

CAPSTEAD MORTGAGE CORP

Form 10-Q/A

January 27, 2009

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q/A
(Amendment No. 2)**

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

For the quarterly period ended: September 30, 2008

OR

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

For the transition period from _____ to _____

Commission File Number: 001-08896

CAPSTEAD MORTGAGE CORPORATION

(Exact name of Registrant as specified in its Charter)

Maryland

(State or other jurisdiction of incorporation or organization)

75-2027937

(I.R.S. Employer Identification No.)

8401 North Central Expressway, Suite 800, Dallas, TX

(Address of principal executive offices)

75225

(Zip Code)

Registrant's telephone number, including area code: **(214) 874-2323**

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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act). (Check one):
Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act) YES NO

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.

Common Stock (\$0.01 par value)

58,780,175 as of October 30, 2008

CAPSTEAD MORTGAGE CORPORATION
FORM 10-Q/A
(Amendment No. 2)
FOR THE QUARTER ENDED SEPTEMBER 30, 2008
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EXPLANATORY NOTE RECLASSIFYING RESTATEMENT

On January 12, 2009, Capstead Mortgage Corporation (the Company) filed its Amendment No. 1 to Form 10-Q, filed on Form 10-Q/A, to restate the Company's consolidated statements of income for the quarter and nine months ending September 30, 2008 to reflect (a) interest income from overnight investments and collateral deposits on interest rate swap agreements with interest income on mortgage securities and similar investments to arrive at total interest income and (b) interest expense from unsecured borrowings with interest expense from repurchase arrangements and similar borrowings in order to reflect a more all-inclusive measure of net interest margin. The reclassifications contained in this restatement do not change the Company's previously reported net income, earnings per share or stockholders equity for any of the aforementioned periods. In addition, the restatement does not impact the Company's consolidated balance sheets, statements of stockholders' equity or cash flows for the indicated periods.

This Amendment No. 2 to Form 10-Q has been filed in order to conform Management's Discussion and Analysis more precisely to the revised presentation on the restated consolidated statements of income. This Amendment No. 2 does not amend or restate the financial statements included in Amendment No. 1.

The reclassifications contained in these restatements do not change the Company's previously reported net income, earnings per share or stockholders' equity for any of the aforementioned periods. In addition, the restatements do not impact the Company's consolidated balance sheets, statements of stockholders' equity or cash flows for the indicated periods.

Management and the Audit Committee of the Board of Directors have discussed these matters with the Company's independent registered public accounting firm, Ernst & Young, LLP.

For the convenience of the reader, this Amendment No. 2 to Form 10-Q/A sets forth the Company's original Form 10-Q as filed with the SEC on October 30, 2008 (the Original 10-Q) in its entirety, as amended by, and to reflect, the reclassifications required by this restatement. No other attempt has been made in this Form 10-Q/A to update other disclosures presented in the Original 10-Q, except as required to reflect the effects of the restatement. This Form 10-Q/A does not reflect events occurring after the filing of the Original 10-Q or modify or update those disclosures, including the exhibits to the Original 10-Q affected by subsequent events.

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ITEM 1. FINANCIAL STATEMENTS
PART I. FINANCIAL INFORMATION
CAPSTEAD MORTGAGE CORPORATION
CONSOLIDATED BALANCE SHEETS
(in thousands, except per share amounts)

	<i>September 30, 2008 (unaudited)</i>	<i>December 31, 2007</i>
Assets:		
Mortgage securities and similar investments (\$7.7 billion pledged under repurchase arrangements)	\$ 7,936,112	\$ 7,108,719
Investments in unconsolidated affiliates	3,117	3,117
Interest rate swap agreements at fair value	5,202	
Receivables and other assets	108,502	90,437
Cash and cash equivalents	137,475	6,653
	\$ 8,190,408	\$ 7,208,926
Liabilities:		
Repurchase arrangements and similar borrowings	\$ 7,242,848	\$ 6,500,362
Unsecured borrowings	103,095	103,095
Interest rate swap agreements at fair value	8,867	2,384
Common stock dividend payable	32,024	9,786
Accounts payable and accrued expenses	37,171	32,382
	7,424,005	6,648,009
Stockholders equity:		
Preferred stock \$0.10 par value; 100,000 shares authorized: \$1.60 Cumulative Preferred Stock, Series A, 197 and 202 shares issued and outstanding at September 30, 2008 and December 31, 2007, respectively (\$3,232 aggregate liquidation preference)	2,755	2,828
\$1.26 Cumulative Convertible Preferred Stock, Series B, 15,819 shares issued and outstanding at September 30, 2008 and December 31, 2007 (\$180,025 aggregate liquidation preference)	176,705	176,705
Common stock \$0.01 par value; 250,000 shares authorized: 58,226 and 40,819 shares issued and outstanding at September 30, 2008 and December 31, 2007, respectively	582	408
Paid-in capital	932,113	702,170
Accumulated deficit	(358,155)	(358,155)
Accumulated other comprehensive income	12,403	36,961
	766,403	560,917

\$ 8,190,408 \$ 7,208,926

See accompanying notes to consolidated financial statements.

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CAPSTEAD MORTGAGE CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share amounts)
(unaudited)

	<i>Quarter Ended</i>		<i>Nine Months Ended</i>	
	<i>September 30</i>		<i>September 30</i>	
	<i>2008</i>	<i>2007</i>	<i>2008</i>	<i>2007</i>
	<i>(as Restated, see NOTE 13)</i>			
Interest income:				
Mortgage securities and similar investments	\$ 99,205	\$ 74,949	\$ 302,888	\$ 222,886
Other	346	212	1,932	313
	99,551	75,161	304,820	223,199
Interest expense:				
Repurchase arrangements and similar borrowings	(60,032)	(66,478)	(184,357)	(197,174)
Unsecured borrowings	(2,186)	(2,186)	(6,560)	(6,560)
	(62,218)	(68,664)	(190,917)	(203,734)
	37,333	6,497	113,903	19,465
Other revenue (expense):				
Loss from portfolio restructuring		(8,276)	(1,408)	(8,276)
Other revenue (expense)	(45)	62	(61)	1,069
Incentive compensation	(300)		(4,820)	
Other operating expense	(2,306)	(1,678)	(6,187)	(4,891)
	(2,651)	(9,892)	(12,476)	(12,098)
Income (loss) before equity in earnings of unconsolidated affiliates	34,682	(3,395)	101,427	7,367
Equity in earnings of unconsolidated affiliates	64	247	194	1,486
Net income (loss)	\$ 34,746	\$ (3,148)	\$ 101,621	\$ 8,853
Net income available (loss attributable) to common stockholders:				
Net income (loss)	\$ 34,746	\$ (3,148)	\$ 101,621	\$ 8,853
Less cash dividends paid on preferred stock	(5,062)	(5,064)	(15,189)	(15,192)

\$ 29,684 \$ (8,212) \$ 86,432 \$ (6,339)

Net income (loss) per common share:

Basic	\$ 0.53	\$ (0.43)	\$ 1.66	\$ (0.33)
Diluted	0.52	(0.43)	1.64	(0.33)

Cash dividends declared per share:

Common	\$ 0.550	\$ 0.040	\$ 1.660	\$ 0.100
Series A Preferred	0.400	0.400	1.200	1.200
Series B Preferred	0.315	0.315	0.945	0.945

See accompanying notes to consolidated financial statements.

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CAPSTEAD MORTGAGE CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands, unaudited)

	<i>Nine Months Ended September</i>	
	30	
	2008	2007
Operating activities:		
Net income	\$ 101,621	\$ 8,853
Noncash items:		
Amortization of investment premiums	23,208	17,855
Depreciation and other amortization	184	171
Equity-based compensation costs	948	673
Amounts related to interest rate swap agreements	528	
Loss from portfolio restructuring	1,408	8,276
Net change in receivables, other assets, accounts payable and accrued expenses	17,500	4,968
Net cash provided by operating activities	145,397	40,796
Investing activities:		
Purchases of mortgage securities and similar investments	(2,851,297)	(1,737,579)
Proceeds from sales of mortgage securities and similar investments	766,800	803,363
Principal collections on mortgage securities and similar investments	1,202,737	1,371,343
Investment in unconsolidated affiliates		8,952
Net cash (used in) provided by investing activities	(881,760)	446,079
Financing activities:		
Proceeds from repurchase arrangements and similar borrowings	49,296,731	34,888,670
Principal payments on repurchase arrangements and similar borrowings	(48,554,240)	(35,321,353)
Collateral deposits on interest rate swap agreements	(22,756)	
Payment on early termination of interest rate swap agreement	(2,275)	
Capital stock transactions	233,739	1,518
Dividends paid	(84,014)	(16,738)
Net cash provided by (used in) financing activities	867,185	(447,903)
Net change in cash and cash equivalents	130,822	38,972
Cash and cash equivalents at beginning of period	6,653	5,661
Cash and cash equivalents at end of period	\$ 137,475	\$ 44,633

See accompanying notes to consolidated financial statements.

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**CAPSTEAD MORTGAGE CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2008**

(unaudited)

NOTE 1 BUSINESS

Capstead Mortgage Corporation operates as a self-managed real estate investment trust for federal income tax purposes (a REIT) and is based in Dallas, Texas. Unless the context otherwise indicates, Capstead Mortgage Corporation, together with its subsidiaries, is referred to as Capstead or the Company. Capstead earns income from investing in real estate-related assets on a leveraged basis. These investments currently consist primarily of a core portfolio of residential adjustable-rate mortgage (ARM) securities issued and guaranteed by government-sponsored entities, either Fannie Mae or Freddie Mac, or by an agency of the federal government, Ginnie Mae (collectively, Agency Securities).

NOTE 2 BASIS OF PRESENTATION

Interim Financial Reporting and Reclassifications

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the quarter and nine months ended September 30, 2008 are not necessarily indicative of the results that may be expected for the calendar year ending December 31, 2008. For further information refer to the consolidated financial statements and footnotes thereto incorporated by reference in the Company s annual report on Form 10-K for the year ended December 31, 2007. Certain prior year amounts have been reclassified to conform to the current year presentation.

Accounting for Seller-financed Acquisitions of Mortgage Securities

Capstead generally pledges its *Mortgage securities and similar investments* as collateral under repurchase arrangements and a portion of the Company s acquisitions may initially be financed with sellers. The Company records such assets and the related borrowings gross on its balance sheet, and the corresponding interest income and interest expense gross on its income statement. In addition, the asset is typically a security held available-for-sale, and any change in fair value of the asset is recorded as a component of *Accumulated other comprehensive income*. In February 2008 the Financial Accounting Standards Board (FASB) issued Staff Position 140-3 Accounting for Transfers of Financial Assets and Repurchase Financing Transactions (FSP140-3). Under FSP140-3, certain seller-financed acquisitions entered into after December 31, 2008 will not qualify as acquisitions if the related financing is considered sufficiently linked to the acquisition transaction. Any such seller-financed acquisitions that are deemed to be sufficiently linked will be reported net of related financings at fair value with related changes in fair value reported in earnings until such time as the assets are no longer financed with the sellers. Because such linkage does not exist for the Company s typical acquisition transactions and related financings, management does not believe implementing FSP140-3 will have a material effect on Capstead s results of operations, taxable income or financial condition. Also, it is not expected to affect the Company s status as a REIT or cause it to fail to qualify for its exemption under Investment Company Act of 1940 which requires that the Company must, among other things, maintain at least 55% of its assets directly in qualifying real estate interests.

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Accounting for Variable Interests

The FASB recently issued an exposure draft that would amend FASB Interpretation No. 46(R) "*Consolidation of Variable Interest Entities*" (FIN46(R)), to address concerns raised about FIN46(R)'s complexity and reliance on quantitative analyses and to require a greater scope of entities to be evaluated for consolidation using FIN46(R)'s provisions. The potential amendments, which would be effective for fiscal years beginning after November 15, 2009, would require an enterprise (including its related party and de facto agents) to determine whether it is the primary beneficiary of an entity primarily through a qualitative assessment, considering if it has both the power to direct matters that significantly affect the entity and the right to receive potentially significant benefits or the obligation to absorb potentially significant losses of the entity. The proposed amendment is not expected to have a material impact on the Company.

Fair Value Measurements

In September 2006 the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (SFAS157). SFAS157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. SFAS157's valuation techniques are based on observable and unobservable inputs. Observable inputs reflect readily obtainable data from independent sources, while unobservable inputs are internally derived, reflecting what the reporting entity believes to be market assumptions. SFAS157 classifies these inputs into the following hierarchy:

Level One Inputs Quoted prices for identical instruments in active markets.

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

Level Three Inputs Instruments with primarily unobservable value drivers.

In February 2007 the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115* (SFAS159). This statement permits, but does not require, entities to measure many financial instruments, including liabilities and certain other items, at fair value with resulting changes in fair value reported in earnings. In adopting SFAS157 and SFAS159 on January 1, 2008, the Company determined that it was not necessary to make any substantive changes to its valuation practices and that currently it will not report changes in fair value of any of its financial assets or liabilities in earnings as allowed under SFAS159. Therefore, the adoption of these standards did not have any impact on the Company's consolidated financial statements.

The Company's holdings of mortgage securities, nearly all of which are classified as held available-for-sale, are measured at fair value on a recurring basis using Level Two Inputs. See NOTE 10 for a discussion of fair value methodology utilized and other related fair value disclosures. The Company's interest rate swap agreements are also measured at fair value on a recurring basis primarily using Level Two Inputs that utilize the standard methodology of netting the discounted future fixed cash payments and the discounted expected variable cash receipts based on expected future interest rates derived from observable market interest rate curves. The Company also incorporates both its own nonperformance risk and its counterparties' nonperformance risk in determining the fair value of its interest rate swap agreements. In considering the effect of nonperformance risk, the Company considered the impact of netting and credit enhancements, such as collateral postings and guarantees, and has concluded that counterparty risk is not significant to the overall valuation of these agreements. See NOTE 6 for additional fair value disclosures related to these agreements.

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Basic earnings (loss) per common share is computed by dividing net income (loss), after deducting preferred share dividends, by the weighted average number of common shares outstanding. Diluted earnings (loss) per common share is computed by dividing net income (loss), after deducting dividends on convertible preferred shares when such shares are antidilutive, by the weighted average number of common shares and common share equivalents outstanding, giving effect to equity awards and convertible preferred shares, when such awards and shares are dilutive. For calculation purposes the Series A and B preferred shares are considered dilutive whenever basic earnings per common share exceeds each Series dividend divided by the conversion rate applicable for that period. Components of the computation of basic and diluted earnings (loss) per common share were as follows (in thousands, except per share amounts):

	<i>Quarter Ended</i> <i>September 30</i>		<i>Nine Months Ended</i> <i>September 30</i>	
	<i>2008</i>	<i>2007</i>	<i>2008</i>	<i>2007</i>
Numerators for basic earnings (loss) per common share:				
Net income (loss)	\$ 34,746	\$ (3,148)	\$ 101,621	\$ 8,853
Less Series A and B preferred share dividends	(5,062)	(5,064)	(15,189)	(15,192)
Income available (loss attributable) to common stockholders	\$ 29,684	\$ (8,212)	\$ 86,432	\$ (6,339)
Weighted average common shares outstanding	56,318	19,108	51,991	19,017
Basic earnings (loss) per common share	\$ 0.53	\$ (0.43)	\$ 1.66	\$ (0.33)
Numerators for diluted earnings (loss) per common share:				
Net income (loss)	\$ 34,746	\$ (3,148)	\$ 101,621	\$ 8,853
Less dividends on antidilutive convertible preferred shares		(5,064)		(15,192)
Income available (loss attributable) to common stockholders	\$ 34,746	\$ (8,212)	\$ 101,621	\$ (6,339)
Denominator for diluted earnings (loss) per common share:				
Weighted average common shares outstanding	56,318	19,108	51,991	19,017
Net effect of dilutive equity awards	192		316	
Net effect of dilutive convertible preferred shares	9,842		9,830	
	66,352	19,108	62,137	19,017
Diluted earnings (loss) per common share	\$ 0.52	\$ (0.43)	\$ 1.64	\$ (0.33)

Potentially dilutive securities excluded from the calculation of diluted earnings (loss) per common share were as follows (in thousands):

	<i>Quarter Ended September 30</i>		<i>Nine Months Ended September 30</i>	
	<i>2008</i>	<i>2007</i>	<i>2008</i>	<i>2007</i>
Equity awards:				
Shares issuable under option awards	40	1,020	10	1,020
Nonvested stock awards	148	281		281
Convertible preferred shares:				
Series A shares		202		202
Series B shares		15,819		15,819

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Mortgage securities and similar investments and related weighted average rates classified by collateral type and interest rate characteristics were as follows (dollars in thousands):

	<i>Principal Balance</i>	<i>Investment Premiums (Discounts)</i>	<i>Basis</i>	<i>Carrying Amount ^(a)</i>	<i>Net WAC ^(b)</i>	<i>Average Yield ^(b)</i>
September 30, 2008						
Agency Securities:						
Fannie Mae/Freddie Mac:						
Fixed-rate	\$ 10,762	\$ 29	\$ 10,791	\$ 10,812	6.65%	6.50%
ARMs	7,331,953	98,264	7,430,217	7,445,344	5.48	4.97
Ginnie Mae ARMs	411,779	2,117	413,896	416,635	5.21	5.04
	7,754,494	100,410	7,854,904	7,872,791	5.47	4.98
Residential mortgage loans:						
Fixed-rate	6,028	(8)	6,020	6,020	7.14	6.89
ARMs	9,176	80	9,256	9,256	5.87	5.79
	15,204	72	15,276	15,276	6.37	6.23
Commercial real estate loans:						
Collateral for structured financings	43,233	(12)	43,221	43,221	8.12	9.48
	4,746	78	4,824	4,824	8.11	7.82
	\$ 7,817,677	\$ 100,548	\$ 7,918,225	\$ 7,936,112	5.49	5.00
December 31, 2007						
Agency Securities:						
Fannie Mae/Freddie Mac:						
Fixed-rate	\$ 13,079	\$ 36	\$ 13,115	\$ 13,138	6.63%	6.43%
ARMs	6,382,773	89,017	6,471,790	6,507,447	6.36	5.78
Ginnie Mae ARMs	515,091	2,465	517,556	521,288	5.87	5.62
	6,910,943	91,518	7,002,461	7,041,873	6.33	5.77
Residential mortgage loans:						
Fixed-rate	7,412	(3)	7,409	7,409	7.05	7.14
ARMs	11,097	96	11,193	11,193	7.18	7.05
	18,509	93	18,602	18,602	7.13	7.08
	43,435	(439)	42,996	42,996	10.46	12.21

Commercial real estate loans						
Collateral for structured financings	5,162	86	5,248	5,248	8.14	8.07
	\$ 6,978,049	\$ 91,258	\$ 7,069,307	\$ 7,108,719	6.36	5.80

(a) *Includes mark-to-market for securities classified as available-for-sale, if applicable (see NOTE 10).*

(b) *Net WACs, or weighted average coupons, net of servicing and other fees, are presented as of the indicated balance sheet date. Average Yields are presented for the quarter then ended calculated including the amortization of investment premiums and excluding unrealized gains and losses.*

Agency Securities carry an implied AAA rating and therefore limited credit risk. Residential mortgage loans held by the Company were previously collateral underlying private residential mortgage pass-through securities formed before 1995 when Capstead operated a mortgage conduit. These loans are now carried as whole loans on the Company's balance sheet with the related credit risk borne by the Company. Commercial real estate loans are subordinate loans that carry credit risk associated with specific commercial real estate collateral. Collateral for structured financings consists of private residential mortgage pass-through securities pledged to secure these securitizations. The related credit risk is borne by bondholders of the securitization to which the collateral is pledged. The maturity of mortgage securities is directly affected by the rate of principal prepayments on the underlying mortgage loans.

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Fixed-rate investments are either residential mortgage loans or Agency Securities backed by mortgage loans with fixed rates of interest. Adjustable-rate investments generally are ARM Agency Securities backed by residential mortgage loans that have coupon interest rates that adjust at least annually to more current interest rates or begin doing so after an initial fixed-rate period. After the initial fixed-rate period, if applicable, mortgage loans underlying ARM securities either (i) adjust annually based on specified margins over the one-year Constant Maturity U.S. Treasury Note Rate (CMT) or the one-year London interbank offered rate (LIBOR), (ii) adjust semiannually based on specified margins over six-month LIBOR, or (iii) adjust monthly based on specified margins over indexes such as one-month LIBOR or the Eleventh District Federal Reserve Bank Cost of Funds Index, or over a rolling twelve month average of the one-year CMT index, usually subject to periodic and lifetime limits on the amount of such adjustments during any single interest rate adjustment period and over the contractual term of the loans.

Commercial real estate loans consist of (a) \$4.8 million in subordinated loans accruing interest at 18% and scheduled to pay off over the next nine months through townhome and land sales, pursuant to an extension entered into in September 2008, and (b) \$38.4 million in subordinated loans accruing interest at a margin over one-month LIBOR on a luxury hotel property in the Caribbean that matured October 9, 2008. A pre-workout letter reserving all rights of the lending group was executed prior to maturity to allow additional time to reach a resolution for the financing of this property.

NOTE 5 INVESTMENTS IN UNCONSOLIDATED AFFILIATES

To facilitate the issuance of *Unsecured borrowings*, in September and December 2005 and in September 2006 Capstead formed and capitalized a series of three Delaware statutory trusts through the issuance to the Company of the trusts' common securities totaling \$3.1 million (see NOTE 7). The Company's equity in the earnings of the trusts consists solely of the common trust securities' pro rata share in interest accruing on *Unsecured borrowings* issued to the trusts.

NOTE 6 REPURCHASE ARRANGEMENTS AND SIMILAR BORROWINGS, INCLUDING RELATED HEDGING ACTIVITY

Repurchase arrangements and similar borrowings, classified by type of collateral and maturities, and related weighted average interest rates were as follows (dollars in thousands):

<i>Collateral Type</i>	<i>September 30, 2008</i>		<i>December 31, 2007</i>	
	<i>Borrowings Outstanding</i>	<i>Average Rate*</i>	<i>Borrowings Outstanding</i>	<i>Average Rate*</i>
Borrowings with maturities of 30 days or less:				
Agency Securities	\$ 5,694,868	3.25%	\$ 4,963,674	4.93%
Residential mortgage loans			14,352	6.12
	5,694,868	3.25	4,978,026	4.93
Borrowings with maturities greater than 30 days:				
Agency Securities (31 to 90 days)	415,736	4.09		
Agency Securities (91 to 360 days)	1,127,420	5.05	368,694	4.92
Agency Securities (greater than 360 days)			1,127,420	5.05
	1,543,156	4.79	1,496,114	5.02
Similar borrowings:				
Commercial real estate loans			20,974	6.88
Collateral for structured financings	4,824	8.11	5,248	8.14
	\$ 7,242,848	3.58	\$ 6,500,362	4.96

* *Average Rate is presented as of the indicated balance sheet date and does not include the effects of interest rate swap agreements held as cash flow hedges on a designated portion of 30-day borrowings (see below). After giving effect to these cash flow hedges, the Average Rate was 3.75% at September 30, 2008.*

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Capstead generally pledges its *Mortgage securities and similar investments* as collateral under uncommitted repurchase arrangements with investment banking firms and commercial banks, the terms and conditions of which are negotiated on a transaction-by-transaction basis. Interest rates on these borrowings are generally based on a margin over the federal funds target rate or a corresponding interest rate for longer-term borrowings and amounts available to be borrowed are dependent upon the fair value of the securities pledged as collateral, which fluctuates with changes in interest rates, credit quality and liquidity conditions within the investment banking, mortgage finance and real estate industries. In response to declines in fair value of pledged securities, lenders may require the Company to post additional collateral or pay down borrowings to re-establish agreed upon collateral requirements, referred to as margin calls. The commercial real estate loan borrowing, which matured on August 9, 2008, accrued interest at a margin over one-month LIBOR. The maturity of outstanding structured financings is directly affected by the rate of principal prepayments on the related mortgage pass-through securities pledged as collateral and are currently subject to redemption by the residual bondholders.

Prior to changes in credit market conditions during the fall of 2007, Capstead made use of longer-dated repurchase arrangements to effectively lock in financing spreads on a portion of its investments in longer-to-reset ARM Agency Securities for a significant portion of the fixed-rate terms of these investments. As of September 30, 2008, these longer-term committed borrowings consisted of a series of repurchase arrangements totaling \$1.41 billion with remaining terms of from two to 11 months, an average maturity of seven months and an average interest rate of 5.01%. Capstead had \$82 million of its capital at risk with its largest single counterparty (Cantor Fitzgerald & Company) related to \$1.33 billion of these borrowings. Late in 2007 the Company began using two-year term, one- and three-month LIBOR-indexed, pay-fixed, receive-variable, interest rate swap agreements for this purpose. As of September 30, 2008 the Company's swap position consisted of 15 swap agreements with an aggregate notional amount of \$1.90 billion, an average remaining term of 16 months and an average fixed-rate of 3.44%. The interest rate swap agreements have been designated as cash flow hedges of the variability of the underlying benchmark interest rate of certain current and forecasted 30-day repurchase arrangements. This hedge relationship in effect establishes a relatively stable fixed borrowing rate on the designated borrowings with the variable-rate payments to be received on the swap agreements generally offsetting interest accruing on the designated borrowings that reset monthly to market rates, leaving the fixed-rate payments to be paid on the swap agreements as the Company's effective borrowing rate, subject to certain adjustments.

As of September 30, 2008, an asset for \$5.2 million and a liability for \$8.9 million were recorded on the Company's balance sheet representing the fair value of the swap agreements at quarter-end. Included in *Other revenue* is a holding gain of \$81,000 realized prior to designating one of these agreements as a cash flow hedge during the first quarter of 2008 and included in *Accumulated other comprehensive income* at September 30, 2008 is a net unrealized loss of \$3.9 million that arose while the swap agreements were designated as cash flow hedges. In March 2008 a \$100 million notional amount swap agreement was terminated for a realized loss of \$2.3 million, which is being amortized to earnings over the remaining 15 month term of the derivative (the related amortized balance in *Accumulated other comprehensive income* was \$1.6 million as of September 30, 2008). During the quarter and nine months ended September 30, 2008 the effect of the Company's hedging program utilizing swap agreements was an increase in *Interest expense* of \$4.2 million and \$6.8 million, respectively, consisting of net accrued cash outflows of \$3.8 million and \$6.2 million, respectively, measured hedge ineffectiveness of \$24,000 and \$19,000, respectively, and includes amortization of the terminated swap agreement of \$342,000 and \$591,000, respectively.

The weighted average effective interest rate on *Repurchase arrangements and similar borrowings* was 3.26% for third quarter 2008 including the effects of the swap agreements. The weighted average maturity of these borrowings was 2.0 months at September 30, 2008, with an average effective repricing period of 4.9 months including the effects of the interest rate swap agreements.

Table of Contents**NOTE 7 UNSECURED BORROWINGS**

Unsecured borrowings consist of 30-year junior subordinated notes issued in September 2005, December 2005 and September 2006 by Capstead to Capstead Mortgage Trust I, Trust II and Trust III, respectively. These unconsolidated affiliates of the Company were formed to issue \$3.1 million of the trusts' common securities to Capstead and to privately place \$100 million of preferred securities with unrelated third party investors. Included in *Receivables and other assets* are \$2.7 million in remaining issue costs associated with these transactions. Note balances and related weighted average interest rates as of September 30, 2008 and December 31, 2007 (calculated including issue cost amortization) were as follows (dollars in thousands):

	<i>Borrowings Outstanding</i>	<i>Average Rate</i>
Junior subordinated notes:		
Capstead Mortgage Trust I	\$ 36,083	8.31%
Capstead Mortgage Trust II	41,238	8.46
Capstead Mortgage Trust III	25,774	8.78
	\$ 103,095	8.49

The junior subordinated notes pay interest to the trusts quarterly calculated at fixed rates of 8.19% to 8.685% for ten years from issuance and subsequently at prevailing three-month LIBOR rates plus 3.30% to 3.50% for 20 years, reset quarterly. The trusts remit dividends pro rata to the common and preferred trust securities based on the same terms as the subordinated notes provided that payments on the trusts' common securities are subordinate to payments on the related preferred securities. The Capstead Mortgage Trust I notes and trust securities mature in October 2035 and are redeemable, in whole or in part, without penalty, at the Company's option anytime on or after October 30, 2010. The Capstead Mortgage Trust II notes and trust securities mature in December 2035 and are redeemable, in whole or in part, without penalty, at the Company's option anytime on or after December 15, 2015. The Capstead Mortgage Trust III notes and trust securities mature in September 2036 and are redeemable, in whole or in part, without penalty, at the Company's option anytime on or after September 15, 2016. The weighted average effective interest rate for *Unsecured borrowings* (calculated including issue cost amortization) was 8.49% during the quarter ended September 30, 2008.

NOTE 8 RECENT COMMON EQUITY RAISES

In February 2008 Capstead completed its third public offering since September 2007 raising \$126.7 million in new common equity capital, after underwriting discounts and offering expenses, through the issuance of 8.6 million common shares at a price of \$15.50 per share and during the nine months ended September 30, 2008. In addition, the Company raised \$107.0 million, after expenses, under its continuous offering program by issuing 8.6 million common shares at an average price of \$12.39 per share, including proceeds of \$25.2 million, after expenses, during the third quarter through the issuance of 2.2 million common shares at an average price of \$11.72 per share. Year-to-date, these issuances increased common equity capital by \$233.7 million. Subsequent to quarter-end and through the filing date of this report, the Company further increased its common equity capital by \$5.6 million, after expenses, through the issuance of 555,000 common shares at an average sales price of \$10.08 per share under the continuous offering program. The Company may raise more capital in future periods subject to market conditions and blackout periods associated with the dissemination of earnings and dividend announcements and other important company-specific news. The accompanying September 30, 2008 financial statements and related disclosures do not reflect the effects of shares issued subsequent to quarter-end.

Table of Contents**NOTE 9 COMPREHENSIVE INCOME (LOSS)**

Comprehensive income (loss) is net income (loss) plus other comprehensive loss. Other comprehensive loss currently consists of the change in unrealized gain on mortgage securities classified as available-for-sale and amounts related to derivative financial instruments held as cash flow hedges. As of September 30, 2008, the *Accumulated other comprehensive income* component of *Stockholders' equity* consisted of \$17.9 million in net unrealized gains on mortgage securities held available-for-sale, \$3.9 million in net unrealized losses on interest rate swap agreements held as cash flow hedges and a net unamortized balance of \$1.6 million associated with terminated cash flow hedges. The following provides information regarding the components of comprehensive income (loss) (in thousands):

	<i>Quarter Ended</i> <i>September 30</i>		<i>Nine Months Ended</i> <i>September 30</i>	
	<i>2008</i>	<i>2007</i>	<i>2008</i>	<i>2007</i>
Net income (loss)	\$ 34,746	\$ (3,148)	\$ 101,621	\$ 8,853
Other comprehensive income (loss):				
Amounts related to cash flow hedges:				
Change in net unrealized losses	(1,501)		(1,344)	
Early termination of interest rate swap agreement			(2,275)	
Reclassification adjustment for amounts included in net income (loss)	341	(8)	586	(31)
Amounts related to available-for-sale securities:				
Reclassification adjustments for amounts included in net income (loss)		5,941	1,408	5,941
Change in net unrealized gains	(23,440)	(11,803)	(22,933)	(9,694)
Other comprehensive loss	(24,600)	(5,870)	(24,558)	(3,784)
Comprehensive income (loss)	\$ 10,146	\$ (9,018)	\$ 77,063	\$ 5,069

NOTE 10 DISCLOSURES REGARDING FAIR VALUES OF MORTGAGE SECURITIES AND SIMILAR INVESTMENTS

Fair values of most of Capstead's *Mortgage securities and similar investments* are influenced by changes in, and market expectations for changes in, interest rates and market liquidity conditions, as well as other factors beyond the control of management. Fair values are estimated at each balance sheet date considering recent trading activity for similar investments and pricing levels indicated by lenders in connection with designating collateral for repurchase arrangements, provided such pricing levels are considered indicative of actual market clearing transactions. Currently, only investments in mortgage securities classified as available-for-sale are reported at fair value on the Company's balance sheet with unrealized gains and losses recorded as a component of *Accumulated other comprehensive income* in *Stockholders' equity*.

Fair value disclosures for investments classified as available-for-sale were as follows (in thousands):

	<i>Basis</i>	<i>Gross</i> <i>Unrealized</i> <i>Gains</i>	<i>Gross</i> <i>Unrealized</i> <i>Losses</i>	<i>Fair</i> <i>Value</i>
<i>As of September 30, 2008</i>				
Agency Securities	\$7,844,348	\$32,884	\$14,997	\$7,862,235
<i>As of December 31, 2007</i>				

Agency Securities	\$6,989,619	\$42,090	\$ 2,678	\$7,029,031
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Fair value disclosures for investments classified as held-to-maturity were as follows (in thousands):

	<i>Basis</i>	<i>Gross Unrealized Gains</i>	<i>Gross Unrealized Losses</i>	<i>Fair Value</i>
<i>As of September 30, 2008</i>				
Collateral released from structured financings (Agency Securities)	\$ 10,557	\$ 273	\$	\$ 10,830
Collateral for structured financings	4,824			4,824
	\$ 15,381	\$ 273	\$	\$ 15,654
<i>As of December 31, 2007</i>				
Collateral released from structured financings (Agency Securities)	\$ 12,842	\$ 340	\$	\$ 13,182
Collateral for structured financings	5,248			5,248
	\$ 18,090	\$ 340	\$	\$ 18,430

Disclosures for investments in an unrealized loss position were as follows (in thousands):

	<i>September 30, 2008</i>		<i>December 31, 2007</i>	
	<i>Fair Value</i>	<i>Unrealized Loss</i>	<i>Fair Value</i>	<i>Unrealized Loss</i>
Securities in an unrealized loss position:				
One year or greater	\$ 163,144	\$ 1,891	\$ 281,708	\$ 1,907
Less than one year	2,995,961	13,106	417,656	771
	\$ 3,159,105	\$ 14,997	\$ 699,364	\$ 2,678

Managing a leveraged portfolio of primarily ARM Agency Securities remains the core focus of Capstead's investment strategy and management expects these securities will be held to maturity absent a major shift in the Company's investment focus. By focusing on investing in relatively short-duration ARM Agency Securities, declines in fair value caused by increases in interest rates are typically modest compared to investments in longer-duration assets. These declines can be recovered in a relatively short period of time as the coupon interest rates on the underlying mortgage loans reset to rates more reflective of the then current interest rate environment or the mortgage loans prepay. Consequently, any such declines in value generally would not constitute other-than-temporary impairments in value necessitating impairment charges.

Over the last 15 months, deteriorating conditions in the overall credit markets have led to heightened concerns related to credit risk associated with the mortgage loans underlying Agency Securities and the continued availability of sufficient financing to maintain then existing leverage levels for the mortgage REIT industry. From a credit risk perspective, the real or implied federal government guarantee associated with Agency Securities, particularly in light of the recent conservatorship of Fannie Mae and Freddie Mac, helps ensure that fluctuations in value due to credit risk associated with the underlying mortgage loans will be limited. From a market liquidity perspective, Capstead has responded to contracting market liquidity since the fall of 2007 by reducing portfolio leverage (repurchase agreements and similar borrowings divided by long-term investment capital) through (a) raising \$439.7 million in new common equity capital, (b) selling a limited amount of mortgage securities in the fall of 2007 and again in March 2008, and

(c) when appropriate, curtailing the replacement of portfolio runoff. As a result of these efforts, the Company has lowered its portfolio leverage substantially, which together with maintaining higher than usual cash balances and expanding the number of lending counterparties with whom the Company routinely does business, has provided the Company with financial flexibility to address challenging credit market conditions. In March 2008 the Company sold Agency Securities with a cost basis of \$768.2 million recognizing a loss from portfolio restructuring totaling \$1.4 million (gross realized losses of \$2.7 million, net of gross realized gains of \$1.3 million). No investments were sold during the second and third quarters of 2008. Management believes it is appropriate to maintain the

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Company's leverage near the lower end of its targeted range of eight to 12 times long-term investment capital, which consists of *Stockholders' equity* and *Unsecured borrowings*, net of related investments in statutory trusts. However, should market conditions warrant, the Company will take actions similar to those demonstrated over the previous 15 months in order to maintain sufficient financial flexibility to address ongoing market stresses.

NOTE 11 LONG-TERM INCENTIVE AND OTHER PLANS

Capstead sponsors long-term incentive plans to provide for the issuance of stock awards, option awards and other incentive-based equity awards to directors and employees (collectively, the *Plans*). As of September 30, 2008, the Plans had 1,498,957 common shares remaining available for future issuance. The Company also sponsors a qualified defined contribution retirement plan for all employees and a nonqualified deferred compensation plan for certain of its officers. In general the Company matches up to 50% of a participant's voluntary contribution up to a maximum of 6% of a participant's compensation and discretionary contributions of up to another 3% of compensation regardless of participation in the plans. All Company contributions are subject to certain vesting requirements. Contribution expenses were \$42,000 and \$109,000 for the quarter and nine months ended September 30, 2008, respectively. In 2005 stock awards for a total of 172,600 common shares were issued to directors and employees (average grant date fair value: \$7.86 per share) that vest in four annual installments, subject to certain restrictions, including continuous service. In December 2006 stock awards for a total of 197,500 common shares were issued to employees (grant date fair value: \$8.19 per share) that vest in four annual installments beginning January 2, 2008, subject to similar restrictions. Also during 2006, stock awards for 21,457 common shares were issued to a new employee and certain directors (average grant date fair value: \$6.86 per share), 6,457 shares of which were vested at grant with the remaining shares vesting proportionally over three years, subject to similar restrictions. In 2007, stock awards totaling 6,000 common shares were issued to directors that vested April 15, 2008 (grant date fair value \$9.81). In December 2007, stock awards totaling 150,000 common shares were issued to employees that vest in six annual installments beginning January 2, 2009 (grant date fair value \$13.05) subject to similar restrictions. Stock award activity during the nine months ended September 30, 2008 is summarized below:

	<i>Number of Shares</i>	<i>Weighted Average Grant Date Fair Value</i>
Stock awards outstanding as of December 31, 2007	431,200	\$ 9.82
Grants*	6,000	12.87
Forfeitures	(3,875)	10.70
Vested	(94,851)	8.10
Stock awards outstanding as of September 30, 2008	338,474	10.35

* *In May 2008, stock awards totaling 6,000 common shares were issued to directors that vest April 15, 2009.*

Option awards currently outstanding have contractual terms and vesting requirements at the grant date of up to ten years and generally have been issued with strike prices equal to the quoted market prices of the Company's common shares on the date of grant. The fair value of each option award is estimated on the date of grant using a Black-Scholes

option pricing model. The Company estimates option exercises, expected holding periods and forfeitures based on past experience and current expectations for option performance and employee/director attrition. The risk-free rate is based on market rates for the expected life of the option. Expected dividends are based on historical experience and expectations for future performance. Expected volatility is based on historical experience.

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During 2005 option awards granted to directors and employees totaled 430,000 shares with an average price of \$7.85 and an average fair value of \$0.61 per share, which was determined using average expected terms of four years, volatility factors of 27%, dividend yields of 10% and risk-free rates of 3.76%. During 2006 option awards granted to directors and employees totaled 258,000 shares with an average price of \$7.43 and an average fair value of \$0.78 per share, which was determined using average expected terms of four years, volatility factors of 31%, dividend yields of 10% and risk-free rates of 4.91%. During 2007 option awards granted to directors and employees totaled 220,500 shares with an average price of \$10.46 and an average fair value of \$0.89 per share, which was determined using average expected terms of four years, volatility factors of 27%, dividend yields of 10% and risk-free rates of 4.60%. Option award activity during the nine months ended September 30, 2008 is summarized below:

	<i>Number of Shares</i>	<i>Weighted Average Exercise Price</i>
Option awards outstanding as of December 31, 2007	948,656	\$ 11.47
Grants (average fair value \$2.08)*	30,000	12.87
Forfeitures	(1,875)	10.06
Expirations	(133,224)	29.91
Exercises	(287,807)	7.62
Option awards outstanding as of September 30, 2008	555,750	9.12

* *Option awards granted during 2008 to directors were valued with average expected terms of four years, volatility factors of 50%, dividend yields of 12% and risk-free rates of 2.91%.*

The weighted average remaining contractual term, average exercise price and aggregate intrinsic value for the 215,875 exercisable option awards outstanding as of September 30, 2008 was eight years, \$8.94 and \$468,000, respectively. The total intrinsic value of option awards exercised during the nine months ended September 30, 2008 was \$2.8 million. No option awards were exercised during the third quarter of 2008. Unrecognized compensation costs for all unvested equity awards totaled \$3.0 million as of September 30, 2008, to be expensed over a weighted average period of two years.

In September 2008 Capstead implemented a performance-based compensation program that provides for cash payments equal to the per share dividend amount declared on the Company's common stock multiplied by a notional amount of non-vesting or phantom common shares for a predetermined term (DER grants). DER grants are not attached to any stock or option awards and only have the right to receive the same cash distributions as the Company's common stockholders are entitled to during the related term. In connection with implementing this program, initial grants totaling 225,000 phantom common shares with four-year terms beginning July 1, 2008 were made to certain

executive officers.

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The following summarizes interest income, interest expense and weighted average interest rates as restated for the reclassification of other interest income and interest expense on unsecured borrowings see NOTE 13 (dollars in thousands):

	<i>Quarter Ended September 30</i>				<i>Related Changes in</i>	
	<i>2008</i>		<i>2007</i>		<i>Average</i>	<i>Volume*</i>
	<i>Amount</i>	<i>Average Rate</i>	<i>Amount</i>	<i>Average Rate</i>	<i>Rate*</i>	
Interest income:						
Mortgage securities and similar investments	\$ 99,205	5.00%	\$ 74,949	5.67%	\$ (9,700)	\$ 33,956
Other	346	2.31	212	5.23	(172)	306
	99,551	4.98	75,161	5.67	(9,872)	34,262
Interest expense:						
Repurchase arrangements and similar borrowings	(60,032)	3.26	(66,478)	5.25	(29,751)	23,305
Unsecured borrowings	(2,186)	8.49	(2,186)	8.49		
	(62,218)	3.34	(68,664)	5.31	(29,751)	23,305
	\$ 37,333	1.64	\$ 6,497	0.36	\$ 19,879	\$ 10,957

	<i>Nine Months Ended September 30</i>				<i>Related Changes in</i>	
	<i>2008</i>		<i>2007</i>		<i>Average</i>	<i>Volume*</i>
	<i>Amount</i>	<i>Average Rate</i>	<i>Amount</i>	<i>Average Rate</i>	<i>Rate*</i>	
Interest income:						
Mortgage securities and similar investments	\$ 302,888	5.32%	\$ 222,886	5.58%	\$ (10,825)	\$ 90,827
Other	1,932	3.00	313	5.22	(187)	1,806
	304,820	5.30	223,199	5.58	(11,012)	92,633
Interest expense:						
Repurchase arrangements and similar borrowings	(184,357)	3.49	(197,174)	5.22	(76,310)	63,493
Unsecured borrowings	(6,560)	8.49	(6,560)	8.49		
	(190,917)	3.56	(203,734)	5.28	(76,310)	63,493
	\$ 113,903	1.74	\$ 19,465	0.30	\$ 65,298	\$ 29,140

* *The change in interest income and interest expense due to both volume and rate has been allocated to volume and rate changes in proportion to the relationship of the absolute dollar amounts of the change in each.*

NOTE 13 RESTATEMENT TO RECLASSIFY INTEREST INCOME, INTEREST EXPENSE AND OTHER INCOME (EXPENSE)

After receiving a request from the Securities and Exchange Commission in a comment letter dated December 18, 2008, management concluded that the Company's previously filed consolidated statements of operations for the three years ending December 31, 2007 and for the periods included in its Forms 10-Q filed in 2008, should be reclassified and restated to include interest expense from unsecured borrowings with interest expense from repurchase arrangements and similar borrowings in arriving at net interest margin rather than including interest expense from unsecured borrowings within *Other revenue (expense)*. Accordingly, the consolidated statements of operations for these periods have been restated to reflect interest income from all sources under the caption *Interest income* and interest expense from all sources under the caption *Interest expense*. The resulting net interest margin subtotal no longer provides readers of the Company's consolidated financial statements with solely the net interest margin earned on its portfolio of *Mortgage securities and similar investments* after directly-related secured borrowings, but a more all-inclusive measure of net interest margin that includes interest income earned on overnight cash investments and cash margin balances and interest costs associated with the unsecured borrowings.

The reclassifications contained in these restatements do not change the Company's previously reported net income, earnings per share or stockholders' equity for any of the periods presented. In addition, the restatements do not impact the Company's consolidated balance sheets, statements of stockholders' equity or cash flows for these periods.

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

Explanatory Note See NOTE 13 to the consolidated financial statements for an explanation of the reclassifying restatement of interest income, interest expense and other revenue (expense) reflected throughout this filing.

FINANCIAL CONDITION

Overview

Capstead Mortgage Corporation (together with its subsidiaries, Capstead or the Company) operates as a self-managed real estate investment trust for federal income tax purposes (a REIT) and is based in Dallas, Texas. Capstead earns income from investing its long-term investment capital in real estate-related assets on a leveraged basis. Capstead's core investment strategy is to conservatively manage a leveraged portfolio of residential adjustable-rate mortgage (ARM) securities issued and guaranteed by government-sponsored entities, either Fannie Mae or Freddie Mac, or by an agency of the federal government, Ginnie Mae (collectively, Agency Securities). Agency Securities carry an implied AAA rating with limited, if any, credit risk. Management believes this strategy can produce attractive risk-adjusted returns over the long term while virtually eliminating credit risk and reducing, but not eliminating, sensitivity to changes in interest rates.

Capstead increased its long-term investment capital by 31% during the nine months ended September 30, 2008 to \$866 million by raising nearly \$234 million in new common equity capital through an underwritten public offering that closed in February 2008 and through its continuous offering program. As a result of these common equity raises, book value per common share increased by \$0.77 to \$10.02 per common share during this period. The Company's long-term investment capital consists of common stockholders' equity together with \$179 million of perpetual preferred stockholders' equity (recorded amount) and \$100 million of long-term unsecured borrowings (net of related investments in statutory trusts). Subsequent to quarter-end, the Company raised an additional \$6 million in new common equity capital under its continuous offering program.

Over the last 15 months, deteriorating conditions in the overall credit markets have led to heightened concerns related to credit risk associated with the mortgage loans underlying Agency Securities and the continued availability of sufficient financing to maintain then existing leverage levels for the mortgage REIT industry. From a credit risk perspective, the real or implied federal government guarantee associated with Agency Securities, particularly in light of the recent conservatorship of Fannie Mae and Freddie Mac, helps ensure that fluctuations in value due to credit risk associated with the underlying mortgage loans will be limited. From a market liquidity perspective, Capstead has responded to contracting market liquidity since the fall of 2007 by reducing portfolio leverage (repurchase agreements and similar borrowings divided by long-term investment capital) through (a) raising nearly \$440 million in new common equity capital, (b) selling a limited amount of mortgage securities in the fall of 2007 and again in March 2008 (none during the second and third quarters of 2008), and (c) when appropriate, curtailing the replacement of portfolio runoff. As a result of these efforts, the Company has lowered its portfolio leverage substantially, which together with maintaining higher than usual cash balances and expanding the number of lending counterparties with whom the Company routinely does business, has provided the Company with financial flexibility to address challenging credit market conditions. Management believes it is appropriate to maintain the Company's leverage near the lower end of its targeted range of eight to 12 times long-term investment capital. However, should market conditions warrant, the Company will take actions similar to those demonstrated over the previous 15 months in order to maintain sufficient financial flexibility to a