BIMINI MORTGAGE MANAGEMENT INC
Form S-11/A
December 03, 2004

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As filed with the Securities and Exchange Commission on December 3, 2004

Registration No. 333-120603

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

AMENDMENT NO. 1
TO
FORM S-11

REGISTRATION STATEMENT
UNDER
THE SECURITIES ACT OF 1933

BIMINI MORTGAGE MANAGEMENT, INC.

(Exact name of registrant as specified in its governing instruments)

3305 Flamingo Drive, Suite 100, Vero Beach, Florida 32963
(772) 231-1400

(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

Jeffrey J. Zimmer
Chairman, Chief Executive Officer and President
Bimini Mortgage Management, Inc.
3305 Flamingo Drive, Suite 100, Vero Beach, Florida 32963 (772) 231-1400
(Name, address, including zip code and telephone number, including area code, of agent for service)

copies to:

Robert E. King, Jr. **Clifford Chance US LLP** **31 West 52nd Street** **New York, NY 10019** **(212) 878-8000**	**Charles R. Monroe, Jr.** **Hunton & Williams LLP** **Bank of America Plaza, Suite 3500** **101 South Tryon Street** **Charlotte, NC 28280** **(704) 378-4700**

Approximate date of commencement of proposed sale to the public:
From time to time after the effective date of this registration statement.

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If delivery of the prospectus is expected to be made pursuant to Rule 434, check the following box. o

CALCULATION OF REGISTRATION FEE

Title of Securities being Registered	Proposed Maximum Aggregate Offering Price	Amount of Registration Fee(1)
Class A Common Stock, par value $.001 per share	$72,289,000	$9,159.02

(1) A registration fee in the amount of $6,962.17 on a proposed maximum aggregate offering price of $54,950,000 was paid in connection with the initial filing of this registration statement. The balance of the registration fee due on the increase in the proposed maximum aggregate offering is computed in accordance with Rule 457(c) under the Securities Act by averaging the high and low sale prices of Bimini Mortgage Management, Inc.'s Class A Common Stock as reported by the NYSE on November 29, 2004. Pursuant to Rule 457(p) under the Securities Act, the entire registration fee shall be offset against the unused registration fee paid upon the filing of Registration Statement No. 333-113715, filed by Bimini Mortgage Management, Inc. on March 18, 2004.

The registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the registrant shall file a further amendment which specifically states that this registration statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the registration statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.

SUBJECT TO COMPLETION, DATED DECEMBER 3, 2004

PROSPECTUS

4,000,000 Shares

Class A Common Stock

We are selling 4,000,000 shares of our Class A Common Stock. We have granted the underwriters an option to purchase up to an additional 600,000 shares of our Class A Common Stock to cover over-allotments, if any.

Our Class A Common Stock is listed on the New York Stock Exchange under the symbol "BMM." On December 1, 2004, the last reported sale price of our Class A Common Stock was $16.00.

Our Class A Common Stock is subject to ownership limitations intended to preserve our status as a real estate investment trust, or REIT, for federal income tax purposes.

Investing in our Class A Common Stock involves risks. See "Risk Factors" beginning on page 8 for a discussion of risks relating to our Class A Common Stock, including, among others:

- We commenced operations in December 2003 and have a limited operating history. Accordingly, you have a limited basis to evaluate our ability to operate our business and implement our operating policies and strategies successfully.

- We have not identified specific assets to purchase with the proceeds of this offering, and you will therefore not have the opportunity to evaluate our investments before we make them, which makes your investment more speculative.

- Our officers, Jeffrey J. Zimmer and Robert E. Cauley, have limited experience managing a REIT. Their lack of experience may limit their ability to successfully manage our business as a REIT.

- We rely primarily on short-term borrowings to acquire mortgage related securities some of which have long-term maturities. Interest rate mismatches between our mortgage related securities and our borrowings used to fund our purchases of mortgage related securities might reduce our net income or result in a loss during periods of changing interest rates.

- Increased levels of prepayments on the mortgages underlying our mortgage related securities might decrease our net interest income or result in a net loss.

- We generally seek to borrow eight to 12 times the amount of our equity, which could reduce our net income and our cash available for distributions to stockholders or cause us to suffer losses. There is no limit to the amount of leverage that we may incur.

- Failure to qualify or maintain our qualification as a REIT for federal income tax purposes would subject us to federal income tax on our taxable income at regular corporate rates, thereby reducing the amount of funds available for distributions to stockholders.

	Per Share	Total
Public offering price	$	$
Underwriting discounts	$	$
Proceeds, before expenses, to us	$	$

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

FLAGSTONE SECURITIES **BB&T CAPITAL MARKETS**

The date of this prospectus is

We have filed for registration in the U.S. Patent and Trademark Office for the marks "Bimini Mortgage Management, Inc.", "Bimini Investment Management" and "Bimini." All other brand names or trademarks appearing in this prospectus are the property of their respective holders.

PROSPECTUS SUMMARY

This section summarizes information contained elsewhere in this prospectus. You should read this entire prospectus carefully, including the section titled "Risk Factors" and our financial statements and related notes, before making an investment in our Class A Common Stock. As used in this prospectus, "Bimini," "company," "we," "our," and "us" refer to Bimini Mortgage Management, Inc., except where the context otherwise requires. Unless otherwise indicated, the information in this prospectus assumes that the underwriters will not exercise their over-allotment option to purchase additional shares of our Class A Common Stock, and that the shares of our Class A Common Stock to be sold in this offering are sold at $16.00 per share, which is the last reported sale price of our Class A Common Stock on the New York Stock Exchange on December 1, 2004.

Bimini Mortgage Management, Inc.

General

We were formed in September 2003 to invest primarily in residential mortgage related securities issued by the Federal National Mortgage Association (more commonly known as Fannie Mae), the Federal Home Loan Mortgage Corporation (more commonly known as Freddie Mac) and the Government National Mortgage Association (more commonly known as Ginnie Mae). We will earn returns on the difference between the interest income on our assets and our costs, including the interest expense on the funds we borrow. We intend to borrow between eight and 12 times the amount of our equity capital to attempt to enhance our returns to stockholders. We are self-managed and self-advised. We have elected to be taxed as a real estate investment trust, or REIT, for federal income tax purposes commencing with our taxable year ended December 31, 2003. As a REIT, we generally are not subject to federal income tax on the REIT taxable income that we distribute to our stockholders.

We commenced operations in December 2003, following an initial private placement of our Class A Common Stock. We raised aggregate net proceeds (after commissions and expenses) of approximately $141.7 million between December 2003 and February 2004 in private placements of our Class A Common Stock. In September 2004 we completed the initial public offering of shares of our Class A Common Stock, in which we raised approximately $76.2 million in net proceeds.

As of September 30, 2004 we had a portfolio of mortgage related securities that totaled $1.6 billion and was comprised of 29.7% fixed-rate mortgage-backed securities, 15.7% floating rate collateralized mortgage obligations, 43.1% adjustable-rate mortgage-backed securities, 8.1% hybrid adjustable-rate mortgage-backed securities (securities backed by mortgages with fixed initial rates which, after a period, convert to adjustable rates) and 3.4% balloon maturity mortgage-backed securities (securities backed by mortgages where a significant portion of principal is repaid only at maturity). Of this portfolio, 67% was issued by Fannie Mae, 24% was issued by Freddie Mac and 9% was issued by Ginnie Mae.

Our portfolio had a weighted average yield of 3.02% as of September 30, 2004. Weighted average yield is the composite of the yields on our securities as determined using the yield book model published by Citigroup. Our net weighted average borrowing cost as of September 30, 2004 was 1.55%. The constant prepayment rate for the portfolio was 18.1% for September 2004, which reflects the annualized proportion of principal that was prepaid. The effective duration for the portfolio was 1.05 as of September 30, 2004. Duration measures the price sensitivity of a fixed income security to movements in interest rates. Effective duration captures both the movement in interest rates and the fact that cash flows to a mortgage related security are altered when interest rates move. An effective duration of 1.05 indicates that an interest rate increase of 1% would be expected to cause a 1.05% decline in the value of the securities in our portfolio.

Our principal offices are located at 3305 Flamingo Drive, Suite 100, Vero Beach, Florida 32963. Our telephone number is (772) 231-1400.

Asset Acquisition Strategy

We seek to differentiate our company from other mortgage portfolio managers through our approach to risk management. We invest in a limited universe of mortgage related securities, primarily those issued by Fannie Mae, Freddie Mac and Ginnie Mae. Payment of principal and interest underlying securities issued by Ginnie Mae is guaranteed by the U.S. Government. Fannie Mae and Freddie Mac mortgage related securities are guaranteed as to payment of principal and interest by the respective agency issuing the security. We seek to manage the risk of prepayments of the underlying mortgages by purchasing securities with prepayment characteristics that we expect to result in slower prepayments, such as pools of mortgage-backed securities collateralized by mortgages with low loan balances, mortgages originated under Fannie Mae's Expanded Approval Program or agency pools collateralized by loans against investment properties.

The primary assets in our current portfolio of mortgage related securities are fixed-rate mortgage-backed securities, floating rate collateralized mortgage obligations, adjustable-rate mortgage-backed securities, hybrid adjustable-rate mortgage-backed securities and balloon maturity mortgage-backed securities. The mortgage related securities we acquire are obligations issued by federal agencies or federally chartered entities, primarily Fannie Mae, Freddie Mac and Ginnie Mae.

We have created and will maintain a diversified portfolio in order to avoid undue loan originator, geographic and other types of concentrations. We seek to manage the effects on our income of prepayments of the mortgage loans underlying our securities, at a rate materially different than anticipated, by structuring a diversified portfolio with a variety of prepayment characteristics and investing in mortgage related securities or structures with prepayment protections.

Leverage Strategy

We use leverage in an attempt to increase potential returns to our stockholders. However, the use of leverage may also have the effect of increasing losses when economic conditions are unfavorable. We generally borrow between eight to 12 times the amount of our equity, although our investment policies require no minimum or maximum leverage. We use repurchase agreements to borrow against existing mortgage related securities and use the proceeds to acquire additional mortgage related securities. As of September 30, 2004, we had 17 master repurchase agreements (and outstanding balances under 13 of these agreements) and our repurchase agreements totaled $1.5 billion, or 7 times our equity capital at that date.

We seek to protect our capital base through the use of a risk-based capital methodology that is patterned on the general principles underlying the proposed risk-based capital standard for internationally active banks of the Basel Committee on Banking Supervision. We use our methodology to calculate an internally generated risk measure for each asset in our portfolio. This measure is then used to establish the amount of leverage we use. The goal of our approach is to ensure that our portfolio's leverage ratio is appropriate for the level of risk inherent in the portfolio.

Interest Rate Risk Management

We believe the primary risk inherent in our investments is the effect of movements in interest rates. This risk arises because the effects of interest rate changes on our borrowings will not be perfectly coordinated with the effects of interest rate changes on the income from, or value of, our investments. We therefore follow an interest rate risk management program designed to offset the potential adverse effects resulting from the rate adjustment limitations on our mortgage related securities. We seek to minimize differences between interest rate indices and interest rate adjustment periods of our adjustable-rate securities and related borrowings by matching the terms of assets and related liabilities both as to maturity and to the underlying interest rate index used to calculate interest charges.

We may from time to time use derivative financial instruments to hedge all or a portion of the interest rate risk associated with our borrowings. We may enter into swap or cap agreements, option, put or call agreements, futures contracts, forward rate agreements or similar financial instruments to hedge indebtedness that we may incur. These contracts would be intended to more closely match the effective maturity of, and the interest received on, our assets with the effective maturity of, and the interest owed on, our liabilites. However, no assurances can be given that interest rate risk management strategies can successfully be implemented. Derivative instruments will not be used for speculative purposes.

Risk Factors

An investment in our Class A Common Stock involves material risks. Each prospective purchaser of our Class A Common Stock should consider carefully the matters discussed under "Risk Factors" beginning on page 8 before investing in our Class A Common Stock. Some of the risks include:

- We commenced operations in December 2003 and have a limited operating history. Accordingly, you have a limited basis to evaluate our ability to operate our business and implement our operating policies and strategies successfully.

- We have not identified specific assets to purchase with the proceeds of this offering, and you will therefore not have the opportunity to evaluate our investments before we make them, which makes your investment more speculative.

- Our officers, Jeffrey J. Zimmer and Robert E. Cauley, have limited experience managing a REIT. Their lack of experience may limit their ability to successfully manage our business as a REIT.

- We rely primarily on short-term borrowings to acquire mortgage related securities some of which have long-term maturities. Interest rate mismatches between our mortgage related securities and our borrowings used to fund our purchases of mortgage related securities might reduce our net income or result in a loss during periods of changing interest rates.

- As of September 30, 2004, 33.1% of our portfolio consisted of fixed-rate and balloon maturity mortgage-backed securities. Accordingly, we may experience reduced net income or a loss during periods of rising interest rates.

- Increased levels of prepayments on the mortgages underlying our mortgage related securities might decrease our net interest income or result in a net loss.

- We generally seek to borrow eight to 12 times the amount of our equity, which could reduce our net income and our cash available for distributions to stockholders or cause us to suffer losses. There is no limit on the amount of leverage that we may incur.

- Failure to qualify or maintain our qualification as a REIT for federal income tax purposes would subject us to federal income tax on our taxable income at regular corporate rates, thereby reducing the amount of funds available for distributions to stockholders.

- Our board of directors may change our operating policies and strategies without prior notice to you or stockholder approval, and such changes could harm our business and results of operations and the value of our stock.

- Our officers own shares of Class B Common Stock, which will begin to convert to shares of Class A Common Stock when stockholders' equity attributable to the Class A Common Stock is

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not less than $15.00 per share. If all shares of Class B Common Stock are converted, the 319,388 shares of Class A Common Stock issued would equal approximately 1.6% of the shares of Class A Common Stock expected to be outstanding after this offering. Our officers may take undue risks in managing our company in an attempt to increase stockholders' equity and cause a conversion of these shares.

Competition in purchasing assets consistent with our investment objectives might prevent us from acquiring mortgage related securities at favorable yields, which would harm our results of operations.

Hedging transactions may limit our gains or result in losses. We may hedge our interest rate exposure through the use of derivative instruments. Our hedging transactions, which would be intended to limit losses, involve costs and may actually limit gains and increase our exposure to losses.

If our distributions exceed our REIT taxable income, a portion of the distribution may be deemed a return of capital for federal income tax purposes, which would reduce stockholders' basis in the underlying shares of our Class A Common Stock.

Management

We are self-managed and self-advised. Our two executive officers have significant experience in the mortgage related securities market. Jeffrey Zimmer, our President, Chief Executive Officer and Chairman of the Board, has 20 years experience in the mortgage-backed securities markets, most recently as a managing director at RBS/Greenwich Capital, where he sold and researched almost every type of mortgage-backed security. Robert E. Cauley, CFA, our Secretary, Chief Investment Officer and Chief Financial Officer, has ten years of experience in the mortgage and asset- backed securities markets. Mr. Cauley was most recently Vice President, Portfolio Manager at Federated Investment Management Company where he was also a lead portfolio manager, co-manager, or assistant portfolio manager of $4.25 billion in mortgage and asset-backed securities funds.

This Offering

Class A Common Stock offered by us	4,000,000 shares(1)
Class A Common Stock to be outstanding after this offering	19,765,656 shares(2)(3)
Use of proceeds	We estimate that the net proceeds from this offering will be approximately $59.2 million (after offering expenses and underwriting discounts). We intend to invest 100% of the net proceeds of this offering to expand our portfolio of residential mortgage related securities issued primarily by Fannie Mae, Freddie Mac and Ginnie Mae. Until these assets can be identified and obtained, we may temporarily invest the balance of the proceeds of this offering in interest-bearing short-term investment grade securities or money market accounts consistent with our intention to maintain our qualification as a REIT, or we may hold cash. We estimate that the underwriting discounts and offering expenses will be approximately $4.8 million. See "Use of Proceeds."
Trading	Our Class A Common Stock is traded on the New York Stock Exchange under the symbol "BMM." On December 1, 2004, the last reported sale price of our Class A Common Stock was $16.00.

(1) Excludes up to 600,000 shares of our Class A Common Stock that may be issued by us upon exercise of the underwriters' over-allotment option.

(2) Based on 15,765,656 shares outstanding on September 30, 2004 and excludes up to 600,000 shares of our Class A Common Stock that may be issued by us upon exercise of the underwriters' over-allotment option.

(3) This amount excludes up to 638,776 shares of our Class A Common Stock issuable upon conversion of our shares of Class B Common Stock and Class C Common Stock. See "Description of Capital Stock Common Stock Conversion Rights." This amount also excludes 3,686,400 shares of our Class A Common Stock reserved for issuance under our 2003 stock incentive plan and 313,600 shares of our Class A Common Stock reserved for issuance upon exchange of phantom shares that we have issued under our stock incentive plan.

Our Tax Status

We have elected to be taxed as a REIT under the Internal Revenue Code of 1986 as amended, or the Internal Revenue Code, commencing with our taxable year ended December 31, 2003. Provided that we maintain our qualification as a REIT, we generally will not be subject to federal income tax on our taxable income that is currently distributed to our stockholders. REITs are subject to a number of organizational and operational requirements, including a requirement that they currently distribute at least 90% of their annual REIT taxable income excluding net capital gains. We cannot assure you that we will be able to comply with such requirements in the future. Failure to qualify as a REIT in any taxable year would render us subject to federal income tax on our taxable income at regular corporate rates. Even if we qualify for taxation as a REIT, we may be subject to certain U.S. federal, state, local and foreign taxes on our income and property. In connection with our election to be taxed as a REIT, our charter prohibits any stockholder from directly or indirectly owning more than 9.8% of the outstanding shares, by value or number, whichever is more restrictive, of our common stock or of our stock in the aggregate.

Distributions

To avoid corporate income and excise taxes and to maintain our qualification as a REIT under the Internal Revenue Code, we intend to distribute to our stockholders all or substantially all of our REIT taxable income (which does not necessarily equal net income as calculated in accordance with generally accepted accounting principles, or GAAP). See "Certain Federal Income Tax Consequences Annual Distribution Requirements." All distributions will be made by us at the discretion of our board of directors and will depend on our taxable earnings, financial condition and such other factors as our board of directors deems relevant.

On April 23, 2004, we paid a dividend of $0.39 per share of Class A Common Stock to stockholders of record as of March 10, 2004. On July 9, 2004, we paid a dividend of $0.52 per share of Class A Common Stock to stockholders of record as of June 16, 2004. On October 8, 2004, we paid a dividend of $0.52 per share of Class A and Class B Common Stock to stockholders of record on September 3, 2004. On November 30, 2004, our board of directors declared a dividend of $0.54 per share of Class A and Class B Common Stock relating to operations in the fourth quarter of 2004. The dividend will be paid on December 29, 2004, to stockholders of record on December 10, 2004. We expect that this dividend will be paid from earnings. The completion of this offering will occur after December 10, 2004. Therefore, the shares of our Class A Common Stock offered by this prospectus will not be entitled to this fourth quarter dividend.

Summary Financial Data

The following summary financial data is derived from our unaudited financial statements as of and for the nine months ended September 30, 2004 and our audited financial statements as of December 31, 2003 and for the period from September 24, 2003 (date of inception) through December 31, 2003. The summary financial data should be read in conjunction with the more detailed information contained in our financial statements and related notes and "Management's Discussion and Analysis of Financial Condition and Results of Operations" included elsewhere in this prospectus.

	Nine months ended September 30, 2004	September 24, 2003 (inception) through December 31, 2003
Statement of Operations Data:		
Revenues:		
Interest income	$ 29,170,477	$ 71,480
Interest expense	(11,333,783)	(20,086)
Net interest income	17,836,694	51,394
Gains on sales of mortgage-backed securities	777,053	
Losses on sales of mortgage-backed securities	(655,389)	
Net gain on sales of mortgage-backed securities	121,664	
Expenses:		
Trading costs, commissions and other	705,519	15,583
Other direct costs	127,935	29,899
Compensation and related benefits	1,204,435	35,964
Directors' fees and other public company costs	225,228	
Start-up and organization costs		111,092
Occupancy costs	46,925	13,675
Audit, legal and other professional fees	221,584	85,340
Other administrative expenses	170,284	27,008
Total expenses	2,701,910	318,561
Net income (loss)	$ 15,256,448	$ (267,167)
Basic and diluted income (loss) per Class A common share	$ 1.56	$ (0.54)
Weighted average number of Class A common shares outstanding, used in computing per share amounts:		
Basic and diluted	9,648,176	497,859
Basic and diluted income per Class B common share	$ 1.65	$
Weighted average number of Class B common shares outstanding used in computing per share amounts:		
Basic and diluted	106,074	

	September 30, 2004	December 31, 2003
Balance Sheet Data:		
Mortgage-backed securities available for sale, at fair value	$ 13,051,531	$ 27,750,602
Mortgage-backed securities pledged as collateral, at fair value	1,625,212,534	197,990,559
Total mortgage-backed securities, at fair value	1,638,264,065	225,741,161
Total assets	1,779,529,002	245,285,676
Repurchase agreements	1,548,618,814	188,841,000
Total liabilities	1,560,976,080	188,970,485
Accumulated other comprehensive loss	(63,877)	(19,409)
Total stockholders' equity	$ 218,552,922	$ 56,315,191

	September 30, 2004	December 31, 2003
Class A common shares issued and outstanding	15,765,656	4,012,102
Book value per share of Class A Common Stock	$ 13.86	$ 14.04

RISK FACTORS

You should carefully consider the risks described below before making an investment decision. Our business, financial condition or results of operations could be harmed by any of these risks. Similarly, these risks could cause the market price of our Class A Common Stock to decline and you might lose all or part of your investment. Our forward-looking statements in this prospectus are subject to the following risks and uncertainties. Our actual results could differ materially from those anticipated by our forward-looking statements as a result of the risk factors below.

Risks Related to Our Business

We have a limited operating history and might not be able to operate our business or implement our operating policies and strategies successfully.

We began operations in December of 2003 and therefore have a limited operating history. The results of our operations will depend on many factors, including the availability of opportunities for the acquisition of mortgage related securities, the level and volatility of interest rates, readily accessible short- and long-term funding alternatives in the financial markets and economic conditions. Moreover, delays in fully investing and leveraging our net proceeds of this offering may cause our performance to be weaker than if we were fully invested and leveraged. Our lack of operating history provides you with a limited basis to evaluate the likelihood that we will successfully operate our business and implement our operating policies and strategies as described in this prospectus.

We have not yet identified any specific mortgage related securities to purchase with the net proceeds of this offering and may be unable to invest a significant portion of such net proceeds on acceptable terms or at all, which could harm our financial condition and operating results.

As of the date of this prospectus, we have not identified any specific mortgage related securities which we intend to acquire with the proceeds from this offering. As a result, you will not be able to evaluate the economic merits of any investments we make with the net proceeds of this offering prior to the purchase of your shares. You must rely on our ability to evaluate our investment opportunities.

Until we identify and acquire mortgage related securities consistent with our investment strategy, we intend to temporarily invest the balance of the net proceeds of this offering in readily marketable interest-bearing assets consistent with our intention to maintain our qualification as a REIT. Depending on the amount of leverage that we use, the full investment of the net proceeds of this offering will result in a substantial increase in our total assets. We cannot assure you that we will be able to invest all of these funds in mortgage related securities that meet our investment strategy at favorable prices. As a result, we may not be able to acquire enough mortgage related securities in order to become fully invested after this offering, or we may have to pay more for mortgage related securities than we would like.

Interest rate mismatches between our adjustable-rate securities and our borrowings used to fund our purchases of the mortgage related securities may reduce our net income or result in a loss during periods of changing interest rates.

As of September 30, 2004, 66.9% of the mortgage-backed securities in our portfolio were subject to adjustable interest rates. This means that the interest rates of the securities may vary over time based on changes in a short-term interest rate index, of which there are many. We finance our acquisitions of adjustable-rate securities in part with borrowings that have interest rates based on indices and repricing terms similar to, but perhaps with shorter maturities than, the interest rate indices and repricing terms of the adjustable-rate securities. Short-term interest rates are ordinarily lower than longer-term interest rates. During periods of changing interest rates, this interest rate mismatch between our assets and liabilities could reduce or eliminate our net income and dividend yield and could cause us to suffer a loss. In particular, in a period of rising interest rates, we could experience a decrease in, or elimination of, net income or a net loss because the interest rates on our borrowings adjust faster than the interest rates on our adjustable-rate securities.

Interest rate fluctuations will also cause variances in the yield curve, which may reduce our net income. The relationship between short-term and longer-term interest rates is often referred to as the "yield curve." If short-term interest rates rise disproportionately relative to longer-term interest rates (a flattening of the yield curve), our borrowing costs may increase more rapidly than the interest income earned on our assets. Because our assets may bear interest based on longer-term rates than our borrowings, a flattening of the yield curve would tend to decrease our net income and the market value of our mortgage loan assets. Additionally, to the extent cash flows from investments that return scheduled and unscheduled principal are reinvested in mortgage loans, the spread between the yields of the new investments and available borrowing rates may decline, which would likely decrease our net income. 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.

A significant portion of our portfolio consists of fixed-rate mortgage-backed securities, which may cause us to experience reduced net income or a loss during periods of rising interest rates.

As of September 30, 2004, 33.1% of our portfolio consisted of fixed-rate and balloon maturity mortgage-backed securities. Because the interest rate on a fixed-rate mortgage never changes, over time there can be a divergence between the interest rate on the loan and the current market interest rates. We fund our acquisition of fixed-rate mortgage-backed securities with short-term repurchase agreements and term loans. During periods of rising interest rates, our costs associated with borrowings used to fund the acquisition of fixed-rate assets are subject to increases while the income we earn from these assets remains substantially fixed. This would reduce and could eliminate the net interest spread between the fixed-rate mortgage-backed securities that we purchase and our borrowings used to purchase them, which would reduce our net interest income and could cause us to suffer a loss.

Increased levels of prepayments on the mortgages underlying our mortgage related securities might decrease our net interest income or result in a net loss.

Pools of mortgage loans underlie the mortgage related securities that we acquire. We generally receive payments from the payments that are made on these underlying mortgage loans. When we acquire mortgage related securities, we anticipate that the underlying mortgages will prepay at a projected rate generating an expected yield. When borrowers prepay their mortgage loans faster than expected, this results in corresponding prepayments on the mortgage related securities that are faster than expected. Faster-than-expected prepayments could potentially harm the results of our operations in various ways, including the following:

- We seek to purchase some mortgage related securities that have a higher interest rate than the market interest rate at the time. In exchange for this higher interest rate, we will be required to pay a premium over the market value to acquire the security. In accordance with applicable accounting rules, we will be required to amortize this premium over the term of the mortgage related security. If the mortgage related security is prepaid in whole or in part prior to its maturity date, however, we must expense any unamortized premium that remained at the time of the prepayment.

- A portion of our adjustable-rate mortgage-backed securities may bear interest at rates that are lower than their fully indexed rates, which are equivalent to the applicable index rate plus a margin. If an adjustable-rate mortgage-backed security is prepaid prior to or soon after the time of adjustment to a fully-indexed rate, we will have held that mortgage related security while it was less profitable and lost the opportunity to receive interest at the fully indexed rate over the remainder of its expected life.

If we are unable to acquire new mortgage related securities to replace the prepaid mortgage related securities, our financial condition, results of operations and cash flow may suffer and we could incur losses.

Prepayment rates generally increase when interest rates fall and decrease when interest rates rise, but changes in prepayment rates are difficult to predict. Prepayment rates also may be affected by other factors, including, without limitation, conditions in the housing and financial markets, general economic conditions and the relative interest rates on adjustable-rate and fixed-rate mortgage loans. While we seek to minimize prepayment risk, we must balance prepayment risk against other risks and the potential returns of each investment when selecting investments. No strategy can completely insulate us from prepayment or other such risks.

We may incur increased borrowing costs related to repurchase agreements that would harm our results of operations.

Our borrowing costs under repurchase agreements are generally adjustable and correspond to short-term interest rates, such as LIBOR or a short-term Treasury index, plus or minus a margin. The margins on these borrowings over or under short-term interest rates may vary depending upon a number of factors, including, without limitation:

- the movement of interest rates;
- the availability of financing in the market; and
- the value and liquidity of our mortgage related securities.

Most of our borrowings are collateralized borrowings in the form of repurchase agreements. If the interest rates on these repurchase agreements increase, our results of operations will be harmed and we may incur losses.

Interest rate caps on our adjustable-rate mortgage-backed securities may reduce our income or cause us to suffer a loss during periods of rising interest rates.

Adjustable-rate mortgage-backed securities are typically subject to periodic and lifetime interest rate caps. Periodic interest rate caps limit the amount an interest rate can increase during any given period. Lifetime interest rate caps limit the amount an interest rate can increase through the maturity of a mortgage-backed security. Our borrowings 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 our adjustable-rate mortgage-backed securities. This problem is magnified for adjustable-rate mortgage-backed securities that are not fully indexed. Further, some adjustable-rate mortgage-backed securities 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 adjustable-rate mortgage-backed securities than we need to pay interest on our related borrowings.

As of September 30, 2004, the floating rate collateralized mortgage obligations in our portfolio were subject to a weighted average lifetime interest rate cap of 7.9% and no periodic interest rate caps, the adjustable-rate mortgage-backed securities in our portfolio were subject to a weighted average lifetime interest rate cap of 10.4% and a weighted average periodic interest rate cap of 1.5% and the hybrid adjustable-rate mortgage-backed securities in our portfolio were subject to a weighted average lifetime interest rate cap of 10.2% and a weighted average periodic interest rate cap of 1.9%. Interest rate caps on our mortgage-backed securities could reduce our net interest income or cause us to suffer a net loss if interest rates were to increase beyond the level of the caps.

We may not be able to purchase interest rate caps at favorable prices, which could cause us to suffer a loss in the event of significant changes in interest rates.

Our policies permit us to purchase interest rate caps to help us reduce our interest rate and prepayment risks associated with our investments in mortgage related securities. This strategy potentially helps us reduce our exposure to significant changes in interest rates. A cap contract is ultimately no benefit to us unless interest rates exceed the target rate. If we purchase interest rate caps but do not experience a corresponding increase in interest rates, the costs of buying the caps would reduce our earnings. Alternatively, we may decide not to enter into a cap transaction due to its expense, and we would suffer losses if interest rates later rise substantially. Our ability to engage in interest rate hedging transactions is limited by the REIT gross income requirements. See "Legal and Tax Risks" below.

Our leverage strategy increases the risks of our operations, which could reduce our net income and the amount available for distributions to stockholders or cause us to suffer a loss.

We generally seek to borrow between eight and 12 times the amount of our equity, although at times our borrowings may be above or below this amount. We incur this indebtedness by borrowing against a substantial portion of the market value of our mortgage related securities. Our total indebtedness, however, is not expressly limited by our policies and will depend on our and our prospective lender's estimate of the stability of our portfolio's cash flow. As a result, there is no limit on the amount of leverage that we may incur. We face the risk that we might not be able to meet our debt service obligations or a lender's margin requirements from our income and, to the extent we cannot, we might be forced to liquidate some of our assets at unfavorable prices. Our use of leverage amplifies the risks associated with other risk factors, which could reduce our net income and the amount available for distributions to stockholders or cause us to suffer a loss. For example:

- A majority of our borrowings are secured by our mortgage related securities, generally under repurchase agreements. A decline in the market value of the mortgage related securities used to secure these debt obligations could limit our ability to borrow or result in lenders requiring us to pledge additional collateral to secure our borrowings. In that situation, we could be required to sell mortgage related securities under adverse market conditions in order to obtain the additional collateral required by the lender. If these sales are made at prices lower than the carrying value of the mortgage related securities, we would experience losses.

- A default under a mortgage related security that constitutes collateral for a loan could also result in an involuntary liquidation of the mortgage related security, including any cross-collateralized mortgage related securities. This would result in a loss to us of the difference between the value of the mortgage related security upon liquidation and the amount borrowed against the mortgage related security.

- To the extent we are compelled to liquidate qualified REIT assets to repay debts, our compliance with the REIT rules regarding our assets and our sources of income could be negatively affected, which would jeopardize our status as a REIT. Losing our REIT status would cause us to lose tax advantages applicable to REITs and would decrease our overall profitability and distributions to our stockholders.

- If we experience losses as a result of our leverage policy, such losses would reduce the amounts available for distribution to our stockholders.

An increase in interest rates may adversely affect our book value, which may harm the value of our stock.

Increases in interest rates may negatively affect the fair market value of our mortgage related securities. Our fixed-rate mortgage-backed securities will generally be more negatively affected by such increases. In accordance with GAAP, we will be required to reduce the carrying value of our mortgage related securities by the amount of any decrease in the fair value of our mortgage related securities compared to amortized cost. If unrealized losses in fair value occur, we will have to either reduce current earnings or reduce stockholders' equity without immediately affecting current earnings, depending on how we classify the mortgage related securities under GAAP. In either case, our net book value will decrease to the extent of any realized or unrealized losses in fair value.

Changes in yields may harm the value of our stock.

Our earnings will be derived primarily from the expected positive spread between the yield on our assets and the cost of our borrowings. There is no assurance that there will be a positive spread in either high interest rate environments or low interest rate environments, or that the spread will not be negative. In addition, during periods of high interest rates, our net income, and therefore the dividend yield on our Class A Common Stock, may be less attractive compared to alternative investments of equal or lower risk. Each of these factors could harm the market value of our Class A Common Stock.

We depend on borrowings to purchase mortgage related securities and reach our desired amount of leverage. If we fail to obtain or renew sufficient funding on favorable terms or at all, we will be limited in our ability to acquire mortgage related securities, which will harm our results of operations.

We depend on borrowings to fund acquisitions of mortgage related securities and reach our desired amount of leverage. Accordingly, our ability to achieve our investment and leverage objectives depends on our ability to borrow money in sufficient amounts and on favorable terms. In addition, we must be able to renew or replace our maturing borrowings on a continuous basis. We depend on many lenders to provide the primary credit facilities for our purchases of mortgage related securities. If we cannot renew or replace maturing borrowings on favorable terms or at all, we may have to sell our mortgage related securities under adverse market conditions, which would harm our results of operations and may result in permanent losses.

Possible market developments could cause our lenders to require us to pledge additional assets as collateral. If our assets are insufficient to meet the collateral requirements, we might be compelled to liquidate particular assets at inopportune times and at unfavorable prices.

Possible market developments, including a sharp or prolonged rise in interest rates, a change in prepayment rates or increasing market concern about the value or liquidity of one or more types of mortgage related securities in which our portfolio is concentrated, might reduce the market value of our portfolio, which might cause our lenders to require additional collateral. Any requirement for additional collateral might compel us to liquidate our assets at inopportune times and at unfavorable prices, thereby harming our operating results. If we sell mortgage related securities at prices lower than the carrying value of the mortgage related securities, we would experience losses.

Our use of repurchase agreements to borrow funds may give our lenders greater rights in the event that either we or any of our lenders file for bankruptcy, which may make it difficult for us to recover our collateral in the event of a bankruptcy filing.

Our borrowings under repurchase agreements may qualify for special treatment under the bankruptcy code, giving our lenders the ability to avoid the automatic stay provisions of the bankruptcy code and to take possession of and liquidate our collateral under the repurchase agreements without delay if we file for bankruptcy. Furthermore, the special treatment of repurchase agreements under the bankruptcy code may make it difficult for us to recover our pledged assets in the event that one of our lenders files for bankruptcy. Thus, the use of repurchase agreements exposes our pledged assets to risk in the event of a bankruptcy filing by either our lenders or us.

Because the assets that we acquire might experience periods of illiquidity, we might be prevented from selling our mortgage related securities at favorable times and prices, which could cause us to suffer a loss and/or reduce our distributions to stockholders.

Although we plan to hold our mortgage related securities until maturity, there may be circumstances in which we sell certain of these securities. Mortgage related securities generally experience periods of illiquidity. As a result, we may be unable to dispose of our mortgage related securities at advantageous times and prices or in a timely manner. The lack of liquidity might result from the absence of a willing buyer or an established market for these assets, as well as legal or contractual restrictions on resale. The illiquidity of mortgage related securities may harm our results of operations and could cause us to suffer a loss and/or reduce our distributions to stockholders.

Our board of directors may change our operating policies and strategies without prior notice or stockholder approval and such changes could harm our business and results of operations and the value of our stock.

Although our board of directors has no current plans to do so, it has the authority to modify or waive our current operating policies and our strategies (including our election to operate as a REIT) without prior notice to you and without your approval. Any such changes to our current operating policies and strategies may be unsuccessful and may have an adverse effect on our business, operating results and the market value of our Class A Common Stock.

Competition might prevent us from acquiring mortgage related securities at favorable yields, which could harm our results of operations.

Our net income largely depends on our ability to acquire mortgage related securities at favorable spreads over our borrowing costs. In acquiring mortgage related securities, we compete with other REITs, investment banking firms, savings and loan associations, banks, insurance companies, mutual funds, other lenders and other entities that purchase mortgage related securities, many of which have greater financial resources than we do. Additionally, many of our competitors are not subject to REIT tax compliance or required to maintain an exemption from the Investment Company Act. As a result, we may not be able to acquire sufficient mortgage related securities at favorable spreads over our borrowing costs, which would harm our results of operations.

Our investment strategy involves risk of default and delays in payments, which could harm our results of operations.

We may incur losses if there are payment defaults under our mortgage related securities. Our mortgage related securities will be government or agency certificates. Agency certificates are mortgage related securities issued by Fannie Mae, Freddie Mac and Ginnie Mae. Payment of principal and interest underlying securities issued by Ginnie Mae are guaranteed by the U.S. Government. Fannie Mae and Freddie Mac mortgage related securities are guaranteed as to payment of principal and interest by the respective agency issuing the security. It is possible that guarantees made by Freddie Mac or Fannie Mae would not be honored in the event of default on the underlying securities. Legislation may be proposed to change the relationship between certain agencies, such as Fannie Mae or Freddie Mac, and the federal government. This may have the effect of reducing the actual or perceived credit quality of mortgage related securities issued by these agencies. As a result, such legislation could increase the risk of loss on investments in Fannie Mae and/or Freddie Mac mortgage related securities. We currently intend to continue to invest in such securities, even if such agencies' relationships with the federal government changes.

Decreases in the value of the property underlying our mortgage related securities might decrease the value of our assets.

The mortgage related securities in which we invest are secured by underlying real property interests. To the extent that the market value of the property underlying our mortgage related securities decreases, our security might be impaired, which might decrease the value of our assets.

If we fail to maintain relationships with AVM, L.P. and its affiliate III Associates, or if we do not establish relationships with other repurchase agreement trading, clearing and administrative service providers, we may have to reduce or delay our operations and/or increase our expenditures.

We have engaged AVM, L.P. and its affiliate III Associates, to provide us with certain repurchase agreement trading, clearing and administrative services. See "Business Repurchase Agreement Trading, Clearing and Administrative Services." If we are unable to maintain relationships with AVM and III Associates or are unable to establish successful relationships with other repurchase agreement trading, clearing and administrative service providers, we may have to reduce or delay our operations and/or increase our expenditures and undertake the repurchase agreement trading, clearing and administrative services on our own.

Hedging transactions may adversely affect our earnings, which could adversely affect cash available for distribution to our stockholders.

We may enter into interest rate cap or swap agreements or pursue other hedging strategies, including the purchase of puts, calls or other options and futures contracts. Our hedging activity will vary in scope based on the level and volatility of interest rates and principal prepayments, the type of mortgage-backed securities we hold, and other changing market conditions. Hedging may fail to protect or could adversely affect us because, among other things:

- hedging can be expensive, particularly during periods of rising and volatile interest rates;
- available interest rate hedging may not correspond directly with the interest rate risk for which protection is sought;
- the duration of the hedge may not match the duration of the related liability;
- certain types of hedges may expose us to risk of loss beyond the fee paid to initiate the hedge;
- the amount of income that a REIT may earn from hedging transactions is limited by federal income tax provisions governing REITs;
- the credit quality of the party 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 party owing money in the hedging transaction may default on its obligation to pay.

Our hedging activity may adversely affect our earnings, which could adversely affect cash available for distribution to our stockholders.

Terrorist attacks and other acts of violence or war may affect any market for our Class A Common Stock, the industry in which we conduct our operations, and our profitability.

Terrorist attacks may harm our results of operations and your investment. We cannot assure you that there will not be further terrorist attacks against the United States or U.S. businesses. These attacks or armed conflicts may directly impact the property underlying our mortgage related securities or the securities markets in general. Losses resulting from these types of events are uninsurable.

More generally, any of these events could cause consumer confidence and spending to decrease or result in increased volatility in the United States and worldwide financial markets and economies. They also could result in economic uncertainty in the United States or abroad. Adverse economic conditions could harm the value of the property underlying our mortgage related securities or the securities markets in general, which could harm our operating results and revenues and may result in the volatility of the market value of our securities.

Risks Related to Our Officers

Our officers have not previously managed a REIT, and we cannot assure you that their past experience will be sufficient to successfully manage our business as a REIT.

Our officers, Jeffrey J. Zimmer and Robert E. Cauley, have not previously managed a REIT, and, prior to commencing operations of our company, did not have any experience in complying with the income, asset and other limitations imposed by the REIT provisions of the Internal Revenue Code. Those provisions are complex and the failure to comply with those provisions in a timely manner could cause us to fail to qualify as a REIT or could force us to pay unexpected taxes and penalties. In such event, our net income would be reduced, we could incur a loss, and we would have less cash available for distributions to stockholders.

We depend primarily on two individuals to operate our business, and the loss of such persons would severely and detrimentally affect our operations.

We depend substantially on two individuals, Jeffrey J. Zimmer, our Chairman, Chief Executive Officer and President, and Robert E. Cauley, our Chief Investment Officer and Chief Financial Officer, to manage our business. We depend on the diligence, experience and skill of Mr. Zimmer and Mr. Cauley for the selection, acquisition, structuring and monitoring of our mortgage related securities and associated borrowings. Although we have entered into employment contracts with Mr. Zimmer and Mr. Cauley, those employment contracts may not prevent either Mr. Zimmer or Mr. Cauley from leaving our company. The loss of either of them would likely have a severe negative effect on our business, financial condition, cash flow and results of operations.

Our officers own shares of our Class B Common Stock, and may take undue risks in managing our company in order to cause a conversion of these shares.

In connection with our formation, our founders and officers, Messrs. Zimmer and Cauley, were issued an aggregate of 319,388 shares of our Class B Common Stock. These shares of Class B Common Stock will begin to convert to shares of Class A Common Stock when stockholders' equity attributable to Class A Common Stock is not less than $15.00 per share. Accordingly, our officers may take undue risks in managing our company in an attempt to increase stockholders' equity and cause a conversion of these shares. See "Description of Capital Stock Common Stock Conversion Rights."

Legal and Tax Risks

If we fail to qualify as a REIT, we will be subject to federal income tax as a regular corporation and may face substantial tax liability.

We intend to continue to operate in a manner that will maintain our qualification as a REIT for U.S. federal income tax purposes. However, qualification as a REIT involves the satisfaction of numerous requirements (some on an annual or quarterly basis) established under technical and complex provisions of the Internal Revenue Code for which only a limited number of judicial or administrative interpretations exist. The determination that we qualify as a REIT requires an analysis of various factual matters and circumstances that may not be totally within our control. Accordingly, it is not certain we have qualified or will be able to maintain our qualification as a REIT for federal income tax purposes. Even a technical or inadvertent mistake could jeopardize our REIT status. Furthermore, Congress or the Internal Revenue Service, or IRS, might change tax laws or regulations and the courts might issue new rulings, in each case potentially having retroactive effect, that could make it more difficult or impossible for us to maintain our qualification as a REIT. If we fail to maintain our qualification as a REIT in any tax year, then:

- we would be taxed as a regular domestic corporation, which, among other things, means that we would be unable to deduct distributions to stockholders in computing taxable income and would be subject to federal income tax on our taxable income at regular corporate rates;

- any resulting tax liability could be substantial and would reduce the amount of cash available for distribution to stockholders, and could force us to liquidate assets at inopportune times, causing lower income or higher losses than would result if these assets were not liquidated; and

- unless we were entitled to relief under applicable statutory provisions, we would be disqualified from treatment as a REIT for the subsequent four taxable years following the year during which we lost our qualification, and our cash available for distribution to our stockholders therefore would be reduced for each of the years in which we do not qualify as a REIT.

Even if we remain qualified as a REIT, we may face other tax liabilities that reduce our cash flow. We may also be subject to certain federal, state and local taxes on our income and property. Any of these taxes would decrease cash available for distribution to our stockholders.

Complying with REIT requirements may cause us to forego otherwise attractive opportunities.

To qualify as a REIT for federal income tax purposes, we must continually satisfy tests concerning, among other things, our sources of income, the nature and diversification of our assets, the amounts we distribute to our stockholders and the ownership of our stock. We may also be required to make distributions to our stockholders at unfavorable times or when we do not have funds readily available for distribution. Thus, compliance with REIT requirements may hinder our ability to operate solely with the goal of maximizing profits.

In addition, the REIT provisions of the Internal Revenue Code impose a 100% tax on income from "prohibited transactions." Prohibited transactions generally include sales of assets that constitute inventory or other property held for sale in the ordinary course of a business, other than foreclosure property. This 100% tax could impact our desire to sell mortgage related securities at otherwise opportune times if we believe such sales could result in us being treated as engaging in prohibited transactions. However, we would not be subject to this tax if we were to sell assets through a taxable REIT subsidiary.

Complying with REIT requirements may limit our ability to hedge effectively, which could in turn leave us more exposed to the effects of adverse changes in interest rates.

The REIT provisions of the Internal Revenue Code may substantially limit our ability to hedge mortgage related securities and related borrowings by requiring us to limit our income in each year from qualified hedges, together with any other income not generated from qualified REIT real estate assets, to less than 25% of our gross income. In addition, we must limit our aggregate gross income from non-qualified hedges, fees, and certain other non-qualifying sources, to less than 5% of our annual gross income. As a result, although we will not engage in hedging transactions except the purchase of interest rate caps and forward financing agreements, we may in the future have to limit our use of these techniques or implement these hedges through a taxable REIT subsidiary. This could result in greater risks associated with changes in interest rates than we would otherwise want to incur. If we fail to satisfy the 25% or 5% limitations, unless our failure was due to reasonable cause and not due to willful neglect and we meet certain other technical requirements, we could lose our REIT status for federal income tax purposes. Even if our failure was due to reasonable cause, we may have to pay a penalty tax equal to the amount of income in excess of certain thresholds, multiplied by a fraction intended to reflect our profitability.

Complying with REIT requirements may force us to liquidate otherwise attractive investments, which could negatively affect our profitability.

In order 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 REIT real estate assets. The remainder of our investment in securities 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, generally, no more than 5% of the value of our assets can consist of the securities of any one issuer. If we fail to comply with these requirements, we must dispose of a portion of our assets within 30 days after the end of the calendar quarter in order to avoid losing our REIT status and suffering adverse tax consequences.

Dividends paid by REITs do not qualify for the reduced tax rates under current law, which could negatively affect the value of our stock.

Under current law, the maximum tax rate for dividends paid to individual U.S. stockholders is reduced to 15% (through 2008). Dividends paid by REITs, however, are generally not eligible for the reduced rates. Although this does not adversely affect the taxation of REITs or dividends paid by REITs, the more favorable rates applicable to regular corporate dividends could cause stockholders who are individuals to perceive investments in REITs to be relatively less attractive than investments in the stock of non-REIT corporations that pay dividends to which more favorable rates apply, which could adversely affect the value of the stocks of REITs, including our Class A Common Stock.

Complying with REIT requirements may force us to borrow funds on unfavorable terms or sell our securities at unfavorable prices to make distributions to our stockholders.

As a REIT, we must distribute at least 90% of our annual REIT taxable income (excluding net capital gains) to our stockholders. To the extent that we satisfy this distribution requirement, but distribute less than 100% of our taxable income, we will be subject to federal corporate income tax on our undistributed taxable income. In addition, we will be subject to a 4% nondeductible 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 federal tax laws. From time to time, we may generate taxable income greater than our net income for financial reporting purposes from, among other things, amortization of capitalized purchase premiums, or our taxable income may be greater than our cash flow available for distribution to our stockholders. If we do not have other funds available in these situations, we could be required to borrow funds, sell a portion of our mortgage related securities at unfavorable prices or find other sources of funds in order to meet the REIT distribution requirement and to avoid corporate income tax and the 4% excise tax. These other sources could increase our costs or reduce our equity and reduce amounts available to invest in mortgage related securities.

Failure to maintain an exemption from the Investment Company Act of 1940, as amended, would harm our results of operations.

We intend to conduct our business so as not to become regulated as an investment company under the Investment Company Act. If we fail to qualify for this exemption, our ability to use leverage would be substantially reduced and we would be unable to conduct our business as described in this prospectus.

The Investment Company Act exempts entities that are primarily engaged in the business of purchasing or otherwise acquiring mortgages and other liens on, and interests in, real estate. Under the current interpretation of the SEC staff, in order to qualify for this exemption, we must maintain at least 55% of our assets directly in these qualifying real estate interests, with at least 25% of our remaining assets invested in real estate-related securities. Mortgage related securities that do not represent all of the certificates issued with respect to an underlying pool of mortgages may be treated as separate from the underlying mortgage loans and, thus, may not qualify for purposes of the 55% requirement. Therefore, our ownership of these mortgage related securities is limited by the provisions of the Investment Company Act.

As of September 30, 2004, 70.8% of our portfolio constituted qualifying interests in mortgage related securities for purposes of the Investment Company Act. In satisfying the 55% requirement under the Investment Company Act, we treat as qualifying interests mortgage related securities issued with respect to an underlying pool as to which we hold all issued certificates. If the SEC or its staff adopts a contrary interpretation of such treatment, we could be required to sell a substantial amount of our mortgage related securities under potentially adverse market conditions. Further, in order to ensure that we at all times qualify for the exemption under the Investment Company Act, we may be precluded from acquiring mortgage related securities whose yield is higher than the yield on mortgage related securities that could be purchased in a manner consistent with the exemption. These factors may lower or eliminate our net income.

Misplaced reliance on legal opinions or statements by issuers of mortgage related securities could result in a failure to comply with REIT gross income or asset tests.

When purchasing mortgage related securities, we may rely on opinions of counsel for the issuer or sponsor of such securities, or statements made in related offering documents, for purposes of determining whether and to what extent those securities constitute REIT real estate assets for purposes of the REIT asset tests and produce income which qualifies under the REIT gross income tests. The inaccuracy of any such opinions or statements may adversely affect our REIT qualification and result in significant corporate-level tax.

We may be harmed by changes in various laws and regulations.

The rules dealing with federal income taxation are constantly under review by persons involved in the legislative process and by the Internal Revenue Service and the U.S. Treasury Department. Our business may be harmed by changes to the laws and regulations affecting us, including changes to securities laws and changes to the Internal Revenue Code applicable to the taxation of REITs. New legislation may be enacted into law or new interpretations, rulings or regulations could be adopted, any of which could harm us and our stockholders, potentially with retroactive effect.

We may realize excess inclusion income that would increase the tax liability of us or our stockholders.

If we realize excess inclusion income and allocate it to stockholders, this income cannot be offset by net operating losses of the stockholders. If the stockholder is a tax-exempt entity, then this income would be fully taxable as unrelated business taxable income under Section 512 of the Internal Revenue Code. If the stockholder is a foreign person, it would be subject to federal income tax withholding on this income without reduction or exemption pursuant to any otherwise applicable income tax treaty. In addition, if our stock is held by a stockholder that is a specified tax-exempt entity not subject to tax on unrelated business taxable income, we would be subject to tax on such stockholder's allocable share of our excess inclusion income realized.

Excess inclusion income could result if we hold a residual interest in a real estate mortgage investment conduit, or REMIC. Excess inclusion income also could be generated if we were to issue debt obligations with two or more maturities and the terms of the payments on these obligations bore a relationship to the payments that we received on our mortgage related securities securing those debt obligations (i.e., if we were to own an interest in a taxable mortgage pool). However, Treasury regulations have not been issued regarding the allocation of excess inclusion income to stockholders of a REIT that owns an interest in a taxable mortgage pool. We do not expect to acquire significant amounts of residual interests in REMICs, and we intend to structure our borrowing arrangements in a manner designed to avoid generating significant amounts of excess inclusion income. We do, however, expect to enter into various repurchase agreements that have differing maturity dates and afford the lender the right to sell any pledged mortgage securities if we default on our obligations.

A portion of our distributions may be deemed a return of capital for federal income tax purposes.

The amount of our distributions to the holders of our Class A Common Stock in a given quarter may not correspond to our REIT taxable income for such quarter. If distributions exceed our REIT taxable income, a portion of the distribution may be deemed a return of capital for federal income tax purposes. The amount of return of capital will not be taxable but will reduce stockholders' bases in the underlying shares of Class A Common Stock.

Risks Related to this Offering

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

We intend to make quarterly distributions to our stockholders in amounts such that we distribute all or substantially all of our taxable income in each year, subject to certain adjustments. This, along with other factors, should enable us to maintain our qualification as a REIT under the Internal Revenue Code. We have not established a minimum distribution payment level and our ability to make distributions might be harmed by the risk factors described in this prospectus. All distributions will be made at the discretion of our board of directors and will depend on our earnings, our financial condition, maintenance of our REIT status and such other factors as our board of directors may deem relevant from time to time. We cannot assure you that we will have the ability to make distributions to our stockholders in the future.

The payment of dividends on our Class B Common Stock and the conversion of our Class B Common Stock and Class C Common Stock will dilute the interest of a Class A Common Stockholder in our future earnings and distributions.

The Class B Common Stock is entitled to participate in dividends on a share-for-share basis with the Class A Common Stock, and the Class B Common Stock and Class C Common Stock will be converted into Class A Common Stock when certain conditions are met. Such conversions would increase the number of shares of Class A Common Stock outstanding by 638,776 shares, or 3.2% of the Class A Common Stock outstanding following the completion of this offering. The conversion of the Class C Common Stock would increase the number of shares entitled to share pro rata in our earnings and distributions by 319,388 shares, or 1.6% of the Class A Common Stock outstanding following the completion of this offering. See "Description of Capital Stock Conversion Rights."

Restrictions on ownership of a controlling percentage of our capital stock might limit your opportunity to receive a premium on our stock.

For the purpose of preserving our REIT qualification and for other reasons, our charter prohibits direct or constructive ownership by any person of more than 9.8% of the lesser of the total number or value of the outstanding shares of our common stock or more than 9.8% of the outstanding shares of our combined common and preferred stock. The constructive ownership rules in our charter are complex and may cause the outstanding stock owned by a group of related individuals or entities to be deemed to be constructively owned by one individual or entity. As a result, the acquisition of less than 9.8% of the outstanding stock by an individual or entity could cause that individual or entity to own constructively in excess of 9.8% of the outstanding stock, and thus be subject to the ownership limit in our charter. Any attempt to own or transfer shares of our common or preferred stock in excess of the ownership limit without the consent of our board of directors shall be void, and will result in the shares being transferred by operation of law to a charitable trust. These provisions might inhibit market activity and the resulting opportunity for our stockholders to receive a premium for their shares that might otherwise exist if any person were to attempt to assemble a block of shares of our stock in excess of the number of shares permitted under our charter and which may be in the best interests of our stockholders.

We have implemented certain provisions that could make any change in our board of directors or in control of our company more difficult.

Maryland law, our charter and our bylaws contain provisions, such as provisions prohibiting, without the consent of our board of directors, any single stockholder or group of affiliated stockholders from beneficially owning in excess of an ownership limit, which could make it difficult or expensive for a third party to pursue a tender offer, change in control or takeover attempt that is opposed by our management and board of directors. We also have a staggered board of directors, which makes it difficult for stockholders to change the composition of our board of directors in any one year. These and other anti-takeover provisions could substantially impede the ability of stockholders to change our management and board of directors.

Future offerings of debt securities, which would be senior to our Class A Common Stock upon liquidation, or equity securities, which would dilute our existing stockholders and may be senior to our Class A Common Stock for the purposes of distributions, may harm the value of our Class A Common Stock.

In the future, we may attempt to increase our capital resources by making additional offerings of debt or equity securities, including commercial paper, medium-term notes, senior or subordinated notes and classes of preferred stock or Class A Common Stock, as well as warrants to purchase shares of Class A Common Stock or convertible preferred stock. Upon the liquidation of our company, holders of our debt securities and shares of preferred stock and lenders with respect to other borrowings will receive a distribution of our available assets prior to the holders of our Class A Common Stock. Additional equity offerings by us may dilute the holdings of our existing stockholders or reduce the market value of our Class A Common Stock, or both. Our preferred stock, if issued, would have a preference on distributions that co