

CHIMERA INVESTMENT CORP
Form 10-Q
November 02, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED: SEPTEMBER 30, 2010

OR

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

FOR THE TRANSITION PERIOD FROM _____ TO _____

COMMISSION FILE NUMBER: 1-33796

CHIMERA INVESTMENT CORPORATION
(Exact name of Registrant as specified in its Charter)

MARYLAND

(State or other jurisdiction of incorporation or
organization)

26-0630461

(IRS Employer Identification No.)

1211 AVENUE OF THE AMERICAS, SUITE 2902
NEW YORK, NEW YORK

(Address of principal executive offices)

10036
(Zip Code)

(646) 454-3759
(Registrant's telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all documents and 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 and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, non-accelerated filer, or a smaller reporting company. See definition of “accelerated filer,” “large accelerated filer,” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the last practicable date:

Class	Outstanding at November 1, 2010
Common Stock, \$.01 par value	883,168,113

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CHIMERA INVESTMENT CORPORATION
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
(dollars in thousands, except share and per share data)

	September 30, 2010 (unaudited)	December 31, 2009 (1)
Assets:		
Cash and cash equivalents	\$ 11,949	\$ 24,279
Non-Agency Mortgage-Backed Securities, at fair value		
Senior	1,065,145	2,022,406
Subordinated	1,866,911	376,459
Senior, non-retained	1,967,812	-
Agency Mortgage-Backed Securities, at fair value	1,884,193	1,690,029
Securitized loans held for investment, net of allowance for loan losses of \$6.0 million and \$4.6 million, respectively	389,315	470,533
Accrued interest receivable	47,767	33,128
Other assets	360	1,494
Total assets	\$ 7,233,452	\$ 4,618,328
Liabilities:		
Repurchase agreements	\$ 1,568,223	\$ 1,716,398
Repurchase agreements with affiliates	-	259,004
Securitized debt	320,552	390,350
Securitized debt, non-retained	1,955,665	-
Payable for investments purchased	279,649	-
Accrued interest payable	11,164	3,235
Dividends payable	158,811	113,788
Accounts payable and other liabilities	810	472
Investment management fees payable to affiliate	11,411	8,519
Interest rate swaps, at fair value	24,820	-
Total liabilities	\$ 4,331,105	\$ 2,491,766
Commitments and Contingencies (Note 15)	-	-
Stockholders' Equity:		
Common stock: par value \$0.01 per share; 1,000,000,000 shares authorized, 883,169,403 and 670,371,587 shares issued and outstanding, respectively	\$ 8,822	\$ 6,693
Additional paid-in-capital	3,056,659	2,290,614
Accumulated other comprehensive income (loss)	22,444	(99,754)
Retained earnings (accumulated deficit)	(185,578)	(70,991)
Total stockholders' equity	\$ 2,902,347	\$ 2,126,562
Total liabilities and stockholders' equity	\$ 7,233,452	\$ 4,618,328

(1) Derived from the audited consolidated financial statements at December 31, 2009.

See notes to consolidated financial statements.

CHIMERA INVESTMENT CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)
(dollars in thousands, except share and per share data)
(unaudited)

	For the Quarters Ended		For the Nine Months Ended	
	September	September	September	September
	30,	30,	30,	30,
	2010	2009	2010	2009
Net Interest Income:				
Interest income	\$ 140,405	\$ 104,690	\$ 402,911	\$ 197,774
Interest expense	10,527	9,197	25,099	26,552
Interest income, non-retained	58,090	-	158,780	-
Interest expense, non-retained	32,237	-	87,488	-
Net interest income (expense)	155,731	95,493	449,104	171,222
Other-than-temporary impairments:				
Total other-than-temporary impairment losses	(1,314)	(6,209)	(48,747)	(14,784)
Non-credit portion of loss recognized in other comprehensive income (loss)	436	4,024	38,432	6,104
Net other-than-temporary credit impairment losses	(878)	(2,185)	(10,315)	(8,680)
Other gains (losses):				
Unrealized gains (losses) on interest rate swaps	(13,583)	-	(24,820)	-
Realized gains (losses) on sales of investments, net	2,032	74,508	2,374	87,456
Realized losses on principal write-downs of non-Agency RMBS	(2,517)	(61)	(3,792)	(61)
Total other gains (losses)	(14,068)	74,447	(26,238)	87,395
Net investment income (loss)	140,785	167,755	412,551	249,937
Other expenses:				
Management fee	11,318	8,649	28,695	17,188
Provision for loan losses	482	47	2,112	1,410
General and administrative expenses	1,798	1,057	4,367	2,823
Total other expenses	13,598	9,753	35,174	21,421
Income (loss) before income taxes	127,187	158,002	377,377	228,516
Income taxes	752	-	753	1
Net income (loss)	\$ 126,435	\$ 158,002	\$ 376,624	\$ 228,515
Net income (loss) per share-basic and diluted	\$ 0.14	\$ 0.24	\$ 0.49	\$ 0.51
Weighted average number of shares outstanding-basic and diluted	883,147,726	670,324,864	773,777,431	452,016,981
Comprehensive income (loss):				
Net income (loss)	\$ 126,435	\$ 158,002	\$ 376,624	\$ 228,515
Other comprehensive income (loss):				
Unrealized gains (losses) on available-for-sale securities, net	20,408	238,969	110,465	292,061
Reclassification adjustment for net losses included in net income (loss) for other-than-temporary credit impairment losses	878	2,185	10,315	8,680
	485	(74,447)	1,418	(87,395)

Reclassification adjustment for realized losses (gains) included in net income (loss)				
Other comprehensive income (loss)	21,771	166,707	122,198	213,346
Comprehensive income (loss)	\$148,206	\$324,709	\$498,822	\$441,861

See notes to consolidated financial statements.

CHIMERA INVESTMENT CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
(dollars in thousands, except per share data)
(unaudited)

	Common Stock Par Value	Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings (Accumulated Deficit)	Total
Balance, December 31, 2008	\$1,760	\$831,966	\$ (266,668)	\$ (152,603)	\$414,455
Net income (loss)	-	-	-	228,515	228,515
Other comprehensive income (loss)	-	-	213,346	-	213,346
Net proceeds from common stock offerings	4,635	1,368,259	-	-	1,372,894
Net proceeds from common stock offerings to affiliates	297	89,782	-	-	90,079
Restricted stock grants	1	321	-	-	322
Common dividends declared, \$0.26 per share	-	-	-	(128,582)	(128,582)
Balance, September 30, 2009	\$6,693	\$2,290,328	\$ (53,322)	\$ (52,670)	\$2,191,029
Balance, December 31, 2009	\$6,693	\$2,290,614	\$ (99,754)	\$ (70,991)	\$2,126,562
Net income (loss)	-	-	-	376,624	376,624
Cumulative effect of change in accounting principle	-	-	-	(88,187)	(88,187)
Other comprehensive income (loss)	-	-	122,198	-	122,198
Net proceeds from direct purchase and dividend reinvestment	-	263	-	-	263
Net proceeds from common stock offerings	2,128	765,425	-	-	767,553
Restricted stock grants	1	357	-	-	358
Common dividends declared, \$0.52 per share	-	-	-	(403,024)	(403,024)
Balance, September 30, 2010	\$8,822	\$3,056,659	\$ 22,444	\$ (185,578)	\$2,902,347

See notes to consolidated financial statements.

CHIMERA INVESTMENT CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(dollars in thousands)
(unaudited)

	For the Nine Months Ended September 30, 2010	For the Nine Months Ended September 30, 2009
Cash Flows From Operating Activities:		
Net income	\$376,624	\$228,515
Adjustments to reconcile net income to net cash provided by operating activities:		
Accretion of investment discounts	(187,869)	(38,539)
Unrealized losses (gains) on interest rate swaps	24,820	-
Realized losses (gains) on sales of investments	(2,374)	(87,456)
Realized losses on principal write-downs of non-Agency RMBS	3,792	61
Net other-than-temporary credit impairment losses	10,315	8,680
Provision for loan losses	2,112	1,410
Restricted stock grants	358	322
Changes in operating assets:		
Decrease (increase) in accrued interest receivable	(14,639)	(19,493)
Decrease (increase) in other assets	1,134	927
Changes in operating liabilities:		
Increase (decrease) in accounts payable and other liabilities	338	365
Increase (decrease) in investment management fees payable to affiliate	2,892	6,779
Increase (decrease) in accrued interest payable	7,929	734
Net cash provided by (used in) operating activities	\$225,432	\$102,305
Cash Flows From Investing Activities:		
Mortgage-Backed Securities portfolio:		
Purchases	\$(2,299,939)	\$(4,505,426)
Sales	298,284	1,627,996
Principal payments	562,313	321,095
Mortgage-Backed Securities portfolio, non-retained:		
Principal payments	457,983	-
Securitized loans:		
Principal payments	78,329	82,090
Net cash provided by (used in) investing activities	\$(903,030)	\$(2,474,245)
Cash Flows From Financing Activities:		
Proceeds from repurchase agreements	\$12,780,977	\$52,976,287
Payments on repurchase agreements	(13,188,156)	(51,941,087)
Net proceeds from common stock offerings	767,553	1,372,894
Net proceeds from common stock offerings to affiliates	-	90,079
Payments on securitized debt borrowings	(70,684)	(77,379)
Proceeds from securitized debt borrowings, non-retained	1,127,873	-
Payments on securitized debt borrowings, non-retained	(394,557)	-
Net proceeds from direct purchase and dividend reinvestment	263	-
Common dividends paid	(358,001)	(55,311)
Net cash provided by (used in) financing activities	\$665,268	\$2,365,483

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Net increase (decrease) in cash and cash equivalents	\$(12,330)	\$(6,457)
Cash and cash equivalents at beginning of period	24,279		27,480	
Cash and cash equivalents at end of period	\$11,949		\$21,023	

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CHIMERA INVESTMENT CORPORATION
 CONSOLIDATED STATEMENTS OF CASH FLOW
 (dollars in thousands)

Supplemental disclosure of cash flow information:

Interest paid	\$ 104,658	\$ 25,958
Taxes paid	\$ 753	\$ -
Non-cash investing activities:		
Payable for investments purchased	\$ 279,649	\$ 73,460
Net change in unrealized gain on available-for sale securities	\$ 122,198	\$ 213,346
Non-cash financing activities:		
Common dividends declared, not yet paid	\$ 158,811	\$ 80,311

See notes to consolidated financial statements.

CHIMERA INVESTMENT CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE QUARTER ENDED SEPTEMBER 30, 2010
(Unaudited)

1. Organization

Chimera Investment Corporation (“Company”) was organized in Maryland on June 1, 2007. The Company commenced operations on November 21, 2007 when it completed its initial public offering. The Company has elected to be taxed as a real estate investment trust (“REIT”), under the Internal Revenue Code of 1986, as amended. As long as the Company qualifies as a REIT, the Company will generally not be subject to U.S. federal or state corporate taxes on its income to the extent that the Company distributes at least 90% of its taxable net income to its stockholders. In July 2008, the Company formed Chimera Securities Holdings, LLC, a wholly-owned subsidiary. In June 2009, the Company formed Chimera Asset Holding LLC and Chimera Holding LLC, both wholly-owned subsidiaries. In January 2010, the Company formed Chimera Special Holding LLC, which is a wholly-owned subsidiary of Chimera Asset Holding LLC. In July 2010, the Company formed CIM Trading Company LLC, a wholly-owned subsidiary. Chimera Securities Holdings, LLC, Chimera Asset Holding LLC, Chimera Holding LLC, and Chimera Special Holding LLC are qualified REIT subsidiaries. CIM Trading Company LLC is a taxable REIT subsidiary. Annaly Capital Management, Inc. (“Annaly”) owns approximately 5.1% of the Company’s common shares. The Company is managed by Fixed Income Discount Advisory Company (“FIDAC”), an investment advisor registered with the Securities and Exchange Commission (“SEC”). FIDAC is a wholly-owned subsidiary of Annaly.

2. Summary of the Significant Accounting Policies

(a) Basis of Presentation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, Chimera Securities Holdings, LLC, Chimera Holding LLC, CIM Trading Company LLC and Chimera Asset Holding LLC and its wholly-owned subsidiary, Chimera Special Holding LLC. All intercompany balances and transactions have been eliminated.

(b) Cash and Cash Equivalents

Cash and cash equivalents include cash on hand and cash deposited overnight in money market funds.

(c) Non-Agency and Agency Residential Mortgage-Backed Securities

The Company invests in residential mortgage-backed securities (“RMBS”) representing interests in obligations backed by pools of mortgage loans. The Company classifies its investment securities as either “trading,” “available-for-sale,” or “held-to-maturity.” In addition, the Company delineates between (1) Agency, (2) non-Agency, and (3) non-Agency, non-retained securities. The Agency RMBS are mortgage pass-through certificates, collateralized mortgage obligations (“CMOs”), and other mortgage-backed securities representing interests in or obligations backed by pools of mortgage loans issued or guaranteed as to principal and/or interest repayment by agencies of the U.S. Government or federally chartered corporations such as Government National Mortgage Association (“Ginnie Mae”), the Federal Home Loan Mortgage Corporation (“Freddie Mac”) or the Federal National Mortgage Association (“Fannie Mae”). The non-Agency RMBS portfolio is not issued or guaranteed by Fannie Mae, Freddie Mac, or Ginnie Mae and is therefore subject to credit risk. Non-Agency, non-retained securities are further detailed in Note 8 to these consolidated financial statements.

The Company holds its RMBS as available-for-sale, records investments at estimated fair value as described in Note 5 of these consolidated financial statements, and includes unrealized gains and losses in other comprehensive income (loss) in the consolidated statements of operations and comprehensive income (loss). From time to time, as part of the overall management of its portfolio, the Company may sell any of its RMBS investments and recognize a realized gain or loss as a component of earnings in the consolidated statements of operations and comprehensive income (loss) utilizing the specific identification method.

Interest income on RMBS is computed on the remaining principal balance of the investment security. Premium or discount amortization/accretion on Agency RMBS is recognized over the life of the investment using the effective interest method. Premium or discount amortization/accretion on non-Agency RMBS is recognized in accordance with Accounting Standards Codification (“ASC”) 325, Investment-Other. For non-Agency RMBS, the Company estimates at the time of purchase expected future cash flows, prepayment speeds, credit losses, loss severity, and loss timing based on the Company’s observation of available market data, its experience, and the collective judgment of its management team to determine the effective interest rate on the RMBS. Not less than quarterly, the Company reevaluates, and if necessary, makes adjustments to its analysis utilizing internal models, external market research and sources in conjunction with its view on performance in the non-Agency RMBS sector. Changes to the Company’s assumptions subsequent to the purchase date may increase or decrease the amortization/accretion of premiums or discounts which affects interest income. Changes to assumptions that decrease expected future cash flows may result in other-than-temporary impairment (“OTTI”).

The Company evaluates each investment in its RMBS portfolio for OTTI quarterly or more often if market conditions warrant. The Company determines if it (1) has the intent to sell the security, (2) is more likely than not that it will be required to sell the securities before recovery, or (3) does not expect to recover the entire amortized cost basis of the security. Further, the security is analyzed for credit loss by comparing the difference between the present value of cash flows expected to be collected and the amortized cost basis. The credit loss, if any, will then be recognized in the consolidated statements of operations, while the balance of impairment related to other factors will be recognized in other comprehensive income (loss).

(d) Securitized Loans Held for Investment

The Company’s securitized residential mortgage loans are comprised of fixed-rate and variable-rate loans. Mortgage loans are designated as held for investment, recorded on trade date, and are carried at their principal balance outstanding, plus any premiums or discounts, less allowances for loan losses. Interest income on loans held for investment is recognized over the life of the investment using the effective interest method. Income recognition is suspended for loans when, in the opinion of management, a full recovery of income and principal becomes doubtful. Income recognition is resumed when the loan becomes contractually current and performance is demonstrated to be resumed. The Company estimates fair value of securitized loans as described in Note 5 of these consolidated financial statements.

(e) Allowance for Loan Losses

The Company has established an allowance for loan losses at a level that management believes is adequate based on an evaluation of known and inherent risks related to the Company’s loan portfolio. The estimate is based on a variety of factors including current economic conditions, industry loss experience, the loan originator’s loss experience, credit quality trends, loan portfolio composition, delinquency trends, national and local economic trends, national unemployment data, changes in housing appreciation or depreciation and whether specific geographic areas where the Company has significant loan concentrations are experiencing adverse economic conditions and events such as natural disasters that may affect the local economy or property values. Upon purchase of a pool of loans, the Company obtains written representations and warranties from the sellers that the Company could be reimbursed for the value of the loan if the loan fails to meet the agreed upon origination standards. While the Company has little history of its own to establish loan trends, delinquency trends of the originators and the current market conditions aid in determining the allowance for loan losses. The Company also performs due diligence procedures on a sample of loans that met its criteria during the purchase process. The Company has created an unallocated provision for probable loan losses estimated as a percentage of the remaining unpaid principal balance on the loans. Management’s estimate is based on historical experience of similarly underwritten pools.

When the Company determines it is probable that specific contractually due amounts are uncollectible, the amount is considered impaired. Where impairment is indicated, a valuation write-off is measured based upon the excess of the recorded investment over the net fair value of the collateral, reduced by selling costs. Any deficiency between the

carrying amount of an asset and the net sales price of repossessed collateral is charged to the allowance for loan losses.

(f) Repurchase Agreements

The Company may finance the acquisition of its investment securities through the use of repurchase agreements. Repurchase agreements are treated as collateralized financing transactions and are carried at their contractual amounts, including accrued interest, as specified in the respective agreements.

(g) Securitized Debt and Securitized Debt, Non-Retained

The Company has issued securitized debt to finance its residential mortgage loan portfolio and has re-securitized RMBS to finance a portion of its RMBS portfolio. Certain transactions involving residential mortgage loans are accounted for as financings, and are recorded as an asset called "Securitized loans held for investment" and the corresponding debt as "Securitized debt" in the consolidated statements of financial condition. These securitizations are collateralized by residential adjustable or fixed rate mortgage loans that have been placed in a trust and pay interest and principal payments to the debt holders of that securitization. Re-securitization transactions classified as "Securitized debt, non-retained" reflect the transfer to a trust of fixed or adjustable rate RMBS which are classified as "Non-Agency Mortgage-Backed Securities Senior, non-retained" that pay interest and principal payments to the debt holders of that re-securitization. Re-securitization transactions completed by the Company are accounted for as financings pursuant to the adoption of ASC 810. The holders of securitized debt and securitized debt, non-retained have no recourse to the Company. The Company estimates fair value of securitized debt and securitized debt, non-retained as described in Note 5 to these consolidated financial statements.

(h) Fair Value Disclosure

A complete discussion of the methodology utilized by the Company to fair value its financial instruments is included in Note 5 to these consolidated financial statements.

(i) Derivative Financial Instruments and Hedging Activity

The Company's policies permit it to enter into derivative contracts, including interest rate swaps and interest rate caps, as a means of mitigating its interest rate risk. The Company intends to use interest rate derivative instruments to mitigate interest rate risk rather than to enhance returns. If the Company's hedging activities do not achieve its desired results, the Company's reported earnings may be adversely affected. Interest rate swaps are recorded as either assets or liabilities in the consolidated statement of financial condition, and measured at fair value with realized and unrealized gains and losses recognized in earnings. The Company estimates fair value of interest rate swaps as described in Note 5 of these consolidated financial statements.

(j) Sales, Securitizations, and Re-Securitizations

The Company periodically enters into transactions in which it sells financial assets, such as RMBS, mortgage loans and other assets. Gains and losses on sales of assets are computed on the specific identification method whereby the Company records a gain or loss on the difference between the carrying value of the asset and the proceeds from the sale. In addition, the Company from time to time securitizes or re-securitizes assets and sells tranches in the newly securitized assets. These transactions may be recorded as either a sale and the assets contributed to the securitization are removed from the consolidated statements of financial condition and a gain or loss is recognized, or as a financing whereby the assets contributed to the securitization are not derecognized but rather the liabilities issued by the securitization are recorded to reflect the term financing of the assets. In these securitizations and re-securitizations, the Company may retain senior or subordinated interests in the securitized and/or re-securitized assets.

(k) Income Taxes

The Company qualifies to be taxed as a REIT, and therefore it generally will not be subject to corporate, federal, or state income tax to the extent that qualifying distributions are made to stockholders and the REIT requirements, including certain asset, income, distribution and stock ownership tests are met. If the Company failed to qualify as a REIT and did not qualify for certain statutory relief provisions, the Company would be subject to 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 REIT qualification was lost. The Company and its subsidiary CIM Trading Company LLC have made joint elections to treat the subsidiary as a taxable REIT subsidiary. As such, CIM Trading Company LLC is taxable as a domestic C corporation and subject to federal, state, and local income taxes based upon its taxable income.

(l) Net Income per Share

The Company calculates basic net income per share by dividing net income for the period by the weighted-average shares of its common stock outstanding for that period. Diluted net income per share takes into account the effect of dilutive instruments, such as stock options, but uses the average share price for the period in determining the number of incremental shares that are to be added to the weighted average number of shares outstanding. The Company had no potentially dilutive securities outstanding during the periods presented.

(m) Stock-Based Compensation

The Company accounts for stock based compensation awards granted to the employees of FIDAC and its affiliates in accordance with ASC 505-50, Equity-Based Payments to Non-Employees. Accounting principles generally accepted in the United States of America ("GAAP") requires the Company to measure the fair value of the equity instrument using the stock prices and other measurement assumptions as of the earlier of either the date at which a performance commitment by the counterparty is reached or the date at which the counterparty's performance is complete.

Compensation expense related to the grants of stock and stock options is recognized over the vesting period of such grants based on the fair value of the stock on the vesting date.

(n) Use of Estimates

The preparation of the consolidated financial statements in conformity with GAAP 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 period. The most significant estimates are related to the following: all investment securities classified as available-for-sale and interest rate swaps are reported at their estimated fair value; all investment securities are amortized/accreted based on yields that incorporate management's assumptions as to the expected performance of the investment over time; and loan loss provisions reflect management estimates with regard to expected losses of the securitized loan portfolio. Actual results could differ from those estimates.

(o) Recent Accounting Pronouncements

Assets

Receivables (ASC 310)

In April 2010, the FASB issued Accounting Standards Update ("ASU") 2010-18, which addresses the effect of a loan modification when a loan is part of a pool accounted for as a single asset. This update clarifies the treatment of a troubled debt restructuring. This guidance allows acquired assets, which have evidence of credit deterioration upon acquisition and common risk characteristics, to be accounted for in the aggregate as a pool. Upon establishment of the pool, the pool becomes the unit of accounting. Any purchase discount is not allocated to individual loans, thus all of the loans in the pool accrete at a single pool rate based on cash flow projections for the pool. Likewise, impairment analysis is performed on the pool as a whole, not on individual loans. Modifications to loans, even if those modifications are considered troubled debt restructuring, do not result in a loan being removed from the pool. This treatment is consistent with the current accounting practices of the Company and therefore has no material effect on the Company's consolidated financial statements.

In July 2010, the FASB released ASU 2010-20, which addresses disclosures about the credit quality of financing receivables and the allowance for credit losses. The purpose of this update is to provide greater transparency regarding the allowance for credit losses and the credit quality of financing receivables as well as to assist in the assessment of credit risk exposures and evaluation of the adequacy of allowances for credit losses. Additional disclosures must be provided on a disaggregated basis. The update defines two levels of disaggregation – portfolio segment and class of financing receivable. Additionally, the update requires disclosure of credit quality indicators, past due information and modifications of financing receivables. The update is not applicable to mortgage banking activities (loans originated or purchased for resale to investors); derivative instruments such as repurchase agreements; debt securities; a transferors interest in securitization transactions accounted for as sales under ASC 860; and purchased beneficial interests in securitized financial assets. This update is effective for the Company for interim or annual periods ending on or after December 15, 2010. At this time, the Company is evaluating the effect of this update on future financial reporting.

Broad Transactions

Consolidation (ASC 810)

Effective January 1, 2010, the consolidation standards have been amended by ASU 2009-17. This amendment updates the existing standard and eliminates the exemption from consolidation of a Qualified Special Purpose Entity ("QSPE"). The update requires an enterprise to perform an analysis to determine whether the enterprise's variable interest or interests give it a controlling financial interest in a variable interest entity ("VIE"). The analysis identifies the primary beneficiary of a VIE as the enterprise that has both: a) the power to direct the activities that most significantly impact the entity's economic performance and b) the obligation to absorb losses of the entity or the right to receive

benefits from the entity which could potentially be significant to the VIE. The update requires enhanced disclosures to provide users of financial statements with more transparent information about an enterprises involvement in a VIE. The Company determined it is the primary beneficiary on a number of VIEs formed through re-securitizations. The Company was required to consolidate RMBS re-securitization transactions previously recorded during the year ended December 31, 2009 as sales for GAAP beginning with the effective date of this ASU. Consolidation of these transactions altered the presentation of the consolidated financial statements by increasing its non-Agency portfolio and increasing the value of non-recourse liabilities for which it has no continuing obligation. The consolidation has reversed previously recorded GAAP gains on sales of assets related to the re-securitizations undertaken in 2009. The reversal of this gain will be accreted over the remaining life of the re-securitized assets. The adoption of this guidance has resulted in material changes to the format and content of the Company's consolidated financial statements, as well as enhanced disclosures. Refer to the discussion in Note 8.

Derivatives and Hedging (ASC 815)

The FASB issued ASU 2010-8 in February 2010. ASU 2010-8 provided technical corrections to ASC 815. This update provides a four step analysis to determine whether call or put options that can accelerate the settlement of debt instruments should be considered clearly and closely related to the debt host contract. If it is determined that such option is closely related to the host contract, bifurcation of the host contract from the derivative instrument is not necessary. If an existing hybrid instrument requires bifurcation under this update, a one-time election can be made to utilize the Fair Value Option for the entire contract. This update was effective for the Company January 1, 2010 and continues to have no effect on the consolidated financial statements.

ASU 2010-11 was issued in March 2010 and defined a scope exception for embedded derivative features which involve only the transfer of credit risk that is only in the form of subordination of one financial instrument to another. Such instruments would not be subject to bifurcation under ASC 815. This guidance is effective for the first quarter beginning after June 15, 2010, however early adoption for the first fiscal quarter is allowed. The Company elected to early adopt for the first quarter of 2010. Adoption has had no effect on the consolidated financial statements.

Fair Value Measurements and Disclosures (ASC 820)

In January 2010, FASB issued ASU 2010-06 which increases disclosures regarding the fair value of assets. The key provisions of this guidance include the requirement to disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 including a description of the reason for the transfers. Previously this was only required of transfers between Level 2 and Level 3 assets. Further, reporting entities are required to provide fair value measurement disclosures for each class of assets and liabilities; a class is potentially a subset of the assets or liabilities within a line item in the statement of financial position. Additionally, disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements are required for either Level 2 or Level 3 assets. This portion of the guidance is effective for the Company beginning January 1, 2010. The guidance also requires that the disclosure on any Level 3 assets presents separately information about purchases, sales, issuances and settlements. In other words, Level 3 assets are presented on a gross basis rather than as one net number. However, this last portion of the guidance is not effective for the Company until January 1, 2011. Adoption of this guidance results in increased footnote disclosure in the Company's consolidated financial statements.

Subsequent Events (ASC 855)

In February 2010, the FASB issued ASU 2010-09 as an amendment to ASC 855. This update eliminated the requirement to provide a specific date through which subsequent events were evaluated. The purpose of this update was to alleviate potential conflicts between ASC 855 and SEC reporting requirements. The update was effective upon issuance. The Company evaluated subsequent events through date of issuance of this Quarterly Report on Form 10Q.

Transfers and Servicing (ASC 860)

On June 12, 2009, the FASB issued ASU 2009-16, an amendment update to the accounting standards governing the transfer and servicing of financial assets. This amendment updated the existing standard and eliminated the concept of a QSPE, clarified the surrendering of control to effect sale treatment and modified the financial components approach – limiting the circumstances in which a financial asset or portion thereof should be derecognized when the transferor maintains continuing involvement. It defined the term “Participating Interest”. Under this standard update, the transferor must recognize and initially measure at fair value all assets obtained and liabilities incurred as a result of a transfer, including any retained beneficial interest. Additionally, the amendment required enhanced disclosures regarding the transferors risk associated with continuing involvement in any transferred assets. The amendment was effective beginning January 1, 2010. The Company has determined the amendment had a material impact on the

consolidated financial statements. See discussion under Consolidation (ASC 810) above.

3. Mortgage-Backed Securities

The following tables present the principal value, unamortized premium, unamortized discount, gross unrealized gain, gross unrealized loss, and fair value of the Company's available-for-sale RMBS portfolio as of September 30, 2010 and December 31, 2009, at fair value by asset class. The RMBS portfolio is composed of Agency and non-Agency RMBS collateralized by residential mortgage loans. The Agency RMBS are mortgage pass-through certificates, CMOs, and other mortgage-backed securities representing interests in or obligations backed by pools of mortgage loans issued or guaranteed by Fannie Mae, Freddie Mac, Ginnie Mae. The non-Agency RMBS portfolio is not issued or guaranteed by Fannie Mae, Freddie Mac, or Ginnie Mae and is therefore subject to credit risk. The Company classifies its non-Agency RMBS into senior, subordinated, and senior, non-retained interests. Senior interests in non-Agency RMBS are considered to be entitled to the first principal repayments in their pro-rata ownership interests. At September 30, 2010 the non-Agency RMBS portfolio included \$4.8 billion in notional Interest Only ("IO") senior securities and \$305.0 million in notional IO subordinated securities. At December 31, 2009 the non-Agency RMBS portfolio includes \$379.0 million in notional IO subordinated securities. Securities identified as senior, non-retained have been consolidated pursuant to the adoption of ASC 810. See Note 8 of these consolidated financial statements for a detailed discussion.

September 30, 2010
(dollars in thousands)

	Principal Value	Unamortized Premium	Unamortized Discount	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value
Non-Agency RMBS						
Senior	\$848,334	\$338,344	\$(43,584)	\$29,517	\$(107,466)	\$1,065,145
Subordinated	4,441,909	58,750	(2,692,666)	239,443	(180,525)	1,866,911
Senior, non-retained	2,013,422	86,514	(130,145)	78,186	(80,165)	1,967,812
Agency RMBS	1,782,069	58,670	-	44,504	(1,050)	1,884,193
Total	\$9,085,734	\$542,278	\$(2,866,395)	\$391,650	\$(369,206)	\$6,784,061

December 31, 2009
(dollars in thousands)

	Principal Value	Unamortized Premium	Unamortized Discount	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value
Non-Agency RMBS						
Senior	\$2,757,212	\$1,536	\$(628,209)	\$83,946	\$(192,079)	\$2,022,406
Subordinated	1,616,031	10,346	(1,239,769)	65,996	(76,145)	376,459
Agency RMBS	1,616,450	55,081	(29)	20,767	(2,240)	1,690,029
Total	\$5,989,693	\$66,963	\$(1,868,007)	\$170,709	\$(270,464)	\$4,088,894

The following tables present the gross unrealized losses and estimated fair value of the Company's RMBS by length of time that such securities have been in a continuous unrealized loss position at September 30, 2010 and December 31, 2009. The securities in an unrealized loss position have been evaluated by the Company for OTTI as discussed in the paragraphs following these tables. Twenty-three securities have been in a continuous unrealized loss position for greater than twelve months, of which twenty-two securities are subordinated interests held by the Company that, although performing in line with the Company's expectations, are in unrealized loss position due to significant market value declines consistent with similar asset classes as a result of the credit crisis.

September 30, 2010
(dollars in thousands)

RMBS	Unrealized Loss Position For:					
	Less than 12 Months		12 Months or More		Total	Unrealized
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	
Non-Agency RMBS						
Senior	\$552,227	\$(107,347)	\$181	\$(119)	\$552,408	\$(107,466)
Subordinated	871,962	(150,259)	39,277	(30,266)	911,239	(180,525)
Senior, non-retained	773,837	(80,165)	-	-	773,837	(80,165)
Agency	1,495	(1,050)	-	-	1,495	(1,050)
Total	\$2,199,521	\$(338,821)	\$39,458	\$(30,385)	\$2,238,979	\$(369,206)

December 31, 2009
(dollars in thousands)

RMBS	Unrealized Loss Position For:					
	Less than 12 Months		12 Months or More		Total	Unrealized
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	
Non-Agency RMBS						
Senior	\$539,579	\$(38,466)	\$489,670	\$(153,613)	\$1,029,249	\$(192,079)
Subordinated	179,226	(72,438)	5,862	(3,707)	185,088	(76,145)
Senior, non-retained	-	-	-	-	-	-
Agency	682,681	(2,240)	-	-	682,681	(2,240)
Total	\$1,401,486	\$(113,144)	\$495,532	\$(157,320)	\$1,897,018	\$(270,464)

The Company recorded an \$878 thousand other-than-temporary credit impairment during the quarter ended September 30, 2010 on investments where the expected future cash flows of certain non-Agency RMBS were less than their amortized cost basis. The Company evaluates each investment in its RMBS portfolio for OTTI quarterly or more often if market conditions warrant. The amortized cost of each investment in an unrealized loss position is compared to the present value of expected future cash flows of the position. In estimating future cash flows, the Company evaluated the non-Agency RMBS for OTTI by considering delinquencies, credit losses, loss severities, prepayment speeds, geographic data, borrower characteristics, loan to value ratios, seasoning and credit support in conjunction with broader macroeconomic expectations such as home price depreciation, expectations of future delinquencies and loss severities and the ability of the borrower to refinance or modify their loans. If after determining the expected future cash flows of the position, the amortized cost of the security is less than the present value of its expected future cash flows, an other-than-temporary credit impairment has occurred. If the Company does not intend to sell and is not more likely than not required to sell the debt security prior to its anticipated recovery, the credit loss, if any, is recognized in the statement of operations, while the balance of impairment related to other factors is recognized in Other Comprehensive Income (Loss). If the Company intends to sell the debt security, or will be more likely than not required to sell the security before its anticipated recovery, the full unrealized loss associated with the OTTI is recognized in the statement of operations. The determination cannot be overcome by management judgment of the probability of collecting all cash flows previously projected. A summary of the OTTI included in earnings for the quarters and nine months ended September 30, 2010 and September 30, 2009 is presented below.

	For the Quarter Ended September 30, 2010 (dollars in thousands)	September 30, 2009
Cumulative credit loss beginning balance	\$ 19,433	\$ 6,495
Additions:		
Other-than-temporary impairments not previously recognized	-	1,932
Increases related to other-than-temporary impairments on securities with previously recognized other-than-temporary impairments	878	253
Cumulative credit loss ending balance	\$ 20,311	\$ 8,680

	For the Quarter Ended September 30, 2010 (dollars in thousands)	September 30, 2009
Cumulative credit loss beginning balance	\$ 9,996	\$ -
Additions:		
Other-than-temporary impairments not previously recognized	8,802	8,427
Increases related to other-than-temporary impairments on securities with previously recognized other-than-temporary impairments	1,513	253
Cumulative credit loss ending balance	\$ 20,311	\$ 8,680

The impairment recorded during the quarter ended September 30, 2010 was related to four securities. The impaired investments were subordinated interests in non-Agency RMBS. As of September 30, 2010, the impaired securities had cumulative losses up to 6%, three-month prepayments speeds between 11 and 15 Constant Prepayment Rate (“CPR”), 60+ day delinquencies between 9% and 12% of the pool balance, and weighted average FICO scores on the pools between 720 and 745.

The Company’s investment guidelines place no restrictions on the credit rating of the assets the Company is able to hold in its portfolio. The portfolio is most heavily weighted to contain RMBS with credit risk. The Company chooses assets for the portfolio after carefully evaluating each investment’s risk profile.

	September 30, 2010		December 31, 2009	
AAA	29.25 %		39.41 %	
AA	0.71 %		0.75 %	
A	1.75 %		0.55 %	
BBB	0.89 %		1.07 %	
BB	0.02 %		1.77 %	
B	0.11 %		2.18 %	
Below B or not rated	67.27 %		54.27 %	
Total	100.00 %		100.00 %	

The table above reflects the credit rating of the Company’s consolidated RMBS portfolio. At September 30, 2010, approximately 21% of the AAA, AA, and A securities balance reflected in the table above include senior,

non-retained, non-Agency RMBS.

The AAA rated assets in the RMBS portfolio are predominantly Agency RMBS and senior non-retained non-Agency RMBS. As the Company securitizes or re-securitizes assets, it expects the Below B or not rated percentages in the portfolio to increase as the Company typically retains the subordinated tranches of these types of transactions.

Actual maturities of mortgage-backed securities are generally shorter than stated contractual maturities. Actual maturities of the Company's RMBS are affected by the contractual lives of the underlying mortgages, periodic payments of principal and prepayments of principal. The following tables summarize the Company's RMBS at September 30, 2010 and December 31, 2009 according to their estimated weighted-average life classifications. The weighted-average lives of the mortgage-backed securities at September 30, 2010 and December 31, 2009 in the tables below are based on consensus constant prepayment speeds. The prepayment model considers current yield, forward yield, steepness of the curve, current mortgage rates, mortgage rates of the outstanding loan, loan age, margin and volatility.

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September 30, 2010
(dollars in thousands)

	Weighted Average Life			Total
	Less than one year	Greater than one year and less than five years	Greater than five years	
Fair value				
Non-Agency RMBS				
Senior	\$ 25,170	\$ 711,001	\$ 328,974	\$ 1,065,145
Subordinated	6,988	181,688	1,678,235	1,866,911
Senior, non-retained	188,428	1,466,460	312,924	1,967,812
Agency RMBS	-	1,884,193	-	1,884,193
Total fair value	\$ 220,586	\$ 4,243,342	\$ 2,320,133	\$ 6,784,061
Amortized cost				
Non-Agency RMBS				
Senior	\$ 26,731	\$ 707,029	\$ 409,334	\$ 1,143,094
Subordinated	10,343	215,300	1,582,350	1,807,993
Senior, non-retained	243,659	1,437,905	288,227	1,969,791
Agency RMBS	-	1,840,739	-	1,840,739
Total amortized cost	\$ 280,733	\$ 4,200,973	\$ 2,279,911	\$ 6,761,617

December 31, 2009
(dollars in thousands)

	Weighted Average Life			Total
	Less than one year	Greater than one year and less than five years	Greater than five years	
Fair value				
Non-Agency RMBS				
Senior	\$ 20,533	\$ 1,520,809	\$ 481,064	\$ 2,022,406
Subordinated	137	204,481	171,841	376,459
Agency RMBS	-	1,690,029	-	1,690,029
Total fair value	\$ 20,670	\$ 3,415,319	\$ 652,905	\$ 4,088,894
Amortized cost				
Non-Agency RMBS				
Senior	\$ 20,549	\$ 1,631,461	\$ 478,530	\$ 2,130,540
Subordinated	76	244,937	141,594	386,607
Agency RMBS	-	1,671,502	-	1,671,502
Total amortized cost	\$ 20,625	\$ 3,547,900	\$ 620,124	\$ 4,188,649

The non-Agency RMBS portfolio is subject to credit risk. The Company seeks to mitigate credit risk through its asset selection process. The non-Agency RMBS portfolio is primarily collateralized by what the Company classifies as Alt-A first lien mortgages. The Company categorizes collateral as Alt-A regardless of whether the loans were originally described as “prime” if the behavior of the collateral when the Company purchased the security more typically resembles Alt-A. The Company defines Alt-A collateral characteristics to be when the 60+ day delinquency bucket of

the pool is greater than 5% and weighted average FICO scores are greater than 650 at origination. At September 30, 2010, 99% of the non-Agency RMBS are Alt-A collateral. At December 31, 2009, 78% of the non-Agency RMBS were Alt-A collateral. The investment securities contained in this portion of the portfolio have the following collateral characteristics at September 30, 2010 and December 31, 2009.

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	September 30, 2010		December 31, 2009			
Number of securities in portfolio	483		209			
Weighted average maturity (years)	27.6		28.5			
Weighted average amortized loan to value	72.9	%	73.8	%		
Weighted average FICO	715.6		715.7			
Weighted average loan balance (in thousands)	\$421.3		\$415.9			
Weighted average percentage owner occupied	83.0	%	82.8	%		
Weighted average percentage single family residence	60.4	%	59.9	%		
Weighted average current credit enhancement	16.3		12.2			
Weighted average geographic concentration	CA	57.3	%	CA	44.8	%
	FL	13.9	%	FL	17.3	%
	NY	7.0	%	NY	7.5	%
	NJ	3.7	%	MD	4.9	%
	VA	3.4	%	NJ	4.4	%

The information presented in the table above includes senior, non-retained, non-Agency RMBS consolidated pursuant to the adoption of ASC 810 on January 1, 2010 by the Company.

The table below presents origination year for the Company's portfolio of non-Agency RMBS at September 30, 2010 and December 31, 2009.

Origination Year as a Percentage of Outstanding Principal Balance	September 30, 2010		December 31, 2009	
2004	0.2	%	0.0	%
2005	10.5	%	8.7	%
2006	24.5	%	36.7	%
2007	63.2	%	50.8	%
2008	1.3	%	3.8	%
2009	0.3	%	0.0	%
Total	100.0	%	100.0	%

The assets classified as non-Agency MBS under the subheading "Senior, non-retained" in the Company's consolidated financial statements were financed by selling AAA-rated bonds to third parties. The liability related to the financing is reflected in the Company's consolidated financial statements as "Securitized debt, non-retained." Secured borrowings under GAAP do not reflect a gain or loss on the sale of the bonds over their cost basis but rather amortize or accrete the gains or losses over the life of the bonds. The Company has no continuing involvement with the transferred assets except for its right to receive principal and interest cash flows from the bonds it has retained.

During the quarters ended September 30, 2010 and December 31, 2009, the Company recorded no non-recourse financing with third party investors.

During the quarter ended September 30, 2010, the Company sold RMBS with a carrying value of \$206.0 million for realized gains of \$2.0 million. During the quarter ended September 30, 2009, the Company sold RMBS with a carrying value of \$32.1 million for realized gains of approximately \$2.4 million.

4. Securitized Loans Held for Investment

The following table represents the Company's securitized residential mortgage loans classified as held for investment at September 30, 2010 and December 31, 2009. At September 30, 2010, approximately 56% of the Company's securitized loans are adjustable rate mortgage loans and 44% are fixed rate mortgage loans. All of the adjustable rate loans held for investment are hybrid adjustable rate mortgages ("ARMs"). Hybrid ARMs are mortgages that have interest rates that are fixed for an initial period (typically three, five, seven or ten years) and thereafter reset at regular intervals subject to interest rate caps. The periodic cap on all hybrid ARMs in the securitized loan portfolio range from 0.00% to 3.00% for the quarters ended September 30, 2010 and December 31, 2009, respectively. The securitized loans held for investment are carried at their principal balance outstanding, plus premiums or discounts, less an allowance for loan losses.

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September 30, 2010 December 31, 2009

Securitized loans, at principal balance	\$	395,356	\$	475,084
Less: allowance for loan losses		6,041		4,551
Securitized loans held for investment	\$	389,315	\$	470,533

The securitized loan portfolio is collateralized by prime, jumbo, first lien residential mortgages of which 55% were originated during 2008 and 43% were originated during 2007. A summary of key characteristics of these loans follows.

	September 30, 2010		December 31, 2009	
Number of loans	564		681	
Weighted average maturity (years)	26.6		27.2	
Weighted average amortized loan to value	74.0	%	73.0	%
Weighted average FICO	756		756	
Weighted average loan balance (in thousands)	\$677.7		\$690.1	
Weighted average percentage owner occupied	90.8	%	90.9	%
Weighted average percentage single family residence	58.8	%	60.0	%
Weighted average geographic concentration	CA	33.0 %	CA	33.8 %
	FL	6.6 %	FL	6.4 %
	IL	6.0 %	NJ	6.3 %
	NJ	5.6 %	IL	6.0 %
	VA	4.9 %	VA	4.8 %

The following table summarizes the changes in the allowance for loan losses for the securitized mortgage loan portfolio during the quarters ended September 30, 2010 and December 31, 2009.

	September 30, 2010		December 31, 2009	
Balance, beginning of period	\$	5,569	\$	1,621
Provision for loan losses		482		3,101
Charge-offs		(10)		(171)
Balance, end of period	\$	6,041	\$	4,551

On a quarterly basis, the Company evaluates the adequacy of its allowance for loan losses. The Company's allowance for loan losses at September 30, 2010 was \$6.0 million, representing 155 basis points of the principal balance of the Company's securitized mortgage loan portfolio. The Company's allowance for loan losses at December 31, 2009 was \$4.6 million, representing 97 basis points of the principal balance of the Company's securitized loan portfolio. At September 30, 2010, 2.63% of the securitized loans held for investment were greater than 60 days delinquent and 1.27% were in some stage of bankruptcy, foreclosure, or were real estate owned. At December 31, 2009, 1.82% of the securitized loans held for investment were greater than 60 days delinquent and 0.89% were in some stage of bankruptcy, foreclosure, or real estate owned.

5. Fair Value Measurements

GAAP defines fair value, establishes a framework for measuring fair value, establishes a three-level valuation hierarchy for disclosure of fair value measurement and enhances disclosure requirements for fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

Level 1 – inputs to the valuation methodology are quoted prices (unadjusted) for identical assets and liabilities in active markets.

Level 2 – inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level 3 – inputs to the valuation methodology are unobservable and significant to fair value.

The following discussion describes the methodologies utilized by the Company to fair value its financial instruments by instrument class.

Short-term Instruments

The carrying value of cash and cash equivalents, accrued interest receivable, dividends payable, accounts payable, and accrued interest payable generally approximates estimated fair value due to the short term nature of these financial instruments.

Non-Agency and Agency RMBS

The Company determines the fair value of its investment securities utilizing a pricing model that incorporates such factors as coupon, prepayment speeds, weighted average life, collateral composition, borrower characteristics, expected interest rates, life caps, periodic caps, reset dates, collateral seasoning, expected losses, expected default severity, credit enhancement, and other pertinent factors. Management reviews the fair values generated by the model to determine whether prices are reflective of the current market. Management performs a validation of the fair value calculated by the pricing model by comparing its results to independent prices provided by dealers in the securities and/or third party pricing services. The Company believes the observable inputs used in its model in conjunction with dealer and/or third party pricing services meets the criteria for classification as Level 2.

Any changes to the valuation methodology are reviewed by management to ensure the changes are appropriate. As markets and products develop and the pricing for certain products becomes more transparent, the Company will continue to refine its valuation methodologies. The methods used to produce a fair value calculation may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Company believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies, or assumptions, to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date. The Company uses inputs that are current as of the measurement date, which may include periods of market dislocation, during which price transparency may be reduced.

Non-Agency, Non-Retained RMBS

The non-Agency, non-retained securities reflected in the consolidated financial statements are securities consolidated pursuant to the Company's adoption of ASC 860 and ASC 810 on January 1, 2010. These assets have been financed with third parties without recourse to the Company in the normal course of the Company's portfolio optimization strategy. The Company classifies these assets as Level 3 as the fair valuation of these securities involves significant reliance on unobservable inputs. The Company fair values these assets at the actual sale price obtained in the financing of the debt to the third party as any current or future appreciation or depreciation of the assets is not realizable by the Company. See Note 8 to these consolidated financial statements for a detailed discussion of these securities.

Interest Rate Swaps

The Company obtains quotations from third parties to determine the fair values of its interest rate swaps. Management reviews the fair values determined by its pricing model and compares its results to dealer quotes received on each interest rate swap to validate reasonableness. The dealer quotes will incorporate common market pricing methods, including a spread measurement to the Treasury curve or interest rate swap curve as well as underlying characteristics of the particular contract. Interest rate swaps are modeled by the Company by incorporating such factors as the Treasury curve, LIBOR rates, and the pay rate on the interest rate swaps.

During times of market dislocation, as has been experienced for some time, the observability of prices and inputs can be reduced for certain instruments. If dealers or independent pricing services are unable to provide a price for an asset, or if the price provided by them is deemed unreliable by the Company, then the asset will be valued at its fair value as determined in good faith by the Company. In addition, validating third party pricing for the Company's investments may be more subjective as fewer participants may be willing to provide this service to the

Company. Illiquid investments typically experience greater price volatility as a ready market does not exist. As fair value is not an entity-specific measure and is a market-based approach which considers the value of an asset or liability from the perspective of a market participant, observability of prices and inputs can vary significantly from period to period. A condition such as this can cause instruments to be reclassified from Level 1 to Level 2 or Level 2 to Level 3 when the Company is unable to obtain third party pricing verification.

If at the valuation date, the fair value of an investment security is less than its amortized cost at the date of the consolidated statement of financial condition, the Company analyzes the investment security for OTTI. Management evaluates the Company's RMBS for OTTI at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been lower than carrying value, (2) the intent of the Company to sell the investment prior to recovery in fair value (3) whether the Company will more likely than not be required to sell the investment before the expected recovery, and (4) the expected future cash flows of the investment in relation to its amortized cost. Unrealized losses on assets that are considered OTTI due to credit are recognized in earnings and the cost basis of the assets are adjusted.

At September 30, 2010, the Company has classified a portion of its assets and liabilities as Level 2 or Level 3. At December 31, 2009, the Company classified its assets as Level 2. The Company's financial assets and liabilities carried at fair value on a recurring basis are valued at September 30, 2010 and December 31, 2009 as presented below.

	September 30, 2010		
	Level 1	Level 2	Level 3
	(dollars in thousands)		
Assets:			
Non-Agency RMBS			
Senior	\$ -	\$ 1,065,145	\$ -
Subordinated	-	1,866,911	-
Senior, non-retained	-	-	1,967,812
Agency mortgage-backed securities	-	1,884,193	-
Liabilities:			
Interest rate swaps	-	24,820	-

	December 31, 2009		
	Level 1	Level 2	Level 3
	(dollars in thousands)		
Assets:			
Non-Agency RMBS			
Senior	\$ -	\$ 2,022,406	\$ -
Subordinated	-	376,459	-
Agency mortgage-backed securities	-	1,690,029	-

The table below presents a reconciliation of changes in assets classified as Level 3 in the Company's consolidated financial statements for the quarters and nine months ended September 30, 2010 and 2009. All of the assets classified as Level 3 as of the period ended September 30, 2010 have been added to this classification due to the adoption of ASC 860 and ASC 810 by the Company on January 1, 2010. A discussion of the method of fair valuing these assets is included above in Non-Agency, Non-Retained RMBS. Transfers in to Level 3 relate to senior non-Agency RMBS classified as Level 2 in the prior period and transferred to third party investors in non-recourse financing transactions during the current period. Additions relate to senior non-Agency RMBS securitized during the current period and transferred to third party investors in non-recourse financing transactions. Unrealized gains on the assets are included in other comprehensive income (loss).

Fair Value Reconciliation, Level 3
(dollars in thousands)

	September 30, 2010	September 30, 2009
Non-Agency RMBS		
Senior, non-retained		
Beginning balance Level 3 assets	\$ 2,133,486	\$ -
Transfers in to Level 3	-	-
Additions	-	-
Principal payments	(168,250)	-
Accretion of investment discounts	30,699	-
Other than temporary impairment	-	-
Total unrealized gains (losses) for the period	(28,123)	-
Ending balance Level 3 assets	\$ 1,967,812	\$ -

Fair Value Reconciliation, Level 3
(dollars in thousands)

	September 30, 2010	September 30, 2009
Non-Agency RMBS		
Senior, non-retained		
Beginning balance Level 3 assets	\$ -	\$ -
Transfers in to Level 3	186,246	-
Additions	2,090,707	-
Principal payments	(383,116)	-
Accretion of investment discounts	76,068	-
Other than temporary impairment	(1,490)	-
Total unrealized gains (losses) for the period	(603)	-
Ending balance Level 3 assets	\$ 1,967,812	\$ -

As of the quarters ended September 30, 2010 and September 30, 2009, the Company was able to obtain third party pricing verification for all assets classified as Level 2. In the aggregate, the Company's fair valuation of RMBS investments were 1.04% higher than the aggregated dealer marks for the quarter ended September 30, 2010 and 0.89% higher than the aggregated dealer marks for the quarter ended September 30, 2009.

Securitized Loans Held for Investment

The Company records securitized loans held for investment when it securitizes loans and records the transaction as a “financing.” The Company carries securitized loans held for investment at principal value, plus premiums or discounts paid, less an allowance for loan losses. The Company estimates the future cash flows of the assets underlying its securitized loans held for investment for purposes of determining whether an OTTI charge is required. The Company estimates the fair value of its securitized loans held for investment at the loss adjusted expected future cash flows of the collateral. The Company models each underlying asset by considering, among other items, the nature of the underlying collateral, coupon, servicer, actual and expected defaults, actual and expected default severities, reset indices, and prepayment speeds in conjunction with market research for similar collateral performance and management’s expectations of general economic conditions in the sector and greater economy.

Repurchase Agreements

The Company records repurchase agreements at their contractual amounts including accrued interest payable. Repurchase agreements are collateralized financing transactions utilized by the Company to acquire investment securities. Due to the short term nature of these financial instruments, the Company estimated the fair value of these repurchase agreements to be the contractual obligation plus accrued interest payable at maturity.

Securitized Debt

The Company records securitized debt for certificates or notes financed without recourse to the Company in securitization or re-securitization transactions treated as “financings” pursuant to ASC 860. The Company carries securitized debt at the principal balance outstanding on non-retained notes associated with its securitized loans held for investment plus premiums or discounts recorded with the sale of the notes to third parties. The premiums or discounts associated with the sale of the notes or certificates are amortized over the life of the instrument. The Company estimates the fair value of securitized debt by estimating the future cash flows associated with underlying assets collateralizing the secured debt outstanding. The Company models each underlying asset by considering, among other items, the structure of the underlying security, coupon, servicer, actual and expected defaults, actual and expected default severities, reset indices, and prepayment speeds in conjunction with market research for similar collateral performance and management’s expectations of general economic conditions in the sector and greater economy.

The following table presents the carrying value and estimated fair value, as described above, of the Company’s financial instruments at September 30, 2010 and December 31, 2009.

	September 30, 2010		December 31, 2009	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Non-Agency RMBS	\$4,899,868	\$4,899,868	\$2,398,865	\$2,398,865
Agency RMBS	1,884,193	1,884,193	1,690,029	1,690,029
Securitized loans held for investment	389,315	393,207	470,533	453,388
Repurchase agreements	(1,568,223)	(1,570,517)	(1,975,402)	(1,977,664)
Securitized debt	(320,552)	(335,783)	(390,350)	(408,404)
Securitized debt, non-retained	(1,955,665)	(1,950,817)	-	-
Interest rate swaps	(24,820)	(24,820)	-	-

6. Repurchase Agreements

The Company had outstanding \$1.6 billion and \$2.0 billion of repurchase agreements with weighted average borrowing rates of 0.48% and 0.60% and weighted average remaining maturities of 47 and 26 days as of September 30, 2010 and December 31, 2009, respectively. At September 30, 2010 and December 31, 2009, RMBS pledged as collateral under these repurchase agreements had an estimated fair value of \$1.7 billion and \$2.0 billion, respectively. The average daily balances of the Company’s repurchase agreements for the quarters ended September 30, 2010 and December 30, 2009 were \$1.3 billion and \$2.3 billion, respectively. The interest rates of these repurchase agreements are generally indexed to the one-month LIBOR rate and re-price accordingly.

At September 30, 2010 and December 31, 2009, the repurchase agreements collateralized by RMBS had the following remaining maturities.

	September 30, 2010	December 31, 2009
	(dollars in thousands)	
Overnight	\$ 198,679	\$ -
1-30 days (1)	778,596	1,772,662
30 to 59 days	151,595	62,243
60 to 89 days	230,634	-
90 to 119 days	-	-

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Greater than or equal to 120 days	208,719	140,497
Total	\$ 1,568,223	\$ 1,975,402

(1) Repurchase agreements with affiliates totaled \$259.0 million as of December 31, 2009. There were no repurchase agreements with affiliates as of September 30, 2010.

At September 30, 2010 and December 31, 2009, the Company did not have an amount at risk greater than 10% of its equity with any counterparty.

7. Securitized Debt

All of the Company's securitized debt is collateralized by residential mortgage loans or RMBS. For financial reporting purposes, the Company's securitized debt is accounted for as a financing. Thus, the residential mortgage loans or RMBS held as collateral are recorded in the assets of the Company as securitized loans held for investment or RMBS and the securitized debt is recorded as a liability in the statements of financial condition.

At September 30, 2010, the Company's securitized debt collateralized by residential mortgage loans had a principal balance of \$335.8 million. The debt matures between the years 2023 and 2038. At September 30, 2010, the debt carried a weighted average cost of financing equal to 5.52%, that is secured by residential mortgage loans of which approximately 44% of the remaining principal balance pays a fixed rate of 6.31% and 56% of the remaining principal balance pays a variable rate of 5.53%. At December 31, 2009, the Company's securitized debt collateralized by residential mortgage loans had a principal balance of \$390.4 million. At December 31, 2009, the debt carried a weighted average cost of financing equal to 5.50%, that is secured by residential mortgage loans of which approximately 43% of the remaining principal balance pays a fixed rate of 6.33% and 57% of the remaining principal balance pays a variable rate of 5.63%.

At September 30, 2010, the Company's securitized debt, non-retained, collateralized by RMBS had a principal balance of \$2.0 billion. The debt matures between the years 2035 and 2047. At September 30, 2010, the debt carried a weighted average cost of financing equal to 5.25%. At December 31, 2009 the Company did not have securitized debt collateralized by RMBS.

The following table presents the estimated principal repayment schedule of the securitized debt and securitized debt, non-retained held by the Company at September 30, 2010 and December 31, 2009, based on expected cash flows of the residential mortgage loans or RMBS, as adjusted for projected losses, collateralizing the debt.

	September 30, 2010	December 31, 2009
	(dollars in thousands)	
Within One Year	\$ 568,696	\$ 37,192
One to Three Years	861,401	70,885
Three to Five Years	377,406	59,382
Greater Than or Equal to Five Years	479,097	240,945
Total	\$ 2,286,600	\$ 408,404

The significant increase in debt reflected in the table above reflects the Company's adoption of ASC 810 on January 1, 2010. See Note 8 for a more detailed discussion.

Maturities of the Company's securitized debt are dependent upon cash flows received from the underlying loans. The estimate of their repayment is based on scheduled principal payments on the underlying loans. This estimate will differ from actual amounts to the extent prepayments and/or loan losses are experienced. See Note 4 for a more detailed discussion of the loans collateralizing the securitized debt.

8. Consolidation

In June 2009, the FASB issued two new accounting standards that amended guidance applicable to the accounting for transfers of financial assets and the consolidation of VIEs (ASC 860 and ASC 810, respectively). The primary affect of these standards was to eliminate the concept of a QPSE when transferring assets and to remove the exemption of a QSPE when applying the consolidation standard. The Company adopted these new accounting standards as of

January 1, 2010.

The Company uses securitization trusts or variable interest entities in its securitization and re-securitization transactions. Prior to January 1, 2010, these variable interest entities met the definition of QSPE's and, as such, were not subject to consolidation. Effective January 1, 2010, all such variable interest entities must be considered for consolidation based on the criteria in ASC 810.

Per ASC 810, an entity shall consolidate a VIE when that entity has a variable interest that provides the reporting entity with a controlling financial interest. The assessment of the characteristics of the reporting entity's VIE shall consider the VIEs purpose and design. A controlling financial interest is defined as (a) the power to direct the activities of a VIE that most significantly impact the VIEs economic performance and (b) the obligation to absorb losses of the VIE that could potentially be significant to the VIE and/or the right to receive benefits from the VIE that could potentially be significant to the VIE.

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Since the Company's inception, the Company has created VIEs for the purpose of securitizing whole mortgage loans or re-securitizing RMBS and obtaining permanent, non-recourse term financing. The Company evaluated its interest in each securitization trust VIE to determine the primary beneficiary status. The Company found that seven trusts, one of which had been consolidated since its inception, met the requirements of consolidation. The Company determined that in these seven securitizations, based on holding all of the subordinate interests, it maintains the obligation to absorb losses and/or the right to receive benefits from the VIE that could be significant to the VIE. In addition, the Company had the power to direct activities of the trust or was determined to have the ability to control the trust due to its contribution in the purpose and design of the structure. The remaining two trusts evaluated did not meet the requirements to consolidate due to the inability to control one of the trusts and the lack of obligations to absorb losses on the other trust.

VIEs for Which the Company is the Primary Beneficiary

Based on the Company's consolidation evaluation, the Company consolidated three VIEs on January 1, 2010 that were not previously consolidated and consolidated three VIEs that it created during 2010. The Company's retained beneficial interest is typically the subordinated tranches of these re-securitizations and in some cases the Company may hold interests in additional tranches. The effect in the current year is the inclusion of an additional \$2.0 billion of non-Agency mortgage-backed securities at fair value no longer retained by the Company and the inclusion in its liabilities of \$2.0 billion of non-recourse securitized debt associated with these re-securitizations.

On an ongoing basis, the Company's retained beneficial interests will be fair valued as Level 2 assets. The consolidated third-party owned interests will be fair valued as Level 3 assets using the sale price as fair value. This is due to the fact that the Company has no control over the third-party interests and will not receive any future value from them. Line items pertaining to the third-party owned interests are separately stated within the Company's consolidated financial statements and labeled as "non-retained".

The trusts are structured as pass through entities that receive principal and interest on the underlying collateral and distribute those payments to the certificate holders. The assets and other instruments held by the securitization entities are restricted and can only be used to fulfill the obligations of the securitization entity. Additionally, the obligations of the securitization entities do not have any recourse to the general credit of any other consolidated subsidiaries, nor to the Company as the primary beneficiary. The Company's risks associated with its involvement with these VIEs is limited to its risks and rights as a certificate holder of the bonds it has retained. See Note 5 for a discussion of the fair value measurement of the assets and liabilities.

The securitization entities newly consolidated by the Company are similar in nature to the Company's portfolio as a whole. The securitization entities are all composed of RMBS of the quality and characteristics of assets reflected in the RMBS classifications found in the Company's consolidated financial statements. See Note 3 for a discussion of the securities characteristics of the portfolio.

The table below presents the assets and liabilities of consolidated entities as of January 1, 2010. The cumulative effect adjustment reflects the reversal of realized gains of \$98.1 million previously recorded on the sales of these newly consolidated trusts net of the additional accretion of discounts due to consolidating the trusts. At December 31, 2009, none of the re-securitization transactions completed during 2009 were consolidated.

	Carrying Value (1) (dollars in thousands)	
Assets		
Non-Agency RMBS		
Senior, non-retained	\$	1,114,034
Liabilities		
Securitized debt, non-retained		1,202,221
Net assets and liabilities of newly consolidated entities		(88,187)
Cumulative effect adjustment to retained earnings upon adoption	\$	(88,187)

(1) Carrying value represents the amount the assets would have been recorded at in the consolidated financial statements at January 1, 2010 had they been recorded in the consolidated financial statements on the date the Company first met the conditions for consolidation.

The cumulative effect of adopting ASC 810 on January 1, 2010 based on the shares outstanding on that date was to reduce the beginning book value of the Company by \$0.13 per share.

The table below reflects the assets and liabilities recorded in the consolidated statements of financial condition related to the newly consolidated securitization entities as of September 30, 2010.

	September 30, 2010 (dollars in thousands)	
Assets		
Non-Agency RMBS		
Senior, non-retained	\$	1,967,812
Liabilities		
Securitized debt, non-retained	\$	1,955,665

The consolidation of these securitization entities increases both the income and expense recorded in the consolidated statement of operations for the Company as detailed in the table below.

	For the Quarter Ended September 30, 2010	For the Nine Months Ended September 30, 2010
	(dollars in thousands)	
Interest income, non-retained	\$ 58,090	\$ 158,780
Interest expense, non-retained	32,237	87,488
Net interest income, non-retained	\$ 25,853	\$ 71,292

A discussion of the significant accounting policies of the Company to record income and expense is included in Note 2 to these consolidated financial statements. The effect of adopting ASC 810 based on the weighted average shares outstanding was to increase the net interest income of the Company by approximately \$0.03 and \$0.09 for the quarter and nine months ended September 30, 2010, respectively.

The effect of the consolidation of these securitization entities on the consolidated statement of financial condition for the Company is presented in the table below for the periods presented.

	For the Nine Months Ended September 30, 2010	For the Nine Months Ended September 30, 2009
(dollars in thousands)		
Proceeds from securitized debt borrowings, non-retained	\$ 1,127,873	\$ -
Payments on securitized debt borrowings, non-retained	(394,557)	-
Increase (decrease) in accrued interest receivable	8,804	-
Increase (decrease) in accrued interest payable	(8,804)	-
Net cash flows, non-retained	\$ 733,316	\$ -

VIEs for Which the Company is Not the Primary Beneficiary

The table below represents the carrying amounts and classification of assets recorded on the Company's consolidated financial statements related to its variable interests in non-consolidated VIEs, as well as its maximum exposure to loss as a result of its involvement with these VIEs.

	September 30, 2010		December 31, 2009	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Assets				
Non-Agency RMBS				
Senior	\$ 413	\$ 715	\$ 47,998	\$ 46,047
Subordinated	8,427	6,806	9,701	7,081
Agency RMBS	2,999	1,963	4,730	4,720
Total	\$ 11,839	\$ 9,484	\$ 62,429	\$ 57,848

The Company's involvement with VIEs for which it is not the primary beneficiary generally are in the form of purchasing securities issued by the trusts similar to its investments in other RMBS that are not part of a trust it has evaluated for consolidation. The Company's maximum exposure to loss in these entities is represented by the fair value of these assets. This amount does not include OTTI or other write-downs that the Company previously recognized through earnings.

9. Interest Rate Swaps

In connection with the Company's interest rate risk management strategy, the Company economically hedges a portion of its interest rate risk by entering into derivative financial instrument contracts. These derivative financial instrument contracts do not qualify as hedges under ASC 815, Derivatives and Hedging. As of September 30, 2010, such instruments are comprised of interest rate swaps, which in effect modify the cash flows on repurchase agreements. The use of interest rate swaps creates exposure to credit risk relating to potential losses that could be recognized if the counterparties to these instruments fail to perform their obligations under the contracts. In the event of a default by the counterparty, the Company could have difficulty obtaining its RMBS pledged as collateral for swaps. The Company does not anticipate any defaults by its counterparties.

The Company's swaps are used to lock in the fixed rate related to a portion of its current and anticipated future 30-day term repurchase agreements.

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The table below summarizes the location and fair value of interest rate swaps reported in the Consolidated Statement of Financial Condition as of September 30, 2010. The Company had no interest rate swaps outstanding as of December 31, 2009.

	Location on Consolidated Statement of Financial Condition (dollars in thousands)	Notional Amount	Net Estimated Fair Value/Carrying Value
September 30, 2010	Assets	\$ -	\$ -
September 30, 2010	Liabilities	\$ 450,000	\$ (24,820)

The effect of the Company's interest rate swaps on the Consolidated Statement of Operations and Comprehensive Income (Loss) is presented below.

	Location on Consolidated Statement of Operations and Comprehensive Income (Loss)	Unrealized Gain (Loss) on Interest Rate Swaps
	Interest Expense	
	(dollars in thousands)	
For the quarter ended:		
September 30, 2010	\$ 2,493	\$ (13,583)
For the nine months ended:		
September 30, 2010	\$ 3,192	\$ (24,820)

The weighted average pay rate on the Company's interest rate swaps at September 30, 2010 was 2.59% and the weighted average receive rate was 0.26%. The Company had no interest rate swaps outstanding as of September 30, 2009.

10. Common Stock

On September 24, 2009, the Company implemented a dividend reinvestment and share purchase plan ("DRSPP"). The DRSPP provides holders of record of its common stock an opportunity to automatically reinvest all or a portion of their cash distributions received on common stock in additional shares of our common stock as well as to make optional cash payments to purchase shares of our common stock. Persons who are not already stockholders may also purchase our common stock under the plan through optional cash payments. The DRSPP is administered by the Administrator, The Bank of New York Mellon. During the nine months ended September 30, 2010, the Company raised \$263,000 by issuing 67,596 shares through the DRSPP. During the nine months ended September 30, 2009 no shares were issued under the DRSPP.

On March 31, 2010 the Company announced the sale of 85,000,000 shares of common stock at \$3.61 per share for estimated proceeds, less the underwriters' discount and offering expenses, of \$306.7 million. In addition, on April 1, 2010, the underwriters exercised the option to purchase up to an additional 12,750,000 shares of common stock to cover over-allotments for proceeds, less the underwriters' discount, of approximately \$46.0 million. The sale was completed on April 7, 2010. In all, the Company raised net proceeds of approximately \$352.7 million in this offering.

On June 22, 2010 the Company announced the sale of 100,000,000 shares of common stock at \$3.61 per share for estimated proceeds, less the underwriters' discount and offering expenses, of \$360.8 million. In addition, on June 25, 2010, the underwriters exercised the option to purchase up to an additional 15,000,000 shares of common stock to cover over-allotments for proceeds, less the underwriters' discount, of approximately \$54.2 million. The sale was completed on June 28, 2010. In all, the Company raised net proceeds of approximately \$415.0 million in this offering.

There was no preferred stock issued or outstanding as of September 30, 2010 and December 31, 2009.

During the quarter ended September 30, 2010, the Company declared dividends to common shareholders totaling \$158.8 million or \$0.18 per share. During the quarter ended December 31, 2009, the Company declared dividends to common shareholders totaling \$113.8 million or \$0.17 per share.

11. Long Term Incentive Plan

The Company has adopted a long term stock incentive plan to provide incentives to its independent directors and employees of FIDAC and its affiliates, to stimulate their efforts towards the Company's continued success, long-term growth and profitability and to attract, reward and retain personnel and other service providers. The incentive plan authorizes the Compensation Committee of the board of directors to grant awards, including incentive stock options, non-qualified stock options, restricted shares and other types of incentive awards. The specific award granted to an individual is based upon, in part, the individual's position within FIDAC, the individual's position within the Company, his or her contribution to the Company's performance, market practices, as well as the recommendations of FIDAC. The incentive plan authorizes the granting of options or other awards for an aggregate of the greater of 8.0% of the outstanding shares of the Company's common stock up to a ceiling of 40,000,000 shares.

On January 2, 2008, the Company granted restricted stock awards in the amount of 1,301,000 shares to FIDAC's employees and the Company's independent directors. The awards to the independent directors vested on the date of grant and the awards to FIDAC's employees vest quarterly over a period of 10 years. Of these shares, as of September 30, 2010, 383,875 shares have vested and 41,735 shares were forfeited or cancelled.

On December 22, 2009, the Compensation Committee awarded each independent director \$45,000 in common stock which vested on December 31, 2009.

As of September 30, 2010, there was \$16.3 million of total unrecognized compensation costs related to non-vested share-based compensation arrangements granted under the long term incentive plan, based on the closing price of the shares on the grant date. That cost is expected to be recognized over a weighted-average period of 7.3 years. The total fair value of shares vested, less those forfeited during the quarter ended September 30, 2010 was \$112,062, based on the closing price of the stock on the vesting date.

12. 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 provided it satisfies on a continuing basis, through actual investment and operating results, the REIT requirements including certain asset, income, distribution and stock ownership tests. Most states recognize REIT status as well. During the quarter ended September 30, 2010, the Company recorded \$752,000 in income tax expense related to federal REIT excise tax due as a result of a shortfall in the Company's 2009 distributions as compared to the amount required under applicable law. During the quarter ended September 30, 2009, the Company recorded no income tax expense related to state and federal tax liabilities on undistributed income.

In general, common stock cash dividends declared by the Company will be considered ordinary income to stockholders for income tax purposes. From time to time, a portion of the Company's dividends may be characterized as capital gains or return of capital. For the quarter ended September 30, 2010, the Company estimates that all income distributed in the form of dividends will be characterized as ordinary income.

During July 2010, the Company formed CIM Trading Company LLC, a wholly-owned subsidiary, and made a joint election to treat the subsidiary as a taxable REIT subsidiary ("TRS"). As such, CIM Trading Company LLC is taxable as a domestic C corporation and subject to federal, state, and local income taxes based upon its taxable income. For the quarter ended September 30, 2010, no income tax expense has been recorded for this TRS as the Company does not expect the subsidiary to have federal taxable income for the year.

13. Credit Risk and Interest Rate Risk

The Company's primary components of market risk are credit risk and interest rate risk. The Company is subject to credit risk and interest rate risk in connection with its investments in non-Agency residential mortgage loans and credit sensitive mortgage-backed securities. When the Company assumes credit risk, it attempts to minimize interest rate risk through asset selection, hedging and matching the income earned on mortgage assets with the cost of related liabilities. The Company is subject to interest rate risk, primarily in connection with its investments in fixed-rate and adjustable-rate mortgage-backed securities, residential mortgage loans, and borrowings under repurchase agreements. The Company attempts to minimize credit risk through due diligence and asset selection by purchasing loans underwritten to agreed-upon specifications of selected originators. The Company has established a whole loan target market including prime borrowers with FICO scores generally greater than 650, Alt-A documentation, geographic diversification, owner-occupied property, and moderate loan to value ratio. These factors are considered to be important indicators of credit risk.

14. Management Agreement and Related Party Transactions

The Company has entered into a management agreement with FIDAC, which provides for an initial term through December 31, 2010 with an automatic one-year extension option and subject to certain termination rights. The Company pays FIDAC a quarterly management fee equal to 1.50% per annum of the gross Stockholders' Equity (as defined in the management agreement) of the Company.

Management fees accrued and paid to FIDAC for the quarters ended September 30, 2010 and 2009 were \$11.3 million and \$8.6 million, respectively. Management fees accrued and paid to FIDAC for the nine months ended September 30, 2010 and 2009 were \$28.7 million and \$17.2 million, respectively.

The Company is obligated to reimburse FIDAC for its costs incurred under the management agreement. In addition, the management agreement permits FIDAC to require the Company to pay for its pro rata portion of rent, telephone, utilities, office furniture, equipment, machinery and other office, internal and overhead expenses that FIDAC incurred in the operation of the Company. These expenses are allocated between FIDAC and the Company based on the ratio of the Company's proportion of gross assets compared to all remaining gross assets managed by FIDAC as calculated at each quarter end. FIDAC and the Company will modify this allocation methodology, subject to the Company's board of directors' approval if the allocation becomes inequitable (i.e., if the Company becomes very highly leveraged compared to FIDAC's other funds and accounts). During the quarter ended September 30, 2010, the Company reimbursed FIDAC approximately \$177,000 for such expenses. During the quarter ended September 30, 2009, FIDAC waived its right to request reimbursement from the Company for these expenses.

During the quarters ended September 30, 2010 and December 31, 2009, 48,125 and 32,225 shares of restricted stock issued by the Company to FIDAC's employees vested, as discussed in Note 11.

In April 2009, the Company entered into a Securities Industry and Financial Markets Association standard preprinted form Master Repurchase Agreement with RCap Securities, Inc., an affiliate. This standard agreement does not contain any sort of liquidity, net worth or other similar types of positive or negative covenants. Rather, the agreement contains covenants that require the buyer and seller of securities to deliver collateral or securities, and similar covenants which are customary in the form Master Repurchase Agreement. At September 30, 2010 and December 31, 2009, the Company had no financing under this agreement. The Company has been in compliance with all covenants of this agreement since it entered into this agreement.

In March 2008, the Company entered into a Securities Industry and Financial Markets Association standard preprinted form Master Repurchase Agreement with Annaly. This standard agreement does not contain any sort of liquidity, net worth or other similar types of positive or negative covenants. Rather, the agreement contains covenants that require the buyer and seller of securities to deliver collateral or securities, and similar covenants which are customary in the form Master Repurchase Agreement. At September 30, 2010, the Company had no financing under this agreement. At December 31, 2009, the Company financed \$259.0 million under this agreement at a weighted average rate of 1.72%. The Company has been in compliance with all covenants of this agreement since it entered into this agreement.

15. Commitments and 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 reported or unreported contingencies at September 30, 2010.

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

Special Note Regarding Forward-Looking Statements

We make forward-looking statements in this report that are subject to risks and uncertainties. These forward-looking statements include information about possible or assumed future results of our business, financial condition, liquidity, results of operations, plans and objectives. When we use the words “believe,” “expect,” “anticipate,” “estimate,” “plan,” “continue,” “intend,” “should,” “may,” “would,” “will” or similar expressions, we intend to identify forward-looking statements. Statements regarding the following subjects, among others, are forward-looking by their nature:

- our business and investment strategy;
- our projected financial and operating results;
- our ability to maintain existing financing arrangements, obtain future financing arrangements and the terms of such arrangements;
 - general volatility of the securities markets in which we invest;
- the implementation, timing and impact of, and changes to, various government programs, including the Term Asset-Backed Securities Loan Facility and the Public-Private Investment Program;
 - our expected investments;
 - changes in the value of our investments;
- interest rate mismatches between our mortgage-backed securities and our borrowings used to fund such purchases;
 - changes in interest rates and mortgage prepayment rates;
 - effects of interest rate caps on our adjustable-rate mortgage-backed securities;
 - rates of default or decreased recovery rates on our investments;
- prepayments of the mortgage and other loans underlying our mortgage-backed or other asset-backed securities;
 - the degree to which our hedging strategies may or may not protect us from interest rate volatility;
- impact of and changes in governmental regulations, tax law and rates, accounting guidance, and similar matters;
 - availability of investment opportunities in real estate-related and other securities;
 - availability of qualified personnel;
 - estimates relating to our ability to make distributions to our stockholders in the future;
 - our understanding of our competition; and

- market trends in our industry, interest rates, the debt securities markets or the general economy.

The forward-looking statements are based on our beliefs, assumptions and expectations of our future performance, taking into account all information currently available to us. You should not place undue reliance on these forward-looking statements. These beliefs, assumptions and expectations can change as a result of many possible events or factors, not all of which are known to us. Some of these factors are described under the caption ‘‘Risk Factors’’ in our most recent Annual Report on Form 10-K and any subsequent Quarterly Reports on Form 10-Q. If a change occurs, our business, financial condition, liquidity and results of operations may vary materially from those expressed in our forward-looking statements. Any forward-looking statement speaks only as of the date on which it is made. New risks and uncertainties arise from time to time, and it is impossible for us to predict those events or how they may affect us. Except as required by law, we are not obligated to, and do not intend to, update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Executive Summary

We are a specialty finance company that invests, either directly or indirectly through our subsidiaries, in residential mortgage-backed securities, or RMBS, residential mortgage loans, real estate related securities and various other asset classes. We are externally managed by Fixed Income Discount Advisory Company, which we refer to as FIDAC or our Manager. FIDAC is a fixed-income investment management company that is registered as an investment adviser with the Securities and Exchange Commission, or SEC. FIDAC is a wholly owned subsidiary of Annaly Capital Management, Inc., or Annaly. FIDAC has a broad range of experience in managing investments in Agency RMBS, which are mortgage pass-through certificates, collateralized mortgage obligations, or CMOs, and other mortgage-backed securities representing interests in or obligations backed by pools of mortgage loans issued or guaranteed by the Federal National Mortgage Association, or Fannie Mae, the Federal Home Loan Mortgage Corporation, or Freddie Mac, and the Government National Mortgage Association, or Ginnie Mae, non-Agency RMBS, collateralized debt obligations, or CDOs, and other real estate related investments.

We have elected and intend to qualify to be taxed as a real estate investment trust, or REIT, for federal income tax purposes commencing with our taxable year ended on December 31, 2007. Our targeted asset classes and the principal investments we expect to make in each are as follows:

- RMBS, including:
 - o Non-Agency RMBS, including investment-grade and non-investment grade classes, including the BB-rated, B-rated, below B-rated, and non-rated classes
 - o Agency RMBS
- Residential mortgage loans, including:
 - o Prime mortgage loans
 - o Jumbo prime mortgage loans
 - o Alt-A mortgage loans
- Commercial mortgage loans
- Asset Backed Securities, or ABS, including:
 - o Commercial mortgage-backed securities, or CMBS
 - o Debt and equity tranches of collateralized debt obligations, or CDOs
 - o Consumer and non-consumer ABS, including investment-grade and non-investment grade classes, including the BB-rated, B-rated and non-rated classes

We completed our initial public offering on November 21, 2007. In that offering and in a concurrent private offering we raised net proceeds of approximately \$533.6 million from the sales of shares of our common stock. Since then we have raised an aggregate of approximately \$2.5 billion in follow-on offerings from the sales of shares of our common stock.

Our objective is to provide attractive risk-adjusted returns to our investors over the long-term, primarily through dividends and secondarily through capital appreciation. We intend to achieve this objective by investing in a broad class of financial assets to construct an investment portfolio that is designed to achieve attractive risk-adjusted returns and that is structured to comply with the various federal income tax requirements for REIT status and to maintain our exemption from the Investment Company Act of 1940, or the 1940 Act.

Since we commenced operations in November 2007, we have focused our investment activities on acquiring non-Agency RMBS and on purchasing residential mortgage loans that have been originated by select high-quality originators, including the retail lending operations of leading commercial banks. Our investment portfolio is weighted toward non-Agency RMBS. At September 30, 2010, approximately 83% of our investment portfolio was non-Agency RMBS, 12% of our investment portfolio was Agency RMBS, and 5% of our investment portfolio was secured residential mortgage loans. At December 31, 2009, approximately 68% of our investment portfolio was non-Agency RMBS, 25% of our investment portfolio was Agency RMBS, and 7% of our investment portfolio was secured residential mortgage loans. We expect that over the near term our investment portfolio will continue to be weighted toward RMBS, subject to maintaining our REIT qualification and our 1940 Act exemption. In addition, we have engaged in and depending on market conditions, anticipate continuing to engage in transactions with residential mortgage lending operations of leading commercial banks and other high-quality originators in which we identify and re-underwrite residential mortgage loans owned by such entities, and rather than purchasing and securitizing such residential mortgage loans ourselves, we and the originator structure the securitization and we purchase the resulting mezzanine and subordinate non-Agency RMBS. We may also engage in similar transactions with non-Agency RMBS in which we acquire non-Agency RMBS and re-securitize those securities. We then sell some or all of the resulting AAA-rated RMBS and may retain some of the AAA-rated RMBS and other subordinate bonds and interests.

Our investment strategy is intended to take advantage of opportunities in the current interest rate and credit environment. We will adjust our strategy to changing market conditions by shifting our asset allocations across these various asset classes as interest rate and credit cycles change over time. We believe that our strategy, combined with FIDAC's experience, will enable us to pay dividends and achieve capital appreciation throughout changing market cycles. We expect to take a long-term view of assets and liabilities, and our reported earnings and mark-to-market valuations at the end of a financial reporting period will not significantly impact our objective of providing attractive risk-adjusted returns to our stockholders over the long-term.

We use leverage to seek to increase our potential returns and to fund the acquisition of our assets. Our income is generated primarily by the difference, or net spread, between the income we earn on our assets and the cost of our borrowings. We expect to finance our investments using a variety of financing sources including, when available, repurchase agreements, warehouse facilities, securitizations, commercial paper and term financing CDOs. We manage our debt by utilizing interest rate hedges, such as interest rate swaps, to reduce the effect of interest rate fluctuations related to our debt.

Recent Developments

We commenced operations in November 2007 in the midst of challenging market conditions which affected the cost and availability of financing from the facilities with which we expected to finance our investments. These instruments included repurchase agreements, warehouse facilities, securitizations, asset-backed commercial paper, or ABCP, and term CDOs. The liquidity crisis which commenced in August 2007 affected each of these sources—and their individual providers—to different degrees; some sources generally became unavailable, some remained available but at a high cost, and some were largely unaffected. For example, in the repurchase agreement market, non-Agency RMBS became harder to finance, depending on the type of assets collateralizing the RMBS. The amount, term and margin requirements associated with these types of financings were also impacted. At that time, warehouse facilities to finance whole loan prime residential mortgages were generally available from major banks, but at significantly higher costs and had greater margin requirements than previously offered. It was also extremely difficult to term finance whole loans through securitization or bonds issued by a CDO structure. Financing using ABCP froze as issuers became unable to place (or roll) their securities, which resulted, in some instances, in forced sales of mortgage-backed securities, or MBS, and other securities which further negatively impacted the market value of these assets.

Although the credit markets had been undergoing much turbulence, as we started ramping up our portfolio in late 2007, we noted a slight easing. We entered into a number of repurchase agreements we could use to finance

RMBS. In January 2008, we entered into two whole mortgage loan repurchase agreements. As we began to see the availability of financing, we were also seeing better underwriting standards used to originate new mortgages. We commenced buying and financing RMBS and also entered into agreements to purchase whole mortgage loans. We purchased high credit quality assets which we believed we would be readily able to finance.

Beginning in mid-February 2008, credit markets experienced a dramatic and sudden adverse change. The severity of the limitation on liquidity was largely unanticipated by the markets. Credit once again froze, and in the mortgage market, valuations of non-Agency RMBS and whole mortgage loans came under severe pressure. This credit crisis began in early February 2008, when a heavily leveraged investor announced that it had to de-lever and liquidate a portfolio of approximately \$30 billion of non-Agency RMBS. Prices of these types of securities dropped dramatically, and lenders started lowering the prices on non-Agency RMBS that they held as collateral to secure the loans they had extended. The subsequent failure in March 2008 of Bear Stearns & Co. worsened the crisis. As the year progressed, deterioration in the fair value of our assets continued, we received and met margin calls under our repurchase agreements, which resulted in our obtaining additional funding from third parties, including from Annaly Capital Management, Inc., or Annaly, an affiliate, and taking other steps to increase our liquidity.

Many of the challenges of the first half of 2008 have continued through the third quarter of 2010, as financing difficulties have severely pressured liquidity and asset values. In September 2008, Lehman Brothers Holdings, Inc., a major investment bank, experienced a major liquidity crisis and failed. Securities trading remains limited and mortgage securities financing markets remain challenging as the industry continues to report negative news. This dislocation in the non-Agency mortgage sector has made it difficult for us to obtain short-term financing on favorable terms. As a result, we have completed loan securitizations in order to obtain long-term financing and terminated our un-utilized whole loan repurchase agreements in order to avoid paying non-usage fees under those agreements. In addition, we have in the past sought and received funding from Annaly. Under these circumstances, we expect to take actions intended to protect our liquidity, which may include reducing borrowings and disposing of assets as well as raising capital.

During this period of market dislocation, fiscal and monetary policymakers established new liquidity facilities for primary dealers and commercial banks, reduced short-term interest rates, and passed legislation that is intended to address the challenges of mortgage borrowers and lenders. This legislation, the Housing and Economic Recovery Act of 2008, seeks to forestall home foreclosures for distressed borrowers and assist communities with foreclosure problems.

Subsequent to June 30, 2008, there were increased market concerns about Freddie Mac and Fannie Mae's ability to withstand future credit losses associated with securities held in their investment portfolios, and on which they provide guarantees, without the direct support of the federal government. In September 2008 Fannie Mae and Freddie Mac were placed into the conservatorship of the Federal Housing Finance Agency, or FHFA, their federal regulator, pursuant to its powers under The Federal Housing Finance Regulatory Reform Act of 2008, a part of the Housing and Economic Recovery Act of 2008. As the conservator of Fannie Mae and Freddie Mac, the FHFA controls and directs the operations of Fannie Mae and Freddie Mac and may (1) take over the assets of and operate Fannie Mae and Freddie Mac with all the powers of the shareholders, the directors, and the officers of Fannie Mae and Freddie Mac and conduct all business of Fannie Mae and Freddie Mac; (2) collect all obligations and money due to Fannie Mae and Freddie Mac; (3) perform all functions of Fannie Mae and Freddie Mac which are consistent with the conservator's appointment; (4) preserve and conserve the assets and property of Fannie Mae and Freddie Mac; and (5) contract for assistance in fulfilling any function, activity, action or duty of the conservator.

In addition to FHFA becoming the conservator of Fannie Mae and Freddie Mac, (i) the U.S. Department of Treasury and FHFA have entered into preferred stock purchase agreements between the U.S. Department of Treasury, or the Treasury, and Fannie Mae and Freddie Mac pursuant to which the Treasury will ensure that each of Fannie Mae and Freddie Mac maintains a positive net worth; (ii) the Treasury has established a new secured lending credit facility which will be available to Fannie Mae, Freddie Mac, and the Federal Home Loan Banks, which is intended to serve as a liquidity backstop, which was available through December 2009; and (iii) the Treasury has initiated a temporary program to purchase RMBS issued by Fannie Mae and Freddie Mac. Although the Treasury has committed capital to Fannie Mae and Freddie Mac, there can be no assurance that these actions will be adequate for their needs. If these actions are inadequate, Fannie Mae and Freddie Mac could continue to suffer losses and could fail to honor their guarantees and other obligations. The future roles of Fannie Mae and Freddie Mac could be significantly reduced and the nature of their guarantees could be considerably diminished. Any changes to the nature of the guarantees provided by Fannie Mae and Freddie Mac could redefine what constitutes Mortgage-Backed Securities and could have broad adverse market implications.

Given the highly fluid and evolving nature of these events, it is unclear how our business will be impacted. Based upon the further activity of the U.S. government or market response to developments at Fannie Mae or Freddie Mac, our business could be adversely impacted.

The Emergency Economic Stabilization Act of 2008, or EESA, was enacted in October 2008. The EESA provides the U.S. Secretary of the Treasury with the authority to establish a Troubled Asset Relief Program, or TARP, to purchase

from financial institutions up to \$700 billion of equity or preferred securities, residential or commercial mortgages and any securities, obligations, or other instruments that are based on or related to such mortgages, that in each case was originated or issued on or before March 14, 2008, as well as any other financial instrument that the U.S. Secretary of the Treasury, after consultation with the Chairman of the Board of Governors of the Federal Reserve System, determines the purchase of which is necessary to promote financial market stability, upon transmittal of such determination, in writing, to the appropriate committees of the U.S. Congress. The EESA also provides for a program that would allow companies to insure their troubled assets.

The U.S. Government, Federal Reserve and other governmental and regulatory bodies have taken or are considering taking other actions to address the financial crisis. The Term Asset-Backed Securities Loan Facility, or TALF, was first announced by the Treasury on November 25, 2008, and has been expanded in size and scope since its initial announcement. Under the TALF, the Federal Reserve Bank of New York, or the FRBNY, provides non-recourse loans to borrowers to fund their purchase of eligible assets. The FRBNY has stopped accepting applications for credit under the TALF program for all collateral.

In November 2008, the Federal Reserve announced an expansion of its open-market operations to support the credit markets through the purchase of up to \$100 billion in Agency debt and \$500 billion in Agency MBS. In March 2009, the Federal Reserve further expanded the program to include purchase of up to \$300 billion of longer term Treasury securities and increased total purchases of Agency debt and MBS to \$200 billion and \$1.25 trillion respectively. These purchases were completed by March 31, 2010.

In addition, on March 23, 2009, the U.S. Treasury, in conjunction with the Federal Deposit Insurance Corporation, or FDIC, and the Federal Reserve, announced the establishment of the Public-Private Investment Program, or PPIP. The PPIP is designed to encourage the transfer of certain illiquid legacy real estate-related assets off of the balance sheets of financial institutions, restarting the market for these assets and supporting the flow of credit and other capital into the broader economy.

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act, or the Dodd-Frank Act. The Dodd-Frank Act provides for new regulations on financial institutions and creates new supervisory and advisory bodies, including the new Consumer Financial Protection Bureau. The Dodd-Frank Act tasks many agencies with issuing a variety of new regulations, including rules related to mortgage origination and servicing, securitization and derivatives. As the Dodd-Frank Act has only recently been enacted and because a significant number of regulations have yet to be proposed or adopted in final form, it is not possible for us to predict how the Dodd-Frank Act will impact our business.

Although these aggressive steps are intended to protect and support the US housing and mortgage market, we continue to operate under difficult market conditions. As a result, there can be no assurance that the EESA, the TARP, the TALF, the large scale asset purchases, PPIP, the Dodd-Frank Act or other policy initiatives will have a beneficial impact on the financial markets, including current extreme levels of volatility. We cannot predict whether or when such actions may occur or what impact, if any, such actions could have on our business, results of operations and financial condition.

Trends

We expect the results of our operations to be affected by various factors, many of which are beyond our control. Our results of operations will primarily depend on, among other things, the level of our net interest income, the market value of our assets, and the supply of and demand for such assets. Our net interest income, which reflects the amortization of purchase premiums and accretion of discounts, varies primarily as a result of changes in interest rates, borrowing costs, and prepayment speeds, which is a measurement of how quickly borrowers pay down the unpaid principal balance on their mortgage loans.

Prepayment Speeds. Prepayment speeds, as reflected by the Constant Prepayment Rate, or CPR, vary according to interest rates, the type of investment, conditions in financial markets, competition and other factors, none of which can be predicted with any certainty. In general, when interest rates rise, it is relatively less attractive for borrowers to refinance their mortgage loans, and as a result, prepayment speeds tend to decrease. When interest rates fall, prepayment speeds tend to increase. For mortgage loan and RMBS investments purchased at a premium, as prepayment speeds increase, the amount of income we earn decreases because the purchase premium we paid for the bonds amortizes faster than expected. Conversely, decreases in prepayment speeds result in increased income and can

extend the period over which we amortize the purchase premium. For mortgage loan and RMBS investments purchased at a discount, as prepayment speeds increase, the amount of income we earn increases because of the acceleration of the accretion of the discount into interest income. Conversely, decreases in prepayment speeds result in decreased income and can extend the period over which we accrete the purchase discount into interest income.

Rising Interest Rate Environment. As indicated above, as interest rates rise, prepayment speeds generally decrease. Rising interest rates, however, increase our financing costs which may result in a net negative impact on our net interest income. In addition, if we acquire Agency and non-Agency RMBS collateralized by monthly reset adjustable-rate mortgages, or ARMs, and three- and five-year hybrid ARMs, such interest rate increases could result in decreases in our net investment income, as there could be a timing mismatch between the interest rate reset dates on our RMBS portfolio and the financing costs of these investments. We expect, however, that our fixed-rate assets would decline in value in a rising interest rate environment and that our net interest spreads on fixed rate assets could decline in a rising interest rate environment to the extent such assets are financed with floating rate debt.

Falling Interest Rate Environment. As interest rates fall, prepayment speeds generally increase. Falling interest rates, however, decrease our financing costs which may result in a net positive impact on our net interest income. In addition, if we acquire Agency and non-Agency RMBS collateralized by monthly reset adjustable-rate mortgages, or ARMs, and three- and five-year hybrid ARMs, such interest rate decreases could result in increases in our net investment income, as there could be a timing mismatch between the interest rate reset dates on our RMBS portfolio and the financing costs of these investments. We expect, however, that our fixed-rate assets would increase in value in a falling interest rate environment and that our net interest spreads on fixed rate assets could increase in a falling interest rate environment to the extent such assets are financed with floating rate debt.

Credit Risk. One of our strategic focuses is acquiring assets which we believe to be of high credit quality. We believe this strategy will generally keep our credit losses and financing costs low. We retain the risk of potential credit losses on all of the residential mortgage loans we hold in our portfolio. Additionally, some of our investments in RMBS may be qualifying interests for purposes of maintaining our exemption from the 1940 Act because we retain a 100% ownership interest in the underlying loans. If we purchase all classes of these securitizations, we have the credit exposure on the underlying loans. Prior to the purchase of these securities, we conduct a due diligence process that allows us to remove loans that do not meet our credit standards based on loan-to-value ratios, borrowers' credit scores, income and asset documentation and other criteria that we believe to be important indications of credit risk.

Size of Investment Portfolio. The size of our investment portfolio, as measured by the aggregate unpaid principal balance of our mortgage loans and aggregate principal balance of our mortgage related securities and the other assets we own is also a key revenue driver. Generally, as the size of our investment portfolio grows, the amount of interest income we receive increases. The larger investment portfolio, however, drives increased expenses as we incur additional interest expense to finance the purchase of our assets.

Since changes in interest rates may significantly affect our activities, our operating results depend, in large part, upon our ability to effectively manage interest rate risks and prepayment risks while maintaining our status as a REIT.

Current Environment. Weakness in the broader mortgage markets could adversely affect one or more of our potential lenders or any of our lenders and could cause one or more of our potential lenders or any of our lenders to be unwilling or unable to provide us with financing or require us to post additional collateral. In general, this could potentially increase our financing costs and reduce our liquidity or require us to sell assets at an inopportune time. We expect to use a number of sources to finance our investments, including repurchase agreements, warehouse facilities, securitizations, asset-backed commercial paper and term CDOs. Current market conditions have affected the cost and availability of financing from each of these sources and their individual providers to different degrees; some sources generally are unavailable, some are available but at a high cost, and some are largely unaffected. For example, in the repurchase agreement market, borrowers have been affected differently depending on the type of security they are financing. Non-Agency RMBS have been harder to finance, depending on the type of assets collateralizing the RMBS. The amount, term and margin requirements associated with these types of financings have been negatively impacted.

Currently, warehouse facilities to finance whole loan prime residential mortgages are generally available from major banks, but at a significantly higher cost and have greater margin requirements than previously offered. Many major banks that offer warehouse facilities have also reduced the amount of capital available to new entrants and consequently the size of those facilities offered now are smaller than those previously available.

It is currently a challenging market to term finance whole loans through securitization or bonds issued by a CDO structure. The highly rated senior bonds in these securitizations and CDO structures currently have liquidity, but at much wider spreads than issues priced in recent history. The junior subordinate tranches of these structures currently have few buyers and current market conditions have forced issuers to retain these lower rated bonds rather than sell them.

Certain issuers of ABCP have been unable to place (or roll) their securities, which has resulted, in some instances, in forced sales of MBS and other securities which has further negatively impacted the market value of these assets. These market conditions are fluid and likely to change over time. As a result, the execution of our investment strategy may be dictated by the cost and availability of financing from these different sources.

If one or more major market participants fails or otherwise experiences a major liquidity crisis, as was the case for Bear Stearns & Co. in March 2008, and Lehman Brothers Holdings Inc. in September 2008, it could negatively impact the marketability of all fixed income securities and this could negatively impact the value of the securities we acquire, thus reducing our net book value. Furthermore, if many of our potential lenders or any of our lenders are unwilling or unable to provide us with financing, we could be forced to sell our securities or residential mortgage loans at an inopportune time when prices are depressed.

As described above, there has been significant government action in the capital markets. However, there can be no assurance that the government's actions with respect to Freddie Mac and Fannie Mae, the EESA, the TARP, the TALF, the PPIP, the Dodd-Frank Act or other policy initiatives will have a beneficial impact on the financial markets. To the extent the market does not respond favorably to these actions, or these actions do not function as intended, our business may not receive the anticipated positive impact from them. In addition, the U.S. Government, Federal Reserve and other governmental and regulatory bodies have taken or are considering taking other actions to address the financial crisis. We cannot predict whether or when such actions may occur or what impact, if any, such actions could have on our business, results of operations and financial condition.

In the current market, it may be difficult or impossible to obtain third party pricing on the investments we purchase. In addition, validating third party pricing for our investments may be more subjective as fewer participants may be willing to provide this service to us. Moreover, the current market is more illiquid than in recent history for some of the investments we purchase. Illiquid investments typically experience greater price volatility as a ready market does not exist. As volatility increases or liquidity decreases we may have greater difficulty financing our investments which may negatively impact our earnings and the execution of our investment strategy.

Market conditions are evolving on a number of fronts. Regulatory and technical dynamics continue to develop, and monetary policy initiatives, including the prospect of large scale asset purchases by the Federal Reserve, continue to support asset prices and lower yields across a wide range of market sectors, including ours.