0%	30.0%
Agency CMBS ⁽³⁾	3.0%	5.0%	25.0%
Non-Agency RMBS	15.0%	50.0%	n/a
Non-Agency CMBS	10.0%	35.0%	n/a
Other securities	16.7%	50.0%	n/a
Residential Whole Loans ⁽¹⁾	5.0%	20.0%	n/a
Commercial Loans ⁽²⁾	15.0%	60.0%	n/a

⁽¹⁾ Includes Residential Bridge Loans.

⁽²⁾ Includes Securitized commercial loans.

⁽³⁾ For Agency CMBS whose payment is not guaranteed by Freddie Mac haircuts can be as high as 25%.

A significant decrease in asset value, advance rate, or an increase in the haircut could result in us having to sell assets in order to meet additional margin calls by our repurchase agreement counterparties. Our inability to post adequate collateral for a margin call by the counterparty could result in a condition of default under our repurchase agreements. We expect to mitigate our risk to margin calls by deploying leverage at the portfolio level at amounts below our available financing under our repurchase agreements.

In order to reduce our exposure of risk associated with concentration to any one repurchase agreement counterparty, we seek to diversify our exposure by entering into repurchase agreements with multiple counterparties. At December 31, 2019, we had 34 master repurchase agreements with our counterparties and outstanding borrowings under 21 of such agreements. Our total outstanding borrowings under our repurchase agreements was \$2.8 billion, with a maximum net exposure to any single repurchase agreement counterparty of \$132.3 million, or 23.4% of equity.

Convertible Senior Unsecured Notes

As of December 31, 2019, we had \$205.0 million of 6.75% convertible senior unsecured notes outstanding. The notes mature on October 1, 2022, unless earlier converted, redeemed or repurchased by the holders pursuant to their terms, and are not redeemable by us except during the final three months prior to maturity. We view this financing as an attractive source of longer-term capital, which we believe was more cost efficient than issuing straight equity.

Securitized Debt

As of December 31, 2019, Arroyo Mortgage Trust 2019-2 (a subsidiary) had \$801.1 million securitized mortgage backed notes outstanding. The notes, excluding the Owner Certificates, issued by were four classes, with a weighted average fixed interest rate of 3.425% per annum. All of the Notes are anticipated to have a final payment date in April 2049. We view the notes as an

attractive source of longer-term financing for our Residential Whole Loan portfolio. We may redeem the offered notes on or after the earlier of (i) the three-year anniversary of the closing date or ii) the date on which the aggregate collateral balance is 20% of the original principal balance. The notes are redeemable at their face value plus accrued interest. The mortgage-backed notes are classified in "Securitized Debt" in the Consolidated Balance Sheets.

Separately, as of December 31, 2019, the Company had three consolidated variable interest entities that had outstanding borrowings of \$681.7 million, which is classified in "Securitized Debt" in the Consolidated Balance Sheets.

Our Hedging and Risk Management Strategy

Our overall portfolio strategy is designed to generate attractive returns to our investors through various economic cycles. We believe our broad approach to investing in the real estate mortgage markets, which considers all categories of real estate assets, allows us to invest in a diversified portfolio and help mitigate our portfolio from risks that arise from investing in a single or limited collateral type. In connection with our risk management activities, we enter into a variety of derivative and non-derivative instruments. Our primary objective for acquiring these derivatives and non-derivative instruments is to mitigate our exposure to future events that are outside our control. Our derivative instruments are designed to mitigate the effects of market risk and cash flow volatility associated with interest rate risk, including prepayment risk. As part of our hedging strategy, we may enter into interest rate swaps, including forward starting swaps, interest rate swaptions, U.S. Treasury options, future contracts, TBAs, total return swaps, credit default swaps, foreign current swaps and forwards and other similar instruments.

Regulation

REIT Qualification

We elected to be taxed as a REIT under Section 856 through 860 of the Internal Revenue Code of 1986, as amended (the "Code"), commencing with our taxable year ended December 31, 2012. We will generally not be subject to corporate U.S. federal income tax to the extent that we make qualifying distributions to stockholders, and provided that we satisfy, on a continuing basis, through actual investment and operating results, the REIT requirements including certain asset, income, distribution and stock ownership tests. If we fail to qualify as a REIT, and do not qualify for certain statutory relief provisions, we 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 we lost our REIT qualification. The failure to qualify as a REIT could have a material adverse impact on our results of operations and amounts available for distribution to stockholders.

Investment Company Act Exemption

We conduct our operations so that we are not considered an investment company under the 1940 Act in reliance on the exemption provided by Section 3(c)(5)(C) of the 1940 Act. Section 3(c)(5)(C), as interpreted by the staff of the SEC, requires that: (i) at least 55% of our investment portfolio consist of "mortgages and other liens on and interest in real estate," or "qualifying real estate interests," and (ii) at least 80% of our investment portfolio consist of qualifying real estate interests plus "real estate-related assets." We have relied and intend to continue to rely on current interpretations of the staff of the SEC in an effort to continue to qualify for an exemption from registration under the 1940 Act. For more information on the exemptions that we utilize refer to Item 1A, "Risk Factors" of this annual report on Form 10-K.

Competition

Our net income depends, in part, on our ability to acquire assets at favorable spreads over our borrowing costs. In acquiring our target assets, we compete with other 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. In addition, other REITs with similar asset acquisition objectives, including a number that have been recently formed and others that may be organized in the future, compete with us in acquiring assets and obtaining financing. These competitors may be significantly larger than us, may have access to greater capital and other resources or may have other advantages. In addition, some competitors may have higher risk tolerances or different risk assessments, which could allow them to consider a wider variety of investments, and establish more relationships, than us. Current market conditions may attract more competitors, which may increase the competition for sources of financing. An increase in the competition for sources of funding could adversely affect the availability and cost of financing, and thereby adversely affect the market price of our common stock.

Employees

We are externally managed pursuant to the management agreement dated May 9, 2012. We have no employees. All of our officers and two of our directors, James W. Hirschmann III and Jennifer W. Murphy, are employees of our Manager. Our Manager is responsible for, among other duties: (i) performing all of our day-to-day functions; (ii) determining investment criteria in conjunction with our Board of Directors; (iii) sourcing, analyzing and executing investments, asset sales and financings; (iv) performing asset management duties; and (v) performing financial and accounting management.

Corporate Governance and Internet Address

We emphasize the importance of professional business conduct and ethics through our corporate governance initiatives. In 2014, the Board took additional steps to enhance governance by appointing a lead independent director and adding a fourth independent director so that our Board of Directors consists of two-thirds independent directors. The audit, nominating and corporate governance, risk, and compensation committees of our Board of Directors are composed entirely of independent directors. We have adopted corporate governance guidelines and a code of business conduct and ethics, which delineate our standards for our officers and directors.

Our internet address is www.westernassetmcc.com. The information on our website is not incorporated by reference in this Annual Report on Form 10-K. We make available, free of charge through a link on our site, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to such reports, if any, as filed or furnished with the SEC, as soon as reasonably practicable after such filing or furnishing. Our site also contains our code of business conduct and ethics, corporate governance guidelines and the charters of our audit committee, nominating and corporate governance committee and compensation committee of our Board of Directors. Within the time period required by the rules of the SEC and the New York Stock Exchange, or NYSE, we will post on our website any amendment to our code of business conduct and ethics as defined in the code. Our documents filed with, or furnished to, the SEC are also available for review on the SEC's website at www.sec.gov.

Item 1A. Risk Factors

Our business and operations are subject to a number of risks and uncertainties, the occurrence of which could adversely affect our business, financial condition, results of operations and ability to make distributions to stockholders and could cause the value of our capital stock to decline.

Risks related to our business

We may not be able to successfully operate our business or generate sufficient revenue to make or sustain distributions to our stockholders.

We cannot assure you that we will be able to continue to operate our business successfully or implement our operating policies and strategies as described herein. The results of our operations depend on several factors, including the availability of opportunities for the acquisition of assets, the level and volatility of interest rates, the availability of adequate short and long-term financing, conditions in the financial markets and economic conditions.

We may change any of our strategies, policies or procedures without stockholder consent.

We may change any of our strategies, policies or procedures with respect to investments, acquisitions, growth, operations, indebtedness, capitalization, distributions, financing strategy and leverage at any time without the consent of our stockholders, which could result in an investment portfolio with a different risk profile. A change in our investment strategy may increase our exposure to interest rate risk, default risk and real estate market fluctuations. Furthermore, a change in our asset allocation could result in our making investments in asset categories different from those described herein. These changes could adversely affect our financial condition, results of operations, the market price of our common stock and our ability to make distributions to our stockholders.

Increases in interest rates could adversely affect the value of our investments and cause our interest expense to increase, which could result in reduced earnings or losses and negatively affect our profitability as well as the cash available for distribution to our stockholders.

Our investment portfolio contains a significant allocation to MBS, as well Residential Whole Loans. The relationship between short-term and longer-term interest rates is often referred to as the “yield curve.” In a normal yield curve environment, an investment in such assets will generally decline in value if long-term interest rates increase. Declines in market value may ultimately reduce earnings or result in losses to us, which may negatively affect cash available for distribution to our stockholders. Ordinarily, short-term interest rates are lower than longer-term interest rates. If short-term interest rates rise disproportionately relative to longer-term interest rates (a flattening of the yield curve), our borrowing costs will generally

increase more rapidly than the interest income earned on our assets. Because our investments on average, generally bear interest based on longer-term rates than our borrowings, a flattening of the yield curve would tend to decrease our net interest margin, net income, book value and the market value of our net assets. It is also possible that short-term interest rates may exceed longer-term interest rates (a yield curve inversion), in which event our borrowing costs may exceed our interest income and we could incur operating losses. Additionally, to the extent cash flows from investments that return scheduled and unscheduled principal are reinvested, the spread between the yields on the new investments and available borrowing rates may decline, which would likely decrease our net income. A significant risk associated with our target assets is the risk that both long-term and short-term interest rates will increase significantly. If long-term rates increase significantly, the market value of these investments will decline, and the duration and weighted average life of the investments will increase. At the same time, an increase in short-term interest rates will increase the amount of interest owed on the repurchase agreements we enter into to finance the purchase of our investments.

Changes to, or the elimination of, LIBOR may adversely affect interest expense related to our loans and investments.

In July 2017, the United Kingdom Financial Conduct Authority (the authority that regulates LIBOR) announced it intends to stop persuading or compelling banks to submit rates for the calculation of LIBOR after 2021. The Alternative Reference Rates Committee (“ARRC”) has proposed that the Secured Overnight Financing Rate (“SOFR”) is the rate that represents best practice as the alternative to USD-LIBOR for use in derivatives and other financial contracts that are currently indexed to USD-LIBOR. ARRC has proposed a paced market transition plan to SOFR from USD-LIBOR and organizations are currently working on industry wide and company specific transition plans as it relates to derivatives and cash markets exposed to USD-LIBOR. We have material contracts, including agreements governing certain of our indebtedness, that are indexed to USD-LIBOR and are monitoring this activity and evaluating the related risks. In addition, approximately half of our investment portfolio pays interest at a variable rate that is tied to LIBOR. If LIBOR is no longer available, we may need to renegotiate some of our agreements to determine a replacement index or rate of interest. To the extent the replacement index or rate of interest is lower than the existing LIBOR-based rate it could have an adverse impact on the value of such investments, our financial condition and results of operations. In September 2019, the FASB proposed guidance that would help facilitate the market transition from existing reference rates to alternative rates. However, at this time, it is not possible to predict the effect of any such changes, any establishment of alternative reference rates or any other reforms to LIBOR that may be enacted in the United Kingdom or elsewhere. Uncertainty as to the nature of such potential changes, alternative reference rates or other reforms may adversely affect the trading market for LIBOR-based securities, including our material contracts that are indexed to USD-LIBOR. Furthermore, we may need to renegotiate any agreements governing our indebtedness extending beyond 2021 that utilize LIBOR as a factor in determining the interest rate to replace LIBOR with the new standard that is established. There is currently no definitive information regarding the future utilization of LIBOR or of any particular replacement rate. As such, potential effect of any such event on our business, financial condition and results of operations cannot yet be determined.

We cannot assure you that our internal controls over financial reporting will consistently be effective.

We are responsible for establishing and maintaining adequate internal control over financial reporting designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. We cannot ensure you that there will not be any material weaknesses or significant deficiencies in our internal control over financial reporting in the future.

Cybersecurity risk and cyber incidents may adversely affect our business by causing a disruption to our operations, a compromise or corruption of our confidential information and/or damage to our business relationships, all of which could negatively impact our financial results.

A cyber incident is considered to be any adverse event that threatens the confidentiality, integrity or availability of our information resources. These incidents may be an intentional attack or an unintentional event and could involve gaining unauthorized access to our information systems for purposes of misappropriating assets, stealing confidential information, corrupting data or causing operational disruption. The result of these incidents may include disrupted operations, misstated or unreliable financial data, liability for stolen assets or information, increased cybersecurity protection and insurance cost, litigation and damage to our investor relationships. As our reliance on technology has increased, so have the risks posed to both our information systems, both internal and those provided by our Manager and third party service providers. Our Manager has implemented processes, procedures and internal controls to help mitigate cybersecurity risks and cyber intrusions, but these measures, as well as our increased awareness of the nature and extent of a risk of a cyber incident, do not guarantee that our financial results, operations or confidential information will not be negatively impacted by such an incident.

Risks related to our investing strategy

Our investments in Non-Agency MBS, Residential Whole Loans, Commercial Loans and Residential Bridge Loans involve credit risks, which could materially adversely affect our results of operations.

The holder of a residential mortgages, commercial mortgages or MBS assumes the risk that the related borrowers may default on their obligations to make full and timely payments of principal and interest. Under our investment policy, we have the ability to acquire Non-Agency MBS, Residential Whole Loans, Commercial Loans and Residential Bridge Loans. In general, these investments carry greater investment risk than Agency MBS because the former are not guaranteed as to principal or interest by the U.S. Government, any federal agency or any federally chartered corporation. Higher-than-expected rates of default and/or higher-than-expected loss severities on these investments could adversely affect the value of these assets. Accordingly, defaults in the payment of principal and/or interest on our Residential Whole Loans, Commercial Loans, Residential Bridge Loans, and Non-Agency MBS and would likely result in our incurring losses of income from, and/or losses in market value relating to, these assets, which could materially adversely affect our results of operations.

In particular, our portfolio of Residential Whole Loans and Commercial Loans continued to be one of our faster growing asset class during 2019. We expect that our investment portfolio in Residential Whole Loans and Commercial Loans will continue to increase during 2020. As a holder of these loans, we are subject to the risk that the related borrowers may default or have defaulted on their obligations to make full and timely payments of principal and interest. A number of factors impact a borrower's ability to repay including, among other things, changes in employment status, changes in interest rates or the availability of credit, and changes in real estate values. In addition to the credit risk associated with these assets, Residential Whole Loans and Commercial Loans are less liquid than certain of our other credit sensitive assets, which may make them more difficult to dispose of if the need or desire arises. If actual results are different from our assumptions in determining the prices paid to acquire such loans, particularly if the market value of the underlying properties decreases significantly subsequent to purchase, we may incur significant losses, which could materially adversely affect our results of operations.

We operate in a highly competitive market for investment opportunities and competition may limit our ability to acquire desirable investments in our portfolio assets and could also affect the pricing of these securities.

We operate in a highly competitive market for investment opportunities. Currently, our profitability depends, in large part, on our ability to acquire our portfolio assets at attractive prices. In acquiring these assets, we compete with a variety of institutional investors, including other REITs, specialty finance companies, public and private funds (including other funds managed by our Manager), commercial and investment banks, commercial finance and insurance companies and other financial institutions. Many of our competitors are substantially larger and have considerably greater financial, technical, marketing and other resources than we do. Other REITs have recently raised, or may raise, additional capital, and may have investment objectives that overlap with ours, which may create additional competition for investment opportunities. Some competitors may have a lower cost of funds and access to funding sources that may not be available to us, such as funding from the U.S. Government. Many of our competitors are not subject to the operating constraints associated with REIT tax compliance or maintenance of an exemption from the 1940 Act. 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 investments and establish more relationships than us. Furthermore, competition for investments in our portfolio assets may lead to the price of such assets increasing, which may further limit our ability to generate desired returns. We cannot assure you that the competitive pressures we face will not have a material adverse effect on our business, financial condition and results of operations. Also, as a result of this competition, desirable investments in these assets may be limited in the future and we may not be able to take advantage of attractive investment opportunities from time to time, as we can provide no assurance that we will be able to identify and make investments that are consistent with our investment objectives.

A lack of liquidity in our investments may adversely affect our business.

Many of the assets we acquire are not publicly traded. A lack of liquidity may result from the absence of a willing buyer or an established market for these assets, as well as legal or contractual restrictions on resale or the unavailability of financing for these assets. In addition, mortgage-related assets generally experience periods of illiquidity, especially during periods of economic stress such as the economic recession in 2008 which resulted in increased delinquencies and defaults with respect to residential and commercial mortgage loans. The illiquidity of our investments may make it difficult for us to sell such investments if the need or desire arises. In addition, if we are required to liquidate all or a portion of our portfolio quickly, we may realize significantly less than the value at which we have previously recorded our investments. Further, we may face other restrictions on our ability to liquidate an investment in a business entity to the extent that we or our Manager has or could be attributed with material, non-

public information regarding such business entity. As a result, our ability to vary our portfolio in response to changes in economic and other conditions may be relatively limited, which could adversely affect our results of operations and financial condition.

An economic recession and declining real estate values could impair our assets and harm our operations.

The risks associated with our business are more severe during economic recessions and are compounded by declining real estate values. The Residential Whole Loans, Residential Bridge Loans, Commercial Loans, Non-Agency RMBS and Non-Agency CMBS in which we invest a part of our capital will be particularly sensitive to these risks. Declining real estate values will likely reduce the level of new mortgage loan originations since borrowers often use appreciation in the value of their existing properties to support the purchase of additional properties. Borrowers will also be less able to pay principal and interest on loans underlying the securities in which we invest if the value of residential and commercial real estate weakens further. Further, declining real estate values significantly increase the likelihood that we will incur losses on these investments in the event of default because the value of collateral on the mortgages underlying such securities may be insufficient to cover the outstanding principal amount of the loan. Any sustained period of increased payment delinquencies, foreclosures or losses could adversely affect our net interest income from these investments, which could have an adverse effect on our financial condition, results of operations and our ability to make distributions to our stockholders

Our investments in Residential Whole Loans, Residential Bridge Loans and Commercial Loans subject us to servicing-related risks, including those associated with foreclosure and liquidation.

We rely on third-party servicers to service and manage the mortgages underlying our loan portfolio. The ultimate returns generated by these investments may depend on the quality of the servicer. If a servicer is not vigilant in seeing that borrowers make their required monthly payments, borrowers may be less likely to make these payments, resulting in a higher frequency of default. If a servicer takes longer to liquidate non-performing mortgages, our losses related to those loans may be higher than originally anticipated. Any failure by servicers to service these mortgages and/or to competently manage and dispose of REO properties could negatively impact the value of these investments and our financial performance. In addition, while we have contracted with third-party servicers to carry out the actual servicing of the loans (including all direct interface with the borrowers), for loans that we purchase together with the related servicing rights, we are nevertheless ultimately responsible, vis-à-vis the borrowers and state and federal regulators, for ensuring that the loans are serviced in accordance with the terms of the related notes and mortgages and applicable law and regulation. In light of the current regulatory environment, such exposure could be significant even though we might have contractual claims against our servicers for any failure to service the loans to the required standard.

The foreclosure process, especially in judicial foreclosure states such as New York, Florida and New Jersey, can be lengthy and expensive, and the delays and costs involved in completing a foreclosure, and then subsequently liquidating the REO property through sale, may materially increase any related loss. In addition, at such time as title is taken to a foreclosed property, it may require more extensive rehabilitation than we estimated at acquisition. Thus, a material amount of foreclosed residential mortgage loans, particularly in the states mentioned above, could result in significant losses in our Residential Whole Loan portfolio and could materially adversely affect our results of operations.

The commercial mortgage loans underlying the CMBS and our Commercial Loans we may acquire are subject to defaults, foreclosure timeline extension, fraud and commercial price depreciation and unfavorable modification of loan principal amount, interest rate and amortization of principal, which could result in losses to us.

CMBS may be secured by a single commercial mortgage loan or a pool of commercial mortgage loans. Commercial mortgage loans may be secured by multifamily or commercial property and are subject to risks of delinquency and foreclosure, and risks of loss that may be greater than similar risks associated with loans made on the security of residential property. The ability of a borrower to repay a loan secured by an income-producing property typically is dependent primarily upon the successful operation of such property rather than upon the existence of independent income or assets of the borrower. If the net operating income of the property is reduced, the borrower's ability or willingness to repay the loan may be impaired. Net operating income of an income-producing property can be affected by, among other things,

- tenant mix;
- success of tenant businesses;
- property management decisions;
- property location and condition;
- competition from comparable types of properties;

- changes in laws that increase operating expenses or limit rents that may be charged;
- any need to address environmental contamination at the property or the occurrence of any uninsured casualty at the property;
- changes in national, regional or local economic conditions and/or specific industry segments;
- declines in regional or local real estate values;
- declines in regional or local rental or occupancy rates;
- increases in interest rates;
- real estate tax rates and other operating expenses;
- changes in governmental rules, regulations and fiscal policies, including environmental legislation; and
- acts of God, terrorist attacks, social unrest and civil disturbances.

If our Manager overestimates the loss-adjusted yields of our CMBS investments, we may experience losses.

Our Manager will analyze any CMBS investments we may acquire based on loss-adjusted yields, taking into account estimated future losses on the mortgage loans included in the securitization's pool of loans, and the estimated impact of these losses on expected future cash flows. Our Manager's loss estimates may not prove accurate, as actual results may vary from estimates. In the event that our Manager underestimates the pool level losses relative to the price we pay for a particular CMBS investment, we may experience losses with respect to such investment.

If we do not control the special servicing of the mortgage loans included in the CMBS in which we invest and, in such cases, the special servicer may take actions that could adversely affect our interests.

With respect to CMBS in which we invest, overall control over the special servicing of the related underlying mortgage loans will be held by a "directing certificateholder" or a "controlling class representative," which is appointed by the holders of the most subordinate class of CMBS in such series. We may not have the right to appoint the directing certificateholder. In connection with the servicing of the specially serviced mortgage loans, the related special servicer may, at the direction of the directing certificateholder, take actions with respect to the specially serviced mortgage loans that could adversely affect our interests.

Our investments are recorded at fair value, and quoted prices or observable inputs may not be available to determine such value, resulting in the use of significant unobservable inputs to determine value.

We expect that the values of some of our investments may not be readily determinable. We measure the fair value of these investments on at least a monthly basis. The fair value at which our assets are recorded may not be an indication of their realizable value. Ultimate realization of the value of an asset depends to a great extent on economic and other conditions that are beyond the control of our Manager, our Company or our Board of Directors. Further, fair value is only an estimate based on good faith judgment of the price at which an investment can be sold since market prices of investments can only be determined by negotiation between a willing buyer and seller. If we were to liquidate a particular asset, the realized value may be more than or less than the amount at which such asset is valued. Accordingly, the value of our common stock could be adversely affected by our determinations regarding the fair value of our investments, whether in the applicable period or in the future. Additionally, such valuations may fluctuate over short periods of time.

Our determination of the fair value of our investments for GAAP includes inputs provided by third party dealers and pricing services. Valuations of certain investments in which we invest are often difficult to obtain. In general, dealers and pricing services heavily disclaim their valuations. Dealers may claim to furnish valuations only as an accommodation and without special compensation, and so they may disclaim any and all liability for any direct, incidental, or consequential damages arising out of any inaccuracy or incompleteness in valuations, including any act of negligence or breach of any warranty. Depending on the complexity and illiquidity of a security, valuations of the same security can vary substantially from one dealer or pricing service to another. Therefore, our results of operations for a given period could be adversely affected if our determinations regarding the fair market value of these investments are materially different than the values that we ultimately realize upon their disposal. Due to an overall increase in market volatility, the valuation process has been particularly challenging recently as market events have made valuations of certain assets more difficult, unpredictable and volatile.

Declines in value of the assets in which we invest will adversely affect our financial position and results of operations, and make it more costly to finance these assets.

We use our investments as collateral for our financings. Any decline in their value, or perceived market uncertainty about their value, would likely make it difficult for us to obtain financing on favorable terms or at all, or maintain our compliance with terms of any financing arrangements already in place. Our investments in mortgage-backed securities and Whole Loans are recorded at fair value under a fair value option election at the time of purchase with changes in fair value reported in earnings. As a result, a decline in fair values of our mortgage-backed securities and Whole Loans could reduce both our earnings and stockholders' equity. If market conditions result in a decline in the fair value of our assets, our financial position and results of operations could be adversely affected.

Interest rate mismatches between our RMBS and Whole Loans backed by ARMs or hybrid ARMs and our borrowings used to fund our purchases of these assets may cause us to suffer losses.

We may fund our RMBS and Whole Loans with borrowings that have interest rates that adjust more frequently than the interest rate indices and repricing terms of RMBS and Whole Loans backed by adjustable-rate mortgages, or ARMs, or hybrid ARMs. Accordingly, if short-term interest rates increase, our borrowing costs may increase faster than the interest rates on RMBS and Whole Loans backed by ARMs or hybrid ARMs adjust. As a result, in a period of rising interest rates, we could experience a decrease in net income or a net loss.

In most cases, the interest rate indices and repricing terms of RMBS and Whole Loans backed by ARMs or hybrid ARMs and our borrowings will not be identical, thereby potentially creating an interest rate mismatch between our investments and our borrowings. While the historical spread between relevant short-term interest rate indices has been relatively stable, there have been periods when the spread between these indices was volatile. During periods of changing interest rates, these interest rate index mismatches could reduce our net income or produce a net loss, and adversely affect the level of our dividends and the market price of our common stock.

In addition, RMBS and Whole Loans backed by ARMs or hybrid ARMs will typically be subject to lifetime interest rate caps that limit the amount an interest rate can increase through the maturity of the RMBS and Whole Loans. However, our borrowings under repurchase agreements typically are not subject to similar restrictions. Accordingly, in a period of rapidly increasing interest rates, the interest rates paid on our borrowings could increase without limitation while caps could limit the interest rates on these types of RMBS and Whole Loans. This problem is magnified for RMBS and Whole Loans backed by ARMs or hybrid ARMs that are not fully indexed. Further, some RMBS and Whole Loans backed by ARMs or hybrid ARMs may be subject to periodic payment caps that result in a portion of the interest being deferred and added to the principal outstanding. As a result, we may receive less cash income on these types of RMBS and Whole Loans than we need to pay interest on our related borrowings. These factors could reduce our net interest income and cause us to suffer a loss during periods of rising interest rates.

As of December 31, 2019, our Non-Agency RMBS and Whole Loans were secured by ARMs, Hybrid ARMs, pay option ARMs and fixed-rate mortgages. There can be no assurance that this will not change in the future.

Prepayment may adversely affect our profitability.

The RMBS assets and Residential Whole Loans we acquire are backed by pools of residential mortgage loans. We receive payments, generally, from the payments that are made on these underlying residential mortgage loans. While commercial mortgages frequently include limitations on the ability of the borrower to prepay, residential mortgages generally do not. When borrowers prepay their residential mortgage loans at rates that are faster than expected, the net result is prepayments that are faster than expected on the related RMBS and Residential Whole Loans. These faster than expected payments may adversely affect our profitability.

We may purchase RMBS assets and Residential Whole Loans that have a higher interest rate than the then prevailing market interest rate. In exchange for this higher interest rate, we may pay a premium to par value to acquire the asset. In accordance with accounting rules, we amortize this premium over the expected term of the asset. If the asset is prepaid in whole or in part at a faster than expected rate, we must expense all or a part of the remaining unamortized portion of the premium, which can adversely affect our profitability.

Prepayments generally increase when interest rates fall and decrease when interest rates rise, but changes in prepayment are difficult to predict. House price appreciation, while increasing the value of the collateral underlying our RMBS and Residential Whole Loans, may increase prepayments as borrowers may be able to refinance at more favorable terms. Prepayments can also occur when borrowers default on their residential mortgages and the mortgages are prepaid from the proceeds of a foreclosure sale of the property (an involuntary prepayment), or when borrowers sell the property and use the sale proceeds to prepay the mortgage as part of a physical relocation. Prepayments also may be affected by conditions in the housing and financial markets, increasing defaults on residential mortgage loans, which could lead to an acceleration of the payment of the related principal, general economic conditions and the relative interest rates on fixed-rate mortgages and ARMs. While we seek to manage prepayment risk, in selecting RMBS and Residential Whole Loans investments we must balance prepayment risk against other

risks, the potential returns of each investment and the cost of hedging our risks. No strategy can completely insulate us from prepayment or other such risks, and we may deliberately retain exposure to prepayment or other risks.

In addition, a decrease in prepayment may adversely affect our profitability. When borrowers prepay their residential mortgage loans at slower than expected rates, prepayments on the RMBS may be slower than expected. These slower than expected payments may adversely affect our profitability. We may purchase RMBS assets that have a lower interest rate than the then prevailing market interest rate. In exchange for this lower interest rate, we may pay a discount to par value to acquire the asset. In accordance with accounting rules, we accrete this discount over the expected term of the asset based on our prepayment assumptions. If the asset is prepaid at a slower than expected rate, however, we must accrete the remaining portion of the discount at a slower than expected rate. This will extend the expected life of the asset and result in a lower than expected yield on assets purchased at a discount to par.

We could be materially and adversely affected by poor market conditions where the properties securing the mortgage loans underlying our investments are geographically concentrated.

Our performance depends on the economic conditions in markets in which the properties securing the mortgage loans underlying our investments are concentrated. As of December 31, 2019, a substantial portion of our investments had underlying properties in California. Our financial condition, results of operations, the market price of our common stock and our ability to make distributions to our stockholders could be materially and adversely affected by this geographic concentration if market conditions, such as an oversupply of space or a reduction in demand for real estate in an area, deteriorate in California. Moreover, due to the geographic concentration of properties securing the mortgages underlying our investments, the Company may be disproportionately affected by general risks such as natural disasters, including major wildfires, floods and earthquakes and , severe or inclement weather, should such developments occur in or near the markets in California in which such properties are located.

We may incur losses as a result of unforeseen or catastrophic events, including the emergence of a pandemic and acts of terrorism.

The occurrence of unforeseen or catastrophic events, including the emergence of a pandemic, such as coronavirus, or other widespread health emergency (or concerns over the possibility of such an emergency) terrorist attacks could create economic and financial disruptions, and could lead to operational difficulties that could impair our ability to manage our businesses.

We may make investments in non U.S. dollar denominated securities, which will be subject to currency rate exposure and risks associated with the uncertainty of foreign laws and markets.

Some of our real estate-related securities investments may be denominated in foreign currencies, and therefore, we expect to have currency risk exposure to any such foreign currencies. A change in foreign currency exchange rates may have an adverse impact on returns on our non U.S. dollar denominated investments. Although we may hedge our foreign currency risk subject to the REIT income tests, we may not be able to do so successfully and may incur losses on these investments as a result of exchange rate fluctuations. To the extent that we invest in non U.S. dollar denominated securities, in addition to risks inherent in the investment in securities generally discussed in this Form 10-K, we will also be subject to risks associated with the uncertainty of foreign laws and markets, including, but not limited to, unexpected changes in regulatory requirements, political and economic instability in certain geographic locations, difficulties in managing international operations, currency exchange controls, potentially adverse tax consequences, additional accounting and control expenses and the administrative burden of complying with a wide variety of foreign laws.

We are highly dependent on information systems and systems failures could significantly disrupt our business, which may, in turn, negatively affect the market price of our common stock and our ability to make distributions to all stockholders.

Our business is highly dependent on communications and information systems of our Manager and other third party service providers. Any failure or interruption of our Manager's or other third party service providers' systems could cause delays or other problems in our securities trading activities, which could have a material adverse effect on our operating results and negatively affect the market price of our common stock and our ability to make distributions to our stockholders.

Loss of our exemption from regulation pursuant to the 1940 Act would adversely affect us.

We conduct our business so as not to become regulated as an investment company under the 1940 Act in reliance on the exemption provided by Section 3(c)(5)(C) of the 1940 Act. Section 3(c)(5)(C), as interpreted by the staff of the SEC, requires that: (i) at least 55% of our investment portfolio consist of "mortgages and other liens on and interest in real estate," or "qualifying real estate interests," and (ii) at least 80% of our investment portfolio consist of qualifying real estate interests plus "real estate-related assets." In satisfying this 55% requirement, based on pronouncements of the SEC staff, we may treat whole pool Agency RMBS

and CMBS as qualifying real estate interests. The SEC staff has not issued guidance with respect to whole pool Non-Agency RMBS. Accordingly, based on our own judgment and analysis of the SEC's pronouncements with respect to whole pool Agency RMBS, we may also treat Non-Agency RMBS issued with respect to an underlying pool of mortgage loans in which we hold all of the certificates issued by the pool as qualifying real estate interests. We currently treat partial pool Agency, Non-Agency RMBS and partial pool CMBS as real estate-related assets. We treat any ABS, interest rate swaps or other derivative hedging transactions we enter into as miscellaneous assets that will not exceed 20% of our total assets. We rely on guidance published by the SEC staff or on our analyses of guidance published with respect to other types of assets to determine which assets are qualifying real estate assets and real estate-related assets.

The SEC in 2011 solicited public comment on a wide range of issues relating to Section 3(c)(5)(C), including the nature of the assets that qualify for purposes of the exemption and whether mortgage REITs should be regulated in a manner similar to investment companies. There can be no assurance that the laws and regulations governing the 1940 Act status of REITs, including the guidance of the Division of Investment Management of the SEC regarding this exemption, will not change in a manner that adversely affects our operations. To the extent that the SEC or its staff publishes new or different guidance with respect to these matters, we may be required to adjust our strategy accordingly. In addition, we may be limited in our ability to make certain investments and these limitations could require us to hold assets we might wish to sell or to sell assets we might wish to hold. To the extent that the SEC staff provides more specific guidance regarding any of the matters bearing upon the exemption we rely on from the 1940 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 we have chosen.

The mortgage related investments that we acquire are limited by the provisions of the 1940 Act and the rules and regulations promulgated thereunder. If the SEC determines that any of these securities are not qualifying interests in real estate or real estate-related assets, adopts a contrary interpretation with respect to these securities or otherwise believes we do not satisfy the above exceptions or changes its interpretation of the above exceptions, we could be required to restructure our activities or sell certain of our assets. We may be required at times to adopt less efficient methods of financing certain of our mortgage related investments and we may be precluded from acquiring certain types of higher yielding securities. The net effect of these factors would be to lower our net interest income. If we fail to qualify for an exemption from registration as an investment company or an exclusion from the definition of an investment company, our ability to use leverage would be substantially reduced. Further, if the SEC determined that we were an unregistered investment company, we could be subject to monetary penalties and injunctive relief in an action brought by the SEC, we would potentially be unable to enforce contracts with third parties which could seek to obtain rescission of transactions undertaken during the period for which it was established we were an unregistered investment company. If we were required to register as an investment company, it would result in a change of our financial statement requirements. Our business will be materially and adversely affected if we fail to qualify for this exemption from regulation pursuant to the 1940 Act. In addition, the loss of our 1940 Act exemption would also permit our Manager to terminate the Management Agreement, which could result in material adverse effect on our business and results of operations.

Compliance with our 1940 Act exemption will limit our ability to invest in certain of our target assets.

At times the Manager may be limited in allocating equity to target that do not qualify as real estate or real estate related assets for purposes of the 1940 Act exemption. This limitation could adversely affect the performance of our portfolio if these non qualifying assets presents more attractive investment opportunities. Among the current target assets that are not real estate assets are ABS, non pool Agency and Non-Agency MBS, GSE Risk Sharing Securities and certain Commercial Mezzanine Loans.

The downgrade of the U.S. Government's or certain European countries' credit ratings and any future downgrades of the U.S. Government's or certain European countries' credit ratings may materially adversely affect our business, financial condition and results of operations.

On August 5, 2011, Standard & Poor's downgraded the U.S. Government's credit rating for the first time in history. More recently, concerns over economic recession, geopolitical issues, the ability of certain European sovereigns to honor their debt obligations and the exposure of certain European financial institutions to such debt, potential deflationary pressures in Europe, slowing growth in China, rapid decline in the price of oil and certain other commodities, the availability and cost of financing, the mortgage market, uncertainty related to political events such as the government spending and tax policy and uncertain real estate market have contributed to volatility and relatively low expectations for the world economy and domestic and international markets. Europe remains vulnerable to volatile financial and credit markets due to economic and political uncertainties, including the United Kingdom's decision to withdraw from the European Union, the ongoing refugee crisis, financial uncertainty in Greece and a lack of confidence in the European Union's banking system. Because FNMA and FHLMC are in conservatorship of the U.S. Government, downgrades to the U.S. Government's credit rating could impact the credit risk associated with Agency MBS and, therefore, decrease the value of the Agency MBS in which we invest. In addition, the downgrade of the U.S. Government's credit rating and the credit ratings of certain European countries has created broader financial turmoil and uncertainty, which has recently weighed heavily on the global banking system. Therefore, the downgrade of the U.S. Government's credit rating and the credit

ratings of certain European countries and any future downgrades of the U.S. Government's credit rating or the credit ratings of certain European countries may materially adversely affect our business, financial condition and results of operations.

Risks related to financing and hedging

Our strategy involves significant leverage, which may amplify losses.

Our current target leverage generally ranges between three to ten times the amount of our stockholders' equity (calculated in accordance with U.S. GAAP). We incur this leverage by borrowing against a substantial portion of the market value of our assets. By utilizing this leverage, we can enhance our returns. Nevertheless, this leverage, which is fundamental to our investment strategy, also creates significant risks.

As a result of our significant leverage, we may incur substantial losses if our borrowing costs increase. Our borrowing costs may increase for any of the following reasons:

- short-term interest rates increase;
- the market value of our securities decreases;
- interest rate volatility increases; or
- the availability of financing in the market decreases.

Fluctuations in interest rates could materially affect our financial results

In July 2017, the United Kingdom Financial Conduct Authority (the authority that regulates LIBOR) announced it intends to stop persuading or compelling banks to submit rates for the calculation of LIBOR after 2021. The Alternative Reference Rates Committee ("ARRC") has proposed that the Secured Overnight Financing Rate ("SOFR") is the rate that represents best practice as the alternative to USD-LIBOR for use in derivatives and other financial contracts that are currently indexed to USD-LIBOR. ARRC has proposed a paced market transition plan to SOFR from USD-LIBOR and organizations are currently working on industry wide and company specific transition plans as it relates to derivatives and cash markets exposed to USD-LIBOR. We have material contracts, including agreements governing certain of our indebtedness that are indexed to USD-LIBOR and are monitoring this activity and evaluating the related risks. In September 2019, the FASB proposed guidance that would help facilitate the market transition from existing reference rates to alternative rates. However, at this time, it is not possible to predict the effect of any such changes, any establishment of alternative reference rates or any other reforms to LIBOR that may be enacted in the United Kingdom or elsewhere. Uncertainty as to the nature of such potential changes, alternative reference rates or other reforms may adversely affect the trading market for LIBOR-based securities, including our material contract that are indexed to USD-LIBOR. Furthermore, we may need to renegotiate any credit agreements extending beyond 2021 that utilize LIBOR as a factor in determining the interest rate to replace LIBOR with the new standard that is established. There is currently no definitive information regarding the future utilization of LIBOR or of any particular replacement rate. As such, potential effect of any such event on our business, financial condition and results of operations cannot yet be determined.

There can be no assurance that our Manager will be able to prevent mismatches in the maturities of our assets and liabilities.

Because we employ financial leverage in funding our portfolio, mismatches in the maturities of our assets and liabilities can create risk in the need to continually renew or otherwise refinance our liabilities. Our net interest margins are dependent upon a positive spread between the returns on our asset portfolio and our overall cost of funding. Our Manager actively employs portfolio-wide and security-specific risk measurement and management processes in our daily operations. Our Manager's risk management tools include software and services licensed or purchased from third parties, in addition to proprietary systems and analytical methods developed internally. There can be no assurance that these tools and the other risk management techniques described above will protect us from asset/liability risks.

We may be subject to margin calls under our master repurchase agreements, which could result in defaults or force us to sell assets under adverse market conditions or through foreclosure.

We have entered into master repurchase agreements with various financial institutions and borrow under these master repurchase agreements to finance the acquisition of assets for our investment portfolio. Pursuant to the terms of borrowings under our master repurchase agreements, a decline in the value of the subject assets may result in our lenders initiating margin calls. A margin call means that the lender requires us to pledge additional collateral to re-establish the ratio of the value of the collateral to the amount of the borrowing. The specific collateral value to borrowing ratio that would trigger a margin call is not set in the master repurchase agreements and will not be determined until we engage in a repurchase transaction under these agreements.

Our fixed-rate securities generally are more susceptible to margin calls as increases in interest rates tend to have a greater negative affect on the market value of fixed-rate securities. If we are unable to satisfy margin calls, our lenders may foreclose on our collateral. The threat of or occurrence of a margin call could force us to sell our assets, either directly or through a foreclosure, under adverse market conditions. Because of the significant leverage we have, we may incur substantial losses upon the threat or occurrence of a margin call.

If a counterparty to our repurchase transactions defaults on its obligation to resell the underlying security back to us at the end of the transaction term, or if the value of the underlying security has declined as of the end of that term, or if we default on our obligations under the repurchase agreement, we will lose money on our repurchase transactions.

When we engage in repurchase transactions, we generally sell securities to lenders (repurchase agreement counterparties) and receive cash from these lenders. The lenders are obligated to resell the same securities back to us at the end of the term of the transaction. Because the cash we receive from the lender when we initially sell the securities to the lender will be less than the value of those securities (this difference is the haircut), if the lender defaults on its obligation to resell the same securities back to us we may incur a loss on the transaction equal to the amount of the haircut (assuming there was no change in the value of the securities). We would also lose money on a repurchase transaction if the value of the underlying securities has declined as of the end of the transaction term, as we would have to repurchase the securities based on their initial value but would receive securities worth less than that amount. Further, if we default on one of our obligations under a repurchase transaction, the lender can terminate the transaction and cease entering into any other repurchase transactions with us. Our inability to post adequate collateral for a margin call by the counterparty, in a time frame as short as the close of the same business day, could result in a condition of default under our repurchase agreements, thereby enabling the counterparty to liquidate the collateral pledged by us, which may have a material adverse effect on our financial position, results of operations and cash flows. Certain of our repurchase agreements contain cross-default provisions, such that if a default occurs under an agreement with any specific lender, that lender could also declare a default under other repurchase agreements or other financing or derivative contracts, if any, with such lender. Further, 16 of the counterparties to our repurchase agreements held, as of December 31, 2019, collateral valued in excess of 5% of our stockholders' equity as security for our obligations under the applicable repurchase agreements. Any losses we incur on our repurchase transactions could adversely affect our earnings and thus our cash available for distribution to our stockholders.

If a counterparty to one of our swap agreements or TBAs defaults on its obligations, we may incur losses.

If a counterparty to one of the bilateral swap agreements that we enter into or TBAs that we enter into defaults on its obligations under the agreement, we may not receive payments due under the agreement, and thus, we may lose any unrealized gain associated with the agreement. In the case of a swap agreement, the fact that such swap agreement hedged a liability means that the liability could cease to be hedged upon the default of a counterparty. Additionally, we may also risk the loss of any collateral we have pledged to secure our obligations under a bilateral swap agreement if the counterparty, or in the case of a cleared swap, if our clearing broker, becomes insolvent or files for bankruptcy.

Failure to procure adequate repurchase agreement financing, which generally have short terms, or to renew or replace repurchase agreement financing as it matures, would adversely affect our results of operations.

We use repurchase agreement financing as a strategy to increase the return on our investment portfolio. However, we may not be able to achieve our desired leverage ratio for a number of reasons, including if the following events occur:

- our lenders do not make repurchase agreement financing available to us at acceptable rates;
- certain of our lenders exit the repurchase market;
- our lenders require that we pledge additional collateral to cover our borrowings, which we may be unable to do; or
- we determine that the leverage would expose us to excessive risk.

We cannot assure you that any, or sufficient, repurchase agreement financing will be available to us on terms that are acceptable to us. In recent years, investors and financial institutions that lend in the securities repurchase market, have tightened lending standards in response to the difficulties and changed economic conditions that have materially adversely affected the MBS market. These market disruptions have been most pronounced in the Non-Agency MBS market, and the impact has also extended to Agency MBS, which has made the value of these assets unstable and relatively illiquid compared to prior periods. Any decline in their value, or perceived market uncertainty about their value, would make it more difficult for us to obtain financing on favorable terms or at all, or maintain our compliance with terms of any financing arrangements then in place.

As of December 31, 2019, we had amounts outstanding under repurchase agreements with 21 separate lenders and had repurchase agreements with 34 different lenders. Prior to entering into a lending relationship with any financial institution, our Manager does a thorough credit review of such potential lender. Notwithstanding the foregoing, a material adverse development

involving one or more major financial institutions or the financial markets in general, in addition to the regulatory changes, could result in our lenders reducing our access to funds available under our repurchase agreements or terminating such agreements altogether.

Furthermore, because we rely primarily on short-term borrowings, our ability to achieve our investment objectives will depend not only on our ability to borrow money in sufficient amounts and on favorable terms, but also on our ability to renew or replace on a continuous basis our maturing short-term borrowings. If we are unable to renew or replace our maturing short-term borrowings due to liquidity shortfalls in the repurchase agreement market and other short-term funding markets, changes in the regulatory environment or for any other reason, we will have to sell some or all of our assets, possibly under adverse market conditions which may have a material adverse effect on our financial position, results of operations and cash flows. In addition, the aforementioned changes to the regulatory capital requirements imposed on our lenders may significantly increase the cost of the financing that they provide to us. Our lenders also may revise their eligibility requirements for the types of assets they are willing to finance or the terms of such financings, based on, among other factors, the recent changes in the regulatory environment and their management of perceived risk, particularly with respect to assignee liability.

Our repurchase agreement financing may require us to provide additional collateral and may restrict us from leveraging our assets as fully as desired.

We use repurchase agreements to finance acquisitions of our investments. If the market value of the asset pledged or sold by us to a financing institution pursuant to a repurchase agreement declines, we may be required by the financing institution to provide additional collateral or pay down a portion of the funds advanced, but we may not have the funds available to do so, which could result in defaults. Posting additional collateral to support our credit will reduce our liquidity and limit our ability to leverage our assets, which could adversely affect our business. In the event we do not have sufficient liquidity to meet such requirements, financing institutions can accelerate repayment of our indebtedness, increase interest rates, liquidate our collateral or terminate our ability to borrow. Such a situation would likely result in a rapid deterioration of our financial condition and possibly necessitate a filing for bankruptcy protection.

On the date each month that principal payments are announced (i.e., the factor day for our Agency RMBS), the value of our Agency RMBS pledged as collateral under our repurchase agreements is reduced by the amount of the prepaid principal and, as a result, our lenders will typically initiate a margin call requiring the pledge of additional collateral or cash, in an amount equal to such prepaid principal, in order to re-establish the required ratio of borrowing to collateral value under such repurchase agreements. Accordingly, with respect to our Agency RMBS the announcement on factor day of principal prepayments is in advance of our receipt of the related scheduled payment, thereby creating a short-term receivable for us in the amount of such principal prepayments; however, under our repurchase agreements, we may receive a margin call relating to the related reduction in value of our Agency RMBS and prior to receipt of this short-term receivable, be required to post additional collateral or cash in an amount equal to the product of the advance rate of such repurchase agreement and the principal prepayment on or about factor day, which would reduce our liquidity during the period in which the short-term receivable is outstanding. As a result, in order to meet any such margin calls, we could be forced to sell assets in order to maintain liquidity. Forced sales under adverse market conditions may result in lower sales prices than ordinary market sales in the normal course of business.

Further, financial institutions providing the repurchase facilities may require us to maintain a certain amount of cash uninvested or to set aside non-levered assets sufficient to maintain a specified liquidity position which would allow us to satisfy our collateral obligations. As a result, we may not be able to leverage our assets as fully as we would choose which could reduce our return on equity. If we are unable to meet these collateral obligations, our financial condition could deteriorate rapidly.

Lenders may require us to enter into restrictive covenants relating to our operations.

When we obtain further financing, lenders could impose restrictions on us that would affect our ability to incur additional debt, our capability to make distributions to stockholders and our flexibility to determine our operating policies. Loan documents we execute may contain negative covenants that limit, among other things, our ability to repurchase stock, distribute more than a certain amount of our funds from operations, and employ leverage beyond certain amounts.

Our rights under repurchase agreements may be subject to the effects of the bankruptcy laws in the event of the bankruptcy or insolvency of us or our counterparties under the repurchase agreements.

In the event of our insolvency or bankruptcy, certain repurchase agreements may qualify for special treatment under the U.S. Bankruptcy Code, the effect of which, among other things, would be to allow the lender under the applicable repurchase agreement to avoid the automatic stay provisions of the U.S. Bankruptcy Code and to take possession of and liquidate the assets that we have pledged under their repurchase agreements. In the event of the insolvency or bankruptcy of a lender during the term of a repurchase agreement, the lender may be permitted, under applicable insolvency laws, to repudiate the contract, and our claim against the lender for damages may be treated simply as the claim of an unsecured creditor. In addition, if the lender is a broker or dealer subject to the Securities Investor Protection Act of 1970, or an insured depository institution subject to the Federal Deposit

Insurance Act, our ability to exercise our rights to recover our securities under a repurchase agreement or to be compensated for any damages resulting from the lender's insolvency may be further limited by those statutes. These claims would be subject to significant delay and, if and when received, may be substantially less than the damages we actually incur.

An increase in our borrowing costs relative to the interest that we receive on our portfolio investments may adversely affect our profitability and cash available for distribution to our stockholders.

As long as we earn a positive spread between interest and other income we earn on our leveraged assets and our borrowing costs, we believe that we can generally increase our profitability by using greater amounts of leverage. We cannot, however, assure you that repurchase financing will remain an efficient source of long-term financing for our assets. The amount of leverage that we use may be limited because our lenders might not make funding available to us or they may require that we provide additional collateral to secure our borrowings. If our financing strategy is not viable, we will have to find alternative forms of financing for our assets which may not be available to us on acceptable terms or at acceptable rates. In addition, in response to certain interest rate and investment environments or to changes in the market liquidity, we could adopt a strategy of reducing our leverage by selling assets or not reinvesting principal payments as MBS amortize and/or prepay, thereby decreasing the outstanding amount of our related borrowings. Such an action could reduce interest income, interest expense and net income, the extent of which would be dependent on the level of reduction in assets and liabilities as well as the sale prices for which assets were sold.

As our financings mature, we will be required either to enter into new borrowings or to sell certain of our investments. Since we rely primarily on borrowings under repurchase agreements to finance our assets, our ability to achieve our investment objectives depends on our ability to borrow funds in sufficient amounts and on acceptable terms, and on our ability to renew or replace maturing borrowings on a continuous basis. Our repurchase agreement credit lines are renewable at the discretion of our lenders and, as such, do not contain guaranteed roll-over terms. Our ability to enter into repurchase transactions in the future will depend on the market value of our assets pledged to secure the specific borrowings, the availability of acceptable financing and market liquidity and other conditions existing in the lending market at that time. If we are unable to renew or replace maturing borrowings, we could be forced to sell assets in order to maintain liquidity. Forced sales under adverse market conditions could result in lower sales prices than ordinary market sales in the normal course of business. Further, an increase in short-term interest rates at the time that we seek to enter into new borrowings would reduce the spread between our returns on our assets and the cost of our borrowings. This would adversely affect our returns on our assets, which might reduce earnings and, in turn, cash available for distribution to our stockholders.

Our investments in Residential and Commercial Whole Loans are difficult to value and are dependent upon the ability to finance, refinance and securitize such investments. The inability to do so could materially and adversely affect our liquidity and earnings and limit the cash available for distribution to our stockholders.

We may seek to finance and refinance our Residential Whole Loans and Commercial Whole Loans to generate greater value from such loan. However, there may be impediments to executing either a financing or refinancing strategy for these investments. The financing of these investments presents additional challenges because in general it is less available than repurchase financing for MBS, especially Agency CMBS and Agency RMBS, and likely to have less advantageous pricing and more onerous terms. Accordingly, there can be no assurance that we will be able to finance Whole Loans at all, let alone on terms we believe are advantageous.

We may enter into hedging transactions that could expose us to contingent liabilities in the future.

Subject to maintaining our qualification as a REIT and exemption from registration under the 1940 Act, part of our investment strategy may involve entering into economic hedging transactions that could require us to fund cash payments in certain circumstances (such as the early termination of the hedging instrument caused by an event of default or other early termination event, or the decision by a counterparty to request margin securities it is contractually owed under the terms of the hedging instrument). The amount due would be equal to the unrealized loss of the open swap positions with the respective counterparty and could also include other fees and charges. These economic losses will be reflected in our results of operations, and our ability to fund these obligations will depend on the liquidity of our assets and access to capital at the time, and the need to fund these obligations could adversely impact our financial condition.

Hedging against interest rate exposure may adversely affect our earnings, which could reduce our cash available for distribution to our stockholders.

Subject to maintaining our qualification as a REIT and exemption from registration under the 1940 Act, we may pursue various economic hedging strategies to seek to reduce our exposure to adverse changes in interest rates. Our hedging activity varies in scope based on the level and volatility of interest rates, the type of assets held and other changing market conditions. Interest rate hedging may fail to protect or could adversely affect us because, among other things:

- interest rate hedging can be expensive, particularly during periods of rising and volatile interest rates;

- available interest rate hedges may not correspond directly with the interest rate risk for which protection is sought;
- due to a credit loss, the duration of the hedge may not match the duration of the related liability;
- the amount of income that a REIT may earn from hedging transactions (other than hedging transactions that satisfy certain requirements of the Code or that are done through a taxable REIT subsidiary (a "TRS")) to offset interest rate losses is limited by U.S. federal tax provisions governing REITs);
- the value of derivatives used for hedging may be adjusted from time to time in accordance with accounting rules to reflect changes in fair value. Downward adjustments or "mark-to-market losses," would reduce our stockholders' equity;
- the credit quality of the hedging counterparty owing money on the hedge may be downgraded to such an extent that it impairs our ability to sell or assign our side of the hedging transaction; and
- the hedging counterparty owing money in the hedging transaction may default on its obligation to pay.

Our hedging transactions, which are intended to limit losses, may actually adversely affect our earnings, which could reduce our cash available for distribution to our stockholders.

While the majority of our interest rate swaps are traded on a regulated exchange, certain hedging instruments are traded over the counter and do not trade on regulated exchanges and, therefore, are not guaranteed by an exchange or a clearing house. In addition, over the counter instruments are more lightly regulated by U.S. and foreign governmental authorities. Consequently, there may be no requirements with respect to record keeping, financial responsibility or segregation of customer funds and positions. Furthermore, the enforceability of agreements underlying hedging transactions may depend on compliance with applicable statutory and commodity and other regulatory requirements and, depending on the identity of the counterparty, applicable international requirements. The business failure of a hedging counterparty with whom we enter into a hedging transaction which did not clear through a clearing house would most likely result in its default. Default by a party with whom we enter into a hedging transaction may result in the loss of unrealized profits and force us to cover our commitments, if any, at the then current market price. Although generally we seek to reserve the right to terminate our hedging positions, it may not always be possible to dispose of or close out a hedging position without the consent of the hedging counterparty and we may not be able to enter into an offsetting contract in order to cover our risk. There can be no assurance that a liquid secondary market will exist for any hedging instruments purchased or sold, and we may be required to maintain a position until exercise or expiration, which could result in losses.

Risks associated with our relationship with our Manager

Our Board of Directors has approved very broad investment guidelines for our Manager and does not approve each investment and financing decision made by our Manager.

Our Manager is authorized to follow very broad investment guidelines. Our Board of Directors periodically reviews our investment guidelines and our investment portfolio but does not, and is not required to review all of our proposed investments, except that an investment in a security structured or issued by another entity managed by our Manager must be approved by at least two-thirds (2/3) of our independent directors prior to such investment. In addition, in conducting periodic reviews, our Board of Directors may rely primarily on information provided to them by our Manager. Furthermore, our Manager may use complex strategies, and transactions entered into by our Manager may be costly, difficult or impossible to unwind by the time they are reviewed by our Board of Directors. Our Manager has great latitude within the broad parameters of our investment guidelines in determining the types and amounts of Agency and Non-Agency RMBS, CMBS, ABS and Whole Loan investments it may decide are attractive investments for us, which could result in investment returns that are substantially below expectations or that result in losses, which would materially and adversely affect our business operations and results. Further, decisions made and investments and financing arrangements entered into by our Manager may not fully reflect the best interests of our stockholders.

There are conflicts of interest in our relationship with our Manager that could result in decisions that are not in the best interests of our stockholders.

We are subject to conflicts of interest arising out of our relationship with our Manager. We do not have any employees. All of our executive officers and two of our directors, James W. Hirschmann III and Jennifer W. Murphy, are employees of our Manager. Our Management Agreement with our Manager was negotiated between related parties and its terms, including fees and other amounts payable, may not be as favorable to us as if it had been negotiated at arm's-length with an unaffiliated third party. In addition, the obligations of our Manager and its officers and personnel to engage in other business activities may reduce the time our Manager and its officers and personnel spend managing us.

We compete for investment opportunities directly with other client portfolios managed by our Manager. Clients of our Manager have investment mandates and objectives that target the same assets as us. A substantial number of client accounts managed by our Manager have exposure to RMBS, CMBS and other investments and may have similar investment mandates and objectives. While our Manager has only a limited number of client accounts investing in Whole loans, the supply of Whole Loan investments meeting the Manager's investment criteria is extremely limited. In addition, our Manager may have additional clients that compete directly with us for investment opportunities in the future. Our Manager has an investment allocation policy in place that is intended to ensure that no single client is intentionally favored over another and that trades are allocated in a fair and equitable manner. We may compete with our Manager or its other clients for investment or financing opportunities sourced by our Manager; however, we may either not be presented with the opportunity or have to compete with our Manager to acquire these investments or have access to these sources of financing. Our Manager and our executive officers may choose to allocate favorable investments to itself or to its or other clients instead of to us. Further, at times when there are turbulent conditions in the mortgage markets or distress in the credit markets or other times when we will need focused support and assistance from our Manager, our Manager's other clients will likewise require greater focus and attention, placing our Manager's resources in high demand. In such situations, we may not receive the level of support and assistance that we may receive if we were internally managed or if our Manager did not act as a manager for other entities. There is no assurance that our Manager's allocation policies that address some of the conflicts relating to our access to investment and financing sources will be adequate to address all of the conflicts that may arise.

We pay our Manager a management fee that is not tied to our performance. The management fee may not sufficiently incentivize our Manager to generate attractive risk-adjusted returns for us. This could hurt both our ability to make distributions to our stockholders and the market price of our common stock. Furthermore, the compensation payable to our Manager will increase as a result of future issuances of our equity securities, even if the issuances are dilutive to existing stockholders.

As of December 31, 2019, our Manager owned 1,383,865 shares of our common stock. To the extent our Manager elects to sell all or a portion of these shares in the future, our Manager's interests may be less aligned with our interests.

We are dependent on our Manager and its key personnel for our success.

We have no separate facilities and are completely reliant on our Manager. All of our executive officers and two of our directors, are employees of our Manager. Our Manager has significant discretion as to the implementation of our investment and operating policies and strategies. Accordingly, we believe that our success will depend to a significant extent upon the efforts, experience, diligence, skill and network of business contacts of the executive officers and key personnel of our Manager. The executive officers and key personnel of our Manager evaluate, negotiate, close and monitor our investments; therefore, our success depends on their continued service. The departure of any of the executive officers or key personnel of our Manager could have a material adverse effect on our performance. In addition, we offer no assurance that our Manager will remain our investment manager or that we will continue to have access to our Manager's principals and professionals. The term of our Management Agreement with our Manager expires on May 16, 2021, with automatic one-year renewals thereafter. If the Management Agreement is terminated and no suitable replacement is found to manage us, we may not be able to execute our business plan. Moreover, our Manager is not obligated to dedicate any of its personnel exclusively to us nor is it obligated to dedicate any specific portion of its time to our business, and none of our Manager's personnel are contractually dedicated to us under our Management Agreement with our Manager.

The Management Agreement with our Manager was not negotiated on an arm's-length basis, may not be as favorable to us as if it had been negotiated with an unaffiliated third party and may be costly and difficult to terminate.

All of our executive officers and two of our directors are employees of our Manager. Our Management Agreement with our Manager was negotiated between related parties and its terms, including fees payable, may not be as favorable to us as if it had been negotiated with an unaffiliated third party.

Termination of the Management Agreement with our Manager without cause is difficult and costly. Our independent directors review our Manager's performance and any fees payable to our Manager annually and the Management Agreement may be terminated annually upon the affirmative vote of at least two-thirds (2/3) of our independent directors based upon: (i) our Manager's unsatisfactory performance that is materially detrimental to us; or (ii) our determination that any fees payable to our Manager are not fair, subject to our Manager's right to prevent termination based on unfair fees by accepting a reduction of management fees agreed to by at least two-thirds (2/3) of our independent directors. We are required to provide our Manager 180 days prior notice of any such termination. Unless terminated for cause, we are required to pay our Manager a termination fee equal to three times the average annual management fee earned by our Manager during the prior 24-month period immediately preceding such termination, calculated as of the end of the most recently completed fiscal quarter before the date of termination. This provision increases the effective cost to us of electing not to renew, or defaulting in our obligations under, the Management Agreement, thereby adversely affecting our inclination to end our relationship with our Manager, even if we believe our Manager's performance is not satisfactory.

Our Manager is only contractually committed to serve us until May 16, 2021. The Management Agreement is automatically renewable for one-year terms; provided, however, that our Manager may terminate the Management Agreement annually upon 180 days prior notice. If the Management Agreement is terminated and no suitable replacement is found to manage us, we may not be able to execute our business plan.

Pursuant to the Management Agreement, our Manager does not assume any responsibility other than to render the services called for thereunder and is not responsible for any action of our Board of Directors in following or declining to follow its advice or recommendations. Our Manager maintains a contractual as opposed to a fiduciary relationship with us. Under the terms of the Management Agreement, our Manager, its officers, stockholders, members, managers, directors, personnel, any person controlling or controlled by our Manager and any person providing sub-advisory services to our Manager are not liable to us, our directors, our stockholders or any partners for acts or omissions performed in accordance with and pursuant to the Management Agreement, except because of acts constituting bad faith, willful misconduct, gross negligence, or reckless disregard of their duties under the Management Agreement. In addition, we indemnify our Manager, its officers, stockholders, members, managers, directors, personnel, any person controlling or controlled by our Manager and any person providing sub-advisory services to our Manager with respect to all expenses, losses, damages, liabilities, demands, charges and claims arising from acts of our Manager not constituting bad faith, willful misconduct, gross negligence, or reckless disregard of duties, performed in good faith in accordance with and pursuant to the Management Agreement.

Our Manager's management fee is payable regardless of our performance.

We pay our Manager a management fee regardless of the performance of our portfolio. Our Manager's entitlement to non-performance-based compensation might reduce its incentive to devote its time and effort to seeking assets that provide attractive risk-adjusted returns for our portfolio. This in turn could hurt both our ability to make distributions to our stockholders and the market price of our common stock.

Our Manager is subject to extensive regulation as an investment advisor, which could adversely affect its ability to manage our business.

Our Manager is subject to regulation as an investment advisor by various regulatory authorities that are charged with protecting the interests of its clients, including us. Instances of criminal activity and fraud by participants in the investment management industry and disclosures of trading and other abuses by participants in the financial services industry have led the U.S. government and regulators to the rules and regulations governing, and oversight of, the U.S. financial system, including the investment management industry and more aggressive enforcement of the existing laws and regulations. Our Manager could be subject to civil liability, criminal liability, or sanction, including revocation of its registration as an investment adviser, revocation of the licenses of its employees, censures, fines, or temporary suspension or permanent bar from conducting business, if it is found to have violated any of these laws or regulations. Any such liability or sanction could adversely affect its ability to manage our business. Our Manager must continually address conflicts between its interests and those of its clients, including us. In addition, the SEC and other regulators have increased their scrutiny of potential conflicts of interest. We believe our Manager has procedures and controls that are reasonably designed to address these issues. However, appropriately dealing with conflicts of interest is complex and difficult and if our Manager fails, or appears to fail, to deal appropriately with conflicts of interest, it could face litigation or regulatory proceedings or penalties, any of which could adversely affect its ability to manage our business.

Risks related to our common stock

The market price and trading volume of our common stock may vary substantially.

Our common stock is listed on the NYSE under the symbol "WMC." The stock markets, including the NYSE, have experienced significant price and volume fluctuations over the past several years. As a result, the market price of our common stock is likely to be similarly volatile, and investors in our common stock may experience a decrease in the value of their shares. Accordingly, no assurance can be given as to the ability of our stockholders to sell their common stock or the price that our stockholders may obtain for their common stock.

Some of the factors that could negatively affect the market price of our common stock include:

- actual or anticipated variations in our quarterly operating results;
- changes in our earnings estimates or publication of research reports about us or the real estate industry;
- changes in market valuations of similar companies;
- adverse market reaction to any increased indebtedness we incur in the future;

- additions to or departures of our Manager's key personnel;
- actions by our stockholders;
- changes in our dividend policy or payments; and
- speculation in the press or investment community.

Market factors unrelated to our performance could also negatively impact the market price of our common stock. One of the factors that investors may consider in deciding whether to buy or sell our common stock is our distribution rate as a percentage of our stock price relative to market interest rates. If market interest rates increase, prospective investors may seek alternative investments paying higher dividends or interest. As a result, interest rate fluctuations and conditions in the capital markets can affect the market value of our common stock. For instance, if interest rates rise, it is likely that the market price of our common stock will decrease as market rates on interest-bearing securities increase.

Investing in our common stock may involve a high degree of risk.

The investments that we make in accordance with our investment objectives may result in a high amount of risk when compared to alternative investment options and volatility or loss of principal. Our investments may be highly speculative and aggressive, and therefore an investment in our common stock may not be suitable for someone with lower risk tolerance.

Common stock eligible for future sale may have adverse effects on our share price.

We cannot predict the effect, if any, of future sales of our common stock, or the availability of shares for future sales, on the market price of our common stock. The market price of our common stock may decline significantly when the restrictions on resale (or lock up agreements), which may attach to future sales of our common stock, by certain of our stockholders lapse. Sales of substantial amounts of common stock or the perception that such sales could occur may adversely affect the prevailing market price for our common stock.

Also, we may issue additional shares in follow-on public offerings or private placements to make new investments or for other purposes. We are not required to offer any such shares to existing stockholders on a preemptive basis. Therefore, it may not be possible for existing stockholders to participate in such future share issuances, which may dilute the existing stockholders' interests in us.

We have not established a minimum distribution payment level and we cannot assure you of our ability to pay distributions in the future.

We intend to pay quarterly distributions and to make distributions to our stockholders in an amount such that we distribute all or substantially all of our net taxable income, calculated in accordance with the REIT requirements, each year. We have not established a minimum distribution payment level and our ability to pay distributions may be adversely affected by a number of factors, including the risk factors described herein. All distributions will be made at the discretion of our Board of Directors and will depend on our earnings, our financial condition, debt covenants, maintenance of our REIT qualification and other factors our Board of Directors may deem relevant from time to time. We believe that a change in any one of the following factors could adversely affect our results of operations and impair our ability to pay distributions to our stockholders:

- the profitability of our existing investments and the investment of net proceeds of any subsequent offering;
- our ability to make profitable investments;
- margin calls or other expenses that reduce our cash flow;
- decreases in the value of our portfolio or defaults in our asset portfolio; and
- the fact that anticipated operating expense levels may not prove accurate, as actual results may vary from estimates.

We cannot assure you that we will achieve investment results that will allow us to make a specified level of cash distributions or year-to-year increases in cash distributions in the future. In addition, some of our distributions may include a return in capital.

Future offerings of debt or equity securities, which would rank senior to our common stock, may adversely affect the market price of our common stock.

If we decide to issue debt or equity securities in the future, which would rank senior to our common stock, it is likely that they will be governed by an indenture or other instrument containing covenants restricting our operating flexibility. Additionally,

any convertible or exchangeable securities that we issue in the future may have rights, preferences and privileges more favorable than those of our common stock and may result in dilution to owners of our common stock. We and, indirectly, our stockholders, will bear the cost of issuing and servicing such securities. Because our decision to issue debt or equity securities in any future offering will depend on market conditions and other factors beyond our control, we cannot predict or estimate the amount, timing or nature of our future offerings. Thus holders of our common stock will bear the risk of our future offerings reducing the market price of our common stock and diluting the value of their stock holdings in us. Furthermore, the compensation payable to our Manager will increase as a result of future issuances of our equity securities, including issuances upon exercise of the warrants, described below, even if the issuances are dilutive to existing stockholders.

Conversion of our convertible senior unsecured notes may dilute the ownership interest of existing stockholders, including holders who had previously converted their notes.

The Company has issued \$205.0 million aggregate principal amount of 6.75% convertible senior unsecured notes. The notes mature on October 1, 2022, unless earlier converted, redeemed or repurchased by the holders pursuant to their terms, and are not redeemable by the Company except during the final three months prior to maturity.

The notes are convertible into, at the Company's election, cash, shares of the Company's common stock or a combination of both, subject to the satisfaction of certain conditions and during specified periods. The conversion rate is subject to adjustment upon the occurrence of certain specified events and the holders may require the Company to repurchase all or any portion of their notes for cash equal to 100% of the principal amount of the notes, plus accrued and unpaid interest, if the Company undergoes a fundamental change as specified in the agreement. The initial conversion rate was 83.1947 shares of common stock per \$1,000 principal amount of notes and represented a conversion price of \$12.02 per share of common stock.

To the extent we issue shares of our common stock upon conversion of the notes, the conversion of some or all of our notes will dilute the ownership interests of existing stockholders. Any sales in the public market of shares of our common stock issuable upon such conversion of the notes could adversely affect the prevailing market price.

Risks related to our organization and structure

Our authorized but unissued shares of common and preferred stock may prevent a change in our control.

Our amended and restated certificate of incorporation authorizes us to issue additional authorized but unissued shares of common or preferred stock. In addition, our Board of Directors may, without stockholder approval, amend our amended and restated certificate of incorporation to increase the aggregate number of our shares of stock or the number of shares of stock of any class or series that we have authority to issue and classify or reclassify any unissued shares of common or preferred stock and set the preferences, rights and other terms of the classified or reclassified shares. As a result, our Board of Directors may establish a series of shares of common or preferred stock that could delay or prevent a transaction or a change in control that might involve a premium price for our shares of common stock or otherwise be in the best interest of our stockholders.

Ownership limitations may restrict change of control or business combination opportunities in which our stockholders might receive a premium for their shares.

To maintain our qualification as a REIT, no more than 50% in value of our outstanding capital stock may be owned, directly or indirectly, by five or fewer individuals during the last half of any calendar year. "Individuals" for this purpose include natural persons, private foundations, some employee benefit plans and trusts, and some charitable trusts. To assist us in maintaining our qualification as a REIT, our amended and restated certificate of incorporation generally prohibits any person from directly or indirectly owning more than 9.8% in value or in number of shares, whichever is more restrictive, of the outstanding shares of our capital stock or more than 9.8% in value or in number of shares, whichever is more restrictive, of the outstanding shares of our common stock. This ownership limitation could have the effect of discouraging a takeover or other transaction in which holders of our common stock might receive a premium for their shares over the then prevailing market price or which holders might believe to be otherwise in their best interests.

Provisions in our amended and restated certificate of incorporation, our amended and restated bylaws and Delaware law may have the effect of preventing or hindering a change in control and adversely affecting the market price of our common stock.

Provisions in our amended and restated certificate of incorporation and our amended and restated bylaws and applicable provisions of the Delaware General Corporation Law may make it more difficult and expensive for a third party to acquire control of us even if a change of control would be beneficial to the interests of our stockholders. These provisions could discourage potential takeover attempts and could adversely affect the market price of our common stock.

We may pay distributions from offering proceeds, borrowings or the sale of assets to the extent that distributions exceed earnings or cash flow from our operations.

We may pay distributions from offering proceeds, borrowings or the sale of assets to the extent that distributions exceed earnings or cash flow from our operations. Such distributions would reduce the amount of cash we have available for investing and other purposes and could be dilutive to our financial results. In addition, funding our distributions from our net proceeds may constitute a return of capital to our investors, which would have the effect of reducing each stockholder's basis in its shares of common stock.

Risks Related to REIT Status

If we do not qualify as a REIT or fail to remain qualified as a REIT, we will be subject to U.S. federal income tax as a regular corporation and could face a substantial tax liability, which would reduce the amount of cash available for distribution to our stockholders.

We believe we have operated and intend to continue to operate in a manner that allows us to qualify as a REIT. Our qualification as a REIT depends on our satisfaction of certain asset, income, organizational, distribution, stockholder ownership and other requirements on a continuing basis. Our ability to satisfy the asset tests depends upon our analysis of the characterization and fair market values of our assets, some of which are not susceptible to a precise determination, and for which we will not obtain independent appraisals. Our compliance with the annual REIT income and quarterly asset requirements also depends upon our ability to successfully manage the composition of our income and assets on an ongoing basis. Accordingly, there can be no assurance that the IRS will not contend that our interests in our subsidiaries or in securities of other issuers will not cause a violation of the REIT requirements.

If we were to fail to qualify as a REIT in any taxable year, and we do not qualify for certain statutory relief provisions, we would be subject to U.S. federal income tax, on our taxable income at regular corporate rates, and dividends paid to our stockholders would not be deductible by us in computing our taxable income. Any resulting corporate tax liability could be substantial and would reduce the amount of cash available for distribution to our stockholders, which in turn could have an adverse impact on the value of our common stock. Unless we were entitled to relief under certain Code provisions, we also would be disqualified from taxation as a REIT for the four taxable years following the year in which we failed to qualify as a REIT.

Dividends payable by REITs do not qualify for the reduced tax rates available for some dividends.

The maximum tax rate applicable to income from "qualified dividends" payable to U.S. stockholders that are individuals, trusts and estates is currently 20%, exclusive of the 3.8% investment tax surcharge. Dividends payable by REITs, however, generally are not eligible for the qualified dividend reduced rates. Stockholders that are individuals, trusts or estates generally may deduct 20% of the aggregate amount of ordinary dividends distributed by us, subject to certain limitations for taxable years beginning after December 31, 2017 and before January 1, 2026. While the qualified dividend rules do not adversely affect the taxation of REITs or dividends payable by REITs, the more favorable rates applicable to regular corporate qualified dividends could cause investors who are individuals, trusts and estates to perceive investments in REITs to be relatively less attractive than investments in the stocks of non-REIT corporations that pay dividends, which could adversely affect the value of the stock of REITs, including our common stock.

REIT distribution requirements could adversely affect our ability to execute our business plan.

We generally must distribute annually at least 90% of our net taxable income, determined without regard to the dividends paid deduction and excluding net capital gains, in order for U.S. federal corporate income tax not to apply to earnings that we distribute. To the extent that we satisfy this distribution requirement, but distribute less than 100% of our REIT taxable income, we will be subject to U.S. federal corporate income tax on our undistributed REIT taxable income. In addition, we will be subject to a nondeductible 4% excise tax if the actual amount that we pay out to our stockholders in a calendar year is less than a minimum amount specified under U.S. federal tax laws. We intend to continue to make distributions to our stockholders to comply with the REIT requirements of the Code and avoid corporate income tax and the 4% annual excise tax.

From time to time, we may generate taxable income greater than our income for financial reporting purposes prepared in accordance with U.S. GAAP, or differences in timing between the recognition of taxable income and the actual receipt of cash may occur. For example, the Code limits our ability to use capital losses to offset ordinary income, thereby requiring us to distribute such ordinary income. If we do not have other funds available in these situations we could be required to borrow funds on unfavorable terms, sell investments at disadvantageous prices or distribute amounts that would otherwise be invested in future acquisitions to make distributions sufficient to enable us to pay out enough of our taxable income to satisfy the REIT distribution requirement and to avoid corporate income tax and the nondeductible 4% excise tax in a particular year. These alternatives could increase our costs or reduce our equity. Thus, compliance with the REIT requirements may hinder our ability to grow, which could adversely affect the value of our common stock.

Even if we remain qualified as a REIT, we may face other tax liabilities that reduce our cash flow.

Even if we remain qualified for taxation as a REIT, we may be subject to certain U.S. federal, state and local taxes on our income and assets, including taxes on any undistributed income, tax on income from some activities conducted as a result of a foreclosure, excise taxes, state or local income, property and transfer taxes, such as mortgage recording taxes, and other taxes. In addition, to meet the REIT qualification requirements, prevent the recognition of certain types of non-cash income, and to avert the imposition of a 100% tax that applies to certain gains derived by a REIT from dealer property or inventory, we may hold some of our assets through TRSs or other consolidated entities that will be subject to corporate-level income tax at regular corporate rates. We may also incur a 100% excise tax on transactions with a TRS if they are not conducted on an arm's-length basis. The payment of any of these taxes would decrease cash available for distribution to our stockholders.

Complying with REIT requirements may cause us to liquidate or forgo otherwise attractive opportunities.

To qualify as a REIT, we must ensure that at the end of each calendar quarter, at least 75% of the value of our assets consists of cash, cash items, government securities and qualified real estate assets, including certain mortgage loans and securities. The remainder of our investments in securities (other than government securities, qualified real estate assets and securities issued by a TRS) generally cannot include more than 10% of the outstanding voting securities of any one issuer or more than 10% of the total value of the outstanding securities of any one issuer. In addition, in general, no more than 5% of the value of our total assets (other than government securities, qualified real estate assets and securities issued by a TRS) can consist of the securities of any one issuer, and no more than 20% of the value of our total assets can be represented by securities of one or more TRSs. If we fail to comply with these requirements at the end of any calendar quarter, we must correct the failure within 30 days after the end of the calendar quarter or qualify for certain statutory relief provisions to avoid losing our REIT qualification and suffering adverse tax consequences. As a result, we may be required to liquidate otherwise attractive investments from our investment portfolio. These actions could have the effect of reducing our income and amounts available for distribution to our stockholders.

In addition to the asset tests set forth above, to qualify as a REIT we must continually satisfy tests concerning, among other things, the sources of our income, the nature and diversification of our assets, the amounts we distribute to our stockholders and the ownership of our stock. We may be required to make distributions to stockholders at disadvantageous times or when we do not have funds readily available for distribution and may be unable to pursue investments that would be otherwise advantageous to us in order to satisfy the source-of-income or asset-diversification requirements for qualifying as a REIT. Thus, compliance with the REIT requirements may hinder our ability to make and, in certain cases, to maintain ownership of, certain attractive investments.

We may be required to report taxable income for certain investments in excess of the economic income we ultimately realize from them.

We have acquired and may acquire in the future mortgage-backed securities and other portfolio instruments in the secondary market for less than their face amount. In addition, pursuant to our ownership of certain mortgage-backed securities, we may be treated as holding certain debt instruments acquired in the secondary market for less than their face amount. The discount at which such securities or debt instruments are acquired may reflect doubts about their ultimate collectability rather than current market interest rates. The amount of such discount will nevertheless generally be treated as "market discount" for U.S. federal income tax purposes. Under general tax rules, accrued market discount is reported as income when, and to the extent that, any payment of principal of the mortgage-backed security or debt instrument is made. If we collect less on the mortgage-backed security or debt instrument than our purchase price plus the market discount we had previously reported as income, we may not be able to benefit from any offsetting capital loss deductions to the extent we do not have offsetting capital gains.

In addition, pursuant to our ownership of certain mortgage-backed securities or debt instruments, we may be treated as holding distressed debt investments that are subsequently modified by agreement with the borrower. If the amendments to the outstanding debt are "significant modifications" under applicable Treasury regulations, the modified debt may be considered to have been reissued to us at a gain in a debt-for-debt exchange with the borrower. In that event, we may be required to recognize taxable gain to the extent the principal amount of the modified debt exceeds our adjusted tax basis in the unmodified debt, even if the value of the debt or the payment expectations have not changed.

Moreover, some of the mortgage-backed securities or debt instruments that we acquire may have been issued with original issue discount. Under general tax rules, we are required to report such original issue discount based on a constant yield method and will be taxed based on the assumption that all future projected payments due on such mortgage-backed securities will be made. If such mortgage-backed securities turn out not to be fully collectable, an offsetting loss deduction will become available only in the later year that uncollectability is provable.

Finally, in the event that mortgage-backed securities or any debt instruments we are treated as holding pursuant to our investments in mortgage-backed securities are delinquent as to mandatory principal and interest payments, we may nonetheless be required to continue to recognize the unpaid interest as taxable income as it accrues, despite doubt as to its ultimate collectability. Similarly, we may be required to accrue interest income with respect to subordinate mortgage-backed securities at the stated rate

regardless of whether corresponding cash payments are received or are ultimately collectable. In each case, while we would in general ultimately have an offsetting loss deduction available to us when such interest was determined to be uncollectable, the utility of that deduction could depend on our having taxable income in that later year or thereafter.

Certain apportionment rules may affect our ability to comply with the REIT asset and gross income tests.

The Code provides that a regular or a residual interest in a real estate mortgage investment conduit, or REMIC, is generally treated as a real estate asset for the purpose of the REIT asset tests, and any amount includible in our gross income with respect to such an interest is generally treated as interest on an obligation secured by a mortgage on real property for the purpose of the REIT gross income tests. If, however, less than 95% of the assets of a REMIC in which we hold an interest consist of real estate assets (determined as if we held such assets), we will be treated as holding our proportionate share of the assets of the REMIC for the purpose of the REIT asset tests and receiving directly our proportionate share of the income of the REMIC for the purpose of determining the amount of income from the REMIC that is treated as interest on an obligation secured by a mortgage on real property.

The "taxable mortgage pool" rules may increase the taxes that we or our stockholders may incur, and may limit the manner in which we effect future securitizations.

Securitizations could result in the creation of taxable mortgage pools for U.S. federal income tax purposes. As a REIT, so long as we own 100% of the equity interests in a taxable mortgage pool, we generally would not be adversely affected by the characterization of the securitization as a taxable mortgage pool. Certain categories of stockholders, however, such as foreign stockholders eligible for treaty or other benefits, stockholders with net operating losses, and certain tax-exempt stockholders that are subject to unrelated business income tax, could be subject to increased taxes on a portion of their dividend income from us that is attributable to the taxable mortgage pool. In addition, to the extent that our stock is owned by tax-exempt "disqualified organizations," such as certain government-related entities and charitable remainder trusts that are not subject to tax on unrelated business income, we may incur a corporate level tax on a portion of our income from the taxable mortgage pool. In that case, we may reduce the amount of our distributions to any disqualified organization whose stock ownership gave rise to the tax. Moreover, we would be precluded from selling equity interests in these securitizations to outside investors, or selling any debt securities issued in connection with these securitizations that might be considered to be equity interests for tax purposes. These limitations may prevent us from using certain techniques to maximize our returns from securitization transactions.

Our ability to invest in and dispose of "to be announced" securities could be limited by our election to be subject to tax as a REIT.

We may purchase Agency RMBS through "to-be-announced" forward contracts, or TBAs. In certain instances, rather than take delivery of the Agency RMBS subject to a TBA, we may dispose of the TBA through a dollar roll transaction in which we agree to purchase similar securities in the future at a predetermined price or otherwise, which may result in the recognition of income or gains. We account for dollar roll transactions as purchases and sales of securities. The law is unclear regarding whether TBAs will be qualifying assets for the 75% asset test and whether income and gains from dispositions of TBAs will be qualifying income for the 75% gross income test. Accordingly, our ability to purchase Agency RMBS through TBAs and to dispose of TBAs, through dollar roll transactions or otherwise, could be limited.

The failure of securities subject to repurchase agreements to qualify as real estate assets could adversely affect our ability to qualify as a REIT.

We enter into financing arrangements that are structured as sale and repurchase agreements pursuant to which we nominally sell certain of our securities to a counterparty and simultaneously enter into an agreement to repurchase these securities at a later date in exchange for a purchase price. Economically, these agreements are financings which are secured by the securities sold pursuant thereto. We believe that we will be treated for REIT asset and income test purposes as the owner of the securities that are the subject of any such sale and repurchase agreement notwithstanding that such agreement may transfer record ownership of the securities to the counterparty during the term of the agreement. It is possible, however, that the IRS could assert that we did not own the securities during the term of the sale and repurchase agreement, in which case we could fail to qualify as a REIT.

Liquidation of assets may jeopardize our REIT qualification or create additional tax liability for us.

To continue to qualify as a REIT, we must comply with requirements regarding the composition of our assets and our sources of income. If we are compelled to liquidate our investments to repay obligations to our lenders, we may be unable to comply with these requirements, ultimately jeopardizing our qualification as a REIT, or we may be subject to a 100% tax on any resulting gain if we sell assets that are treated as dealer property or inventory.

Complying with REIT requirements may limit our ability to hedge effectively and may cause us to incur tax liabilities.

The REIT provisions of the Code substantially limit our ability to hedge our assets and liabilities. Any income from a hedging transaction we enter into to manage risk of interest rate changes with respect to borrowings made or to be made to acquire or carry real estate assets does not constitute "gross income" for purposes of the 75% or 95% gross income tests, provided that certain identification requirements are met. To the extent that we fail to properly identify such transactions as hedges, or enter into other types of hedging transactions, the income from those transactions is likely to be treated as non-qualifying income for purposes of both of the gross income tests. As a result of these rules, we limit our use of advantageous hedging techniques, and we may implement those hedges through a domestic TRS. This could increase the cost of our hedging activities because our TRS would be subject to tax on gains or expose us to greater risks associated with changes in interest rates than we would otherwise want to bear. In addition, losses in our TRS will generally not provide any tax benefit, except for being carried forward against future taxable income in the TRS.

Qualifying as a REIT involves highly technical and complex provisions of the Code.

Qualification as a REIT involves the application of highly technical and complex Code provisions for which only limited judicial and administrative authorities exist. Even a technical or inadvertent violation could jeopardize our REIT qualification. Our qualification as a REIT will depend on our satisfaction of certain asset, income, organizational, distribution, stockholder ownership and other requirements on a continuing basis. In addition, our ability to satisfy the requirements to qualify as a REIT depends in part on the actions of third parties over which we have no control or only limited influence.

New legislation or administrative or judicial action, in each instance potentially with retroactive effect, could make it more difficult or impossible for us to qualify as a REIT

The U.S. federal income tax treatment of REITs may be modified, possibly with retroactive effect, by legislative, judicial or administrative action at any time, which could affect the U.S. federal income tax treatment of an investment in us. The U.S. federal income tax rules dealing with REITs constantly are under review by persons involved in the legislative process, the IRS and the U.S. Treasury Department, which results in statutory changes as well as frequent revisions to regulations and interpretations. Revisions in U.S. federal tax laws and interpretations thereof could affect or cause us to change our investments and commitments and affect the tax considerations of an investment in us.

Item 1B. Unresolved Staff Comment

None

Item 2. Properties

Our executive and administrative offices are located in Pasadena, California, in office space shared with our Manager. We do not own any materially important physical properties; however, we have residential homes (or real estate owned) that we acquire, from time to time, through foreclosures on mortgage loans.

Item 3. Legal Proceedings

None.

Item 4. Mine Safety Disclosures.

Not applicable.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Our common stock is listed on the NYSE under the symbol "WMC."

The following table summarizes our dividends declared on common stock, on a per share basis, for the years ended December 31, 2019 and 2018:

<u>Declaration Date</u>	<u>Record Date</u>	<u>Payment Date</u>	<u>Common Stock Dividend</u>
2019			
December 19, 2019	December 30, 2019	January 24, 2020	\$0.31
September 19, 2019	September 30, 2019	October 25, 2019	\$0.31
June 20, 2019	July 1, 2019	July 26, 2019	\$0.31
March 21, 2019	April 1, 2019	April 26, 2019	\$0.31
2018			
December 19, 2018	December 31, 2018	January 25, 2019	\$0.31
September 17, 2018	September 27, 2018	October 26, 2018	\$0.31
June 21, 2018	July 2, 2018	July 26, 2018	\$0.31
March 22, 2018	April 2, 2018	April 26, 2018	\$0.31

In order to maintain our qualification as a REIT, we must make annual distributions to our stockholders of at least 90% of our taxable income (not including net capital gains). We have adopted a policy of paying regular quarterly dividends on our common stock. Refer to Note 12- "Stockholders' Equity" to our Consolidated Financial Statements included in Item 8 of this annual report on Form 10-K for details on the tax characterization of our dividend.

A combination of cash and stock dividends has been paid on our common stock since our initial public offering. Dividends are declared at the discretion of the Board of Directors and depend on actual and anticipated cash from operations, our financial condition, capital requirements, the annual distribution requirements under the REIT provisions of the Internal Revenue Code and other factors the Board of Directors may consider relevant.

As of March 3, 2020, we had 6 registered holders of our common stock and 53,523,876 shares outstanding.

Securities Authorized for Issuance Under Equity Compensation Plans

In conjunction with our IPO and concurrent private placement, our Board of Directors approved the Western Asset Mortgage Capital Corporation Equity Plan (the "Equity Plan") and the Western Asset Manager Equity Plan (the "Manager Equity Plan" and collectively the "Equity Incentive Plans"). For further details, see Note 11- "Share-Based Payments" to the Consolidated Financial Statements included under Item 8 in this Form 10-K.

The following table presents certain information about the Equity Incentive Plans as of December 31, 2019:

<u>Award</u>	<u>Number of securities to be issued upon exercise of outstanding options, warrants and rights</u>	<u>Weighted-average exercise price of outstanding options, warrants and rights</u>	<u>Number of securities remaining available for future issuance under equity compensation plans</u>
Restricted common stock	N/A	N/A	688,305
Total	—	—	688,305

Stockholder Return Performance

The following graph is a comparison of the cumulative total stockholder return on the Company's common stock, the Standard & Poor's 500 Index (the "S&P 500 Index"), the Russell 2000 Index (the "Russell 2000") and the FTSE NAREIT Mortgage REITs Index (the "FTSE Mortgage REIT"), a peer group index for a five-year period from December 31, 2014 to December 31, 2019, and accordingly does not take into account the dividend the Company declared on December 19, 2019 and paid on January 24, 2020. The graph assumes that \$100 was invested on December 31, 2014 in the Company's common stock, the S&P 500 Index, the Russell 2000 and the FTSE Mortgage REIT and that all dividends were reinvested without the payment of any commissions. There can be no assurance that the performance of the Company's shares will continue in line with the same or similar trends depicted in the graph below.

Total Return Performance



Index	12/31/14	12/31/15	12/31/16	12/31/17	12/31/18	12/31/19
Western Asset Mortgage Capital Corp	100.00	83.97	94.73	105.53	100.42	140.40
S&P 500	100.00	101.38	113.51	138.29	132.23	173.86
Russell 2000	100.00	95.59	115.95	132.94	118.30	148.49
FTSE NAREIT Mortgage REIT	100.00	91.12	111.95	134.10	130.71	158.60

Recent Sales of Unregistered Securities: Use of Proceeds from Registered Securities

Not applicable.

Item 6. Selected Financial Data

The information below should be read in conjunction with Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements and related notes included in Item 8. "Financial Statements and Supplementary Data," included in this annual report on Form 10-K.

in thousands—except share and per share data	Year ended December 31, 2019	Year ended December 31, 2018	Year ended December 31, 2017	Year ended December 31, 2016	Year ended December 31, 2015
Operating Data:					
Net Interest Income	66,990	71,122	75,918	91,326	125,099
Other Income (Loss)	25,710	(21,328)	30,444	(91,939)	(112,100)
Operating expenses	12,873	14,749	10,519	11,493	12,888
General and administrative expenses	8,071	7,927	7,259	9,753	9,595
Income (loss) before income taxes	71,756	27,118	88,584	(21,859)	(9,484)
Income tax provision	1,057	709	3,487	3,156	—
Net Income (loss)	\$ 70,699	\$ 26,409	\$ 85,097	\$ (25,015)	\$ (9,484)
Net income (loss) per Common Share—Basic	\$ 1.37	\$ 0.61	\$ 2.03	\$ (0.61)	\$ (0.25)
Net income (loss) per Common Share—Diluted	\$ 1.37	\$ 0.61	\$ 2.03	\$ (0.61)	\$ (0.25)
Dividends Declared per Share of Common Stock	\$ 1.24	\$ 1.24	\$ 1.24	\$ 1.38	\$ 2.49
Balance Sheet Data (at period end):					
Total assets	\$ 5,160,971	\$ 4,497,395	\$ 3,886,906	\$ 3,156,016	\$ 3,414,429
Total liabilities	\$ 4,596,510	\$ 3,994,386	\$ 3,420,868	\$ 2,725,534	\$ 2,902,781
Total stockholders' equity	\$ 564,461	\$ 503,009	\$ 466,038	\$ 430,482	\$ 511,648
Other Data:					
Cash flow provided by (used in):					
Operating activities	\$ (52,240)	\$ 107,052	\$ 59,382	\$ 11,546	\$ 133,898
Investing activities	\$ (478,503)	\$ (716,875)	\$ (1,202,572)	\$ 504,631	\$ 1,359,855
Financing activities	\$ 537,227	\$ 639,594	\$ 1,145,043	\$ (494,799)	\$ (1,516,439)

ITEM 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The following discussion provides the reader a narrative from the perspective of management and should be read in conjunction with our consolidated financial statements and related notes included in Item 8, "Financial Statements and Supplementary Data" of this annual report on Form 10-K.

Overview

The size and composition of our portfolio depend on investment strategies implemented by our Manager, the accessibility to capital and overall market conditions, including availability of attractively priced target assets and financing. Our objective is to provide an attractive risk adjusted return to our stockholders over the long term. Our Manager has built a diversified portfolio of our target assets to better enable us to deliver attractive returns through market cycles. Our portfolio is mainly comprised of Agency CMBS, Non-Agency CMBS, Residential Whole loans and Commercial Loans. To a lesser extent, we have investments in Agency RMBS, Residential Bridge Loans, Non-Agency RMBS, GSE Risk Sharing Securities and ABS investments secured by a portfolio of private student loans. In addition, our holdings include four securitized commercial loans from the three consolidated CMBS VIEs.

We use leverage as part of our business strategy in order to increase potential returns to our stockholders. We accomplish this by borrowing against existing investments primarily through repurchase agreements. We may also change our financing strategy and leverage without the consent of our stockholders.

We operate and elected to be taxed as a REIT, commencing with our taxable year ended December 31, 2012. We generally will not be subject to U.S. federal income taxes on our taxable income to the extent that we annually distribute, in accordance with the REIT regulations, all of our net taxable income to stockholders and maintain our intended qualification as a REIT. Certain of our non-qualifying investments were held in our taxable REIT subsidiary or "TRS." Net income generated in our TRS is taxable and subject to federal, state and local income tax at the applicable corporate tax rates.

We also intend to operate our business in a manner that will permit us to maintain our exemption from registration under the 1940 Act.

Factors Impacting Our Operating Results

Our business is affected by general U.S. residential and commercial real estate fundamentals and the overall U.S. and international economic environment. In particular, our strategy is influenced by the specific characteristics of these markets, including, but not limited to, interest rate levels and credit spreads.

Our operating results can be affected by a number of factors and primarily depend on, among other things, the size of our investment portfolio, our net interest income, changes in the market value of our investments, derivative instruments and to a lesser extent realized gains and losses on the sale of our investments and termination of our derivative instruments. Our overall performance is also impacted by the supply and demand for our target assets in the market, the terms and availability of financing for such assets, general economic conditions, the impact of U.S Government actions that affect the real estate and mortgage sectors, and the unanticipated credit events experienced by borrowers whose loans are included in our MBS, as well as our Residential Whole Loans, Residential Bridge Loan and Commercial Loan borrowers.

Our net interest income, which includes the amortization of purchase premiums and accretion of discounts, will vary primarily as a result of changes in interest rates, defaults and loss severity rates, borrowing costs, and prepayment speeds on our MBS and other Target Assets (as defined herein) investments. Similarly, the overall value of our investment portfolio will be impacted by these factors as well as changes in the value of residential and commercial real estate and continuing regulatory changes.

See the Item 1A. "Risk Factors" in this annual report on Form 10-K for additional factors that may impact our operating results.

Recent Market Conditions

Our business is affected by general U.S. residential real estate fundamentals, domestic and foreign commercial real estate fundamentals and the overall U.S. and international economic environment. In particular, our strategy is influenced by the specific characteristics of these markets, including, but not limited to, prepayment rates and interest rate levels. We expect the results of our operations to be affected by various factors, many of which are beyond our control.

Our Manager's outlook for 2020, is as follows; i) Coronavirus will cause growth setbacks in the global recovery . ii) U.S. and global inflation will continue to be subdued, iii) sustained monetary policy accommodation by the Federal Reserve and European Central Bank suggests "low for long", and iv) spread products should outperform government bonds.

Against this backdrop, we remain constructive on housing fundamentals and expect modest home price growth over the coming years. Credit underwriting standards are historically high, making the quality of new loan production strong. We remain positive on the credit risk of GSEs (Fannie Mae and Freddie Mac) and recently issued non-agency loans as well as re-performing loans and securities. We also remain constructive on the CMBS market, due to broadly positive commercial real estate fundamentals and a favorable economic outlook. Here, we are positive on short-duration, well-structured single-borrower securitizations and loans; in conduit deals we see better value in AAA rated bonds.

During the fourth quarter of 2019, the Federal Reserve continued monetary easing, reducing the fed funds rate a quarter point in October 2019. They also significantly increased liquidity in the repurchase agreement market through its Open Market Operations. The yield curve steepened during the quarter, with 2-year Treasury yields declining five basis points and 10-year yields increasing 25 basis points. We saw credit spreads and spreads on Agency MBS tighten. Although there was a modest benefit from declining interest rates, the spread widening on our Agency CMBS portfolio overshadowed this benefit resulting in a slight decline in our book value of 0.5%.

Critical Accounting Policies

The consolidated financial statements include our accounts, those of our consolidated wholly-owned TRS and certain variable interest entities ("VIEs") in which we are the primary beneficiary. All intercompany amounts have been eliminated in consolidation. In accordance with GAAP, our consolidated financial statements require the use of estimates and assumptions that involve the exercise of judgment and use of assumptions as to future uncertainties. In accordance with SEC guidance, the following discussion addresses the accounting policies that we currently apply. Our most critical accounting policies will involve decisions and assessments that could affect our reported assets and liabilities, as well as our reported revenues and expenses. We believe that all of the decisions and assessments upon which our consolidated financial statements have been based were reasonable at the time made and based upon information available to us at that time. For a review of recent accounting pronouncements that may impact our results of operations, refer Note 2 - "Summary of Significant Accounting Policies" contained in this annual report on Form 10-K.

Valuation of Financial Instruments

We disclose the fair value of our financial instruments according to a fair value hierarchy (Levels I, II, and III, as defined below). ASC 820 "Fair Value Measurements and Disclosures" establishes a framework for measuring fair value and expands financial statement disclosure requirements for fair value measurements. ASC 820 further specifies a hierarchy of valuation techniques, which is based on whether the inputs into the valuation technique are observable or unobservable. The hierarchy is as follows:

Level I — Quoted prices in active markets for identical assets or liabilities.

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

Level III — Prices are determined using significant unobservable inputs. In situations where quoted prices or observable inputs are unavailable, for example, when there is little or no market activity for an investment at the end of the period, unobservable inputs may be used.

The level in the fair value hierarchy within which a fair value measurement in its entirety falls is based on the lowest level input that is significant to the fair value measurement in its entirety. Transfers between levels are determined by us at the end of the reporting period.

Mortgage-Backed Securities and Other Securities

Our mortgage-backed securities and other securities portfolio primarily consists of Agency RMBS, Non-Agency RMBS, Agency CMBS, Non-Agency CMBS, ABS and other real estate related assets. These investments are recorded in accordance with

ASC 320, "Investments - Debt and Equity Securities," ASC 325-40, "Beneficial Interests in Securitized Financial Assets" or ASC 310-30, "Loans and Debt Securities Acquired with Deteriorated Credit Quality." We have chosen to make a fair value election pursuant to ASC 825, "Financial Instruments" for our mortgage-backed securities and other securities portfolio. Electing the fair value option allows us to record changes in fair value in the Consolidated Statements of Operations as a component of "Unrealized gain (loss), net."

If we purchase securities with evidence of credit deterioration, we will analyze to determine if the guidance found in ASC 310-30, "Loans and Debt Securities Acquired with Deteriorated Credit Quality" is applicable.

We evaluate securities for other-than-temporary impairment ("OTTI") on at least a quarterly basis. The determination of whether a security is other-than-temporarily impaired involves judgments, estimates and assumptions based on subjective and objective factors. As a result, the timing and amount of an OTTI constitutes an accounting estimate that may change materially over time.

When the fair value of an investment security is less than its amortized cost at the balance sheet date, the security is considered impaired, and the impairment is designated as either "temporary" or "other-than-temporary." When a security is impaired, an OTTI is considered to have occurred if (i) if we intend to sell the security (i.e., a decision has been made as of the reporting date) or (ii) it is more likely than not that we will be required to sell the security before recovery of its amortized cost basis. If we intend to sell the security or if it is more likely than not that we will be required to sell the security before recovery of its amortized cost basis, the entire amount of the impairment loss, if any, is recognized in earnings as OTTI and the cost basis of the security is adjusted to its fair value. Additionally, for securities accounted for under ASC 325-40 an OTTI is deemed to have occurred when there is an adverse change in the expected cash flows to be received and the fair value of the security is less than its carrying amount. In determining whether an adverse change in cash flows occurred, the present value of the remaining cash flows, as estimated at the initial transaction date (or the last date previously revised), is compared to the present value of the expected cash flows at the current reporting date. The estimated cash flows reflect those a "market participant" would use and are discounted at a rate equal to the current yield used to accrete interest income. Any resulting OTTI adjustments are reflected in "Other than temporary impairment" in our Consolidated Statements of Operations.

Increases in interest income may be recognized on a security on which we have previously recorded an OTTI charge if the cash flow of such security subsequently improves.

In addition, unrealized losses on our Agency securities, with explicit guarantee of principal and interest by the governmental sponsored entity ("GSE"), are not credit losses but rather were due to changes in interest rates and prepayment expectations. These securities would not be considered other than temporarily impaired provided we did not intend to sell the security.

Residential Whole Loans

Investments in Residential Whole Loans are recorded in accordance with ASC 310-20, "Nonrefundable Fees and Other Costs." We have chosen to make the fair value election pursuant to ASC 825 for our entire Residential Whole-Loan portfolio. Residential Whole Loans are recorded at fair value with periodic changes in fair market value being recorded in earnings as a component of "Unrealized gain (loss), net." All other costs incurred in connection with acquiring Residential Whole Loans or committing to purchase these loans are charged to expense as incurred.

On a quarterly basis, we evaluate the collectability of both interest and principal of each loan, if circumstances warrant, to determine whether such loan is impaired. A loan is impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due according to the existing contractual terms. When a loan is impaired, we do not record an allowance for loan loss as we have elected the fair value option. However, income recognition is suspended for loans at the earlier of the date at which payments become 90-days past due or when, in the opinion of management, a full recovery of income and principal becomes doubtful. When the ultimate collectability of the principal of an impaired loan is in doubt, all payments are applied to principal under the cost recovery method. When the ultimate collectability of the principal of an impaired loan is not in doubt, contractual interest is recorded as interest income when received, under the cash basis method until an accrual is resumed when the loan becomes contractually current and performance is demonstrated to be resumed. A loan is written off when it is no longer realizable and/or legally discharged.

Residential Bridge Loans

For the Bridge Loans acquired prior to October 25, 2017, we did not elect the fair value option pursuant to ASC 825 and accordingly these loans are recorded at their principal amount outstanding, net of any premium or discount in the Consolidated

Balance Sheets. Commencing with purchases subsequent to October 25, 2017, we decided to elect the fair value option pursuant to ASC 825 to be consistent with the accounting of our other investments, which are all carried at fair value. These loans are recorded at fair value with periodic changes in fair market value being recorded in earnings as a component of "Unrealized gain (loss), net". All other costs incurred in connection with acquiring the Residential Bridge Loans or committing to purchase these loans are charged to expense as incurred.

A loan is impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due according to the existing contractual terms. We evaluate each of Residential Bridge Loans on a quarterly basis. These loans are individually specific as they relate to the borrower, collateral type, interest rate, LTV and term as well as geographic location. We evaluate the collectability of both principal and interest of each loan. When a loan is impaired, the impairment is then measured based on fair value of the collateral, since these loans are collateral dependent. Upon measurement of impairment, we record an allowance to reduce the carrying value of the loan with a corresponding charge to net income for those loans that we did not elect the fair value option. Significant judgments are required in determining impairment, including assumptions regarding the value of the loan, the value of the underlying collateral and other provisions such as guarantees. We will not record an allowance for loan loss for the Residential Bridge Loans that Company has elected the fair value option.

Income recognition is suspended for loans at the earlier of the date at which payments become 90-days past due or when, in the opinion of management, a full recovery of income and principal becomes doubtful. When the ultimate collectability of the principal of an impaired loan is in doubt, all payments are applied to principal under the cost recovery method. When the ultimate collectability of the principal of an impaired loan is not in doubt, contractual interest is recorded as interest income when received, under the cash basis method until an accrual is resumed when the loan becomes contractually current and performance is demonstrated to be resumed. A loan is written off when it is no longer realizable and/or it is legally discharged.

Securitized Commercial Loans

Securitized commercial loans are comprised of commercial loans of consolidated variable interest entities which were sponsored by third parties. These loans are recorded in accordance with ASC 310-20, "Nonrefundable Fees and Other Costs." We have chosen to make the fair value election pursuant to ASC 825. Accordingly, these loans are recorded at fair value with periodic changes in fair value being recorded in earnings as a component of "Unrealized gain (loss), net."

The securitized commercial loans are typically collateralized by commercial real estate. As a result, we regularly evaluate the extent and impact of any credit migration associated with the performance and/or value of the underlying collateral property as well as the financial and operating capability of the borrower on a loan by loan basis. On a quarterly basis, we evaluate the collectability of both interest and principal of each loan, if circumstances warrant, to determine whether such loan is impaired. A loan is impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due according to the existing contractual terms. When a loan is impaired, we do not record an allowance for loan loss as we have elected the fair value option. However, income recognition is suspended for loans at the earlier of the date at which payments become 90-days past due or when, in the opinion of management, a full recovery of income and principal becomes doubtful. When the ultimate collectability of the principal of an impaired loan is in doubt, all payments are applied to principal under the cost recovery method. When the ultimate collectability of the principal of an impaired loan is not in doubt, contractual interest is recorded as interest income when received, under the cash basis method until an accrual is resumed. Interest income accrual is resumed when the loan becomes contractually current and performance is demonstrated. A loan is written off when it is no longer realizable and/or legally discharged.

Commercial Loans

Investments in Commercial Loans, which are comprised of commercial mortgage loans and commercial mezzanine loans, are recorded in accordance with ASC 310-20, "Nonrefundable Fees and Other Costs." We have chosen to make the fair value election pursuant to ASC 825 for our Commercial Loan portfolio. Accordingly, these loans are recorded at fair value with periodic changes in fair value being recorded in earnings as a component of "Unrealized gain (loss), net." All other costs incurred in connection with acquiring the Commercial Loans or committing to purchase these loans are charged to expense as incurred.

Our loans are typically collateralized by commercial real estate. As a result, we regularly evaluate the extent and impact of any credit migration associated with the performance and or value of the underlying collateral property as well as the financial and operating capability of the borrower on a loan by loan basis. On a quarterly basis, we evaluate the collectability of both interest and principal of each loan, if circumstances warrant, to determine whether such loan is impaired. A loan is impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due according to the existing contractual terms. When a loan is impaired, we do not record an allowance for loan loss as we have elected the fair value option. However, income recognition is suspended for loans at the earlier of the date at which payments become 90-days past due or when,

in the opinion of management, a full recovery of income and principal becomes doubtful. When the ultimate collectability of the principal of an impaired loan is in doubt, all payments are applied to principal under the cost recovery method. When the ultimate collectability of the principal of an impaired loan is not in doubt, contractual interest is recorded as interest income when received, under the cash basis method until an accrual is resumed. Interest income accrual is resumed when the loan becomes contractually current and performance is demonstrated to be resumed. A loan is written off when it is no longer realizable and/or legally discharged.

Interest Income Recognition

Agency MBS, Non-Agency MBS and other securities, excluding Interest-Only Strips, rated AA and higher at the time of purchase

Interest income on mortgage-backed and other securities is accrued based on the respective outstanding principal balances and corresponding contractual terms. We record interest income in accordance with ASC subtopic 835-30 "Imputation of Interest," using the effective interest method. As such premiums and discounts associated with Agency MBS, Non-Agency MBS and other securities, excluding Interest-Only Strips, rated AA and higher at the time of purchase, are amortized into interest income over the estimated life of such securities. Adjustments to premium and discount amortization are made for actual prepayment activity. We estimate prepayments at least quarterly for our securities and, as a result, if the projected prepayment speed increases, we will accelerate the rate of amortization on premiums or discounts and make a retrospective adjustment to historical amortization. Alternatively, if projected prepayment speeds decrease, we will reduce the rate of amortization on the premiums or discounts and make a retrospective adjustment to historical amortization.

Non-Agency MBS and other securities that are rated below AA at the time of purchase and Interest-Only Strips that are not classified as derivatives

Interest income on Non-Agency MBS and other securities that are rated below AA at the time of purchase and Interest-Only Strips that are not classified as derivatives are also recognized in accordance with ASC 835, using the effective yield method. The effective yield on these securities is based on the projected cash flows from each security, which is estimated based on our observation of the then current information and events, where applicable, and will include assumptions related to interest rates, prepayment rates and the timing and amount of credit losses. On at least a quarterly basis, we review and, if appropriate, make adjustments to our cash flow projections based on input and analysis received from external sources, internal models, and our judgment about interest rates, prepayment rates, the timing and amount of credit losses, and other factors. Changes in cash flows from those originally projected, or from those estimated at the last evaluation, may result in a prospective change in the yield/interest income recognized on such securities. Actual maturities of the securities are affected by the contractual lives of the underlying collateral, periodic payments of scheduled principal, and prepayments of principal. Therefore, actual maturities of the securities will generally be shorter than stated contractual maturities.

Based on the projected cash flow of such securities purchased at a discount to par value, we may designate a portion of such purchase discount as credit protection against future credit losses and, therefore, not accrete such amount into interest income. The amount designated as credit discount may be adjusted over time, based on the actual performance of the security, its underlying collateral, actual and projected cash flow from such collateral, economic conditions and other factors. If the performance of a security with a credit discount is more favorable than forecasted, a portion of the amount designated as credit discount may be accreted into interest income prospectively.

Loan Portfolio

Interest income on our residential loan portfolio and commercial loan portfolio is recorded using the effective interest method based on the contractual payment terms of the loan. Any premium amortization or discount accretion will be reflected as a component of "Interest income" in our Consolidated Statements of Operations.

Variable Interest Entities ("VIEs")

VIEs are defined as entities that by design either lack sufficient equity for the entity to finance its activities without additional subordinated financial support or are unable to direct the entity's activities or are not exposed to the entity's losses or entitled to its residual returns. We evaluate all of our interests in VIEs for consolidation. When the interests are determined to be variable interests, we assess whether we are deemed the primary beneficiary. The primary beneficiary of a VIE is determined to be the party that has both the power to direct the activities of a VIE that most significantly impact the VIE's economic performance and the obligation to absorb losses or the right to receive benefits of the VIE that could potentially be significant to the VIE.

To assess whether we have the power to direct the activities of a VIE that most significantly impact the VIE's economic performance, we consider all facts and circumstances, including our role in establishing the VIE and our ongoing rights and responsibilities. This assessment includes first, identifying the activities that most significantly impact the VIE's economic performance; and second, identifying which party, if any, has power over those activities. In general, the parties that make the most significant decisions affecting the VIE or have the right to unilaterally remove those decision makers is deemed to have the power to direct the activities of a VIE.

To assess whether we have the obligation to absorb losses of the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE, we consider all of our economic interests. This assessment requires that we apply judgment in determining whether these interests, in the aggregate, are considered potentially significant to the VIE. Factors considered in assessing significance include: the design of the VIE, including its capitalization structure; subordination of interests; payment priority; relative share of interests held across various classes within the VIE's capital structure; and the reasons why the interests are held by us.

In instances where the Company and its related parties have variable interests in a VIE, we consider whether there is a single party in the related party group that meets both the power and losses or benefits criteria on its own as though no related party relationship existed. If one party within the related party group meets both these criteria, such reporting entity is the primary beneficiary of the VIE and no further analysis is needed. If no party within the related party group on its own meets both the power and losses or benefits criteria, but the related party group as a whole meets these two criteria, the determination of primary beneficiary within the related party group requires significant judgment. The analysis is based upon qualitative as well as quantitative factors, such as the relationship of the VIE to each of the members of the related-party group, as well as the significance of the VIE's activities to those members, with the objective of determining which party is most closely associated with the VIE.

Ongoing assessments of whether an enterprise is the primary beneficiary of a VIE is required.

Derivatives and Hedging Activities

Subject to maintaining our qualification as a REIT for U.S. federal income tax purposes, as part of our hedging strategy, we may enter into interest rate swaps, including forward starting swaps, interest rate swaptions, U.S. Treasury options, futures contracts, TBAs, Agency and Non-Agency interest only strips total return swaps, credit default swaps and foreign current swaps and forwards. Derivatives, subject to REIT requirements, are used for hedging purposes rather than speculation. We determine the fair value of our derivative positions and obtain quotations from third parties, including the Chicago Mercantile Exchange or CME, to facilitate the process of determining such fair values. If our hedging activities do not achieve the desired results, reported earnings may be adversely affected.

GAAP requires an entity to recognize all derivatives as either assets or liabilities on the balance sheet and to measure those instruments at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative. The fair value adjustment will affect either other comprehensive income in stockholders' equity until the hedged item is recognized in earnings or net income depending on whether the derivative instrument is designated and qualifies as a hedge for accounting purposes and if so, the nature of the hedging activity. We have elected not to apply hedge accounting for our derivative instruments. Accordingly, we record the change in fair value of our derivative instruments, which includes net interest rate swap payments/receipts (including accrued amounts) and net currency payments/receipts (including accrued amounts) related to interest rate swaps and currency swaps, respectively in "Gain (loss) on derivative instruments, net" in our Consolidated Statements of Operations.

Proceeds and payments on settlement of swaptions, mortgage put options, futures contracts credit default swaps and TBAs are included in cash flows from investing activities. Proceeds and payments on settlement of forward contracts are reflected in cash flows from financing activities in our Consolidated Statements of Cash Flows. For Agency and Non-Agency Interest-Only Strips accounted for as derivatives, the purchase, sale and recovery of basis activity is included with MBS and other securities under cash flows from investing activities in our Consolidated Statements of Cash Flows.

We evaluate the terms and conditions of our holdings of Agency and Non-Agency Interest-Only Strips, interest rate swaptions, currency forwards, futures contracts and TBAs to determine if these instruments have the characteristics of an investment or should be considered a derivative under GAAP. In determining the classification of our holdings of Interest-Only Strips, we evaluate the securities to determine if the nature of the cash flows has been altered from that of the underlying mortgage collateral. Interest-Only Strips, for which the underlying mortgage collateral has been included into a structured security that alters the cash flows from the underlying mortgage collateral, are accounted for as derivatives. The carrying value of our Agency and Non-Agency Interest-Only Strips, accounted for as derivatives, is included in "Mortgage-backed securities and other securities, at fair value" in our Consolidated Balance Sheets. The carrying value of interest rate swaptions, currency forwards, futures contracts and TBAs

is included in "Derivative assets, at fair value" or "Derivative liability, at fair value" in our Consolidated Balance Sheets. Interest earned or paid along with the change in fair value of these instruments accounted for as derivatives is recorded in "Gain (loss) on derivative instruments, net" in our Consolidated Statements of Operations.

We evaluate all of our financial instruments to determine if such instruments are derivatives or contain features that qualify as embedded derivatives. An embedded derivative is separated from the host contract and accounted for separately when all of the guidance criteria are met. Hybrid instruments that are remeasured at fair value through earnings, including the fair value option, are not bifurcated. Derivative instruments, including derivative instruments accounted for as liabilities are recorded at fair value and are re-valued at each reporting date, with changes in the fair value together with interest earned or paid (including accrued amounts) reported in "Gain (loss) on derivative instruments, net" in our Consolidated Statements of Operations.

2019 Activity

Investment Activity

We continually evaluate our investment portfolio, focusing on expected future prepayment trends, supply of and demand, costs of financing, costs of hedging, expected future interest rate volatility and the overall shape of the U.S. Treasury and interest rate swap yield curves. We utilized the proceeds from our May secondary equity offering, our two convertible note issuances and net proceeds from sales and paydowns, along with related borrowing to acquire \$3.6 billion of investments.

The following table presents our investing activity for the year ended December 31, 2019 (dollars in thousands):

Investment Type	Balance at December 31, 2018	Purchases	Principal Payments and Basis Recovery	Proceeds from Sales	Transfers to REO	Realized Gain/(Loss)	Unrealized Gain/(loss)	Premium and discount amortization, net	OTTI	Balance at December 31, 2019
Agency CMBS and Agency CMBS IOs	\$ 1,486,142	\$ 762,648	\$ (23,874)	\$ (891,072)	N/A	\$ 28,603	\$ 78,665	\$ (2,327)	\$ (216)	\$ 1,438,569
Agency RMBS and Agency RMBS IOs	19,837	583,982	(50,697)	(205,310)	N/A	1,560	8,247	(711)	(222)	356,686
Non-Agency RMBS	50,555	—	(3,131)	—	N/A	—	(230)	(49)	(1,331)	45,814
Non-Agency CMBS	200,301	207,177	(46,478)	(40,235)	N/A	(1,308)	(890)	4,017	(6,565)	316,019
Other securities ⁽¹⁾	59,906	27,678	(1,911)	—	N/A	—	1,564	(6,472)	(604)	80,161
Total MBS and other securities	1,816,741	1,581,485	(126,091)	(1,136,617)	N/A	28,855	87,356	(5,542)	(8,938)	2,237,249
Residential Whole Loans	1,041,885	579,124	(262,149)	—	—	—	20,790	(3,790)	—	1,375,860
Residential Bridge Loans	221,719	—	(179,548)	—	(5,029)	(487)	501	(737)	—	36,419
Commercial Loans	216,123	350,232	(197,245)	—	—	—	(121)	1,224	—	370,213
Securitized commercial loans	1,013,511	1,113,231	(1,214,688)	—	—	—	(1,070)	(1,944)	—	909,040
Total Investments	\$ 4,309,979	\$ 3,624,072	\$ (1,979,721)	\$ (1,136,617)	\$ (5,029)	\$ 28,368	\$ 107,456	\$ (10,789)	\$ (8,938)	\$ 4,928,781

(1) Other securities include \$61.7 million of GSE CRTs and \$18.5 million of ABS at December 31, 2019.

During 2019, due to favorable risk adjusted returns, we opportunistically increased our exposure to Agency RMBS. We continued to see favorable risk-adjusted returns in credit sensitive investments, particularly Residential Whole Loans, Commercial Loans and Non-Agency CMBS. As a result, we continue to deploy capital into these investments. At December 31, 2019, we held \$3.1 billion in credit sensitive investments, primarily consisting of 43.8% in Residential Whole Loans, 29.0% in securitized commercial loans (our risk is limited to only our direct ownership interest in the trust), 11.8% in Commercial Loans, 10.1% in Non-Agency CMBS, 1.5% in Non-Agency RMBS, 1.2% in Residential Bridge Loans, and 2.6% in GSE credit risk transfer and ABS securities. We work to mitigate the credit risk on our credit sensitive holdings by developing relationships with originators that adhere to our investment guidelines for our Residential Whole Loans. For our Commercial Loans and other investments, we perform a detailed credit analysis on the underlying collateral at the time of purchase.

Portfolio Characteristics

Our Agency Portfolio

The following table summarizes our Agency portfolio by investment category as of December 31, 2019 (dollars in thousands):

	Principal Balance	Amortized Cost	Fair Value	Net Weighted Average Coupon
Agency CMBS	\$ 1,347,929	\$ 1,374,443	\$ 1,435,477	3.4%
Agency CMBS IOs and IIOs accounted for as derivatives ⁽¹⁾	N/A	N/A	3,092	0.4%
Total Agency CMBS	1,347,929	1,374,443	1,438,569	3.1%
Agency RMBS	327,814	333,287	340,771	3.5%
Agency RMBS IOs and IIOs ⁽¹⁾	N/A	8,661	10,343	2.8%
Agency RMBS IOs and IIOs accounted for as derivatives ⁽¹⁾	N/A	N/A	5,572	3.0%
Total Agency RMBS	327,814	341,948	356,686	3.3%
Total	\$ 1,675,743	\$ 1,716,391	\$ 1,795,255	3.1%

(1) IOs and IIOs have no principal balances and bear interest based on a notional balance. The notional balance is used solely to determine interest distributions on the interest-only class of securities.

Credit Sensitive Portfolio

The following table presents information by vintage⁽¹⁾ as it relates to our credit sensitive investment portfolio at December 31, 2019:

Credit Sensitive Securities	Pre 2006	2006	2007	2011	2012	2013	2014	2015	2016	2017	2018	2019	Total
Non-Agency RMBS	—%	0.1%	—%	—%	—%	—%	—%	—%	—%	0.9%	0.3%	—%	1.3%
Non-Agency RMBS IOs	—%	—%	—%	—%	—%	—%	—%	—%	—%	0.2%	0.1%	—%	0.3%
Non-Agency CMBS	—%	0.3%	0.4%	1.4%	0.1%	—%	0.9%	1.5%	0.4%	0.5%	1.9%	2.7%	10.1%
Other securities	0.3%	—%	—%	—%	—%	—%	0.1%	0.2%	0.7%	0.1%	1.1%	—%	2.5%
Residential Whole Loans	—%	—%	—%	0.2%	0.2%	1.5%	0.7%	0.1%	1.1%	4.9%	24.3%	10.9%	43.9%
Residential Bridge Loans	—%	—%	—%	—%	—%	—%	—%	—%	—%	0.2%	0.9%	—%	1.1%
Securitized commercial loans	—%	—%	—%	—%	—%	—%	—%	0.8%	—%	—%	21.6%	6.6%	29.0%
Commercial Loans	—%	—%	—%	—%	—%	—%	—%	—%	—%	—%	3.0%	8.8%	11.8%
Total	0.3%	0.4%	0.4%	1.6%	0.3%	1.5%	1.7%	2.6%	2.2%	6.8%	53.2%	29.0%	100.0%

(1) Based on carrying amount of the investments.

Non-Agency RMBS

The following table presents the fair value and weighted average purchase price for each of our Non-agency RMBS categories, including IOs accounted for as derivatives, together with certain of their respective underlying loan collateral attributes and current performance metrics as of December 31, 2019 (fair value dollars in thousands):

Category	Fair Value	Weighted Average					
		Purchase Price	Life (Years)	Original LTV	Original FICO	60+ Day Delinquent	6-Month CPR
Prime	\$ 10,681	\$ 64.04	12.1	68.9%	769	0.1%	12.6%
Alt-A	35,133	64.87	11.5	80.9%	663	8.7%	8.2%
Total	\$ 45,814	\$ 64.68	11.6	78.1%	688	6.7%	9.2%

Non-Agency CMBS

The following table presents certain characteristics of our Non-Agency CMBS portfolio as of December 31, 2019 (dollars in thousands):

Type	Vintage	Principal		Weighted Average	
		Balance	Fair Value	Life (Years)	Original LTV
Conduit:					
	2006-2009	\$ 35,830	\$ 22,785	1.5	72.7%
	2010-2019	104,106	82,402	4.1	61.4%
		139,936	105,187	3.5	63.8%
Single Asset:					
	2010-2019	214,522	210,832	2.3	64.8%
Total		\$ 354,458	\$ 316,019	2.7	64.4%

Residential Whole Loans

The Residential Whole Loans have low LTV's and are comprised of 2,908 Non-QM adjustable rate mortgages, 612 conforming fixed rate mortgages and 9 investor fixed rate mortgages. The following table presents certain information about our Residential Whole-Loans investment portfolio as of December 31, 2019 (dollars in thousands):

Current Coupon Rate	Number of Loans	Principal Balance	Original LTV	Weighted Average			
				Original FICO Score ⁽¹⁾	Expected Life (years) ⁽²⁾	Contractual Maturity (years)	Coupon Rate
3.01 - 4.00%	53	\$ 17,284	61.7%	736	2.4	28.0	3.9%
4.01 - 5.00%	1,689	557,144	61.4%	744	2.8	28.5	4.8%
5.01 - 6.00%	1,682	713,397	62.0%	736	3.0	28.3	5.4%
6.01 - 7.00%	103	37,102	54.1%	727	3.8	25.3	6.2%
7.01 - 8.00%	2	516	73.2%	753	4.7	28.6	7.1%
Total	3,529	\$ 1,325,443	61.5%	739	3.0	28.3	5.2%

(1) The original FICO score is not available for 286 loans with a principal balance of approximately \$94.6 million at December 31, 2019. We have excluded these loans from the weighted average computations.

(2) Excludes the expected lives of the conforming Residential Whole Loans held by RCR Trust.

Residential Bridge Loans

Our Residential Bridge Loans are comprised of short-term fixed rate mortgages secured by non-owner occupied single and multi-family residences with low LTVs, generally up to 85%. The following table presents certain information about our Residential Bridge Loans investment portfolio at December 31, 2019 (dollars in thousands):

Current Coupon Rate	Number of Loans	Principal Balance	Weighted Average		
			Original LTV	Contractual Maturity (months)	Coupon Rate
7.01 – 9.00%	36	\$ 22,409	70.2%	5.8	8.4%
9.01 – 11.00%	28	9,972	74.0%	5.6	10.1%
11.01 - 13.00%	9	2,741	63.1%	2.0	11.7%
13.01 - 15.00%	1	1,125	75.0%	0.0	13.5%
17.01 – 19.00%	2	949	75.0%	0.0	18.0%
Total	76	\$ 37,196	71.0%	5.6	9.5%

Non-performing Loans

The following table presents the aging of the Residential Whole Loans and Bridge Loans as of December 31, 2019 (dollars in thousands):

	Residential Whole Loans			Bridge Loans		
	No of Loans	Principal	Fair Value	No of Loans	Principal	Fair Value ⁽¹⁾
Current	3,467	\$ 1,300,238	\$ 1,350,590	41	\$ 23,353	\$ 23,329
1-30 days delinquent	41	13,537	14,012	2	303	306
31-60 days delinquent	5	1,338	1,334	4	1,147	1,135
61-90 days delinquent	4	3,205	3,224	2	285	280
90+ days delinquent	12	7,125	6,700	27	12,108	11,369
Total	3,529	\$ 1,325,443	\$ 1,375,860	76	\$ 37,196	\$ 36,419

(1) Includes \$3.1 million loans carried at amortized cost.

As of December 31, 2019, there were 12 Residential Whole Loans carried at fair value in non-accrual status with an unpaid principal balance of approximately \$7.1 million and a fair value of approximately \$6.7 million. These nonperforming loans represent approximately 0.5% of the total outstanding principal balance. No allowance or provision for credit losses was recorded as of and for the year ended December 31, 2019 since the valuation adjustment, if any, would be reflected in the fair value of these loans. The Company stopped accruing interest income for these loan when they became contractually 90 days delinquent.

As of December 31, 2019, there were 27 Residential Bridge Loans carried at fair value in non-accrual status with an unpaid principal balance of approximately \$12.1 million and a fair value of \$11.4 million. These nonperforming Residential Bridge Loans represent approximately 32.6% of the total outstanding principal balance. No allowance and provision for credit losses was recorded for loans carried at fair value as of and for the year ended December 31, 2019 since valuation adjustments, if any, would be reflected in the fair value of these loans. We stopped accruing interest income for these loans when they became contractually 90 days delinquent.

As of December 31, 2019, we had 11 real estate owned ("REO") properties with an aggregate carrying value of \$3.3 million related to foreclosed Bridge Loans. The REO properties are held for sale and accordingly carried at the lower of cost or fair value less cost to sell. The REO properties are classified in "Other assets" in the Consolidated Balance Sheet.

Commercial Real Estate Investments

Securitized Commercial Loans

In November 2015, we acquired a \$14.0 million variable interest in CMSC Trust, which is a VIE that we were required to consolidate. Please refer to Note 6 - "Commercial Real Estate Investments" for details. The CMSC Trust holds a \$24.0 million mezzanine loan collateralized by interests in commercial real estate. The mezzanine loan serves as collateral for the \$24.0 million of securitized debt issued. Refer to Note 7 - "Financings" for details on the associated securitized debt.

In March 2018, we acquired a \$67.8 million variable interest in RETL 2018 Trust, which is a VIE that we were required to consolidate. Please refer to Note 6 - "Commercial Real Estate Investments" for details. The RETL 2018 Trust held a commercial loan collateralized by first mortgages, deeds of trusts and interests in commercial real estate located throughout the United States and Puerto Rico. The commercial loan served as collateral for the securitized debt issued by RETL 2018 Trust. Refer to Note 7 - "Financings" for details on the associated securitized debt. In March 2019, RETL, the securitized debt was refinanced and the outstanding principal balance of the securitized debt issued by RETL 2018 Trust was paid in full and the trust was liquidated.

RETL 2018 was refinanced with a new securitization RETL 2019-RVP ("RETL 2019 Trust") in March 2019. We acquired a \$65.3 million variable interest in the trust certificates issued by RETL 2019 Trust, including \$45.3 million which represents the 5% eligible risk retention certificate. Please refer to Note 6 - "Commercial Real Estate Investments" for details. The RETL 2019 Trust holds a commercial loan collateralized by first mortgages, deeds of trusts and interests in commercial real estate located throughout the United States and Puerto Rico. The outstanding principal balance on this commercial loan is \$674.3 million as of December 31, 2019. The commercial loan served as collateral for the \$674.3 million securitized debt issued by RETL 2019 Trust. Refer to Note 7 - "Financings" for details on the associated securitized debt.

In December 2019, we acquired a \$161.4 million interest in the trust certificates issued by the MRCD 2019-PRKC Mortgage Trust (MRCD Trust"), including \$10.5 million HRR certificates, which represents the initial controlling class. We determined that MRCD Trust was a VIE and that we were also the primary beneficiary because the Manager was involved in certain aspects of the design of the trust and we own the controlling class. As the primary beneficiary, we consolidated MRCD Trust and its investment in the trust certificates (HRR class and a portion of the A class) of MRCD Trust were eliminated in the consolidation. The MRCD Trust holds two commercial loans, collateralized by first mortgages, deeds of trusts and interests in commercial real estate. The outstanding principal balance on first commercial loan is \$234.5 million as of December 31, 2019 and bears an interest rate of 4.27%. The outstanding principal balance on second commercial loan is \$10.5 million as of December 31, 2019 and bears an interest rate of 12.02%. The loans' stated maturity date is December 9, 2024.

Commercial Loans

In February 2019, our wholly-owned subsidiary, CRE LLC acquired a \$76.0 million commercial first mortgage loan ("CRE 3") secured by health care and rehabilitation centers. CRE 3 has a maturity date of January 9, 2021 with a one-year extension option and bears an interest rate of one month LIBOR plus 7.0%. In May 2019, CRE 3 was paid in full.

In June 2019, CRE LLC acquired a \$50.0 million commercial first mortgage loan ("CRE 4") secured by nursing facilities. CRE 4 has a maturity date of January 11, 2022 with two one-year extension options and bears an interest rate of one month LIBOR plus 4.75%.

In August 2019, CRE LLC acquired a \$90.0 million commercial mezzanine loan ("CRE 5") secured by commercial real estate properties in retail and entertainment industries. CRE 5 has a maturity date of June 29, 2021 with a two-year first extension and a one-year second extension. The loan is interest only and bears an interest rate of one month LIBOR plus 9.25%.

In September 2019, CRE LLC acquired a \$40.0 million commercial first mortgage loan ("CRE 6") secured by commercial real estate properties in retail industry. CRE 6 has a maturity date of August 6, 2021 with a two one-year extension and bears an interest rate of one month LIBOR plus 3.02%.

In December 2019, CRE LLC acquired three separate commercial first mortgage loans ("CRE 7," "CRE 8," and "CRE 9") with a total principal balance of \$45.0 million secured by commercial real estate properties in the hospitality industry. Each loan has a maturity date of November 6, 2021 with a three one-year extension and bears an interest rate of one month LIBOR plus 3.75%.

In December 2019, CRE LLC acquired a \$4.4 million commercial first mortgage loan ("CRE 10") secured by assisted living centers. CRE 10 has a maturity date of December 6, 2022 and bears an interest rate of one month LIBOR plus 4.85%.

Commercial Loan Trust

Revolving Small Balance Commercial Trust 2018-1

In January 2019, RSBC Trust acquired a \$13.6 million commercial real estate mortgage loan ("SBC 4") secured by multi-family apartment complex. SBC 4 matures on December 1, 2021 with a one-year extension option, bears an interest rate of one month LIBOR plus 4.0% subject to a LIBOR floor of 2.0% and requires monthly principal and interest payments.

In January 2019, RSBC Trust acquired a \$32.0 million interest-only commercial real estate mortgage loan ("SBC 5") secured by skilled nursing facilities. SBC 5 matures on July 6, 2021 and bears an interest rate of one month LIBOR plus 4.1%.

Geographic Concentration

The mortgages underlying our Non-Agency RMBS and Non-Agency CMBS are located in various states across the United States and other countries. The following table presents the five largest concentrations by location for the mortgages collateralizing our Non-Agency RMBS and Non-Agency CMBS as of December 31, 2019, based on fair value (dollars in thousands):

Non-Agency RMBS			Non-Agency CMBS		
	Concentration	Fair Value		Concentration	Fair Value
California	25.6%	\$ 11,728	California	16.2%	\$ 51,308
Florida	9.2%	4,204	Nevada	10.9%	34,298
New York	6.8%	3,104	Illinois	6.1%	19,193
Georgia	5.1%	2,336	Florida	5.0%	15,698
Maryland	4.7%	2,155	Bahamas	4.8%	15,041

The following table presents the various states across the United States in which the collateral securing our Residential Whole Loans and Residential Bridge Loans at December 31, 2019, based on principal balance, is located (dollars in thousands):

Residential Whole Loans			Residential Bridge Loans		
	Concentration	Principal Balance		Concentration	Principal Balance
California	66.1%	\$ 875,738	California	50.4%	\$ 18,763
New York	16.2%	214,141	Washington	13.1%	4,863
Georgia	3.4%	45,189	New York	12.1%	4,518
Florida	2.8%	36,641	Florida	8.9%	3,296
New Jersey	2.3%	30,450	New Jersey	3.8%	1,424
Other	9.2%	123,284	Other	11.7%	4,332
Total	100.0%	\$ 1,325,443	Total	100.0%	\$ 37,196

Financing Activity

Repurchase Agreements

At December 31, 2019, we had 34 master repurchase agreements with our counterparties and had outstanding borrowings under 21 of such agreements. The following table summarizes our 2019 financing activity under our repurchase agreements for the twelve months ended December 31, 2019 (dollars in thousands):

Collateral	Balance at December 31, 2018	Proceeds	Repayments	Balance at December 31, 2019
Agency CMBS	\$ 1,392,649	\$ 9,398,879	\$ (9,439,280)	\$ 1,352,248
Agency RMBS	14,650	1,936,698	(1,603,074)	348,274
Non-Agency RMBS	30,922	204,679	(205,120)	30,481
Non-Agency CMBS	134,814	847,909	(792,333)	190,390
Residential Whole Loans ⁽¹⁾	863,356	4,635,432	(5,022,616)	476,172
Residential Bridge Loans ⁽¹⁾	204,754	1,119,287	(1,294,172)	29,869
Commercial loans ⁽¹⁾	131,788	2,609,859	(2,517,053)	224,594
Securitized commercial loans ⁽¹⁾	7,543	319,022	(210,478)	116,087
Other securities	38,361	309,806	(291,405)	56,762
Borrowings under repurchase agreements	\$ 2,818,837	\$ 21,381,571	\$ (21,375,531)	\$ 2,824,877
Less unamortized debt issuance costs	—	N/A	N/A	76
Borrowings under repurchase agreements, net	\$ 2,818,837	\$ 21,381,571	\$ (21,375,531)	\$ 2,824,801

(1) The borrowings and collateral pledged attributed to loans owned through trust certificates. The trust certificates are eliminated upon consolidation.

At December 31, 2019, we had outstanding repurchase agreement borrowings with the following counterparties:

(dollars in thousands) Repurchase Agreement Counterparties	Amount Outstanding	Percent of Total Amount Outstanding	Company Investments Held as Collateral	Counterparty Rating ⁽¹⁾
Citigroup Global Markets Inc.	\$ 576,634	20.4%	\$ 595,702	A+
Credit Suisse AG, Cayman Islands Branch ⁽²⁾	371,725	13.2%	501,325	A+
Royal Bank of Canada	337,664	12.0%	349,439	AA-
Barclays Capital Inc.	251,440	8.9%	323,529	A
JP Morgan Securities LLC	203,363	7.2%	222,882	A+
JPMorgan Chase Bank, National Association	164,265	5.8%	175,294	A-
Mirae Asset Securities (USA) Inc.	164,227	5.8%	168,396	BBB
UBS Securities LLC	140,048	5.0%	142,804	A+
South Street Securities LLC	108,678	3.8%	112,174	Unrated
Bank of Montreal	105,622	3.7%	110,139	A+
Nomura Securities International, Inc. ⁽³⁾	102,956	3.6%	138,148	Unrated
UBS AG, London Branch	76,774	2.7%	109,523	A+
The Bank of Nova Scotia	55,738	2.0%	57,436	A+
SunTrust Robinson Humphrey, Inc. ⁽⁴⁾	45,187	1.6%	47,419	Unrated
Mizuho Securities USA Inc.	39,705	1.4%	43,320	A
Credit Suisse Securities (USA) LLC	37,333	1.3%	65,703	A+
All other counterparties ⁽⁵⁾	43,518	1.6%	52,573	
Total	<u>\$ 2,824,877</u>	<u>100.0%</u>	<u>\$ 3,215,806</u>	

(1) The counterparty ratings presented above are the long-term issuer credit ratings as rated at December 31, 2019 by S&P.

(2) Includes master repurchase agreements in which the buyer includes Alpine Securitization LTD., a Credit Suisse sponsored asset-backed commercial paper conduit.

(3) Nomura Holdings, Inc., the parent company of Nomura Securities International, Inc., is rated BBB+ by S&P at December 31, 2019.

(4) SunTrust Banks Inc, the parent company of SunTrust Robinson Humphrey, Inc. is rated P-2 by Moody's at December 31, 2019.

(5) Represents amount outstanding with four counterparties, which each holds collateral valued less than 5% of our stockholders' equity as security for our obligations under the applicable repurchase agreements as of December 31, 2019.

The following table presents our average repurchase agreement borrowings, excluding unamortized debt issuance costs, by type of collateral pledged for the years ended December 31, 2019 and December 31, 2018 (dollars in thousands):

Collateral	Year ended December 31, 2019	Year ended December 31, 2018
Agency CMBS	\$ 1,488,995	\$ 1,845,679
Agency RMBS	261,210	424,525
Non-Agency RMBS	28,234	62,971
Non-Agency CMBS	159,336	207,293
Residential Whole Loans	562,871	411,265
Commercial Loans	203,686	37,975
Securitized commercial loans	29,569	5,836
Residential Bridge Loans	105,657	205,989
Other securities	48,592	65,568
Total	<u>\$ 2,888,150</u>	<u>\$ 3,267,101</u>
Maximum borrowings during the period ⁽¹⁾	<u>\$ 3,100,204</u>	<u>\$ 3,573,043</u>

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

Securitized Debt

We acquired a variable interest in CMSC Trust, RETL 2019 Trust and MRCD Trust and were required to consolidate the CMBS VIEs. Refer to Note 7 - "Financings" for details.

At December 31, 2019, the consolidated CMSC Trust's commercial mortgage pass-through certificate, which bears a fixed interest rate of 8.9% and matures on June 6, 2020, had an outstanding balance of \$10.6 million and a fair value of \$10.6 million.

The following table summarizes the consolidated RETL 2019 Trust's commercial mortgage pass-through certificates at December 31, 2019 which is classified in "Securitized debt, net" in the Consolidated Balance Sheets (dollars in thousands):

Classes	Principal Balance ⁽¹⁾	Coupon	Fair Value ⁽¹⁾	Contractual Maturity
Class A	\$ 219,431	2.9%	\$ 219,567	3/15/2021
Class B	101,200	3.3%	101,326	3/15/2021
Class C	277,821	3.8%	278,517	3/15/2021
Class X-CP ⁽²⁾	N/A	1.2%	1,026	4/15/2020
Class X-EXT ⁽²⁾	N/A	—%	31	3/15/2021
	<u>\$ 598,452</u>		<u>\$ 600,467</u>	

(1) Excluded the principal and fair value of classes owned by us that are eliminated in the Consolidated Balance Sheets.

(2) Class X-CP and Class X-EXT are interest-only classes with an initial notional balance of \$308.4 million each.

The following table summarizes MRCD Trust's commercial mortgage pass-through certificates at December 31, 2019 which is classified in "Securitized debt, net" in the Consolidated Balance Sheets (dollars in thousands):

Classes	Principal Balance ⁽¹⁾	Coupon	Fair Value ⁽¹⁾	Contractual Maturity
Class A	\$ 83,560	4.3%	\$ 70,591	12/9/2024
	<u>\$ 83,560</u>		<u>\$ 70,591</u>	

(1) Excluded the principal and fair value of classes owned by us that are eliminated in the Consolidated Balance Sheets.

In May 2019, we completed a residential mortgage-backed securitization comprised of a portion of our Residential Whole Loan portfolio. RMI 2015 Trust and RNR Trust collectively transferred \$945.5 million of Non-QM Residential Whole Loans, to a wholly-owned subsidiary of the Company, Arroyo Mortgage Trust 2019-2 ("Arroyo Trust") and Arroyo Trust issued \$919.0 million of mortgage-backed notes and we retained the subordinate Non-Offered Securities. At September 30, 2019, Residential Whole Loans, with an outstanding principal balance of approximately \$814.0 million, serve as collateral for the Arroyo Trust's securitized debt.

The following table summarizes the consolidated Arroyo Trust's issued mortgage-backed notes at September 30, 2019 which is classified in "Securitized debt, net" in the Consolidated Balance Sheets (dollars in thousands):

Classes	Principal Balance	Coupon	Carrying Value	Contractual Maturity
Issued Mortgage-Backed Notes				
Class A-1	\$ 681,668	3.3%	\$ 681,666	4/25/2049
Class A-2	36,525	3.5%	36,524	4/25/2049
Class A-3	57,866	3.8%	57,864	4/25/2049
Class M-1	25,055	4.8%	25,055	4/25/2049
Subtotal	801,114		\$ 801,109	
Less: Unamortized deferred financing costs	N/A		5,298	
Total	<u>\$ 801,114</u>		<u>\$ 795,811</u>	

Convertible Senior Unsecured Notes

In August 2019, we issued \$40.0 million aggregate principal amount of 6.75% convertible senior unsecured notes (the "August 2019 Reopened Notes") for net proceeds of \$38.8 million. The August 2019 Reopened Notes have substantially identical terms as the existing notes issued in October 2017. The notes mature on October 1, 2022, unless earlier converted, redeemed or repurchased by the holders pursuant to their terms, and are not redeemable by us except during the final three months prior to maturity.

In December 2019, we issued another \$50.0 million aggregate principal amount of 6.75% convertible senior unsecured notes (the "December 2019 Reopened Notes") for net proceeds of \$49.2 million. The December 2019 Reopened Notes have substantially identical terms as the existing notes issued in October 2017. The notes mature on October 1, 2022, unless earlier converted, redeemed or repurchased by the holders pursuant to their terms, and are not redeemable by us except during the final three months prior to maturity.

Hedging Activity

In connection with our risk management activities, we enter into a variety of derivative and non-derivative instruments. Our primary objective for acquiring these derivatives and non-derivative instruments is to mitigate our exposure to future events that are outside our control. Our derivative instruments are designed to mitigate the effects market risk and cash flow volatility associated with interest rate risk, including associated prepayment risk. As part of our hedging strategy, we may enter into, among other things, interest rate swaps, including forward starting swaps, interest rate swaptions, U.S. Treasury options, Eurodollar, Volatility Index and U.S. Treasury futures, TBAs, total return swaps, credit default swaps, foreign currency swaps and forwards and other similar instruments.

The following tables summarize the hedging activity during the twelve months ended December 31, 2019 (dollars in thousands):

Derivative Instrument	Notional Amount at December 31, 2018	Acquisitions	Settlements, Terminations or Expirations	Notional Amount at December 31, 2019
Fixed pay interest rate swaps	\$ 3,127,800	\$ 3,497,500	\$ (4,074,300)	\$ 2,551,000
Variable pay interest rate swaps	728,400	1,759,800	(1,083,200)	1,405,000
Interest rate swaptions	—	162,803	(162,803)	—
Options - long positions	—	435,600	(435,600)	—
Options - short positions	—	1,063,300	(1,063,300)	—
Futures contracts - long positions	—	567,300	(567,300)	—
Futures contracts - short positions	300,400	1,437,200	(1,737,600)	—
Credit default swaps	50,000	151,000	(50,000)	151,000
TBA securities - long positions	—	3,200,000	(2,200,000)	1,000,000
TBA securities - short positions	—	3,200,000	(2,200,000)	1,000,000
Total derivative instruments	\$ 4,206,600	\$ 15,474,503	\$ (13,574,103)	\$ 6,107,000

Derivative Instrument	Fair Value at December 31, 2018	Acquisitions	Settlements, Terminations or Expirations	Realized Gains / Losses	Mark-to- market	Fair Value at December 31, 2019
Fixed pay interest rate swaps	\$ (5,470)	\$ (32,894)	\$ 194,324	\$ (160,611)	\$ 7,652	\$ 3,001
Variable pay interest rate swaps	2,054	7,608	(55,099)	47,464	(2,512)	(485)
Interest rate swaptions	—	332	—	(332)	—	—
Options - long positions	—	485	—	(485)	—	—
Options - short positions	—	(2,157)	294	1,863	—	—
Futures contracts - long positions	—	—	(3,801)	3,801	—	—
Futures contracts - short positions	(4,657)	—	16,663	(16,663)	4,657	—
Credit default swaps	549	(4,252)	367	(540)	1,029	(2,847)
TBA securities	—	—	(1,934)	1,934	(928)	(928)
Total derivative instruments	<u>\$ (7,524)</u>	<u>\$ (30,878)</u>	<u>\$ 150,814</u>	<u>\$ (123,569)</u>	<u>\$ 9,898</u>	<u>\$ (1,259)</u>

As of December 31, 2019, we had approximately \$2.6 billion of fixed pay rate interest rate swaps and \$1.4 billion of variable pay rate interest rate swap. The following tables provide additional information on our fixed pay interest rate swaps and variable pay interest rate swaps (dollars in thousands):

December 31, 2019				
Fixed Pay Interest Rate Swap Remaining Term	Notional Amount	Average Fixed Pay Rate	Average Floating Receive Rate	Average Maturity (Years)
1 year or less	\$ 200,000	1.8%	1.9%	0.4
Greater than 3 years and less than 5 years	622,400	2.6%	1.9%	4.1
Greater than 5 years	1,728,600	2.1%	2.0%	8.9
Total	<u>\$ 2,551,000</u>	<u>2.2%</u>	<u>2.0%</u>	<u>7.1</u>

December 31, 2019				
Variable Pay Interest Rate Swap Remaining Term	Notional Amount	Average Variable Pay Rate	Average Fixed Receive Rate	Average Maturity (Years)
Greater than 1 years and less than 3 years	\$ 810,000	2.0%	2.0%	1.6
Greater than 3 years and less than 5 years	550,000	1.9%	1.6%	5.0
Greater than 5 years	45,000	1.9%	2.3%	19.5
Total	<u>\$ 1,405,000</u>	<u>2.0%</u>	<u>1.9%</u>	<u>3.5</u>

Capital Markets Activity

The following is a summary of activity during 2019:

In May 2019, we completed a secondary public offering in which we sold 5,000,000 shares of our common stock at a price of \$10.14 per share, for net proceeds of approximately \$49.3 million after subtracting underwriting commissions and offering expenses of approximately \$1.4 million. We used the net proceeds from the offering to opportunistically invest in our target assets in accordance with our investment guidelines.

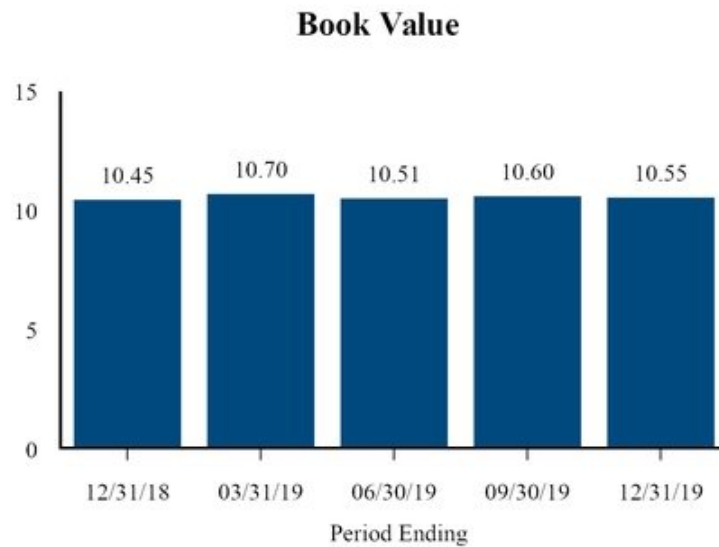
In April 2017, we entered into an equity distribution agreement with JMP Securities LLC under which we may offer and sell up to \$100.0 million shares of common stock in an At-The-Market equity offering. During the year ended December 31, 2019, we sold 299,497 shares under this agreement for net proceeds of \$3.0 million.

Dividends

Our dividend remained stable at \$0.31 for each of the 15 quarters ending on December 31, 2019. For the quarter ended December 31, 2019, we generated a dividend yield of approximately 12.0% based on the stock closing price of \$10.33 at December 31, 2019.

Book Value

The following chart reflects our book value per common share basic and diluted shares over five consecutive quarters:



Our book value per common share basic and diluted, net of our quarterly dividends was \$10.55 at December 31, 2019, an increase of \$0.10 or 1.0% when compared to our December 31, 2018 book value of \$10.45. The increase in book value was mainly attributable to the composition of our portfolio and spread tightening in our Agency MBS portfolio when compared to the fourth quarter of 2018.

Results of Operations

General

Our operating results mainly depend upon the difference between the yield on our investments, the cost of our borrowings, including our hedging activities, the composition and changes in market prices of our portfolio and our expenses. For the year ended December 31, 2019, we generated net income of \$70.7 million or \$1.37 per basic and diluted weighted common share, compared to net income of \$26.4 million or \$0.61 per basic and diluted weighted common share for the year ended December 31, 2018. Our results of operations, for the year ended December 31, 2019, was positively impacted by tighter spreads on our Agency portfolio. Our credit sensitive portfolio continued to perform well with the favorable environment in both residential and commercial real estate markets.

Comparison of the year ended December 31, 2019 to the year ended December 31, 2018

Net Interest Income

The following tables set forth certain information regarding our net interest income on our investment portfolio for the years ended December 31, 2019 and December 31, 2018 (dollars in thousands):

Year ended December 31, 2019	Average Amortized Cost of Assets	Total Interest Income	Yield on Average Assets
Investments			
Agency CMBS	\$ 1,517,394	\$ 48,959	3.23%
Agency RMBS	268,554	9,128	3.40%
Non-Agency RMBS	47,982	2,468	5.14%
Non-Agency CMBS	226,072	18,195	8.05%
Residential Whole Loans	1,196,675	57,234	4.78%
Residential Bridge Loans	115,199	8,109	7.04%
Commercial loans	348,884	28,556	8.18%
Securitized commercial loans	830,311	39,454	4.75%
Other securities	69,894	5,161	7.38%
Total investments	\$ 4,620,965	\$ 217,264	4.70%
	Average Carrying Value	Total Interest Expense	Average Cost of Funds ⁽¹⁾
Borrowings			
Repurchase agreements	\$ 2,888,151	\$ 90,802	3.14%
Convertible senior unsecured notes, net	130,457	10,556	8.09%
Securitized debt	1,305,158	48,916	3.75%
Total borrowings	\$ 4,323,766	\$ 150,274	3.48%
Net interest income and net interest margin ⁽²⁾		\$ 66,990	1.45%
Year ended December 31, 2018	Average Amortized Cost of Assets	Total Interest Income	Yield on Average Assets
Investments			
Agency CMBS	\$ 1,976,291	\$ 59,502	3.01%
Agency RMBS	442,145	14,415	3.26%
Non-Agency RMBS	92,789	6,047	6.52%
Non-Agency CMBS	294,811	26,424	8.96%
Residential Whole Loans	494,438	23,331	4.72%
Residential Bridge Loans	223,015	15,889	7.12%
Commercial loans	88,091	6,898	7.83%
Securitized commercial loans	931,090	48,422	5.20%
Other securities	96,810	8,434	8.71%
Total investments	\$ 4,639,480	\$ 209,362	4.51%
	Average Carrying Value	Total Interest Expense	Average Cost of Funds ⁽¹⁾
Borrowings			
Repurchase agreements	\$ 3,267,101	\$ 86,742	2.66%
Convertible senior unsecured notes, net	109,456	9,058	8.28%
Securitized debt	957,816	42,440	4.43%
Total borrowings	\$ 4,334,373	\$ 138,240	3.19%
Net interest income and net interest margin ⁽²⁾		\$ 71,122	1.53%

- (1) Average cost of funds does not include the interest expense related to our derivatives. In accordance with GAAP, such costs are included in "Gain (loss) on derivative instruments, net" in the Consolidated Statements of Operations.
- (2) Since we do not apply hedge accounting, our net interest margin in this table does not reflect the benefit / cost of our interest rate swaps. See Non-GAAP Financial Measure section for net investment income table that includes the benefit / cost from our interest rate swaps.

Interest Income

For the years ended December 31, 2019 and December 31, 2018, we earned interest income on our investments of approximately \$217.3 million and \$209.4 million, respectively. The increase in interest income for the year ended December 31, 2019 as compared to the year ended December 31, 2018 was primarily the result of an overall higher yielding investment portfolio. The weighted average yield increased to 4.70% for the year ended December 31, 2019 from 4.51% for the year ended December 31, 2018. Our credit sensitive investments contributed approximately \$159.2 million or 73.3% to interest income for the period. Under the current market conditions, we expect to continue to increase our investments in Residential Whole Loans, Commercial Loans, Non-Agency CMBS and opportunistically invest in Agency CMBS and Agency RMBS.

Interest Expense

Interest expense increased from \$138.2 million for the year ended December 31, 2018 to \$150.3 million for the year ended December 31, 2019. Our higher borrowing costs reflect: (i) higher interest rates on our repurchase agreements in 2019 coupled with higher costs associated with financing our credit-sensitive investments, which generally have higher interest rates; (ii) the issuance of an additional \$90.0 million aggregate principal amount of 6.75% convertible senior unsecured notes in 2019; and (iii) an increase in the average outstanding securitized debt of \$347.3 million from the consolidation of the Arroyo Trust and MRCD Trust. Our average cost of funds on our repurchase agreements increased from 2.66% for the year ended December 31, 2018 to 3.14% for the year ended December 31, 2019. We utilize interest rate swaps to mitigate our interest rate exposure. However, since we do not apply hedge accounting the reduction in interest expense is reflected in "Gain (loss) on derivatives, net."

Other income (loss), net

Realized gain (loss) on investments, net

Realized gain (loss) on investments represents the net gain (loss) on sales or settlements from our investment portfolio. Our Manager regularly reviews the characteristics of our portfolio and may make changes to our portfolio in order to adjust such portfolio characteristics in response to and/or anticipation of changing market conditions in an effort to achieve the appropriate risk reward ratio.

The following table presents the realized gains (losses) of our investments for each of the years ended December 31, 2019 and December 31, 2018 (dollars in thousands):

	Year ended December 31, 2019				Year ended December 31, 2018			
	Proceeds	Gross Gains	Gross Losses	Net Gain (Loss)	Proceeds	Gross Gains	Gross Losses	Net Gain (Loss)
Agency CMBS	\$ 891,072	\$ 32,793	\$ (4,190)	\$ 28,603	\$ 1,534,967	\$ —	\$ (51,045)	\$ (51,045)
Agency RMBS	205,310	1,559	—	1,559	589,854	18	(23,997)	(23,979)
Non-Agency RMBS ⁽¹⁾	—	—	—	—	99,842	7,008	(478)	6,530
Non-Agency CMBS	40,235	317	(1,624)	(1,307)	140,292	3,086	(6,201)	(3,115)
Other securities	—	—	—	—	65,099	8,400	—	8,400
Residential Bridge Loans ⁽¹⁾	—	232	(762)	(530)	569	—	(48)	(48)
Loans transferred to REO ⁽²⁾	5,029	516	(473)	43	—	—	—	—
Disposition of REO	1,761	38	(128)	(90)	—	—	—	—
Total	\$ 1,143,407	\$ 35,455	\$ (7,177)	\$ 28,278	\$ 2,430,623	\$ 18,512	\$ (81,769)	\$ (63,257)

(1) Realized gains/losses recognized on the final settlement of the loans.

(2) Realized gains/losses recognized on the transfer of Residential Bridge Loans to REO. Proceeds represent the fair value less estimated selling costs of the real estate on the date of transfer.

Other than temporary impairment

We evaluate securities for OTTI on at least a quarterly basis. The determination of whether a security is other-than-temporarily impaired involves judgments, estimates and assumptions based on subjective and objective factors. As a result, the timing and amount of an OTTI constitutes an accounting estimate that may change materially over time.

The following table presents the other-than-temporary impairments we recorded on our securities portfolio (dollars in thousands):

	Year ended December 31, 2019	Year ended December 31, 2018
Agency RMBS ⁽¹⁾	\$ 74	\$ 807
Non-Agency RMBS	1,331	996
Non-Agency CMBS	6,565	8,660
Other securities	604	717
Total	<u>\$ 8,574</u>	<u>\$ 11,180</u>

(1) Other-than-temporary impairment on Agency RMBS includes impairments on Agency RMBS IOs and unrealized loss on Agency RMBS securities that we had the intent to sell at the end of the period.

Unrealized gain (loss), net

Our investments and securitized debt, for which we have elected the fair value option, are recorded at fair value with the periodic changes in fair value being recorded in earnings. The change in unrealized gain (loss) is directly attributable to changes in market pricing on the underlying investments and securitized debt during the period. For the year ended December 31, 2019, unrealized gain (loss) increased to a net unrealized gain of \$107.5 million from a net unrealized loss of \$24.7 million for the year ended December 31, 2018. The majority of the increase in net unrealized gain (loss) was a result of tighter credit spreads on our Agency portfolio and in 2019, which positively impacted the value of these securities, accounting for the majority of the increase in unrealized gains in the portfolio.

The following table presents the net unrealized gains (losses) we recorded on our investments and securitized debt (dollars in thousands):

	Year ended December 31, 2019	Year ended December 31, 2018
Agency CMBS	\$ 78,544	\$ (25,040)
Agency RMBS	8,510	(2,289)
Non-Agency RMBS	(230)	(3,960)
Non-Agency CMBS	(890)	15,805
Residential Whole Loans	20,790	(444)
Residential Bridge Loans	501	(1,896)
Commercial loans	(121)	631
Securitized commercial loans	(1,070)	(16)
Other securities	1,564	(7,352)
Securitized debt	(294)	116
Other liabilities	225	(226)
Total	<u>\$ 107,529</u>	<u>\$ (24,671)</u>

Gain (loss) on derivatives, net

In order to mitigate interest rate risk resulting from our repurchase agreement borrowings, we enter into a variety of derivative and non-derivative instruments. Our primary objective for acquiring these derivatives and non-derivative instruments is to mitigate our exposure to future events that are outside our control.

The following table presents the components of gain (loss) on derivatives for the years ended December 31, 2019 and December 31, 2018 (dollars in thousands):

	Realized Gain (Loss), net						
Description	Other Settlements / Expirations	Variation Margin Settlement	Mark-to-market	Return (Recovery) of Basis	Contractual interest income(expense), net ⁽¹⁾	Total	
Year ended December 31, 2019							
Interest rate swaps	\$ (4,978)	\$ (108,169)	\$ 5,140	\$ 5,769	\$ 3,732	\$ (98,506)	
Interest rate swaptions	(332)	—	—	—	—	(332)	
Agency and Non-Agency Interest-Only Strips - accounted for as derivatives	—	—	(508)	(2,688)	3,277	81	
Options	1,378	—	—	—	—	1,378	
Futures contracts	(12,862)	—	4,657	—	—	(8,205)	
Credit default swaps	(178)	—	1,029	—	—	851	
TBAs	1,934	—	(928)	—	—	1,006	
Total	\$ (15,038)	\$ (108,169)	\$ 9,390	\$ 3,081	\$ 7,009	\$ (103,727)	
Year ended December 31, 2018							
Interest rate swaps	\$ 163	\$ 76,979	\$ (5,147)	\$ 2,465	\$ 3,693	\$ 78,153	
Agency and Non-Agency Interest-Only Strips - accounted for as derivatives	—	—	(655)	(3,661)	4,511	195	
Options	(871)	—	300	—	—	(571)	
Futures contracts	6,112	—	(5,285)	—	—	827	
Credit default swaps	(241)	—	396	—	—	155	
TBAs	(800)	—	10	—	—	(790)	
Total	\$ 4,363	\$ 76,979	\$ (10,381)	\$ (1,196)	\$ 8,204	\$ 77,969	

(1) Contractual interest income (expense), net on derivative instruments includes interest settlement paid or received.

Other, net

For the years ended December 31, 2019 and December 31, 2018, "Other, net" consisted of income of \$2.2 million and loss of \$189 thousand, respectively. The balance is mainly comprised of interest on cash balances, miscellaneous net interest income (expense) on cash collateral for our repurchase agreements and derivatives and miscellaneous fees collected on residential mortgage loans.

Expenses

Management Fee Expense

We incurred management fee expense of approximately \$7.4 million and \$8.7 million for the years ended December 31, 2019 and December 31, 2018, respectively. Pursuant to the terms of the Management Agreement, our Manager is paid a management fee equal to 1.5% per annum of our stockholders' equity (as defined in the Management Agreement), calculated and payable (in cash) quarterly in arrears. Although in May 2019, we completed a secondary public offering for net proceeds of approximately \$49.3 million after subtracting underwriting commissions and had net realized gains on sales of investments of approximately \$28.3 million, these increases were offset by the realized losses on our interest rate swaps which resulted in a decrease in the stockholders' equity that was utilized to calculate our management fee.

The management fees, expense reimbursements and the relationship between our Manager and us are discussed further in Note 10, "Related Party Transactions" to the consolidated financial statements contained in this annual report on Form 10-K.

Other Operating Expenses

We incurred other operating expenses of approximately \$5.5 million and \$6.1 million for the years ended December 31, 2019 and December 31, 2018, respectively. Other operating cost is comprised of derivative transaction costs, custody, and asset

management/loan servicing fees. The decrease was primarily a result of a reduction in asset management and servicing fees related to our Residential Bridge Loans, which were all acquired servicing released.

General and Administrative Expenses

General and administrative expenses was relatively flat year over year.

Comparison of the year ended December 31, 2018 to the year ended December 31, 2017

Net Interest Income

The following tables set forth certain information regarding our net interest income on our investment portfolio for the years ended December 31, 2018 and December 31, 2017 (dollars in thousands):

Year ended December 31, 2018	Average Amortized Cost of Assets	Total Interest Income	Yield on Average Assets
Investments			
Agency CMBS	\$ 1,976,291	\$ 59,502	3.01%
Agency RMBS	442,145	14,415	3.26%
Non-Agency RMBS	92,789	6,047	6.52%
Non-Agency CMBS	294,811	26,424	8.96%
Residential Whole Loans	494,438	23,331	4.72%
Residential Bridge Loans	223,015	15,889	7.12%
Commercial loans	88,091	6,898	7.83%
Securitized commercial loans	931,090	48,422	5.20%
Other Securities	96,810	8,434	8.71%
Total	<u>\$ 4,639,480</u>	<u>\$ 209,362</u>	<u>4.51%</u>
	Average Carrying Value	Total Interest Expense	Average Cost of Funds⁽¹⁾
Borrowings			
Repurchase agreements	\$ 3,267,101	\$ 86,742	2.66%
Convertible senior unsecured notes, net	109,456	9,058	8.28%
Securitized debt	957,816	42,440	4.43%
Total borrowings	<u>\$ 4,334,373</u>	<u>\$ 138,240</u>	<u>3.19%</u>
Net interest income and net interest margin ⁽³⁾		<u>\$ 71,122</u>	<u>1.53%</u>

Year ended December 31, 2017	Average Amortized Cost of Assets	Total Interest Income	Yield on Average Assets
Investments			
Agency CMBS	\$ 1,354,720	\$ 40,571	2.99%
Agency RMBS	898,883	25,050	2.79%
Non-Agency RMBS	88,566	6,127	6.92%
Non-Agency CMBS	323,769	27,455	8.48%
Residential Whole Loans	207,786	8,515	4.10%
Residential Bridge Loans	52,696	4,487	8.51%
Securitized commercial loan	24,964	2,247	9.00%
Other Securities	116,683	9,839	8.43%
Total	\$ 3,068,067	\$ 124,291	4.05%

	Average Carrying Value	Total Interest Expense	Average Cost of Funds ⁽¹⁾
Borrowings			
Repurchase agreements	\$ 2,713,199	\$ 45,128	1.66%
Convertible senior unsecured notes, net ⁽²⁾	108,743	2,264	8.34%
Securitized debt	10,984	981	8.93%
Total borrowings	\$ 2,832,926	\$ 48,373	1.76%
Net interest income and net interest margin ⁽³⁾		\$ 75,918	2.47%

(1) Average cost of funds does not include the interest expense related to our derivatives. In accordance with GAAP, such costs are included in "Gain (loss) on derivative instruments, net" in the Consolidated Statements of Operations.

(2) The convertible senior unsecured notes, net are reflected at the balance as of December 31, 2017. The average cost of financing is calculated based on annualized interest expense divided by the average carrying value for the period outstanding.

(3) Since we do not apply hedge accounting, our net interest margin in this table does not reflect the benefit of our interest rate swaps. See Non-GAAP Financial Measure section for net investment income table that includes the benefit from our interest rate swaps.

Interest Income

For the year ended December 31, 2018 and December 31, 2017, we earned interest income on our investments of approximately \$209.4 million and \$124.3 million, respectively. The increase in interest income for the year ended December 31, 2018 as compared to the year ended December 31, 2017 was primarily the result of an overall higher yielding larger investment portfolio, generating an increase interest income of approximately \$52.0 million from our Agency CMBS, Residential Whole and Bridge Loans, Commercial Loans and approximately \$46.0 million from RETL securitized commercial loan, which was acquired in March 2018. This increase was partially offset by a decrease \$10.6 million interest income from our Agency RMBS investments as a result of significantly reducing our investment in this asset class.

Interest Expense

Interest expense increased from \$48.4 million for the year ended December 31, 2017 to \$138.2 million for the year ended December 31, 2018. Our higher borrowing costs reflect: (i) an increase in our average outstanding borrowings due to a larger average outstanding investment portfolio. Our average outstanding borrowings increased by \$1.5 billion to \$4.3 billion for the year ended December 31, 2018 from \$2.8 billion for the year ended December 31, 2017; (ii) higher interest rates on our repurchase agreements in 2018 coupled with higher costs associated with financing our credit-sensitive investments, which generally have higher interest rates. Our average cost of funds on our repurchase agreements increased from 1.66% for the year ended December 31, 2017 to 2.66% for the year ended December 31, 2018. We utilize interest rate swaps to mitigate our interest rate exposure. As of December 31, 2018, we have effectively hedged approximately 85% of our repurchase agreement debt by entering into interest rate swaps with a weighted average fixed rate of 2.3% for a weighted average term of 5.3 years. However, since we do not apply hedge accounting the reduction in interest expense is reflected in "Gain (loss) on derivatives, net"; (iii) The issuance of \$115.0 million aggregate principal amount of 6.75% convertible senior unsecured notes in October 2017; and (iv) the securitized debt of \$957.8 million from the consolidation of the RETL securitized trust in March of 2018.

Other income (loss)

Realized gain (loss) on investments, net

Realized gain (loss) on investments represents the net gain (loss) on sales from our investment portfolio. Our Manager regularly reviews the characteristics of our portfolio and may make changes to our portfolio in order to adjust such portfolio characteristics in response to and/or anticipation of changing market conditions in an effort to achieve the appropriate risk reward ratio. Accordingly, we expected to continue to redeploy capital into credit sensitive investments in order to adjust the overall characteristics of our portfolio.

The following table presents the sales and realized gains (loss) of our investments for the years ended December 31, 2018 and December 31, 2017 (dollars in thousands):

	Year ended December 31, 2018				Year ended December 31, 2017			
	Proceeds	Gross Gains	Gross Losses	Net Gain (Loss)	Proceeds	Gross Gains	Gross Losses	Net Gain (Loss)
Agency CMBS	\$ 1,534,967	\$ —	\$ (51,045)	\$ (51,045)	\$ —	\$ —	\$ —	\$ —
Agency RMBS ⁽¹⁾	589,854	18	(23,997)	(23,979)	1,251,985	5,020	(7,936)	(2,916)
Non-Agency RMBS ⁽¹⁾	99,842	7,008	(478)	6,530	243,838	24,356	(2,241)	22,115
Non-Agency CMBS	140,292	3,086	(6,201)	(3,115)	54,875	2,543	(1,803)	740
Other securities	65,099	8,400	—	8,400	38,447	713	(54)	659
Residential Bridge loans ⁽²⁾	569	—	(48)	(48)	—	—	—	—
Total	\$ 2,430,623	\$ 18,512	\$ (81,769)	\$ (63,257)	\$ 1,589,145	\$ 32,632	\$ (12,034)	\$ 20,598

(1) Excludes Interest-Only Strips, accounted for as derivatives.

(2) Realized gains/losses recognized on the final settlement of the loans.

Other than temporary impairment

We evaluate securities for OTTI on at least a quarterly basis. The determination of whether a security is other-than-temporarily impaired involves judgments, estimates and assumptions based on subjective and objective factors. As a result, the timing and amount of an OTTI constitutes an accounting estimate that may change materially over time.

The following table presents the other-than-temporary impairments we recorded on our securities portfolio (dollars in thousands):

	Year ended December 31, 2018	Year ended December 31, 2017
Agency RMBS ⁽¹⁾	\$ 807	\$ 5,774
Non-Agency RMBS	996	—
Non-Agency CMBS	8,660	15,117
Other securities	717	1,982
Total	\$ 11,180	\$ 22,873

(1) Other-than-temporary impairment on Agency RMBS includes impairments on Agency RMBS IOs and unrealized loss on Agency RMBS securities that we had the intent to sell at the end of the period.

Unrealized gain (loss), net

Our investments and securitized debt, for which we have elected the fair value option, are recorded at fair value with the periodic changes in fair value being recorded in earnings. The change in unrealized gain (loss) is directly attributable to changes in market pricing on the underlying investments and securitized debt during the period. For the year ended December 31, 2018, unrealized gain (loss) decreased to a net unrealized loss of \$24.7 million from a net unrealized gain of \$28.4 million for the year ended December 31, 2017. The decrease in net unrealized gain (loss) was a result of significantly wider spreads on our Agency portfolio in the fourth quarter of 2018, which negatively impacted the value of these securities, accounting for the majority of the increase in unrealized losses in the portfolio.

The following table presents the net unrealized gains (losses) we recorded on our investment and securitized debt (dollars in thousands):

	Year ended December 31, 2018	Year ended December 31, 2017
Agency CMBS	\$ (25,040)	\$ 5,747
Agency RMBS	(2,289)	7,207
Non-Agency RMBS	(3,960)	(12,040)
Non-Agency CMBS	15,805	13,453
Residential Whole Loans	(444)	723
Residential Bridge Loans	(1,896)	558
Commercial loans	631	—
Securitized commercial loans	(16)	805
Other securities	(7,352)	12,297
Securitized debt	116	(354)
Other liabilities	(226)	—
Total	\$ (24,671)	\$ 28,396

Gain (loss) on derivatives, net

In order to mitigate interest rate risk resulting from our repurchase agreement borrowings, we enter into a variety of derivative and non-derivative instruments. Our primary objective for acquiring these derivatives and non-derivative instruments is to mitigate our exposure to future events that are outside our control.

The following table presents the components of gain (loss) on derivatives for the year ended December 31, 2018 and December 31, 2017 (dollars in thousands):

	Realized Gain (Loss), net						
Description	Other Settlements / Expirations	Variation Margin Settlement	Mark-to-market	Return (Recovery) of Basis	Contractual interest income(expense), net ⁽¹⁾	Total	
Year ended December 31, 2018							
Interest rate swaps	\$ 163	\$ 76,979	\$ (5,147)	\$ 2,465	\$ 3,693	\$ 78,153	
Agency and Non-Agency Interest-Only Strips - accounted for as derivatives	—	—	(655)	(3,661)	4,511	195	
Options	(871)	—	300	—	—	(571)	
Futures contracts	6,112	—	(5,285)	—	—	827	
Credit default swaps	(241)	—	396	—	—	155	
TBAs	(800)	—	10	—	—	(790)	
Total	\$ 4,363	\$ 76,979	\$ (10,381)	\$ (1,196)	\$ 8,204	\$ 77,969	
Year ended December 31, 2017							
Interest rate swaps ⁽²⁾	\$ (150,607)	\$ 20,258	\$ 148,947	\$ 524	\$ (14,606)	\$ 4,516	
Interest rate swaptions	(115)	—	—	—	—	(115)	
Agency and Non-Agency Interest-Only Strips - accounted for as derivatives	526	—	(902)	(5,995)	7,438	1,067	
Options	(1,453)	—	(300)	—	—	(1,753)	
Futures contracts	(9,130)	—	3,044	—	—	(6,086)	
Foreign currency forwards	32	—	35	—	—	67	
Total return swaps	(552)	—	1,673	—	469	1,590	
Credit default swaps	(11)	—	(22)	—	—	(33)	
TBAs	4,049	—	(10)	—	—	4,039	
Total	\$ (157,261)	\$ 20,258	\$ 152,465	\$ (5,471)	\$ (6,699)	\$ 3,292	

(1) Contractual interest income (expense), net on derivative instruments includes interest settlement paid or received.

(2) "Other Settlements /Expirations" and "Market to Market" include the effects of the April 2017 restructuring of our interest rate swaps.

Other, net

For the years ended December 31, 2018 and December 31, 2017, "Other, net" consisted of expense of \$189 thousand and income of \$1.0 million, respectively. The balance mainly comprised of net interest income (expense) on cash collateral for our repurchase agreements and derivatives and miscellaneous fees collected on residential mortgage loans.

Expenses

Management Fee Expense

We incurred management fee expense of approximately \$8.7 million and \$8.1 million for the years ended December 31, 2018 and December 31, 2017, respectively. Pursuant to the terms of the Management Agreement, our Manager is paid a management fee equal to 1.5% per annum of our stockholders' equity (as defined in the Management Agreement), calculated and payable (in cash) quarterly in arrears. In September 2018, we completed a secondary public offering, for net proceeds of approximately \$67.7 million after subtracting underwriting commissions and offering costs. Our Manager will not earn a management fee on the newly issued equity through March 31, 2019, to reduce any impact on earnings as the capital was deployed into our target assets. Therefore the increase was attributable to realized gains on the termination of certain interest rate swaps increasing stockholders' equity utilized to calculate the management fee.

The management fees, expense reimbursements and the relationship between our Manager and us are discussed further in Note 10, "Related Party Transactions" to the consolidated financial statements contained in this annual report on Form 10-K.

Other Operating Expenses

We incurred other operating expenses of approximately \$6.1 million and \$2.4 million for the years ended December 31, 2018 and December 31, 2017, respectively. Other operating cost is comprised of derivative transaction costs, custody, and asset management/loan servicing fees. The increase was primarily a result of a larger portfolio of Residential Bridge Loans, Commercial Loans and a portfolio of conforming Residential Whole Loans, which were all acquired servicing released, thereby increasing the associated third party management/loan servicing fees.

General and Administrative Expenses

We incurred general and administrative expenses of approximately \$7.9 million and \$7.3 million for the years ended December 31, 2018 and December 31, 2017, respectively. The following describes the key components of general and administrative expenses.

Compensation Expense

Compensation expense decreased from approximately \$2.7 million for the year ended December 31, 2017 to approximately \$2.2 million for the year ended December 31, 2018. The decrease was a result of lower stock-based compensation from awards becoming fully vested in the first half of 2018. We did not issue any new stock-based awards to our Manager or executive officers in 2018 and 2017.

Professional Fees

Professional fees increased to approximately \$4.3 million for the year ended December 31, 2018 from approximately \$3.2 million for the year ended December 31, 2017. The increase was primarily a result of higher professional fees incurred in connection with becoming Sarbanes Oxley 404(b) complaint, professional fees in connection with one-time transaction costs and higher outsourced accounting fees due to a larger investment portfolio.

Other general and administrative expenses

Other general and administrative expenses was relatively flat year over year.

Non-GAAP Financial Measures

We believe that our non-GAAP measures (described below), when considered with GAAP, provide supplemental information useful to investors in evaluating the results of our operations. Our presentations of such non-GAAP measures may not be comparable to similarly-titled measures of other companies, who may use different calculations. As a result, such non-

GAAP measures should not be considered as substitutes for our GAAP net income, as measures of our financial performance or any measure of our liquidity under GAAP.

Core Earnings

Core Earnings is a Non-GAAP financial measure that is used by us to approximate cash yield or income associated with our portfolio and is defined as GAAP net income (loss) as adjusted, excluding: (i) net realized gain (loss) on investments and termination of derivative contracts; (ii) net unrealized gain (loss) on investments; (iii) net unrealized gain (loss) resulting from mark-to-market adjustments on derivative contracts; (iv) other than temporary impairment; (v) provision for income taxes; (vi) non-cash stock-based compensation expense; (vii) non-cash amortization of the convertible senior unsecured notes discount; (viii) one-time charges such as acquisition costs and impairment on loans and (ix) one-time events pursuant to changes in GAAP and certain other non-cash charges after discussions between us, our Manager and our independent directors and after approval by a majority of the our independent directors.

We utilize Core Earnings as a key metric to evaluate the effective yield of the portfolio. Core Earnings allows us to reflect the net investment income of our portfolio as adjusted to reflect the net interest rate swap interest expense. Core Earnings allows us to isolate the interest expense associated with our interest rate swaps in order to monitor and project our borrowing costs and interest rate spread.

We believe that the Non-GAAP measure, when considered with GAAP, provides supplemental information useful to investors in evaluating the results of our operations. Our presentation of Core Earnings may not be comparable to similarly-titled measures of other companies, who may use different calculations. As a result, Core Earnings should not be considered as a substitute for our GAAP net income, as a measure of our financial performance or any measure of our liquidity under GAAP.

The table below reconciles Net Income to Core Earnings for the years ended December 31, 2019, December 31, 2018 and December 31, 2017:

(dollars in thousands)	Year ended December 31, 2019	Year ended December 31, 2018	Year ended December 31, 2017
Net Income	\$ 70,699	\$ 26,409	\$ 85,097
Income tax provision	1,057	709	3,487
Net Income before income taxes	71,756	27,118	88,584
Adjustments:			
<i>Investments:</i>			
Unrealized (gain) loss on investments, securitized debt and other liabilities	(107,529)	24,671	(28,396)
Other than temporary impairment	8,574	11,180	22,873
Realized (gain) loss on sale of investments	(28,278)	63,257	(20,598)
Realized (gain) loss on foreign currency transactions	—	—	1
One-time transaction costs	1,084	812	146
<i>Derivative Instruments:</i>			
Net realized (gain) loss on derivatives	123,569	(81,534)	136,992
Net unrealized (gain) loss on derivatives	(9,390)	10,381	(152,465)
Amortization of discount on convertible senior unsecured notes	718	550	137
Non-cash stock-based compensation expense	564	265	981
Total adjustments	(10,688)	29,582	(40,329)
Core Earnings	\$ 61,068	\$ 56,700	\$ 48,255

Alternatively, our Core Earnings can also be derived as presented in the table below by starting with Adjusted net interest income, which includes interest income on Interest-Only Strips accounted for as derivatives and other derivatives, and net interest expense incurred on interest rate swaps and foreign currency swaps and forwards (a Non-GAAP financial measure) subtracting

Total expenses, adding Non-cash stock based compensation, adding one-time transaction costs, adding amortization of discount on convertible senior notes, and adding interest income on cash balances and other income (loss), net:

(dollars in thousands)	Year ended December 31, 2019	Year ended December 31, 2018	Year ended December 31, 2017
Net interest income	\$ 66,990	\$ 71,122	\$ 75,918
Interest income from IOs and IIOs accounted for as derivatives	589	850	1,912
Net interest income (expense) from interest rate swaps	9,501	6,158	(14,082)
Adjusted net interest income	77,080	78,130	63,748
Total expenses	(20,944)	(22,676)	(17,778)
Non-cash stock-based compensation	564	265	981
One-time transaction costs	1,084	812	146
Amortization of discount on convertible unsecured senior notes	718	550	137
Interest income on cash balances and other income (loss), net	2,566	(381)	1,021
Core Earnings	\$ 61,068	\$ 56,700	\$ 48,255

Net Interest Income and Net Interest Margin

The following tables set forth certain information regarding our net investment income for the years ended December 31, 2019, December 31, 2018 and December 31, 2017 (dollars in thousands):

Year ended December 31, 2019	Average Amortized Cost of Assets ⁽¹⁾	Total Interest Income ⁽²⁾	Yield on Average Assets
Investments			
Agency CMBS	\$ 1,521,668	\$ 49,056	3.22 %
Agency RMBS	275,054	9,620	3.50 %
Non-Agency RMBS	47,982	2,468	5.14 %
Non-Agency CMBS	226,072	18,195	8.05 %
Residential Whole Loans	1,196,675	57,234	4.78 %
Residential Bridge Loans	115,199	8,109	7.04 %
Commercial loans	348,884	28,556	8.18 %
Securitized commercial loans	830,311	39,454	4.75 %
Other securities	69,894	5,161	7.38 %
Total investments	\$ 4,631,739	\$ 217,853	4.70 %
<i>Adjustments:</i>			
Securitized commercial loans from consolidated VIEs	(830,311)	(39,454)	4.75 %
Investments in consolidated VIEs eliminated in consolidation	88,781	7,875	8.87 %
Adjusted total investments	\$ 3,890,209	\$ 186,274	4.79 %
	Average Carrying Value	Total Interest Expense ⁽³⁾	Average Effective Cost of Funds
Borrowings			
Repurchase agreements	\$ 2,888,151	\$ 90,802	3.14 %
Convertible senior unsecured notes, net	130,457	10,556	8.09 %
Securitized debt, net	1,305,158	48,916	3.75 %
Interest rate swaps	n/a	(9,501)	(0.22)%
Total borrowings	\$ 4,323,766	\$ 140,773	3.26 %
<i>Adjustments:</i>			
Securitized debt from consolidated VIEs ⁽⁴⁾	\$ (729,745)	\$ (30,312)	4.15 %
Adjusted total borrowings	\$ 3,594,021	\$ 110,461	3.07 %
Adjusted net interest income and net interest margin		\$ 75,813	1.95 %

Year ended December 31, 2018	Average Amortized Cost of Assets ⁽¹⁾	Total Interest Income ⁽²⁾	Yield on Average Assets
Investments			
Agency CMBS	\$ 1,982,164	\$ 59,698	3.01 %
Agency RMBS	450,998	15,069	3.34 %
Non-Agency RMBS	92,789	6,047	6.52 %
Non-Agency CMBS	294,811	26,424	8.96 %
Residential Whole Loans	494,438	23,331	4.72 %
Residential Bridge Loans	223,015	15,889	7.12 %
Commercial loans	88,091	6,898	7.83 %
Securitized commercial loans	931,090	48,422	5.20 %
Other securities	96,810	8,434	8.71 %
Total investments	\$ 4,654,206	\$ 210,212	4.52 %
<i>Adjustments:</i>			
Securitized commercial loan from consolidated VIEs	(931,090)	(48,422)	5.20 %
Investments in consolidated VIE eliminated in consolidation	60,006	6,675	11.12 %
Adjusted total investments	\$ 3,783,122	\$ 168,465	4.45 %
	Average Carrying Value	Total Interest Expense ⁽³⁾	Average Effective Cost of Funds
Borrowings			
Repurchase agreements	\$ 3,267,101	\$ 86,742	2.66 %
Convertible senior unsecured notes, net	109,456	9,058	8.28 %
Securitized debt	957,816	42,440	4.43 %
Interest rate swaps	n/a	(6,158)	(0.14)%
Total borrowings	\$ 4,334,373	\$ 132,082	3.05 %
<i>Adjustments:</i>			
Securitized debt from consolidated VIEs ⁽⁴⁾	\$ (957,816)	\$ (42,440)	4.43 %
Adjusted total borrowings	\$ 3,376,557	\$ 89,642	2.65 %
Adjusted net interest income and net interest margin		\$ 78,823	2.08 %

Year ended December 31, 2017	Average Amortized Cost of Assets ⁽¹⁾	Total Interest Income ⁽²⁾	Yield on Average Assets
Investments			
Agency CMBS	\$ 1,363,269	\$ 40,827	2.99%
Agency RMBS	912,211	26,197	2.87%
Non-Agency RMBS	88,835	6,167	6.94%
Non-Agency CMBS	323,769	27,455	8.48%
Residential Whole Loans	207,786	8,515	4.10%
Residential Bridge Loans	52,696	4,487	8.51%
Securitized commercial loan	24,964	2,247	9.00%
Other securities	116,683	9,839	8.43%
Total return swaps	3,629	469	12.92%
Total investments	\$ 3,093,842	\$ 126,203	4.08%
Adjustments:			
Securitized commercial loan from consolidated VIE	(24,964)	(2,247)	9.00%
Investment in consolidated VIE eliminated in consolidation	13,980	1,265	9.05%
Adjusted total investments	\$ 3,082,858	\$ 125,221	4.06%
	Average Carrying Value	Total Interest Expense ⁽³⁾	Average Effective Cost of Funds
Borrowings			
Repurchase agreements	\$ 2,713,199	\$ 45,128	1.66%
Convertible senior unsecured notes, net ⁽⁵⁾	108,743	2,264	8.34%
Securitized debt	10,984	981	8.93%
Interest rate swaps	n/a	14,082	0.51%
Total borrowings	\$ 2,832,926	\$ 62,455	2.27%
Adjustments:			
Securitized debt from consolidated VIE ⁽⁴⁾	\$ (10,984)	\$ (981)	8.93%
Adjusted total borrowings	\$ 2,821,942	\$ 61,474	2.18%
Adjusted net interest income and net interest margin		\$ 63,747	2.07%

(1) Includes Agency and Non-Agency Interest-Only Strips accounted for as derivatives.

(2) Refer to below table for components of interest income.

(3) Includes the net amount paid, including accrued amounts and premium amortization for MAC interest rate swaps during the periods included in gain/loss on derivative instruments for GAAP.

(4) Includes only the third-party sponsored securitized debt from RETL Trust, CMSC Trust and MRCD Trust.

(5) The convertible senior unsecured notes, net are reflected at the balance as of December 31, 2017. The average cost of financing is calculated based on annualized interest expense divided by the average carrying value for the period outstanding.

The following table reconciles total interest income to adjusted interest income, which includes interest income on Agency and Non-Agency Interest-Only Strips classified as derivatives (Non-GAAP financial measure) for the years ended December 31, 2019, December 31, 2018 and December 31, 2017:

(dollars in thousands)	Year ended December 31, 2019	Year ended December 31, 2018	Year ended December 31, 2017
Coupon interest income:			
Agency CMBS	\$ 51,286	\$ 60,148	\$ 40,064
Agency RMBS	12,181	19,507	38,108
Non-Agency RMBS	4,682	7,120	5,602
Non-Agency CMBS	14,178	20,058	19,179
Residential Whole Loans	61,024	24,300	9,609
Residential Bridge Loans	8,846	18,299	4,863
Commercial loans	27,332	6,624	—
Securitized commercial loans	41,398	51,009	2,247
Other securities	11,633	14,805	8,280
Subtotal coupon interest	\$ 232,560	\$ 221,870	\$ 127,952
Premium accretion, discount amortization and amortization of basis, net:			
Agency RMBS	\$ (3,053)	\$ (5,092)	\$ (13,058)
Agency CMBS	(2,327)	(646)	507
Non-Agency RMBS	(2,214)	(1,073)	525
Non-Agency CMBS	4,017	6,366	8,276
Residential Whole Loans	(3,790)	(969)	(1,094)
Residential Bridge Loans	(737)	(2,410)	(376)
Commercial loans	1,224	274	—
Securitized commercial loans	(1,944)	(2,587)	—
Other securities	(6,472)	(6,371)	1,559
Subtotal accretion and amortization	\$ (15,296)	\$ (12,508)	\$ (3,661)
Interest income	\$ 217,264	\$ 209,362	\$ 124,291
Contractual interest income, net of amortization of basis on Agency and Non-Agency Interest-Only Strips, classified as derivatives ⁽¹⁾ :			
Coupon interest income	\$ 3,277	\$ 4,511	\$ 7,438
Amortization of basis	(2,688)	(3,661)	(5,995)
Total Return swaps	—	—	469
Subtotal	\$ 589	\$ 850	\$ 1,912
Total adjusted interest income	\$ 217,853	\$ 210,212	\$ 126,203

(1) Reported in "Gain (loss) on derivative instruments, net" in our Consolidated Statements of Operations.

Effective Cost of Funds includes the net interest component related to our interest rate swaps, as well as the impact of our foreign currency swaps and forwards. While we have not elected hedge accounting for these instruments, such derivative instruments are viewed by us as an economic hedge against increases in future market interest rates on our liabilities and changes in foreign currency exchange rates on our assets and liabilities and are characterized as hedges for purposes of satisfying the REIT requirements and therefore the Effective Cost of Funds reflects interest expense adjusted to include the realized gain/loss (i.e., the interest income/expense component) for all of our interest rate swaps and the impact of our foreign currency swaps and forwards.

The following table reconciles the Effective Cost of Funds (Non-GAAP financial measure) with interest expense for the years ended December 31, 2019, December 31, 2018 and December 31, 2017:

	Year ended December 31, 2019		Year ended December 31, 2018		Year ended December 31, 2017	
(dollars in thousands)	Reconciliation	Cost of Funds/Effective Borrowing Costs	Reconciliation	Cost of Funds/Effective Borrowing Costs	Reconciliation	Cost of Funds/Effective Borrowing Costs
Interest expense	\$ 150,274	3.48 %	\$ 138,240	3.19 %	\$ 48,373	1.94 %
<i>Adjustments:</i>						
Interest expense on Securitized debt from consolidated VIEs	(30,312)	(4.15)%	(42,440)	(4.43)%	(981)	(8.93)%
Net interest (received) paid — interest rate swaps	(9,501)	(0.22)%	(6,158)	(0.14)%	14,082	0.51 %
Effective Borrowing Costs	\$ 110,461	3.07 %	\$ 89,642	2.65 %	\$ 61,474	2.18 %
Weighted average borrowings	\$ 3,594,021		\$ 3,376,557		\$ 2,821,942	

Liquidity and Capital Resources

General

Liquidity is a measure of our ability to meet potential cash requirements, including ongoing commitments to repay borrowings, fund and maintain our assets and operations, make distributions to our stockholders, and other general business needs. To maintain our REIT qualifications under the Internal Revenue Code, we must distribute annually at least 90% of our taxable income, excluding capital gains and, such distributions requirements limit our ability to retain earnings and increase capital for operations. We believe that our significant capital resources and access to financing will provide us with financial flexibility at levels sufficient to meet current and anticipated capital requirements, including funding new investment opportunities, paying distributions to our stockholders and servicing our debt obligations.

Our liquidity and capital resources are managed on a daily basis to ensure that we have sufficient liquidity to absorb market events that could negatively impact collateral valuations and result in margin calls as well as to ensure that we have the flexibility to manage our investment portfolio to take advantage of market opportunities. As of December 31, 2019, our principal sources of cash consist of borrowings under repurchase agreements, payments of principal and interest on our investment portfolio and cash generated from operations and, if market conditions permit, secondary public stock offerings.

As part of our risk management process, our Manager closely monitors our liquidity position. This includes the development and evaluation of various alternative processes and procedures, which continue to be updated with regard to scenario testing for purposes of assessing our liquidity in the face of different economic and market developments. We believe we have sufficient current liquidity and access to additional liquidity to meet financial obligations for at least the next 12 months.

Sources of Liquidity

Principal Sources of Cash

We held cash of approximately \$31.3 million, \$22.0 million and \$48.0 million at December 31, 2019, December 31, 2018 and December 31, 2017, respectively. Our primary sources of cash currently consist of repurchase agreement borrowings, investment income, principal repayments on investments and the proceeds from debt and equity offerings, to the extent available in the capital markets. In the future, we expect our primary sources of liquidity to consist of payments of principal, investment income, unused borrowing capacity under our financing sources and future issuances of equity and debt securities.

Repurchase Agreements

As of December 31, 2019, we had 34 master repurchase agreements with our counterparties. We had borrowings under 21 of the 34 master repurchase agreements of approximately \$2.8 billion at December 31, 2019. The following table presents our repurchase agreement borrowings, by type of collateral pledged, as of December 31, 2019 and December 31, 2018, and the respective effective cost of funds (Non-GAAP financial measure) for the years ended December 31, 2019 and December 31, 2018, respectively. See "Non-GAAP Financial Measures" (dollars in thousands):

Collateral	Borrowings Outstanding	Value of Collateral Pledged	Weighted Average Interest Rate end of period	Weighted Average Cost of Funds	Weighted Average Effective Cost of Funds (Non-GAAP) ⁽¹⁾	Weighted Average Haircut end of period
December 31, 2019						
Agency CMBS, at fair value	\$ 1,352,248	\$ 1,400,230	2.05%	2.51%	2.51 %	5.13%
Agency RMBS, at fair value	348,274	356,687	1.99%	2.47%	2.47 %	5.35%
Non-Agency RMBS, at fair value	30,481	45,816	3.56%	3.93%	3.93 %	36.70%
Non-Agency CMBS, at fair value	190,390	246,797	3.05%	3.64%	3.64 %	22.46%
Residential Whole Loans, at fair value ⁽²⁾	476,172	529,495	3.32%	4.03%	4.03 %	7.88%
Residential Bridge Loans ⁽²⁾	29,869	34,897	3.93%	4.61%	4.61 %	20.00%
Commercial loans, at fair value ⁽²⁾	224,594	350,213	3.93%	4.71%	4.71 %	33.60%
Securitized commercial loan, at fair value ⁽²⁾	116,087	171,640	3.93%	3.61%	3.61 %	31.38%
Other securities, at fair value	56,762	80,031	3.23%	3.85%	3.85 %	28.30%
Interest rate swaps	n/a	n/a	n/a	n/a	(0.33)%	n/a
Total	\$ 2,824,877	\$ 3,215,806	2.61%	3.14%	2.81 %	11.11%
December 31, 2018						
Agency CMBS, at fair value	\$ 1,392,649	\$ 1,486,142	2.71%	2.06%	2.06 %	5.03%
Agency RMBS, at fair value	14,650	19,837	3.09%	2.00%	2.00 %	21.66%
Non-Agency RMBS, at fair value	30,922	50,555	4.06%	3.57%	3.57 %	35.21%
Non-Agency CMBS, at fair value	134,814	186,552	4.05%	3.69%	3.69 %	25.59%
Residential Whole Loans, at fair value ⁽²⁾	863,356	1,041,885	4.08%	4.01%	4.01 %	15.94%
Residential Bridge Loans ⁽²⁾	204,754	221,486	4.50%	4.50%	4.50 %	20.00%
Commercial loans, at fair value ⁽²⁾	131,788	196,123	4.55%	4.65%	4.65 %	35.00%
Securitized commercial loan, at fair value ⁽²⁾	7,543	13,688	4.30%	4.01%	4.01 %	45.00%
Other securities, at fair value	38,361	59,780	4.18%	3.81%	3.81 %	35.83%
Interest rate swaps	n/a	n/a	n/a	n/a	(0.19)%	n/a
Total	\$ 2,818,837	\$ 3,276,048	3.45%	2.66%	2.47 %	12.63%

(1) The effective cost of funds for the period presented is calculated on an annualized basis and includes interest expense for the period and net periodic interest payments on interest rate swaps, net of premium amortization on MAC swaps, of approximately \$9.5 million received and \$6.2 million received for the years ended December 31, 2019 and 2018, respectively. While interest rate swaps are not accounted for using hedge accounting, such instruments are viewed by us as an economic hedge against increases in interest rates on our liabilities and are treated as hedges for purposes of satisfying the REIT requirements. See "Non-GAAP Financial Measures."

(2) Repurchase agreement borrowings collateralized by Whole Loans, Bridge Loans and securitized commercial loans owned through trust certificates. The trust certificates are eliminated upon consolidation.

We are also required to pledge cash or securities as collateral as part of a margin arrangement for our derivative contracts, calculated daily, subject either to the terms of individual agreements for bilateral agreements and the clearinghouse rules in the case of cleared swaps. The amount of margin that we are required to post will vary and generally reflects collateral posted with respect to swaps that are in an unrealized loss position to us and a percentage of the aggregate notional amount of swaps per counterparty as well as margin posted with our clearing broker, pursuant to clearinghouse rules and practices, for cleared swaps. Conversely, if our bilateral swaps and swaptions are in an unrealized gain position, our counterparties are required to post collateral with us, under the same terms that we post collateral with them. We may enter into a MAC interest rate swap in which we may receive or make a payment at the time of entering such interest rate swap to compensate for the out of the market nature of such interest rate swap. Similar to all other interest rate swaps, these interest rate swaps are also subject to margin requirements.

Convertible Senior Unsecured Notes

In August 2019, we issued an additional \$40.0 million aggregate principal amount of 6.75% convertible senior unsecured notes (the "August 2019 Reopened Notes") for net proceeds of \$38.8 million. The August 2019 Reopened Notes have substantially identical terms as the existing notes issued in October 2017. The notes mature on October 1, 2022, unless earlier converted, redeemed or repurchased by the holders pursuant to their terms, and are not redeemable by us except during the final three months prior to maturity.

In December 2019, we issued an additional \$50.0 million aggregate principal amount of 6.75% convertible senior unsecured notes (the "December 2019 Reopened Notes") for net proceeds of \$49.2 million. The December 2019 Reopened Notes have substantially identical terms as the existing notes issued in October 2017. The notes mature on October 1, 2022, unless earlier converted, redeemed or repurchased by the holders pursuant to their terms, and are not redeemable by us except during the final three months prior to maturity.

At-The-Market Program

In April 2017, we entered into an equity distribution agreement with JMP Securities LLC, or "JMP," under which we may offer and sell up to \$100.0 million shares of common stock in an At-The-Market equity offering from time to time through JMP. During the year ended December 31, 2019, we sold 299,497 shares under this agreement for net proceeds of \$3.0 million.

Secondary Public Offering

In September 2018, we completed a secondary public offer in which we sold 6,500,000 shares of our common stock, including all 303,422 shares in treasury stock, at a price of \$10.85 per share, for net proceeds of approximately \$67.7 million after subtracting underwriting commissions and offering expenses of approximately \$2.8 million.

In May 2019, we completed a secondary public offering in which we sold 5,000,000 shares of our common stock at a price of \$10.14 per share, for net proceeds of approximately \$49.3 million after subtracting underwriting commissions and offering expenses of approximately \$1.4 million. We used the net proceeds from the offering to opportunistically invest in our target assets in accordance with our investment guidelines.

Securitized Debt

In May 2019, a wholly owned subsidiary completed a residential mortgage-backed securitization comprised of a portion of its Residential Whole Loan portfolio. RMI 2015 Trust and RNR Trust collectively transferred \$945.5 million of Non-QM Residential Whole Loans, to a wholly-owned subsidiary of the Company, Arroyo Mortgage Trust 2019-2 ("Arroyo Trust") and Arroyo Trust issued \$919.0 million of mortgage-backed notes and we retained the subordinate Non-Offered Securities. At December 31, 2019, Residential Whole Loans, with an outstanding principal balance of approximately \$814.0 million, serve as collateral for the Arroyo Trust's securitized debt.

The following table summarizes the consolidated Arroyo Trust's issued mortgage-backed notes at December 31, 2019 which is classified in "Securitized debt" in the Consolidated Balance Sheets (dollars in thousands):

Classes	Principal Balance	Coupon	Carrying Value	Contractual Maturity
Issued Mortgage-Backed Notes				
Class A-1	\$ 681,668	3.3%	\$ 681,666	4/25/2049
Class A-2	36,525	3.5%	36,524	4/25/2049
Class A-3	57,866	3.8%	57,864	4/25/2049
Class M-1	25,055	4.8%	25,055	4/25/2049
Subtotal	801,114		\$ 801,109	
Less: Unamortized deferred financing costs	N/A		5,298	
Total	\$ 801,114		\$ 795,811	

Cash Generated from Operations

For the year ended December 31, 2019, net cash used in operating activities was approximately \$52.2 million. This was primarily attributable to the net income we earned on our investments net of adjustments pertaining to the amortization/accretion of premiums and discounts and other non-cash items less operating expenses, general and administrative and margin settlements on our interest rate swaps. For the year ended December 31, 2018, net cash provided by operating activities was approximately \$107.1 million. This was primarily attributable to the net income we earned on our investments net of adjustments pertaining to the amortization/accretion of premiums and discounts and other non-cash items less operating expenses, general and administrative and margin settlements on our interest rate swaps. For the year ended December 31, 2017, net cash provided by operating activities was by approximately \$59.4 million. This was primarily attributable to the net income we earned on our investments net of adjustments pertaining to the amortization/accretion of premiums and discounts and other non-cash items less operating expenses, general and administrative and margin settlements on our interest rate swaps.

Cash Provided by and Used in Investing Activities

For the year ended December 31, 2019, net cash used in investing activities was approximately \$478.5 million. This was primarily attributable to our investment acquisitions, including an investment from a consolidated CMBS VIEs, which was partially offset by proceeds from sales and receipts of principal payments on our investments. For the year ended December 31, 2018, net cash used in investing activities was approximately \$716.9 million. This was primarily attributable to our investment acquisitions, including an investment from a consolidated CMBS VIE, which was partially offset by proceeds from sales of MBS and other securities and by our receipt of principal payments on MBS and other securities. For the year ended December 31, 2017, net cash used in investing activities was approximately \$1.2 billion. This was primarily attributable to our to our investment acquisitions, which was partially offset by proceeds from sales, and receipts of principal payments on our investments.

Cash Provided by and Used in Financing Activities

For the year ended December 31, 2019, net cash provided by financing was approximately \$537.2 million. This was primarily attributable to net proceeds from financings during the year and a secondary public offering. Our net cash provided by financing activities was partially offset by dividends paid on our common stock. For the year ended December 31, 2018, net cash provided by financing activity was approximately \$639.6 million. This was primarily attributable to net proceeds from financings during the year and a secondary public offering. Our net cash provided by financing activities was partially offset by dividends paid on our common stock. For the year ended December 31, 2017, net cash provided by financing activity was approximately \$1.1 billion. This was primarily attributable to net proceeds from financings during the year, which was partially offset by dividends paid on our common stock.

Contractual Obligations and Commitments

Our contractual obligations as of December 31, 2019 are as follows (dollars in thousands):

	Less than 1 year	1 to 3 years	3 to 5 years	More than 5 years	Total
Borrowings under repurchase agreements	\$ 2,472,651	\$ 142,348	\$ 209,878	\$ —	\$ 2,824,877
Contractual interest on repurchase agreements	30,255	19,408	5,433	—	55,096
Convertible senior unsecured notes	—	205,000	—	—	205,000
Contractual interest on convertible senior unsecured notes	13,838	27,675	—	—	41,513
Securitized debt ⁽²⁾	10,581	598,452	83,560	801,114	1,493,707
Contractual interest on securitized debt ⁽³⁾	52,810	67,920	62,912	678,487	862,129
Total: GAAP Basis - Excluding TBA - long positions	2,580,135	1,060,803	361,783	1,479,601	5,482,322
TBA—long positions	1,012,598	—	—	—	1,012,598
Total	\$ 3,592,733	\$ 1,060,803	\$ 361,783	\$ 1,479,601	\$ 6,494,920

- (1) The table above does not include amounts due under the Management Agreement (as defined herein) with our Manager, as those obligations do not have fixed and determinable payments.
- (2) The securitized debt is non-recourse to us and can only be settled with the loans that serve as collateral. The collateral for the securitized debt has a principal balance of \$1.8 billion. Assumes entire outstanding principal balance at December 31, 2019 is paid at maturity.
- (3) For variable rate debt, the one month LIBOR rate as of December 31, 2019 of 1.7% was used to calculate the contractual interest.

Management Agreement

On May 9, 2012, we entered into a management agreement (the "Management Agreement") with our Manager which describes the services to be provided by our Manager and compensation for such services. Our Manager is responsible for managing our operations, including: (i) performing all of our day-to-day functions; (ii) determining investment criteria in conjunction with our Board of Directors; (iii) sourcing, analyzing and executing investments, asset sales and financings; (iv) performing asset management duties; and (v) performing financial and accounting management, subject to the direction and oversight of our Board of Directors. Pursuant to the terms of the Management Agreement, our Manager is paid a management fee equal to 1.50% per annum of our stockholders' equity, (as defined in the Management Agreement), calculated and payable (in cash) quarterly in arrears. Refer to Note 10 - "Related Party Transactions" to our Consolidated Financial Statements included in Item 8 included in this annual report on Form 10-K.

Off-Balance Sheet Arrangements

We do not have any relationships with any entities or financial partnerships, such as entities often referred to as structured investment vehicles, or special purpose or variable interest entities, established to facilitate off-balance sheet arrangements or other contractually narrow or limited purposes.

Further, other than guaranteeing certain obligations of our wholly-owned taxable REIT subsidiary or TRS and the obligations of our wholly-owned subsidiary, WMC CRE LLC, we have not guaranteed any obligations of any entities or entered into any commitment to provide additional funding to any such entities.

Dividends

We intend to make regular quarterly dividend distributions to holders of our common stock. U.S. federal income tax law generally requires that a REIT distribute annually, in accordance with the REIT regulations, at least 90% of its REIT taxable income for the taxable year, without regard to the deduction for dividends paid and excluding net capital gains as well as undistributed taxable income retained by a TRS. To the extent that we distribute less than 100% of our net taxable income, in accordance with the REIT regulations, for any given year, we will pay tax on such amount at the regular corporate rates. We intend to pay regular quarterly dividends to our stockholders based on our net taxable income, if and to the extent authorized by our Board of Directors. Before we pay any dividend, whether for U.S. federal income tax purposes or otherwise, we must first meet both our operating requirements and debt service on our repurchase agreements and other debts payable. If our cash available for distribution is less than our net taxable income, we could be required to sell assets or borrow funds to make cash distributions or we may make a portion of the required distribution in the form of a taxable stock distribution or distribution of debt securities.

ITEM 7A. Quantitative and Qualitative Disclosures about Market Risk.

We seek to manage the risks related to the credit quality of our assets, interest rates, liquidity, prepayment speeds and market values while, at the same time, seeking to provide an opportunity to stockholders to realize attractive risk-adjusted returns from our assets through ownership of our common stock. While we do not seek to avoid risk completely, our Manager seeks to actively manage risk for us, to earn sufficient compensation to justify taking those risks and to maintain capital levels consistent with the risks we undertake.

Credit Risk

We are subject to varying degrees of credit risk in connection with our assets. Although we do not expect to encounter credit risk in our Agency CMBS and Agency RMBS, we are exposed to the risk of potential credit losses from general credit spread widening related to Non-Agency RMBS, Non-Agency CMBS, Residential Whole Loans, Residential Bridge Loans, Commercial Loans and other portfolio investments in addition to unexpected increase in borrower defaults on these investments. Investment decisions are made following a bottom-up credit analysis and specific relevant risk assumptions. As part of the risk management process, our Manager uses detailed proprietary models, applicable to evaluate, depending on the asset class, house price appreciation and depreciation by region, prepayment speeds and foreclosure/default frequency, cost and timing. If our Manager determines that the proposed investment can meet the appropriate risk and return criteria as well as complement our existing asset portfolio, the investment will undergo a more thorough analysis.

As of December 31, 2019, 16 of the counterparties that we had outstanding repurchase agreement borrowings held collateral which we posted as security for such borrowings in excess of 5% of our stockholders' equity. Prior to entering into a repurchase agreement with any particular institution, our Manager does a thorough review of such potential counterparty. Such review, however, does not assure the creditworthiness of such counterparty nor that the financial wherewithal of the counterparty will not deteriorate in the future.

Interest Rate Risk

Interest rates are highly sensitive to many factors, including fiscal and monetary policies and domestic and international economic and political considerations, as well as other factors beyond our control. We are subject to interest rate risk in connection with our assets and our related financing obligations. In general, we expect to finance the acquisition of our assets through financings in the form of repurchase agreements, warehouse facilities, securitizations, bank credit facilities (including term loans and revolving facilities) and public and private equity and debt issuances in addition to transaction or asset specific funding arrangements. Subject to maintaining our qualification as a REIT for U.S. federal income tax purposes, we may utilize derivative financial instruments to hedge the interest rate risk associated with our borrowings. These hedging activities may not be effective. We also may engage in a variety of interest rate management techniques that seek to mitigate changes in interest rates or other potential influences on the values of our assets.

Interest Rate Effect on Net Interest Income

Our operating results will depend in large part on differences between the income earned on our assets and our borrowing costs. The cost of our borrowings is generally based on prevailing market interest rates. During a period of rising interest rates, our borrowing costs generally will increase and the yields earned on our leveraged fixed-rate mortgage assets will remain static. Further, the cost of such financing could increase at a faster pace than the yields earned on our leveraged ARM and hybrid ARM assets. This could result in a decline in our net interest spread and net interest margin. The severity of any such decline would depend on our asset/liability composition at the time as well as the magnitude and duration of the interest rate increase. Further, an increase in short-term interest rates could also have a negative impact on the market value of our assets. If any of these events happen, we could experience a decrease in net income or incur a net loss during these periods, which could adversely affect our liquidity and results of operations.

Interest Rate Cap Risk

To the extent we invest in adjustable-rate RMBS and Whole-Loans, such instruments may be subject to interest rate caps, which potentially could cause such instruments to acquire many of the characteristics of fixed-rate securities if interest rates were to rise above the cap levels. This issue is magnified to the extent we acquire ARM and hybrid ARM assets that are not based on mortgages which are fully indexed. In addition, ARM and hybrid ARM assets may be subject to periodic payment caps that result in some portion of the interest being deferred and added to the principal outstanding or a portion of the incremental interest rate increase being deferred. To the extent we invest in such ARM and/or hybrid ARM assets, we could potentially receive less cash

income on such assets than we would need to pay the interest cost on our related borrowings. To mitigate interest rate mismatches, we may utilize the hedging strategies discussed above under “Interest Rate Risk.”

Interest Rate Effects on Fair value

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

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

Market Risk

Our MBS and other assets are reflected at their fair value with unrealized gains and losses included in earnings. The fair value of our investments fluctuates primarily due to changes in interest rates and other factors. Generally, in a rising interest rate environment, the fair value of these assets would be expected to decrease; conversely, in a decreasing interest rate environment, the fair value of these securities would be expected to increase.

The sensitivity analysis table presented below shows the estimated impact of an instantaneous parallel shift in the yield curve, up and down 50 and 100 basis points, on the market value of our interest rate-sensitive investments, including interest rate swaps, Interest-Only Strips, and net interest income at December 31, 2019, assuming a static portfolio of assets. When evaluating the impact of changes in interest rates, prepayment assumptions and principal reinvestment rates are adjusted based on our Manager’s expectations. The analysis presented utilizes our Manager’s assumptions, models and estimates, which are based on our Manager’s judgment and experience.

Change in Interest Rates	Percentage Change in Projected Net Interest Income	Percentage Change in Projected Portfolio Value
+1.00%	34.38%	(1.09)%
+0.50%	19.67%	(0.52)%
-0.50%	11.99%	0.48 %
-1.00%	28.52%	0.94 %

While the table above reflects the estimated immediate impact of interest rate increases and decreases on a static portfolio, we may rebalance our portfolio from time to time either to seek to take advantage of or reduce the impact of changes in interest rates. It is important to note that the impact of changing interest rates on market value and net interest income can change significantly when interest rates change beyond 100 basis points from current levels. Therefore, the volatility in the market value of our assets could increase significantly when interest rates change beyond amounts shown in the table above. In addition, other factors impact the market value of and net interest income from our interest rate-sensitive investments and derivative instruments, such as the shape of the yield curve, market expectations as to future interest rate changes and other market conditions. Accordingly, interest income would likely differ from that shown above and such difference might be material and adverse to our stockholders.

Certain assumptions have been made in connection with the calculation of the information 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. The base interest rate scenario assumes interest rates at December 31, 2019. The analysis presented utilizes assumptions and estimates based on our Manager’s judgment and experience. Furthermore, while we generally expect to retain such assets and the associated interest rate risk, future purchases and sales of assets could materially change our interest rate risk profile.

Prepayment Risk

The value of our Agency and Non-Agency RMBS and our Residential Whole Loans may be affected by prepayment rates on the underlying residential mortgage. We acquire RMBS and Residential Whole Loans and anticipate that the underlying residential mortgages will prepay at a projected rate generating an expected yield. If we purchase assets at a premium to par value, when borrowers prepay their residential mortgage loans faster than expected, the corresponding prepayments may reduce the

expected yield on our residential mortgage assets because we will have to amortize the related premium on an accelerated basis and, in the case of Agency RMBS, other than interest-only strips, and certain other investment grade rated securities, we are required to make a retrospective adjustment to historical amortization. Conversely, if we purchase assets at a discount to par value, when borrowers prepay their residential mortgage loans slower than expected, such decrease may reduce the expected yield on such assets because we will not be able to accrete the related discount as quickly as originally anticipated and, in the case of Agency RMBS, other than interest-only strips, and certain other investment grade rated securities, we will be required to make a retrospective adjustment to historical amortization.

The value of our Agency and Non-Agency CMBS, as well as Commercial Whole Loans, will also be affected by prepayment rates; however, commercial mortgages frequently limit the ability of the borrower to prepay, thereby providing a certain level of prepayment protection. Common restrictions include yield maintenance and prepayment penalties, the proceeds of which are generally at least partially allocable to these securities, as well as defeasance.

Likewise, the value of our ABS and other structured securities will also be affected prepayment rates. The collateral underlying such securities may, similar to most residential mortgages, allow the borrower to prepay at any time or, similar to commercial mortgages, limit the ability of the borrower to prepay by imposing lock-out provisions, prepayment penalties and/or make whole provisions.

Extension Risk

Most residential mortgage loans do not prohibit the partial or full prepayment of principal outstanding. Accordingly, while the stated maturity of a residential mortgage loan may be 30 years, or in some cases even longer, historically the vast majority of residential mortgage loans are satisfied prior to their maturity date. In periods of rising interest rates, borrowers have less incentive to refinance their existing mortgages and mortgage financing may not be as readily available. This generally results in a slower rate of prepayments and a corresponding longer weighted average life for RMBS and Residential Whole Loans. The increase, or extension, in weighted average life is commonly referred to as “Extension Risk” which can negatively impact our portfolio. To the extent we receive smaller pre-payments of principal, we will have less capital to invest in new assets. This is extremely detrimental in periods of rising interest rates as we will be unable to invest in new higher coupon investments and a larger portion of our portfolio will remain invested in lower coupon investments. Further, our borrowing costs are generally short-term and, even if hedged, are likely to increase in a rising interest rate environment, thereby reducing our net interest margin. Finally, to the extent we acquired securities at a discount to par, a portion of the overall return on such investments is based on the recovery of this discount. Slower principal prepayments will result in a longer recovery period and a lower overall return on our investment.

Prepayment rates on Agency and Non-Agency CMBS, as well as Commercial Whole Loans, are generally less volatile than residential mortgage assets as commercial mortgages usually limit the ability of the borrower to prepay the mortgage prior to maturity or a period shortly before maturity. Accordingly, extension risk for Agency and Non-Agency CMBS and Commercial Whole Loans is generally less than RMBS and Residential Whole Loans as it presumed that other than defaults (i.e., involuntary prepayments), most commercial mortgages will remain outstanding for the contractual term of the mortgage.

Prepayment rates on ABS and our other structured securities will be determined by the underlying collateral. The extension risk of such securities will generally be less than residential mortgages, but greater than commercial mortgages.

Real Estate Risk

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

Counterparty Risk

The following discussion on counterparty risk reflects how these transactions are structured, rather than how they are presented for financial reporting purposes.

When we engage in repurchase transactions, we generally sell securities to lenders (i.e., repurchase agreement counterparties) and receive cash from the lenders. The lenders are obligated to resell the same securities back to us at the end of

the term of the transaction. Because the cash we receive from the lender when we initially sell the securities to the lender is less than the value of those securities (this difference is the haircut), if the lender defaults on its obligation to resell the same securities back to us, we could incur a loss on the transaction up to the amount of the haircut (assuming there was no change in the value of the securities).

If a counterparty to a bi-lateral interest rate swap cannot perform under the terms of the interest rate swap, we may not receive payments due under that agreement, and thus, we may lose any unrealized gain associated with the interest rate swap. We may also risk the loss of any collateral we have pledged to secure our obligations under interest rate swap if the counterparty becomes insolvent or files for bankruptcy. In the case of a cleared swap, if our clearing broker were to default, become insolvent or file for bankruptcy, we may also risk the loss of any collateral we have posted to the clearing broker unless we were able to transfer or “port” our positions and held collateral to another clearing broker. In addition, the interest rate swap would no longer mitigate the impact of changes in interest rates as intended. Most of our interest swaps are currently cleared through a central clearing house which reduces but does not eliminate the aforementioned risks. Also see “Liquidity Risk” below.

Prior to entering into a trading agreement or transaction with any particular institution where we take on counterparty risk, our Manager does a thorough review of such potential counterparty. Such review, however, does not assure the creditworthiness of such counterparty nor that the financial wherewithal of the counterparty will not deteriorate in the future.

Funding Risk

We have financed a substantial majority of our assets with repurchase agreement financing. Over time, as market conditions change, in addition to these financings, we may use other forms of leverage. Changes in the regulatory environment, as well as, weakness in the financial markets, the residential mortgage markets, the commercial mortgage markets, the asset-backed securitization markets and the economy generally could adversely affect one or more of our potential lenders and could cause one or more of our potential lenders to be unwilling or unable to provide us with financing or to increase the costs of that financing.

Liquidity Risk

Our liquidity risk is principally associated with the financing of long-maturity assets with short-term borrowings in the form of repurchase agreements. Although the interest rate adjustments of these assets and liabilities fall within the guidelines established by our operating policies, maturities are not required to be, nor are they, matched.

Should the value of our assets pledged as collateral suddenly decrease, margin calls relating to our repurchase agreements could increase, causing an adverse change in our liquidity position. Our inability to post adequate collateral for a margin call by the counterparty could result in a condition of default under our repurchase agreements, thereby enabling the counterparty to liquidate the collateral pledged by us, which may have a material adverse consequence on our business and results of operations.

In an instance of severe volatility, or where the additional stress on liquidity resulting from volatility is sustained over an extended period of time, we could be required to sell securities, possibly even at a loss to generate sufficient liquidity to satisfy collateral and margin requirements which could have a material adverse effect on our financial position, results of operations and cash flows.

Additionally, if one or more of our repurchase agreement counterparties chose not to provide on-going funding, our ability to finance would decline or exist at possibly less advantageous terms. Further, if we are unable to renew, replace or expand repurchase financing with other sources of financing on substantially similar terms, it may have a material adverse effect on our business, financial position, results of operations and cash flows, due to the long-term nature of our investments and relatively short-term maturities of our repurchase agreements. As such, there is no assurance that we will always be able to roll over our repurchase agreements.

The costs associated with our borrowings are generally based on prevailing market interest rates. During a period of rising interest rates, our borrowing costs generally will increase while the yields earned on our existing portfolio of leveraged fixed-rate MBS and other fixed rate assets will remain static. Further, certain of our floating rate assets may contain annual or lifetime interest rate caps as well as limit the frequency or timing of changes to the underlying interest rate index. This could result in a decline in our net interest spread and net interest margin. The severity of any such decline would depend on our asset/liability composition at the time, as well as the magnitude and duration of the interest rate increase. Further, an increase in short-term interest rates could also have a negative impact on the market value of our assets. If any of these events happen, we could experience a decrease in net income or incur a net loss during these periods, which could have a material adverse effect on our liquidity and results of operations.

In addition, the assets that comprise our investment portfolio are not traded on a public exchange. A portion of these assets may be subject to legal and other restrictions on resale or will otherwise be less liquid than publicly traded securities. The illiquidity of our assets may make it difficult for us to sell such assets if the need or desire arises, including in response to changes in economic and other conditions. Recent regulatory changes have imposed new capital requirements and other restrictions on banks and other market intermediaries' ability and desire to hold assets on their balance sheets and otherwise make markets in fixed income securities and other assets resulting in reduced liquidity in many sectors of the market. This regulatory trend is expected to continue. As a result of these developments, it may become increasingly difficult for us to sell assets in the market, especially in credit oriented sectors such as Non-Agency RMBS and CMBS, ABS and Whole Loans.

We enter into interest rate swaps to manage our interest rate risk. We are required to pledge cash or securities as collateral as part of a margin arrangement, calculated daily, in connection with the interest rate swaps. The amount of margin that we are required to post will vary and generally reflects collateral required to be posted with respect to interest rate swaps that are in an unrealized loss position to us and is generally based on a percentage of the aggregate notional amount of interest rate swaps per counterparty. Margin calls could adversely affect our liquidity. Our inability to post adequate collateral for a margin call could result in a condition of default under our interest rate swap agreements, thereby resulting in liquidation of the collateral pledged by us, which may have a material adverse consequence on our business, financial position, results of operations and cash flows. Conversely, if our interest rate swaps are in an unrealized gain position, our counterparties to bilateral swaps are required to post collateral with us, under the same terms that we post collateral with them. We generally enter into a MAC interest rate swap in which we receive or make a payment at the time of entering such interest rate swap to compensate for the out of the market nature of such interest rate swap. Similar to all other interest rate swaps, MAC interest rate swaps are subject to the margin requirements previously described.

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 directly correlate with inflation rates or changes in inflation rates. Our consolidated financial statements are prepared in accordance with GAAP and our distributions will be determined by our Board of Directors consistent with our obligation to distribute to our stockholders at least 90% of our net taxable income on an annual basis, in accordance with the REIT regulations, in order to maintain our REIT qualification. In each case, our activities and consolidated balance sheets are measured with reference to historical cost and/or fair market value without considering inflation.

Foreign Investment risk

We have invested in non U.S. CMBS transactions and, in the future, we may make other investments in non U.S. issuers and transactions. These investments present certain unique risks, including those resulting from future political, legal, and economic developments, which could include favorable or unfavorable changes in currency exchange rates, exchange control regulations (including currency blockage), expropriation, nationalization, or confiscatory taxation of assets, adverse changes in investment capital or exchange control regulations (which may include suspension of the ability to transfer currency from a country), political changes, diplomatic developments, difficulty in obtaining and enforcing judgments against non U.S. entities, the possible imposition of the applicable country's governmental laws or restrictions, and the reduced availability of public information concerning issuers. In the event of a nationalization, expropriation, or other confiscation of assets, we could lose our entire investment in a security. Legal remedies available to investors in certain jurisdictions may be more limited than those available to investors in the United States. Issuers of non U.S. securities may not be subject to the same degree of regulation as U.S. issuers.

Furthermore, non U.S. issuers are not generally subject to uniform accounting, auditing, and financial reporting standards or other regulatory practices and requirements comparable to those applicable to U.S. issuers. There is generally less government supervision and regulation of non U.S. exchanges, brokers, and issuers than there is in the United States, and there is greater difficulty in taking appropriate legal action in non U.S. courts. There are also special tax considerations that apply to securities of non U.S. issuers and securities principally traded overseas.

To the extent that our investments are denominated in U.S. dollars, these investments are not affected directly by changes in currency exchange rates relative to the dollar and exchange control regulations. We are, however, subject to currency risk with respect to such investments to the extent that a decline in a non U.S. issuer's or borrower's own currency relative to the dollar may impair such issuer's or borrower's ability to make timely payments of principal and/or interest on a loan or other debt security. To the extent that our investments are in non-dollar denominated securities, the value of the investment and the net investment income available for distribution may be affected favorably or unfavorably by changes in currency exchange rates relative to the dollar and exchange control regulations.

Currency exchange rates can be volatile and affected by, among other factors, the general economics of a country, the actions of governments or central banks and the imposition of currency controls and speculation. In addition, a security may be denominated in a currency that is different from the currency where the issuer is domiciled.

Currency Risk

We have and may continue in the future to invest in assets which are denominated in a currency other than U.S. dollars and may finance such investments with repurchase financing or other forms of financing which may also be denominated in a currency other than U.S. dollars. To the extent we make such investments and/or enter into such financing arrangements, we may utilize foreign currency swaps, forwards or other derivative instruments to hedge our exposure to foreign currency risk. Despite being economic hedges, we have elected not to treat such derivative instruments as hedges for accounting purposes and therefore the changes in the value of such instruments, including actual and accrued payments, will be included in our Consolidated Statements of Operations. While such transactions are entered into in an effort to minimize our foreign currency risk, there can be no assurance that they will perform as expected. If actual prepayments of the foreign denominated asset are faster, or slower, than expected, the hedge instrument is unlikely to fully protect us from changes in the valuation of such foreign currency. Further, as with interest rate swaps, there is counterparty risk associated with the future creditworthiness of such counterparty.

Item 8. Financial Statements and Supplementary Data.

Index to Financial Statements

Report of Independent Registered Public Accounting Firm	75
Consolidated Balance Sheets as of December 31, 2019 and 2018	77
Consolidated Statement of Operations for the years ended December 31, 2019, December 31, 2018 and December 31, 2017	79
Consolidated Statement of Changes in Stockholders' Equity for the years ended December 31, 2019, December 31, 2018 and December 31, 2017	80
Consolidated Statement of Cash Flow for the years ended December 31, 2019, December 31, 2018 and December 31, 2017	81
Notes to Consolidated Financial Statements	84

Index to Financial Statement Schedules

Schedule IV—Mortgage Loans on Real Estate	137
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Financial Statements Schedules other than the one listed above are omitted because the required information is not applicable or deemed not material, or the required information is presented in the financial statements and/or in the notes to financial statements.

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of Western Asset Mortgage Capital Corporation:

Opinions on the Financial Statements and Internal Control over Financial Reporting

We have audited the accompanying consolidated balance sheets of Western Asset Mortgage Capital Corporation and its subsidiaries (the “Company”) as of December 31, 2019 and 2018, and the related consolidated statements of operations, changes in stockholders’ equity, and cash flows for each of the three years in the period ended December 31, 2019, including the related notes and accompanying schedule of mortgage loans on real estate as of December 31, 2019 (collectively referred to as the “consolidated financial statements”). We also have audited the Company’s internal control over financial reporting as of December 31, 2019, based on criteria established in *Internal Control - Integrated Framework* (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2019 and 2018, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2019 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2019, based on criteria established in *Internal Control - Integrated Framework* (2013) issued by the COSO.

Basis for Opinions

The Company’s management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in Management’s Report on Internal Control over Financial Reporting appearing under Item 9A. Our responsibility is to express opinions on the Company’s consolidated financial statements and on the Company’s internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the consolidated financial statements included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

Definition and Limitations of Internal Control over Financial Reporting

A company’s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company’s internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company’s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PricewaterhouseCoopers, LLP

Los Angeles, California
March 6, 2020

We have served as the Company’s auditor since 2011.

Western Asset Mortgage Capital Corporation and Subsidiaries

Consolidated Balance Sheets

(in thousands—except share and per share data)

	December 31, 2019	December 31, 2018
Assets:		
Cash and cash equivalents	\$ 31,331	\$ 21,987
Restricted cash	52,948	55,808
Agency mortgage-backed securities, at fair value (\$1,756,917 and \$1,505,979 pledged as collateral, at fair value, respectively)	1,795,255	1,505,979
Non-Agency mortgage-backed securities, at fair value (\$292,613 and \$237,107 pledged as collateral, at fair value, respectively)	361,833	250,856
Other securities, at fair value (\$80,031 and \$59,780 pledged as collateral, at fair value, respectively)	80,161	59,906
Residential Whole-Loans, at fair value (\$1,375,860 and \$1,041,885 pledged as collateral, at fair value, respectively)	1,375,860	1,041,885
Residential Bridge Loans (\$33,269 and \$211,999 at fair value and \$34,897 and \$221,486 pledged as collateral, respectively)	36,419	221,719
Securitized commercial loans, at fair value	909,040	1,013,511
Commercial Loans, at fair value (\$350,213 and \$196,123 pledged as collateral, at fair value, respectively)	370,213	216,123
Investment related receivable	19,931	42,945
Interest receivable	19,413	21,959
Due from counterparties	98,947	39,623
Derivative assets, at fair value	5,111	2,606
Other assets	4,509	2,488
Total Assets⁽¹⁾	\$ 5,160,971	\$ 4,497,395
Liabilities and Stockholders' Equity:		
Liabilities:		
Repurchase agreements, net	\$ 2,824,801	\$ 2,818,837
Convertible senior unsecured notes, net	197,299	110,060
Securitized debt, net (\$681,643 and \$949,626 at fair value and \$142,905 and \$246,802 held by affiliates, respectively)	1,477,454	949,626
Interest payable (includes \$647 and \$816 on securitized debt held by affiliates, respectively)	15,001	8,532
Due to counterparties	709	17,781
Derivative liability, at fair value	6,370	10,130
Accounts payable and accrued expenses	3,188	3,858
Payable to affiliate	2,148	4,615
Dividend payable	16,592	14,916
Other liabilities	52,948	56,031
Total Liabilities⁽²⁾	4,596,510	3,994,386
Commitments and contingencies		
Stockholders' Equity:		
Common stock, \$0.01 par value, 500,000,000 shares authorized, and 53,523,876 and 48,116,379 outstanding, respectively	535	481
Preferred stock, \$0.01 par value, 100,000,000 shares authorized and no shares outstanding	—	—
Additional paid-in capital	889,227	833,810
Retained earnings (accumulated deficit)	(325,301)	(331,282)
Total Stockholders' Equity	564,461	503,009
Total Liabilities and Stockholders' Equity	\$ 5,160,971	\$ 4,497,395

See notes to consolidated financial statements.

Western Asset Mortgage Capital Corporation and Subsidiaries

Consolidated Balance Sheets

(in thousands—except share and per share data)

(1) Assets of consolidated VIEs included in the total assets above:

	December 31, 2019	December 31, 2018
Cash and cash equivalents	\$ 7,589	\$ 674
Restricted cash	52,948	55,808
Residential Whole-Loans, at fair value (\$1,375,860 and \$1,041,885 pledged as collateral, at fair value, respectively)	1,375,860	1,041,885
Residential Bridge Loans (\$31,748 and \$211,766 at fair value and \$34,897 and \$221,486 pledged as collateral, respectively)	34,897	221,486
Securitized commercial loans, at fair value	909,040	1,013,511
Commercial Loans, at fair value (\$90,788 and \$196,123 pledged as collateral, respectively)	90,788	196,123
Investment related receivable	19,138	42,945
Interest receivable	10,829	15,540
Other assets	90	178
Total assets of consolidated VIEs	\$ 2,501,179	\$ 2,588,150

(2) Liabilities of consolidated VIEs included in the total liabilities above:

Securitized debt, net (\$681,643 and \$949,626 at fair value and \$142,905 and \$246,802 held by affiliates, respectively)	\$ 1,477,454	\$ 949,626
Interest payable (includes \$647 and \$816 on securitized debt held by affiliates, respectively)	3,886	2,419
Accounts payable and accrued expenses	185	708
Other liabilities	52,948	56,033
Total liabilities of consolidated VIEs	\$ 1,534,473	\$ 1,008,786

See notes to consolidated financial statements.

Western Asset Mortgage Capital Corporation and Subsidiaries

Consolidated Statements of Operations

(in thousands—except share and per share data)

	For the years ended December 31,		
	2019	2018	2017
Net Interest Income			
Interest income	\$ 217,264	\$ 209,362	\$ 124,291
Interest expense (includes \$5,674, \$13,739 and \$981 on securitized debt held by affiliates, respectively)	150,274	138,240	48,373
Net Interest Income	66,990	71,122	75,918
Other Income (Loss)			
Realized gain (loss) on sale of investments, net	28,278	(63,257)	20,598
Other than temporary impairment	(8,574)	(11,180)	(22,873)
Unrealized gain (loss), net	107,529	(24,671)	28,396
Gain (loss) on derivative instruments, net	(103,727)	77,969	3,292
Other, net	2,204	(189)	1,031
Other Income (Loss)	25,710	(21,328)	30,444
Expenses			
Management fee to affiliate	7,354	8,673	8,100
Other operating expenses	5,519	6,076	2,419
General and administrative expenses:			
Compensation expense	2,591	2,186	2,692
Professional fees	3,980	4,299	3,242
Other general and administrative expenses	1,500	1,442	1,325
Total general and administrative expenses	8,071	7,927	7,259
Total Expenses	20,944	22,676	17,778
Income before income taxes	71,756	27,118	88,584
Income tax provision	1,057	709	3,487
Net income	\$ 70,699	\$ 26,409	\$ 85,097
Net income per Common Share — Basic	\$ 1.37	\$ 0.61	\$ 2.03
Net income per Common Share — Diluted	\$ 1.37	\$ 0.61	\$ 2.03

See notes to consolidated financial statements.

Western Asset Mortgage Capital Corporation and Subsidiaries

Consolidated Statements of Changes in Stockholders' Equity

(in thousands—except shares and share data)

	Common Stock Outstanding		Additional Paid-In Capital	Retained Earnings (Accumulated) Deficit	Treasury Stock	Total
	Shares	Par				
Balance at December 31, 2016	41,919,801	\$ 419	\$ 765,042	\$ (334,979)	\$ —	\$ 430,482
Vesting of restricted stock	—	—	981	—	—	981
Equity component of convertible senior unsecured notes	—	—	2,656	—	—	2,656
Treasury Stock	(125,722)	—	—	—	(1,232)	(1,232)
Net income	—	—	—	85,097	—	85,097
Dividends on common stock	—	—	84	(52,030)	—	(51,946)
Balance at December 31, 2017	41,794,079	419	768,763	(301,912)	(1,232)	466,038
Net proceeds from public offerings of common stock	6,196,578	62	64,818	—	—	64,880
Offering costs,	—	—	(373)	—	—	(373)
Vesting of restricted stock	—	—	265	—	—	265
Treasury Stock	125,722	—	213	—	1,232	1,445
Net income	—	—	—	26,409	—	26,409
Dividends on common stock	—	—	124	(55,779)	—	(55,655)
Balance at December 31, 2018	48,116,379	481	833,810	(331,282)	—	503,009
Net proceeds from public offerings of common stock	5,299,497	53	52,661	—	—	52,714
Offering costs	—	—	(430)	—	—	(430)
Grants of restricted stock	108,000	1	(1)	—	—	—
Vesting of restricted stock	—	—	564	—	—	564
Equity component of convertible senior unsecured notes	—	—	2,445	—	—	2,445
Net income	—	—	—	70,699	—	70,699
Dividends on common stock	—	—	178	(64,718)	—	(64,540)
Balance at December 31, 2019	53,523,876	\$ 535	\$ 889,227	\$ (325,301)	\$ —	\$ 564,461

See notes to consolidated financial statements.

Western Asset Mortgage Capital Corporation and Subsidiaries

Consolidated Statements of Cash Flows

(in thousands)

	For the year ended December 31,		
	2019	2018	2017
Cash flows from operating activities:			
Net income	\$ 70,699	\$ 26,409	\$ 85,097
Adjustments to reconcile net income to net cash (used in) provided by operating activities:			
Premium amortization and (discount accretion), net	7,398	5,374	(2,070)
Interest income earned added to principal of securities	—	—	(46)
Amortization of deferred financing costs	1,488	767	192
Amortization of discount on convertible senior unsecured notes	718	550	137
Restricted stock amortization	564	265	981
Interest payments and basis recovered on MAC interest rate swaps	5,772	2,465	525
Premium on purchase of Residential Whole Loans	(15,304)	(15,850)	(1,239)
Premium on purchase of Residential Bridge Loans	—	(3,889)	(753)
Premium on purchase of securitized commercial loans	(3,769)	(3,019)	—
Unrealized (gain) loss, net	(107,529)	24,671	(28,396)
Unrealized (gain) loss on derivative instruments, net	(9,390)	10,381	(148,308)
Other than temporary impairment	8,574	11,180	22,873
Realized loss on sale of real estate owned ("REO"), net	90	—	—
Realized (gain) loss on sale of investments, net	(28,368)	63,257	(20,598)
(Gain) loss on derivatives, net	9,631	(10,316)	156,076
Loss on foreign currency transactions, net	—	—	1
Changes in operating assets and liabilities:			
Decrease (increase) in interest receivable	2,546	(8,356)	5,209
Decrease (increase) in other assets	1,157	(184)	(1,763)
Increase (decrease) in interest payable	6,469	210	(7,719)
(Decrease) increase in accounts payable and accrued expenses	(519)	563	(274)
(Decrease) increase in payable to related party	(2,467)	2,574	(543)
Net cash (used in) provided by operating activities	(52,240)	107,052	59,382
Cash flows from investing activities:			
Purchase of securities	(1,581,485)	(1,128,399)	(2,881,276)
Proceeds from sale of securities	1,136,617	2,430,054	1,593,914
Principal repayments and basis recovered on securities	126,091	123,837	240,785
Proceeds from sale of REO	1,033	—	—
Purchase of Residential Whole Loans	(563,821)	(873,911)	(87,640)
Principal repayments on Residential Whole Loans	254,125	76,942	42,176
Purchase of commercial loans	(350,232)	(235,857)	—
Principal repayments on commercial loans	197,245	20,638	—
Purchase of securitized commercial loans	(1,109,461)	(1,350,000)	—
Principal repayments on securitized commercial loans	1,214,688	361,781	154
Purchase of Residential Bridge Loans	—	(418,953)	(142,913)
Principal repayments on Residential Bridge Loans	211,316	274,964	31,794
Payment of premium for option derivatives	(780)	(1,757)	(16,355)
Premium received from option derivatives	2,158	1,236	14,553
Premium for credit default swaps, net	3,885	(297)	74
Net settlements of TBAs	1,934	(800)	4,035

See notes to consolidated financial statements.

Western Asset Mortgage Capital Corporation and Subsidiaries

Consolidated Statements of Cash Flows (Continued)

(in thousands)

	For the year ended December 31,		
	2019	2018	2017
Proceeds from (Payments on) termination of futures, net	(12,862)	6,112	(9,130)
Due from counterparties, net	(2,850)	—	8,449
Payments on total return swaps	—	—	(552)
Interest payments and basis recovered on MAC interest rate swaps	(5,772)	(2,465)	(525)
Premium for interest rate swaptions, net	(332)	—	(115)
Net cash used in investing activities	(478,503)	(716,875)	(1,202,572)
Cash flows from financing activities:			
Net proceeds from issuance of common stock	52,714	64,880	—
Payment of offering costs	(580)	(195)	(94)
Repurchase of common stock	—	(1,733)	(1,094)
Proceeds from sale of treasury stock	—	3,177	—
Proceeds from repurchase agreement borrowings	21,381,571	21,472,963	18,438,166
Proceeds from convertible note offering	90,625	—	115,000
Repayments of repurchase agreement borrowings	(21,375,531)	(21,905,812)	(17,342,124)
Proceeds from securitized debt	1,828,361	1,285,219	—
Repayments of securitized debt	(1,292,141)	(344,612)	(68)
Proceeds from forward contracts	—	—	8,246
Repayments of forward contracts	—	—	(8,214)
Payments made for deferred financing costs	(8,522)	—	(3,837)
Due from counterparties, net	(56,474)	47,307	(9,707)
Due to counterparties, net	(17,072)	16,291	750
Increase (decrease) in other liabilities, net	(2,860)	55,808	—
Dividends paid on common stock	(62,864)	(53,699)	(51,981)
Net cash provided by financing activities	537,227	639,594	1,145,043
Effect of exchange rate changes on cash and cash equivalents	—	—	(1)
Net increase in cash and cash equivalents	6,484	29,771	1,852
Cash, cash equivalents and restricted cash, beginning of period	77,795	48,024	46,172
Cash, cash equivalents and restricted cash, end of period	\$ 84,279	\$ 77,795	\$ 48,024
Supplemental disclosure of operating cash flow information:			
Interest paid	\$ 144,987	\$ 138,524	\$ 43,032
Income taxes paid	\$ 549	\$ 1,635	\$ 4,966
Supplemental disclosure of non-cash financing/investing activities:			
Underwriting and offering costs payable	\$ 27	\$ 177	\$ —
Repurchase of common stock, not settled	\$ —	\$ —	\$ (137)
Securities purchased, not settled	\$ —	\$ —	\$ (17,217)
Derivative collateral offset against derivatives	\$ —	\$ —	\$ (157,913)
Dividends and distributions declared, not paid	\$ 16,592	\$ 14,916	\$ 12,960

See notes to consolidated financial statements.

Western Asset Mortgage Capital Corporation and Subsidiaries

Consolidated Statements of Cash Flows (Continued)

(in thousands)

	For the year ended December 31,		
	2019	2018	2017
Principal payments of Residential Whole Loans, not settled	\$ 17,254	\$ 9,230	\$ 2,286
Principal payments of Residential Bridge Loans, not settled	\$ 1,949	\$ 33,717	\$ 5,381
Other assets - Transfer of Bridge Loans to REO	\$ 5,029	\$ 143	\$ —
Proceeds from sale of REO, not settled	\$ 728	\$ —	\$ —
Reconciliation of cash, cash equivalents and restricted cash reported in the Consolidated Balance Sheets:			
Cash and cash equivalents	\$ 31,331	\$ 21,987	\$ 48,024
Restricted cash	52,948	55,808	—
Total cash, cash equivalents and restricted cash shown in the Consolidated Statements of Cash Flows	\$ 84,279	\$ 77,795	\$ 48,024

See notes to consolidated financial statements.

Western Asset Mortgage Capital Corporation and Subsidiaries

Notes to Consolidated Financial Statements

(in thousands—except share and per share data)

The following defines certain of the commonly used terms in these Notes to Consolidated Financial Statements: "Agency" or "Agencies" refer to a federally chartered corporation, such as the Federal National Mortgage Association ("Fannie Mae" or "FNMA") or the Federal Home Loan Mortgage Corporation ("Freddie Mac" or "FHLMC"), or an agency of the U.S. Government, such as the Government National Mortgage Association ("Ginnie Mae" or "GNMA"); references to "MBS" refer to mortgage backed securities, including residential mortgage-backed securities or "RMBS," commercial mortgage-backed securities or "CMBS," and "Interest-Only Strips" (as defined herein); "Agency MBS" refer to RMBS, CMBS and Interest-Only Strips issued or guaranteed by the Agencies while "Non-Agency MBS" refer to RMBS, CMBS and Interest-Only Strips that are not issued or guaranteed by the Agencies; references to "ARMs" refers to adjustable rate mortgages; references to "Interest-Only Strips" refer to interest-only ("IO") and inverse interest-only ("IIO") securities issued as part of or collateralized with MBS; references to "TBA" refer to To-Be-Announced Securities; references to "Residential Whole Loans," "Residential Bridge Loans" and "Commercial Loans" (collectively "Whole Loans") refer to individual mortgage loans secured by single family, multi-family and commercial properties.

Note 1—Organization

Western Asset Mortgage Capital Corporation, a Delaware corporation, and its subsidiaries (the "Company") commenced operations in May 2012. The Company invests in, finances and manages a diversified portfolio of real estate related securities, Whole Loans and other financial assets. The Company's portfolio is comprised of Agency CMBS, Agency RMBS (including TBAs), Non-Agency RMBS, Non-Agency CMBS, Non-Qualified Residential Whole Loans ("Non-QM"), Conforming Residential Whole Loans, Residential Bridge Loans and Commercial Loans. In addition, and to a significantly lesser extent, the Company has invested in other securities including certain Agency obligations that are not technically MBS as well as certain Non U.S. CMBS and in asset-backed securities ("ABS") investments secured by a portfolio of private student loans. The Company's investment strategy is based on Western Asset Management Company, LLC's (the "Manager") perspective of which mix of portfolio assets it believes provides the Company with the best risk-reward opportunities at any given time. The Manager will vary the allocation among various asset classes subject to maintaining the Company's qualification as a REIT and maintaining its exemption from the Investment Company Act of 1940, as amended (the "1940 Act"). These restrictions limit the Company's ability to invest in non-qualifying MBS, non-real estate assets and/or assets which are not secured by real estate. Accordingly, the Company's portfolio will continue to be principally invested in qualifying MBS, Whole Loans and other real estate related assets.

The Company is externally managed by the Manager, an investment advisor registered with the Securities and Exchange Commission ("SEC"). The Manager is a wholly-owned subsidiary of Legg Mason, Inc ("Legg Mason"). The Company operates and has elected to be taxed as a real estate investment trust or "REIT" commencing with its taxable year ended December 31, 2012.

Note 2—Basis of Presentation and Summary of Significant Accounting Policies

Basis of Presentation and Consolidation

The accompanying financial statements and related notes have been prepared in conformity with generally accepted accounting principles in the United States of America ("GAAP"). The consolidated financial statements include the accounts of the Company, its wholly -owned subsidiaries and variable interest entities ("VIEs") in which it is considered the primary beneficiary. All intercompany amounts between the Company and its subsidiaries and consolidated VIEs have been eliminated in consolidation.

Variable Interest Entities

VIEs are defined as entities that by design either lack sufficient equity for the entity to finance its activities without additional subordinated financial support or are unable to direct the entity's activities or are not exposed to the entity's losses or entitled to its residual returns. The Company evaluates all of its interests in VIEs for consolidation. When the interests are determined to be variable interests, the Company assesses whether it is deemed the primary beneficiary. The primary beneficiary of a VIE is determined to be the party that has both the power to direct the activities of a VIE that most significantly impact the VIE's economic performance and the obligation to absorb losses or the right to receive benefits of the VIE that could potentially be significant to the VIE.

To assess whether the Company has the power to direct the activities of a VIE that most significantly impact the VIE's economic performance, it considers all facts and circumstances, including its role in establishing the VIE and its ongoing rights and responsibilities. This assessment includes: first, identifying the activities that most significantly impact the VIE's economic performance; and second, identifying which party, if any, has power over those activities. In general, the parties that make the

Western Asset Mortgage Capital Corporation and Subsidiaries**Notes to Consolidated Financial Statements (Continued)****(in thousands—except share and per share data)**

most significant decisions affecting the VIE or have the right to unilaterally remove those decision makers is deemed to have the power to direct the activities of a VIE.

To assess whether the Company has the obligation to absorb losses of the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE, it considers all of its economic interests. This assessment requires the Company to apply judgment in determining whether these interests, in the aggregate, are considered potentially significant to the VIE. Factors considered in assessing significance include: the design of the VIE, including its capitalization structure; subordination of interests; payment priority; relative share of interests held across various classes within the VIE's capital structure; and the reasons why the interests are held by the Company.

In instances where the Company and its related parties have variable interests in a VIE, the Company considers whether there is a single party in the related party group that meets both the power and losses or benefits criteria on its own as though no related party relationship existed. If one party within the related party group meets both these criteria, such reporting entity is the primary beneficiary of the VIE and no further analysis is needed. If no party within the related party group on its own meets both the power and losses or benefits criteria, but the related party group as a whole meets these two criteria, the determination of primary beneficiary within the related party group requires significant judgment. The analysis is based upon qualitative as well as quantitative factors, such as the relationship of the VIE to each of the members of the related-party group, as well as the significance of the VIE's activities to those members, with the objective of determining which party is most closely associated with the VIE.

Ongoing assessments of whether an enterprise is the primary beneficiary of a VIE are required.

Use of Estimates

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

Earnings (Loss) Per Share

GAAP requires use of the two-class method in computing earnings per share for all periods presented for each class of common stock and participating securities as if all earnings for the period had been distributed. Under the two-class method, during periods of net income, the net income is first reduced for dividends declared on all classes of securities to arrive at undistributed earnings. During periods of net losses, the net loss is reduced for dividends declared on participating securities only if the security has the right to participate in the earnings of the entity and an objectively determinable contractual obligation to share in net losses of the entity. The Company's participating securities are not allocated a share of the net loss, as the participating securities do not have a contractual obligation to share in the net losses of the Company.

The remaining earnings are allocated to common stockholders and participating securities, to the extent that each security shares in earnings, as if all of the earnings for the period had been distributed. Each total is then divided by the applicable number of weighted average outstanding common shares to arrive at basic earnings per share. For the diluted earnings, the denominator includes the weighted average outstanding common shares and all potential common shares assumed issued if they are dilutive. The numerator is adjusted for any changes in income or loss that would result from the assumed conversion of these potential common shares.

Offering Costs

Offering costs borne by the Company in connection with common stock offerings and private placements are reflected as a reduction of additional paid-in-capital. Offering costs borne by the Company in connection with its shelf registration will be deferred and recorded in "Other assets" until such time the Company completes a common stock offering where all or a portion will be reclassified and reflected as a reduction of additional paid-in-capital. The deferred offering costs will be expensed upon the expiration of the shelf if the Company does not complete an equity offering.

Cash and Cash Equivalents

Western Asset Mortgage Capital Corporation and Subsidiaries**Notes to Consolidated Financial Statements (Continued)****(in thousands—except share and per share data)**

The Company considers all highly liquid short-term investments with original maturities of 90 days or less when purchased to be cash equivalents. Cash and cash equivalents are exposed to concentrations of credit risk. The Company places its cash and cash equivalents with what it believes to be high credit quality institutions. At times such investments may be in excess of the Federal Deposit Insurance Corporation insurance limit.

Restricted Cash

Restricted cash represents cash held by the trustee or servicer for mortgage escrows in connection with the Company's securitized loan and commercial loan investments held in its consolidated VIEs. These escrows consist of principal and interest escrows, capital improvement reserves, repair reserves, real estate tax and insurance reserves and tenant reserves. The corresponding liability is recorded in "Other liabilities" in the Consolidated Balance Sheets. The restricted cash is not available for general corporate use.

Valuation of Financial Instruments

The Company discloses the fair value of its financial instruments according to a fair value hierarchy (Levels I, II, and III, as defined below). ASC 820, "Fair Value Measurement and Disclosures" establishes a framework for measuring fair value and expands financial statement disclosure requirements for fair value measurements. ASC 820 further specifies a hierarchy of valuation techniques, which is based on whether the inputs into the valuation technique are observable or unobservable. The hierarchy is as follows:

Level I — Quoted prices in active markets for identical assets or liabilities.

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

Level III — Prices are determined using significant unobservable inputs. In situations where quoted prices or observable inputs are unavailable, for example, when there is little or no market activity for an investment at the end of the period, unobservable inputs may be used.

The level in the fair value hierarchy within which a fair value measurement in its entirety falls is based on the lowest level input that is significant to the fair value measurement in its entirety. Transfers between levels are determined by the Company at the end of the reporting period. Refer to Note 3 - "Fair Value of Financial Instruments."

Mortgage-Backed Securities and Other Securities

The Company's mortgage-backed securities and other securities portfolio primarily consists of Agency CMBS, Non-Agency CMBS, Agency RMBS, Non-Agency RMBS, ABS and other real estate related securities, these investments are recorded in accordance with ASC 320, "Investments - Debt and Equity Securities" and ASC 325-40, "Beneficial Interests in Securitized Financial Assets." The Company has chosen to elect the fair value option pursuant to ASC 825, "Financial Instruments" for its mortgage-backed securities and other securities portfolio. Electing the fair value option allows the Company to record changes in fair value in the Consolidated Statements of Operations as a component of "Unrealized gain (loss), net."

If the Company purchases securities with evidence of credit deterioration, it will analyze to determine if the guidance found in ASC 310-30, "Loans and Debt Securities Acquired with Deteriorated Credit Quality" is applicable.

The Company evaluates securities for other-than-temporary impairment ("OTTI") on at least a quarterly basis. The determination of whether a security is other-than-temporarily impaired involves judgments, estimates and assumptions based on subjective and objective factors. As a result, the timing and amount of an OTTI constitutes an accounting estimate that may change materially over time.

When the fair value of an investment security is less than its amortized cost at the balance sheet date, the security is considered impaired, and the impairment is designated as either "temporary" or "other-than-temporary." When a security is impaired, an OTTI is considered to have occurred if (i) the Company intends to sell the security (i.e., a decision has been made as

Western Asset Mortgage Capital Corporation and Subsidiaries**Notes to Consolidated Financial Statements (Continued)****(in thousands—except share and per share data)**

of the reporting date) or (ii) it is more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis. If the Company intends to sell the security or if it is more likely than not that the Company will be required to sell the real estate security before recovery of its amortized cost basis, the entire amount of the impairment loss, if any, is recognized in earnings as OTTI and the cost basis of the security is adjusted to its fair value. Additionally, for securities accounted for under ASC 325-40 an OTTI is deemed to have occurred when there is an adverse change in the expected cash flows to be received and the fair value of the security is less than its carrying amount. In determining whether an adverse change in cash flows occurred, the present value of the remaining cash flows, as estimated at the initial transaction date (or the last date previously revised), is compared to the present value of the expected cash flows at the current reporting date. The estimated cash flows reflect those a “market participant” would use and are discounted at a rate equal to the current yield used to accrete interest income. Any resulting OTTI adjustments are reflected in the “Other than temporary impairment” in the Consolidated Statements of Operations.

Increases in interest income may be recognized on a security in which the Company previously recorded an OTTI charge if the cash flow of such security subsequently improves.

In addition, unrealized losses on the Company's Agency securities, with explicit guarantee of principal and interest by the governmental sponsored entity (“GSE”), are not credit losses but rather were due to changes in interest rates and prepayment expectations. These securities would not be considered other than temporarily impaired provided the Company did not intend to sell the security.

Residential Whole Loans

Investments in Residential Whole Loans are recorded in accordance with ASC 310-20, “Nonrefundable Fees and Other Costs.” The Company has chosen to elect the fair value option pursuant to ASC 825 for our entire Residential Whole-Loan portfolio. Residential Whole Loans are recorded at fair value with periodic changes in fair market value being recorded in earnings as a component of “Unrealized gain (loss), net.” All other costs incurred in connection with acquiring Residential Whole Loans or committing to purchase these loans are charged to expense as incurred.

On a quarterly basis, the Company evaluates the collectability of both interest and principal of each loan, if circumstances warrant, to determine whether such loan is impaired. A loan is impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the existing contractual terms. When a loan is impaired, the Company does not record an allowance for loan loss as it has elected the fair value option. However, income recognition is suspended for loans at the earlier of the date at which payments become 90-days past due or when, in the opinion of management, a full recovery of income and principal becomes doubtful. When the ultimate collectability of the principal of an impaired loan is in doubt, all payments are applied to principal under the cost recovery method. When the ultimate collectability of the principal of an impaired loan is not in doubt, contractual interest is recorded as interest income when received, under the cash basis method until an accrual is resumed when the loan becomes contractually current and performance is demonstrated.

Residential Bridge Loans

For the Bridge Loans acquired prior to October 25, 2017, the Company did not elect the fair value option pursuant to ASC 825. These loans are recorded at their principal amount outstanding, net of any premium or discount. Commencing with purchases on October 25, 2017, the Company decided to elect the fair value option pursuant to ASC 825 to be consistent with the accounting of its' other investments, which are all carried at fair value. These loans are recorded at fair value with periodic changes in fair market value being recorded in earnings as a component of “Unrealized gain (loss), net.” All other costs incurred in connection with acquiring the Residential Bridge Loans or committing to purchase these loans are charged to expense as incurred.

A loan is impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the existing contractual terms. The Company evaluates each of its Residential Bridge Loans on a quarterly basis. These loans are individually specific as they relate to the borrower, collateral type, interest rate, LTV and term as well as geographic location. The Company evaluates the collectability of both principal and interest of each loan. When a loan is impaired, the impairment is then measured based on fair value of the collateral less cost to sell, since these loans are collateral dependent. For loans the Company did not elect the fair value option, upon measurement of impairment, the Company records an allowance to reduce the carrying value of the loan with a corresponding charge to earnings. Significant judgments are required in determining impairment, including assumptions regarding the value of the loan, the value of the underlying collateral and other

Western Asset Mortgage Capital Corporation and Subsidiaries**Notes to Consolidated Financial Statements (Continued)****(in thousands—except share and per share data)**

provisions such as guarantees. The Company will not record an allowance for loan loss for the Residential Bridge Loans that it has elected the fair value option.

Income recognition is suspended for loans at the earlier of the date at which payments become 90-days past due or when, in the opinion of management, a full recovery of income and principal becomes doubtful. When the ultimate collectability of the principal of an impaired loan is in doubt, all payments are applied to principal under the cost recovery method. When the ultimate collectability of the principal of an impaired loan is not in doubt, contractual interest is recorded as interest income when received, under the cash basis method until an accrual is resumed when the loan becomes contractually current and performance is demonstrated.

Securitized Commercial Loans

Securitized commercial loans are comprised of commercial loans of consolidated variable interest entities which were sponsored by third parties. These loans are recorded in accordance with ASC 310-20, "Nonrefundable Fees and Other Costs." The Company has chosen to elect the fair value option pursuant to ASC 825. Accordingly, these loans are recorded at fair value with periodic changes in fair value being recorded in earnings as a component of "Unrealized gain (loss), net."

The securitized commercial loans are typically collateralized by commercial real estate. As a result, the Company regularly evaluates the extent and impact of any credit migration associated with the performance and/or value of the underlying collateral property as well as the financial and operating capability of the borrower on a loan by loan basis. On a quarterly basis, the Company evaluates the collectability of both interest and principal of each loan, if circumstances warrant, to determine whether such loan is impaired. A loan is impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the existing contractual terms. When a loan is impaired, the Company does not record an allowance for loan loss as the Company has elected the fair value option. However, income recognition is suspended for loans at the earlier of the date at which payments become 90-days past due or when, in the opinion of management, a full recovery of income and principal becomes doubtful. When the ultimate collectability of the principal of an impaired loan is in doubt, all payments are applied to principal under the cost recovery method. When the ultimate collectability of the principal of an impaired loan is not in doubt, contractual interest is recorded as interest income when received, under the cash basis method until an accrual is resumed. Interest income accrual is resumed when the loan becomes contractually current and performance is demonstrated.

Commercial Loans

Investments in Commercial Loans, which are comprised of first lien commercial mortgage loans and commercial mezzanine loans, are recorded in accordance with ASC 310-20, "Nonrefundable Fees and Other Costs." The Company has chosen to make the fair value election pursuant to ASC 825 for its Commercial Loan portfolio. Accordingly, these loans are recorded at fair value with periodic changes in fair value being recorded in earnings as a component of "Unrealized gain (loss), net." All other costs incurred in connection with acquiring the Commercial Loans or committing to purchase these loans are charged to expense as incurred.

The Company's loans are typically collateralized by commercial real estate. As a result, the Company regularly evaluates the extent and impact of any credit migration associated with the performance and or value of the underlying collateral property as well as the financial and operating capability of the borrower on a loan by loan basis. On a quarterly basis, the Company evaluates the collectability of both interest and principal of each loan, if circumstances warrant, to determine whether such loan is impaired. A loan is impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the existing contractual terms. When a loan is impaired, the Company does not record an allowance for loan loss as the Company has elected the fair value option. However, income recognition is suspended for loans at the earlier of the date at which payments become 90-days past due or when, in the opinion of management, a full recovery of income and principal becomes doubtful. When the ultimate collectability of the principal of an impaired loan is in doubt, all payments are applied to principal under the cost recovery method. When the ultimate collectability of the principal of an impaired loan is not in doubt, contractual interest is recorded as interest income when received, under the cash basis method until an accrual is resumed. Interest income accrual is resumed when the loan becomes contractually current and performance is demonstrated.

Interest Income Recognition

Agency MBS, Non-Agency MBS and other securities, excluding Interest-Only Strips, rated AA and higher at the time of purchase

Western Asset Mortgage Capital Corporation and Subsidiaries**Notes to Consolidated Financial Statements (Continued)****(in thousands—except share and per share data)**

Interest income on mortgage-backed and other securities is accrued based on the respective outstanding principal balances and corresponding contractual terms. The Company records interest income in accordance with ASC subtopic 835-30 "Imputation of Interest," using the effective interest method. As such premiums and discounts associated with Agency MBS, Non-Agency MBS and other securities, excluding Interest-Only Strips, are amortized into interest income over the estimated life of such securities. Adjustments to premium and discount amortization are made for actual prepayment activity. The Company estimates prepayments at least quarterly for its securities and, as a result, if the projected prepayment speed increases, the Company will accelerate the rate of amortization on premiums or discounts and make a retrospective adjustment to historical amortization. Alternatively, if projected prepayment speeds decrease, the Company will reduce the rate of amortization on the premiums or discounts and make a retrospective adjustment to historical amortization.

Non-Agency MBS and other securities that are rated below AA at the time of purchase and Interest-Only Strips that are not classified as derivatives

Interest income on Non-Agency MBS and other securities that are rated below AA at the time of purchase and Interest-Only Strips that are not classified as derivatives are also recognized in accordance with ASC 835, using the effective yield method. The effective yield on these securities is based on the projected cash flows from each security, which is estimated based on the Company's observation of the then current information and events, where applicable, and will include assumptions related to interest rates, prepayment rates and the timing and amount of credit losses. On at least a quarterly basis, the Company reviews and, if appropriate, makes adjustments to its cash flow projections based on input and analysis received from external sources, internal models, and its judgment about interest rates, prepayment rates, the timing and amount of credit losses, and other factors. Changes in cash flows from those originally projected, or from those estimated at the last evaluation, may result in a prospective change in the yield/interest income recognized on such securities. Actual maturities of the securities are affected by the contractual lives of the underlying collateral, periodic payments of scheduled principal, and prepayments of principal. Therefore, actual maturities of the securities will generally be shorter than stated contractual maturities.

Based on the projected cash flow of such securities purchased at a discount to par value, the Company may designate a portion of such purchase discount as credit protection against future credit losses and, therefore, not accrete such amount into interest income. The amount designated as credit discount may be adjusted over time, based on the actual performance of the security, its underlying collateral, actual and projected cash flow from such collateral, economic conditions and other factors. If the performance of a security with a credit discount is more favorable than forecasted, a portion of the amount designated as credit discount may be accreted into interest income prospectively.

Loan Portfolio

Interest income on the Company's residential loan portfolio and commercial loan portfolio is recorded using the effective interest method based on the contractual payment terms of the loan. Any premium amortization or discount accretion will be reflected as a component of "Interest income" in the Consolidated Statements of Operations.

Purchases and Sales of Investments

The Company accounts for a contract for the purchase or sale of securities, or other securities that do not yet exist on a trade date basis, which it intends to take possession and thus recognizes the acquisition or disposition of the securities at the inception of the contract.

Sales of investments are driven by the Company's portfolio management process. The Company seeks to mitigate risks including those associated with prepayments and will opportunistically rotate the portfolio into securities and/or other investments the Company's Manager believes have more favorable attributes. Strategies may also be employed to manage net capital gains, which need to be distributed for tax purposes. Realized gains or losses on sales of investments, including Agency Interest-Only Strips not characterized as derivatives, are a component of "Realized gain (loss) on sale of investments, net" in the Consolidated Statements of Operations, and are recorded at the time of disposition. Realized gains or losses on Interest-Only Strips which are characterized as derivatives are a component of "Gain (loss) on derivative instruments, net" in the Consolidated Statements of Operations.

Western Asset Mortgage Capital Corporation and Subsidiaries**Notes to Consolidated Financial Statements (Continued)****(in thousands—except share and per share data)*****Due From Counterparties / Due To Counterparties***

"Due from counterparties" represents cash posted by the Company with its counterparties as collateral for the Company's interest rate and/or futures contracts, repurchase agreements, and TBAs. "Due to counterparties" represents cash posted with the Company by its counterparties as collateral under the Company's interest rate and/or currency derivative financial instruments, repurchase agreements, and TBAs. Included in "Due from counterparties" and/or "Due to counterparties" are daily variation margin settlement amounts with counterparties which are based on the price movement of the Company's futures contracts. Daily variation margin on only the Company's centrally cleared derivatives was treated as a settlement and classified as either "Derivative assets, at fair value" or "Derivative liability, at fair value" in the Consolidated Balance Sheets. In addition, as provided below, "Due to counterparties" may include non-cash collateral in which the Company has the obligation to return and which the Company has either sold or pledged. To the extent the Company receives collateral other than cash from its counterparties, such assets are not included in the Company's Consolidated Balance Sheets. Notwithstanding the foregoing, if the Company either rehypothecates such assets or pledges the assets as collateral pursuant to a repurchase agreement, the cash received and the corresponding liability are reflected in the Consolidated Balance Sheets.

Derivatives and Hedging Activities

Subject to maintaining its qualification as a REIT for U.S. federal income tax purposes, the Company as part of its hedging strategy, we may enter into interest rate swaps, including forward starting swaps, interest rate swaptions, U.S. Treasury options, Eurodollar, Volatility Index and U.S. Treasury futures, TBAs, total return swaps, credit default swaps and forwards to hedge the interest rate and currency risk associated with its portfolio and related borrowings. Derivatives, subject to REIT requirements, are used for hedging purposes rather than speculation. The Company has also entered into a total return swap, which transfers the total return of the referenced security to the Company. The Company determines the fair value of its derivative positions and obtains quotations from third parties, including the Chicago Mercantile Exchange or CME, to facilitate the process of determining such fair values. The Company does not necessarily seek to hedge all such risks. In addition, if the Company's hedging activities do not achieve the desired results, reported earnings may be adversely affected.

GAAP requires an entity to recognize all derivatives as either assets or liabilities on the balance sheet and to measure those instruments at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative. The fair value adjustment will affect either other comprehensive income in stockholders' equity until the hedged item is recognized in earnings or net income depending on whether the derivative instrument is designated and qualifies as a hedge for accounting purposes and if so, the nature of the hedging activity. The Company elected not to apply hedge accounting for its derivative instruments. Accordingly, the Company records the change in fair value of its derivative instruments, which includes net interest rate swap payments/receipts (including accrued amounts) and net currency payments/receipts (including accrued amounts) related to interest rate swaps and currency swaps, respectively, in "Gain (loss) on derivative instruments, net" in its Consolidated Statements of Operations.

In January 2017, the CME amended its rulebooks to legally characterize variation margin payments and receipts for over-the-counter derivatives they clear as settlements of the derivatives' exposure rather than collateral against exposure. As a result of the change in legal characterization, effective January 1, 2017, variation margin is no longer classified as collateral in the Consolidated Balance Sheets in either "Due from counterparties" or "Due to counterparties," but rather a component of the respective "Derivative asset, at fair value" or "Derivative liability, at fair value" in the Consolidated Balance Sheets. The variation margin is now considered partial settlements of the derivative contract and will result in realized gains or losses which prior to January 1, 2017 were classified as unrealized gains or losses on derivatives. Prior to the CME rulebook change variation margin was included in financing activities in the Company's Consolidated Statement of Cash Flows in either "Due from counterparties, net" or "Due to counterparties, net." Commencing in January 2017, cash postings for variation margin are included in operating activities in the Consolidated Statements of Cash Flows.

In the Company's Consolidated Statements of Cash Flows, premiums received or paid on termination of its interest rate swaps are included in cash flows from operating activities. Notwithstanding the foregoing, proceeds and payments on settlement of swaptions, futures contracts and TBAs are included in cash flows from investing activities. Proceeds and payments on settlement of forward contracts are reflected in cash flows from financing activities in the Company's Consolidated Statements of Cash Flows. For Agency and Non-Agency Interest-Only Strips accounted for as derivatives, the purchase, sale and recovery of basis activity is included with MBS and other securities under cash flows from investing activities in the Company's Consolidated Statements of Cash Flows.

Western Asset Mortgage Capital Corporation and Subsidiaries**Notes to Consolidated Financial Statements (Continued)****(in thousands—except share and per share data)**

The Company evaluates the terms and conditions of its holdings of Agency and Non-Agency Interest-Only Strips, interest rate swaptions, currency forwards, futures contracts and TBAs to determine if these instruments have the characteristics of an investment or should be considered a derivative under GAAP. In determining the classification of its holdings of Interest-Only Strips, the Company evaluates the securities to determine if the nature of the cash flows have been altered from that of the underlying mortgage collateral. Interest-Only Strips, for which the underlying mortgage collateral has been included into a structured security that alters the cash flows from the underlying mortgage collateral, are accounted for as derivatives. The carrying value of the Agency and Non-Agency Interest-Only Strips, accounted for as derivatives, is included in "Mortgage-backed securities and other securities, at fair value" in the Consolidated Balance Sheets. The carrying value of interest rate swaptions, currency forwards, futures contracts and TBAs is included in "Derivative assets, at fair value" or "Derivative liability, at fair value" in the Consolidated Balance Sheets. Interest earned or paid along with the change in fair value of these instruments accounted for as derivatives is recorded in "Gain (loss) on derivative instruments, net" in its Consolidated Statements of Operations.

The Company evaluates all of its financial instruments to determine if such instruments are derivatives or contain features that qualify as embedded derivatives. An embedded derivative is separated from the host contract and accounted for separately when all of the guidance criteria are met. Hybrid instruments that are remeasured at fair value through earnings, including the fair value option are not bifurcated. Derivative instruments, including derivative instruments accounted for as liabilities, are recorded at fair value and are re-valued at each reporting date, with changes in the fair value together with interest earned or paid (including accrued amounts) reported in "Gain (loss) on derivative instruments, net" in the Consolidated Statements of Operations.

Repurchase Agreements and Reverse Repurchase Agreements

Investments sold under repurchase agreements are treated as collateralized financing transactions, unless they meet all the criteria for sales treatment. Securities financed through a repurchase agreement remain in the Company's Consolidated Balance Sheets as assets and cash received from the lender is recorded in the Company's Consolidated Balance Sheets as a liability. Interest payable in accordance with repurchase agreements is recorded as "Accrued interest payable" in the Consolidated Balance Sheets. Interest paid (including accrued amounts) in accordance with repurchase agreements is recorded as interest expense.

The Company may borrow securities under reverse repurchase agreements to deliver a security owned and sold by the Company but pledged to a different counterparty under a separate repurchase agreement when in the Manager's view terminating the outstanding repurchase agreement is not in the Company's best interest. Cash paid to the borrower is recorded in the Company's Consolidated Balance Sheets as an asset. Interest receivable in accordance with reverse repurchase agreements is recorded as accrued interest receivable in the Consolidated Balance Sheets. The Company reflects all proceeds on reverse repurchase agreement and repayment of reverse repurchase agreement, on a net basis in the Consolidated Statements of Cash Flows. Upon sale of a pledged security, the Company recognizes an obligation to return the borrowed security in the Consolidated Balance Sheet in "Due to counterparties." The Company establishes haircuts to ensure the market value of the underlying asset remains sufficient to protect the Company in the event of default by the counterparty. Realized gains and losses associated with the sale of the security are recognized in "Realized gain (loss) on sale of investments, net" in the Consolidated Statements of Cash Flows.

Convertible Senior Unsecured Notes

Convertible senior unsecured notes include unsecured convertible debt that is carried at its unpaid principal balance, net of any unamortized deferred issuance costs, in the Company's Consolidated Balance Sheets. Interest on the notes is payable semiannually until such time the notes mature or are converted into shares of the Company's common stock. ASC 470-20 "Debt-Debt with Conversion and Other Options" requires that convertible debt instruments with cash settlement features, including partial cash settlement, account for the liability component and equity component (conversion feature) of the instrument separately. The initial value of the liability component will reflect the present value of the discounted cash flows using the nonconvertible debt borrowing rate at the time of issuance. The debt discount represents the difference between the proceeds received from the issuance and the initial carrying value of the liability component, which is accreted back to the notes principal amount through interest expense over the life of the notes.

Western Asset Mortgage Capital Corporation and Subsidiaries**Notes to Consolidated Financial Statements (Continued)****(in thousands—except share and per share data)*****Share-based Compensation***

Compensation cost related to restricted common stock issued to the Company's independent directors, including any restricted stock which is subject to a deferred compensation program, is measured at its fair value at the grant date and amortized into expense over the service period on a straight-line basis. Compensation cost related to restricted common stock issued to the Manager and to employees of the Manager, including officers and certain directors, of the Company who are employees of the Manager and its affiliates, is initially measured at fair value at the grant date, and amortized into expense over the vesting period on a straight-line basis.

Income Taxes

The Company operates and has elected to be taxed as a REIT commencing with its taxable year ended December 31, 2012. Accordingly, the Company will generally not be subject to corporate U.S. federal or state income tax to the extent that the Company makes qualifying distributions to stockholders, and provided that 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, the Company 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 failure to qualify as a REIT could have a material adverse impact in the Company's results of operations and amounts available for distribution to stockholders.

As a REIT, if the Company fails to distribute in any calendar year (subject to specific timing rules for certain dividends paid in January) at least the sum of (i) 85% of its ordinary income for such year, (ii) 95% of its capital gain net income for such year, and (iii) any undistributed taxable income from the prior year, the Company would be subject to a non-deductible 4% excise tax on the excess of such required distribution over the sum of (i) the amounts actually distributed and (ii) the amounts of income retained and on which the Company has paid corporate income tax.

The dividends paid deduction for qualifying dividends paid to stockholders is computed using the Company's taxable income as opposed to net income reported in the Consolidated Statements of Operations. Taxable income, generally, will differ from net income reported in the Consolidated Statements of Operations because the determination of taxable income is based on tax regulations and not GAAP.

From time to time the Company may create and elect to treat certain 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 domestic TRS is subject to U.S. federal, state and local corporate income taxes, and its value, along with all other TRS's, may not exceed 20% of the value of the Company. If the TRS generates net income it may declare dividends to the Company, which will be included in the Company's taxable income and necessitate a distribution to its stockholders. Conversely, if the Company retains earnings at the TRS level, no distribution is required and it can increase book equity of the consolidated entity. As of December 31, 2019, the Company has a single wholly-owned subsidiary which it has elected to treat as a domestic TRS.

Current and deferred taxes are recorded on earnings (losses) recognized by the Company's TRS. Deferred income tax assets and liabilities are calculated based upon temporary differences between the Company's U.S. GAAP consolidated financial statements and the federal and state basis of assets and liabilities as of the Consolidated Balance Sheet date. The Company evaluates the realizability of its deferred tax assets and recognizes a valuation allowance if, based on available evidence, it is more likely than not that some or all of its deferred tax assets will not be realized. In evaluating the realizability of the deferred tax asset, the Company will consider the expected future taxable income, existing and projected book to tax differences as well as tax planning strategies. This analysis is inherently subjective, as it is based on forecasted earning and business and economic activity. Changes in estimates of deferred tax asset realizability, if any, are included in "Income tax provision (benefit)" in the Consolidated Statements of Operations.

Comprehensive Income (Loss)

The Company has none of the components of comprehensive income (loss) and therefore comprehensive income (loss) is not presented.

Western Asset Mortgage Capital Corporation and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

(in thousands—except share and per share data)

Recently adopted accounting pronouncements

Description	Adoption Date	Effect on Financial Statements
In July 2017, the FASB issued ASU 2017-11, "Earnings Per Share (Topic 260), Distinguishing Liabilities from Equity (Topic 480), Derivative and Hedges (Topic 815): Part I - Accounting for Certain Financial Instruments with Down Round Features and Part II - Replacement of the Indefinite Deferral for Mandatory Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatory Redeemable Noncontrolling Interest with a Scope Exception." Part I of this update changes the classification analysis of certain financial instruments (such as warrants and convertible instruments) with down round features. Down round features are features of certain equity-linked financial instruments (or embedded features) that result in the strike price being reduced on the basis of the pricing of future equity offerings. When determining whether certain financial instruments should be classified as liabilities or equity instruments, a down round feature no longer precludes equity classification when assessing whether the instrument is indexed to an entity's own stock. Entities that present earnings per share are required to recognize the effect of the down round feature when it is triggered. The amendments in Part II of this update recharacterize the indefinite deferral of certain provisions of Topic 480 that now are presented as pending content in the Codification, to a scope exception. Those amendments do not have an accounting effect.	First quarter 2019.	The adoption of this standard did not have a material impact on the Company's consolidated financial statements.
In June 2018, the FASB issued ASU 2018-07, "Compensation-Stock Compensation (Topic 718), Improvements to Nonemployee Share-Based Payment Accounting." The amendments in this update expand the scope of Topic 718 to include share-based payment transactions for acquiring goods and services from nonemployees.	First quarter 2019.	The adoption of this standard did not have a material impact on the Copompany's consolidated financial statements.
In July 2018, the FASB issued ASU 2018-09, "Codification Improvements." The amendments in this update affect a wide variety of Topics in the Codification including derivatives and hedging, stock compensation-income taxes, distinguishing liabilities from equity, debt modification and extinguishment, reporting comprehensive income, business combinations-income taxes, financial services and Plan accounting.	First quarter 2019.	The adoption of this standard did not have a material impact on the Company's consolidated financial statements.

Western Asset Mortgage Capital Corporation and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

(in thousands—except share and per share data)

Recently issued accounting pronouncements

Description	Effective Date	Effect on Financial Statements
In June 2016, the FASB issued ASU 2016-13, "Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments." This standard significantly changes how an entity will measure credit losses for most financial assets and certain other instruments that aren't measured at fair value through the income statement. The standard will replace the current "incurred loss" approach with an "expected loss" model for instruments measured at amortized cost. For available for sale debt securities, entities will be required to record an allowance rather than reduce the carrying amount, as is currently done under the other than temporary impairment model. It also simplifies the accounting model for purchased credit impaired debt securities and loans. In November 2018, the FASB issued ASU 2018-19, "Codification Improvements to Topic 326, Financial Instruments-Credit Losses." This update was issued related to ASU 2016-13 to increase the stakeholders' awareness of the amendments to scope and transition and effective date requirements and to expedite the improvements. In November 2019, the FASB issued ASU 2019-11, "Codification Improvements to Topic 326, Financial Instruments-Credit Losses." The amendments in this update clarify or address stakeholders' specific issues about certain aspects of the amendments in Update 2016-13.	First quarter 2020.	The Company evaluated the impact this standard will have on its consolidated financial statements. However, since the Company elects the fair value option for its financial assets, the adoption of this guidance will not have a material impact on its consolidated financial statements.
In August 2018, the FASB issued ASU 2018-13, "Fair Value Measurement (Topic 820), Disclosure Framework-Changes to the Disclosure Requirements for Fair Value Measurement." The amendments in this update modify the disclosure requirements on fair value measurements including the consideration of costs and benefits.	First quarter 2020.	The Company evaluated the impact this standard will have on its consolidated financial statements and the adoption will not have a material impact on its consolidated financial statements.
In April 2019, the FASB issued ASU 2019-04, "Codification Improvements to Topic 326, Financial Instruments-Credit Losses, Topic 815, Derivatives and Hedging, and Topic 825, Financial Instruments." The amendments in this update represent changes to clarify, correct errors in, or improve the Codification. The amendments should make the Codification easier to understand and easier to apply by eliminating inconsistencies and providing clarification.	First quarter 2020.	The Company evaluated the impact this standard will have on its consolidated financial statements and the adoption will not have a material impact on its consolidated financial statements.
In May 2019, the FASB issued ASU 2019-05, "Financial Instruments-Credit Losses (Topic 326)." The amendments in this Update provide entities that have certain instruments within the scope of Subtopic 326-20 with an option to irrevocably elect the fair value option in the Subtopic 825-10, Financial Instruments-Overall, upon adoption of Topic 326. An entity that elects the fair value option should subsequently apply the guidance in Subtopic 820-10, Fair Value Measurement-Overall, and 825-10.	First quarter 2020.	The Company evaluated the impact this standard will have on its consolidated financial statements and the adoption will not have a material impact on its consolidated financial statements.
In January 2020, the FASB issued ASU 2020-01, "Investments-Equity Securities (Topic 321), Investment-Equity Method and Joint Ventures (Topic 323, and Derivatives and Hedging (Topic 815)." The amendments in this Update clarify the interaction of the accounting for equity securities under Topic 321 and investments accounted for under the equity method of accounting in Topic 323 and the accounting for certain forward contracts and purchase options accounted for under Topic 815.	First quarter 2021.	The Company is evaluating the impact this standard may have on its consolidated financial statements.

Note 3—Fair Value of Financial Instruments

The following tables present the Company's financial instruments carried at fair value as of December 31, 2019 and December 31, 2018, based upon the valuation hierarchy (dollars in thousands):

Assets	December 31, 2019			
	Fair Value			
	Level I	Level II	Level III	Total
Agency CMBS	\$ —	\$ 1,435,477	\$ —	\$ 1,435,477
Agency CMBS Interest-Only Strips accounted for as derivatives, included in MBS	—	3,092	—	3,092
Agency RMBS	—	340,771	—	340,771
Agency RMBS Interest-Only Strips	—	—	10,343	10,343
Agency RMBS Interest-Only Strips accounted for as derivatives, included in MBS	—	—	5,572	5,572
Subtotal Agency MBS	—	1,779,340	15,915	1,795,255
Non-Agency RMBS	—	—	38,131	38,131
Non-Agency RMBS Interest-Only Strips	—	—	7,683	7,683
Non-Agency CMBS	—	316,019	—	316,019
Subtotal Non-Agency MBS	—	316,019	45,814	361,833
Other securities	—	62,965	17,196	80,161
Total mortgage-backed securities and other securities	—	2,158,324	78,925	2,237,249
Residential Whole Loans	—	—	1,375,860	1,375,860
Residential Bridge Loans	—	—	33,269	33,269
Commercial loans	—	—	370,213	370,213
Securitized commercial loans	—	—	909,040	909,040
Derivative assets	—	5,111	—	5,111
Total Assets	\$ —	\$ 2,163,435	\$ 2,767,307	\$ 4,930,742
Liabilities				
Derivative liabilities	\$ —	\$ 6,370	\$ —	\$ 6,370
Securitized debt	—	680,586	1,057	681,643
Total Liabilities	\$ —	\$ 686,956	\$ 1,057	\$ 688,013

	December 31, 2018			
	Fair Value			
	Level I	Level II	Level III	Total
Assets				
Agency CMBS	\$ —	\$ 1,481,984	\$ —	\$ 1,481,984
Agency CMBS Interest-Only Strips accounted for as derivatives, included in MBS	—	4,158	—	4,158
Agency RMBS Interest-Only Strips	—	—	12,135	12,135
Agency RMBS Interest-Only Strips accounted for as derivatives, included in MBS	—	—	7,702	7,702
Subtotal Agency MBS	—	1,486,142	19,837	1,505,979
Non-Agency RMBS	—	—	39,026	39,026
Non-Agency RMBS Interest-Only Strips	—	—	11,529	11,529
Non-Agency CMBS	—	200,301	—	200,301
Subtotal Non-Agency MBS	—	200,301	50,555	250,856
Other securities	—	50,955	8,951	59,906
Total mortgage-backed securities and other securities	—	1,737,398	79,343	1,816,741
Residential Whole Loans	—	—	1,041,885	1,041,885
Residential Bridge Loans	—	—	211,999	211,999
Commercial loans	—	—	216,123	216,123
Securitized commercial loan	—	—	1,013,511	1,013,511
Derivative assets	—	2,606	—	2,606
Total Assets	\$ —	\$ 1,740,004	\$ 2,562,861	\$ 4,302,865
Liabilities				
Derivative liabilities	\$ 4,657	\$ 5,473	\$ —	\$ 10,130
Securitized debt	—	947,340	2,286	949,626
Total Liabilities	\$ 4,657	\$ 952,813	\$ 2,286	\$ 959,756

When available, the Company uses quoted market prices to determine the fair value of an asset or liability. If quoted market prices are not available, the Company will use independent pricing services and if the independent pricing service cannot price a particular asset or liability, the Company will obtain third party broker quotes. The Manager's pricing group, which functions independently from its portfolio management personnel, reviews the third party broker quotes by comparing the broker quotes for reasonableness to alternate sources when available. If independent pricing services or third party broker quotes are not available, the Company determines the fair value of the securities using valuation techniques that use, when possible, current market-based or independently sourced market parameters, such as interest rates and when applicable, estimates of prepayments and credit losses.

In instances when the Company is required to consolidate a VIE that is determined to be a qualifying collateralized financing entity ("CFE"), under GAAP and the Company has elected the fair value option for the securitized debt, the Company will measure both the financial assets and financial liabilities of the VIE using the fair value of either the VIE's financial assets or financial liabilities, whichever is more observable.

Mortgage-backed securities and other securities

In determining the proper fair value hierarchy or level the Company considers the amount of available observable market data for each security. Agency RMBS and Agency CMBS, given the amount of available observable market data, generally are classified in Level II. For newly issued Agency CMBS securities that have not settled at period end and do not have a CUSIP yet, the Company utilizes a broker quote due to lack of observable market data, accordingly these securities are classified in Level III. For Agency IOs, Non-Agency RMBS, CMBS and other securities, to determine whether a security should be a Level II, the

securities are grouped by security type and the Manager reviews the internal trade history, for the quarter, for each security type. If there is sufficient trade data above a predetermined threshold of a security type, the Manager determines it has sufficient observable market data and the security will be categorized as a Level II; otherwise, the security is classified as a Level III.

Values for the Company's securities are based upon prices obtained from independent third party pricing services. The valuation methodology of the third party pricing services incorporates market information and commonly used market pricing methods, which include actual trades and quoted prices for similar or identical instruments, and are designed to produce a pricing process that is responsive to market conditions. Depending on the type of asset and the underlying collateral, the primary inputs to the model include yields for TBAs, Agency RMBS, the U.S. Treasury market and floating rate indices such as LIBOR, the Constant Maturity Treasury rate and the prime rate as a benchmark yield. In addition, the model may incorporate the current weighted average maturity and additional pool level information such as prepayment speeds, default frequencies and default severities, if applicable. When the third party pricing service cannot adequately price a particular security, the Company utilizes a broker's quote which is reviewed for reasonableness by the Manager's pricing group.

Residential Whole Loans and Residential Bridge Loans

Values for the Company's Non-QM Residential Whole Loans and Bridge Loans are based upon prices obtained from an independent third party pricing service that specializes in loan valuation, utilizing a discounted cash flow valuation model that is calibrated to recent loan trade execution. Their valuation methodology incorporates commonly used market pricing methods, which include the inputs considered most significant to the determination of fair value of the Company's Residential Whole Loans and Residential Bridge Loans. The key loan inputs include loan balance, interest rate, loan to value, delinquencies and fair value of the collateral for collateral dependent loans. The assumption made by the independent third party pricing service includes the market discount rate, yield, default assumption and loss severity. Other inputs and assumptions relevant to the pricing of Residential Whole Loans include FICO scores and prepayment speeds.

Values for the Conforming Residential Whole Loan Portfolio, are based on a third party pricing service valuation model that assigns a loan value using TBA prices, adjusted for delivery to Fannie Mae using Fannie Mae's loan-level price adjustment matrix. In addition to pricing the underlying mortgages, the third party pricing service uses a service release premium valuation representing the sale of the right to service the mortgages. Together, the TBA price and service release premium price form the "All-In" price for these mortgages.

The Company reviews the analysis provided by pricing service as well as the key assumptions made available to the company. Due to the inherent uncertainty of such valuation, the fair values established for residential loans held by the Company may differ from the fair values that would have been established if a readily available market existed for these loans. Accordingly, the Company's loans are classified as Level III.

Commercial Loans

Values for the Company's Commercial Loans are based upon prices obtained from an independent third party pricing service that specializes in loan valuation, utilizing a valuation model that is calibrated to recent loan trade execution. Their valuation methodology incorporates commonly used market pricing methods, which include the inputs considered most significant to the determination of fair value of the Company's Commercial Loans. The assumptions made by the independent third party pricing vendor include a market discount rate, default assumption and loss severity. The Company reviews the analysis provided by pricing service as well as the key assumptions. Due to the inherent uncertainty of such valuation, the fair values established for commercial loans held by the Company may differ from the fair values that would have been established if a readily available market existed for these loans. Accordingly, the Company's commercial loans are classified as a Level III.

Securitized commercial loans

Values for the Company's securitized commercial loans are based on the CFE valuation methodology. Since there is an extremely limited market for the securitized commercial loans, the Company determined the securitized debt is more actively traded and therefore was more observable. Due to the inherent uncertainty of the securitized commercial loan's valuation, the Company classifies its securitized commercial loans as Level III.

Securitized debt

Values for the Company's securitized debt are based upon prices obtained from independent third party pricing services. The valuation methodology of the third party pricing services incorporates market information and commonly used market pricing methods, which include actual trades and quoted prices for similar or identical instruments. In determining the proper fair value hierarchy or level, the Company considers the amount of available observable market data for each security. Since the securitized

debt represents traded debt securities, the Manager's pricing team reviews the trade activity during the quarter for each security to determine the appropriate level within the fair value hierarchy. If there is sufficient trade data above a predetermined volume threshold, the Manager determines it has sufficient observable market data and the debt security will be categorized as a Level II. If there is not sufficient observable market data the debt security will be categorized as a Level III.

Derivatives

Values for the Company's derivatives are based upon prices from third party pricing services, whose pricing is subject to review by the Manager's pricing committee. In valuing its over-the-counter interest rate derivatives, such as swaps and swaptions, its currency derivatives, such as swaps and forwards and credit derivatives such as total return swaps, the Company considers the creditworthiness of both the Company and its counterparties, along with collateral provisions contained in each derivative agreement, from the perspective of both the Company and its counterparties. No credit valuation adjustment was made in determining the fair value of interest rate and/or futures contracts for the years ended December 31, 2019 and December 31, 2018.

Third Party Pricing Data Review

The Company performs quarterly reviews of the independent third party pricing data. These reviews may include a review of the valuation methodology used by third party valuation specialists and review of the daily change in the prices provided by the independent pricing vendor which exceed established tolerances or comparisons to executed transaction prices, utilizing the Manager's pricing group. The Manager's pricing group, which functions independently from its portfolio management personnel, reviews the price differences or changes in price by comparing the vendor price to alternate sources including other independent pricing services or broker quotations. If the price change or difference cannot be corroborated, the Manager's pricing group consults with the portfolio management team for market color in reviewing such pricing data as warranted. To the extent that the Manager has information, typically in the form of broker quotations that would indicate that a price received from the independent pricing service is outside of a tolerance range, the Manager generally challenges the independent pricing service price.

The following tables present a summary of the available quantitative information about the significant unobservable inputs used in the fair value measurement of financial instruments for which the Company has utilized Level III inputs to determine fair value as of December 31, 2019 and December 31, 2018 (dollars in thousands).

	Fair Value at	Valuation Technique	Unobservable Input	Range		Weighted Average
	December 31, 2019			Minimum	Maximum	
Residential Whole-Loans ⁽²⁾	1,200,566	Discounted Cash Flow	Yield	3.4%	7.0%	3.7%
			Weighted Average Life	1.4	7.8	3.0
Residential Bridge Loans ⁽³⁾	33,269	Discounted Cash Flow	Yield	7.5%	27.0% ⁽¹⁾	9.8%
			Weighted Average Life	0.3	1.8	0.8
Commercial Loans	370,213	Discounted Cash Flow	Yield	4.7%	10.9%	7.5%
			Weighted Average Lie	0.4	2.9	1.6

	Fair Value at	Valuation Technique	Unobservable Input	Range		Weighted Average
	December 31, 2018			Minimum	Maximum	
Residential Whole-Loans	1,041,885	Discounted Cash Flow	Yield	3.5%	7.9%	5.5%
			Weighted Average Life	0.8	10.3	2.8
Residential Bridge Loans	211,999	Discounted Cash Flow	Yield	5.6%	145.3% ⁽¹⁾	11.3%
			Weighted Average Life	0.1	1.6	0.5
Commercial Loans:	216,123	Discounted Cash Flow	Yield	6.7%	9.2%	7.6%
			Weighted Average Life	0.9	2.7	2.1

- (1) Yield to maturity is the total return on the loan expressed as an annual rate. Delinquent Bridge Loans that are nearing maturity and with fair value that is significantly less than the principal amount have a higher yield to maturity.
- (2) Excludes \$175,294 Conforming Residential Whole Loans, which are valued using TBA prices, adjusted for delivery to Fannie Mae using Fannie Mae's loan-level price adjustment matrix. As of December 31, 2019, the TBA prices used for valuing the conforming loans range from \$101.39 to \$107.63.

The following tables present additional information about the Company's financial instruments which are measured at fair value on a recurring basis for which the Company has utilized Level III inputs to determine fair value:

Year ended December 31, 2019								
\$ in thousands	Agency MBS	Non-Agency MBS	Other Securities	Residential Whole Loans	Residential Bridge Loans	Commercial Loans	Securitized Commercial Loans	Securitized Debt
Beginning balance	\$ 19,837	\$ 50,555	\$ 8,951	\$ 1,041,885	\$ 211,999	\$ 216,123	\$ 1,013,511	\$ 2,286
Transfers into Level III from Level II	—	—	8,386	—	—	—	—	—
Transfers from Level III into Level II	—	—	—	—	—	—	—	—
Purchases	—	—	—	544,426	—	274,422	1,113,231	—
Sales and settlements	(401)	—	—	—	—	—	—	3,769
Transfers to REO	—	—	—	—	(2,677)	—	—	—
Principal repayments	—	(965)	(555)	(228,163)	(175,422)	(121,245)	(1,214,688)	—
Total net gains/losses included in net income								
Realized gains/(losses), net on assets	—	—	—	—	(351)	—	—	—
Other than temporary impairment	(222)	(1,332)	—	—	—	—	—	—
Unrealized gains/(losses), net on assets ⁽¹⁾	762	(229)	693	20,887	397	(122)	(1,070)	—
Unrealized (gains)/losses, net on liabilities ⁽²⁾	—	—	—	—	—	—	—	(2,373)
Premium and discount amortization, net	(4,061)	(2,215)	(279)	(3,175)	(677)	1,035	(1,944)	(2,625)
Ending balance	\$ 15,915	\$ 45,814	\$ 17,196	\$ 1,375,860	\$ 33,269	\$ 370,213	\$ 909,040	\$ 1,057
Unrealized gains/(losses), net on assets held at the end of the period ⁽¹⁾	\$ 780	\$ (229)	\$ 693	\$ 21,768	\$ (488)	\$ 128	\$ (1,042)	\$ —
Unrealized gains/(losses), net on liabilities held at the end of the period ⁽²⁾	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 375

Year ended December 31, 2018

\$ in thousands	Agency MBS	Non-Agency MBS	Other Securities	Residential Whole Loans	Residential Bridge Loans	Commercial Loans	Securitized Commercial Loans	Securitized Debt
Beginning balance	\$ 17,217	\$ 8,735	\$ 9,239	\$ 237,423	\$ 64,526	\$ —	\$ 24,876	\$ 10,945
Transfers into Level III from Level II	22,795	39,084	9,708	—	—	—	—	—
Transfers from Level III into Level II	(16,805)	—	(8,697)	—	—	—	—	(10,899)
Purchases	2,093	8,602	—	860,576	207,705	215,322	1,353,020	—
Sales and settlements	—	(4,180)	—	—	—	—	—	12
Principal repayments	(53)	(307)	(604)	(55,186)	(57,528)	—	(361,782)	(44)
Total net gains / (losses) included in net income								
Realized gains/(losses), net on assets	—	258	—	—	—	—	—	—
Other than temporary impairment	(735)	(918)	(161)	—	—	—	—	—
Unrealized gains/(losses), net on assets ⁽¹⁾	(630)	1,183	(532)	(415)	(1,806)	631	(16)	—
Unrealized (gains)/losses, net on liabilities ⁽²⁾	—	—	—	—	—	—	—	1,996
Premium and discount amortization, net	(4,045)	(1,902)	(2)	(513)	(898)	170	(2,587)	276
Ending balance	<u>\$ 19,837</u>	<u>\$ 50,555</u>	<u>\$ 8,951</u>	<u>\$ 1,041,885</u>	<u>\$ 211,999</u>	<u>\$ 216,123</u>	<u>\$ 1,013,511</u>	<u>\$ 2,286</u>
Unrealized gains/(losses), net on assets held at the end of the period ⁽¹⁾	\$ (272)	\$ 1,184	\$ (464)	\$ 351	\$ (1,370)	\$ 631	\$ (16)	\$ —
Unrealized gains/(losses), net on liabilities held at the end of the period ⁽²⁾	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ (1,998)

(1) Gains and losses are included in "Unrealized gain (loss), net" in the Consolidated Statements of Operations.

(2) Gains and losses on securitized debt are included in "Unrealized gain (loss), net" in the Consolidated Statements of Operations.

Transfers between hierarchy levels for the years ended December 31, 2019 and December 31, 2018 were based on the availability of sufficient observable inputs. Movements from Level II to Level III was based on the back-testing of historical sales transactions performed by the Manager, which did not provide sufficient observable data to meet Level II versus Level III criteria, resulting in the movement from Level II to Level III. Movements from Level III to Level II was based on information received from a third party pricing service which, along with the back-testing of historical sales transactions performed by the Manager, which provided the sufficient observable data for the movement from Level III to Level II. The Company did not have transfers between either Level I and Level II or Level I and Level III for the years ended December 31, 2019 and December 31, 2018.

Other Fair Value Disclosures

Certain Residential Bridge Loans, repurchase agreement borrowings, convertible senior unsecured notes and securitized debt are not carried at fair value in the consolidated financial statements. The following table presents the carrying value and estimated fair value of the Company's financial instruments that are not carried at fair value, as of December 31, 2019 and December 31, 2018, in the consolidated financial statements (dollars in thousands):

	December 31, 2019		December 31, 2018	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Assets				
Residential Bridge Loans	\$ 3,150	\$ 3,148	\$ 9,720	\$ 9,603
Total	\$ 3,150	\$ 3,148	\$ 9,720	\$ 9,603
Liabilities				
Borrowings under repurchase agreements	\$ 2,824,801	\$ 2,829,093	\$ 2,818,837	\$ 2,823,615
Convertible senior unsecured notes	197,299	209,172	110,060	108,531
Securitized debt ⁽¹⁾	801,109	810,914	—	—
Total	\$ 3,823,209	\$ 3,849,179	\$ 2,928,897	\$ 2,932,146

(1) Carrying value excludes \$5.3 million of deferred financing costs

"Due from counterparties" and "Due to counterparties" in the Company's Consolidated Balance Sheets are reflected at cost which approximates fair value.

Residential Bridge Loans

Values for the Company's Bridge Loans are based upon prices obtained from an independent third party pricing service that specializes in loan valuation, utilizing a discounted cash flow valuation model that is calibrated to recent loan trade execution. Their valuation methodology incorporates commonly used market pricing methods, which include the inputs considered most significant to the determination of fair value of the Residential Bridge Loans. The key loan inputs include loan balance, interest rate, loan to value, FICO score, debt to income ratio and delinquencies. The assumption made by the independent third party pricing service includes the market discount rate, prepayment, default assumption and loss severity. The Company reviews the analysis provided by pricing service as well as the key assumptions made available to the Company. Due to the inherent uncertainty of such valuation, the fair values established for residential bridge loans held by the Company may differ from the fair values that would have been established if a readily available market existed for these loans. Accordingly, the Company's loans are classified as Level III.

Borrowings under repurchase agreements

The fair values of the borrowings under repurchase agreements are based on a net present value technique. This method discounts future estimated cash flows using rates the Company determined best estimates current market interest rates that would be offered for loans with similar characteristics and credit quality. The use of different market assumptions or estimation methodologies could have a material effect on the fair value amounts. This fair value measurement is based on observable inputs, and as such, are classified as Level II.

Convertible senior unsecured notes

The fair value of the convertible senior unsecured notes is based on quoted market prices. Accordingly, the Company's convertible senior unsecured notes are classified as Level I.

Securitized debt

Values for the Company's securitized debt, related to the securitization of a portion of its Residential Whole Loans, are based upon prices obtained from independent third party pricing services. The valuation methodology of the third party pricing services incorporates market information and commonly used market pricing methods, which include actual trades and quoted prices for similar or identical instruments. In determining the proper fair value hierarchy or level, the Company considers the amount of available observable market data for each security. Since the securitized debt represents traded debt securities, the Manager's pricing team reviews the trade activity during the quarter for each security to determine the appropriate level within the fair value hierarchy. If there is sufficient trade data above a predetermined threshold, the Manager determines it has sufficient observable market data and the debt security will be categorized as a Level II. If there is not sufficient observable market data the debt security will be categorized as a Level III. At December 31, 2019, there was not sufficient observable market data for the debt to be classified as a Level II, accordingly it was classified as a Level III.

Note 4 - Mortgage-Backed Securities and other securities

The following tables present certain information about the Company's investment portfolio at December 31, 2019 and December 31, 2018 (dollars in thousands):

	December 31, 2019							
	Principal Balance	Unamortized Premium (Discount), net	Discount Designated as Credit Reserve and OTTI	Amortized Cost	Unrealized Gain	Unrealized Loss	Estimated Fair Value	Net Weighted Average Coupon
Agency CMBS	\$ 1,347,929	\$ 26,514	\$ —	\$ 1,374,443	\$ 66,832	\$ (5,798)	\$ 1,435,477	3.4%
Agency CMBS Interest-Only Strips, accounted for as derivatives ⁽¹⁾⁽²⁾	N/A	N/A	N/A	N/A	N/A	N/A	3,092	0.4%
Subtotal Agency CMBS	1,347,929	26,514	—	1,374,443	66,832	(5,798)	1,438,569	3.1%
Agency RMBS	327,814	5,473	—	333,287	7,484	—	340,771	3.5%
Agency RMBS Interest-Only Strips ⁽¹⁾	N/A	N/A	N/A	8,661	1,820	(138)	10,343	2.8%
Agency RMBS Interest-Only Strips, accounted for as derivatives ⁽¹⁾⁽²⁾	N/A	N/A	N/A	N/A	N/A	N/A	5,572	3.0%
Subtotal Agency RMBS	327,814	5,473	—	341,948	9,304	(138)	356,686	3.3%
Total Agency MBS	1,675,743	31,987	—	1,716,391	76,136	(5,936)	1,795,255	3.1%
Non-Agency RMBS	52,767	4,492	(20,256)	37,003	1,388	(260)	38,131	4.8%
Non-Agency RMBS Interest-Only Strips ⁽¹⁾	N/A	N/A	N/A	7,705	636	(658)	7,683	0.6%
Subtotal Non-Agency RMBS	52,767	4,492	(20,256)	44,708	2,024	(918)	45,814	1.0%
Non-Agency CMBS	354,458	(17,909)	(22,016)	314,533	6,359	(4,873)	316,019	5.1%
Total Non-Agency MBS	407,225	(13,417)	(42,272)	359,241	8,383	(5,791)	361,833	2.7%
Other securities ⁽³⁾	71,896	(2,437)	(6,203)	73,975	6,392	(206)	80,161	6.7%
Total	\$ 2,154,864	\$ 16,133	\$ (48,475)	\$ 2,149,607	\$ 90,911	\$ (11,933)	\$ 2,237,249	3.1%

December 31, 2018

	Principal Balance	Unamortized Premium (Discount), net	Discount Designated as Credit Reserve and OTTI	Amortized Cost	Unrealized Gain	Unrealized Loss	Estimated Fair Value	Net Weighted Average Coupon
Agency CMBS	\$ 1,493,675	\$ 5,820	\$ —	\$ 1,499,495	\$ 12,083	\$ (29,594)	\$ 1,481,984	3.3%
Agency CMBS Interest-Only Strips, accounted for as derivatives ⁽¹⁾⁽²⁾	N/A	N/A	N/A	N/A	N/A	N/A	4,158	0.4%
Subtotal Agency CMBS	1,493,675	5,820	—	1,499,495	12,083	(29,594)	1,486,142	3.0%
Agency RMBS Interest-Only Strips ⁽¹⁾	N/A	N/A	N/A	11,480	1,062	(407)	12,135	2.2%
Agency RMBS Interest-Only Strips, accounted for as derivatives ⁽¹⁾⁽²⁾	N/A	N/A	N/A	N/A	N/A	N/A	7,702	2.9%
Subtotal Agency RMBS	—	—	—	11,480	1,062	(407)	19,837	2.5%
Total Agency MBS	1,493,675	5,820	—	1,510,975	13,145	(30,001)	1,505,979	2.9%
Non-Agency RMBS	54,887	6,909	(23,731)	38,065	961	—	39,026	4.8%
Non-Agency RMBS Interest- Only Strips ⁽¹⁾	N/A	N/A	N/A	11,154	382	(7)	11,529	0.6%
Subtotal Non-Agency RMBS	54,887	6,909	(23,731)	49,219	1,343	(7)	50,555	1.0%
Non-Agency CMBS	240,431	(20,317)	(22,189)	197,925	5,021	(2,645)	200,301	5.9%
Total Non-Agency MBS	295,318	(13,408)	(45,920)	247,144	6,364	(2,652)	250,856	2.4%
Other securities ⁽³⁾	47,042	(1,129)	(7,603)	55,284	5,012	(390)	59,906	9.0%
Total	\$ 1,836,035	\$ (8,717)	\$ (53,523)	\$ 1,813,403	\$ 24,521	\$ (33,043)	\$ 1,816,741	2.9%

- (1) IOs and IIOs have no principal balances and bear interest based on a notional balance. The notional balance is used solely to determine interest distributions on interest-only class of securities. At December 31, 2019, the notional balance for Agency RMBS IOs and IIOs, Non-Agency RMBS IOs and IIOs, Agency RMBS IOs and IIOs, accounted for as derivatives, and Agency CMBS IOs and IIOs, accounted for as derivatives was \$121.7 million, \$442.4 million, \$64.8 million and \$160.2 million, respectively. At December 31, 2018, the notional balance for Agency RMBS IOs and IIOs, Non-Agency RMBS IOs and IIOs, Agency RMBS IOs and IIOs, accounted for as derivatives and Agency CMBS IOs and IIOs, accounted for as derivatives was \$158.8 million, \$519.9 million, \$89.8 million, \$172.2 million, respectively.
- (2) Interest on these securities is reported as a component of "Gain (loss) on derivative instruments, net" in the Consolidated Statements of Operations.
- (3) Other securities include residual interests in asset-backed securities which have no principal balance and an amortized cost of approximately \$10.7 million and \$17.0 million, as of December 31, 2019 and December 31, 2018, respectively.

As of December 31, 2019 and December 31, 2018, the weighted average expected remaining term of the MBS and other securities investment portfolio was 7.9 years and 8.5 years, respectively.

The following table presents the changes in the components of the Company's purchase discount and amortizable premium on its Non-Agency RMBS, Non-Agency CMBS and other securities for the years ended December 31, 2019, December 31, 2018 and December 31, 2017 (dollars in thousands):

	Year ended December 31, 2019			Year ended December 31, 2018			Year ended December 31, 2017		
	Discount Designated as Credit Reserve and OTTI	Accrutable Discount ⁽¹⁾	Amortizable Premium ⁽¹⁾	Discount Designated as Credit Reserve and OTTI	Accrutable Discount ⁽¹⁾	Amortizable Premium ⁽¹⁾	Discount Designated as Credit Reserve and OTTI	Accrutable Discount ⁽¹⁾	Amortizable Premium ⁽¹⁾
Balance at beginning of period	\$ (53,523)	\$ (29,465)	\$ 14,928	\$ (72,915)	\$ (68,438)	\$ 20,872	\$ (130,484)	\$ (109,822)	\$ 44,527
Accretion of discount	—	4,364	—	—	7,137	—	—	10,715	—
Amortization of premium	—	—	(1,215)	—	—	(675)	—	—	(843)
Realized credit losses	7,290	—	—	5,863	—	—	2,391	—	—
Purchases	(28)	(7,953)	819	(7,182)	(6,473)	435	(19,385)	(1,205)	7,259
Sales	26,706	—	(19,640)	32,301	40,338	(9,590)	89,628	33,166	(31,118)
Net impairment losses recognized in earnings	(6,612)	—	—	(9,733)	—	—	(15,310)	—	—
Transfers/release of credit reserve ⁽²⁾	(22,308)	2,889	19,419	(1,857)	(2,029)	3,886	245	(1,292)	1,047
Balance at end of period	\$ (48,475)	\$ (30,165)	\$ 14,311	\$ (53,523)	\$ (29,465)	\$ 14,928	\$ (72,915)	\$ (68,438)	\$ 20,872

(1) Together with coupon interest, accretable purchase discount and amortizable premium is recognized as interest income over the life of the security.

(2) Subsequent reductions of a security's non-accrutable discount results in a corresponding reduction in its amortizable premium.

The following tables present the fair value and contractual maturities of the Company's investment securities at December 31, 2019 and December 31, 2018 (dollars in thousands):

	December 31, 2019				
	< or equal to 10 years	> 10 years and < or equal to 20 years	> 20 years and < or equal to 30 years	> 30 years	Total
Agency CMBS	\$ 973,189	\$ 462,288	\$ —	\$ —	\$ 1,435,477
Agency CMBS Interest-Only Strips, accounted for as derivatives	—	—	—	3,092	3,092
Agency RMBS	—	—	340,771	—	340,771
Agency RMBS Interest-Only Strips	2,413	1,966	5,964	—	10,343
Agency RMBS Interest-Only Strips, accounted for as derivatives	669	3,893	1,010	—	5,572
Subtotal Agency	976,271	468,147	347,745	3,092	1,795,255
Non-Agency RMBS	—	—	8,966	29,165	38,131
Non-Agency RMBS Interest-Only Strips	—	—	1,716	5,967	7,683
Non-Agency CMBS	89,782	125,282	92,610	8,345	316,019
Subtotal Non-Agency	89,782	125,282	103,292	43,477	361,833
Other securities	25,824	31,823	2,768	19,746	80,161
Total	\$ 1,091,877	\$ 625,252	\$ 453,805	\$ 66,315	\$ 2,237,249

	December 31, 2018				
	< or equal to 10 years	> 10 years and < or equal to 20 years	> 20 years and < or equal to 30 years	> 30 years	Total
Agency CMBS	\$ 1,101,820	\$ 380,164	\$ —	\$ —	\$ 1,481,984
Agency CMBS Interest-Only Strips, accounted for as derivatives	—	—	—	4,158	4,158
Agency RMBS Interest-Only Strips	3,577	2,402	6,156	—	12,135
Agency RMBS Interest-Only Strips, accounted for as derivatives	1,089	4,053	2,560	—	7,702
Subtotal Agency	1,106,486	386,619	8,716	4,158	1,505,979
Non-Agency RMBS	—	—	8,540	30,486	39,026
Non-Agency RMBS Interest-Only Strips	—	—	4,310	7,219	11,529
Non-Agency CMBS	28,754	53,653	72,921	44,973	200,301
Subtotal Non-Agency	28,754	53,653	85,771	82,678	250,856
Other securities	7,698	26,020	—	26,188	59,906
Total	\$ 1,142,938	\$ 466,292	\$ 94,487	\$ 113,024	\$ 1,816,741

The following tables present the gross unrealized losses and estimated fair value of the Company's MBS and other securities by length of time that such securities have been in a continuous unrealized loss position at December 31, 2019 and December 31, 2018 (dollars in thousands):

	December 31, 2019								
	Less than 12 Months			12 Months or More			Total		
	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses	Number of Securities
Agency CMBS	\$ 214,084	\$ (5,798)	16	\$ —	\$ —	—	\$ 214,084	\$ (5,798)	16
Agency RMBS Interest-Only Strips	1,376	(43)	4	1,828	(95)	7	3,204	(138)	11
Subtotal Agency	215,460	(5,841)	20	1,828	(95)	7	217,288	(5,936)	27
Non-Agency RMBS	13,214	(260)	1	—	—	—	13,214	(260)	1
Non-Agency RMBS Interest-Only Strips	1,716	(658)	1	—	—	—	1,716	(658)	1
Non-Agency CMBS	171,650	(4,302)	31	18,069	(571)	4	189,719	(4,873)	35
Subtotal Non-Agency	186,580	(5,220)	33	18,069	(571)	4	204,649	(5,791)	37
Other securities	10,512	(206)	2	—	—	—	10,512	(206)	2
Total	\$ 412,552	\$ (11,267)	55	\$ 19,897	\$ (666)	11	\$ 432,449	\$ (11,933)	66

December 31, 2018									
	Less than 12 Months			12 Months or More			Total		
	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses	Number of Securities
Agency CMBS	\$ 29,413	\$ (307)	3	\$ 879,549	\$ (29,287)	72	\$ 908,962	\$ (29,594)	75
Agency RMBS Interest-Only Strips	3,277	(124)	7	3,917	(283)	9	7,194	(407)	16
Subtotal Agency	32,690	(431)	10	883,466	(29,570)	81	916,156	(30,001)	91
Non-Agency RMBS	—	—	—	500	—	1	500	—	1
Non-Agency RMBS Interest-Only Strips	957	(7)	2	—	—	—	957	(7)	2
Non-Agency CMBS	65,339	(712)	7	19,323	(1,933)	3	84,662	(2,645)	10
Subtotal Non-Agency	66,296	(719)	9	19,823	(1,933)	4	86,119	(2,652)	13
Other securities	15,208	(390)	2	—	—	—	15,208	(390)	2
Total	\$ 114,194	\$ (1,540)	21	\$ 903,289	\$ (31,503)	85	\$ 1,017,483	\$ (33,043)	106

At December 31, 2019 and December 31, 2018, the Company did not intend to sell any of its MBS and other securities that were in an unrealized loss position, and it is “more likely than not” that the Company will not be required to sell these MBS and other securities before recovery of their amortized cost basis, which may be at their maturity date.

Generally, the Company records Other Than Temporary Impairment ("OTTI") when the credit quality of the underlying collateral deteriorates, and or the scheduled payments are faster than previously projected. The credit deterioration could be as a result of, but not limited to, increased projected realized losses, foreclosures, delinquencies and the likelihood of the borrower being able to make payments in the future. Generally, a prepayment occurs when a loan has a higher interest rate relative to current interest rates and lenders are willing to extend credit at the lower current interest rate or the underlying collateral for the loan is sold or transferred. Refer to Note 2 "Summary of Significant Accounting Policies - Mortgage-Backed Securities and Other Securities."

The following table presents the OTTI the Company recorded on its securities portfolio (dollars in thousands):

	For the year ended December 31, 2019	For the year ended December 31, 2018	For the year ended December 31, 2017
Agency RMBS ⁽¹⁾	\$ 74	\$ 807	\$ 5,774
Non-Agency RMBS	1,331	996	—
Non-Agency CMBS	6,565	8,660	15,117
Other securities	604	717	1,982
Total	\$ 8,574	\$ 11,180	\$ 22,873

(1) Other-than-temporary impairment on Agency RMBS includes impairments on Agency RMBS IOs and unrealized loss on Agency RMBS securities that the Company had the intent to sell at the end of the period, if applicable.

The following table presents components of interest income on the Company's MBS and other securities for the three years ended December 31, 2019, December 31, 2018 and December 31, 2017, respectively (dollars in thousands):

	For the year ended December 31, 2019			For the year ended December 31, 2018			For the year ended December 31, 2017		
	Coupon Interest	Net (Premium Amortization/Amortization Basis) Discount Amortization	Interest Income	Coupon Interest	Net (Premium Amortization/Amortization Basis) Discount Amortization	Interest Income	Coupon Interest	Net (Premium Amortization/Amortization Basis) Discount Amortization	Interest Income
Agency CMBS	\$ 51,286	\$ (2,327)	\$ 48,959	\$ 60,148	\$ (646)	\$ 59,502	\$ 40,064	\$ 507	\$ 40,571
Agency RMBS	12,181	(3,053)	9,128	19,507	(5,092)	14,415	38,108	(13,058)	25,050
Non-Agency RMBS	4,682	(2,214)	2,468	7,120	(1,073)	6,047	5,602	525	6,127
Non-Agency CMBS	14,178	4,017	18,195	20,058	6,366	26,424	19,179	8,276	27,455
Other securities	11,633	(6,472)	5,161	14,805	(6,371)	8,434	8,280	1,559	9,839
Total	<u>\$ 93,960</u>	<u>\$ (10,049)</u>	<u>\$ 83,911</u>	<u>\$ 121,638</u>	<u>\$ (6,816)</u>	<u>\$ 114,822</u>	<u>\$ 111,233</u>	<u>\$ (2,191)</u>	<u>\$ 109,042</u>

The following tables present the sales and realized gains (losses) of the Company's MBS and other securities for the three years ended December 31, 2019, December 31, 2018 and December 31, 2017, respectively (dollars in thousands):

	For the year ended December 31, 2019			
	Proceeds	Gross Gains	Gross Losses	Net Gain (Loss)
Agency CMBS	\$ 891,072	\$ 32,793	\$ (4,190)	\$ 28,603
Agency RMBS	205,310	1,559	—	1,559
Non-Agency CMBS	40,235	317	(1,624)	(1,307)
Total	<u>\$ 1,136,617</u>	<u>\$ 34,669</u>	<u>\$ (5,814)</u>	<u>\$ 28,855</u>

	For the year ended December 31, 2018			
	Proceeds	Gross Gains	Gross Losses	Net Gain (Loss)
Agency CMBS	\$ 1,534,967	\$ —	\$ (51,045)	\$ (51,045)
Agency RMBS	589,854	18	(23,997)	(23,979)
Non-Agency RMBS	99,842	7,008	(478)	6,530
Non-Agency CMBS	140,292	3,086	(6,201)	(3,115)
Other securities	65,099	8,400	—	8,400
Total	<u>\$ 2,430,054</u>	<u>\$ 18,512</u>	<u>\$ (81,721)</u>	<u>\$ (63,209)</u>

	For the year ended December 31, 2017			
	Proceeds	Gross Gains	Gross Losses	Net Gain (Loss)
Agency RMBS ⁽¹⁾	\$ 1,251,985	\$ 5,020	\$ (7,936)	\$ (2,916)
Non-Agency RMBS ⁽²⁾	243,838	24,356	(2,241)	22,115
Non-Agency CMBS	54,875	2,543	(1,803)	740
Other securities	38,447	713	(54)	659
Total	\$ 1,589,145	\$ 32,632	\$ (12,034)	\$ 20,598

(1) Excludes proceeds for Agency RMBS Interest-Only Strips, accounted for as derivatives, of approximately \$2.6 million and gross realized gains of approximately \$432 thousand.

(2) Excludes proceeds for Non-Agency RMBS Interest-Only Strips, accounted for as derivatives, of approximately \$2.2 million, gross realized gains of \$274 thousand and gross realized losses of \$180 thousand.

Unconsolidated CMBS VIEs

The Company's economic interests held in unconsolidated CMBS VIEs are limited in nature to those of a passive holder of CMBS issued by securitization trusts; the Company was not involved in the design or creation of the securitization trusts. The Company evaluates its CMBS holdings for potential consolidation of the securitized trust, in which it owns the most subordinate tranche or a portion of the controlling class. As of December 31, 2019 and December 31, 2018, the Company held ten and seven variable interests in unconsolidated CMBS VIEs, respectively, in which it either owned the most subordinate class or a portion of the controlling class. The Company determined it was not the primary beneficiary and accordingly, the CMBS VIEs were not consolidated in the Company's consolidated financial statements. As of December 31, 2019 and December 31, 2018, the Company's maximum exposure to loss from these variable interests did not exceed the carrying value of these investments of \$117.7 million and \$118.4 million, respectively. These investments are classified in "Non-Agency mortgage-backed securities, at fair value" in the Company's Consolidated Balance Sheets. Further, as of December 31, 2019 and December 31, 2018, the Company did not guarantee any obligations of unconsolidated entities or enter into any commitment or intent to provide funding to any such entities.

Note 5—Residential Whole Loans and Bridge Loans

Residential Whole-Loan Trust

The consolidated financial statements include the consolidation of Revolving Mortgage Investment Trust 2015-1QR2 ("RMI 2015 Trust") since it met the definition of a VIE and the Company determined that it was the primary beneficiary of the trust because it was involved in the design of the trust, has oversight rights on defaulted assets and has other significant decision making powers. In addition, the Company has the obligation to absorb losses to the extent of its ownership interest and the right to receive benefits from the trust that could potentially be significant to the trust. RMI 2015 Trust has issued a trust certificate that is wholly-owned by the Company and represents the entire beneficial interest in pools of Non-QM Residential Whole Loans held by the trust. As of December 31, 2019 and December 31, 2018, the Company financed the trust certificate with \$209.9 million and \$618.7 million, respectively, on long-term financing facilities which automatically roll until such time as they are terminated or until certain conditions of default. The financing liability is held outside the trust. The Company classifies the underlying Residential Whole Loans owned by the trust in "Residential Whole Loans, at fair value" in the Consolidated Balance Sheets and has eliminated the intercompany trust certificate in consolidation.

In August 2018, the Company formed Revolving Mortgage Investment Trust 2018-RCR ("RCR Trust") to acquire Conforming Residential Whole Loans. The Company determined that RCR Trust was a VIE and that the Company was the primary beneficiary of the trust because it was involved in the design of the trust, has oversight rights on defaulted assets and has other significant decision making powers. In addition, the Company has the obligation to absorb losses to the extent of its ownership interest and the right to receive benefits from the trust that could potentially be significant to the trust. As of December 31, 2019, and December 31, 2018, the Company financed the trust certificate with \$164.3 million and \$250.4 million, respectively, of repurchase agreements, which is a liability held outside the trust. The Company classifies the underlying conforming mortgages owned by the trust in "Residential Whole Loans, at fair value" in the Consolidated Balance Sheets. The Company has eliminated the intercompany trust certificate in consolidation.

In September 2018, the Company formed Revolving Mortgage Investment Trust 2018-RNR ("RNR Trust") to acquire Non-QM Residential Whole Loans. The Company determined that RNR Trust was a VIE and that the Company was the primary beneficiary because it was involved in the design of the trust, has oversight rights on defaulted assets and has other significant decision making powers. In addition, the Company has the obligation to absorb losses to the extent of its ownership interest and the right to receive benefits from the trust that could potentially be significant to the trust. As of December 31, 2019 and December 31, 2018, the Company's trust certificate was financed with \$8.1 million and \$15.1 million, respectively, of repurchase agreements, which is a liability held outside the trust. The Company classifies the underlying Non-QM Residential Whole Loans in "Residential Whole Loans, at fair value" in the Consolidated Balance Sheets. The Company has eliminated the intercompany trust certificate in consolidation.

In May 2019, the Company completed a residential mortgage-backed securitization comprised of a portion of its Residential Whole Loan portfolio. During the securitization, RMI 2015 Trust and RNR Trust collectively transferred \$945.5 million of Non-QM Residential Whole Loans, to a wholly-owned subsidiary of the Company, Arroyo Mortgage Trust 2019-2 ("Arroyo Trust"). The Company issued \$919.0 million of mortgage-backed notes and retained all the subordinate and residual debt securities ("Owner Certificates"), which includes the required the 5% eligible risk retention. Refer to Note 7 - "Financings" for details on the associated securitized debt. The Company determined that Arroyo Trust was a VIE and that the Company was also the primary beneficiary because the Manager was involved in the design of the trust and the Company has significant decision making powers. In addition, the Company has the obligation to absorb losses to the extent of its ownership interest and the right to receive benefits from the Arroyo Trust that could potentially be significant to the trust. The Company classifies the underlying Non-QM Residential Whole Loans in "Residential Whole Loans, at fair value" in the Consolidated Balance Sheets. The Company has eliminated the intercompany Owner Certificates in consolidation.

In November 2019, the Company formed Revolving Mortgage Investment Trust 2019-RBR ("RBR Trust") to acquire Non-QM Residential Whole Loans. The Company determined that RBR Trust was a VIE and that the Company was the primary beneficiary because it was involved in the design of the trust, has oversight rights on defaulted assets and has other significant decision making powers. In addition, the Company has the obligation to absorb losses to the extent of its ownership interest and the right to receive benefits from the trust that could potentially be significant to the trust. As of December 31, 2019, the Company's trust certificate was financed with \$91.7 million of repurchase agreements, which is a liability held outside the trust. The Company classifies the underlying Non-QM Residential Whole Loans in "Residential Whole Loans, at fair value" in the Consolidated Balance Sheets. The Company has eliminated the intercompany trust certificate in consolidation.

Residential Bridge Loan Trust

In February 2017, the Company formed Revolving Mortgage Investment Trust 2017-BRQ1 ("RMI 2017 Trust") and acquired the trust certificate, which represents the entire beneficial interest in pools of Residential Bridge Loans and certain Residential Whole Loans held by the trust. Residential Bridge Loans are mortgage loans secured by residences, typically short-term. The Company determined that RMI Trust was a VIE and that the Company was the primary beneficiary because it was involved in the design of the trust, has oversight rights on defaulted assets and has other significant decision making powers. In addition, the Company has the obligation to absorb losses to the extent of its ownership interest and the right to receive benefits from the trust that could potentially be significant to the trust. As of December 31, 2019 and December 31, 2018, the Company financed the trust certificate with \$32.1 million and \$207.5 million, respectively, of repurchase agreement borrowings, which is a liability held outside the trust. The Company classifies both the underlying Residential Bridge Loans carried at amortized cost and the Residential Bridge Loans that it elected the fair value option in "Residential Bridge Loans" and the Residential Whole Loans in "Residential Whole Loans, at fair value" in the Consolidated Balance Sheets. The Company has eliminated the intercompany trust certificate in consolidation.

Consolidated Residential Whole-Loan and Residential Bridge Loan Trusts

The Company assesses modifications to VIEs on an ongoing basis to determine if a significant reconsideration event has occurred that would change the Company's initial consolidation assessment. The five consolidated Residential Whole-Loan trusts collectively hold 3,520 Residential Whole Loans and the consolidated Bridge Loan Trust holds 68 Residential Bridge Loans and 9 Residential Whole Loans as of December 31, 2019.

The following table presents a summary of the assets and liabilities of the consolidated residential whole-loan trusts and residential bridge loan trust included in the Consolidated Balance Sheets as of December 31, 2019 and December 31, 2018 (dollars in thousands):

	December 31, 2019	December 31, 2018
Cash and cash equivalents	\$ 1,811	\$ 674
Residential Whole-Loans, at fair value (\$1,375,860 and \$1,041,885 pledged as collateral, at fair value, respectively)	1,375,860	1,041,885
Residential Bridge Loans (\$31,748 and \$211,766 at fair value and \$34,897 and \$221,486 pledged as collateral, respectively)	34,897	221,486
Commercial loan, at fair value	—	30,000
Investment related receivable	19,138	42,945
Interest receivable	7,840	11,807
Other assets	90	178
Total assets	\$ 1,439,636	\$ 1,348,975
Securitized debt, net	\$ 795,811	\$ —
Interest payable	2,367	—
Accounts payable and accrued expenses	173	677
Other liabilities	—	225
Total liabilities	\$ 798,351	\$ 902

The Company's risk with respect to its investment in each residential loan trust is limited to its direct ownership in the trust. The Residential Whole Loans, Residential Bridge Loans and Commercial Loan held by the consolidated trusts are held solely to satisfy the liabilities of the trust, and creditors of the trust have no recourse to the general credit of the Company. The Company is not contractually required and has not provided any additional financial support to the trusts for the years ended December 31, 2019 and December 31, 2018.

The following table presents the components of the carrying value of Residential Whole Loans and Residential Bridge Loans as of December 31, 2019 and December 31, 2018 (dollars in thousands):

	Residential Whole Loans, at Fair Value		Residential Bridge Loans, at Fair Value ⁽¹⁾		Residential Bridge Loans, at Amortized Cost ⁽¹⁾	
	December 31, 2019	December 31, 2018	December 31, 2019	December 31, 2018	December 31, 2019	December 31, 2018
Principal balance	\$ 1,325,443	\$ 1,023,524	\$ 34,041	\$ 212,491	\$ 3,155	\$ 9,766
Unamortized premium	28,588	17,629	79	1,164	6	16
Unamortized discount	(2,839)	(3,145)	(13)	(316)	(11)	(62)
Amortized cost	1,351,192	1,038,008	34,107	213,339	3,150	9,720
Gross unrealized gains	26,363	7,573	10	212	N/A	N/A
Gross unrealized losses	(1,695)	(3,696)	(848)	(1,552)	N/A	N/A
Fair value	\$ 1,375,860	\$ 1,041,885	\$ 33,269	\$ 211,999	N/A	N/A

(1) These loans are classified in "Residential Bridge Loans" in the Consolidated Balance Sheets

Residential Whole Loans

The Residential Whole Loans have low LTV's and are comprised of 2,908 Non-QM adjustable rate mortgages, 612 conforming fixed rate mortgages and nine investor fixed rate mortgages. The following tables present certain information about the Company's Residential Whole Loan investment portfolio at December 31, 2019 and December 31, 2018 (dollars in thousands):

December 31, 2019							
Current Coupon Rate	Number of Loans	Principal Balance	Original LTV	Weighted Average			
				Original FICO Score ⁽¹⁾	Expected Life (years) ⁽²⁾	Contractual Maturity (years)	Coupon Rate
3.01 - 4.00%	53	\$ 17,284	61.7%	736	2.4	28.0	3.9%
4.01 - 5.00%	1,689	557,144	61.4%	744	2.8	28.5	4.8%
5.01 - 6.00%	1,682	713,397	62.0%	736	3.0	28.3	5.4%
6.01 - 7.00%	103	37,102	54.1%	727	3.8	25.3	6.2%
7.01 - 8.00%	2	516	73.2%	753	4.7	28.6	7.1%
Total	3,529	\$ 1,325,443	61.5%	739	3.0	28.3	5.2%

(1) The original FICO score is not available for 286 loans with a principal balance of approximately \$94.6 million at December 31, 2019. The Company has excluded these loans from the weighted average computations.

(2) Excludes the expected lives of the conforming Residential Whole Loans held by RCR Trust.

December 31, 2018							
Current Coupon Rate	Number of Loans	Principal Balance	Original LTV	Weighted Average			
				Original FICO Score ⁽¹⁾	Expected Life (years)	Contractual Maturity (years)	Coupon Rate
3.01 - 4.00%	66	\$ 22,046	61.6%	738	6.5	29.0	3.9%
4.01 - 5.00%	1,395	490,073	62.3%	739	3.0	29.0	4.8%
5.01 - 6.00%	1,283	496,722	62.7%	727	2.5	28.5	5.4%
6.01 - 7.00%	37	14,589	59.5%	731	1.5	24.8	6.2%
7.01 - 8.00%	1	94	70.0%	689	1.8	29.1	8.0%
Total	2,782	\$ 1,023,524	62.4%	733	2.8	28.7	5.1%

(1) The original FICO score is not available for 274 loans with a principal balance of approximately \$93.2 million at December 31, 2018. The Company has excluded these loans from the weighted average computations.

The following table presents the various states across the United States in which the collateral securing the Company's Residential Whole Loans at December 31, 2019 and December 31, 2018, based on principal balance, is located (dollars in thousands):

December 31, 2019			December 31, 2018		
State	Concentration	Principal Balance	State	Concentration	Principal Balance
California	66.1%	\$ 875,738	California	67.1%	\$ 686,275
New York	16.2%	214,141	New York	17.1%	175,390
Georgia	3.4%	45,189	Georgia	2.6%	26,918
Florida	2.8%	36,641	Massachusetts	2.1%	21,197
New Jersey	2.3%	30,450	Florida	1.9%	19,942
Other	9.2%	123,284	Other	9.2%	93,802
Total	100.0%	\$ 1,325,443	Total	100.0%	\$ 1,023,524

Residential Bridge Loans

The Residential Bridge Loans are comprised of short-term non-owner occupied fixed rate loans secured by single or multi-unit residential properties, with LTVs generally not to exceed 85%. The following tables present certain information about the Company's Residential Bridge Loan investment portfolio at December 31, 2019 and December 31, 2018 (dollars in thousands):

December 31, 2019

Current Coupon Rate	Number of Loans	Principal Balance	Weighted Average		
			Original LTV	Contractual Maturity (months) ⁽¹⁾	Coupon Rate
7.01 – 9.00%	36	\$ 22,409	70.2%	5.8	8.4%
9.01 – 11.00%	28	9,972	74.0%	5.6	10.1%
11.01 – 13.00%	9	2,741	63.1%	2.0	11.7%
13.01 – 15.00%	1	1,125	75.0%	0.0	13.5%
17.01 – 19.00%	2	949	75.0%	0.0	18.0%
Total	76	\$ 37,196	71.0%	5.6	9.5%

December 31, 2018

Current Coupon Rate	Number of Loans	Principal Balance	Weighted Average		
			Original LTV	Contractual Maturity (months) ⁽¹⁾	Coupon Rate
5.01 – 7.00%	8	\$ 3,169	60.4%	1.1	6.7%
7.01 – 9.00%	275	140,675	72.6%	5.9	8.3%
9.01 – 11.00%	186	63,954	73.8%	4.4	9.9%
11.01 – 13.00%	39	11,017	71.3%	4.6	11.8%
13.01 – 15.00%	1	88	65.0%	4.0	14.0%
17.01 – 19.00%	11	3,354	73.7%	2.3	18.0%
Total	520	\$ 222,257	72.7%	5.3	9.1%

(1) Non-performing loans that are past their maturity date are excluded from the calculation of the weighted average contractual maturity.

The following table presents the various states across the United States in which the collateral securing the Company's Residential Bridge Loans at December 31, 2019 and December 31, 2018, based on principal balance, is located (dollars in thousands):

December 31, 2019			December 31, 2018		
State	Concentration	Principal Balance	State	Concentration	Principal Balance
California	50.4%	\$ 18,763	California	53.9%	\$ 119,761
Washington	13.1%	4,863	New York	9.5%	21,160
New York	12.1%	4,518	Washington	6.6%	14,711
Florida	8.9%	3,296	Florida	5.7%	12,672
New Jersey	3.8%	1,424	New Jersey	4.7%	10,419
Other	11.7%	4,332	Other	19.6%	43,534
Total	100.0%	\$ 37,196	Total	100.0%	\$ 222,257

Non-performing Loans

The following table presents the aging of the Residential Whole Loans and Bridge Loans as of December 31, 2019 (dollars in thousands):

	Residential Whole Loans			Bridge Loans		
	No of Loans	Principal	Fair Value	No of Loans	Principal	Fair Value ⁽¹⁾
Current	3467	\$ 1,300,238	\$ 1,350,590	41	\$ 23,353	\$ 23,329
1-30 days delinquent	41	13,537	14,012	2	303	306
31-60 days delinquent	5	1,338	1,334	4	1,147	1,135
61-90 days delinquent	4	3,205	3,224	2	285	280
90+ days delinquent	12	7,125	6,700	27	12,108	11,369
Total	3,529	\$ 1,325,443	\$ 1,375,860	76	\$ 37,196	\$ 36,419

(1) Includes \$3.1 million loans carried at amortize cost.

Residential Whole Loans

As of December 31, 2019, there were 12 Residential Whole Loans carried at fair value in non-accrual status with an unpaid principal balance of approximately \$7.1 million and a fair value of approximately \$6.7 million. These nonperforming loans represent approximately 0.5% of the total outstanding principal balance. No allowance or provision for credit losses was recorded as of and for the year ended December 31, 2019 since the valuation adjustment, if any, would be reflected in the fair value of these loans. The Company stopped accruing interest income for these loans when they became contractually 90 days delinquent. As of December 31, 2018, there were no Residential Whole-Loans in non-accrual status.

Residential Bridge Loans

As of December 31, 2019, there were 27 Residential Bridge Loans carried at fair value in non-accrual status with an unpaid principal balance of approximately \$12.1 million and a fair value of \$11.4 million. These nonperforming loans represent approximately 32.6% of the total outstanding Bridge Loans principal balance of \$37.2 million. These loans are collateral dependent with a weighted average original LTV of 72.1%.

As of December 31, 2018, there were 3 Residential Bridge Loans carried at amortized cost in non-accrual status with an unpaid principal balance of approximately \$1.1 million and 9 Residential Bridge Loans carried at fair value in non-accrual status with an unpaid principal balance of \$4.0 million and a fair value of \$3.8 million. These nonperforming loans represented approximately 2.3% of the total outstanding Bridge Loans principal balance of \$222.3 million. These loans are collateral dependent with a weighted average original LTV of 70.0%.

The Company concluded that an allowance for loan loss was not necessary for loans carried at amortized costs as of and for the years ended December 31, 2019 and December 31, 2018 since the fair value of the collateral balance less the cost to sell was in excess of the outstanding principal and interest balances. For loans carried at fair value no loan loss was recorded as of and for the years ended December 31, 2019 and December 31, 2018 since the valuation adjustment, if any, would be reflected in the fair value of these loans. The Company stopped accruing interest income for these loans when they became contractually 90 days delinquent.

As of December 31, 2019, the Company had real estate owned ("REO") with an aggregate carrying value of \$3.3 million related to foreclosed Bridge Loans. The REO properties are held for sale and accordingly carried at the lower of cost or fair value less cost to sell. The REO properties are classified in "Other assets" in the Consolidated Balance Sheet.

Note 6 - Commercial Loans

Securitized Commercial Loans

Securitized commercial loans is comprised of commercial loans from consolidated third party sponsored CMBS VIE's. At December 31, 2019, the Company had variable interests in three CMBS VIEs, CMSC Trust 2015 - Longhouse MZ, RETL 2019-RVP and MRCD 2019-PRKC Mortgage Trust, that it determined it was the primary beneficiary and was required to consolidate. The commercial loans that serve as collateral for the securitized debt issued by these VIEs can only be used to settle the securitized debt. Refer to Note 7 - "Financings" for details on the associated securitized debt. The Company assesses modifications to VIEs on an ongoing basis to determine if a significant reconsideration event has occurred that would change the Company's initial consolidation assessment.

CMSC Trust 2015 - Longhouse MZ

In November 2015, the Company acquired a \$14.0 million interest in the trust certificate issued by CMSC Trust 2015 - Longhouse MZ ("CMSC Trust"), with an outstanding balance of \$13.5 million and a fair value of \$13.5 million at December 31, 2019. The Company determined that CMSC Trust was a VIE and that the Company was the primary beneficiary because it was involved in certain aspects of the design of the trust, has certain oversight rights on defaulted assets and has other significant decision making powers. In addition, the Company has the obligation to absorb losses to the extent of its ownership interest and the right to receive benefits from the trust that the Company believes could potentially be significant to the trust. As the primary beneficiary, the Company was required to consolidate CMSC Trust and accordingly its \$13.5 million investment in CMSC Trust was eliminated in consolidation. The CMSC Trust holds a \$24.0 million mezzanine loan, which bears an interest rate of 9%, collateralized by interests in commercial real estate. The mezzanine loan serves as collateral for the \$24.0 million of trust certificates issued. Refer to Note 7 - "Financings" for details on the associated securitized debt.

RETL 2019-RVP and RETL 2018-RVP

In March 2018, the Company acquired a \$67.8 million interest in the trust certificate issued by RETL 2018-RVP ("RETL 2018 Trust"), which represents the 5% eligible horizontal residual interest under the Credit Risk Retention Rules of Section 15G of the Exchange Act. Under the credit risk retention rules, the Company must retain its investment for five years and is limited in its ability to finance and hedge its investment. The trust certificate's pass-through rate is one month LIBOR plus 9.5%. The Company determined that RETL 2018 Trust was a VIE and that the Company was the primary beneficiary because the Manager was involved in certain aspects of the design of the trust and the Company together with other related party entities own more than 50% of the controlling class. The owner of 50% or more of the controlling class has certain oversight rights on defaulted assets and has other significant decision making powers. In addition, the Company has the obligation to absorb losses to the extent of its ownership interest from the trust that the Company believes could potentially be significant to the trust. As the primary beneficiary, the Company consolidated RETL 2018 and its investment in the trust certificates (HRR class) of RETL 2018 was eliminated in the consolidation. In March 2019, the securitized debt was refinanced and the outstanding principal balance issued by RETL 2018 Trust was paid in full.

RETL 2018 was refinanced with a new securitization RETL 2019-RVP ("RETL 2019 Trust") in March 2019. The Company acquired a \$65.3 million interest in the trust certificates issued by the RETL 2019 Trust, including \$45.3 million which represents the 5% eligible risk retention certificate. The Company determined that RETL 2019 Trust was a VIE and that the Company was also the primary beneficiary because the Manager was involved in certain aspects of the design of the trust and the Company together with other related party entities own more than 50% of the controlling class. As the primary beneficiary, the Company consolidated RETL 2019 Trust and its investment in the trust certificates (HRR class and a portion of the C class) of RETL 2019 Trust were eliminated in the consolidation. The RETL 2019 Trust holds a commercial loan collateralized by first mortgages, deeds of trusts and interests in commercial real estate. The outstanding principal balance on this commercial loan is \$674.3 million as of December 31, 2019. The loan's stated maturity date is March 15, 2021 (subject to the borrower's option to extend the initial stated maturity date for two successive one-year terms) and bears an interest rate of one month LIBOR plus 2.30%.

MRCD 2019-PRKC Mortgage Trust

In December 2019, the Company acquired a \$161.4 million interest in the trust certificates issued by the MRCD 2019-PRKC Mortgage Trust ("MRCD Trust"), including \$10.5 million which represents the initial controlling class (HRR class). The Company determined that MRCD Trust was a VIE and that the Company was also the primary beneficiary because the Manager was involved in certain aspects of the design of the trust and the Company owns the controlling class. As the primary beneficiary, the Company consolidated MRCD Trust and its investment in the trust certificates (HRR class and a portion of the A class) of MRCD Trust were eliminated in the consolidation. The MRCD Trust holds two commercial loans, class A and class HRR, collateralized by first mortgages, deeds of trusts and interests in commercial real estate. The outstanding principal balance on class A commercial loan is \$234.5 million as of December 31, 2019 and bears an interest rate of 4.27%. The outstanding principal

balance on class HRR commercial loan is \$10.5 million as of December 31, 2019 and bears an interest rate of 12.02%. The loans' stated maturity date is December 9, 2024.

Commercial Loans

In January 2019, WMC CRE LLC ("CRE LLC"), a wholly-owned subsidiary of the Company, and WMC CRE Mezzanine Loan Subsidiary LCC ("CRE Mezz"), a wholly-owned subsidiary of CRE LLC, were formed for the purpose of acquiring commercial loans.

The following table presents the commercial loans held by CRE LLC and CRE Mezz as of December 31, 2019 (dollars in thousands):

Loan	Acquisition Date	Loan Type	Principal Balance	Fair Value	Original LTV	Interest Rate	Maturity Date	Extension Option	Collateral
CRE 1	March 2018	Interest-Only Mezzanine loan	\$ 20,000	\$ 20,000	71%	1-Month LIBOR plus 6.50%	12/9/2020	Two One-Year Extensions	Hotel
CRE 2	June 2018	Interest-Only First Mortgage	30,000	30,000	65%	1-Month LIBOR plus 4.50%	6/9/2020	One-Year Extension	Hotel
CRE 4	June 2019	Principal & Interest First Mortgage	50,000	50,000	75%	1-Month LIBOR plus 4.75%	1/11/2022	Two One-Year Extensions	Nursing Facilities
CRE 5	August 2019	Interest-Only Mezzanine loan	90,000	90,000	58%	1-Month LIBOR plus 9.25%	6/29/2021	Two-Year First Extension and One-Year Second Extension	Entertainment and Retail
CRE 6	September 2019	Interest-Only First Mortgage	40,000	40,000	63%	1-Month LIBOR plus 3.02%	8/6/2021	Two One-Year Extensions	Retail
CRE 7	December 2019	Interest-Only First Mortgage	24,535	24,535	62%	1-Month LIBOR plus 3.75%	11/6/2021	Three One-Year Extensions	Hotel
CRE 8	December 2019	Interest-Only First Mortgage	13,206	13,206	62%	1-Month LIBOR plus 3.75%	11/6/2021	Three One-Year Extensions	Hotel
CRE 9	December 2019	Interest-Only First Mortgage	7,259	7,259	62%	1-Month LIBOR plus 3.75%	11/6/2021	Three One-Year Extensions	Hotel
CRE 10	December 2019	Interest-Only First Mortgage	4,425	4,425	79%	1-Month LIBOR plus 4.85%	12/6/2022	None	Assisted Living
			\$ 279,425	\$ 279,425					

Commercial Loan Trust

In March 2018, the Company formed the Revolving Small Balance Commercial Trust 2018-1 ("RSBC Trust") to acquire commercial real estate mortgage loans. The Company determined that the wholly-owned RSBC Trust was a VIE and that the Company was the primary beneficiary because it was involved in the design of the trust and holds significant decision making powers. In addition, the Company has the obligation to absorb losses to the extent of its ownership interest and the right to receive benefits from the trust that could potentially be significant to the trust. As of December 31, 2019, the Company financed the trust certificate with \$62.7 million of repurchase agreements, which is a liability held outside the trust.

The following table presents the commercial real estate loans held by RSBC Trust as of December 31, 2019 (dollars in thousands):

Loan	Acquisition Date	Loan Type	Principal Balance	Fair Value	LTV	Interest Rate	Maturity Date	Extension Option	Collateral
SBC 1	July 2018	Interest-Only First Mortgage	\$ 45,188	\$ 45,188	74%	One-Month LIBOR plus 4.25% ⁽¹⁾	7/1/2020	Two One-Year Extensions	Nursing Facilities
SBC 4	January 2019	Interest-Only First Mortgage	13,600	13,600	84%	One-Month LIBOR plus 4.00% ⁽²⁾	12/1/2021	One-Year Extension	Apartment Complex
SBC 5	January 2019	Interest-Only First Mortgage	32,000	32,000	49%	One-Month LIBOR plus 4.10%	7/1/2021	None	Nursing Facilities
			\$ 90,788	\$ 90,788					

(1) Subject to LIBOR floor of 1.25%.
(2) Subject to LIBOR floor of 2.00%.

Consolidated Securitized Commercial Loan Trusts and Commercial Loan Trust

The Company assesses modifications to VIEs on an ongoing basis to determine if a significant reconsideration event has occurred that would change the Company's initial consolidation assessment. The four consolidated trusts, CMSC Trust, RETL 2019 Trust, MRCD Trust and RSBC Trust collectively hold seven commercial loans as of December 31, 2019.

The following table presents a summary of the assets and liabilities of the four consolidated trusts included in the Consolidated Balance Sheets as of December 31, 2019 and December 31, 2018 (dollars in thousands):

	December 31, 2019	December 31, 2018
Cash	\$ 5,778	\$ —
Restricted cash	52,948	55,808
Securitized commercial loans, at fair value	909,040	1,013,511
Commercial Loans, at fair value	90,788	166,123
Interest receivable	2,989	3,733
Total assets	\$ 1,061,543	\$ 1,239,175
Securitized debt, at fair value	\$ 681,643	\$ 949,626
Interest payable	1,519	2,419
Accounts payable and accrued expenses	12	31
Other liabilities	52,948	55,808
Total liabilities	\$ 736,122	\$ 1,007,884

The Company's risk with respect to its investment in each commercial loan trust is limited to its direct ownership in the trust. The commercial loans held by the consolidated trusts are held solely to satisfy the liabilities of the trust, and creditors of the trust have no recourse to the general credit of the Company. The assets of a consolidated trust can only be used to satisfy the obligations of that trust. The Company is not contractually required and has not provided any additional financial support to the trusts for the years ended December 31, 2019 and December 31, 2018.

The following table presents the components of the carrying value of the commercial real estate loans as of December 31, 2019 and December 31, 2018 (dollars in thousands):

	CMSC Trust Securitized Commercial Loan, at Fair Value		RETL Trust Securitized Commercial Loan, at Fair Value		MRCD Trust Commercial Loans, at Fair Value		RSBC Trust Commercial Loans, at Fair Value		Commercial Loans, at Fair Value	
	December 31, 2019	December 31, 2018	December 31, 2019	December 31, 2018	December 31, 2019	December 31, 2018	December 31, 2019	December 31, 2018	December 31, 2019	December 31, 2018
Principal balance	\$ 24,048	\$ 24,456	\$ 674,331	\$ 988,609	\$ 245,000	\$ —	\$ 90,788	\$ 166,432	\$ 279,425	\$ 50,000
Unamortized premium	—	—	1,836	431	—	—	—	—	—	—
Unamortized discount	—	—	—	—	(35,119)	—	(215)	(736)	(294)	(205)
Amortized cost	24,048	24,456	676,167	989,040	209,881	—	90,573	165,696	279,131	49,795
Gross unrealized gains	9	—	269	29	—	—	215	427	294	205
Gross unrealized losses	—	(14)	—	—	(1,334)	—	—	—	—	—
Fair value	\$ 24,057	\$ 24,442	\$ 676,436	\$ 989,069	\$ 208,547	\$ —	\$ 90,788	\$ 166,123	\$ 279,425	\$ 50,000

Note 7—Financings

Repurchase Agreements

The Company primarily finances its investment acquisitions with repurchase agreements. The repurchase agreements bear interest at a contractually agreed-upon rate and typically have terms ranging from one month to three months. The Company's repurchase agreement borrowings are accounted for as secured borrowings when the Company maintains effective control of the financed assets. Under the repurchase agreements, the respective counterparties retain the right to determine the fair value of the underlying collateral. A reduction in the value of pledged assets requires the Company to post additional securities as collateral, pay down borrowings or establish cash margin accounts with the counterparties in order to re-establish the agreed-upon collateral requirements, and is referred to as a margin call. The inability of the Company to post adequate collateral for a margin call by a counterparty, in a time frame as short as the close of the same business day, could result in a condition of default under the Company's repurchase agreements, thereby enabling the counterparty to liquidate the collateral pledged by the Company, which may have a material adverse effect on the Company's financial position, results of operations and cash flows. Under the terms of the repurchase agreements the Company may rehypothecate pledged U.S. Treasury securities it receives from its repurchase agreement as incremental collateral in order to increase the Company's cash position. At December 31, 2019 and December 31, 2018, the Company did not have any rehypothecated U.S. Treasury securities.

Certain of the repurchase agreements provide the counterparty with the right to terminate the agreement if the Company does not maintain certain equity and leverage metrics, the most restrictive of which include a limit on leverage based on the composition of the Company's portfolio. For all the repurchase agreements with outstanding borrowings, the Company was in compliance with the terms of such financial tests as of December 31, 2019.

As of December 31, 2019, the Company had 34 master repurchase agreements with its counterparties and borrowings under 21 of the 34 counterparties. The following table summarizes certain characteristics of the Company's repurchase agreements at December 31, 2019 and December 31, 2018 (dollars in thousands):

Securities Pledged	December 31, 2019			December 31, 2018		
	Repurchase Agreement Borrowings	Weighted Average Interest Rate on Borrowings Outstanding at end of period	Weighted Average Remaining Maturity (days)	Repurchase Agreement Borrowings	Weighted Average Interest Rate on Borrowings Outstanding at end of period	Weighted Average Remaining Maturity (days)
Short Term Borrowings:						
Agency CMBS	\$ 1,352,248	2.05%	26	\$ 1,392,649	2.71%	40
Agency RMBS	348,274	1.99%	52	14,650	3.09%	21
Non-Agency RMBS	30,481	3.56%	9	30,922	4.06%	18
Non-Agency CMBS	190,390	3.05%	35	134,814	4.05%	48
Residential Whole Loans ⁽¹⁾	102,029	3.51%	27	863,356	4.08%	93
Residential Bridge Loans ⁽¹⁾	29,869	3.93%	28	204,754	4.50%	25
Commercial Loans ⁽¹⁾	62,746	4.04%	28	131,788	4.55%	26
Securitized commercial loans ⁽¹⁾	116,087	3.93%	49	7,543	4.30%	15
Other securities	56,762	3.23%	34	38,361	4.18%	26
Subtotal	2,288,886	2.41%	32	2,818,837	3.45%	54
Long Term Borrowings:						
Residential Whole Loans ^{(1) (2)}	374,143	3.27%	898	—	—%	—
Commercial Loans ⁽²⁾	161,848	3.88%	590	—	—%	—
Subtotal	535,991	3.45%	805	—	—%	—
Repurchase agreements borrowings	\$ 2,824,877	2.61%	179	\$ 2,818,837	3.45%	54
Less unamortized debt issuance costs	76	N/A	N/A	—	N/A	N/A
Repurchase agreements borrowings, net	\$ 2,824,801	2.61%	179	\$ 2,818,837	3.45%	54

(1) Repurchase agreement borrowings on loans owned are through trust certificates. The trust certificates are eliminated in consolidation.

(2) Certain Residential Whole Loans and Commercial Loans were financed under two new longer term repurchase agreements. The Company entered into a \$700.0 million residential and \$200.0 million commercial facility. These facilities automatically roll until such time as they are terminated or until certain conditions of default. The weighted average remaining maturity days was calculated using expected weighted life of the underlying collateral.

At December 31, 2019 and December 31, 2018, repurchase agreements collateralized by investments had the following remaining maturities:

(dollars in thousands)	December 31, 2019	December 31, 2018
1 to 29 days	\$ 1,480,286	\$ 1,867,957
30 to 59 days	552,786	144,778
60 to 89 days	255,814	555,695
Greater than or equal to 90 days	535,991	250,407
Total	\$ 2,824,877	\$ 2,818,837

At December 31, 2019, the following table reflects amounts of collateral at risk under its repurchase agreements greater than 10% of the Company's equity with any counterparty (dollars in thousands):

Counterparty	December 31, 2019		
	Amount of Collateral at Risk, at fair value	Weighted Average Remaining Maturity (days)	Percentage of Stockholders' Equity
Credit Suisse AG, Cayman Islands Branch	\$ 132,306	1024	23.4%
Barclays Capital Inc.	73,203	38	13.0%

Collateral for Borrowings under Repurchase Agreements

The following table summarizes the Company's collateral positions, with respect to its borrowings under repurchase agreements at December 31, 2019 and December 31, 2018 (dollars in thousands):

	December 31, 2019			December 31, 2018		
	Assets Pledged	Accrued Interest	Assets Pledged and Accrued Interest	Assets Pledged	Accrued Interest	Assets Pledged and Accrued Interest
Assets pledged for borrowings under repurchase agreements:						
Agency CMBS, at fair value	\$ 1,400,230	\$ 3,916	\$ 1,404,146	\$ 1,486,142	\$ 4,262	\$ 1,490,404
Agency RMBS, at fair value	356,687	1,336	358,023	19,837	453	20,290
Non-Agency RMBS, at fair value	45,816	414	46,230	50,555	479	51,034
Non-Agency CMBS, at fair value	246,797	951	247,748	186,552	915	187,467
Residential Whole Loans, at fair value ⁽¹⁾	529,495	3,704	533,199	1,041,885	8,145	1,050,030
Residential Bridge Loans ⁽¹⁾	34,897	471	35,368	221,486	3,528	225,014
Commercial Loans, at fair value ⁽¹⁾	350,213	1,855	352,068	196,123	1,067	197,190
Securitized commercial loans, at fair value ⁽¹⁾	171,640	674	172,314	13,688	88	13,776
Other securities, at fair value	80,031	128	80,159	59,780	147	59,927
Cash ⁽²⁾	43,499	—	43,499	1,226	—	1,226
Total	<u>\$ 3,259,305</u>	<u>\$ 13,449</u>	<u>\$ 3,272,754</u>	<u>\$ 3,277,274</u>	<u>\$ 19,084</u>	<u>\$ 3,296,358</u>

(1) Loans owned through trust certificates are pledged as collateral. The trust certificates are eliminated upon consolidation.

(2) Cash posted as collateral is included in "Due from counterparties" in the Company's Consolidated Balance Sheets.

A reduction in the value of pledged assets typically results in the repurchase agreement counterparties initiating a margin call. At December 31, 2019 and December 31, 2018, investments held by counterparties as security for repurchase agreements totaled approximately \$3.2 billion and approximately \$3.3 billion, respectively. Cash collateral held by repurchase agreement counterparties at December 31, 2019 and December 31, 2018 was approximately \$43.5 million and \$1.2 million, respectively. Cash posted by repurchase agreement counterparties at December 31, 2019 and December 31, 2018, was approximately \$709 thousand and \$17.8 million, respectively. In addition, at December 31, 2019 and December 31, 2018, the Company held securities with a fair value of \$0 and \$5.2 million, respectively, received as collateral from its repurchase agreement counterparties to satisfy margin requirements. The Company has the ability to repledge collateral received from its repurchase counterparties.

Convertible Senior Unsecured Notes

At December 31, 2019, the Company had \$205.0 million aggregate principal amount of 6.75% convertible senior unsecured notes outstanding through three issuances described below.

In October 2017, the Company issued \$115.0 million aggregate principal amount of 6.75% convertible senior unsecured notes for net proceeds of \$111.1 million. The notes mature on October 1, 2022, unless earlier converted, redeemed or repurchased by the holders pursuant to their terms, and are not redeemable by the Company except during the final three months prior to maturity.

In August 2019, the Company issued an additional \$40.0 million aggregate principal amount of 6.75% convertible senior unsecured notes (the "August 2019 Reopened Notes") for net proceeds of \$38.8 million after subtracting underwriting commissions and debt offering expenses. The August 2019 Reopened Notes have substantially identical terms as the existing notes issued in October 2017. The notes mature on October 1, 2022, unless earlier converted, redeemed or repurchased by the holders pursuant to their terms, and are not redeemable by us except during the final three months prior to maturity.

In December 2019, the Company issued another \$50.0 million aggregate principal amount of 6.75% convertible senior unsecured notes (the "December 2019 Reopened Notes") for net proceeds of \$49.2 million. The December 2019 Reopened Notes have substantially identical terms as the existing notes issued in October 2017. The notes mature on October 1, 2022, unless earlier converted, redeemed or repurchased by the holders pursuant to their terms, and are not redeemable by us except during the final three months prior to maturity.

The notes are convertible into, at the Company's election, cash, shares of the Company's common stock or a combination of both, subject to the satisfaction of certain conditions and during specified periods. The conversion rate is subject to adjustment upon the occurrence of certain specified events and the holders may require the Company to repurchase all or any portion of their notes for cash equal to 100% of the principal amount of the notes, plus accrued and unpaid interest, if the Company undergoes a fundamental change as specified in the agreement. The initial conversion rate was 83.1947 shares of common stock per \$1,000 principal amount of notes and represented a conversion price of \$12.02 per share of common stock.

Securitized Debt

CMSC Trust 2015 - Longhouse MZ

CMSC Trust issued \$25.0 million in commercial pass-through certificates. The outstanding principal balance of the trust certificates was \$24.0 million at December 31, 2019, with a fair value of \$24.1 million. The trust certificates bear a fixed interest rate of 8.9% and mature on June 6, 2020. The Company has chosen to make the fair value election pursuant to ASC 825 for the debt and accordingly the periodic change in fair value are recorded in current period earnings in the Consolidated Statements of Operations as a component of "Unrealized gain (loss), net."

The Company owns \$13.5 million of the trust certificates which was eliminated in consolidation and the remaining \$10.6 million is held by related parties and is carried at a fair value of \$10.6 million and recorded in "Securitized debt, net" in the consolidated balance sheets. The securitized debt of the CMSC Trust can only be settled with the commercial loan, with an outstanding principal balance of \$24.0 million at December 31, 2019, that serves as collateral for the securitized debt and is non-recourse to the Company.

RETL 2019 Trust

The following table summarizes RETL 2019 Trust's commercial mortgage pass-through certificates at December 31, 2019 (dollars in thousands):

Classes	Principal Balance	Coupon	Fair Value	Contractual Maturity
Class A	\$ 219,431	2.9%	\$ 219,567	3/15/2021
Class B	101,200	3.3%	101,326	3/15/2021
Class C	308,400	3.8%	309,171	3/15/2021
Class HRR	45,300	10.2%	45,314	3/15/2021
Class X-CP ⁽¹⁾	N/A	1.2%	1,026	4/15/2020
Class X-EXT ⁽¹⁾	N/A	—%	31	3/15/2021
	<u>\$ 674,331</u>		<u>\$ 676,435</u>	

(1) Class X-CP and Class X-EXT are interest-only classes with an initial notional balance of \$308.4 million each.

The Company acquired \$30.6 million of the class C certificates and the entire class of HRR certificates principal, which are eliminated in consolidation and the remaining RETL debt with a fair value of \$600.5 million is recorded in "Securitized debt, net" in the consolidated balance sheets. Of the remaining outstanding principal balance of \$598.5 million, excluding the interest-only debt securities, \$60.6 million is owned by related parties and \$537.9 million is owned by third parties. The securitized debt of the RETL 2019 Trust can only be settled with the commercial loan, with an outstanding principal balance of approximately \$674.3 million at December 31, 2019, that serves as collateral for the securitized debt and is non-recourse to the Company. The Company has chosen to make the fair value election pursuant to ASC 825 for the debt and accordingly the periodic change in fair value are recorded in current period earnings in the Consolidated Statements of Operations as a component of "Unrealized gain (loss), net."

Arroyo Trust

In May 2019, the Company completed a residential mortgage-backed securitization comprised of \$945.5 million of Non-QM Residential Whole Loans, issuing \$919.0 million of mortgage-backed notes. The Company did not elect the fair value option for these notes and accordingly they are recorded at their principal balance less unamortized deferred financing costs and classified in "Securitized debt, net" in the Consolidated Balance Sheets. The following table summarizes the issued Arroyo Trust's residential mortgage pass-through certificates at December 31, 2019 (dollars in thousands):

Classes	Principal Balance	Coupon	Carrying Value	Contractual Maturity
Offered Notes:				
Class A-1	\$ 681,668	3.3%	\$ 681,666	4/25/2049
Class A-2	36,525	3.5%	36,524	4/25/2049
Class A-3	57,866	3.8%	57,864	4/25/2049
Class M-1	25,055	4.8%	25,055	4/25/2049
Subtotal	\$ 801,114		\$ 801,109	
Less: Unamortized Deferred Financing Costs	N/A		5,298	
Total	\$ 801,114		\$ 795,811	

The Company retained the non-offered securities in the securitization, which include the class B, Class A-IO-S and Class XS certificates. These non-offered securities are eliminated in the consolidation. The securitized debt of the Arroyo Trust can only be settled with the residential loans that serve as collateral for the securitized debt and is non-recourse to the Company. At December 31, 2019, Residential Whole Loans, with an outstanding principal balance of approximately \$814.0 million, serve as collateral for the Arroyo Trust's securitized debt. The Company may redeem the offered notes on or after the earlier of (i) the three-year anniversary of the closing date or ii) the date on which the aggregate collateral balance is 20% of the original principal balance. The notes are redeemable at their face value plus accrued interest.

MRCD Trust

The following table summarizes MRCD Trust's commercial mortgage pass-through certificates at December 31, 2019 (dollars in thousands):

Classes	Principal Balance	Coupon	Fair Value	Contractual Maturity
Class A	\$ 234,500	4.3%	\$ 198,104	12/9/2024
Class HRR	10,500	12.0%	10,443	12/9/2024
	\$ 245,000		\$ 208,547	

The Company acquired \$150.9 million of the class A certificates and the entire class of HRR certificates principal, which are eliminated in consolidation and the remaining MRCD debt with a fair value of \$70.6 million is recorded in "Securitized debt,

net" in the consolidated balance sheets. The remaining outstanding principal balance of \$83.6 million is owned by related parties. The securitized debt of the MRCD Trust can only be settled with the commercial loan, with an outstanding principal balance of approximately \$245.0 million at December 31, 2019, that serves as collateral for the securitized debt and is non-recourse to the Company. The Company has chosen to make the fair value election pursuant to ASC 825 for the debt and accordingly the periodic change in fair value are recorded in current period earnings in the Consolidated Statements of Operations as a component of "Unrealized gain (loss), net."

Note 8—Derivative Instruments

The Company's derivatives may include interest rate swaps, options, futures contracts, TBAs, Agency and Non-Agency Interest-Only Strips that are classified as derivatives, credit default swaps and total return swaps.

The following table summarizes the Company's derivative instruments at December 31, 2019 and December 31, 2018 (dollars in thousands):

Derivative Instrument	Accounting Designation	Consolidated Balance Sheets Location	December 31, 2019		December 31, 2018	
			Notional Amount	Fair Value	Notional Amount	Fair Value
Interest rate swaps, asset	Non-Hedge	Derivative assets, at fair value	\$ 2,701,000	\$ 3,017	\$ 1,128,400	\$ 2,057
Credit default swaps, asset	Non-Hedge	Derivative assets, at fair value	60,100	948	50,000	549
TBA securities, asset	Non-Hedge	Derivative assets, at fair value	1,000,000	1,146	—	—
Total derivative instruments, assets				5,111		2,606
Interest rate swaps, liability	Non-Hedge	Derivative liability, at fair value	1,255,000	(501)	2,727,800	(5,473)
Futures contracts, liability	Non-Hedge	Derivative liability, at fair value	—	—	300,400	(4,657)
Credit default swaps, liability	Non-Hedge	Derivative liability, at fair value	90,900	(3,795)	—	—
TBA securities, liability	Non-Hedge	Derivative liability, at fair value	1,000,000	(2,074)	—	—
Total derivative instruments, liabilities				(6,370)		(10,130)
Total derivative instruments, net				\$ (1,259)		\$ (7,524)

The following tables summarize the effects of the Company's derivative positions, including Interest-Only Strips characterized as derivatives and TBAs, which are reported in "Gain (loss) on derivative instruments, net" in the Consolidated Statements of Operations for the years ended December 31, 2019, December 31, 2018 and December 31, 2017 (dollars in thousands):

Description	Realized Gain (Loss), net		Return (Recovery) of Basis	Mark-to-Market	Contractual interest income (expense), net	Total
	Other Settlements / Expirations	Variation Margin Settlement				
Year ended December 31, 2019						
Interest rate swaps	\$ (4,978)	\$ (108,169)	\$ 5,769	\$ 5,140	\$ 3,732	\$ (98,506)
Interest rate swaptions	(332)	—	—	—	—	(332)
Interest-Only Strips—accounted for as derivatives	—	—	(2,688)	(508)	3,277	81
Options	1,378	—	—	—	—	1,378
Futures contracts	(12,862)	—	—	4,657	—	(8,205)
Credit default swaps	(178)	—	—	1,029	—	851
TBAs	1,934	—	—	(928)	—	1,006
Total	<u>\$ (15,038)</u>	<u>\$ (108,169)</u>	<u>\$ 3,081</u>	<u>\$ 9,390</u>	<u>\$ 7,009</u>	<u>\$ (103,727)</u>
Year ended December 31, 2018						
Interest rate swaps	\$ 163	\$ 76,979	\$ 2,465	\$ (5,147)	\$ 3,693	\$ 78,153
Interest-Only Strips—accounted for as derivatives	—	—	(3,661)	(655)	4,511	195
Options	(871)	—	—	300	—	(571)
Futures contracts	6,112	—	—	(5,285)	—	827
Credit default swaps	(241)	—	—	396	—	155
TBAs	(800)	—	—	10	—	(790)
Total	<u>\$ 4,363</u>	<u>\$ 76,979</u>	<u>\$ (1,196)</u>	<u>\$ (10,381)</u>	<u>\$ 8,204</u>	<u>\$ 77,969</u>
Year ended December 31, 2017						
Interest rate swaps	\$ (150,607)	\$ 20,258	\$ 524	\$ 148,947	\$ (14,606)	\$ 4,516
Interest rate swaptions	(115)	—	—	—	—	(115)
Interest-Only Strips—accounted for as derivatives	526	—	(5,995)	(902)	7,438	1,067
Options	(1,453)	—	—	(300)	—	(1,753)
Futures contracts	(9,130)	—	—	3,044	—	(6,086)
Foreign currency forwards	32	—	—	35	—	67
Total return swap	(552)	—	—	1,673	469	1,590
Credit default swaps	(11)	—	(22)	—	—	(33)
TBAs	4,049	—	—	(10)	—	4,039
Total	<u>\$ (157,261)</u>	<u>\$ 20,258</u>	<u>\$ (5,471)</u>	<u>\$ 152,465</u>	<u>\$ (6,699)</u>	<u>\$ 3,292</u>

At December 31, 2019 and December 31, 2018, the Company had cash pledged as collateral for its derivatives which represents upfront cash collateral upon the Company entering into an interest rate swap transaction and cash collateral for other derivatives of approximately \$55.4 million and approximately \$38.0 million respectively, which is reported in "Due from counterparties" in the Consolidated Balance Sheets.

Interest rate swaps and interest rate swaptions

The Company enters into interest rate swaps and interest rate swaptions to mitigate its exposure to higher short-term interest rates in connection with its repurchase agreements. Interest rate swaps generally involve the receipt of variable-rate amounts

from a counterparty in exchange for the Company making fixed-rate payments over the life of the interest rate swap without exchange of the underlying notional amount. Notwithstanding the foregoing, in order to manage its hedge position with regard to its liabilities, the Company on occasion will enter into interest rate swaps which involve the receipt of fixed-rate amounts from a counterparty in exchange for the Company making variable-rate payments over the life of the interest rate swap without exchange of the underlying notional amount. The Company also enters into forward starting swaps and interest rate swaptions to help mitigate the effects of changes in interest rates on a portion of its borrowings under repurchase agreements. Interest rate swaptions provide the Company the option to enter into an interest rate swap agreement for a predetermined notional amount, stated term and pay and receive interest rates in the future. The Company generally enters into MAC (Market Agreed Coupon) interest rate swaps in which it may receive or make a payment at the time of entering such interest rate swap to compensate for the out of the market nature of such interest rate swap. At December 31, 2019, the Company had made upfront cash collateral payments of \$52.6 million, which is classified in "Due from counterparties" in the Consolidated Balance Sheets. Similar to all other interest rate swaps, these interest rate swaps are also subject to margin requirements as previously described.

The Company has not elected to account for its interest rate swaps as "hedges" under GAAP, accordingly the change in fair value of the interest rate swaps not designated in hedging relationships are recorded together with periodic net interest settlement amounts in "Gain (loss) on derivatives instruments, net" in the Consolidated Statements of Operations.

Interest Rate Swaps

The following tables provide additional information on our fixed pay interest rate swaps and the variable pay interest rate swap as of December 31, 2019 and December 31, 2018 (dollars in thousands):

December 31, 2019				
Fixed Pay Interest Rate Swap Remaining Term	Notional Amount	Average Fixed Pay Rate	Average Floating Receive Rate	Average Maturity (Years)
1 year or less	\$ 200,000	1.8%	1.9%	0.4
Greater than 3 years and less than 5 years	622,400	2.6%	1.9%	4.1
Greater than 5 years	1,728,600	2.1%	2.0%	8.9
Total	\$ 2,551,000	2.2%	2.0%	7.1

December 31, 2019				
Variable Pay Interest Rate Swap Remaining Term	Notional Amount	Average Variable Pay Rate	Average Fixed Receive Rate	Average Maturity (Years)
Greater than 1 years and less than 3 years	\$ 810,000	2.0%	2.0%	1.6
Greater than 3 years and less than 5 years	550,000	1.9%	1.6%	5
Greater than 5 years	45,000	1.9%	2.3%	19.5
Total	\$ 1,405,000	2.0%	1.9%	3.5

December 31, 2018				
Fixed Pay Interest Rate Swap Remaining Term	Notional Amount	Average Fixed Pay Rate	Average Floating Receive Rate	Average Maturity (Years)
1 year or less	\$ 400,000	1.5%	2.8%	0.5
Greater than 1 year and less than 3 years	200,000	1.8%	2.6%	1.4
Greater than 3 years and less than 5 years	1,104,700	2.3%	2.5%	3.8
Greater than 5 years	1,423,100	2.5%	2.5%	9.9
Total	\$ 3,127,800	2.3%	2.6%	6.0

Variable Pay Interest Rate Swap Remaining Term	December 31, 2018			
	Notional Amount	Average Variable Pay Rate	Average Fixed Receive Rate	Average Maturity (Years)
Greater than 5 years	\$ 728,400	2.5%	2.4%	8.3
Total	\$ 728,400	2.5%	2.4%	8.3

As of December 31, 2019 and December 31, 2018, the Company had no variable pay or fixed pay forward starting swaps.

Futures Contracts

The Company may enter into Eurodollar, Volatility Index and U.S. Treasury futures. As of December 31, 2019, the Company had no open futures contracts. As of December 31, 2018, the Company had entered into contracts to sell or short positions for U.S. Treasuries with a notional amount of \$300.4 million, with a fair value in a liability position of \$4.7 million and an expiration date of March 2019.

To-Be-Announced Securities

The Company purchased or sold TBAs during the years ended December 31, 2019 and December 31, 2018. There were no open TBA positions as of December 31, 2018. The following is a summary of the Company's TBA positions as of December 31, 2019, reported in "Derivative assets, at fair value" and "Derivative liability, at fair value" in the Consolidated Balance Sheets (dollars in thousands):

	December 31, 2019	
	Notional Amount	Fair Value
Purchase contracts, asset	\$ 1,000,000	\$ 1,146
Purchase contracts, liability	(1,000,000)	(2,074)
TBA securities, net	\$ —	\$ (928)

The following tables present additional information about the Company's contracts to purchase and sell TBAs for the year ended December 31, 2019 (dollars in thousands):

	Notional Amount	Additions	Settlement, Termination,	Notional Amount
	December 31, 2018		Expiration or Exercise	December 31, 2019
Purchase of TBAs	\$ —	\$ 3,200,000	\$ (2,200,000)	\$ 1,000,000
Sale of TBAs	\$ —	\$ 3,200,000	\$ (2,200,000)	\$ 1,000,000

Interest-Only Strips

The Company also invests in Interest-Only Strips. In determining the classification of its holdings of Interest-Only Strips, the Company evaluates the securities to determine if the nature of the cash flows has been altered from that of the underlying mortgage collateral. Generally, Interest-Only Strips for which the security represents a strip off of a mortgage pass through security will be considered a hybrid instrument classified as an MBS investment in the Consolidated Balance Sheets utilizing the fair value option. Alternatively, those Interest-Only Strips, for which the underlying mortgage collateral has been included into a structured security that alters the cash flows from the underlying mortgage collateral, are accounted for as derivatives at fair value with changes recognized in "Gain (loss) on derivative instruments, net" in the Consolidated Statements of Operations, along with any interest received. The carrying value of these Interest-Only Strips is included in "Agency mortgage-backed securities, at fair value" in the Consolidated Balance Sheets.

Credit Default Swaps

In 2019, the Company entered into credit default swaps and, in the future, may continue to enter into these types of credit derivatives. Under these instruments, the buyer makes a monthly premium payment over the term of the contract in exchange for the seller making a payment for losses of the reference securities, upon the occurrence of a specified credit event.

Note 9—Offsetting Assets and Liabilities

The following tables present information about certain assets and liabilities that are subject to master netting agreements (or similar agreements) and can potentially be offset in the Company's Consolidated Balance Sheets at December 31, 2019 and December 31, 2018 (dollars in thousands):

	December 31, 2019					
		Gross Amounts Offset in the Consolidated Balance Sheets	Net Amounts of Assets presented in the Consolidated Balance Sheets	Gross Amounts Not Offset in the Consolidated Balance Sheets		
Description	Gross Amounts			Financial Instruments ⁽¹⁾	Cash Collateral ⁽¹⁾	Net Amount
Derivative Assets						
Agency and Non-Agency Interest-Only Strips, accounted for as derivatives included in MBS	\$ 8,665	\$ —	\$ 8,665	\$ (8,665)	\$ —	\$ —
Derivative asset, at fair value ⁽²⁾	5,111	—	5,111	(2,576)	—	2,535
Total derivative assets	\$ 13,776	\$ —	\$ 13,776	\$ (11,241)	\$ —	\$ 2,535
Derivative Liabilities and Repurchase Agreements						
Derivative liability, at fair value ⁽²⁾⁽³⁾	\$ 6,370	\$ —	\$ 6,370	\$ (2,576)	\$ (2,819)	\$ 975
Repurchase Agreements ⁽⁴⁾	2,824,801	—	2,824,801	(2,824,801)	—	—
Total derivative liability	\$ 2,831,171	\$ —	\$ 2,831,171	\$ (2,827,377)	\$ (2,819)	\$ 975

(1) Amounts disclosed in the Financial Instruments column of the tables above represent securities, Whole Loans and securitized commercial loan collateral pledged and derivative assets that are available to be offset against liability balances associated with repurchase agreement and derivative liabilities. Amounts disclosed in the Cash Collateral column of the tables above represents amounts pledged or received as collateral against derivative transactions.

(2) Derivative asset, at fair value and Derivative liability, at fair value includes interest rate swaps, credit default swaps and futures contracts.

(3) Cash collateral pledged against the Company's derivative counterparties was approximately \$55.4 million as of December 31, 2019.

(4) The carrying value of investments pledged against the Company's repurchase agreements was approximately \$3.2 billion as of December 31, 2019.

December 31, 2018

Description	Gross Amounts	Gross Amounts Offset in the Consolidated Balance Sheets	Net Amounts of Assets presented in the Consolidated Balance Sheets	Gross Amounts Not Offset in the Consolidated Balance Sheets		Net Amount
				Financial Instruments ⁽¹⁾	Cash Collateral ⁽¹⁾	
Derivative Assets						
Agency and Non-Agency Interest-Only Strips, accounted for as derivatives included in MBS	\$ 11,860	\$ —	\$ 11,860	\$ (11,860)	\$ —	\$ —
Derivative asset, at fair value ⁽²⁾	2,606	—	2,606	(2,057)	—	549
Total derivative assets	\$ 14,466	\$ —	\$ 14,466	\$ (13,917)	\$ —	\$ 549
Derivative Liabilities and Repurchase Agreements						
Derivative liability, at fair value ⁽²⁾⁽³⁾	\$ 10,130	\$ —	\$ 10,130	\$ (2,057)	\$ (8,073)	\$ —
Repurchase Agreements ⁽⁴⁾	2,818,837	—	2,818,837	(2,818,837)	—	—
Total derivative liability	\$ 2,828,967	\$ —	\$ 2,828,967	\$ (2,820,894)	\$ (8,073)	\$ —

(1) Amounts disclosed in the Financial Instruments column of the tables above represent securities, Whole Loans and securitized commercial loan collateral pledged and derivative assets that are available to be offset against liability balances associated with repurchase agreement and derivative liabilities. Amounts disclosed in the Cash Collateral column of the tables above represents amounts pledged or received as collateral against derivative transactions.

(1) Derivative asset, at fair value and Derivative liability, at fair value includes interest rate swaps, credit default swaps and futures contracts.

(2) Cash collateral pledged against the Company's derivative counterparties was approximately \$38.0 million as of December 31, 2018.

(3) The carrying value of investments pledged against the Company's repurchase agreements was approximately \$3.3 billion as of December 31, 2018.

Certain of the Company's repurchase agreement and derivative transactions are governed by underlying agreements that generally provide for a right of set-off in the event of default or in the event of a bankruptcy of either party to the transaction.

Note 10—Related Party Transactions

Management Agreement

In connection with the Company's initial public offering ("IPO") in May 2012, the Company entered into a management agreement (the "Management Agreement") with the Manager, which describes the services to be provided by the Manager and compensation for such services. The Manager is responsible for managing the Company's operations, including: (i) performing all of its day-to-day functions; (ii) determining investment criteria in conjunction with the Board of Directors; (iii) sourcing, analyzing and executing investments, asset sales and financings; (iv) performing asset management duties; and (v) performing financial and accounting management, subject to the direction and oversight of the Company's Board of Directors. Pursuant to the terms of the Management Agreement, the Manager is paid a management fee equal to 1.50% per annum of the Company's stockholders' equity (as defined in the Management Agreement), calculated and payable (in cash) quarterly in arrears. For purposes of calculating the management fee, "stockholders' equity" means the sum of the net proceeds from any issuances of the Company's equity securities since inception (allocated on a pro rata daily basis for such issuances during the fiscal quarter of any such issuance), plus retained earnings, calculated in accordance with GAAP, at the end of the most recently completed fiscal quarter (without taking into account any non-cash equity compensation expense incurred in current or prior periods), less any amount paid for repurchases of the Company's shares of common stock, excluding any unrealized gains or losses on our investments and derivatives and other non-cash items, (excluding OTTI) that have impacted stockholders' equity as reported in the Company's consolidated financial statements prepared in accordance with GAAP, regardless of whether such items are included in other comprehensive income or loss, or in net income, and excluding one-time events pursuant to changes in GAAP and certain other non-cash charges after discussions between the Manager and the Company's independent directors and after approval by a majority of the Company's independent directors. However, if the Company's stockholders' equity for any given quarter is negative based on the calculation described above, the Manager will not be entitled to receive any management fee for that quarter.

On August 3, 2016, the Company and the Manager entered into an amendment to the Management Agreement that amended the definition of "Equity" in the Management Agreement. Under the new definition, for all periods beginning on January

1, 2016, OTTI will reduce the Company's "Equity" for any completed fiscal quarter that OTTI was recognized, which in turn will reduce the Company's management fee from what would have been payable before the amendment.

In addition, the Company may be required to reimburse the Manager for certain expenses as described below, and shall reimburse the Manager for the compensation paid to the Company's chief financial officer, controller and their staff. Expense reimbursements to the Manager are made in cash on a regular basis. The Company's reimbursement obligation is not subject to any dollar limitation. Because the Manager's personnel perform certain legal, accounting, due diligence tasks and other services that outside professionals or outside consultants otherwise would perform, the Manager may be paid or reimbursed for the documented cost of performing such tasks, provided that such costs and reimbursements are in amounts which are no greater than those which would be payable to outside professionals or consultants engaged to perform such services pursuant to agreements negotiated on an arm's-length basis.

The Management Agreement may be amended, supplemented or modified by agreement between the Company and the Manager. The Management Agreement expires on May 16, 2021. It is automatically renewed for one year terms on each May 15th unless previously terminated as described below. The Company's independent directors review the Manager's performance and any fees payable to the Manager annually and, the Management Agreement may be terminated annually upon the affirmative vote of at least two-thirds (2/3) of the Company's independent directors, based upon: (i) the Manager's unsatisfactory performance that is materially detrimental to the Company; or (ii) the Company's determination that any fees payable to the Manager are not fair, subject to the Manager's right to prevent such termination due to unfair fees by accepting a reduction of management fees agreed to by at least two-thirds (2/3) of the Company's independent directors. The Company will provide the Manager 180 days prior notice of any such termination. Unless terminated for cause, the Company will pay the Manager a termination fee equal to three times the average annual management fee earned by the Manager during the prior 24-month period immediately preceding the date of termination, calculated as of the end of the most recently completed fiscal quarter prior to the date of termination.

The Company may also terminate the Management Agreement at any time, without the payment of any termination fee, with 30 days prior written notice from the Company's Board of Directors for cause, which will be determined by at least two-thirds (2/3) of the Company's independent directors, which is defined as: (i) the Manager's continued material breach of any provision of the Management Agreement (including the Manager's failure to comply with the Company's investment guidelines); (ii) the Manager's fraud, misappropriation of funds, or embezzlement against the Company; (iii) the Manager's gross negligence in the performance of its duties under the Management Agreement; (iv) the occurrence of certain events with respect to the bankruptcy or insolvency of the Manager, including an order for relief in an involuntary bankruptcy case or the Manager authorizing or filing a voluntary bankruptcy petition; (v) the Manager is convicted (including a plea of nolo contendere) of a felony; or (vi) the dissolution of the Manager.

In September 2018, the Company completed a secondary public offering in which it sold 6,500,000 shares of its common stock for net proceeds of approximately \$67.7 million after subtracting underwriting commissions and offering expenses. Refer to Note 12- "Stockholders' Equity" for details on the secondary public offering. The Company's Manager did not earn a management fee on the issued equity through March 31, 2019, to reduce any impact on earnings as the Company fully deployed the capital into its target assets.

For the years ended December 31, 2019, December 31, 2018 and December 31, 2017 the Company incurred \$7.4 million, \$8.7 million and \$8.1 million in management fees, respectively.

In addition to the management fee, the Company is also responsible for reimbursing the Manager for certain expenses paid by the Manager on behalf of the Company, as defined in the Management Agreement. For the years ended December 31, 2019, December 31, 2018 and December 31, 2017, the Company recorded expenses included in general and administrative expenses totaling approximately \$1.6 million, \$1.5 million and \$1.4 million, respectively, related to reimbursable employee costs. Any such expenses incurred by the Manager and reimbursed by the Company, including the employee compensation expense, are typically included in the Company's general and administrative expense in the Consolidated Statements of Operations. At December 31, 2019 and December 31, 2018, approximately \$2.0 million and approximately \$4.2 million, respectively, for management fees incurred but not yet paid was included in "Payable to affiliate" in the Consolidated Balance Sheets. In addition, at December 31, 2019 and December 31, 2018, approximately \$181 thousand and approximately \$379 thousand, respectively of reimbursable costs incurred but not yet paid was included in "Payable to affiliate" in the Consolidated Balance Sheets.

Note 11—Share-Based Payments

In conjunction with the Company's IPO and concurrent private placement, the Company's Board of Directors approved the Western Asset Mortgage Capital Corporation Equity Plan (the "Equity Plan") and the Western Asset Manager Equity Plan (the "Manager Equity Plan" and collectively the "Equity Incentive Plans"). The Equity Incentive Plans include provisions for grants of restricted common stock and other equity-based awards to the Manager, its employees and employees of its affiliates and to the Company's directors, officers and employees. The Company can issue up to 3.0% of the total number of issued and outstanding shares of its common stock (on a fully diluted basis) at the time of each award (other than any shares previously issued or subject to awards made pursuant to one of the Company's Equity Incentive Plans) under these Equity Incentive Plans. Upon the completion of the Company's most recent secondary public offering, the number of shares of common stock available under the Equity Incentive Plans increased to 1,582,594. Approximately 894,289 of shares have been issued under the Equity Plans with 688,305 shares available for issuance as of December 31, 2019.

Under the Equity Plan, the Company made the following grants during the years ended December 31, 2019 and December 31, 2018:

On June 7, 2018, the Company granted a total of 25,904 shares (6,476 each) of restricted common stock under the Equity Plan to the Company's four independent directors. These restricted shares vested in full on June 1, 2019, the first anniversary of the grant date. Each of the independent directors has elected to defer the shares granted to him under the Company's Director Deferred Fee Plan (the "Director Deferred Fee Plan"). The Director Deferred Fee Plan permits eligible members of the Company's board of directors to defer certain stock awards made under its director compensation programs. The Director Deferred Fee Plan allows directors to defer issuance of their stock awards and therefore defer payment of any tax liability until the deferral is terminated, pursuant to the election form executed each year by each eligible director.

On March 28, 2019, the Company granted 108,000 shares of restricted common stock to the Manager under the Manager Equity Plan. One-third of the shares will vest on March 28, 2020, one-third will vest on March 28, 2021 and the remaining one-third will vest on March 28, 2022.

On June 6, 2019, the Company granted a total of 28,780 shares (7,195 each) of restricted common stock under the Equity Plan to the Company's four independent directors. These restricted shares will vest in full on June 6, 2020, the first anniversary of the grant date. Each of the independent directors has elected to defer the shares granted to him under the Company's Director Deferred Fee Plan (the "Director Deferred Fee Plan"). The Director Deferred Fee Plan permits eligible members of the Company's board of directors to defer certain stock awards made under its director compensation programs. The Director Deferred Fee Plan allows directors to defer issuance of their stock awards and therefore defer payment of any tax liability until the deferral is terminated, pursuant to the election form executed each year by each eligible director.

During the years ended December 31, 2019, December 31, 2018 and December 31, 2017, 29,200, 84,203 and 152,630 restricted common shares vested, respectively, including shares whose issuance has been deferred under the Director Deferred Fee Plan. The Company recognized stock-based compensation expense of approximately \$564 thousand, \$265 thousand and \$981 thousand for the years ended December 31, 2019, December 31, 2018 and December 31, 2017, respectively. In addition, the Company had unamortized compensation expense of \$968 thousand and \$117 thousand for equity awards at December 31, 2019 and December 31, 2018, respectively.

All restricted common shares granted, other than those whose issuance has been deferred pursuant to the Director Deferred Fee Plan, possess all incidents of ownership, including the right to receive dividends and distributions currently, and the right to vote. Dividend equivalent payments otherwise allocable to restricted common shares under the Company's Director Deferred Fee Plan are deemed to purchase additional phantom shares of the Company's common stock that are credited to each participant's deferral account. The award agreements include restrictions whereby the restricted shares cannot be sold, assigned, transferred, pledged, hypothecated or otherwise disposed of prior to the lapse of restrictions under the respective award agreement. The restrictions lapse on the unvested restricted shares awarded when vested, subject to the grantee's continuing to provide services to the Company as of the vesting date. Unvested restricted shares and rights to dividends thereon are forfeited upon termination of the grantee.

The following is a summary of restricted common stock vesting dates as of December 31, 2019 and December 31, 2018, including shares whose issuance has been deferred under the Director Deferred Fee Plan:

Vesting Date	December 31, 2019	December 31, 2018
	Shares Vesting	Shares Vesting
June 2019	—	27,476
March 2020	36,000	—
June 2020	30,592	—
March 2021	36,000	—
March 2022	36,000	—
	<u>138,592</u>	<u>27,476</u>

The following table presents information with respect to the Company's restricted stock for the years ended December 31, 2019 and December 31, 2018, including shares whose issuance has been deferred under the Director Deferred Fee Plan:

	December 31, 2019		December 31, 2018	
	Shares of Restricted Stock	Weighted Average Grant Date Fair Value ⁽¹⁾	Shares of Restricted Stock	Weighted Average Grant Date Fair Value ⁽¹⁾
Outstanding at beginning of period	753,973	\$ 16.77	725,449	\$ 17.00
Granted ⁽²⁾	140,316	10.34	28,524	10.75
Outstanding at end of period	<u>894,289</u>	<u>\$ 15.76</u>	<u>753,973</u>	<u>\$ 16.77</u>
Unvested at end of period	<u>138,592</u>	<u>\$ 10.34</u>	<u>27,476</u>	<u>\$ 10.78</u>

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

(2) Includes 3,536 shares and 2,620 shares of restricted stock attributed to dividends on restricted stock under the Director Deferred Fee Plan for the years ended December 31, 2019 and December 31, 2018, respectively.

Note 12—Stockholders' Equity

At-The-Market Program

In April 2017, the Company entered into an equity distribution agreement with JMP Securities LLC under which the Company may offer and sell up to \$100.0 million shares of common stock in an At-The-Market equity offering. During the year ended December 31, 2019, the Company sold 299,497 shares under this agreement for net proceeds of \$3.0 million.

Secondary Public Offerings

In September 2018, the Company completed a secondary public offering in which it sold 6,500,000 of its common stock, including 303,422 shares of treasury stock, at a price of \$10.85 per share, for net proceeds of approximately \$67.7 million after subtracting underwriting commissions and offering expenses of approximately \$2.8 million. The Company used the net proceeds from the offering to opportunistically invest in its target assets in accordance with its investment guidelines.

In May 2019, the Company completed a secondary public offering in which it sold 5,000,000 shares of our common stock at a price of \$10.14 per share, for net proceeds of approximately \$49.3 million after subtracting underwriting commissions and offering expenses of approximately \$1.4 million. The Company used the net proceeds from the offering to opportunistically invest in its target assets in accordance with its investment guidelines.

Stock Repurchase Program

On December 19, 2019, the Board of Directors of the Company reauthorized its repurchase program of up to 2,700,000 shares of its common stock through December 31, 2021. The previous reauthorization announced on December 21, 2017 of the Company's repurchase program of up to 2,100,000 shares of its common stock expired on December 31, 2019. Purchases made pursuant to the program will be made in the open market, in privately negotiated transactions, or pursuant to any trading plan that may be adopted in accordance with Rules 10b5-1 and 10b-18 of the Securities and Exchange Act of 1934, as amended. The

authorization does not obligate the Company to acquire any particular amount of common shares and the program may be suspended or discontinued at the Company's discretion without prior notice. The timing, manner, price and amount of any repurchases will be determined by the Company in its discretion and will be subject to economic and market conditions, stock price, applicable legal requirements and other factors. The Company has repurchased 303,422 shares of common stock accounted for as treasury stock pursuant to the authorization. In September 2018, the Company re-issued all 303,422 shares in treasury stock as part of its secondary public offering.

Dividends

The following table presents cash dividends declared and paid by the Company on its common stock:

Declaration Date	Record Date	Payment Date	Amount per Share	Tax Characterization
2019				
December 19, 2019	December 30, 2019	January 24, 2020	\$ 0.31	Ordinary income
September 19, 2019	September 30, 2019	October 25, 2019	\$ 0.31	Ordinary income
June 20, 2019	July 1, 2019	July 26, 2019	\$ 0.31	Ordinary income
March 21, 2019	April 1, 2019	April 26, 2019	\$ 0.31	Ordinary income
2018				
December 19, 2018	December 31, 2018	January 25, 2019	\$ 0.31	Ordinary income
September 17, 2018	September 27, 2018	October 26, 2018	\$ 0.31	Ordinary income
June 21, 2018	July 2, 2018	July 26, 2018	\$ 0.31	Ordinary income
March 22, 2018	April 2, 2018	April 26, 2018	\$ 0.31	Ordinary income

Note 13—Net Income per Common Share

The table below presents basic and diluted net income per share of common stock using the two-class method for the years ended December 31, 2019, December 31, 2018 and December 31, 2017 (dollars, other than shares and per share amounts, in thousands):

	For the year ended December 31, 2019	For the year ended December 31, 2018	For the year ended December 31, 2017
<i>Numerator:</i>			
Net income attributable to common stockholders and participating securities for basic and diluted earnings per share	\$ 70,699	\$ 26,409	\$ 85,097
<i>Less:</i>			
Dividends and undistributed earnings allocated to participating securities	303	138	312
Net income allocable to common stockholders—basic and diluted	<u>\$ 70,396</u>	<u>\$ 26,271</u>	<u>\$ 84,785</u>
<i>Denominator:</i>			
Weighted average common shares outstanding for basic earnings per share	<u>51,278,932</u>	<u>43,388,810</u>	<u>41,817,455</u>
Weighted average common shares outstanding for diluted earnings per share	<u>51,278,932</u>	<u>43,388,810</u>	<u>41,817,455</u>
Basic earnings per common share	<u>\$ 1.37</u>	<u>\$ 0.61</u>	<u>\$ 2.03</u>
Diluted earnings per common share	<u>\$ 1.37</u>	<u>\$ 0.61</u>	<u>\$ 2.03</u>

For the years ended December 31, 2019, December 31, 2018 and December 31, 2017, the Company excluded the effects of the convertible senior unsecured notes from the computation of diluted earnings per share since the average market value per share of the Company's common stock was below the exercise price of the convertible senior unsecured notes. For the years ended December 31, 2019, December 31, 2018 and December 31, 2017, the Company excluded the effects of the warrants from the computation of diluted earnings per share since the average market value per share of the Company's common stock was below the exercise price of the warrants.

Note 14—Income Taxes

As a REIT, the Company is not subject to federal income tax to the extent that it makes qualifying distributions to its stockholders and satisfies on a continuing basis, through actual investment and operating results, the REIT requirements including certain asset, income and stock ownership tests.

Based on the Company's analysis of any potential uncertain income tax positions, the Company concluded that it does not have any uncertain tax positions that meet the recognition or measurement criteria as of December 31, 2019. The Company files U.S. federal and state income tax returns. As of December 31, 2019, U.S. federal tax returns filed by the Company for 2018, 2017 and 2016 and state tax returns filed for 2018, 2017, 2016 and 2015 are open for examination pursuant to relevant statutes of limitation. In the event that the Company incurs income tax related interest and penalties, the Company's policy is to classify them as a component of its provision for income taxes.

Income Tax Provision

Subject to the limitation under the REIT asset test rules, the Company is permitted to own up to 100% of the stock of one or more TRS. Currently, the Company owns one TRS that is taxable as a corporation and is subject to federal, state and local income tax on its net income at the applicable corporate rates. The TRS, which was formed in Delaware on July 28, 2014, is a limited liability company and a wholly-owned subsidiary of the Company. For the years ended December 31, 2019, December 31, 2018 and December 31, 2017, the Company recorded a federal and state tax provision of approximately \$1.1 million, \$709 thousand and \$3.5 million, respectively.

The following table summarizes the Company's income tax provision for the years ended December 31, 2019, December 31, 2018 and December 31, 2017 (dollars in thousands):

	For the year ended December 31, 2019	For the year ended December 31, 2018	For the year ended December 31, 2017
Current Tax Provision (Benefit)			
Federal	\$ 860	\$ 709	\$ 4,076
State	197	—	(267)
Total Current Provision for Income Taxes, net	1,057	709	3,809
Deferred Provision (Benefit) for Income Taxes			
Federal	—	—	85
State	—	—	(407)
Total Deferred Benefit for Income Taxes, net	—	—	(322)
Total Income Tax Provision, net	\$ 1,057	\$ 709	\$ 3,487

Deferred Tax Asset and Deferred Tax Liability

As of December 31, 2019 and December 31, 2018, the Company recorded a deferred tax asset of approximately \$8.5 million and \$6.0 million, respectively, relating to capital loss carryforward and temporary differences as a result of the timing of income recognition of certain investments held in the TRS. The capital loss carryforwards may only be recognized to the extent of capital gains. There is uncertainty as to the TRS ability to recognize capital gains in the future. As a result, the Company has concluded it is more likely than not the deferred tax asset will not be realized and has recorded a full valuation allowance.

In addition, the REIT generated net operating losses ("NOL's") for the year ended December 31, 2017 related to its swap terminations and for the California return a portion of the NOL's is apportioned to the TRS. The Company recorded a deferred

state tax asset of \$6.0 million and \$5.5 million in the REIT and \$1.3 million and \$993 thousand in the TRS as of December 31, 2019 and December 31, 2018, respectively. The TRS can carryback the NOL's to each of the two preceding years and receive a refund for taxes paid. As a result, the Company has concluded it is more likely than not the deferred tax asset will not be realized with the exception of the TRS carryback to 2015 and has recorded a combined valuation allowance of \$6.9 million and \$6.1 million as of December 31, 2019 and December 31, 2018, respectively. The Company also recorded a deferred federal tax liability of \$85 thousand, as of December 31, 2019 and December 31, 2018, in anticipation of the receipt of the state tax refund as a result of the carryback of the California NOL.

The following tables disclose the components of the Company's deferred tax asset and deferred tax liability at December 31, 2019 and 2018 (dollars in thousands):

Deferred Tax Asset	December 31, 2019	December 31, 2018
Net operating loss available for carry-back and carry-forward ⁽¹⁾	\$ 7,295	\$ 6,503
Net capital loss carry-forward ⁽¹⁾	6,775	4,271
Investments	1,719	1,720
Deferred tax asset	15,789	12,494
Allowance	(15,382)	(12,087)
Net deferred tax asset	<u>\$ 407</u>	<u>\$ 407</u>

Deferred Tax Liability	December 31, 2019	December 31, 2018
Net operating loss available for carry-back and carry-forward	\$ 85	\$ 85
Net deferred tax liability	<u>\$ 85</u>	<u>\$ 85</u>

(1) Net operating loss available for carry-forward begin to expire in 2037. Net capital loss available for carry-forward begin to expire in 2020.

Reconciliation of Tax Rate to Effective Tax Rate

The Company's effective tax rate differs from its combined federal and state income tax rate primarily due to the deduction of dividends distributions to be paid under Code Section 857(a). The reconciliation of these rates are as follows:

	For the year ended December 31, 2019	For the year ended December 31, 2018
Federal statutory rate	21.0 %	21.0 %
State statutory rate, net of federal benefit	(1.0)%	1.5 %
Other	0.1 %	(0.8)%
Change in valuation allowance	3.6 %	(1.3)%
REIT earnings not subject to corporate taxes	(22.2)%	(17.8)%
Effective Tax Rate	<u>1.5 %</u>	<u>2.6 %</u>

Tax Cuts and Jobs Act

On December 22, 2017, the President of the United States signed and enacted comprehensive tax legislation into law H.R. 1, commonly referred to as the Tax Cuts and Jobs Act (the "Tax Act"). The Tax Act significantly revised the U.S. corporate income tax by, among other things, lowering the corporate income tax rate from 35% to 21%.

Note 15—Contingencies

From time to time, the Company may become involved in various claims and legal actions arising in the ordinary course of business. Management is not aware of any material contingencies at December 31, 2019.

Note 16—Summarized Quarterly Results (unaudited)

The following is a presentation of selected unaudited results of operations:

	Quarter Ended			
	March 31, 2019	June 30, 2019	September 30, 2019	December 31, 2019
Net Interest Income				
Interest income	\$ 52,033	\$ 53,818	\$ 55,652	\$ 55,761
Interest expense	36,400	37,958	39,082	36,834
Net Interest Income	15,633	15,860	16,570	18,927
Other Income (Loss)				
Realized gain (loss) on sale of investments, net	(5,105)	(8)	21,399	11,992
Other than temporary impairment	(1,232)	(3,295)	(1,819)	(2,228)
Unrealized gain (loss), net	50,781	74,614	35,030	(52,896)
Gain (loss) on derivative instruments, net	(27,148)	(71,530)	(47,056)	42,007
Other, net	236	532	918	518
Other Income (Loss)	17,532	313	8,472	(607)
Expenses				
Management fee to affiliate	1,735	1,832	1,800	1,987
Other operating expenses	1,598	1,253	1,589	1,079
General and administrative expenses:				
Compensation expense	544	705	671	671
Professional fees	1,215	761	973	1,031
Other general and administrative expenses	185	530	344	441
Total general and administrative expenses	1,944	1,996	1,988	2,143
Total Expenses	5,277	5,081	5,377	5,209
Income before income taxes				
	27,888	11,092	19,665	13,111
Income tax provision (benefit)	12	478	(55)	622
Net income	\$ 27,876	\$ 10,614	\$ 19,720	\$ 12,489
Net income per Common Share — Basic	\$ 0.58	\$ 0.21	\$ 0.37	\$ 0.23
Net income per Common Share — Diluted	\$ 0.58	\$ 0.21	\$ 0.37	\$ 0.23

	Quarter Ended			
	March 31, 2018	June 30, 2018	September 30, 2018	December 31, 2018
Net Interest Income:				
Interest income	\$ 39,727	\$ 57,154	\$ 54,461	\$ 58,020
Interest expense	20,697	38,134	38,517	40,892
Net Interest Income	19,030	19,020	15,944	17,128
Other Income (Loss):				
Realized gain (loss) on sale of investments, net	575	(5,608)	(24,229)	(33,995)
Other than temporary impairment	(2,916)	(2,974)	(2,533)	(2,757)
Unrealized gain (loss), net	(68,961)	(31,693)	13,128	62,855
Gain (loss) on derivative instruments, net	79,582	28,490	24,625	(54,728)
Other, net	47	(145)	(2)	(89)
Other Income (Loss)	8,327	(11,930)	10,989	(28,714)
Expenses:				
Management fee to affiliate	2,180	2,259	2,284	1,950
Other operating expenses	969	1,555	1,609	1,943
General and administrative expenses:				
Compensation expense	510	572	552	552
Professional fees	1,295	818	1,065	1,121
Other general and administrative expenses	361	397	335	349
Total general and administrative expenses	2,166	1,787	1,952	2,022
Total Expenses	5,315	5,601	5,845	5,915
Income (loss) before income taxes				
	22,042	1,489	21,088	(17,501)
Income tax provision	313	36	206	154
Net income (loss)	\$ 21,729	\$ 1,453	\$ 20,882	\$ (17,655)
Net income (loss) per Common Share—Basic				
	\$ 0.52	\$ 0.03	\$ 0.50	\$ (0.37)
Net income (loss) per Common Share—Diluted				
	\$ 0.52	\$ 0.03	\$ 0.50	\$ (0.37)

Note 17—Subsequent Events (unaudited)

On February 18, 2020, Franklin Resources, Inc. (“Franklin”) and Legg Mason announced that they had entered into an agreement under which Franklin would acquire Legg Mason and its affiliates, including the Manager. The transaction is expected to close in the third quarter of 2020 and is subject to customary closing conditions. Upon completion of the transaction the Manager would become a wholly owned subsidiary of Franklin.

Western Asset Mortgage Capital Corporation and Subsidiaries
Schedule IV
Mortgage Loans on Real Estate
As of December 31, 2019

\$ in thousands Asset Type	Description	Number of Loans	Interest Rate	Maturity Date	Periodic Payment Terms ⁽¹⁾	Prior Liens	Face Amount of Mortgages	Carrying Amount of Mortgages	Principal Amount of Loans Subject to Delinquent Principal or Interest
Residential Whole-Loans and Bridge Loans									
Adjustable Rate Residential Mortgage Loan Held in Securitization Trusts	Original Loan Balance \$0 - \$249,999	730	Hybrid ARM 4.5% to 6.6%	11/01/2041 to 12/01/2049	P&I	\$ —	\$ 120,652	\$ 125,569	\$ —
Adjustable Rate Residential Mortgage Loan Held in Securitization Trusts	Original Loan Balance \$250,000 - \$499,999	1,051	Hybrid ARM 4.5% to 6.5%	01/01/2042 to 12/01/2049	P&I	—	356,183	370,434	1,446
Adjustable Rate Residential Mortgage Loan Held in Securitization Trusts	Original Loan Balance \$500,000 - \$749,999	345	Hybrid ARM 4.5% to 6.5%	02/01/2042 to 12/01/2049	P&I	—	198,888	206,818	646
Adjustable Rate Residential Mortgage Loan Held in Securitization Trusts	Original Loan Balance \$750,000 - \$999,999	147	Hybrid ARM 4.5% to 6.4%	05/01/2043 to 12/01/2049	P&I	—	121,140	125,727	790
Adjustable Rate Residential Mortgage Loan Held in Securitization Trusts	Original Loan Balance \$1,000,000 - \$1,249,999	34	Hybrid ARM 4.0% to 5.9%	09/01/2043 to 12/01/2049	P&I	—	36,536	37,649	1,006
Adjustable Rate Residential Mortgage Loan Held in Securitization Trusts	Original Loan Balance \$1,250,000 - \$1,499,999	14	Hybrid ARM 4.6% to 6.0%	12/01/2041 to 12/01/2049	P&I	—	18,452	19,228	—
Adjustable Rate Residential Mortgage Loan Held in Securitization Trusts	Original Loan Balance \$1,500,000 and above	27	Hybrid ARM 4.8% to 6.2%	02/01/2042 to 11/01/2049	P&I	—	65,071	67,418	—
Variable Rate Residential Mortgage Loan Held in Securitization Trusts	Original Loan Balance \$0 - \$249,999	4	Variable 6.2% to 6.4%	02/01/2044 to 05/01/2044	P&I	—	558	586	—
Variable Rate Residential Mortgage Loan Held in Securitization Trusts	Original Loan Balance \$250,000 - \$499,999	6	Variable 5.5% to 6.3%	04/01/2044 to 11/01/2047	P&I	—	2,026	2,128	—
Variable Rate Residential Mortgage Loan Held in Securitization Trusts	Original Loan Balance \$500,000 - \$749,999	1	Variable 6.2% to 6.2%	04/01/2044 to 04/01/2044	P&I	—	450	473	—
Variable Rate Residential Mortgage Loan Held in Securitization Trusts	Original Loan Balance \$1,250,000 - \$1,499,999	2	Variable 6.2% to 6.4%	02/01/2044 to 05/01/2044	P&I	—	1,344	1,415	—
Fixed Rate Residential Mortgage Loan Held in Securitization Trusts	Original Loan Balance \$0 - \$249,999	422	Fixed 3.8% to 7.1%	07/01/2026 to 12/01/2049	P&I	—	66,458	68,988	247

\$ in thousands Asset Type	Description	Number of Loans	Interest Rate	Maturity Date	Periodic Payment Terms ⁽¹⁾	Prior Liens	Face Amount of Mortgages	Carrying Amount of Mortgages	Principal Amount of Loans Subject to Delinquent Principal or Interest
Fixed Rate Residential Mortgage Loan Held in Securitization Trusts	Original Loan Balance \$250,000 - \$499,999	552	Fixed 3.8% to 7.5%	09/01/2026 to 12/01/2049	P&I	—	189,163	195,762	719
Fixed Rate Residential Mortgage Loan Held in Securitization Trusts	Original Loan Balance \$500,000 - \$749,999	128	Fixed 3.9% to 6.4%	11/01/2033 to 12/01/2049	P&I	—	73,638	76,076	—
Fixed Rate Residential Mortgage Loan Held in Securitization Trusts	Original Loan Balance \$750,000 - \$999,999	35	Fixed 4.6% to 5.9%	11/01/2033 to 12/01/2049	P&I	—	30,096	31,212	—
Fixed Rate Residential Mortgage Loan Held in Securitization Trusts	Original Loan Balance \$1,000,000 - \$1,249,999	12	Fixed 5.0% to 5.9%	02/01/2048 to 12/01/2049	P&I	—	13,095	13,586	—
Fixed Rate Residential Mortgage Loan Held in Securitization Trusts	Original Loan Balance \$1,250,000 - \$1,499,999	8	Fixed 4.7% to 6.3%	02/01/2036 to 12/01/2049	P&I	—	9,980	10,371	—
Fixed Rate Residential Mortgage Loan Held in Securitization Trusts	Original Loan Balance \$1,500,000 and above	11	Fixed 5.3% to 5.7%	09/01/2048 to 10/01/2049	P&I	—	21,714	22,420	2,271
Fixed Rate Residential Bridge Loans Held in Securitization Trusts	Original Loan Balance \$0 - \$249,999	34	Fixed 7.5% to 18.0%	12/31/2019 to 03/01/2021	Interest Only ⁽³⁾	—	4,722	4,545	1,930
Fixed Rate Residential Bridge Loans Held in Securitization Trusts	Original Loan Balance \$250,000 - \$499,999	13	Fixed 7.5% to 11.3%	12/31/2019 to 02/01/2021	Interest Only ⁽³⁾	—	4,907	4,887	420
Fixed Rate Residential Bridge Loans Held in Securitization Trusts	Original Loan Balance \$500,000 - \$749,999	10	Fixed 7.8% to 12.7%	12/31/2019 to 08/01/2020	Interest Only ⁽³⁾	—	6,251	6,133	2,071
Fixed Rate Residential Bridge Loans Held in Securitization Trusts	Original Loan Balance \$750,000 - \$999,999	11	Fixed 7.8% to 18.0%	12/31/2019 to 12/01/2020	Interest Only ⁽³⁾	—	9,662	9,418	3,595
Fixed Rate Residential Bridge Loans Held in Securitization Trusts	Original Loan Balance \$1,000,000 - \$1,249,999	4	Fixed 8.0% to 13.5%	12/31/2019 to 09/01/2020	Interest Only ⁽³⁾	—	4,526	4,464	1,125
Fixed Rate Residential Bridge Loans Held in Securitization Trusts	Original Loan Balance \$1,250,000 - \$1,499,999	2	Fixed 9.0% to 10.8%	12/31/2019 to 12/31/2019	Interest Only ⁽³⁾	—	2,690	2,624	1,295
Fixed Rate Residential Bridge Loans Held in Securitization Trusts	Original Loan Balance \$1,500,000 and above	2	Fixed 7.8% to 8.5%	12/31/2019 to 08/01/2020	Interest Only ⁽³⁾	—	4,437	4,348	1,672
Total Residential Whole-Loans and Bridge Loans						\$ —	\$ 1,362,639	\$ 1,412,279	\$ 19,233

Western Asset Mortgage Capital Corporation and Subsidiaries
Schedule IV
Commercial Real Estate Loans
As of December 31, 2019

\$ in thousands Asset Type	Description	Number of Loans	Interest Rate	Maturity Date	Periodic Payment Terms(1)	Prior Liens	Face Amount of Mortgages	Carrying Amount of Mortgages	Principal Amount of Loans Subject to Delinquent Principal or Interest
Commercial Loans									
Commercial Loan Held in Securitization Trust	Original Loan Balance \$45,187,500	1	LIBOR + 4.25%	07/01/2020	Interest Only ⁽⁴⁾	\$ —	\$ 45,188	\$ 45,188	\$ —
Commercial Loan Held in Securitization Trust	Original Loan Balance \$13,600,000	1	LIBOR + 4.00%	12/01/2021	Interest Only ⁽⁴⁾	—	13,600	13,600	—
Commercial Loan Held in Securitization Trust	Original Loan Balance \$32,000,000	1	LIBOR + 4.10%	07/01/2021	Interest Only ⁽⁴⁾	\$ —	\$ 32,000	\$ 32,000	\$ —
Commercial Mezzanine Loan	Original Loan Balance \$20,000,000	1	LIBOR + 6.50%	12/09/2020	Interest Only ⁽⁴⁾	—	20,000	20,000	—
Commercial Loan	Original Loan Balance \$30,000,000	1	LIBOR + 4.50%	06/09/2020	Interest Only ⁽⁴⁾	—	30,000	30,000	—
Commercial Loan	Original Loan Balance \$50,000,000	1	LIBOR + 4.75%	01/11/2022	Interest Only ⁽⁴⁾	—	50,000	50,000	—
Commercial Loan	Original Loan Balance \$90,000,000	1	LIBOR + 9.25%	06/29/2021	Interest Only ⁽⁴⁾	—	90,000	90,000	—
Commercial Loan	Original Loan Balance \$40,000,000	1	LIBOR + 3.02%	08/09/2021	Interest Only ⁽⁴⁾	—	40,000	40,000	—
Commercial Loan	Original Loan Balance \$13,206,521	1	LIBOR + 3.75%	11/06/2021	Interest Only ⁽⁴⁾	—	13,206	13,206	—
Commercial Loan	Original Loan Balance \$24,534,783	1	LIBOR + 3.75%	11/06/2021	Interest Only ⁽⁴⁾	—	24,535	24,535	—
Commercial Loan	Original Loan Balance \$7,258,696	1	LIBOR + 3.75%	11/06/2021	Interest Only ⁽⁴⁾	—	7,259	7,259	—
Commercial Loan	Original Loan Balance \$4,425,400	1	LIBOR + 4.85%	12/06/2022	Interest Only ⁽⁴⁾	—	4,425	4,425	—
Total Commercial Loans						\$ —	\$ 370,213	\$ 370,213	\$ —
Securitized Commercial Loans									
Commercial Loan Held in Securitization Trust	Original Loan Balance \$900,000,000	1	LIBOR + 8.50%	03/09/2021	Interest Only ⁽⁴⁾	—	674,331	676,436	—
Commercial Loan Held in Securitization Trust	Original Loan Balance \$234,500,000	1	Fixed 4.27%	12/09/2024	Interest Only ⁽⁴⁾	—	234,500	198,104	—

\$ in thousands Asset Type	Description	Number of Loans	Interest Rate	Maturity Date	Periodic Payment Terms(1)	Prior Liens	Face Amount of Mortgages	Carrying Amount of Mortgages	Principal Amount of Loans Subject to Delinquent Principal or Interest
Commercial Loan Held in Securitization Trust	Original Loan Balance \$10,500,000	1	Fixed 12.02%	12/09/2024	Interest Only ⁽⁴⁾	—	10,500	10,443	—
Commercial Mezzanine Loan Held in Securitization Trust	Original Loan Balance \$25,000,000	1	Fixed 9.00%	07/06/2020	P&I ⁽²⁾	—	24,048	24,057	—
Total Securitized Commercial Loans						\$ —	\$ 943,379	\$ 909,040	\$ —
Total Residential and Commercial Loans						\$ —	\$ 2,676,231	\$ 2,691,532	\$ 19,233

(1) Principal and interest ("P&I")

(2) Interest only payments for initial 2 years. After 2 years, monthly P&I payments are based on an 2 years amortization schedule and a balloon payment is due on the maturity date.

(3) Residential Bridge Loans are mainly interest only loans with a balloon payment at maturity.

(4) The borrower may prepay the commercial loan in whole or in part at any time in accordance with the terms of the loan agreement.

Reconciliation of Carrying Value of Mortgage Loans on Real Estate:

	2019	2018	2017
Beginning balance	\$ 2,493,238	\$ 368,972	\$ 216,361
Additions during period:			
New mortgage loans	2,042,587	2,901,479	232,545
Unrealized gains	21,291	631	3,167
Deductions during period:			
Collections of principal	1,858,659	769,748	80,550
Amortization of premium and (discounts)	5,247	5,692	1,470
Unrealized losses	1,191	2,356	1,081
Realized losses	487	48	—
Balance at end of period	\$ 2,691,532	\$ 2,493,238	\$ 368,972

ITEM 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

None.

ITEM 9A. Controls and Procedures***(a) Evaluation of Disclosure Controls and Procedures***

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

The Company's Chief Executive Officer and Chief Financial Officer evaluated the effectiveness of the design and operation of our disclosure controls and procedures. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level as of December 31, 2019.

(b) Management's Report on Internal Control over Financial Reporting

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is defined in Rules 13a-15(f) and 15d-15(f) promulgated under the Exchange Act as a process designed by, or under the supervision of, the Company's Chief Executive Officer and Chief Financial Officer and effected by the Company's Board of Directors, management and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles, and includes those policies and procedures that:

- pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company;
- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and
- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risks that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

Management of the Company has assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2019. In making its assessment of internal control over financial reporting, management used the criteria described in "Internal Control—Integrated Framework" (2013 framework) issued by the Committee of Sponsoring Organizations of the Treadway Commission, ("COSO"). Based on this evaluation, management concluded that the Company's internal control over financial reporting was effective as of December 31, 2019 based on criteria in "Internal Control—Integrated Framework" (2013 framework) issued by the COSO.

The effectiveness of the Company's internal control over financial reporting as of December 31, 2019 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which appears herein.

(c) Changes in Internal Control over Financial Reporting

There have been no changes in our internal control over financial reporting during the three months ended December 31, 2019, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

ITEM 9B. Other Information

None.

PART III

ITEM 10. Directors, Executive Officers and Corporate Governance

The information regarding the Company's directors, executive officers and certain other matters required by Item 401 of Regulation S-K is incorporated herein by reference to the Company's proxy statement relating to its annual meeting of stockholders to be held on or about June 6, 2019 (the "Proxy Statement"), to be filed with the SEC within 120 days after December 31, 2019.

The information regarding compliance with Section 16(a) of the Exchange Act required by Item 405 of Regulation S-K is incorporated herein by reference to the Proxy Statement to be filed with the SEC within 120 days after December 31, 2019.

The information regarding the Company's Code of Business Conduct and Ethics required by Item 406 of Regulation S-K is incorporated herein by reference to the Proxy Statement to be filed with the SEC within 120 days after December 31, 2019.

The information regarding certain matters pertaining to the Company's corporate governance required by Item 407(c)(3), (d)(4) and (d)(5) of Regulation S-K is incorporated by reference to the Proxy Statement to be filed with the SEC within 120 days after December 31, 2019.

ITEM 11. Executive Compensation.

The information regarding executive compensation and other compensation related matters required by Items 402 and 407(e)(4) and (e)(5) of Regulation S-K is incorporated herein by reference to the Proxy Statement to be filed with the SEC within 120 days after December 31, 2019.

ITEM 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder

The tables on equity compensation plan information and beneficial ownership of the Company required by Items 201(d) and 403 of Regulation S-K are incorporated herein by reference to the Proxy Statement to be filed with the SEC within 120 days after December 31, 2019.

ITEM 13. Certain Relationships and Related Transactions and Director Independence

The information regarding transactions with related persons, promoters and certain control persons and director independence required by Items 404 and 407(a) of Regulation S-K is incorporated herein by reference to the Proxy Statement to be filed with the SEC within 120 days after December 31, 2019.

ITEM 14. Principal Accounting Fees and Services

The information concerning principal accounting fees and services and the Audit Committee's pre-approval policies and procedures required by Item 9(e) of Schedule 14A is incorporated herein by reference to the Proxy Statement to be filed with the SEC within 120 days after December 31, 2019.

ITEM 15. Exhibits

Documents filed as part of this report:

- 1) Financial Statements

WESTERN ASSET MORTGAGE CAPITAL CORPORATION

Consolidated Balance Sheets as of December 31, 2019 and 2018	77
Consolidated Statements of Operations for the years ended December 31, 2019, December 31, 2018 and December 31, 2017	79
Consolidated Statements of Changes in Stockholders' Equity for the years ended December 31, 2019, December 31, 2018 and December 31, 2017	80
Consolidated Statements of Cash Flow for the years ended December 31, 2019, December 31, 2018 and December 31, 2017	81
Notes to Consolidated Financial Statements	84
Schedule IV—Mortgage Loans on Real Estate	137

Financial Statements Schedules other than the one listed above are omitted because the required information is not applicable or deemed not material, or the required information is presented in the financial statements and/or in the notes to financial statements.

2) Exhibits

The following exhibits are filed as part of this report.

Exhibit No.	Description
3.1*	Amended and restated certificate of incorporation of Western Asset Mortgage Capital Corporation, incorporated by reference to Exhibit 3.1 to Amendment No. 10 Form S-11 (Registration Statement No. 333-159962), filed May 8, 2012
3.2*	Amendment to the Amended and restated certificate of incorporation of Western Asset Mortgage Capital Corporation, dated June 3, 2016, incorporated by reference to Exhibit 3.3 to the Annual report on Form 10-K, filed March 7, 2017.
3.3*	Amended and restated bylaws of Western Asset Mortgage Capital Corporation, incorporated by reference to Exhibit 3.2 to Amendment No. 10 Form S-11 (Registration Statement No. 333-159962), filed May 8, 2012.
4.1*	Specimen Common Stock Certificate of Western Asset Mortgage Capital Corporation, incorporated by reference to Exhibit 4.1 to Amendment No. 10 Form S-11 (Registration Statement No. 333-159962), filed May 8, 2012
4.2*	Indenture, dated as of October 2, 2017, between Western Asset Mortgage Capital Corporation and Wells Fargo Bank, National Association, incorporated by reference to Exhibit 4.1 to the Current Report on Form 8-K, filed on October 3, 2017.
4.3*	First Supplemental Indenture, dated as of October 2, 2017, between Western Asset Mortgage Capital Corporation and Wells Fargo Bank, National Association, incorporated by reference to Exhibit 4.2 to the Current Report on Form 8-K, filed on October 3, 2017.
4.4*	Form of 6.75% Convertible Senior Notes due 2022 (attached as Exhibit A to the First Supplemental Indenture filed as Exhibit 4.3 hereto), incorporated by reference to Exhibit 4.3 to the Current Report on Form 8-K, filed on October 3, 2017.
4.5*	Description of securities registered under Section 12 of the Exchange Act.
10.1*	Amendment to the Management Agreement between Western Asset Mortgage Capital Corporation and Western Asset Management Company, dated August 3, 2016, incorporated by reference to Exhibit 10.1 to the Quarterly Report on Form 10-Q, filed August 5, 2016.
10.2*	Form of Warrant, incorporated by reference to Exhibit 10.2 to Amendment No. 9 Form S-11 (Registration Statement No. 333-159962), filed April 30, 2012.
10.3*	Management Agreement, dated May 9, 2012, between Western Asset Mortgage Capital Corporation and Western Asset Management Company, incorporated by reference to Exhibit 10.4 to the Quarterly Report on Form 10-Q, filed August 14, 2012.
10.4*	Registration Rights Agreement, dated May 15, 2012, among Western Asset Mortgage Capital Corporation, Western Asset Management Company and certain individual holders named therein, incorporated by reference to Exhibit 10.5 to the Quarterly Report on Form 10-Q, filed August 14, 2012.
10.5*+	Western Asset Mortgage Capital Corporation Equity Plan, incorporated by reference to Exhibit 10.5 to Amendment No. 9 Form S-11 (Registration Statement No. 333-159962), filed April 30, 2012.
10.6*+	Western Asset Mortgage Capital Corporation Manager Equity Plan, incorporated by reference to Exhibit 10.6 to Amendment No. 9 Form S-11 (Registration Statement No. 333-159962), filed April 30, 2012.

Exhibit No.	Description
10.7*	<u>Form of Indemnification Agreement between Western Asset Mortgage Capital Corporation and a director, incorporated by reference to Exhibit 10.7 to Amendment No. 9 Form S-11 (Registration Statement No. 333-159962), filed April 30, 2012.</u>
10.8*+	<u>Restricted Stock Award Agreement, dated May 15, 2012, for Western Asset Management Company, incorporated by reference to Exhibit 10.9 to the Quarterly Report on Form 10-Q, filed August 14, 2012.</u>
10.9*+	<u>Form of Restricted Stock Award Agreement for independent directors, incorporated by reference to Exhibit 10.2 to the Form S-8 dated May 15, 2012 (File No. 1-35543).</u>
10.10*	<u>Equity Distribution Agreement, dated March 6, 2017, among Western Asset Mortgage Capital Corporation, Western Asset Management Company and JMP Securities LLC, incorporated by reference to Exhibit 1.1 to the Current Report on Form 8-K, filed March 9, 2017.</u>
23.1	<u>Consent of Independent Registered Public Accounting Firm</u>
31.1	<u>Rule 13a-14(a) / 15d-14(a) Certification of Chief Executive Officer.</u>
31.2	<u>Rule 13a-14(a) / 15d-14(a) Certification of Chief Financial Officer.</u>
32.1	<u>Section 1350 Certifications of Chief Executive Officer and Chief Financial Officer</u>
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

* Fully or partly previously filed.

+ Management contract or compensatory plan arrangement.

ITEM 16. Form 10-K Summary

None.

SIGNATURES

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

WESTERN ASSET MORTGAGE CAPITAL CORPORATION
By: /s/ Jennifer W. Murphy
Jennifer W. Murphy
President, Chief Executive Officer and Director
March 6, 2020

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

By: /s/ Jennifer W. Murphy
Jennifer W. Murphy
President, Chief Executive Officer and Director (Principal Executive Officer)
March 6, 2020

By: /s/ LISA MEYER
Lisa Meyer
Chief Financial Officer & Treasurer (Principal Financial and Accounting Officer)
March 6, 2020

By: /s/ JAMES W. HIRSCHMANN III
James W. Hirschmann III
Director
March 6, 2020

By: /s/ EDWARD D. FOX JR.
Edward D. Fox Jr.
Director
March 6, 2020

By: /s/ RICHARD ROLL
Richard Roll
Director
March 6, 2020

By: /s/ M. CHRISTIAN MITCHELL
M. Christian Mitchell
Director
March 6, 2020

By: /s/ RANJIT M. KRIPALANI
Ranjit M. Kripalani
Director
March 6, 2020

**DESCRIPTION OF WESTERN ASSET MORTGAGE CAPITAL CORPORATION SECURITIES REGISTERED PURSUANT TO SECTION 12 OF
THE SECURITIES EXCHANGE ACT**

Description of Common Stock

The following is a summary of the rights and preferences of our common stock, and the related provisions of our amended and restated certificate of incorporation and amended and restated bylaws, as each is in effect as the date hereof, copies of which are incorporated by reference as Exhibits 3.1 and 3.3 to our Annual Report on Form 10-K for the year ended December 31, 2019 of which this Exhibit 4.5 is a part. While we believe that the following description covers the material terms of our common stock, the description may not contain all of the information that is important to you. We encourage you to read carefully our amended and restated certificate of incorporation, amended and restated bylaws and the other documents we refer to for a more complete understanding of our common stock.

Except as otherwise indicated or the context otherwise requires, the terms “Company,” “us,” “we” and “our” refer to Western Asset Mortgage Capital Corporation. The rights of our stockholders are generally covered by Delaware law and our amended and restated certificate of incorporation and amended and restated bylaws (each as amended and restated and in effect on the date hereof). The terms of our common stock are therefore subject to Delaware law.

General

Our amended and restated certificate of incorporation provides that we may issue up to 500,000,000 shares of common stock, par value \$0.01 per share. As of December 31, 2019, 53,523,876 shares of common stock were issued and outstanding.

Voting rights

Subject to the restrictions contained in our amended and restated certificate of incorporation regarding the transfer and ownership of our capital stock and except as may otherwise be specified in the terms of any class or series of common stock, our common stockholders are entitled to one vote per share. Our common stockholders are not entitled to cumulate their votes in the election of directors. Generally, all matters to be voted on by stockholders 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 holders of our common stock present in person or represented by proxy, voting together as a single class. Except as otherwise provided by law, amendments to our amended and restated certificate of incorporation must be approved by a majority or, in some cases, a super-majority of the combined voting power of all shares of common stock, voting together as a single class.

Dividend rights

Subject to the restrictions contained in our amended and restated certificate of incorporation regarding the transfer and ownership of our capital stock, our common stockholders share ratably (based on the number of common shares held) if and when any dividend is declared by our board of directors. Dividends consisting of common stock may be paid only as follows: (1) common stock may be paid only to holders of common stock; and (2) shares shall be paid proportionally with respect to each outstanding common share. We may not subdivide or combine shares of any class of common stock or issue a dividend on shares of any class of common stock without at the same time proportionally subdividing or combining shares of any other class or issuing a similar dividend on any other class.

Liquidation rights

Upon our liquidation, dissolution or winding up, each of our common stockholders are entitled to a pro rata dividend of any assets available for dividend to common stockholders.

Other matters

In the event of our merger or consolidation with or into another company in connection with which shares of common stock are converted into or exchangeable for shares of stock, other securities or property (including cash), our common stockholders are entitled to receive the same kind and amount of shares of stock and other securities and property (including cash). No shares of our common stock are subject to redemption or have preemptive rights to purchase additional shares. All the outstanding shares of common stock are validly issued, fully paid and non-assessable.

Restrictions on ownership and transfer of our capital stock

In order to continue to qualify as a REIT under the Internal Revenue Code of 1986, as amended, or the Internal Revenue Code, for each taxable year beginning after December 31, 2012, our shares of capital stock (which includes our preferred stock, par value \$0.01 per share, of which 0 shares are issued and outstanding as of December 31, 2019) must be beneficially owned by 100 or more persons during at least 335 days of a taxable year of 12 months or during a proportionate

part of a shorter taxable year. Also, for our taxable years beginning after December 31, 2012, no more than 50% of the value of our outstanding shares of capital stock may be owned, directly or constructively, by five or fewer individuals (as defined in the Internal Revenue Code to include certain entities) during the second half of any calendar year.

Our amended and restated certificate of incorporation, subject to certain exceptions, contains restrictions on the number of shares of our capital stock that a person may own and may prohibit certain entities from owning our shares. Our amended and restated certificate of incorporation provides that (subject to certain exceptions described below) no person may beneficially or constructively own, or be deemed to own by virtue of the attribution provisions of the Internal Revenue Code, more than 9.8% in value or in number of shares, whichever is more restrictive, of our outstanding shares of common or capital stock. Pursuant to our amended and restated certificate of incorporation, our board of directors has the power to increase or decrease the percentage of common or capital stock that a person may beneficially or constructively own. However, any decreased stock ownership limit will not apply to any person whose percentage ownership of our common or capital stock, as the case may be, is in excess of such decreased stock ownership limit until that person's percentage ownership of our common or capital stock, as the case may be, equals or falls below the decreased stock ownership limit. Until such a person's percentage ownership of our common or capital stock, as the case may be, falls below such decreased stock ownership limit, any further acquisition of common stock will be in violation of the decreased stock ownership limit. If our board of directors changes the stock ownership limit, it will: (1) notify each stockholder of record of any such change; and (2) publicly announce any such change, in each case at least 30 days prior to the effective date of such change. For purposes of this calculation, warrants treated as held by any stockholder will be deemed to have been exercised when calculating such holder's ownership of capital stock. However, warrants held by other unrelated persons will not be deemed to have been exercised.

Our amended and restated certificate of incorporation also prohibits any person from beneficially or constructively owning shares of our capital stock that would result in our being "closely held" under Section 856(h) of the Internal Revenue Code or otherwise cause us to fail to qualify as a REIT and from transferring shares of our capital stock if the transfer would result in our capital stock being beneficially owned by fewer than 100 persons. In addition, no such person may own an interest in any tenant that would cause us to own, actually or constructively, more than a 9.9% interest in such tenant. Any person who acquires or attempts or intends to acquire beneficial or constructive ownership of shares of our capital stock that will or may violate any of the foregoing restrictions on transferability and ownership, or who is the intended transferee of shares of our capital stock that are transferred to the trust (as described below), is required to give written notice immediately to us and provide us with such other information as we may request in order to determine the effect of such transfer on our qualification as a REIT. The foregoing restrictions on transferability and ownership will not apply if our board of directors determines that it is no longer in our best interests to attempt to qualify, or to continue to qualify, as a REIT.

Our board of directors, in its sole discretion, may exempt a person from the foregoing restrictions. The person seeking an exemption must provide to our board of directors such representations and undertakings and satisfy such conditions, in each case as our board of directors may deem reasonably necessary to conclude that granting the exemption will not cause us to lose our qualification as a REIT. Our board of directors may also require a ruling from the Internal Revenue Service, or the IRS, or an opinion of counsel in order to determine or ensure our qualification as a REIT in the context of granting such exemptions.

Any attempted transfer of our capital stock which, if effective, would result in a violation of the foregoing restrictions will cause the number of shares causing the violation (rounded up to the nearest whole share) to be automatically transferred to a trust for the exclusive benefit of one or more charitable beneficiaries, and the proposed transferee will not acquire any rights in such shares. The automatic transfer will be deemed to be effective as of the close of business on the business day (as defined in our amended and restated certificate of incorporation) prior to the date of the transfer. If, for any reason, the transfer to the trust does not occur or would not prevent a violation of the restrictions on ownership contained in our amended and restated certificate of incorporation, our amended and restated certificate of incorporation provides that the purported transfer will be void ab initio. Shares of our capital stock held in the trust will be issued and outstanding shares. The proposed transferee will not benefit economically from ownership of any shares of our capital stock held in the trust, will have no rights to dividends and no rights to vote or other rights attributable to the shares of capital stock held in the trust. The trustee of the trust will have all voting rights and rights to dividends or other distributions with respect to shares held in the trust. These rights will be exercised for the exclusive benefit of the charitable beneficiary. Any dividend or other distribution paid prior to our discovery that shares of capital stock have been transferred to the trust will be paid by the recipient to the trustee upon demand. Any dividend or other distribution authorized but unpaid will be paid when due to the trustee. Any dividend or distribution paid to the trustee will be held in trust for the charitable beneficiary. Subject to Delaware law, the trustee will have the authority to rescind as void any vote cast by the proposed transferee prior to our discovery that the shares have been transferred to the trust and to recast the vote in accordance with the desires of the trustee acting for the benefit of the charitable beneficiary. However, if we have already taken irreversible corporate action, then the trustee will not have the authority to rescind and recast the vote.

Within 20 days of receiving notice from us that shares of our capital stock have been transferred to the trust, the trustee will sell the shares to a person designated by the trustee, whose ownership of the shares will not violate the above ownership limitations. Upon such sale, the interest of the charitable beneficiary in the shares sold will terminate and the trustee will distribute the net proceeds of the sale to the proposed transferee and to the charitable beneficiary as follows: the proposed transferee will receive the lesser of: (1) the price paid by the proposed transferee for the shares or, if the proposed transferee did not give value for the shares in connection with the event causing the shares to be held in the trust (e.g., a gift, devise or other

similar transaction), the market price (as defined in our amended and restated certificate of incorporation) of the shares on the day of the event causing the shares to be held in the trust and (2) the price received by the trustee from the sale or other disposition of the shares. Any net sale proceeds in excess of the amount payable to the proposed transferee will be paid immediately to the charitable beneficiary. If, prior to our discovery that shares of our capital stock have been transferred to the trust, the shares are sold by the proposed transferee, then: (1) the shares shall be deemed to have been sold on behalf of the trust and (2) to the extent that the proposed transferee received an amount for the shares that exceeds the amount the proposed transferee was entitled to receive, the excess shall be paid to the trustee upon demand.

In addition, shares of our capital stock held in the trust will be deemed to have been offered for sale to us, or our designee, at a price per share equal to the lesser of the price per share in the transaction that resulted in the transfer to the trust (or, in the case of a devise or gift, the market price at the time of the devise or gift) and the market price on the date we, or our designee, accept the offer. We will have the right to accept the offer until the trustee has sold the shares. Upon a sale to us, the interest of the charitable beneficiary in the shares sold will terminate and the trustee will distribute the net proceeds of the sale to the proposed transferee.

Every owner of more than 5% (or such lower percentage as required by the Internal Revenue Code or the regulations promulgated thereunder) in number or in value of all classes or series of our capital stock, including shares of our common stock, within 30 days after the end of each taxable year, will be required to give written notice to us stating the name and address of such owner, the number of shares of each class and series of shares of our capital stock that the owner beneficially owns and a description of the manner in which the shares are held. Each owner shall provide to us such additional information as we may request to determine the effect, if any, of the beneficial ownership on our qualification as a REIT and to ensure compliance with the ownership limitations. In addition, each such owner shall, upon demand, be required to provide to us such information as we may request, in good faith, to determine our qualification as a REIT and to comply with the requirements of any taxing authority or governmental authority or to determine such compliance and to ensure compliance with the 9.8% ownership limitations in our amended and restated certificate of incorporation.

These ownership limitations could delay, defer or prevent a transaction or a change in control that might involve a premium price for our common stock or might otherwise be in the best interests of our stockholders.

Anti-takeover effects of Delaware law and our amended and restated certificate of incorporation and amended and restated bylaws

Our amended and restated certificate of incorporation, which has been filed with the State of Delaware and became effective immediately prior to the completion of our initial public offering on May 15, 2012, and our amended and restated bylaws contain provisions that are intended to enhance the likelihood of continuity and stability in the composition of our board of directors and that may have the effect of delaying, deferring or preventing a future takeover or change in control of our company unless the takeover or change in control is approved by our board of directors. In addition to the above-described restrictions regarding the transfer and ownership of our capital stock, these provisions include the following:

Stockholder action by written consent

Our amended and restated certificate of incorporation provides that stockholder action may not be taken by written consent in lieu of a meeting and that stockholder action may be taken only at an annual or special meeting of stockholders.

Elimination of the ability to call special meetings

Our amended and restated bylaws provide that, except as otherwise required by law, special meetings of our stockholders can only be called by our president, pursuant to a resolution adopted by a majority of our board of directors or a committee of our board of directors that has been duly designated by our board of directors and whose powers and authority include the power to call such meetings, or by the chairman of our board of directors. Stockholders are not permitted to call a special meeting or to require our board of directors to call a special meeting.

Removal of directors; board of directors vacancies

Our amended and restated certificate of incorporation, as amended, provides that members of our board of directors may only be removed with the affirmative vote of the holders of at least a majority of the combined voting power of all the shares of all classes of our capital stock entitled to vote generally in the election of directors. Our amended and restated bylaws provide that only our board of directors may fill vacant directorships. These provisions would prevent a stockholder from gaining control of our board of directors by removing incumbent directors and filling the resulting vacancies with such stockholder's own nominees.

Amendment of amended and restated certificate of incorporation and amended and restated bylaws

The General Corporation Law of the State of Delaware, or the DGCL, generally provides that the affirmative vote of a majority of the outstanding shares entitled to vote is required to amend or repeal a corporation's amended and restated certificate of incorporation or amended and restated bylaws, unless the amended and restated certificate of incorporation requires a greater percentage. Our amended and restated certificate of incorporation generally requires the approval of both a

majority of the combined voting power of all the classes of shares of our capital stock entitled to vote generally in the election of directors and a majority of the members of our board of directors to amend any provisions of our amended and restated certificate of incorporation, except that provisions of our amended and restated certificate of incorporation relating to the powers, numbers, classes, elections, terms and removal of our directors, as well as the ability to fill vacancies on our board of directors requires the affirmative vote of at least 66% of the combined voting power of all the shares of all classes of our capital stock entitled to vote generally in the election of directors. In addition, our amended and restated certificate of incorporation: (1) grants our board of directors the authority to amend and repeal our amended and restated bylaws without a stockholder vote in any manner not inconsistent with the DGCL; and (2) requires that stockholders may only amend our amended and restated bylaws with the affirmative vote of 66% of the combined voting power of all the shares of all classes of our capital stock entitled to vote generally in the election of directors.

The foregoing provisions of our amended and restated certificate of incorporation and amended and restated bylaws could discourage potential acquisition proposals and could delay or prevent a change in control. These provisions are intended to enhance the likelihood of continuity and stability in the composition of our board of directors and in the policies formulated by our board of directors and to discourage certain types of transactions that may involve an actual or threatened change of control. These provisions are designed to reduce our vulnerability to an unsolicited acquisition proposal. The provisions also are intended to discourage certain tactics that may be used in proxy fights. However, such provisions could have the effect of discouraging others from making tender offers for our shares and, as a consequence, they also may inhibit fluctuations in the market price of our common stock that could result from actual or rumored takeover attempts. Such provisions also may have the effect of preventing changes in our management or delaying or preventing a transaction that might benefit you or other minority stockholders.

Section 203 of the DGCL

We have elected not to be subject to Section 203 of the DGCL, an anti-takeover law. In general, Section 203 prohibits a publicly-held Delaware corporation from engaging in a “business combination” with an “interested stockholder” for a period of three years following the date the person became an interested stockholder, unless (with certain exceptions) the “business combination” or the transaction in which the person became an interested stockholder is approved in a prescribed manner. Generally, a “business combination” includes a merger, asset or stock sale, or other transaction resulting in a financial benefit to the interested stockholder. Generally, an “interested stockholder” is a person who, together with affiliates and associates, owns (or within three years prior to the determination of interested stockholder status, did own) 15% or more of a corporation’s voting stock. In our amended and restated certificate of incorporation, we have elected not to be bound by Section 203 of the DGCL.

Limitations on liability and indemnification of officers and directors

Our amended and restated certificate of incorporation and amended and restated bylaws provide indemnification for our directors and officers to the fullest extent permitted by the DGCL, except that such directors and officers will not be indemnified to the extent that any such person has committed willful misfeasance, bad faith, gross negligence or reckless disregard involved in the conduct of such person’s duty to or for us. In addition, as permitted by Delaware law, our amended and restated certificate of incorporation includes provisions that eliminate the personal liability of our directors for monetary damages resulting from breaches of certain fiduciary duties as a director. The effect of this provision is to restrict our rights and the rights of our stockholders in derivative suits to recover monetary damages against a director for breach of fiduciary duties as a director, except that a director will be personally liable to the extent such director has committed willful misfeasance, bad faith, gross negligence or reckless disregard of such director’s duties involved in the conduct of the office of director.

We have entered into indemnification agreements with each of our directors and executive officers that provide for indemnification to the maximum extent permitted by Delaware law.

The above-described limitation of liability and indemnification may be held not to be enforceable for violations of the federal securities laws of the United States.

Transfer agent and registrar

The transfer agent and registrar for our shares of common stock is American Stock Transfer and Trust Company.

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We hereby consent to the incorporation by reference in the Registration Statements on Form S-3 (No. 333-189242, No. 333-194775, and No. 333-216496) and S-8 (No. 333-181441) of Western Asset Mortgage Capital Corporation and its subsidiaries of our report dated March 6, 2019 relating to the financial statements and financial statement schedule and the effectiveness of internal control over financial reporting, which appears in this Form 10-K.

/s/ PricewaterhouseCoopers LLP

Los Angeles, California

March 6, 2020

CERTIFICATIONS

I, Jennifer W. Murphy, certify that:

1. I have reviewed this annual report on Form 10-K of Western Asset Mortgage Capital Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have):
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, if any, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's Board of Directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 6, 2020

By: /s/ Jennifer W. Murphy
 Name: Jennifer W. Murphy
 Title: President, Chief Executive Officer and Director

CERTIFICATIONS

I, Lisa Meyer, certify that:

1. I have reviewed this annual report on Form 10-K of Western Asset Mortgage Capital Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have):
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, if any, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's Board of Directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 6, 2020

By: /s/ LISA MEYER
Name: Lisa Meyer
Title: Chief Financial Officer & Treasurer

Certification of Chief Executive Officer and Chief Financial Officer

**Pursuant to
18 U.S. C. Section 1350
as adopted pursuant to
Section 906 of The Sarbanes-Oxley Act of 2002**

The undersigned, the President and Chief Executive Officer of Western Asset Mortgage Capital Corporation (the "Company"), hereby certifies on the date hereof, pursuant to 18 U.S.C. 1350(a), as adopted pursuant to Section 906 of The Sarbanes-Oxley Act of 2002, that the Annual Report on Form 10-K for the period ended December 31, 2019 (the "Form 10-K"), fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, and that the information contained in the Form 10-K fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: March 6, 2020 By: /s/ Jennifer W. Murphy
Name: Jennifer W. Murphy
Title: *President and Chief Executive Officer*

The undersigned, the Chief Financial Officer (principal financial officer and principal accounting officer) of Western Asset Mortgage Capital Corporation (the "Company"), hereby certifies on the date hereof, pursuant to 18 U.S.C. 1350(a), as adopted pursuant to Section 906 of The Sarbanes-Oxley Act of 2002, that the Annual Report on Form 10-K for the period ended December 31, 2019 (the "Form 10-K"), fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, and that the information contained in the Form 10-K fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: March 6, 2020 By: /s/ LISA MEYER
Name: Lisa Meyer
Title: *Chief Financial Officer & Treasurer*

The written statement is being furnished and shall not be deemed filed by the Company for purposes of Section 18 of the Securities Exchange Act of 1934, as amended.

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.