DYNEX CAPITAL INC
Form 10-Q/A
August 21, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549
FORM 10-Q/A
Amendment No. 1

R Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended June 30, 2012
or
£ Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
Commission File Number: 1-9819
DYNEX CAPITAL, INC.
(Exact name of registrant as specified in its charter)

Virginia	52-1549373
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
4991 Lake Brook Drive, Suite 100, Glen Allen, Virginia	23060-9245
(Address of principal executive offices)	(Zip Code)

(804) 217-5800
(Registrant's telephone number, including area code)

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

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

Large accelerated filer	£	Accelerated filer	R
Non-accelerated filer	£ (Do not check if a smaller reporting company)	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 R

On July 31, 2012, the registrant had 54,367,218 shares outstanding of common stock, $0.01 par value, which is the registrant's only class of common stock.

Explanatory Note

This Amendment No. 1 (this "Amendment") to the Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 of Dynex Capital, Inc. (the "Company") filed on August 8, 2012 (the "Original Filing") is being filed to correct certain inadvertent typographical errors in Part I, Item 3, "Quantitative and Qualitative Disclosures About Market Risk" of the Original Filing.

The Amendment corrects the following typographical errors related to decimal placement in the table disclosing the effect of various basis point changes in interest rates under the caption "Quantitative and Qualitative Disclosures About Market Risk – Interest Rate Risk – Effect of Changes in Interest Rates on Net Interest Income and Market Value":

•For the 100 basis point increase in interest rate sensitivity on "percentage change in projected net interest income", the Company erroneously disclosed a decrease of (0.5%) instead of a decrease of (5.4%);
•For the 50 basis point increase in interest rate sensitivity on "percentage change in projected market value", the Company erroneously disclosed a decrease of (5.8%) instead of a decrease of (0.6%); and
•For the 50 basis point decrease in interest rate sensitivity on "percentage change in projected market value", the Company erroneously disclosed an increase of 5.2% instead of an increase of 0.5%.

In addition, the Amendment corrects the caption of the second column of the table disclosing non-Agency MBS credit ratings under the caption "Quantitative and Qualitative Disclosures About Market Risk – Credit Risk" by changing the original caption of "IOs" to the amended caption of "CMBS IOs."

Other than as expressly set forth above, this Amendment does not, and does not purport to, update or restate the information in any Item of the Original Filing or reflect any events that have occurred after the Original Filing was filed. Accordingly, this Amendment should be read in conjunction with the Original Filing.

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Item 3. Quantitative and Qualitative Disclosures about Market Risk

We seek to manage various risks inherent in our business strategy, which include interest rate, prepayment, reinvestment, market value, credit, and liquidity risks. We do not seek to avoid risk completely, but rather, we attempt to manage these risks while earning an acceptable risk-adjusted return for our shareholders.

Interest Rate Risk

Investing in interest-rate sensitive investments on a leveraged basis subjects us to interest rate risk. Interest rate risk arises primarily because that the maturities of our assets are generally longer than those of our liabilities and because our adjustable rate assets may have limits or caps on the amount that an interest rate may reset. Interest rate risk impacts our net interest income and the market value of our investments (and therefore our book value). Specifically, interest rate risk arises from changes in the absolute level of rates, changes in the shape/slope of interest rate curves, and changes in the relationships between short-term and long-term rates. We attempt to manage our exposure to changes in interest rates by investing in shorter duration instruments and managing our investment portfolio within risk tolerances set by our Board of Directors. Our current goal is to maintain a net portfolio duration (a measure of interest rate risk) within a range of 0.5 to 1.5 years. Our portfolio duration could drift outside of our target range due to changes in market conditions, interest rates, market spreads, and activity in our investment portfolio. We will use interest rate swaps to help manage our interest rate risk and, where practical, we will attempt to fund our assets with financings that have similar terms as the related investments. Interest rate swap agreements generally result in interest savings in a rising interest rate environment when the current market interest rate we receive on the swap (which generally is equal to one-month LIBOR) rises higher than the stated fixed rate we pay on the notional amount for each interest rate swap agreement. Alternatively, a declining or stable interest rate environment generally results in interest expense equal to the difference between the stated fixed rate we pay less the current market interest rate we receive. Because we use leverage to support our investment portfolio, changes in interest rates can be disproportionately favorable or unfavorable on our results of operations and our book value.

Interest rate risk also arises from changes in market credit spreads reflecting the perceived riskiness of assets relative to risk-free rates (e.g., swap rates and mortgage rates relative to the Treasury securities rates). Increases in market credit spreads with no corresponding change in the underlying risk-free rate will result in a reduction in the value of our investments. We do not attempt to hedge credit spread risk but rather try to manage it by investing in assets that we believe have less volatility.

Interest Rate Reset Risk. The rates on our borrowings are based primarily on LIBOR and will generally reset on a more frequent basis than the interest rates on our investments. During a period of rising short-term interest rates, our net interest income will generally decrease because the interest rates on our borrowings may reset at a higher interest rate more quickly than the interest rates on our investments. This reduction in net interest income will be larger when short-term interest rates are rising rapidly. Conversely, in a period of falling short-term interest rates, our net interest income will typically increase. Any increase or decrease in our net interest income for at least a portion of our investment portfolio may be temporary as the yields on Agency ARMs and securitized adjustable-rate mortgage loans adjust to new interest rates after a lag period.

Interest Rate Cap Risk. Our adjustable rate investments have interest rates which are predominantly based upon six-month and one-year LIBOR, and generally contain periodic (interim) or lifetime interest rate caps which often limit the amount by which the interest rate may reset. Periodic caps on our investments typically range from 1-5% annually, and lifetime caps are typically 5% above the initial rate of the underlying adjustable-rate mortgage loan. Generally, the interest rates on our borrowings used to finance these assets are based on one to three month LIBOR, reset every 30 to 90 days, and will not have periodic or lifetime interest rate caps. In addition, certain of our securitized mortgage loans have a fixed rate of interest and are financed with borrowings with interest rates that adjust

monthly.

The following table presents information about the lifetime and interim interest rate caps on our adjustable-rate Agency MBS portfolio as of June 30, 2012:

Lifetime Interest Rate Caps on ARM MBS	% of Total		Interim Interest Rate Caps on ARM MBS	% of Total	
9.0% to 10.0%	69.1	%	1.0%	0.5	%
>10.0% to 11.0%	25.2	%	2.0%	15.6	%
>11.0% to 12.1%	5.7	%	5.0%-6.0%	83.9	%
	100.0	%		100.0	%

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Effect of Changes in Interest Rates on Net Interest Income and Market Value. The table below shows the sensitivity of our projected net interest income and the projected market value of our investments (for those carried at fair value on our balance sheet, and including all derivative instruments) as they existed as of June 30, 2012 based on an instantaneous parallel shift in market interest rates as set forth in the table. The "percentage change in projected net interest income" included in the table below is based on the projected net income on the investment portfolio over the next twenty-four months. The projections are based upon a variety of assumptions including investment prepayment speeds, credit performance, and the availability of financing over the projection period.

The table below assumes a static portfolio throughout the projected period and does not consider any reinvestment or rebalancing of the investment portfolio or additional hedging activity by the Company. Changes in our types of investments, changes in future interest rates, changes in credit spreads, changes in the shape of the yield curve, the availability of financing and/or the mix of our investments and financings may cause actual results to differ significantly from the modeled results. There can be no assurance that assumed events used for the model below will occur, or that other events will not occur, that would affect the outcomes; therefore, the tables below and all related disclosures constitute forward-looking statements.

	June 30, 2012	
Basis Point Change in Interest Rates	Percentage change in projected net interest income[(1)]	Percentage change in projected market value[(2)]
+100	(5.4)%	(1.2)%
+50	(2.4)%	(0.6)%
0	—%	—
-50	4.4%	0.5%
-100	5.6%	1.0%

(1) Includes changes in interest expense from the financings for our investments as well as our derivative instruments.

(2) Includes changes in market value of our derivative instruments, but excludes changes in market value of our financings because they are not carried at fair value on our balance sheet.

The table above is intended to demonstrate our sensitivity to interest rates based on our investments and associated financings and derivative instruments as of June 30, 2012. The impact of changing interest rates on net interest income and market value of our investments can change significantly when interest rates change beyond the above levels or if market expectations of future interest rates begin to materially change. In addition, other factors will impact the net interest income from and market value of our interest rate-sensitive investments and derivative instruments, such as whether we raise additional capital or change our investment allocations or strategies, changes in prepayment rates on our investments, the shape of the yield curve, market expectations as to future interest rate changes and other market conditions. Accordingly, interest income would likely differ from that shown above, and such difference might be material.

Prepayment and Reinvestment Risk

Prepayment risk is the risk of an early, unanticipated return of principal on an investment. We are subject to prepayment risk from premiums paid on investments which we acquire. In general, purchase premiums on our investments are amortized as a reduction in interest income using the effective yield method under GAAP, adjusted for the actual and anticipated prepayment activity of the investment. An increase in the actual or expected rate of prepayment will typically accelerate the amortization of purchase premiums, thereby reducing the yield/interest income earned on such assets.

Prepayment risk results from both our RMBS and CMBS investments. Loans underlying our CMBS and CMBS IO securities generally have prepayment protection provisions, such as prepayment lock-outs or yield maintenance payment requirements. The yield maintenance payment requirement generally creates an economic disincentive for the loans to prepay, thereby reducing the prepayments on the related securities, and also compensates us in the event that there are prepayments. As a result of prepayment lock-out and yield maintenance provisions, amortization of premiums on CMBS and CMBS IO securities is generally stable from period to period. However, there are no prepayment protections if the loan defaults and the loan is partially or wholly repaid earlier as a result of loss mitigation actions taken by the underlying loan servicer. Loans underlying our RMBS have no prepayment protection.

Principal prepayments on our investments are influenced by changes in market interest rates and a variety of economic, geographic, and other factors beyond our control. In addition, actions taken by the U.S. government could increase prepayments as discussed further in Item 2. Management's Discussion and Analysis under “Trends and Recent Market Impacts”.

The following table discloses the net premium (discount) by months until interest rate reset as well as the net premium (discount) as a percentage of par value (or notional value in the case of CMBS IO) for Agency and non-Agency MBS in our investment portfolio as of June 30, 2012 and December 31, 2011:

(amounts in thousands)	June 30, 2012			December 31, 2011		
Agency:	RMBS	CMBS	CMBS IO	RMBS	CMBS	CMBS IO
0-12 months to reset	$30,348	$—	$—	$15,338	$—	$—
Greater than 12 months to reset	84,809	—	—	70,150	—	—
Fixed rate	5,656	22,412	295,046	(17)	21,627	86,358
Total premium, net	$120,813	$22,412	$295,046	$85,471	$21,627	$86,358
Par/notional balance	$2,216,357	$286,982	$4,543,349	$1,488,397	$266,952	$1,813,096
Premium, net as a % of par value	5.5%	7.8%	6.5%	5.7%	8.1%	4.8%
Non-Agency:						
0-12 months to reset	$4	$—	$—	$(540)	$—	$—
Greater than 12 months to reset	—	—	—	—	—	—
Fixed rate	(855)	(19,105)	63,601	(463)	(13,865)	51,239
Total (discount) premium, net	$(851)	$(19,105)	$63,601	$(1,003)	$(13,865)	$51,239
Par/notional balance	$19,282	$473,198	$1,011,637	$17,119	$359,853	$906,202
(Discount) premium, net as a % of par value	(4.4)%	(4.0)%	6.3%	(5.9)%	(3.9)%	5.7%

We seek to manage our prepayment risk by diversifying our investments, seeking investments which we believe will have superior prepayment performance, and investing in securities which have some sort of prepayment prohibition or yield maintenance (as is the case with CMBS and CMBS IO).

We are also subject to reinvestment risk as a result of the prepayment, repayment or sale of our investments. Yields on assets in which we invest now are generally lower than yields on existing assets that we may sell or which may be repaid, due to lower overall interest rates and more competition for these as investment assets. As a result, our interest income may decline in the future, thereby reducing earnings per share. In order to maintain our investment portfolio size and our earnings, we need to reinvest our capital into new interest-earning assets. If we are unable to find suitable reinvestment opportunities, interest income on our investment portfolio and investment cash flows could be negatively impacted.

Credit Risk

Credit risk is the risk that we will not receive all contractual amounts due on investments that we own due to default by the borrower or due to a deficiency in proceeds from the liquidation of the collateral securing the obligation. We are also exposed to credit risk on investments that we own at a premium, such as CMBS IOs. For investments owned at premiums, defaults on the underlying loan typically result in the complete loss of any remaining unamortized premium we paid.

We attempt to mitigate our credit risk by purchasing Agency MBS, which are guaranteed by Freddie Mac, Fannie Mae, or Ginnie Mae, and higher quality non-Agency MBS. Agency MBS have credit risk to the extent that Fannie Mae or Freddie Mac fails to remit payments on the MBS for which they have issued a guaranty of payment. Given the conservatorship of these entities and the continued support of the U.S. government, we believe this risk is low. For our

non-Agency MBS, we will generally only purchase securities 'A'-rated or better by a least one of the nationally recognized statistical ratings organizations, with the concentration of these securities being rated 'AAA'. For securities, such as CMBS IOs, where we have a higher premium at risk, we seek to invest in securities where we are comfortable with the credit profile of the loans underlying the security.

The following table presents our non-Agency MBS by credit rating as of June 30, 2012:

	June 30, 2012							
	CMBS		CMBS IOs		RMBS		Weighted average	
AAA	34.7	%	100.0	%	41.3	%	42.7	%
AA	12.3	%	—	%	1.4	%	10.5	%
A	52.2	%	—	%	—	%	44.4	%
Below A or not rated	0.8	%	—	%	57.3	%	2.4	%

With respect to our securitized mortgage loans, these loans are well-seasoned, thereby lowering our average loan-to-value (“LTV”) ratio and decreasing our risk of loss. Other efforts to mitigate credit risk include maintaining a risk management function that monitors and oversees the performance of the servicers of the mortgage loans, as well as providing an allowance for loan loss as required by GAAP. In addition, a portion of these loans have "pool" guarantees by which certain parties provide guarantees of repayment on pools of loans up to a limited amount.

Market Value Risk

Market value risk generally represents the risk of loss from the change in the value of a financial instrument due to fluctuations in interest rates and changes in the perceived risk in owning such financial instrument. Securities in our investment portfolio are reflected at their estimated fair value, with the difference between amortized cost and estimated fair value reflected in accumulated other comprehensive income if the securities are deemed available for sale, or fair value, net in our statement of operations if the securities are viewed as trading. Regardless of whether an investment is carried at fair value or at historical cost in our financial statements, we will monitor the change in its market value. In particular, we will monitor changes in the value of investments collateralizing our repurchase agreements for liquidity management and other purposes, including maintaining appropriate collateral margins. The estimated fair value of these securities fluctuates primarily due to changes in interest rates, market valuation of credit risks, and other factors. We attempt to manage this risk by managing our exposure to these factors. For example, the types of derivative instruments we are currently using to hedge the interest rates on our debt tend to increase in value when our investment portfolio decreases in value, although not a one-to-one correlation. See the analysis in the “Interest Rate Risk” section above, which presents the estimated change in our portfolio given changes in market interest rates.

Liquidity Risk

We have liquidity risk principally from the use of recourse repurchase agreements to finance our ownership of securities. In general, our repurchase agreements provide a source of uncommitted short-term financing that finances a longer-term asset, thereby creating a mismatch between the maturity of the asset and of the associated financing. Our repurchase agreements are renewable at the discretion of our lenders and do not contain guaranteed roll-over terms. If we fail to repay the lender at maturity, the lender has the right to immediately sell the collateral and pursue us for any shortfall if the sales proceeds are inadequate to cover the repurchase agreement financing.

At the inception of the repurchase agreement, we post margin collateral to the lender in order to support the amount of the financing and to give the lender a cushion against fluctuations in the value of the collateral pledged. The repurchase agreement lender may also request that we post additional collateral (“margin calls”) in the event of a decline in market value of the collateral pledged, which may happen for market reasons or as a result of the payment delay feature on Agency MBS as discussed in “Liquidity and Capital Resources” in Item 2 of Part I to this Quarterly Report on Form 10-Q. Such margin calls could adversely change our liquidity position. If we fail to meet this margin call, the lender has the right to terminate the repurchase agreement and immediately sell the collateral. If the proceeds from the sale of the collateral are insufficient to repay the entire amount of the repurchase agreement outstanding, we would be required to repay any shortfall. All of our repurchase agreements provide that the lender is responsible for

obtaining collateral valuations, which must be from a generally recognized source agreed to by both us and the lender, or the most recent closing quotation of such source. Given the uncommitted nature of repurchase agreement financing and the varying collateral requirements, we cannot assume that we will always be able to roll over our repurchase agreements as they mature.

For further information, including how we attempt to mitigate liquidity risk and recent developments with respect to our liquidity position, please refer to Note 12 of the Unaudited Consolidated Financial Statements in Item 1 of Part I to this Quarterly Report on Form 10-Q; to "Highlights of Second Quarter and Third Quarter Outlook" and "Liquidity and Capital Resources" in Item 2 of Part I to this Quarterly Report on Form 10-Q; and to "Liquidity and Capital Resources" in Item 7 of Part II of our Annual Report on Form 10-K for the year ended December 31, 2011.

Item 6. Exhibits

Exhibit No.	Description
31.1	Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
31.2	Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

DYNEX CAPITAL, INC.

Date: August 21, 2012

/s/ Thomas B. Akin
Thomas B. Akin
Chairman and Chief Executive Officer
(Principal Executive Officer)

Date: August 21, 2012

/s/ Stephen J. Benedetti
Stephen J. Benedetti
Executive Vice President, Chief Operating Officer and Chief Financial Officer
(Principal Financial Officer)