

Invesco Mortgage Capital Inc.  
Form 10-K  
February 21, 2017

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended December 31, 2016

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 001-34385  
(Exact name of registrant as specified in its charter)

Maryland 26-2749336  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification No.)

1555 Peachtree Street, N.E., Suite 1800 30309  
Atlanta, Georgia (Address of principal executive offices) (Zip Code)  
(404) 892-0896  
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Securities Exchange Act of 1934:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, par value \$0.01 per share	New York Stock Exchange
7.75% Series A Cumulative Redeemable Preferred Stock	New York Stock Exchange
7.75% Fixed-to-Floating Series B Cumulative Redeemable Preferred Stock	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Securities Exchange Act of 1934: None

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, 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  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy

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or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 (check one):

Large accelerated filer  Accelerated filer

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 Act). Yes  No

The aggregate market value of the registrant's common stock held by non-affiliates was \$1,526,549,106 based on the closing sales price on the New York Stock Exchange on June 30, 2016. As of February 16, 2017, there were 111,594,595 outstanding shares of common stock of Invesco Mortgage Capital Inc.

Documents Incorporated by Reference

Part III of this Form 10-K incorporates by reference certain information (solely to the extent explicitly indicated) from the registrant's proxy statement for the 2017 Annual Meeting of Stockholders to be filed pursuant to Regulation 14A.

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### Forward-Looking Statements

We make forward-looking statements in this Report on Form 10-K (“Report”) and other filings we make with the Securities and Exchange Commission (“SEC”) within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), and such statements are intended to be covered by the safe harbor provided by the same. Forward-looking statements are subject to substantial risks and uncertainties, many of which are difficult to predict and are generally beyond our control. These forward-looking statements include information about possible or assumed future results of our business, investment strategies, financial condition, liquidity, results of operations, plans and objectives. When we use the words “believe,” “expect,” “anticipate,” “estimate,” “plan,” “continue,” “intend,” “should,” “may” or similar expressions and conditional verbs such as “will,” “may,” “could,” “should,” and “would,” and any other statement that necessarily depends on future events, we intend to identify forward-looking statements. Factors that could cause actual results to differ from those expressed in our forward-looking statements include, but are not limited to:

- our business and investment strategy;
- our investment portfolio;
- our projected operating results;
- general volatility of financial markets and effects of governmental responses, including actions and initiatives of the U.S. governmental agencies and changes to U.S. government policies, including the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”), mortgage loan modification programs, actions and initiatives of foreign governmental agencies and central banks, monetary policy actions of the Federal Reserve, including actions relating to its agency mortgage-backed securities portfolio and the continuation of re-investment of principal payments, and our ability to respond to and comply with such actions, initiatives and changes;
- the availability of financing sources, including our ability to obtain additional financing arrangements and the terms of such arrangements;
- financing and advance rates for our target assets;
- changes to our expected leverage;
- our expected investments;
- our expected book value per share of common stock;
- interest rate mismatches between our target assets and our borrowings used to fund such investments;
- the adequacy of our cash flow from operations and borrowings to meet our short-term liquidity needs;
- our ability to maintain sufficient liquidity to meet any margin calls;
- changes in the credit rating of the U.S. government;
- changes in interest rates and interest rate spreads and the market value of our target assets;
- changes in prepayment rates on our target assets;
- the impact of any deficiencies in foreclosure practices of third parties and related uncertainty in the timing of collateral disposition;
- our reliance on third parties in connection with services related to our target assets;
- effects of hedging instruments on our target assets;
- rates of default or decreased recovery rates on our target assets;
- modifications to whole loans or loans underlying securities;
- the degree to which our hedging strategies may or may not protect us from interest rate and foreign currency exchange rate volatility;
  - the degree to which derivative contracts expose us to contingent liabilities;
- counterparty defaults;
- compliance with financial covenants in our financing arrangements;
- changes in governmental regulations, zoning, insurance, eminent domain and tax laws and rates, and similar matters and our ability to respond to such changes;



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our ability to maintain our qualification as a real estate investment trust for U.S. federal income tax purposes;

our ability to maintain our exception from the definition of “investment company” under the Investment Company Act of 1940, as amended (the “1940 Act”);

availability of investment opportunities in mortgage-related, real estate-related and other securities;

availability of U.S. Government Agency guarantees with regard to payments of principal and interest on securities;

the market price and trading volume of our capital stock;

availability of qualified personnel of our Manager;

the relationship with our Manager;

estimates relating to taxable income and our ability to continue to make distributions to our stockholders in the future;

estimates relating to fair value of our target assets and loan loss reserves;

our understanding of our competition;

changes to generally accepted accounting principles in the United States of America (“U.S. GAAP”);

the adequacy of our disclosure controls and procedures and internal controls over financial reporting; and

market trends in our industry, interest rates, real estate values, 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 headings “Business”, “Risk Factors” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations”. 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 over time, and it is not possible 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.

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PART I

Item 1. Business.

Our Company

We are a Maryland corporation primarily focused on investing in, financing and managing residential and commercial mortgage-backed securities (“MBS”) and mortgage loans. Our objective is to provide attractive risk-adjusted returns to our investors, primarily through dividends and secondarily through capital appreciation. To achieve this objective, we primarily invest in the following:

Residential mortgage-backed securities (“RMBS”) that are guaranteed by a U.S. government agency such as the Government National Mortgage Association (“Ginnie Mae”) or a federally chartered corporation such as the Federal National Mortgage Association (“Fannie Mae”) or the Federal Home Loan Mortgage Corporation (“Freddie Mac”) (collectively “Agency RMBS”);

RMBS that are not guaranteed by a U.S. government agency (“non-Agency RMBS”);

Credit risk transfer securities that are unsecured obligations issued by government-sponsored enterprises (“GSE CRT”);

Commercial mortgage-backed securities (“CMBS”);

Residential and commercial mortgage loans; and

Other real estate-related financing arrangements.

We were incorporated on June 5, 2008 and commenced operations in 2009. We have elected to be taxed as a real estate investment trust (“REIT”) for U.S. federal income tax purposes under the provisions of the Internal Revenue Code of 1986. To maintain our REIT qualification, we are generally required to distribute at least 90% of our REIT taxable income to our stockholders annually. We operate our business in a manner that permits our exclusion from the definition of an “Investment Company” under the 1940 Act.

Capital Activities

During the three months ended December 31, 2016, we did not repurchase any shares of our common stock. During the year ended December 31, 2016, we repurchased 2,063,451 shares of our common stock at an average repurchase price of \$12.12 per share for a net cost of \$25.0 million, including acquisition expenses. As of December 31, 2016, we had authority to purchase 18,239,082 shares of our common stock through our share repurchase program.

Our Manager

We are externally managed and advised by Invesco Advisers, Inc., our Manager, which is an indirect, wholly-owned subsidiary of Invesco Ltd. (“Invesco”). Our Manager provides us with our management team, including our officers and appropriate support personnel. Each of our officers is an employee of our Manager or one of its affiliates. We do not have any employees. Our Manager is not obligated to dedicate any of its employees exclusively to us, and our Manager and its employees are not obligated to dedicate any specific portion of time to our business. Our Manager is at all times subject to the supervision and oversight of our Board of Directors and has only such functions and authority as we delegate to it. Refer to “Certain Relationships and Related Transactions, and Director Independence” for a discussion of our management fee and our relationship with our Manager.

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### Our Competitive Advantages

We believe that our competitive advantages include the following:

#### Significant Experience of Our Senior Management and Our Manager

Our senior management and structured investments team of our Manager has a long track record and broad experience in managing residential and commercial mortgage-related assets through a variety of credit and interest rate environments and has demonstrated the ability to generate attractive risk-adjusted returns under different market conditions and cycles. In addition, we benefit from the insight and capabilities of Invesco's real estate team, through which we have access to broad and deep teams of experienced investment professionals in real estate and distressed investing. Through these teams, we have real time access to research and data on the mortgage and real estate industries. We believe having in-house access to these resources and expertise provides us with a competitive advantage over other companies investing in our target assets who have less internal resources and expertise.

#### Extensive Strategic Relationships and Experience of our Manager and its Affiliates

Our Manager maintains extensive long-term relationships with other financial intermediaries, including primary dealers, leading investment banks, brokerage firms, leading mortgage originators and commercial banks. We believe these relationships enhance our ability to source, finance and hedge investment opportunities and, thus, will enable us to grow in various credit and interest rate environments.

#### Disciplined Investment Approach

We seek to maximize our risk-adjusted returns through our disciplined investment approach, which relies on rigorous quantitative and qualitative analysis. Our Manager monitors our overall portfolio risk and evaluates the characteristics of our investments in our target assets including, but not limited to, asset type, interest rate, interest rate type, loan balance distribution, geographic concentration, property type, occupancy, loan-to-value ratio and credit score. In addition, with respect to any particular target asset, our Manager's investment team evaluates, among other things, relative valuation, supply and demand trends, shape of yield curves, prepayment rates, loan delinquencies, default rates and loss severity rates. We believe this strategy and our commitment to capital preservation provide us with a competitive advantage when operating in a variety of market conditions.

#### Access to Our Manager's Sophisticated Analytical Tools, Infrastructure and Expertise

Our Manager has created and maintains analytical and portfolio management capabilities to aid in asset selection and risk management. We capitalize on the market knowledge and ready access to data across our target markets that our Manager and its affiliates obtain through their established platforms. We focus on in-depth analysis of the numerous factors that influence our target assets, including: (1) fundamental market and sector review; (2) rigorous cash flow analysis; (3) disciplined asset selection; (4) controlled risk exposure; and (5) prudent balance sheet management.

Through the use of these tools, we analyze factors that affect the rate at which mortgage prepayments occur, including changes in the level of interest rates, trends in residential and commercial real estate prices, general economic conditions, the locations of the properties securing the mortgage loans and other social and demographic conditions. We also benefit from our Manager's and its affiliates' comprehensive financial and administrative infrastructure, including its risk management, financial reporting, legal and compliance teams.

#### Investment Strategy

We invest in a diversified pool of mortgage assets that generate attractive risk-adjusted returns. Our target assets generally include Agency RMBS, non-Agency RMBS, GSE CRT, CMBS, residential and commercial mortgage loans and other real estate-related financing arrangements. In addition to direct purchases of our target assets, we also invest in ventures managed by an affiliate of our Manager, which, in turn, invest in our target assets. We accept varying levels of interest rate risk by managing our hedge portfolio and accept credit and spread risk in order to earn income.

#### Agency RMBS

Agency RMBS are residential mortgage-backed securities issued by a U.S. government agency such as Ginnie Mae, or a federally chartered corporation such as Fannie Mae or Freddie Mac that are secured by a collection of mortgages. Payments of principal and interest on Agency RMBS, not the market value of the securities themselves, are guaranteed by the issuer. Agency RMBS differ from other forms of traditional debt securities, which normally provide for periodic payments of interest in fixed amounts with principal payments at maturity or on specified call dates. Instead, Agency RMBS provide for monthly payments





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of both principal and interest. In effect, these payments are a “pass-through” of scheduled and unscheduled principal payments and the monthly interest payments made by the individual borrowers on the mortgage loans, net of any fees paid to the servicers, guarantors or other related parties of the securities.

The principal may be prepaid at any time due to prepayments or defaults on the underlying mortgage loans. These differences can result in significantly greater price and yield volatility than is the case with other fixed-income securities.

Various factors affect the rate at which mortgage prepayments occur, including changes in the level and directional trends in housing prices, interest rates, general economic conditions, the age of the mortgage loan, the location of the property, social and demographic conditions, government initiated refinance programs, legislative regulations, and industry capacity. Generally, prepayments on Agency RMBS increase during periods of falling mortgage interest rates and decrease during periods of rising mortgage interest rates. However, this may not always be the case. We may reinvest principal repayments at a yield that is higher or lower than the yield on the repaid investment, thus affecting our net interest income by altering the average yield on our assets.

In addition, when interest rates are declining, the value of Agency RMBS with prepayment options may not increase as much as other fixed income securities. The rate of prepayments on underlying mortgages will affect the price and volatility of Agency RMBS and may have the effect of shortening or extending the duration of the security beyond what was anticipated at the time of purchase. When interest rates rise, our holdings of Agency RMBS may experience reduced returns if the owners of the underlying mortgages pay off their mortgages slower than previously anticipated. This is generally referred to as extension risk.

Mortgage pass-through certificates, collateralized mortgage obligations (“CMOs”), Freddie Mac Gold Certificates, Fannie Mae Certificates and Ginnie Mae Certificates are types of Agency RMBS that are collateralized by either fixed-rate mortgage loans (“FRMs”), adjustable-rate mortgage loans (“ARMs”), or hybrid ARMs. FRMs have an interest rate that is fixed for the term of the loan and do not adjust. The interest rates on ARMs generally adjust annually (although some may adjust more frequently) to an increment over a specified interest rate index. Hybrid ARMs have interest rates that are fixed for a specified period of time (typically three, five, seven or ten years) and, thereafter, adjust to an increment over a specified interest rate index. ARMs and hybrid ARMs generally have periodic and lifetime constraints on how much the loan interest rate can change on any predetermined interest rate reset date. Our allocation of our Agency RMBS collateralized by FRMs, ARMs or hybrid ARMs will depend on various factors including, but not limited to, relative value, expected future prepayment trends, supply and demand, costs of hedging, costs of financing, expected future interest rate volatility and the overall shape of the U.S. Treasury and interest rate swap yield curves. We take these factors into account when we make investments.

### Non-Agency RMBS

Non-Agency RMBS are residential mortgage-backed securities that are not issued or guaranteed by a U.S. government agency. Like Agency RMBS, non-Agency RMBS represent interests in “pools” of mortgage loans secured by residential real property. The mortgage loan collateral for non-Agency RMBS generally consists of residential mortgage loans that do not conform to the U.S. government agency underwriting guidelines due to certain factors including mortgage balance in excess of such guidelines, borrower characteristics, loan characteristics and level of documentation. We invest in securities collateralized by the following types of mortgage loans:

#### Prime and Jumbo Prime Mortgage Loans

Prime mortgage loans are mortgage loans that generally require borrower credit histories, debt-to-income ratios and loan-to-value ratios similar to those dictated by GSE underwriting guidelines, though in certain cases they may not meet the same income documentation or other requirements. Jumbo prime mortgage loans are mortgage loans with requirements similar to prime mortgage loans except that the mortgage balance exceeds the maximum amount permitted by GSE underwriting guidelines.

#### Alt-A Mortgage Loans

Alt-A mortgage loans are mortgage loans made to borrowers whose qualifying mortgage characteristics do not conform to GSE underwriting guidelines, but whose borrower characteristics may. Generally, Alt-A mortgage loans allow homeowners to qualify for a mortgage loan with reduced or alternative forms of documentation. The credit quality of Alt-A borrowers generally exceeds the credit quality of subprime borrowers.

**Subprime Mortgage Loans**

Subprime mortgage loans are loans that do not conform to GSE underwriting guidelines. Subprime borrowers generally have imperfect or impaired credit histories and low credit scores.

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### Reperforming Mortgage Loans

Reperforming mortgage loans are residential mortgage loans that have a history of delinquency and generally have been restructured since origination. Repperforming mortgage loans may or may not have originally conformed to GSE underwriting guidelines. Due to past delinquencies, borrowers generally have impaired credit histories and low credit scores, and may have a greater than normal risk of future delinquencies and defaults.

We also invest in non-Agency RMBS structured as re-securitizations of a real estate mortgage investment conduit (“Re-REMIC”). A Re-REMIC is a transaction in which an existing security or securities is transferred to a special purpose entity that has formed a securitization vehicle that has issued multiple classes of securities secured by and payable from cash flows on the underlying securities.

### Government-Sponsored Enterprises Credit Risk Transfer Securities

GSE CRTs are unsecured general obligations of Fannie Mae and Freddie Mac that are structured to provide credit protection to the issuer with respect to defaults and other credit events within pools of residential mortgage loans that collateralize MBS issued and guaranteed by the GSEs. This credit protection is achieved by allowing the GSEs to reduce the outstanding class principal balance of the securities as designated credit events on the loans arise. The GSEs make monthly payments of accrued interest and periodic payments of principal to the holders of the securities. To date, all GSE CRTs have paid a floating interest rate benchmarked to one-month LIBOR.

### CMBS

CMBS are securities backed by obligations (including certificates of participation in obligations) that are principally secured by commercial mortgages on real property or interests therein having a multifamily or commercial use, such as regional malls, retail space, office buildings, industrial or warehouse properties, hotels, apartments, nursing homes and senior living facilities.

CMBS are typically issued in multiple tranches whereby the more senior classes are entitled to priority distributions to make specified interest and principal payments on such tranches. Losses and other shortfalls from expected amounts to be received on the mortgage pool are borne by the most subordinate classes, which receive payments only after the more senior classes have received all principal and/or interest to which they are entitled. The credit quality of CMBS depends on the credit quality of the underlying mortgage loans, which is a function of factors such as the principal amount of loans relative to the value of the related properties, the mortgage loan terms, such as amortization, market assessment and geographic location, construction quality of the property, and the creditworthiness of the borrowers.

### Commercial Mortgage Loans

Commercial mortgage loans are mortgage loans secured by first or second liens on commercial properties such as regional malls, retail space, office buildings, industrial or warehouse properties, hotels, apartments, nursing homes and senior living facilities. These loans, which tend to range in term from two to ten years, can carry either fixed or floating interest rates. They generally permit pre-payments before final maturity but may require the payment to the lender of yield maintenance pre-payment penalties. First lien loans represent the senior lien on a property while second lien loans or second mortgages represent a subordinate or second lien on a property.

### Mezzanine Loans

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

### Unconsolidated Ventures

We have investments in unconsolidated ventures. In circumstances where we have a non-controlling interest but we are deemed to be able to exert significant influence over the affairs of the enterprise, we utilize the equity method of accounting.



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Under the equity method of accounting, the initial investment is increased each period for additional capital contributions and a proportionate share of the entity's earnings and decreased for cash distributions and a proportionate share of the entity's losses.

### Financing Strategy

We generally finance our investments through short- and long-term borrowings structured as repurchase agreements and secured loans. We have historically financed our residential loans held-for-investment through asset-backed securities issued by consolidated securitization trusts. We have also financed investments through the issuances of debt and equity, and may utilize other forms of financing in the future.

### Repurchase Agreements

Repurchase agreements are financings pursuant to which we sell our target assets to the repurchase agreement counterparty, the buyer, for an agreed upon price with the obligation to repurchase these assets from the buyer at a future date and at a price higher than the original purchase price. The amount of financing we receive under a repurchase agreement is limited to a specified percentage of the estimated market value of the assets we sell to the buyer. The difference between the sale price and repurchase price is the cost, or interest expense, of financing under a repurchase agreement. Under repurchase agreement financing arrangements, certain buyers require us to provide additional cash collateral in the event the market value of the asset declines to maintain the ratio of value of the collateral to the amount of borrowing.

### Secured Loans

Our wholly-owned subsidiary, IAS Services LLC, is a member of the Federal Home Loan Bank of Indianapolis ("FHLBI"). As a member of the FHLBI, IAS Services LLC has borrowed funds from the FHLBI in the form of secured advances. FHLBI advances are treated as secured financing transactions and are carried at their contractual amounts. The Federal Housing Finance Agency's ("FHFA") final rule governing Federal Home Loan Bank membership (the "FHFA Rule") became effective on February 19, 2016. The FHFA Rule, among other provisions, excludes captive insurance companies from membership eligibility. The FHFA Rule permits existing captive insurance companies, such as IAS Services LLC, to remain members until February 2021. New advances or renewals that mature after February 2021 are prohibited. As permitted by the FHFA Rule, the FHLBI has indicated it will honor the contractual maturity dates of existing advances to IAS Services LLC that were made prior to the effective date of the final FHFA Rule and extend beyond February 2021.

### Leverage

We use leverage on our target assets to achieve our return objectives, which are adjusted as our investment and financing opportunities change. The amount of leverage we apply to a given asset depends primarily on the expected price volatility and liquidity of the asset we use as collateral, the type of financing, the advance rate against our collateral, and the cost of financing. Shorter duration and higher quality liquid assets generally merit higher leverage due to lower price volatility, higher advance rates, and more attractive financing rates. Assets that are less liquid or exhibit higher price volatility tend to be held unlevered or with lower leverage applied.

We include a table that shows the allocation of our equity to our target assets, our debt-to-equity ratio, and our repurchase agreement debt-to-equity ratio (a non-GAAP financial measure of leverage) in Item 7, "Management's Discussion and Analysis of Operations" of this Report.

### Risk Management Strategy

#### Market Risk Management

Risk management is an integral component of our strategy to deliver returns to our stockholders. Because we invest in MBS, investment losses from prepayment, interest rate volatility or other risks can meaningfully impact our earnings and our distributions to stockholders. In addition, because we employ financial leverage in funding our investment portfolio, mismatches in the maturities of our assets and liabilities can create the need to continually renew or otherwise refinance our liabilities. Our results are dependent upon a positive spread between the returns on our asset portfolio and our overall cost of funding. To minimize the risks to our portfolio, we actively employ portfolio-wide and security-specific risk measurement and management processes in our daily operations. Our Manager's risk management tools include software and services licensed or purchased from third parties, in addition to proprietary software and analytical methods developed by Invesco.

Interest Rate Risk

We engage in a variety of interest rate management techniques that seek to mitigate the influence of interest rate changes on the costs of liabilities and help us achieve our risk management objective. Specifically, we seek to hedge our exposure to potential interest rate mismatches between the interest we earn on our investments and our borrowing costs caused by

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fluctuations in short-term interest rates. We may utilize various derivative financial instruments including puts and calls on securities or indices of securities, futures, interest rate swaps and swaptions, interest rate caps, exchange-traded derivatives, U.S. Treasury securities and options on U.S. Treasury securities and interest rate floors to hedge all or a portion of the interest rate risk associated with the financing of our investment portfolio.

### Spread Risk

We employ a variety of spread risk management techniques that seek to mitigate the influences of spread changes on our book value and our liquidity to help us achieve our investment objectives. We refer to the difference between interest rates on our investments and interest rates on risk free instruments as spreads. The yield on our investments changes over time due to the level of risk free interest rates, the creditworthiness of the security, and the price of the perceived risk. The change in the market yield of our interest rate hedges also changes primarily with the level of risk free interest rates. We manage spread risk through careful asset selection, sector allocation, regulating our portfolio value-at-risk, and maintaining adequate liquidity. Changes in spreads impact our book value and our liquidity and could cause us to sell assets and to change our investment strategy in order to maintain liquidity and preserve book value.

### Credit Risk

We believe that our investment strategy will generally keep our credit losses and financing costs low. However, we retain the risk of potential credit losses on all of our residential and commercial mortgage investments. We seek to manage this risk in part through our pre-acquisition due diligence process. In addition, we re-evaluate the credit risk inherent in our investments on a regular basis pursuant to fundamental considerations such as gross domestic product (“GDP”), unemployment, interest rates, retail sales, store closings/openings, corporate earnings, housing inventory, affordability and regional home price trends. We also review key loan credit metrics including, but not limited to, payment status, current loan-to-value ratios, current borrower credit scores and debt yields. These characteristics assist in determining the likelihood and severity of loan loss as well as prepayment and extension expectations. We then perform structural analysis under multiple scenarios to establish likely cash flow profiles and credit enhancement levels relative to collateral performance projections. This analysis allows us to quantify our opinions of credit quality and fundamental value, which are key drivers of portfolio management decisions.

### Liquidity Risk

We engage in a variety of liquidity management techniques to mitigate the risk of volatility in the marketplace, which may bring significant security price fluctuations, associated margin calls, changing cash needs, and variability in counterparty financing terms. We perform statistical analysis in order to measure and quantify our required liquidity needs under multiple scenarios and time horizons. Liquidity in the form of cash, unencumbered assets, and future cash inflows is consistently monitored and evaluated versus internal targets.

### Foreign Exchange Rate Risk

We have an investment in a commercial loan denominated in foreign currency and an investment in an unconsolidated joint venture whose net assets and results of operations are exposed to foreign currency translation risk when translated in U.S. dollars upon consolidation. We seek to hedge our foreign currency exposures by purchasing currency forward contracts.

### Investment Guidelines

Our board of directors has adopted the following investment guidelines:

- no investment shall be made that would cause us to fail to qualify as a REIT for federal income tax purposes;
  - no investment shall be made that would cause us to be regulated as an investment company under the 1940 Act;
  - our assets will be invested within our target assets; and
- until appropriate investments can be identified, our Manager may pay off short-term debt, or invest the proceeds of any offering in interest-bearing, short-term investments, including funds that are consistent with maintaining our REIT qualification.

These investment guidelines may be changed from time to time by our board of directors without the approval of our stockholders.

### Investment Committee



Our investment committee is comprised of certain of our officers and certain of our Manager's investment professionals. The investment committee periodically reviews our investment portfolio for risk characteristics, investment performance,

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liquidity, portfolio composition, leverage and other applicable items. It also reviews its compliance with our investment policies and procedures, including our investment guidelines, and our Manager provides our board of directors an investment performance report at the end of each quarter in conjunction with its review of our quarterly results.

### Investment Process

Our Manager's investment team has a strong focus on asset selection and on the relative value of various sectors within the mortgage market. Our Manager utilizes this expertise to build a diversified portfolio. Our Manager incorporates its views on the economic environment and the outlook for the mortgage market, including relative valuation, supply and demand trends, the level of interest rates, the shape of the yield curve, prepayment rates, financing and liquidity, housing prices, delinquencies, default rates and loss severity rates of various collateral types.

Our investment process includes sourcing and screening investment opportunities, assessing investment suitability, conducting interest rate and prepayment analysis, evaluating cash flow and collateral performance, reviewing legal structure and servicer and originator information and investment structuring, as appropriate, to ensure an attractive return commensurate with the risk we are bearing. Upon identification of an investment opportunity, the investment will be screened and monitored by our Manager to determine its impact on maintaining our REIT qualification and our exemption from registration under the 1940 Act. We make investments in sectors where our Manager has strong core competencies and where we believe market risk and expected performance can be reasonably quantified.

Our Manager evaluates each of our investment opportunities based on its expected risk-adjusted return relative to the returns available from other, comparable investments. In addition, we evaluate new opportunities based on their relative expected returns compared to assets held in our portfolio. The terms of any leverage available to us for use in funding an investment purchase are also taken into consideration, as are any risks posed by illiquidity or correlations with other assets in the portfolio. Our Manager also develops a macro outlook with respect to each target asset class by examining factors in the broader economy such as gross domestic product, interest rates, unemployment rates and availability of credit, among other factors. Our Manager analyzes fundamental trends in the relevant target asset class sector to adjust or maintain its outlook for that particular target asset class. These macro decisions guide our Manager's assumptions regarding model inputs and portfolio allocations among target assets. Additionally, our Manager conducts extensive diligence with respect to each target asset class by, among other things, examining and monitoring the capabilities and financial wherewithal of the parties responsible for the origination, administration and servicing of relevant target assets.

### Competition

Our net income depends, in large part, on our ability to acquire assets at favorable spreads over our borrowing costs. In acquiring our investments, we compete with other REITs, specialty finance companies, mortgage bankers, insurance companies, mutual funds, institutional investors, investment banking firms, financial institutions, governmental bodies and other entities. Refer to "Management's Discussion and Analysis of Financial Condition and Results of Operations — Market Conditions." In addition, there are numerous REITs with similar asset acquisition objectives. These other REITs increase competition for the available supply of mortgage assets suitable for purchase. Many of our competitors are significantly larger than we are, have access to greater capital and other resources and may have other advantages over us. In addition, some of our competitors may have higher risk tolerances or different risk assessments, which could allow them to consider a wider variety of investments and establish more relationships than we can. Market conditions may attract more competitors, which may increase the competition for sources of financing. An increase in the competition for sources of financing could adversely affect the availability and cost of financing.

We have access to our Manager's professionals and their industry expertise, which we believe provides us with a competitive advantage. These professionals help us assess investment risks and determine appropriate pricing for certain potential investments. These relationships enable us to compete more effectively for attractive investment opportunities. Despite certain competitive advantages, we may not be able to achieve our business goals or expectations due to the competitive risks that we face. For additional information concerning these competitive risks, refer to "Risk Factors — Risks Related to Our Investments — We operate in a highly competitive market for investment opportunities and competition may limit our ability to acquire desirable investments in our target assets and could also

affect the pricing of these securities.”

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### Our Corporate Information

Our principal executive offices are located at 1555 Peachtree Street, N.E., Suite 1800, Atlanta, Georgia 30309. Our telephone number is (404) 892-0896. Our website is [www.invescomortgagecapital.com](http://www.invescomortgagecapital.com). We make available free of charge, through our corporate website, our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. The information on our website is not intended to form a part of or be incorporated by reference into this Report.

### Item 1A. Risk Factors.

Set forth below are the material risks and uncertainties that, if they were to occur, could materially and adversely affect our business, financial condition, results of operations and the trading price of our securities. Additional risks not presently known, or that we currently deem immaterial, also may have a material adverse effect on our business, financial condition and results of operation.

#### Risks Related to Our Investments

Difficult conditions in the mortgage, residential and commercial real estate markets may cause us to experience market losses related to our investments.

Our results of operations are materially affected by conditions in the mortgage market, the residential and commercial real estate markets, the financial markets and the economy generally. Ongoing concerns about the mortgage market and real estate market, as well as inflation, energy costs, geopolitical issues and the availability and cost of credit, continue to contribute to market volatility. There is a strong correlation between home price growth rates and mortgage loan delinquencies. Any deterioration of the real estate market may cause us to experience losses related to our assets and to sell assets at a loss.

Declines in the market values of our investments may adversely affect our results of operations and credit availability, which may reduce earnings and, in turn, cash available for distribution to our stockholders. In addition, a substantial portion of our investments are classified for accounting purposes as “available-for-sale.” Changes in the market values of those assets will be directly charged or credited to stockholders' equity. As a result, a decline in values may reduce our book value.

Because assets we acquire may experience periods of illiquidity, we may lose profits or be prevented from earning capital gains if we cannot sell mortgage-related assets at an opportune time.

We bear the risk of being unable to dispose of our target assets at advantageous times or in a timely manner because mortgage-related assets generally experience periods of illiquidity. The lack of liquidity may result from the absence of a willing buyer or an established market for these assets, as well as legal or contractual restrictions on resale or the unavailability of financing for these assets. As a result, our ability to vary our portfolio in response to changes in economic and other conditions may be relatively limited, which may cause us to incur losses.

In addition, some of the assets that comprise our investment portfolio and that we acquire are not publicly traded. These securities may be less liquid than publicly-traded securities. The illiquidity of our investments may make it difficult for us to sell such investments if the need or desire arises. In addition, if we are required to liquidate all or a portion of our portfolio quickly, we may realize significantly less than the value at which we have previously recorded our investments. As a result, our ability to vary our portfolio in response to changes in economic and other conditions may be relatively limited, which could adversely affect our results of operations and financial condition.

Our investments may be concentrated and will be subject to risk of default.

While we diversify and intend to continue to diversify our portfolio of investments, we are not required to observe specific diversification criteria, except as may be set forth in the investment guidelines adopted by our board of directors. Therefore, our investments in our target assets may at times be concentrated in certain property types that are subject to higher risk of foreclosure, or secured by properties concentrated in a limited number of geographic locations. For example, as of December 31, 2016, a significant percentage of our non-Agency RMBS, GSE CRTs and CMBS was secured by property located in California, as well as New York with respect to our CMBS. Refer to “Management’s Discussion and Analysis of Financial Condition and Results of Operations - Investment Activities - Portfolio Characteristics” for additional information. To the extent that our portfolio is concentrated in any one region

or type of security, downturns relating generally to such region or type of security may result in defaults on a number of our investments within a short time period, which may reduce our net income and the value of our capital stock and accordingly reduce our ability to pay dividends to our stockholders.

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

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

We may invest in investments with which our stockholders may not agree.

Our stockholders will be unable to evaluate the manner in which we invest or the economic merit of our expected investments and, as a result, we may invest in investments with which our stockholders may not agree. The failure of our management to find investments that meet our investment criteria could cause a material adverse effect on our business, financial condition, liquidity, results of operations and ability to make distributions to our stockholders, and could cause the value of our capital stock to decline.

We acquire mortgage-backed and credit risk transfer securities and loans that are subject to defaults, foreclosure timeline extension, fraud and residential and commercial price depreciation, and unfavorable modification of loan principal amount, interest rate and amortization of principal, which could result in losses to us.

Mortgage-backed securities are secured by mortgage loans (primarily single family residential properties for RMBS and single commercial mortgage loans or a pool of commercial mortgage loans for CMBS). GSE CRTs are unsecured obligations of Fannie Mae and Freddie Mac. Coupon payments on GSE CRTs are based on LIBOR, and principal payments and losses are based on prepayments and defined credit events in a reference pool of mortgage loans that collateralize Agency RMBS. Accordingly, our MBS and GSE CRT investments are subject to all the risks of the respective underlying mortgage loans, including risks of defaults, foreclosure timeline extension, fraud, price depreciation and unfavorable modification of loan principal amount, interest rate and amortization of principal. The ability of a borrower to repay a mortgage loan secured by a residential property is dependent in part upon the income and assets of the borrower. A number of factors over which we have no control may impair a borrower's ability to repay their loans.

Commercial mortgage loans are secured by multifamily or commercial property and are subject to risks of delinquency and foreclosure, and risks of loss that may be greater than similar risks associated with loans made on the security of single-family residential property. The ability of a borrower to repay a loan secured by an income-producing property typically is dependent primarily upon the successful operation of such property rather than upon the existence of independent income or assets of the borrower. If the net operating income of the property is reduced, the borrower's ability to repay the loan may be impaired. Net operating income of an income-producing property can be affected by a number of factors over which we have no control.

In the event of any default under a mortgage loan held directly by us, we bear a risk of loss of principal to the extent of any deficiency between the value of the collateral and the principal and accrued interest of the mortgage loan, which could have a material adverse effect on our cash flow from operations. In the event of defaults on the mortgage loans that underlie our investments and the exhaustion of any underlying or any additional credit support, we may not

realize our anticipated return on our investments and we may incur a loss on these investments.

Our investments include non-Agency RMBS collateralized by Alt-A and subprime mortgage loans, which are subject to increased risks.

Our investments include non-Agency RMBS backed by collateral pools of mortgage loans known as “Alt-A mortgage loans,” or “subprime mortgage loans.” These loans have been originated using underwriting standards that are less restrictive

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than those used in underwriting “prime mortgage loans.” These lower standards include mortgage loans made to borrowers having imperfect or impaired credit histories, mortgage loans where the amount of the loan at origination is 80% or more of the value of the mortgage property, mortgage loans made to borrowers who have other debt that represents a large portion of their income and mortgage loans made to borrowers whose income is not required to be disclosed or verified. Due to economic conditions, a decline in home prices, and aggressive lending practices, many Alt-A and subprime mortgage loans have experienced increased rates of delinquency, foreclosure, bankruptcy and loss, and they are likely to continue to experience delinquency, foreclosure, bankruptcy and loss rates that are higher, and that may be substantially higher, than those experienced by mortgage loans underwritten in a more traditional manner. Thus, because of the higher delinquency rates and losses associated with many Alt-A and subprime mortgage loans, the performance of non-Agency RMBS backed by Alt-A and subprime mortgage loans that we may acquire could be correspondingly adversely affected, which could adversely impact our results of operations, financial condition and business.

Our subordinated MBS assets may be in the “first loss” position, subjecting us to greater risks of loss.

We invest in certain tranches of MBS that are only entitled to a portion of the principal and interest payments made on mortgage loans underlying the securities issued by the trust. In general, losses on a mortgage loan included in a RMBS trust will be borne first by the equity holder of the issuing trust if any, and then by the “first loss” subordinated security holder and then by the “second loss” subordinate holder and so on. For CMBS assets, losses on a mortgaged property securing a mortgage loan included in a securitization will be borne first by the equity holder of the property, then by a cash reserve fund or letter of credit, if any, then by the holder of a mezzanine loan or B-Note, if any, then by the “first loss” subordinated security holder (generally, the “B-Piece” buyer) and then by the holder of a higher-rated security. We may acquire securities at every level of such a trust, from the equity position to the most senior tranche. In the event of default and the exhaustion of any classes of securities junior to those which we acquire, our securities will suffer losses as well. In addition, if we overvalue the underlying mortgage portfolio, or if the values subsequently decline and, as a result, less collateral is available to satisfy interest and principal payments due on the related MBS, the securities which we acquire may effectively become the “first loss” position ahead of the more senior securities, which may result in significant losses. The prices of lower credit quality securities are generally less sensitive to interest rate changes than more highly rated securities, but more sensitive to adverse economic downturns or individual issuer developments. A projection of an economic downturn could cause a decline in the value of lower credit quality securities because the ability of obligors of mortgages underlying MBS to make principal and interest payments may be impaired. In such event, existing credit support in the securitization structure may be insufficient to protect us against loss of our principal on these securities.

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

Interest rates are highly sensitive to many factors, including governmental monetary and tax policies, domestic and international economic and political considerations and other factors beyond our control. Interest rate fluctuations present a variety of risks, including the risk of a narrowing of the difference between asset yields and borrowing rates, flattening or inversion of the yield curve and fluctuating prepayment rates, and may adversely affect our income and the value of our assets and capital stock.

We invest in Agency RMBS, non-Agency RMBS, GSE CRTs, CMBS and mortgage loans that are subject to risks related to interest rate fluctuations. In a normal yield curve environment, short-term interest rates are lower than long-term interest rates. Fluctuations in short- or long-term interest rates could have adverse effects on our operations and financial condition, which may negatively affect cash available for distribution to our stockholders. Fluctuations in interest rates could impact us as follows:

If long-term rates increased significantly, the market value of investments in our target assets would decline, and the duration and weighted average life of the investments may increase. We could realize a loss if the securities were sold. Further, declines in market value may reduce book value and ultimately reduce earnings or result in losses to us. An increase in short-term interest rates would increase the amount of interest owed on the repurchase agreements we enter into to finance the purchase of our investments.



If short-term interest rates rise disproportionately relative to longer-term interest rates (a flattening of the yield curve), our borrowing costs may increase more rapidly than the interest income earned on our assets. Because we expect our investments, on average, generally will bear interest based on longer-term rates than our borrowings, a flattening of the yield curve would tend to decrease our net income. Additionally, to the extent cash flows from investments that return scheduled and unscheduled principal are reinvested, the spread between the yields on the new investments and available borrowing rates may decline, which would likely decrease our net income.

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• If short-term interest rates exceed longer-term interest rates (a yield curve inversion), our borrowing costs may exceed our interest income and we could incur operating losses.

• If interest rates fall, we may recognize losses on our swap positions that are not offset by gains on our assets, which may adversely affect our liquidity and financial position.

In a period of rising interest rates, our operating results will depend in large part on the difference between the income from our assets and financing costs. We anticipate that, in most cases, the income from such assets will respond more slowly to interest rate fluctuations than the cost of our borrowings. Consequently, changes in interest rates, particularly short-term interest rates, may significantly influence our net income. Increases in these rates will tend to decrease our net income and the market value of our assets and may negatively affect cash available for distribution to our stockholders.

In addition, market values of our investments may decline without any general increase in interest rates for a number of reasons, such as increases or expected increases in defaults, or increases or expected increases in voluntary prepayments for those investments that are subject to prepayment risk or widening of credit spreads, which may negatively affect cash available for distribution to our stockholders.

An increase in interest rates may cause a decrease in the volume of certain of our target assets which could adversely affect our ability to acquire target assets that satisfy our investment objectives and to generate income and pay dividends.

Rising interest rates generally reduce the demand for mortgage loans due to the higher cost of borrowing. A reduction in the volume of mortgage loans originated may affect the volume of target assets available to us, which could adversely affect our ability to acquire assets that satisfy our investment objectives. Rising interest rates may also cause our target assets that were issued prior to an interest rate increase to provide yields that are below prevailing market interest rates. If rising interest rates cause us to be unable to acquire a sufficient volume of our target assets with a yield that is above our borrowing cost, our ability to satisfy our investment objectives and to generate income and pay dividends may be materially and adversely affected.

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

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

We and our third party loan originators and servicers’ due diligence of potential assets may not reveal all of the liabilities associated with such assets and may not reveal other weaknesses in such assets, which could lead to losses. Before making an asset acquisition, we will assess the strengths and weaknesses of the originator or issuer of the asset as well as other factors and characteristics that are material to the performance of the asset. In making the assessment and otherwise conducting customary due diligence, we will rely on resources available to us, including our third party loan originators and servicers. This process is particularly important with respect to newly formed originators or issuers because there may be little or no information publicly available about these entities and assets. There can be no assurance that our due diligence process will uncover all relevant facts or that any asset acquisition will be successful, which could lead to losses in the value of our portfolio.

We depend on third-party service providers, including mortgage servicers, for a variety of services related to our RMBS. We are, therefore, subject to the risks associated with third-party service providers.

We depend on a variety of services provided by third-party service providers related to our RMBS. We rely on the mortgage servicers who service the mortgage loans backing our RMBS to, among other things, collect principal and interest payments and administer escrow accounts on the underlying mortgages and perform loss mitigation services.

At times, mortgage servicers and other service providers to our RMBS, such as trustees, bond insurance providers and custodians, may not perform in a manner that promotes our interests.

For example, recent legislation intended to reduce or prevent foreclosures through, among other things, loan modifications, short sales and other foreclosure alternatives, may reduce the value of mortgage loans underlying our RMBS. Mortgage servicers may be incentivized to pursue such loan modifications, as well as forbearance plans and other actions intended to prevent foreclosure, even if such loan modifications and other actions are not in the best interests of the beneficial owners of the mortgage loans. Similarly, legislation at both the federal and state level delaying the initiation or completion of foreclosure proceedings on specified types of residential mortgage loans or otherwise limiting the ability of mortgage servicers to take actions that may be essential to preserve the value of the mortgage loans may also reduce the value of mortgage loans

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underlying our RMBS. Any such limitations are likely to cause delayed or reduced collections from mortgagors and generally increase servicing costs and potential foreclosure-related litigation. As a consequence of the foregoing matters, our business, financial condition and results of operations may be adversely affected.

In addition, federal and state governmental and regulatory bodies have pursued settlement agreements with a number of mortgage servicers to address alleged servicing and foreclosure deficiencies related to foreclosure practices, staffing levels and/ or documentation. These agreements may result in the temporary delay of foreclosure proceedings while certain third party servicers modify their foreclosure practices. The extension of foreclosure timelines may increase the backlog of foreclosures and the inventory of distressed homes on the market and create greater uncertainty about housing prices. Prior to making investments in non-Agency RMBS, we carefully consider many factors, including housing prices and foreclosure timelines, and formulate loss assumptions. The concerns about deficiencies in foreclosure practices of servicers may impact our loss assumptions and affect the values of, and our returns on, our investments in non-Agency RMBS.

Our commercial loans held-for investment include investments that involve greater risks of loss than senior loan assets secured by income-producing properties.

We may acquire mezzanine loans, which take the form of subordinated loans secured by second mortgages on the underlying property or loans secured by a pledge of the ownership interests of either the entity owning the property or the entity that owns the interest in the entity owning the property. These types of assets involve a higher degree of risk than long-term senior mortgage lending secured by income-producing real property, because the loan may become unsecured as a result of foreclosure by the senior lender. In the event of a bankruptcy of the entity providing the pledge of its ownership interests as security, we may not have full recourse to the assets of such entity, or the assets of the entity may not be sufficient to satisfy our mezzanine loan. If a borrower defaults on our mezzanine loan or debt senior to our loan, or in the event of a borrower bankruptcy, our mezzanine loan will be satisfied only after the senior debt. As a result, we may not recover some or all of our initial expenditure. In addition, mezzanine loans may have higher loan-to-value ratios than conventional mortgage loans, resulting in less equity in the property and increasing the risk of loss of principal.

In addition, we may make commercial loans structured as preferred equity investments. These investments involve a higher degree of risk than conventional debt financing due to a variety of factors, including their non-collateralized nature and subordinated ranking to other loans and liabilities of the entity in which such preferred equity is held. Accordingly, if the issuer defaults on our investment, we would only be able to proceed against such entity in accordance with the terms of the preferred security, and not against any property owned by such entity. Furthermore, in the event of bankruptcy or foreclosure, we would only be able to recoup our investment after all lenders to, and other creditors of, such entity are paid in full. As a result, we may lose all or a significant part of our investment, which could result in significant losses.

We may acquire B-Notes, mortgage loans typically (i) secured by a first mortgage on a single large commercial property or group of related properties, and (ii) subordinated to an A-Note secured by the same first mortgage on the same collateral. As a result, if a borrower defaults, there may not be sufficient funds remaining for B-Note holders after payment to the A-Note holders. However, because each transaction is privately negotiated, B-Notes can vary in their structural characteristics and risks. For example, the rights of holders of B-Notes to control the process following a borrower default may vary from transaction to transaction. Further, B-Notes typically are secured by a single property and reflect the risks associated with significant concentration.

Significant losses related to our commercial loans held for investment would result in operating losses for us and may limit our ability to make distributions to our stockholders.

If we foreclose on an asset, we may come to own and operate the property securing the loan, which would expose us to the risks inherent in that activity.

When we foreclose on an asset, we may take title to the property securing that asset, and if we do not or cannot sell the property, we would then come to own and operate it as “real estate owned.” Owning and operating real property involves risks that are different (and in many ways more significant) than the risks faced in owning an asset secured by that property. In addition, we may end up owning a property that we would not otherwise have decided to acquire directly at the price of our original investment or at all. We may not manage these properties as well as they might be

managed by another owner, and our returns to investors could suffer. If we foreclose on and come to own property, our financial performance and returns to stockholders could suffer.

Liability relating to environmental matters may impact the value of properties that we may acquire or foreclose on.

If we acquire or foreclose on properties with respect to which we have extended mortgage loans, we may be subject to environmental liabilities arising from such foreclosed properties. Under various U.S. federal, state and local laws, an owner or operator of real property may become liable for the costs of removal of certain hazardous substances released on its property.

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These laws often impose liability without regard to whether the owner or operator knew of, or was responsible for, the release of such hazardous substances.

The presence of hazardous substances may adversely affect an owner's ability to sell real estate or borrow using real estate as collateral. To the extent that an owner of a property underlying one of our debt investments becomes liable for removal costs, the ability of the owner to make payments to us may be reduced, which in turn may adversely affect the value of the relevant mortgage asset held by us and our ability to make distributions to our stockholders. If we acquire any properties, the presence of hazardous substances on a property may adversely affect our ability to sell the property and we may incur substantial remediation costs, thus harming our financial condition. The discovery of material environmental liabilities attached to such properties could have a material adverse effect on our results of operations and financial condition and our ability to make distributions to our stockholders.

We may experience a decline in the market value of our mortgage-backed and credit risk transfer securities. We are required to recognize an "other-than-temporary" impairment under U.S. GAAP if we experience a decline in the market value of our mortgage-backed and credit risk transfer securities if such assets are in an unrealized loss position and we determine that we intend to sell and it is more likely than not that we will be required to sell such assets before recovery of the amortized cost of such assets. If such a determination were to be made, we would recognize unrealized losses through earnings and write down the amortized cost of such assets to a new cost basis, based on the fair market value of such assets on the date they are considered to be other-than-temporarily impaired. Such impairment charges reflect non-cash losses at the time of recognition; subsequent disposition or sale of such assets could further affect our future losses or gains, as they are based on the difference between the sale price received and adjusted amortized cost of such assets at the time of sale.

If our Manager underestimates the collateral loss on our investments, we may experience losses.

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

Our mortgage-backed and credit risk transfer securities are recorded at estimated fair value and, as a result, there is uncertainty as to the value of these investments.

Some of our mortgage-backed and credit risk transfer securities are in the form of securities that are not publicly or actively traded. The fair value of mortgage-backed and credit risk transfer securities that are not publicly or actively traded may not be readily determinable. We value these investments quarterly at fair value, which may include unobservable inputs. Because such valuations are subjective, the fair value of certain of our assets may fluctuate over short periods of time and our determinations of fair value may differ materially from the values that would have been used if a ready market for these securities existed. The value of our capital stock could be adversely affected if our determinations regarding the fair value of these investments were materially higher than the values that we ultimately realize upon their disposal.

Prepayment rates may adversely affect the value of our investment portfolio.

Pools of residential mortgage loans underlie the RMBS that we acquire. In the case of residential mortgage loans, there are seldom any restrictions on borrowers' abilities to prepay their loans. We generally receive prepayments of principal that are made on these underlying mortgage loans. When borrowers prepay their mortgage loans faster than expected, the prepayments on the RMBS are also faster than expected. Faster than expected prepayments could adversely affect our profitability, including in the following ways:

We may purchase RMBS that have a higher interest rate than the market interest rate at the time. In exchange for this higher interest rate, we may pay a premium over the par value to acquire the security. In accordance with U.S. GAAP, we may amortize this premium over the estimated term of the RMBS. If the RMBS is prepaid in whole or in part prior to its maturity date, however, we may be required to expense the premium that was prepaid at the time of the prepayment.

▲ A substantial portion of our adjustable-rate RMBS may bear interest rates that are lower than their fully indexed rates, which are equivalent to the applicable index rate plus a margin. If an adjustable-rate RMBS is prepaid prior to or soon

after the time of adjustment to a fully-indexed rate, we will have held that RMBS while it was least profitable and lost the opportunity to receive interest at the fully indexed rate over the remainder of its expected life.

If we are unable to acquire new RMBS similar to the prepaid RMBS, our financial condition, results of operation and cash flow would suffer. Prepayment rates generally increase when interest rates fall and decrease when interest rates

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rise, but changes in prepayment rates are difficult to predict. Prepayment rates also may be affected by conditions in the housing and financial markets, general economic conditions and the relative interest rates on FRMs and ARMs. While we seek to minimize prepayment risk to the extent practical, in selecting investments we must balance prepayment risk against other risks and the potential returns of each investment. No strategy can completely insulate us from prepayment risk.

Market conditions may upset the historical relationship between interest rate changes and prepayment trends, which would make it more difficult for us to analyze our investment portfolio.

Our success depends on our ability to analyze the relationship of changing interest rates on prepayments of the mortgage loans that underlie our RMBS and mortgage loans we acquire. Changes in interest rates and prepayments affect the market price of the target assets. As part of our overall portfolio risk management, we analyze interest rate changes and prepayment trends separately and collectively to assess their effects on our investment portfolio. In conducting our analysis, we depend on certain assumptions based upon historical trends with respect to the relationship between interest rates and prepayments under normal market conditions. If dislocations in the mortgage market or other developments change the way that prepayment trends have historically responded to interest rate changes, our ability to (1) assess the market value of our investment portfolio, (2) implement our hedging strategies, and (3) implement techniques to reduce our prepayment rate volatility would be significantly affected, which could materially adversely affect our financial position and results of operations.

### Risks Related to Financing and Hedging

We use leverage in executing our business strategy, which may adversely affect the return on our assets and may reduce cash available for distribution to our stockholders, as well as increase losses when economic conditions are unfavorable.

We use leverage to finance our assets through borrowings from repurchase agreements and other secured and unsecured forms of borrowing (including Federal Home Loan Bank advances), and we contribute capital to equity investments. The amount of leverage we may deploy for particular assets will depend upon our Manager's assessment of the credit and other risks of those assets and is limited by our debt covenants.

Our access to financing depends upon a number of factors over which we have little or no control, including:

- general market conditions;
- the lender's view of the quality of our assets, valuation of our assets and our liquidity;
- the lender's perception of our growth potential;
- regulatory requirements of the Federal Housing Finance Authority or Federal Home Loan Bank;
- our current and potential future earnings and cash distributions; and
- the market price of the shares of our capital stock.

Any weakness or volatility in the financial markets, the residential and commercial mortgage markets or the economy generally could adversely affect the factors listed above. In addition, such weakness or volatility could adversely affect one or more of our potential lenders and could cause one or more of our potential lenders to be unwilling or unable to provide us with financing or to increase the costs of that financing. Some of our target assets may be more difficult to finance than others and the market for such financing can change based on many factors over which we have little or no control.

The return on our assets and cash available for distribution to our stockholders may be reduced to the extent that market conditions prevent us from leveraging our assets or cause the cost of our financing to increase relative to the income that can be derived from the assets acquired. Our financing costs will reduce cash available for distributions to stockholders. We may not be able to meet our financing obligations and, to the extent that we cannot, we risk the loss of some or all of our assets to liquidation or sale to satisfy the obligations.

Adverse market conditions and a significantly expanded regulatory environment may make it more difficult for us to secure financing.

Our results of operations are materially affected by conditions in the financial markets and the economy generally. Continuing concerns over the expansion of consumer protection rules and regulations, regulatory enforcement actions and their impact on underwriting standards and the overall availability of consumer credit, as well as inflation, energy



price volatility, geopolitical issues, unemployment, the cost of credit, the mortgage market and the real estate market contribute to market volatility.

Dramatic declines in residential and commercial real estate prices and increased loan defaults could result in significant asset writedowns by financial institutions, which could cause financial institutions to seek additional capital, to merge with other institutions or, in some cases, to fail. In addition, interest rates may experience volatility over concerns related to actual or

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anticipated economic growth rates, unemployment, inflation or uncertainty regarding future U.S. monetary policy. Declines in the value of our assets, or perceived market uncertainty about their value, may make it difficult for us to secure financing on favorable terms, or at all, and to comply with the terms of our existing financing agreements. Further, our profitability may be adversely affected by this significantly expanded regulatory environment and aggressive enforcement climate in addition to the prospect of liquidity challenges if we are unable to secure financing for our assets.

We depend on repurchase agreement financing to acquire our target assets and our inability to access this funding on acceptable terms could have a material adverse effect on our results of operations, financial condition and business. We use repurchase agreement financing as a strategy to increase the return on our assets. However, we may not be able to achieve our desired leverage ratio for a number of reasons, including if the following events occur:

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

Our ability to fund our target assets may be impacted by our ability to secure repurchase agreement financing on acceptable terms. We can provide no assurance that lenders will be willing or able to provide us with sufficient financing. In addition, because repurchase agreements are short-term commitments of capital, lenders may respond to market conditions making it more difficult for us to secure continued financing. During certain periods of the credit cycle, lenders may curtail their willingness to provide financing. For example, in response to market conditions lenders have in the past and may in the future increase financing rates and decrease advance rates. Repurchase agreement counterparties have taken these steps in order to compensate themselves for a perceived increased risk due to the illiquidity of the underlying collateral. In some cases, margin calls have forced borrowers to liquidate collateral in order to meet the capital requirements of these margin calls, resulting in losses. In addition, if major market participants were to exit the repurchase agreement financing business, the value of our portfolio could be negatively impacted, thus reducing net stockholder equity, or book value. Furthermore, if many of our current or potential lenders are unwilling or unable to provide us with repurchase agreement financing, we could be forced to sell our assets at an inopportune time when prices are depressed. In addition, if the regulatory capital requirements imposed on our lenders change, they may be required to significantly increase the cost of the financing that they provide to us. Our lenders also may revise their eligibility requirements for the types of assets they are willing to finance or the terms of such financings, based on, among other factors, the regulatory environment and their management of perceived risk, particularly with respect to assignee liability.

If a counterparty to our repurchase transactions defaults on its obligation to resell the underlying security back to us at the end of the transaction term, if the value of the underlying security has declined as of the end of that term, or if we default on our obligations under the repurchase agreement, we may incur a loss on our repurchase transactions. When we engage in repurchase transactions, we generally sell securities to lenders (repurchase agreement counterparties) and receive cash from these lenders. The lenders are obligated to resell the same or similar securities back to us at the end of the term of the transaction. Because the cash we receive from the lender when we initially sell the securities to the lender is less than the value of those securities (this difference is the haircut), if the lender defaults on its obligation to resell the same securities back to us we may incur a loss on the transaction equal to the amount of the haircut (assuming there was no change in the value of the securities). As of December 31, 2016, two counterparties held collateral that exceeded the amounts borrowed under the related repurchase agreements by more than \$113.5 million, or 5% of our stockholders' equity. Refer to Note 7 - "Borrowings" of our consolidated financial statements included in Part IV, Item 15 of this Report, for additional detail. We may incur a loss on a repurchase transaction if the value of the underlying securities has declined as of the end of the transaction term, as we would have to repurchase the securities for their initial value but would receive securities worth less than that amount. Further, if we default on one of our obligations under a repurchase transaction, the lender can terminate the transaction and cease entering into any other repurchase transactions with us. Some of our repurchase agreements contain cross-default provisions, so that if a default occurs under any one agreement, the lenders under our other agreements could also declare a default. Any losses we incur on our repurchase transactions could adversely affect our earnings and thus our cash available for

distribution to our stockholders.

The repurchase agreements, secured loans and other financing arrangements that we use to finance our investments may require us to provide additional collateral and may restrict us from leveraging our assets as fully as desired.

The amount of financing we receive, or may in the future receive, under our repurchase agreements, secured loans and other financing arrangements, is directly related to the lenders' valuation of the assets that secure the outstanding borrowings. Lenders under our repurchase agreements and secured loans typically have the absolute right to reevaluate the market value of the assets that secure outstanding borrowings at any time. If a lender determines in its sole discretion that the value of the assets has decreased, it has the right to initiate a margin call or increase collateral requirements. A margin call or increased collateral

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requirements would require us to transfer additional assets to such lender without any advance of funds from the lender for such transfer or to repay a portion of the outstanding borrowings. Any such margin call or increased collateral requirements could have a material adverse effect on our results of operations, financial condition, business, liquidity and ability to make distributions to our stockholders, and could cause the value of our capital stock to decline. We may be forced to sell assets at significantly depressed prices to meet such margin calls and to maintain adequate liquidity, which could cause us to incur losses. Moreover, to the extent we are forced to sell assets at such time, given market conditions, we may be selling at the same time as others facing similar pressures, which could exacerbate a difficult market environment and which could result in our incurring significantly greater losses on our sale of such assets. In an extreme case of market duress, a market may not even be present for certain of our assets at any price. Such a situation would likely result in a rapid deterioration of our financial condition and possibly necessitate a filing for bankruptcy protection.

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

A failure to comply with covenants in our repurchase agreements, secured loans and other financing arrangements would have a material adverse effect on us, and any future financings may require us to provide additional collateral or pay down debt.

We are subject to various covenants contained in our existing financing arrangements and may become subject to additional covenants in connection with future financings. Many of our master repurchase agreements, as well as our FHLBI financing arrangements and swap agreements, require us to maintain compliance with various financial covenants, including a minimum tangible net worth, specified financial ratios, such as total debt to total assets and financial information delivery obligations. These covenants may limit our flexibility to pursue certain investments or incur additional debt. If we fail to meet or satisfy any of these covenants, we would be in default under these agreements, and our lenders could elect to declare outstanding amounts due and payable, terminate their commitments, require the posting of additional collateral and/or enforce their interests against existing collateral. We may also be subject to cross-default and acceleration rights and, with respect to collateralized debt, the posting of additional collateral and foreclosure rights upon default. Further, this could also make it difficult for us to satisfy the distribution requirements necessary to maintain our status as a REIT for U.S. federal income tax purposes.

Our use or future use of repurchase agreements to finance our target assets may give our lenders greater rights in the event that either we or a lender files for bankruptcy.

Our borrowings or future borrowings under repurchase agreements for our target assets may qualify for special treatment under the U.S. Bankruptcy Code, giving our lenders the ability to avoid the automatic stay provisions of the U.S. Bankruptcy Code and to take possession of and liquidate the assets that we have pledged under their repurchase agreements without delay in the event that we file for bankruptcy. Furthermore, the special treatment of repurchase agreements under the U.S. Bankruptcy Code may make it difficult for us to recover our pledged assets in the event that a lender party to such agreement files for bankruptcy. Therefore, our use of repurchase agreements to finance our investments exposes our pledged assets to risk in the event of a bankruptcy filing by either a lender or us.

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

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

condition.

Hedging may adversely affect our earnings, which could reduce our cash available for distribution to our stockholders. We pursue various hedging strategies to seek to reduce our exposure to adverse changes in interest rates and currency exchange rates. Our hedging activity varies in scope based on the level and volatility of interest rates, currency exchange rates, the type of assets held and other changing market conditions. Hedging may fail to protect or could adversely affect us because, among other things:

- interest rate and/or currency hedging can be expensive, particularly during periods of rising and volatile interest rates;
- available interest rate hedges may not correspond directly with the interest rate risk for which protection is sought;

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- due to a credit loss, the duration of the hedge may not match the duration of the related liability;
- the amount of income that a REIT may earn from hedging transactions (other than hedging transactions that satisfy certain requirements of the Internal Revenue Code or that are done through a taxable REIT subsidiary (“TRS”)) to offset interest rate losses is limited by U.S. federal tax provisions governing REITs;
- the credit quality of the hedging counterparty owing money on the hedge may be downgraded to such an extent that it impairs our ability to sell or assign our side of the hedging transaction; and
- the hedging counterparty owing money in the hedging transaction may default on its obligation to pay.

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

In addition, the enforceability of agreements underlying hedging transactions may depend on compliance with applicable statutory and commodity and other regulatory requirements and, depending on the identity of the counterparty, applicable international requirements. Any actions taken by regulators could constrain our investment strategy and could increase our costs, either of which could materially and adversely impact our results of operations. The business failure of a hedging counterparty with whom we enter into a hedging transaction will most likely result in its default. Default by a party with whom we enter into a hedging transaction may result in the loss of unrealized profits and force us to cover our commitments, if any, at the then current market price. Although generally we seek to reserve the right to terminate our hedging positions, it may not always be possible to dispose of or close out a hedging position without the consent of the hedging counterparty and we may not be able to enter into an offsetting contract in order to cover our risk. We cannot assure you that a liquid secondary market will exist for hedging instruments purchased or sold, and we may be required to maintain a position until exercise or expiration, which could result in losses.

We may enter into derivative contracts that expose us to contingent liabilities and those contingent liabilities may not appear on our balance sheet. We may invest in synthetic securities, credit default swaps, and other credit derivatives, which expose us to additional risks.

We have entered, and may again in the future, enter into derivative contracts that could require us to make cash payments in certain circumstances. Potential payment obligations would be contingent liabilities and may not appear on our balance sheet. Our ability to satisfy these contingent liabilities depends on the liquidity of our assets and our access to capital and cash. The need to fund these contingent liabilities could adversely impact our financial condition. We may invest in synthetic securities, credit default swaps, and other credit derivatives that reference other real estate securities or indices. These investments may present risks in excess of those resulting from the referenced security or index. These investments are typically a contractual relationship with counterparties and not an acquisition of a referenced security or other asset. In these types of investments, we have no right to directly enforce compliance with the terms of the referenced security or other assets and we have no voting or other consensual rights of ownership with respect to the referenced security or other assets. In the event of insolvency of a counterparty, we will be treated as a general creditor of the counterparty and will have no claim of title with respect to the referenced security.

The markets for these types of investments may not be liquid. Many of these investments incorporate “pay as you go” credit events. For example, the terms of credit default swaps are still evolving and may change significantly, which could make it more difficult to assign such an instrument or determine the “loss” pursuant to the underlying agreement. In a credit default swap, the party wishing to “buy” protection will pay a premium. When interest rates, spreads or the prevailing credit premiums on credit default swaps change, the amount of the termination payment due could change by a substantial amount. In an illiquid market, the determination of this change could be difficult to ascertain and, as a result, we may not achieve the desired benefit of entering into this contractual relationship. As of December 31, 2016, we have no outstanding credit default swaps. We may over time enter into these types of investments as the market for them grows and during times when acquiring other real estate loans and securities may be difficult. We may find credit default swaps and other forms of synthetic securities to be a more efficient method of providing exposure to target investments. Our efforts to manage the risk associated with these investments, including counterparty risks, may prove to be insufficient in enabling us to generate the returns anticipated.



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### Risks Related to Our Company

Maintaining 1940 Act exclusions for our subsidiaries imposes limits on our operations. Failure to maintain an exclusion could have a material negative impact on our operations.

We conduct our operations so that neither we, nor our operating partnership, IAS Operating Partnership LP (the “Operating Partnership”) nor the subsidiaries of the Operating Partnership are required to register as an investment company under the 1940 Act.

Section 3(a)(1)(A) of the 1940 Act defines an investment company as any issuer that is or holds itself out as being engaged primarily in the business of investing, reinvesting or trading in securities. We believe neither we nor our Operating Partnership will be considered an investment company under Section 3(a)(1)(A) of the 1940 Act because neither we nor our Operating Partnership will engage primarily or hold ourselves out as being engaged primarily in the business of investing, reinvesting or trading in securities. Rather, through our Operating Partnership’s wholly-owned or majority-owned subsidiaries, we and our Operating Partnership will be primarily engaged in the non-investment company businesses of these subsidiaries, namely the business of purchasing or otherwise acquiring real property, mortgages and other interests in real estate.

Section 3(a)(1)(C) of the 1940 Act defines an investment company as any issuer that is engaged or proposes to engage in the business of investing, reinvesting, owning, holding or trading in securities and owns or proposes to acquire investment securities having a value exceeding 40% of the value of the issuer’s total assets (exclusive of U.S. government securities and cash items) on an unconsolidated basis, which we refer to as the 40% test. Excluded from the term “investment securities,” among other things, are U.S. government securities and securities issued by majority-owned subsidiaries that are not themselves investment companies and are not relying on the exception from the definition of investment company set forth in Section 3(c)(1) or Section 3(c)(7) of the 1940 Act.

We are a holding company that conduct businesses through the Operating Partnership and the Operating Partnership’s wholly-owned or majority-owned subsidiaries. Both we and the Operating Partnership conduct our operations so that we comply with the 40% test. Accordingly, the securities issued by these subsidiaries that are excepted from the definition of “investment company” under Section 3(c)(1) or Section 3(c)(7) of the 1940 Act, together with any other investment securities the Operating Partnership may own, may not have a value in excess of 40% of the value of the Operating Partnership’s total assets (exclusive of U.S. government securities and cash items) on an unconsolidated basis. Compliance with the 40% test limits the types of businesses in which we are permitted to engage through our subsidiaries. Furthermore, IAS Asset I LLC and certain of the Operating Partnership’s other subsidiaries that we may form in the future intend to rely upon an exception from the definition of investment company under Section 3(c)(5)(C) of the 1940 Act, which is available for entities “primarily engaged in the business of purchasing or otherwise acquiring mortgages and other liens on and interests in real estate.” This exception generally requires that at least 55% of a subsidiary’s portfolio must be comprised of qualifying assets and at least 80% of its portfolio must be comprised of qualifying assets and real estate-related assets (and no more than 20% comprised of miscellaneous assets). In analyzing a subsidiary’s compliance with Section 3(c)(5)(C) of the 1940 Act, we classify investments based in large measure on SEC staff guidance, including no-action letters, and, in the absence of SEC guidance, on our view of what constitutes a qualifying real estate asset and a real estate-related asset.

Qualification for exception from the definition of investment company under the 1940 Act limits our ability to make certain investments. Therefore, IAS Asset I LLC and the Operating Partnership’s other subsidiaries may need to adjust their respective assets and strategy from time-to-time in order to continue to rely on the exception from the definition of investment company under Section 3(c)(5)(C) of the 1940 Act. Any such adjustment in assets or strategy is not expected to have a material adverse effect on our business or strategy. There can be no assurance that we will be able to maintain this exception from the definition of investment company for IAS Asset I LLC and the Operating Partnership’s other subsidiaries intending to rely on Section 3(c)(5)(C) of the 1940 Act.

We may in the future organize one or more subsidiaries that seek to rely on other exceptions from being deemed an investment company under the 1940 Act, such as the exception provided to certain structured financing vehicles by Rule 3a-7. Any such subsidiary would need to be structured to comply with any guidance that may be issued by the SEC staff on the restrictions contained in Rule 3a-7 or any other exception on which we seek to rely.



There can be no assurance that the laws and regulations governing the 1940 Act status of REITs will not change in a manner that adversely affects our operations or inhibits our ability to pursue our strategies. Any issuance of more specific or different guidance relating to the relevant exemptions and exceptions from the definition of an investment company under the 1940 Act could similarly affect or inhibit our operations. If we, the Operating Partnership or its subsidiaries fail to maintain an exception or exemption from the 1940 Act, we could, among other things, be required to (a) change the investments that we hold or the manner in which we conduct our operations to avoid being required to register as an investment company, (b) effect sales of our assets in a manner that, or at a time when, we would not otherwise choose to do so, or (c) register as an investment company. Any of these events could cause us to incur losses and negatively affect the value of our capital stock, the

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sustainability of our business model, and our ability to make distributions, which could have an adverse effect on our business and the market price for our shares of capital stock. In addition, if it were established that we were an unregistered investment company, there would be a risk that we would be subject to monetary penalties or injunctive relief imposed by the SEC.

We may be adversely affected by the current and future economic, regulatory and other actions of government bodies and their agencies.

The U.S. government, Federal Reserve, U.S. Treasury, SEC and other governmental and regulatory bodies have taken a number of economic actions and regulatory initiatives designed to stabilize and stimulate the economy and the financial markets, and additional actions and initiatives may occur in the future.

In addition, foreign financial markets have experienced significant volatility related to events such as the European debt crisis, declining currencies in certain emerging markets and governments' and central banks' responses. Such responses have included the implementation of various financial reforms including but not limited to development of the Basel III standards by the Basel Committee on Banking Supervision.

More broadly, uncertainties regarding geopolitical developments can produce volatility in global financial markets. In this regard, the United Kingdom ("U.K.") electorate voted on June 23, 2016 to exit the European Union ("Brexit"), resulting in market volatility that may continue during the negotiation process. This may impact foreign exchange rate and create regulatory changes, which could have an adverse effect on our business connected with commercial loans originated in the U.K.

There can be no assurance that, in the long term, actions that governments and regulatory bodies or central banks have taken in the past or may take in the future will improve the efficiency and stability of mortgage or financial markets. To the extent the financial markets do not respond favorably to any of these actions or such actions do not function as intended, our business may be harmed. In addition, because the programs are designed, in part, to improve the markets for certain of our target assets, the establishment of these programs may result in increased competition for attractive opportunities in our target assets or, in the case of government-backed refinancing and modification programs, may have the effect of reducing the revenues associated with certain of our target assets. We cannot predict whether or when additional actions or initiatives to stabilize and stimulate the economy and the financial markets may occur, and such actions could have an adverse effect on our business, results of operations and financial condition.

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

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

We are highly dependent on information systems and systems failures could significantly disrupt our business, which may, in turn, negatively affect the market price of our capital stock and our ability to pay dividends.

Our business is highly dependent on third parties' information systems, including our Manager and other service providers. Any failure or interruption of such systems or cyber-attacks or security breaches could cause delays or other problems in our securities trading activities and financial, accounting and other data processing activities, which could have a material adverse effect on our operating results and negatively affect the market price of our capital stock and our ability to pay dividends to our stockholders. In addition, we also face the risk of operational failure, termination or capacity constraints of any of the third parties with which we do business or that facilitate our business activities, including clearing agents or other financial intermediaries we use to facilitate our securities transactions.

Computer malware, viruses and computer hacking and phishing attacks have become more prevalent in our industry and may occur on our Manager's and other service providers' systems in the future. We rely heavily on our and our third party providers' financial, accounting and other data processing systems. It is difficult to determine what, if any, negative impact may directly result from any specific interruption or cyber-attacks or security breaches of such networks or systems or any failure to maintain the performance, reliability and security of our technical infrastructure.

As a result, any computer malware, viruses and computer hacking and phishing attacks may negatively affect our operations.

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We may repurchase shares of our common stock or other securities from time to time. Share repurchases may negatively impact our compliance with covenants in our financing agreements and regulatory requirements (including maintaining exclusions from the requirements of the 1940 Act and qualification as a REIT). Any compliance failures associated with share repurchases could have a material negative impact on our business, financial condition and results of operations. Share repurchases also may negatively impact our ability to invest in our target assets in the future.

As of December 31, 2016, 18,239,082 shares of common stock were available under our Board authorized share repurchase program. We may engage in share repurchases from time-to-time through open market purchases, including block purchases or privately negotiated transactions, or pursuant to any trading plan that may adopted in accordance with Rules 10b5-1 and 10b-18 of the Exchange Act. Certain of our financing agreements have financial covenants, including covenants related to maintaining a certain level of stockholders equity, that may be impacted by our share repurchases. In addition, we generally fund share repurchases with interest income or income from the sale of our assets. The sale of assets to fund share repurchases could impact the allocation of our portfolio for purposes of maintaining an exclusion from the requirements of the 1940 Act and could impact our ability to comply with income and asset tests required to qualify as a REIT. The failure to comply with covenants in our financing agreements, to maintain our exemption from the 1940 Act or to qualify as a REIT could have a material negative impact on our business, financial condition and results of operations. In addition, our decision to repurchase shares of our common stock or other securities and reduce our stockholders' equity could negatively impact our competitive position with peer mortgage REIT companies and other competitors and could negatively impact our ability in the future to invest in assets that have a greater potential return than the repurchase of our common stock.

Our independent registered public accounting firm has advised us that it identified an issue related to an independence requirement contained in the Securities Exchange Act of 1934 regulations regarding auditor independence. In May 2016, PricewaterhouseCoopers LLP (“PwC”) advised us that it had identified an issue related to its independence under Rule 2-01(c)(1)(ii)(A) of Regulation S-X (the “Loan Rule”) with respect to certain of PwC’s lenders who own certain Invesco registered funds managed by our Manager or certain other investment adviser affiliates of Invesco Ltd., our Manager's parent company. The Company and such funds are required to have their financial statements audited by a public accounting firm that qualifies as independent under various SEC rules. As discussed below, the Staff of the Securities and Exchange Commission (the “SEC Staff”) has issued a “no-action” letter to another mutual fund complex under substantially similar circumstances that provides temporary relief for eighteen months from the date of the no-action letter issuance.

The Loan Rule prohibits accounting firms, such as PwC, from having certain financial relationships with their audit clients and affiliated entities. Specifically, the Loan Rule provides, in relevant part, that an accounting firm is not independent if it receives a loan from a lender that is a “record or beneficial owner of more than ten percent of the audit client’s equity securities.” For purposes of the Loan Rule, audit clients include the Company, all of the registered investment companies advised by affiliates of Invesco Ltd., as well as Invesco Ltd. and its other subsidiaries (collectively, the “Invesco Fund Complex”) for which PwC also serves as independent auditor. PwC informed us it has relationships with lenders who hold, as record owner, more than ten percent of the shares of certain funds within the Invesco Fund Complex. These relationships call into question PwC’s independence under the Loan Rule with respect to those funds, as well as the Company and all other funds in the Invesco Fund Complex.

On June 20, 2016, the SEC Staff issued a “no-action” letter to another mutual fund complex (see Fidelity Management & Research Company et al., No-Action Letter) related to the audit independence issue described above. In that letter, the SEC Staff confirmed that it would not recommend enforcement action against an audit client that relied on audit services performed by an audit firm that was not in compliance with the Loan Rule in certain specified circumstances. The circumstances described in the no-action letter appear to be substantially similar to the circumstances that called into question PwC’s independence under the Loan Rule with respect to the Invesco Fund Complex, including the Company. We therefore believe that we can rely on the letter to continue to issue financial statements that are audited by PwC, and we intend to do so. The SEC Staff has indicated that the no-action relief will expire eighteen months from its issuance (i.e., on December 20, 2017). PwC has advised the Audit Committee that it is continuing to have discussions with the SEC Staff regarding permanent relief.

If in the future the independence of PwC is called into question under the Loan Rule by circumstances that are not addressed in the SEC Staff's no-action letter or permanent relief regarding this matter is not granted by the SEC, we will need to take other action and incur additional costs in order for our filings with the SEC containing financial statements to be deemed compliant with applicable securities laws. Such action may include obtaining the review and audit of the financial statements filed by the Company by another independent registered public accounting firm. In addition, under such circumstances the Company's eligibility to issue securities under its existing registration statements on Form S-3 and Form S-8 may be impacted and certain financial reporting covenants with our counterparties may be impacted. A default under our financing agreements could have a material adverse effect on our business, results of operations, financial condition and stock price.

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### Risks Related to Accounting

The preparation of our financial statements involves use of estimates, judgments and assumptions, and our financial statements may be materially affected if our estimates prove to be inaccurate.

Financial statements prepared in accordance with U.S. GAAP require the use of estimates, judgments and assumptions that affect the reported amounts. Different estimates, judgments and assumptions reasonably could be used that would have a material effect on the financial statements, and changes in these estimates, judgments and assumptions are likely to occur from period to period in the future. Significant areas of accounting requiring the application of management's judgment include, but are not limited to, determining the fair value of investment securities, interest income recognition and reserves for loan losses. These estimates, judgments and assumptions are inherently uncertain, and, if they prove to be wrong, we face the risk that charges to income will be required. Any such charges could significantly harm our business, financial condition, results of operations and the price of our securities. Refer to "Management's Discussion and Analysis of Financial Condition and Results of Operations - Critical Accounting Policies" for a discussion of the accounting estimates, judgments and assumptions that we believe are the most critical to an understanding of our business, financial condition and results of operations.

Changes in the fair value of our interest rate swap agreements may result in volatility in our U.S. GAAP earnings.

We enter into derivative transactions to reduce the impact that changes in interest rates will have on our net interest margin. Changes in the fair value of our interest rate swap agreements are recorded in our consolidated statement of operations as "gain (loss) on derivative instruments, net" and may result in volatility in our U.S. GAAP earnings. The total changes in fair value may exceed our consolidated net income in any period or for a full year. Volatility in our net income may adversely affect the price of our capital stock.

Our reported U.S. GAAP financial results differ from our REIT taxable income that impact our dividend distribution requirements and, therefore, our U.S. GAAP results may not be an accurate indicator of future taxable income and dividend distributions.

Generally, the cumulative net income we report over the life of an asset will be the same for U.S. GAAP and tax purposes, although the timing of this income recognition over the life of the asset could be materially different. Differences exist in the accounting for U.S. GAAP net income and REIT taxable income which can lead to significant variances in the amount and timing of when income and losses are recognized under these two measures. Due to these differences, our reported U.S. GAAP financial results could materially differ from our determination of taxable income, which impacts our dividend distribution requirements. Therefore, our U.S. GAAP results may not be an accurate indicator of future REIT taxable income and dividend distributions. Capital gains and losses in a period may impact REIT taxable income and impact the dividend paid in future periods.

### Risks Related to Our Relationship with Our Manager

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

We have no separate facilities and are completely reliant on our Manager. We do not have any employees. Our executive officers are employees of our Manager or one of its affiliates. Our Manager has significant discretion as to the implementation of our investment and operating policies and strategies. Accordingly, we believe that our success depends to a significant extent upon the efforts, experience, diligence, skill and network of business contacts of the executive officers and key personnel of our Manager. The executive officers and key personnel of our Manager evaluate, negotiate, close and monitor our investments; therefore, our success depends on their continued service. The departure of any of the executive officers or key personnel of our Manager who provide management services to us could have a material adverse effect on our performance. In addition, we offer no assurance that our Manager will remain our investment manager or that we will continue to have access to our Manager's principals and professionals. The initial term of our management agreement with our Manager expired on July 1, 2011. The agreement automatically renews for successive one-year terms, and the management agreement is currently in a renewal term. If the management agreement is terminated and no suitable replacement is found to manage us, we may not be able to execute our business plan. Moreover, our Manager is not obligated to dedicate certain of its personnel exclusively to us nor is it obligated to dedicate any specific portion of its time to our business.

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

We are subject to conflicts of interest arising out of our relationship with Invesco and our Manager. Specifically, each of our officers and certain members of our board of directors are employees of our Manager or one of its affiliates. Our Manager and our executive officers may have conflicts between their duties to us and their duties to, and interests in, Invesco. We compete for investment opportunities directly with other clients of our Manager or Invesco and its subsidiaries. A substantial

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number of separate accounts managed by our Manager have limited exposure to our target assets. In addition, in the future our Manager may have additional clients that compete directly with us for investment opportunities. Our Manager has investment allocation policies in place intended to enable us to share equitably with the other clients of our Manager or Invesco and its subsidiaries. There is no assurance that our Manager's allocation policies that address some of the conflicts relating to our access to investment and financing sources will be adequate to address all of the conflicts that may arise. Therefore, we may compete for investment or financing opportunities sourced by our Manager and, as a result, we may either not be presented with the opportunity or have to compete with other clients of our Manager or clients of Invesco and its subsidiaries to acquire these investments or have access to these sources of financing. Our Manager and our executive officers may choose to allocate favorable investments to other clients of Invesco instead of to us. Further, when there are turbulent conditions in the mortgage markets, distress in the credit markets or other times when we will need focused support and assistance from our Manager, Invesco or entities for which our Manager also acts as an investment manager will likewise require greater focus and attention, placing our Manager's resources in high demand. In such situations, we may not receive the level of support and assistance that we may receive if we were internally managed or if our Manager did not act as a manager for other entities.

We pay our Manager substantial management fees regardless of the performance of our portfolio. Our Manager's entitlement to a management fee, which is not based upon performance metrics or goals, might reduce its incentive to devote its time and effort to seeking investments that provide attractive risk-adjusted returns for our portfolio. This in turn could hurt both our ability to make distributions to our stockholders and the market price of our capital stock.

Our Manager would have a conflict in recommending our participation in any equity investment it manages.

Our Manager has a conflict of interest in recommending our participation in any equity investment it manages because the fees payable to it may be greater than the fees payable by us under the management agreement. With respect to equity investments we have made in partnerships managed by an affiliate of our Manager, our Manager has agreed to waive fees at the equity investment level to avoid duplication. To address any potential conflict of interest, we require the terms of any equity investment managed by our Manager to be approved by our audit committee consisting of our independent directors. However, there can be no assurance that all conflicts of interest will be eliminated.

The management agreement with our Manager was not negotiated on an arm's-length basis and may not be as favorable to us as if it had been negotiated with an unaffiliated third party and may be costly and difficult to terminate. Our executive officers and certain members of our board of directors are employees of our Manager or one of its affiliates. Our management agreement with our Manager was negotiated between related parties and its terms, including fees payable, may not be as favorable to us as if it had been negotiated with an unaffiliated third party.

Termination of the management agreement with our Manager without cause is difficult and costly. Our independent directors review our Manager's performance and the management fees annually and the management agreement may be terminated annually upon the affirmative vote of at least two-thirds of our independent directors based upon:

(1) our Manager's unsatisfactory performance that is materially detrimental to us, or (2) a determination that the management fees payable to our Manager are not fair, subject to our Manager's right to prevent termination based on unfair fees by accepting a reduction of management fees agreed to by at least two-thirds of our independent directors.

Our Manager will be provided 180 days prior notice of any such termination. Additionally, upon such a termination, the management agreement provides that we will pay our Manager a termination fee equal to three times the sum of the average annual management fee received by our Manager during the prior 24-month period before such termination, calculated as of the end of the most recently completed fiscal quarter. These provisions may increase the cost of terminating the management agreement and adversely affect our ability to terminate our Manager without cause. If the management agreement is terminated and no suitable replacement is found to manage us, we may not be able to execute our business plan.

Pursuant to the management agreement, our Manager does not assume any responsibility other than to render the services called for thereunder and is not responsible for any action of our board of directors in following or declining to follow its advice or recommendations. Our Manager maintains a contractual, as opposed to a fiduciary, relationship with us. Under the terms of the management agreement, our Manager, its officers, stockholders, members, managers, partners, directors and personnel, any person controlling or controlled by our Manager and any person providing sub-advisory services to our Manager will not be liable to us, any subsidiary of ours, our directors, our stockholders or



any subsidiary's stockholders or partners for acts or omissions performed in accordance with and pursuant to the management agreement, except because of acts constituting bad faith, willful misconduct, gross negligence, or reckless disregard of their duties under the management agreement, as determined by a final non-appealable order of a court of competent jurisdiction. We have agreed to indemnify our Manager, its officers, stockholders, members, managers, directors and personnel, any person controlling or controlled by our Manager and any person providing sub-advisory services to our Manager with respect to all expenses, losses, damages, liabilities, demands, charges and claims arising from acts of our Manager not constituting bad faith, willful misconduct, gross negligence, or reckless disregard of duties, performed in good faith in accordance with and pursuant to the management agreement.

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

Our Manager is authorized to follow very broad investment guidelines. Our board of directors will periodically review our investment guidelines and our investment portfolio but does not, and is not required to, review all of our proposed investments, except that an investment in a security structured or issued by an entity managed by Invesco must be approved by a majority of our independent directors prior to such investment. In addition, in conducting periodic reviews, our board of directors may rely primarily on information provided to them by our Manager. Furthermore, our Manager may use complex strategies, and transactions entered into by our Manager may be costly, difficult or impossible to unwind by the time they are reviewed by our board of directors. Our Manager has great latitude within the broad parameters of our investment guidelines in determining the types and amounts of Agency RMBS, non-Agency RMBS, GSE CRT, CMBS, mortgage loans and mortgage and real-estate financing arrangements (including mezzanine debt and private equity interests) it may decide are attractive investments for us, which could result in investment returns that are substantially below expectations or that result in losses, which would materially and adversely affect our business operations and results.

### Risks Related to Our Capital Stock

The market price and trading volume of our capital stock may be volatile.

The market price of our capital stock may be highly volatile and be subject to wide fluctuations. In addition, the trading volume in our capital stock may fluctuate and cause significant price variations to occur. If the market price of our capital stock declines significantly, our stockholders may be unable to resell their shares at or above the price our stockholders paid for their shares. We cannot assure you that the market price of our capital stock will not fluctuate or decline significantly in the future. Some of the factors that could negatively affect our share price or result in fluctuations in the price or trading volume of our capital stock include:

- actual or anticipated variations in our quarterly operating results or distributions;
- changes in our earnings estimates or publication of research reports about us or the real estate or specialty finance industry;
- decreases in the market valuations of our target assets;
- increased difficulty in maintaining or obtaining financing on attractive terms, or at all;
- increases in market interest rates that lead our stockholders to demand a higher yield;
- changes in market valuations of similar companies;
- adverse market reaction to any increased indebtedness we incur in the future;
- additions or departures of key management personnel;
- actions by institutional stockholders;
- speculation in the press or investment community;
- general market and economic conditions; and
- changes to U.S. federal income tax laws or regulations governing REITs or the administrative interpretation of those laws.

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

We cannot predict the effect, if any, of future sales of our common stock, or the availability of shares for future sales, on the market price of our common stock. Sales of substantial amounts of common stock or the perception that such sales could occur may adversely affect the prevailing market price for our common stock. Also, we may issue additional shares in public offerings or private placements to make new investments or for other purposes. We are not required to offer any such shares to existing stockholders on a preemptive basis. Therefore, it may not be possible for existing stockholders to participate in such future share issuances, which may dilute existing stockholders' interests in us.

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

We pay quarterly distributions and make other distributions to our stockholders in an amount such that we distribute all or substantially all of our REIT taxable income in each year, subject to certain adjustments. We have not established a minimum distribution payment level and our ability to pay distributions may be adversely affected by a

number of factors, including the risk factors described in this Report. All distributions will be made at the discretion of our board of directors and will depend on our earnings, our financial condition, debt covenants, maintenance of our REIT qualification, applicable provisions of Maryland law and other factors as our board of directors may deem relevant from time to time. We believe that a change in any

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one of the following factors could adversely affect our results of operations and impair our ability to pay distributions to our stockholders:

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

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

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

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

A change in market interest rates may cause a material decrease in the market price of our capital stock.

One of the factors that investors may consider in deciding whether to buy or sell shares of our capital stock is our distribution rate as a percentage of our share price relative to market interest rates. If the market price of our capital stock is based primarily on the earnings and return that we derive from our investments and income with respect to our investments and our related distributions to stockholders, and not from the market value of the investments themselves, then interest rate fluctuations and capital market conditions are likely to adversely affect the market price of our capital stock. For instance, if market rates rise without an increase in our distribution rate, the market price of our capital stock could decrease as potential investors may require a higher distribution yield or seek other securities paying higher distributions or interest.

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

We have issued Series A Preferred Stock, Series B Preferred Stock and 5.00% Exchangeable Senior Notes due 2018. If we decide to issue debt or equity securities in the future, which would rank senior to our common stock, it is likely that they will be governed by an indenture or other instrument containing covenants restricting our operating flexibility. Any convertible or exchangeable securities that we issue in the future may have rights, preferences and privileges more favorable than those of our common stock and may result in dilution to owners of our common stock. For example, our preferred shares and debt have a preference on liquidating distributions or a preference on dividend or interest payments that could limit our ability to make a distribution to the holders of our common stock. We and, indirectly, our stockholders, will bear the cost of issuing and servicing such securities. Because our decision to issue debt or equity securities in any future offering will depend on market conditions and other factors beyond our control, we cannot predict or estimate the amount, timing or nature of our future offerings.

Holders of our common stock are not entitled to preemptive rights or other protections against dilution. Thus holders of our common stock will bear the risk of our future offerings reducing the market price of our common stock and diluting the value of their stock holdings in us. Holders of our common stock also bear the risk of holders of our exchangeable notes making an election to exchange their notes for common stock, which could result in significant dilution to our existing stockholders. In addition, future issuances and sales of preferred stock on parity to our Series A Preferred Stock or the Series B Preferred Stock, or the perception that such issuances and sales could occur, may also cause prevailing market prices for the Series A Preferred Stock, Series B Preferred Stock and our common stock to decline and may adversely affect our ability to raise additional capital in the financial markets at times and prices favorable to us.

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## Risks Related to Our Organization and Structure

Certain provisions of Maryland law could inhibit changes in control.

Certain provisions of the Maryland General Corporation Law (the “MGCL”), may have the effect of deterring a third party from making a proposal to acquire us or of impeding a change in control under circumstances that otherwise could provide the holders of our common stock with the opportunity to realize a premium over the then-prevailing market price of our common stock. Under the MGCL, certain “business combinations” (including a merger, consolidation, share exchange, or, in circumstances specified in the statute, an asset transfer or issuance or reclassification of equity securities) between us and an “interested stockholder” (defined generally as any person who beneficially owns 10% or more of our then outstanding voting capital stock or an affiliate or associate of ours who, at any time within the two-year period prior to the date in question, was the beneficial owner of 10% or more of our then outstanding voting capital stock) or an affiliate thereof are prohibited for five years after the most recent date on which the stockholder becomes an interested stockholder. After the five-year prohibition, any business combination between us and an interested stockholder generally must be recommended by our board of directors and approved by the affirmative vote of at least (1) 80% of the votes entitled to be cast by holders of outstanding shares of our voting capital stock; and (2) two-thirds of the votes entitled to be cast by holders of voting capital stock of the corporation other than shares held by the interested stockholder with whom or with whose affiliate the business combination is to be effected or held by an affiliate or associate of the interested stockholder. These super-majority vote requirements do not apply if our common stockholders receive a minimum price, as defined under Maryland law, for their shares in the form of cash or other consideration in the same form as previously paid by the interested stockholder for its shares. These provisions of the MGCL also do not apply to business combinations that are approved or exempted by a board of directors prior to the time that the interested stockholder becomes an interested stockholder. Pursuant to the statute, our board of directors has by resolution exempted business combinations between us and any other person, provided that such business combination is first approved by our board of directors (including a majority of our directors who are not affiliates or associates of such person).

The “control share” provisions of the MGCL provide that “control shares” of a Maryland corporation (defined as shares which, when aggregated with other shares controlled by the stockholder (except solely by virtue of a revocable proxy), entitle the stockholder to exercise one of three increasing ranges of voting power in electing directors) acquired in a “control share acquisition” (defined as the direct or indirect acquisition of ownership or control of “control shares”) have no voting rights except to the extent approved by our stockholders by the affirmative vote of at least two-thirds of all the votes entitled to be cast on the matter, excluding votes entitled to be cast by the acquiror of control shares, our officers and our employees who are also our directors. Our bylaws contain a provision exempting from the control share acquisition statute any and all acquisitions by any person of shares of our stock. There can be no assurance that this provision will not be amended or eliminated at any time in the future.

The “unsolicited takeover” provisions of the MGCL permit our board of directors, without stockholder approval and regardless of what is currently provided in our charter or bylaws, to implement takeover defenses, some of which (for example, a classified board) we do not yet have. These provisions may have the effect of inhibiting a third party from making an acquisition proposal for us or of delaying, deferring or preventing a change in control of us under circumstances that otherwise could provide the holders of shares of common stock with the opportunity to realize a premium over the then current market price. Our charter contains a provision whereby we have elected to be subject to the provisions of Title 3, Subtitle 8 of the MGCL relating to the filling of vacancies on our board of directors. Ownership limitations may restrict change of control of business combination opportunities in which our stockholders might receive a premium for their shares.

In order for us to qualify as a REIT, no more than 50% in value of our outstanding capital stock may be owned, directly or indirectly, by five or fewer individuals during the last half of any calendar year. “Individuals” for this purpose include natural persons, private foundations, some employee benefit plans and trusts, and some charitable trusts. To preserve our REIT qualification, among other purposes, our charter generally prohibits any person from directly or indirectly owning more than 9.8% in value or in number of shares, whichever is more restrictive, of the outstanding shares of our capital stock or more than 9.8% in value or in number of shares, whichever is more restrictive, of the outstanding shares of our common stock. This ownership limitation could have the effect of discouraging a takeover

or other transaction in which holders of our common stock might receive a premium for their shares over the then prevailing market price or which holders might believe to be otherwise in their best interests.

Our authorized but unissued shares of capital stock may prevent a change in our control.

Our charter authorizes us to issue additional authorized but unissued shares of common or preferred stock. In addition, our board of directors may, without stockholder approval, amend our charter to increase the aggregate number of our shares of stock or the number of shares of stock of any class or series that we have authority to issue and classify or reclassify any unissued shares of common or preferred stock and set the preferences, rights and other terms of the classified or reclassified

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shares. As a result, our board of directors may establish a series of shares of common or preferred stock that could delay or prevent a transaction or a change in control that might involve a premium price for our shares of common stock or otherwise be in the best interest of our stockholders.

The change of control conversion feature of our Series A Preferred Stock, Series B Preferred Stock and our Exchangeable Senior Notes may make it more difficult for a party to acquire us or discourage a party from acquiring us.

The change of control conversion feature of our Series A Preferred Stock, Series B Preferred Stock and our Exchangeable Senior Notes may have the effect of discouraging a third party from making an acquisition proposal for us or of delaying, deferring or preventing certain of our change of control transactions under circumstances that otherwise could provide the holders of our common stock, Series A Preferred Stock and Series B Preferred Stock with the opportunity to realize a premium over the then-current market price of such stock or that stockholders may otherwise believe is in their best interests.

We are the sole general partner of our Operating Partnership and could become liable for the debts and other obligations of our Operating Partnership beyond the amount of our initial expenditure.

We are the sole general partner of our Operating Partnership and directly or indirectly conduct all of our business activities through the Operating Partnership and its subsidiaries. As the sole general partner, we are liable for our Operating Partnership's debts and other obligations. Therefore, if our Operating Partnership is unable to pay its debts and other obligations, we will be liable for such debts and other obligations beyond the amount of our expenditure for ownership interests in our Operating Partnership. These obligations could include unforeseen contingent liabilities and could materially adversely affect our financial condition, operating results and ability to make distributions to our stockholders.

Our Exchangeable Senior Notes are recourse obligations to us.

In 2013, our Operating Partnership issued \$400,000,000 in aggregate principal amount of 5.00% Exchangeable Senior Notes due March 15, 2018 (the "Notes"). Because the Company is the sole general partner of the Operating Partnership, these amounts are full recourse obligations of the Company. If we are not able to extend, refinance or repurchase the Notes, we may not have the ability to repay these amounts when they come due. Our inability to repay the Notes could cause the acceleration of our other borrowings, which would have a material adverse effect on our business.

The indenture governing the Notes contains cross-default provisions whereby a default or acceleration of borrowings under other agreements could result in a default under the indenture. If a cross-default occurred, we may not be able to pay our liabilities or access capital from external sources in order to refinance our borrowings. If some or all of our borrowings default and it causes a default under other borrowings, our business, financial condition and results of operations could be materially and adversely affected.

### Tax Risks

Investment in our capital stock has various U.S. federal income tax risks.

This summary of certain tax risks is limited to the U.S. federal tax risks addressed below. Additional risks or issues may exist that are not addressed in this Report and that could affect the U.S. federal income tax treatment of us or our stockholders.

In December 2015, President Obama signed into law the Protecting Americans from Tax Hikes Act of 2015 (the "Act"). The Act includes a number of provisions affecting taxation of REITs and REIT stockholders, some of which include a change to the percentage of assets that may be represented by securities of a Taxable REIT Subsidiary ("TRS"), favorable changes related to prohibited transaction safe harbors, elimination of applicability of preferential dividend rules to 'publicly offered REITs', changes related to debt instruments issued by publicly offered REITs and certain secured debt obligations for purposes of the REIT qualification asset tests and certain changes related to the treatment of hedging income.

We strongly urge you to seek advice based on your particular circumstances from an independent tax advisor concerning the effects of U.S. federal, state and local income tax law on an investment in our capital stock and on your individual tax situation.

Our failure to qualify as a REIT would subject us to U.S. federal income tax and potentially increased state and local taxes, which would reduce the amount of cash available for distribution to our stockholders.

We believe that we have been organized and operated, and we intend to continue to operate, in a manner that enables us to qualify as a REIT for U.S. federal income tax purposes. However, qualification as a REIT involves the application of highly technical and complex Internal Revenue Code provisions for which only a limited number of judicial and administrative interpretations exist. Even an inadvertent or technical mistake could jeopardize our REIT status. Our continued qualification as a REIT will depend on our satisfaction of certain asset, income, organizational, distribution, stockholder ownership and other requirements on a continuing basis.



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Moreover, new legislation, court decisions or administrative guidance, in each case possibly with retroactive effect, may make it more difficult or impossible for us to qualify as a REIT. Thus, while we intend to operate so that we will qualify as a REIT, given the highly complex nature of the rules governing REITs, the ongoing importance of factual determinations, and the possibility of future changes in our circumstances, no assurance can be given that we will so qualify for any particular year.

If we fail to qualify as a REIT in any taxable year, and we do not qualify for certain statutory relief provisions, we would be required to pay U.S. federal income tax on our taxable income, and distributions to our stockholders would not be deductible by us in determining our taxable income. In such a case, we might need to borrow money or sell assets in order to pay our taxes. Our payment of income tax would decrease the amount of our income available for distribution to our stockholders. Furthermore, if we fail to maintain our qualification as a REIT, we no longer would be required to distribute substantially all of our taxable income to our stockholders. In addition, unless we were eligible for certain statutory relief provisions, we could not re-elect to qualify as a REIT until the fifth calendar year following the year in which we failed to qualify.

Complying with REIT requirements may cause us to forego otherwise attractive investment opportunities or financing or hedging strategies.

To qualify as a REIT for U.S. federal income tax purposes, we must continually satisfy various tests regarding the sources of our income, the nature and diversification of our assets, and the amounts we distribute to our stockholders. To meet these tests, we may be required to forego investments we might otherwise make or financing or hedging strategies we might otherwise employ. We may be required to make distributions to stockholders at disadvantageous times or when we do not have funds readily available for distribution. Thus, compliance with the REIT requirements may hinder our investment performance.

Complying with REIT requirements may force us to liquidate otherwise attractive investments.

To qualify as a REIT, we generally must ensure that at the end of each calendar quarter at least 75% of the value of our total assets consists of cash, cash items, government securities, including GSE CRT securities, and qualifying real estate assets, including MBS and certain mortgage loans. The remainder of our investment in securities (other than government securities, securities of our TRSs and qualifying real estate assets) generally cannot include more than 10% of the outstanding voting securities of any one issuer or more than 10% of the total value of the outstanding securities of any one issuer. In addition, no more than 5% of the value of our assets can consist of the securities of any one issuer (other than government securities, securities of our TRSs and qualifying real estate assets), no more than 25% (20% after 2017) of the value of our total securities can be represented by securities of one or more TRSs, and no more than 25% of the value of our assets may consist of "nonqualified publicly offered REIT debt instruments." If we fail to comply with these requirements at the end of any quarter, we must correct the failure within 30 days after the end of such calendar quarter or qualify for certain statutory relief provisions to avoid losing our REIT qualification and suffering adverse tax consequences. As a result, we may be required to liquidate from our portfolio otherwise attractive investments. These actions could have the effect of reducing our income and amounts available for distribution to our stockholders.

REIT distribution requirements could adversely affect our ability to execute our business plan and may require us to incur debt, sell assets or take other actions to make such distributions.

To qualify as a REIT, we must distribute at least 90% of our REIT taxable income (including certain items of non-cash income) to our stockholders each calendar year, determined without regard to the deduction for dividends paid and excluding net capital gains. To the extent that we satisfy the 90% distribution requirement, but distribute less than 100% of our taxable income, we will be subject to U.S. federal corporate income tax on our undistributed taxable income. In addition, we will incur a 4% nondeductible excise tax on the amount, if any, by which our distributions in any calendar year are less than a minimum amount specified under U.S. federal income tax laws. We intend to make sufficient distributions to our stockholders to satisfy the 90% distribution requirement and to avoid both corporate income tax and the 4% nondeductible excise tax.

Our taxable income may be substantially different from our net income as determined by U.S. GAAP. For example, realized capital losses are deducted in determining our U.S. GAAP net income, but may not be deductible in computing our taxable income. In addition, differences in timing between the recognition of taxable income and the

actual receipt of cash may occur. For example, we may invest in debt instruments requiring us to accrue original issue discount (“OID”) or recognize market discount income that generate taxable income in excess of economic income or in advance of the corresponding cash flow. We may also acquire distressed debt investments that are subsequently modified by agreement with the borrower. If amendments to the outstanding debt are “significant modifications” under applicable Treasury Regulations, the modified debt may be considered to have been reissued to us in a debt-for-debt exchange with the borrower, with gain recognized by us to the extent that the principal amount of the modified debt exceeds our cost of purchasing it prior to modification. Finally, we may be required under the terms of the indebtedness that we incur, to use cash received from interest payments to make principal payment on that indebtedness, with the effect that we will recognize income but will not have a corresponding amount of cash available for distribution to our stockholders.

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As a result of the foregoing, we may find it difficult or impossible to meet the REIT distribution requirements in certain circumstances. In such circumstances, we may be required to (1) sell assets in adverse market conditions, (2) borrow on unfavorable terms, (3) distribute amounts that would otherwise be invested or used to repay debt, or (4) make a taxable distribution of our shares of common stock as part of a distribution in which stockholders may elect to receive shares of common stock or (subject to a limit measured as a percentage of the total distribution) cash, in order to comply with the REIT distribution requirements. Thus, compliance with the REIT distribution requirements may hinder our ability to grow, which could adversely affect the value of our common stock. We may choose to pay dividends in our own stock, in which case our stockholders may be required to pay income taxes in excess of the cash dividends received.

We may distribute taxable dividends that are payable in cash and in shares of our common stock at the election of each stockholder. Taxable stockholders receiving such dividends will be required to include the full amount of the dividend income to the extent of our current and accumulated earnings and profits for federal income tax purposes. As a result, a U.S. stockholder may be required to pay income taxes with respect to such dividends in excess of the cash dividends received. If a U.S. stockholder sells the stock it receives as a dividend in order to pay this tax, the sales proceeds may be less than the amount included in income with respect to the dividend, depending on the market price of our stock at the time of the sale. Furthermore, with respect to non-U.S. stockholders, we may be required to withhold U.S. tax with respect to such dividends, including in respect of all or a portion of such dividend that is payable in stock. In addition, if a significant number of our stockholders determine to sell shares of our common stock in order to pay taxes owed on dividends, it may put downward pressure on the trading price of our common stock. Our ownership of and relationship with any TRS that we may form or acquire is subject to limitations, and a failure to comply with the limits would jeopardize our REIT qualification and may result in the application of a 100% excise tax.

A REIT may own up to 100% of the stock of one or more TRSs. A TRS may earn income that would not be qualifying income if earned directly by the parent REIT. Both the subsidiary and the REIT must jointly elect to treat the subsidiary as a TRS. Overall, no more than 25% (20% after 2017) of the value of a REIT's assets may consist of stock or securities of one or more TRSs at the end of any calendar quarter. In addition, the TRS rules impose a 100% excise tax on certain transactions between a TRS and its parent REIT that are not conducted on an arm's length basis. There can be no assurance that we will be able to comply with the TRS limitations or to avoid application of the 100% excise tax discussed above.

Our domestic TRSs would pay U.S. federal, state and local income tax on their taxable income, and their after-tax net income would be available for distribution to us but would not be required to be distributed to us. If we were to organize a TRS as a non-U.S. corporation (or non-U.S. entity treated as a corporation for U.S. federal income tax purposes), we may generate income inclusions relating to the earnings of the non-U.S. TRS, the treatment of which under the REIT gross income tests is not clear.

Liquidation of our assets to repay obligations to our lenders may jeopardize our REIT qualification.

To qualify as a REIT, we must comply with requirements regarding our assets and our sources of income. If we are compelled to liquidate our investments to repay obligations to our lenders, we may be unable to comply with these requirements, ultimately jeopardizing our qualification as a REIT.

Characterization of the repurchase agreements we enter into to finance our investments as sales for tax purposes rather than as secured borrowing transactions, or the failure of a mezzanine loan to qualify as a real estate asset, could adversely affect our ability to qualify as a REIT.

We have entered into repurchase agreements with a variety of counterparties to finance assets in which we invest. When we enter into a repurchase agreement, we generally sell assets to our counterparty to the agreement and receive cash from the counterparty. The counterparty is obligated to resell the assets back to us at the end of the term of the transaction. We believe that, for U.S. federal income tax purposes, we will be treated as the owner of the assets that are the subject of repurchase agreements and that the repurchase agreements will be treated as secured borrowing transactions notwithstanding that such agreements may transfer record ownership of the assets to the counterparty during the term of the agreement. It is possible, however, that the IRS could successfully assert that we did not own these assets during the term of the repurchase agreements, in which case we could fail to qualify as a REIT.

In addition, we may acquire mezzanine loans, which are loans secured by equity interests in a partnership or limited liability company that directly or indirectly owns real property. In Revenue Procedure 2003-65, the IRS provided a safe harbor pursuant to which a mezzanine loan, if it meets each of the requirements contained in the Revenue Procedure, will be treated by the IRS as a real estate asset for purposes of the REIT asset tests, and interest derived from the mezzanine loan will be treated as qualifying mortgage interest for purposes of the 75% gross income test. Although the Revenue Procedure provides a safe harbor on which taxpayers may rely, it does not prescribe rules of substantive tax law. We acquire or originate mezzanine loans

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that do not meet all of the requirements for reliance on this safe harbor. The IRS could challenge treatment of such loans as real estate assets for purposes of the REIT asset and income tests, and if such a challenge were sustained, we could fail to qualify as a REIT.

The “taxable mortgage pool” rules may limit our financing options.

Certain securitizations and other financing structures could result in the creation of taxable mortgage pools for federal income tax purposes. A taxable mortgage pool owned by our Operating Partnership would be treated as a corporation for U.S. federal income tax purposes and may cause us to fail the REIT asset tests. Accordingly, if we were to consider a securitization that would create a taxable mortgage pool, we would have to undertake such securitization through a TRS or a subsidiary that qualified as a REIT. These rules may limit our financing options.

The tax on prohibited transactions will limit our ability to engage in transactions, including certain methods of securitizing mortgage loans, which would be treated as sales for federal income tax purposes.

A REIT’s net income from prohibited transactions is subject to a 100% tax. In general, prohibited transactions are sales or other dispositions of property, other than foreclosure property, but including mortgage loans, held primarily for sale to customers in the ordinary course of business. We might be subject to this tax if we were to dispose of or securitize loans in a manner that was treated as a sale of the loans for federal income tax purposes. Therefore, in order to avoid the prohibited transactions tax, we may choose not to engage in certain sales of loans at the REIT level and may limit the structures we utilize for our securitization transactions, even though the sales or such structures might otherwise be beneficial to us.

Complying with REIT requirements may limit our ability to hedge effectively.

The REIT provisions of the Internal Revenue Code limit our ability to enter into hedging transactions. In order to qualify as a REIT, we must satisfy two gross income tests annually. For these purposes, income with respect to certain hedges of our liabilities or foreign currency risks will be disregarded. Income from other hedges will be non-qualifying income for purposes of both gross income tests. As a result, we might have to limit our use of advantageous hedging techniques or implement those hedges through a TRS. This could increase the cost of our hedging activities or expose us to greater risks associated with changes in interest rates than we would otherwise want to bear.

Purchases of mortgages at a discount may affect our ability to satisfy the REIT asset and gross income tests.

Whether our loan holdings are treated as real estate assets and interest income thereon is treated as qualifying income for purposes of the 75% gross income test depends on whether the loans are adequately secured by real property. If a mortgage loan is secured by both real property and personal property, the value which exceeds 15% of the value of all property securing such loan, and the value of the real property at the time the REIT commits to make or acquire the loan is less than the highest principal amount (i.e., the face amount) of the loan during the year, interest on the loan will be treated as qualifying income only in proportion to the ratio of the value of the real property at the time the REIT commits to make or acquire the loan to the highest principal amount of the loan during the year. Similarly, the IRS issued guidance for determining the extent to which an interest in an “eligible REMIC” (relating to the Home Affordable Refinance Program) is treated as a real estate asset and generates qualifying income for purposes of the 75% gross income test. Failure to accurately apply these rules and manage our income and assets could cause us to fail to qualify as a REIT.

Our qualification as a REIT could be jeopardized as a result of our interests in joint ventures or investment funds.

We currently own, and may continue to acquire, interests in partnerships or limited liability companies that are joint ventures or investment funds. We may not have timely access to information from such partnerships and limited liability companies related to monitoring and managing our REIT qualification. If a partnership or limited liability company in which we own an interest but do not control takes or expects to take actions that could jeopardize our REIT qualification or require us to pay tax, we may be forced to dispose of our interest in such entity. It is possible that a partnership or limited liability company could take an action which could cause us to fail a REIT gross income or asset test and that we would not become aware of such action in time to dispose of our interest in the partnership or limited liability company or take other corrective action on a timely basis. In that case, we could fail to qualify as a REIT unless we are able to qualify for a statutory REIT “savings” provision, which may require us to pay a significant penalty tax to maintain our REIT qualification.

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

We acquire debt instruments in the secondary market for less than their face amount. The discount at which such debt instruments are acquired may reflect doubts about their ultimate collectibility rather than current market interest rates. The amount of such discount will nevertheless generally be treated as “market discount” for federal income tax purposes. Accrued market discount is reported as income when, and to the extent that, any payment of principal of the debt instrument is made. If

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we collect less on the debt instrument than our purchase price plus the market discount we had previously reported as income, we may not be able to benefit from any offsetting loss deductions.

Some of the debt instruments that we acquire may have been issued with OID. We will be required to report such original issue discount based on a constant yield method and will be taxed based on the assumption that all future projected payments due on such debt instruments will be made. If such debt instruments or MBS and GSE CRT turn out not to be fully collectible, an offsetting loss deduction will become available only in the later year that uncollectibility is provable.

In addition, we may acquire debt instruments that are subsequently modified by agreement with the borrower. If the amendments to the outstanding instrument are "significant modifications" under the applicable Treasury regulations, the modified instrument will be considered to have been reissued to us in a debt-for-debt exchange with the borrower. In that event, we may be required to recognize taxable gain to the extent the principal amount of the modified instrument exceeds our adjusted tax basis in the unmodified instrument, even if the value of the instrument or the payment expectations have not changed. Following such a taxable modification, we would hold the modified loan with a cost basis equal to its principal amount for federal tax purposes.

Finally, in the event that any debt instruments acquired by us are delinquent as to mandatory principal and interest payments, or in the event payments with respect to a particular instrument are not made when due, we may nonetheless be required to continue to recognize the unpaid interest as taxable income as it accrues, despite doubt as to its ultimate collectibility. Similarly, we may be required to accrue interest income with respect to debt instruments at its stated rate regardless of whether corresponding cash payments are received or are ultimately collectible. In each case, while we would in general ultimately have an offsetting loss deduction available to us when such interest was determined to be uncollectible, the utility of that deduction could depend on our having taxable income in that later year or thereafter.

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

Even if we qualify as a REIT, we may be subject to certain U.S. federal, state and local taxes on our income and assets, including taxes on any undistributed income, tax on income from some activities conducted as a result of a foreclosure, and state or local income, franchise, property and transfer taxes, including mortgage-related taxes.

We may be subject to adverse legislative or regulatory tax changes that could reduce the market price of our capital stock.

At any time, the U.S. federal income tax laws or regulations governing REITs or the administrative interpretations of those laws or regulations may be amended. We cannot predict when or if any new U.S. federal income tax law, regulation or administrative interpretation, or any amendment to any existing federal income tax law, regulation or administrative interpretation, will be adopted, promulgated or become effective. Any such law, regulation or interpretation may take effect retroactively. We and our stockholders could be adversely affected by any such change in, or any new, federal income tax law, regulation or administrative interpretation.

Dividends paid by REITs do not qualify for the reduced tax rates that apply to other corporate dividends.

The maximum tax rate for "qualified dividends" paid by corporations to individuals is currently 20%. Dividends paid by REITs, however, generally are not "qualified dividends" and generally are taxed at the normal ordinary income rates, currently subject to a maximum rate of 39.6% in the case of non-corporate taxpayers. The more favorable rates applicable to qualified dividends could cause potential investors who are individuals to perceive investments in REITs to be relatively less attractive than investments in the stocks of non-REIT corporations that pay qualified dividends, which could adversely affect the value of the stock of REITs, including our capital stock.

Dividends paid by REITs may be subject to Medicare tax on net investment income.

High-income U.S. individuals, estates, and trusts will be subject to an additional 3.8% tax on net investment income. For these purposes, net investment income includes dividends and gains from sales of stock. In the case of an individual, the tax will be 3.8% of the lesser of the individuals' net investment income or the excess of the individuals' modified adjusted gross income over \$250,000 in the case of a married individual filing a joint return or a surviving spouse, \$125,000 in the case of a married individual filing a separate return, or \$200,000 in the case of a single individual.

Tax-exempt stockholders may realize unrelated business taxable income if we generate excess inclusion income.

If we acquire REMIC residual interests or equity interests in taxable mortgage pools (in a manner consistent with our REIT qualification) and generate “excess inclusion income,” a portion of our dividends received by a tax-exempt stockholder will be treated as unrelated business taxable income. Excess inclusion income would also be subject to adverse federal income tax rules in the case of U.S. taxable stockholders and non-U.S. stockholders.



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Changing the nature of our assets may complicate our ability to satisfy the REIT gross income and asset tests. We have large holdings of RMBS that are qualifying assets for purposes of the REIT asset tests and generate interest income that is qualifying income for purposes of the REIT gross income tests. The REIT asset tests do not require that all assets be qualifying assets, nor do the REIT gross income tests require that all income be qualifying income. Our substantial RMBS holdings have given us room to make investments that may not qualify, all or in part, as real estate assets or that may generate income that may not qualify, all or in part, under one or both of the gross income tests. Reductions in our RMBS holdings would reduce our room for non-qualifying assets and income. In addition, the market value or income potential of real estate-related investments declines as a result of increased interest rates, prepayment rates or other factors, we may need to increase our real estate investments and income and/or liquidate our non-qualifying assets in order to maintain our REIT qualification or exemption from the 1940 Act. If the decline in real estate asset values and/or income occurs quickly, this may be especially difficult to accomplish. This difficulty may be exacerbated by the illiquid nature of any non-real estate assets that we may own. We may have to make investment decisions that we otherwise would not make absent the REIT and Investment Company Act considerations. Furthermore, we may make investments in which the proper application of the REIT gross income and assets tests may not be clear. Mistakes in classifying assets or income for REIT purposes or in projecting the amount of qualifying and non-qualifying income could cause us to fail to qualify as a REIT.

Our qualification as a REIT may depend upon the accuracy of legal opinions or advice rendered or given or statements by the issuers of assets we acquire.

When purchasing securities, we may rely on opinions or advice of counsel for the issuer of such securities, or statements made in related offering documents, for purposes of determining, among other things, whether such securities represent debt or equity securities for U.S. federal income tax purposes, the value of such securities, and also to what extent those securities constitute qualified real estate assets for purposes of the REIT asset tests and produce qualified income for purposes of the 75% gross income test. The inaccuracy of any such opinions, advice or statements may adversely affect our ability to qualify as a REIT.

Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

Our principal executive office is located at 1555 Peachtree Street, NE, Suite 1800, Atlanta, Georgia 30309. As part of our management agreement, our Manager is responsible for providing office space and office services required in rendering services to us.

Item 3. Legal Proceedings.

From time to time, we may be involved in various claims and legal actions arising in the ordinary course of business. As of December 31, 2016, we were not involved in any such legal proceedings.

Item 4. Mine and Safety Disclosures.

Not applicable.

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## PART II

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

## Market Information

Our common stock is traded on the NYSE under the symbol "IVR." The following table sets forth, for the periods indicated, the high and low sale price of our common stock as reported on the NYSE.

	High	Low
2016		
Fourth quarter	\$ 16.04	\$ 14.18
Third quarter	\$ 16.28	\$ 13.42
Second quarter	\$ 14.73	\$ 11.95
First quarter	\$ 12.95	\$ 9.74
2015		
Fourth quarter	\$ 13.50	\$ 11.92
Third quarter	\$ 15.14	\$ 12.02
Second quarter	\$ 16.13	\$ 14.32
First quarter	\$ 16.21	\$ 15.10

## Holders

As of February 16, 2017, there were 108 stockholders of record.

## Dividends

U.S. federal income tax law generally requires that a REIT distribute annually at least 90% of its REIT taxable income, determined without regard to the deduction for dividends paid and excluding net capital gains, and that it pay tax at regular corporate rates on its undistributed taxable income. We intend to continue to pay regular quarterly dividends to our stockholders. Before we pay any dividend, whether for U.S. federal income tax purposes or otherwise, we must first meet both our operating requirements and debt service obligations. If our cash available for distribution is less than our taxable income, we could be required to sell assets or borrow funds to make cash distributions, or we may make a portion of the required distribution in the form of a taxable stock distribution or distribution of debt securities.

The following table sets forth the dividends declared per share of our common stock for the periods indicated.

Date Declared	Dividends Declared Per Share	Date Paid
2016		
December 15, 2016	\$0.40	January 26, 2017
September 14, 2016	\$0.40	October 26, 2016
June 15, 2016	\$0.40	July 26, 2016
March 15, 2016	\$0.40	April 26, 2016
2015		
December 15, 2015	\$0.40	January 26, 2016
September 15, 2015	\$0.40	October 27, 2015
June 15, 2015	\$0.45	July 28, 2015
March 17, 2015	\$0.45	April 28, 2015

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The following table sets forth the dividends declared per share of our common stock and the related tax characterization for the fiscal tax years ended December 31, 2016 and 2015.

Fiscal Tax Year	Tax Characterization of Dividends			
	Dividends Declared	Ordinary Dividends	Capital Gain Distribution	Carry Forward
Common Stock Dividends				
Fiscal tax year 2016 <sup>(1)</sup>	1.600000	1.857840	—	—
Fiscal tax year 2015 <sup>(1)</sup>	1.700000	1.615469	—	0.257840

(1) Ordinary dividends include \$0.257840 of spillover dividend carried-forward from fiscal tax year 2015.

## Performance Graph

The following graph matches the cumulative 5-year total return of holders of Invesco Mortgage Capital Inc.'s common stock with the cumulative total returns of the S&P 500 index and the FTSE NAREIT Mortgage REITs index. The graph assumes that the value of the investment in our common stock and in each of the indices (including reinvestment of dividends) was \$100 on December 31, 2011 and tracks it through December 31, 2016.

Index	12/31/2011	12/31/2012	12/31/2013	12/31/2014	12/31/2015	12/31/2016
Invesco Mortgage Capital Inc.	100.00	160.48	136.53	161.82	146.01	192.94
S&P 500	100.00	116.00	153.57	174.60	177.01	198.18
FTSE NAREIT Mortgage REITs	100.00	119.89	117.54	138.56	126.26	155.11

The stock price performance included in this graph is not necessarily indicative of future stock price performance.

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Use of Proceeds

We used the net proceeds from our common and preferred stock offerings to acquire our target assets in accordance with our objectives and strategies described in Item 1, Business - Investment Strategy. We focus on purchasing our target assets, subject to our investment guidelines and to the extent consistent with maintaining our REIT qualification and exclusion from the requirements of the 1940 Act. Our Manager determines the percentage of our equity that will be invested in each of our target assets.

Repurchases of Equity Securities

In December 2011, our board of directors approved a share repurchase program with no stated expiration date. During the year ended December 31, 2016, we repurchased and concurrently retired 2,063,451 (2015: 9,539,251) shares of our common stock at a weighted average repurchase price of \$12.12 (2015: \$13.17) per share for a net cost of \$25.0 million (2015: \$125.6 million), including acquisition expenses.

As of December 31, 2016, there were 18,239,082 common shares available for repurchase. No shares of common stock were purchased during the quarter ended December 31, 2016. The shares may be repurchased from time to time through privately negotiated transactions or open market transactions, including pursuant to a trading plan in accordance with Rules 10b5-1 and 10b-18 under the Exchange Act or by any combination of such methods. The manner, price, number and timing of share repurchases will be subject to a variety of factors, including market conditions and applicable SEC rules.

Equity Compensation Plans

We will provide the equity compensation plan information required in Item 201(d) of Regulation S-K in our definitive Proxy Statement or in an amendment to this Report not later than 120 days after the end of the fiscal year covered by this Report and is incorporated into this Item 5 by reference.

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## Item 6. Selected Financial Data.

The selected historical financial information as of and for the years ended December 31, 2016, 2015, 2014, 2013 and 2012 presented in the tables below have been derived from our audited financial statements. The information presented below is not necessarily indicative of the trends in our performance.

The information presented below is only a summary and does not provide all of the information contained in our historical financial statements, including the related notes. You should read the information below in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our historical financial statements, including the related notes, included elsewhere in this Report.

## Balance Sheet Data

\$ in thousands	As of December 31,				
	2016	2015	2014	2013	2012
Mortgage-backed and credit risk transfer securities, at fair value	14,981,331	16,065,935	17,248,895	17,348,657	18,470,563
Residential loans, held-for-investment <sup>(1)</sup>	—	—	3,365,003	1,810,262	—
Commercial loans, held-for-investment	273,355	209,062	145,756	64,599	—
Total assets <sup>(1)</sup>	15,706,238	16,767,309	21,218,097	20,337,245	18,914,760
Repurchase agreements	11,160,669	12,126,048	13,622,677	15,451,675	15,720,460
Secured loans	1,650,000	1,650,000	1,250,000	—	—
Asset-backed securities <sup>(1)</sup>	—	—	2,924,787	1,640,355	—
Exchangeable senior notes	397,041	394,573	392,113	389,652	—
Total stockholders' equity	2,241,560	2,241,035	2,610,315	2,376,115	2,558,098
Non-controlling interest	28,624	25,873	28,535	27,120	31,422
Total equity	2,270,184	2,266,908	2,638,850	2,403,235	2,589,520

As of December 31, 2014 and December 31, 2013, our consolidated balance sheets included assets and liabilities of consolidated variable interest entities ("VIEs"). We deconsolidated these VIEs in 2015. As of December 31, 2014 (1) and December 31, 2013, total assets of the consolidated VIEs were \$3,380,597 and \$1,819,295, respectively, and total liabilities of the consolidated VIEs were \$2,938,512 and \$1,648,400, respectively. Refer to Note 3 - "Variable Interest Entities" of our consolidated financial statements for further discussion.

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## Statements of Operations Data

\$ in thousands, except share amounts	For the Years ended December 31,				
	2016	2015	2014	2013	2012
Interest income	478,682	650,132	687,080	680,491	559,730
Interest expense	157,354	277,973	281,895	332,252	237,405
Net interest income	321,328	372,159	405,185	348,239	322,325
(Reduction in) provision for loan losses	—	(213	) (142	) 884	—
Net interest income after provision for loan losses	321,328	372,372	405,327	347,355	322,325
Other income (loss)	(21,824	) (203,697	) (570,001	) (136,737	) 52,485
Expenses	41,806	54,620	52,866	53,144	39,684
Net income (loss)	257,698	114,055	(217,540	) 157,474	335,126
Net income (loss) attributable to non-controlling interest	3,287	1,344	(2,482	) 1,640	4,015
Net income (loss) attributable to Invesco Mortgage Capital Inc.	254,411	112,711	(215,058	) 155,834	331,111
Dividends to preferred stockholders	22,864	22,864	17,378	10,851	5,395
Net income (loss) attributable to common stockholders	231,547	89,847	(232,436	) 144,983	325,716
Earnings per share:					
Net income (loss) attributable to common stockholders					
Basic	2.07	0.74	(1.89	) 1.09	2.82
Diluted	1.98	0.74	(1.89	) 1.09	2.82
Dividends declared per common share	1.60	1.70	1.95	2.30	2.60
Weighted average number of shares of common stock:					
Basic	111,973,404	121,377,585	123,104,934	132,714,012	115,558,668
Diluted	130,254,003	122,843,838	124,529,934	134,173,691	117,012,500

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

The following discussion should be read in conjunction with our consolidated financial statements and the accompanying notes to our consolidated financial statements, which are included in Part IV, Item 15 of this Report.

## Overview

We are a Maryland corporation primarily focused on investing in, financing and managing residential and commercial mortgage-backed securities ("MBS") and mortgage loans. Our objective is to provide attractive risk-adjusted returns to our investors, primarily through dividends and secondarily through capital appreciation. To achieve this objective, we primarily invest in the following:

Residential mortgage-backed securities ("RMBS") that are guaranteed by a U.S. government agency such as the Government National Mortgage Association or a federally chartered corporation such as the Federal National Mortgage Association ("Fannie Mae") or the Federal Home Loan Mortgage Corporation ("Freddie Mac") (collectively "Agency RMBS");

RMBS that are not guaranteed by a U.S. government agency ("non-Agency RMBS");

Credit risk transfer securities that are unsecured obligations issued by government-sponsored enterprises ("GSE CRT");

Commercial mortgage-backed securities ("CMBS");

Residential and commercial mortgage loans; and



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Other real estate-related financing arrangements.

We have elected to be taxed as a real estate investment trust (“REIT”) for U.S. federal income tax purposes under the provisions of the Internal Revenue Code of 1986. To maintain our REIT qualification, we are generally required to distribute at least 90% of our REIT taxable income to our stockholders annually. We operate our business in a manner that permits our exclusion from the definition of an “Investment Company” under the 1940 Act. We are externally managed and advised by Invesco Advisers, Inc., our Manager, which is an indirect, wholly-owned subsidiary of Invesco Ltd.

Capital Activities

On December 15, 2016, we declared the following dividends:

• a dividend of \$0.40 per share of common stock to be paid on January 26, 2017 to stockholders of record as of the close of business on December 27, 2016;

• a dividend of \$0.4844 per share of Series A Preferred Stock to be paid on January 25, 2017 to stockholders of record as of the close of business on January 1, 2017; and

• a dividend of \$0.4844 per share of Series B Preferred Stock to be paid on March 27, 2017 to stockholders of record as of the close of business on March 5, 2017.

During the three months ended December 31, 2016, we did not repurchase any shares of our common stock. During the year ended December 31, 2016, we repurchased 2,063,451 shares of our common stock at an average repurchase price of \$12.12 per share for a net cost of \$25.0 million, including acquisition expenses.



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## Factors Impacting Our Operating Results

Our operating results can be affected by a number of factors and primarily depend on the level of our net interest income and the market value of our assets. Our net interest income, which includes the amortization of purchase premiums and accretion of purchase discounts, varies primarily as a result of changes in market interest rates and prepayment speeds, as measured by the constant prepayment rate (“CPR”) on our target assets. Interest rates and prepayment speeds vary according to the type of investment, conditions in the financial markets, competition and other factors, none of which can be predicted with any certainty. The market value of our assets can be impacted by credit spread premiums (yield advantage over U.S. Treasury notes) and the supply of, and demand for, target assets in which we invest.

## Market Conditions

Macroeconomic factors that affect our business include credit spread premiums, market interest rates, governmental policy initiatives, residential and commercial real estate prices, credit availability, consumer personal income, corporate earnings, employment conditions, financial conditions and inflation.

The global financial markets ended 2016 on a positive note following the U.S. Presidential election, with equity markets rallying and U.S. Treasury yields rising as investors priced in an increased profitability of greater fiscal stimulus, tax reform and an easing of regulatory pressures under the new administration. Subsequently, the Federal Reserve increased the Federal Funds target interest rate at its December meeting. U.S. equity markets rallied after the election, as the S&P 500 Index returned 3.82% for the quarter and returned 11.96% for all of 2016. Financial conditions remained tight throughout 2016, as energy prices rose over the course of the year (the price of WTI Crude ended the year at \$53.72 per barrel, \$9.13 higher than at the end of 2015, and \$3.79 higher over the course of the quarter). As we move into 2017, investor concerns include the ability of the new administration to enact its intended policies, central banks' actions and their impact on the global economy, regulations related to risk retention and higher global capital requirements for financial institutions, the sustainability of China's economic growth, and the potential impact of the Brexit process and resulting stress in the European banking system.

For 2016, U.S. gross domestic product domestic grew by 1.6%, with the consensus forecast for both 2017 and 2018 at 2.3%. Core personal consumption expenditures ended 2016 up 1.7%, while the expectation for 2017 stands at 1.8%, still shy of the 2% target communicated by the Federal Reserve. Monthly increases in payroll employment averaged 165,000 jobs per month for the fourth quarter of 2016, slightly below the average of 179,750 over the last twelve months. The consensus of economists forecast monthly payrolls to increase by 163,000 jobs per month in 2017. Looking forward, an improving labor market coupled with relatively low interest rates and energy prices should be supportive of U.S. consumer spending. Trade may be a headwind, as U.S. dollar exchange rates relative to a basket of major world currencies strengthened to multi-year highs during the fourth quarter of 2016 following the U.S. elections. In summary, it still appears that the U.S. will continue to experience modest economic growth, and core inflation is likely to remain below the Federal Reserve's policy objective of 2%. However, given the ambiguities surrounding the new administration's policy decisions, this outlook remains uncertain.

After falling for the better part of 2016, U.S. Treasury bond yields reversed course and were sharply higher during the fourth quarter. Rates on the long end of the yield curve rose more than rates on the short end during the fourth quarter of 2016, with the yield on the two year U.S. Treasury note up 43 basis points (to 1.19%), the yield on the five year Treasury note up 78 basis points (to 1.93%) and the yield on the 10 year Treasury note up 84 basis points (to 2.44%). Short term rates were also higher, with three-month LIBOR ending the year 39 basis points higher (to 1.00%). We expect the rate environment to remain relatively volatile, as the Federal Reserve continues to signal a willingness to increase the Federal Funds rate, and investors wait to see how the new administration's efforts to increase fiscal stimulus, enact tax reform and provide relief from regulatory burdens unfolds.

During 2016, the performance of Agency RMBS was mixed. Despite underperforming during the fourth quarter, Hybrid ARM Agency RMBS and 15 year fixed-rate Agency RMBS ended the year with positive excess returns, while 30 year fixed-rate Agency RMBS had negative excess returns for both the quarter and the full year. Swap spreads were modestly wider over the course of 2016, with the two year, five year and ten year swap spreads wider by 13.6, 7.0 and 2.75 basis points, respectively. Refinancing activity responded to the higher rate environment and winter seasonal period by slowing materially. The Mortgage Bankers Association refinancing index fell by more than half

during the quarter (from 2,380 to 1,132) and ended the year down 11.1%.

Spreads on CMBS and GSE CRT securities tightened materially in the fourth quarter and year over year, reflecting improving real estate prices, strong investor demand and steady financial conditions. Financing markets remained accommodating in the fourth quarter and throughout 2016. Agency RMBS and credit bond repurchase agreements' rates moved higher in the fourth quarter in line with an increase in the Federal Funds rate, and normal year end bank balance sheet pressures. The outlook for Agency RMBS remains mixed, as increased interest rate volatility and the possibility that reinvestment activity by the Federal Reserve may end earlier than expected weighs on the market. On the positive side, low

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interest rates abroad should support demand for Agency RMBS due to the relatively attractive yield and the implicit U.S. government guarantee.

In addition, the regulatory landscape for our repurchase agreement counterparties continues to evolve following the adoption of new capital rules which generally affects the manner in which banks lend. Regulators are also focused on liquidity requirements which will likely impact how banks fund themselves. While we are not directly subject to compliance with the implementation of rules regarding financial institutions, the effect of these regulations and others could affect our ability to finance our assets in the future.

**Investment Activities**

In 2016, our investment portfolio remained positioned to take advantage of opportunities in both mortgage-backed and credit risk transfer securities and newly originated loans against a backdrop of improving real estate markets.

The table below shows the allocation of our equity as of December 31, 2016 and 2015:

	As of	
	December	
	31,	
	2016	2015
Agency RMBS	41 %	37 %
Commercial Credit <sup>(1)</sup>	32 %	33 %
Residential Credit <sup>(2)</sup>	27 %	30 %
Total	100%	100%

<sup>(1)</sup> CMBS, Commercial Loans and \$33.3 million of Investments in unconsolidated ventures (which are included in Other Assets), are considered commercial credit.

<sup>(2)</sup> Non-Agency RMBS and GSE CRT are considered residential credit.

Over the past year our allocation of equity to Agency RMBS has increased to 41% and our allocation to residential and commercial credit has decreased to 59%. The shift reflects our strategy of decreasing risk in front of the U.S. Presidential election, Federal Reserve meetings and Brexit negotiations, and creates capacity to invest in credit assets should we see favorable market and asset opportunities.

The table below shows the breakdown of our investment portfolio as of December 31, 2016 and 2015:

\$ in thousands	As of December 31,	
	2016	2015
Agency RMBS:		
15 year fixed-rate, at fair value	3,557,928	1,610,930
30 year fixed-rate, at fair value	2,981,717	4,063,957
Hybrid ARM, at fair value	2,474,301	3,309,525
ARM, at fair value	307,873	426,025
Agency CMO, at fair value	344,041	388,819
Non-Agency RMBS, at fair value	1,995,551	2,692,487
GSE CRT, at fair value	768,200	658,228
CMBS, at fair value	2,551,720	2,915,964
Commercial loans, at amortized cost	273,355	209,062
Investment in unconsolidated ventures	33,301	38,413
Total Investment portfolio	15,287,987	16,313,410

During 2016, we primarily reinvested cash flows from sales and principal repayments into 15 year fixed-rate Agency RMBS. We have been increasing our holdings of 15 year fixed-rate Agency RMBS versus 30 year fixed-rate Agency RMBS to decrease our interest rate risk and further reduce book value volatility. As of December 31, 2016 our holdings of 15 year fixed-rate Agency RMBS represented 23% of our total investment portfolio versus 10% of our total investment portfolio as of December 31, 2015. We have continued to hold certain 30 year fixed-rate Agency RMBS securities that have relatively lower interest rate risk because they are collateralized by mortgages with higher coupons. We expect these securities to prepay more favorably than their applicable cohorts based on their seasoning

and collateral attributes. Additionally, we hold Hybrid ARM

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Agency RMBS and ARM Agency RMBS that we believe have lower durations and better cash flow certainty relative to current coupon 30 year fixed-rate Agency RMBS. Further, we own Agency collateralized mortgage obligations ("CMOs"), some of which are interest-only securities ("IOs").

Our portfolio of investments that have credit exposure include non-Agency RMBS, GSE CRTs, CMBS and commercial estate loans. Rather than relying on the rating agencies, we utilize proprietary models as well as third party applications to quantify and monitor the credit risk associated with our portfolio holdings. Our analysis generally begins at the underlying asset level, where we gather detailed information on loan, borrower, and property characteristics that inform our expectations for future performance. In addition to base case cash flow projections, we perform a range of scenario stresses to gauge the sensitivity of returns to potential deviations in underlying asset behavior. We perform this detailed credit analysis at the time of initial purchase and regularly throughout the holding period of each investment.

With respect to our non-Agency RMBS portfolio, we primarily invest in RMBS collateralized by prime and Alt-A loans. In addition, we have invested in re-securitizations of real estate mortgage investment conduit ("Re-REMIC") RMBS and reperforming mortgage loans that we believe provide attractive risk adjusted returns. We also invest in GSE CRTs, which have the added benefit of paying a floating rate coupon and reduce our need to hedge interest rate risk. Our GSE CRT holdings increased modestly over the past twelve months. We view GSE CRT as an attractive asset class based on the strength of the U.S. housing market, the strong performance of reference mortgage loans to date, and potentially compelling relative value.

Our CMBS portfolio generally consists of assets originated during and after 2010 ("CMBS 2.0"). CMBS investments represent approximately 17% of our total investment portfolio as of December 31, 2016.

During 2016, we purchased or originated five new commercial real estate loans. As of December 31, 2016, our commercial real estate loan portfolio includes ten mezzanine loans that we purchased or originated. The commercial real estate loan portfolio's weighted average loan-to-value ratio is approximately 66%, based on the most recently attained independent property appraisals and the relevant loan amounts. For further details on the loan portfolio, refer to Note 5 - "Commercial Loans Held-for-Investment" of our consolidated financial statements in Part IV, Item 15 of this Report.

New credit risk retention rules for commercial mortgage-backed securities became effective under the Dodd-Frank Wall Street Reform and Consumer Protection Act on December 24, 2016. The new credit risk retention rules require originators and/or an investor to retain 5% of the fair market value of any new securitizations. Risk retention can be achieved by the originator or investor retaining a pro-rata portion of the classes of notes and equity ("vertical option"), a horizontal "first-loss" piece which is most subordinate in the capital structure ("horizontal option") or a combination of the horizontal and vertical options ("L-shaped option").

The credit risk retention rules allow the sponsor of a transaction to retain at least 5% of the fair market value of the CMBS or sell all or a portion of this amount to a qualified third-party purchaser ("B-piece investor"). There is a minimum five year holding period for the retained investment. At this point, we think it is possible we could see all of these options eventually adopted by the market.

The new risk retention rules have the potential to increase borrowing costs and limit existing borrower loan re-financing options if the number of market participants, or the level of investor CMBS demand, decreases. Despite this possibility, we do not expect CMBS issuance to slow materially relevant to 2016 as issuers and investors are making notable strides to adapt their businesses. As a result, we expect to continue to find attractive opportunities in both new issue and legacy CMBS. Additionally, our direct lending capabilities position us well to find opportunities in both mezzanine and senior mortgage commercial real estate loan investments.

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## Portfolio Characteristics

The table below illustrates the vintage distribution of our non-Agency RMBS, GSE CRT and CMBS portfolio as of December 31, 2016 as a percentage of fair value:

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Total
Prime	0.4%	1.5%	4.3%	3.7%	8.0%	2.3%	—%	—%	—%	—%	12.7%	10.1%	1.4%	0.2%	44.0%
Alt-A	—%	0.7%	7.5%	6.4%	7.8%	—%	—%	—%	—%	—%	—%	—%	—%	—%	22.0%
Re-REMIC <sup>(1)</sup>	—%	—%	—%	—%	0.4%	—%	0.6%	4.4%	8.7%	3.4%	0.7%	—%	—%	—%	18.0%
Subprime/reperforming	—%	—%	—%	—%	0.3%	—%	—%	—%	—%	—%	2.6%	10.0%	1.9%	—%	14.0%
Total Non-Agency	0.4%	2.2%	11.8%	10.1%	16.5%	2.3%	0.6%	4.4%	8.7%	3.4%	16.0%	20.1%	3.3%	0.2%	100.0%
GSE CRT	—%	—%	—%	—%	—%	—%	—%	—%	—%	—%	33.8%	39.1%	9.7%	17.4%	100.0%
CMBS	—%	—%	0.1%	0.1%	—%	—%	—%	6.4%	24.3%	14.9%	15.3%	33.4%	5.5%	—%	100.0%

(1) For Re-REMICs, the table reflects the year in which the resecuritizations were issued. The vintage distribution of the securities that collateralize our Re-REMIC investments is 7.7% for 2005, 24.0% for 2006 and 68.3% for 2007.

The tables below represent the geographic concentration of the underlying collateral for our non-Agency RMBS, GSE CRT and CMBS portfolio as of December 31, 2016:

Non-Agency RMBS State	Percentage	GSE CRT State	Percentage	CMBS State	Percentage
California	41.4%	California	19.8%	California	14.7%
New York	7.7%	Texas	6.0%	New York	13.9%
Florida	6.3%	New York	4.4%	Texas	10.1%
Virginia	3.6%	Virginia	4.3%	Florida	6.0%
Maryland	3.5%	Florida	4.2%	Pennsylvania	4.6%
New Jersey	3.5%	Illinois	3.9%	Illinois	4.3%
Massachusetts	2.9%	Massachusetts	3.4%	New Jersey	3.7%
Illinois	2.9%	Washington	3.3%	Ohio	3.0%
Washington	2.6%	New Jersey	3.2%	Michigan	3.0%
Texas	2.1%	Colorado	3.2%	Virginia	2.8%
Other	23.5%	Other	44.3%	Other	33.9%
Total	100.0%	Total	100.0%	Total	100.0%

## Financing and Other Liabilities.

We enter into repurchase agreements to finance the majority of our target assets. These agreements are secured by our Agency RMBS, non-Agency RMBS, GSE CRTs and CMBS. In addition, these agreements are generally settled on a short-term basis, usually ranging from one to twelve months, and bear interest at rates that have historically moved in close relationship to LIBOR. At each settlement date, we refinance each repurchase agreement at the market interest rate at that time. As of December 31, 2016, we had entered into repurchase agreements totaling \$11.2 billion (2015: \$12.1 billion). The decrease in our repurchase agreement balance was primarily due to a lower overall investment portfolio balance and our strategy of reducing leverage in advance of the U.S. Presidential election and anticipated increase in the Federal Funds interest rate.

Our wholly-owned subsidiary, IAS Services LLC, is a member of the FHLBI. As a member of the FHLBI, IAS Services LLC has borrowed funds from the FHLBI in the form of secured advances. As of December 31, 2016, IAS Services LLC had \$1.65 billion in outstanding secured advances. For the year ended December 31, 2016, IAS Services LLC had weighted average borrowings of \$1.65 billion with a weighted average borrowing rate of 0.66% and a weighted average maturity of 7.35 years.

On January 12, 2016, new FHFA rules were adopted that exclude captive insurance companies from Federal Home Loan Bank membership. Under the new rules, IAS Services LLC is permitted to remain a member of the Federal Home Loan Bank until February 2021, and the FHLBI is permitted to honor the contractual maturity of our existing advances. Accordingly, we do not expect there to be any impact to our existing FHLBI borrowings under the FHFA Rule.



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The following table presents the amount of collateralized borrowings outstanding under repurchase agreements and secured loans as of the end of each quarter, the average amount outstanding during the quarter and the maximum balance outstanding during the quarter:

\$ in thousands	Collateralized borrowings under repurchase agreements and secured loans		
	Quarter-end balance	Average quarterly balance	Maximum balance outstanding
March 31, 2015	14,883,081	14,785,890	14,883,081
June 30, 2015	14,724,860	14,860,637	14,950,089
September 30, 2015	14,587,131	14,765,282	14,879,873
December 31, 2015	13,776,048	14,286,242	14,730,071
March 31, 2016	12,837,159	13,137,569	13,501,433
June 30, 2016	13,418,647	13,075,770	13,418,647
September 30, 2016	13,710,502	13,826,469	13,984,960
December 31, 2016	12,810,669	13,215,697	13,626,829

In 2013, our wholly-owned subsidiary, IAS Operating Partnership LP, issued \$400.0 million in aggregate principal amount of Exchangeable Senior Notes (the "Notes") due March 15, 2018. The Notes bear interest at 5.00% per annum, payable semi-annually in arrears on March 15 and September 15 of each year, beginning September 15, 2013. The Notes may be exchanged for shares of our common stock at the applicable exchange rate at any time prior to the close of business on March 13, 2018. The initial exchange rate for each \$1,000 aggregate principal amount of the Notes is 42.0893 shares of our common stock, equivalent to an exchange price of approximately \$23.76 per share, and the maximum exchange rate is 48.4027 shares of our common stock, equivalent to an exchange price of approximately \$20.66 per share.

We have also committed to invest up to \$121.6 million in unconsolidated ventures that are sponsored by an affiliate of our Manager. As of December 31, 2016, \$106.1 million of our commitment to these unconsolidated ventures has been called. We are committed to fund an additional \$15.5 million in additional capital to fund future investments and to cover future expenses should they occur.

We record a liability for mortgage-backed and credit risk transfer securities purchased, for which settlement has not taken place, as an investment related payable. As of December 31, 2016 and 2015, we had investment related payables of \$9.2 million and \$167,000, respectively. Our liability balance fluctuates based on our volume of unsettled trades. We record a receivable for mortgage-backed and credit risk transfer securities sold for which settlement has not taken place as an investment related receivable. As of December 31, 2016 and 2015, we had investment related receivables of \$43.9 million and \$154.6 million, respectively. Our receivable balance fluctuates based on our volume of unsettled trades.

**Hedging Instruments.**

We generally hedge as much of our interest rate and foreign exchange risk as we deem prudent in light of market conditions. No assurance can be given that our hedging activities will have the desired beneficial impact on our results of operations or financial condition. Our investment policies do not contain specific requirements as to the percentages or amount of risk that we are required to hedge.

Hedging may fail to protect or could adversely affect us because, among other things:

- available interest rate hedging may not correspond directly with the interest rate risk for which protection is sought;
- the duration of the hedges may not match the duration of the related liabilities;
- our counterparty in the hedging transaction may default on its obligation to pay;
  - the credit quality of our counterparty on the hedge may be downgraded to such an extent that it impairs our ability to sell or assign our side of the hedging transaction; and
- the value of derivatives used for hedging may be adjusted from time-to-time in accordance with accounting rules to reflect changes in fair value.



As of December 31, 2016, we have entered into interest rate swap agreements designed to mitigate the effects of increases in interest rates under a portion of our borrowings. These swap agreements provide for fixed interest rates indexed off of one-month and three-month LIBOR and effectively fix the floating interest rates on \$6.5 billion (2015: \$11.5 billion) of borrowings.

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During the year ended December 31, 2016, we terminated swaps with a notional amount of \$5.0 billion and realized losses of \$69.1 million. The terminated swaps were predominantly maturing in 2016 and offered little protection from rising rates. Additionally, our investment and repurchase agreement balances decreased due to asset sales to facilitate stock repurchases, further reducing our need for hedging. Our overall interest rate risk did not change materially as a result of the swap terminations.

As of December 31, 2016, we have no outstanding interest rate swaptions. As of December 31, 2015, we held \$300.0 million in notional amount of fixed receive interest rate swaptions as an asset with a fair value of \$0. The swaptions that we held at December 31, 2015 expired unexercised, and we realized a net loss of \$1.5 million. We purchase interest rate swaptions to reduce the impact that interest rate volatility has on our portfolio. The change in the notional amount of swaptions held was due to our views on the potential for change in volatility.

As of December 31, 2016 and December 31, 2015, we have no outstanding futures contracts. During the year ended December 31, 2015, we sold U.S. Treasury futures contracts of \$248.3 million in notional amount and realized a net loss of \$943,000. We periodically invest in U.S. Treasury futures to help mitigate the potential impact of changes in interest rates on the performance of our portfolio.

As of December 31, 2016 and December 31, 2015, we have no outstanding to-be-announced securities ("TBAs"). During the year ended December 31, 2015, we settled TBAs of \$446.0 million in notional amount and realized a net loss of \$2.3 million. When we enter into TBAs, we agree to purchase or deliver in the future Agency RMBS with certain principal and interest terms. We periodically purchase or sell certain TBAs to help mitigate the potential impact of changes in interest rates on the performance of our portfolio.

As of December 31, 2016, we held \$62.3 million (2015: \$76.3 million) in notional amount of currency forward contracts as an asset with a fair value of \$101,000 (2015: \$1.9 million) and a liability with a fair value of \$395,000 (2015: \$103,000). During the year ended December 31, 2016, we settled currency forward contracts of \$307.5 million (2015: \$131.0 million) in notional amount and realized a net gain of \$12.6 million (2015: \$1.2 million). We use currency forward contracts to help mitigate the potential impact of changes in foreign currency exchange rates on our investments denominated in foreign currencies.

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## Book Value per Share

We calculate book value per share as follows:

In thousands except per share amounts	Years Ended December 31,		
	2016	2015	2014
Numerator (adjusted equity):			
Total equity	2,270,184	2,266,908	2,638,850
Less: Liquidation preference of Series A Preferred Stock	(140,000 )	(140,000 )	(140,000 )
Less: Liquidation preference of Series B Preferred Stock	(155,000 )	(155,000 )	(155,000 )
Total adjusted equity	1,975,184	1,971,908	2,343,850
Denominator (number of shares - fully diluted) <sup>(1)</sup> :			
Beginning shares - fully diluted	115,045	124,536	125,935
Proceeds from issuance of common stock, net of offering costs	3	13	16
Repurchase of shares of common stock	(2,063 )	(9,539 )	(1,438 )
Stock awards	35	35	23
Ending shares - fully diluted	113,020	115,045	124,536
Book value per common share	17.48	17.14	18.82

(1) Number of shares - fully diluted includes total common shares outstanding plus Operating Partnership Units convertible into shares of common stock (1,425,000 shares).

Our book value per diluted common share increased in 2016 due to tighter credit spreads, which resulted in an increase in valuations for our residential and commercial credit investments. Although we saw a benefit from credit spreads tightening in 2016, interest rates also rose, causing our Agency RMBS portfolio to decrease in value. The decrease was partially offset by our interest rate hedges. Refer to Item 7A. "Quantitative and Qualitative Disclosures About Market Risk" for interest rate risk and its impact on fair value.

The decrease in our book value in 2015 from 2014 was primarily due to the change in valuation of our investment portfolio that is recorded in accumulated other comprehensive income on our consolidated balance sheets. Refer to Note 4 – "Mortgage-Backed and Credit Risk Transfer Securities" of our consolidated financial statements for the impact of changes in accumulated other comprehensive income on our investment portfolio.

Critical Accounting Policies

Our consolidated financial statements are prepared in accordance with U.S. GAAP, which requires the use of estimates that involve the exercise of judgment regarding matters that are uncertain at the time policies were applied and estimates were made. Accounting estimates discussed in this section are those that we consider to be the most critical to an understanding of our financial statements because they involve significant judgments and uncertainties. All of these estimates reflect our best judgment about current, and for some estimates, future economic and market conditions and their effects based on information available as of the date of these financial statements. If conditions change from those expected, it is possible that the judgments and estimates described below could change, which may result in a change in valuation of our investment portfolio, future impairments of our MBS and GSE CRTs, change in our interest income recognition, allowance for loan losses, and a change in our tax liability among other effects.

**Mortgage-Backed and Credit Risk Transfer Securities.** We record our MBS except RMBS IOs, purchased prior to September 1, 2016, as available-for-sale and report them at fair value. RMBS IOs and GSE CRTs are hybrid financial instruments reported at fair value. Fair value is determined by obtaining valuations from an independent source. If the fair value of a security is not available from a third-party pricing service, we may estimate the fair value of the security using a variety of methods including other pricing services, discounted cash flow analysis, matrix pricing, option adjusted spread models and other fundamental analysis of observable market factors. It is possible that changes in these inputs could change the valuation estimate and lead to impairment of our MBS and GSE CRT portfolio.

Further information is provided in Note 2 - "Summary of Significant Accounting Policies" and Note 4 - "Mortgage-Backed and Credit Risk Transfer Securities."

We have elected the fair value option for all of our MBS purchased on or after September 1, 2016. Prior to September 1, 2016, we have also elected the fair value option for our RMBS IOs. We have also previously elected the fair value option for GSE CRTs purchased on or after August 24, 2015. Under the fair value option, changes in fair value are recognized in the

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consolidated statement of operations. In our view, the fair value option election more appropriately reflects the results of our operations because MBS and GSE CRT fair value changes are accounted for in the same manner as fair value changes in economic hedging instruments. As of December 31, 2016, \$427.5 million or 2.9% of our MBS and GSE CRT are accounted for under the fair value option. Further information is provided in Note 2 - "Summary of Significant Accounting Policies" and Note 4 - "Mortgage-Backed and Credit Risk Transfer Securities".

Other-than-temporary Impairment. We regularly review our available-for-sale portfolio for other-than-temporary impairment. This determination involves both qualitative and quantitative data. It is possible that estimates may be incorrect, economic conditions may change or we may be forced to sell the investment before recovery of our amortized cost. Further information is provided in Note 2 - "Summary of Significant Accounting Policies" and Note 4 - "Mortgage-Backed and Credit Risk Transfer Securities."

Residential and Commercial Loans. Residential loans held-for-investment were carried at unpaid principal balance net of any premiums and an allowance for loan losses. An allowance for loan losses is established based on credit losses inherent in the portfolio. These estimates require consideration of various inputs including, but not limited to, historical loss experience, delinquency status, borrower credit scores, geographic concentrations and loan-to-value ratios. In addition, since we had not incurred any direct losses on our portfolio, we utilized national historical credit performance information from a third party to assist in our analysis.

Commercial loans held-for-investment are carried at amortized cost, net of any allowance for loan losses. We generally consider various factors in evaluating whether a commercial loan is impaired. These factors include, but are not limited to, the loan-to-value ratios, the most recent financial information available for each loan and associated properties, economic trends and the loan sponsor or the borrowing entity's ability to ensure that properties associated with the loan are managed and operating sufficiently.

Changes in our estimates can significantly impact the allowance for loan losses and provision expense. It is also possible that we will experience credit losses that are different from our current estimates or that the timing of those losses may differ from our estimates. Further information on the allowance for loan losses is provided in Note 2 - "Summary of Significant Accounting Policies."

Interest Income Recognition. Interest income on MBS is accrued based on the outstanding principal or notional balance of the securities and their contractual terms. Premiums or discounts are amortized or accreted into interest income over the life of the investment using the effective interest method.

Interest income on our MBS where we may not recover substantially all of our initial investment is based on estimated future cash flows. We estimate future expected cash flows at the time of purchase and determine the effective interest rate based on these estimated cash flows and our purchase price. Over the life of the investments, we update these estimated future cash flows and compute a revised yield based on the current amortized cost of the investment. In estimating these future cash flows, there are a number of assumptions that are subject to uncertainties and contingencies, including but not limited to the rate and timing of principal payments (prepayments, repurchases, defaults and liquidations), the pass through or coupon rate, and interest rate fluctuations. These uncertainties and contingencies are difficult to predict and are subject to future events that may impact our estimate and our interest income. Changes in our original or most recent cash flow projections may result in a prospective change in interest income recognized on these securities, or the amortized cost of these securities. For non-Agency RMBS not of high credit quality, when actual cash flows vary from expected cash flows, the difference is recorded as an adjustment to the amortized cost of the security and the security's yield is revised prospectively.

For Agency RMBS that cannot be prepaid in such a way that we would not recover substantially all of our initial investment, interest income recognition is based on contractual cash flows. We do not estimate prepayments in applying the effective interest method.

Interest income on GSE CRTs purchased prior to August 24, 2015 is accrued based on the coupon rate of the debt host contract which reflects the credit risk of GSE unsecured senior debt with a similar maturity. Premiums or discounts associated with the purchase of credit risk transfer securities are amortized or accreted into interest income over the life of the debt host contract using the effective interest method. Interest income on GSE CRTs purchased on or after August 24, 2015 is based on estimated future cash flows.

Prior to the deconsolidation of the Residential Securitizations, interest income from our residential loans was recognized on an accrual basis with the related premiums amortized into interest income using the effective interest method over the weighted average life of these loans. As needed, these estimated cash flows were updated and a revised yield was computed based on the current amortized cost of the investment.

Interest income from our commercial loans is recognized when earned and deemed collectible or until a loan becomes past due based on the terms of the loan agreement.

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Accounting for Derivative Financial Instruments. We use derivatives to manage interest rate and currency exchange risk. We record all derivatives on our consolidated balance sheets at fair value. Effective December 31, 2013, we voluntarily discontinued hedge accounting for our interest rate swap agreements by de-designating the interest rate swaps as cash flow hedges. As a result of discontinuing hedge accounting, changes in the fair value of the interest rate swaps are recorded in gain (loss) on derivative instruments, net in our consolidated statement of operations, rather than in accumulated other comprehensive income (loss). Further information is provided in Note 9 - “Derivatives and Hedging Activities.”

Income Taxes. We have elected to be taxed as a REIT. Accordingly, we generally will not be subject to U.S. federal and applicable state and local corporate income tax to the extent that we make qualifying distributions and provided we satisfy on a continuing basis, through actual investment and operating results, the REIT requirements including certain asset, income, distribution and stock ownership tests. The REIT qualifications rules are complex and failure to apply them correctly could subject us to U.S. federal, state and local income taxes.

Expected Impact of New Authoritative Guidance on Future Financial Information

In January 2016, the FASB issued guidance to improve certain aspects of classification and measurement of financial instruments, including significant revisions in accounting related to the classification and measurement of investments in equity securities and presentation of certain fair value changes for financial liabilities when the fair value option is elected. The guidance also amends certain disclosure requirements associated with the fair value of financial instruments. We are required to adopt the new guidance in the first quarter of 2018. Early adoption is permitted. We are currently evaluating the potential impact of the new guidance on our consolidated financial statements, as well as available transition methods.

In June 2016, the FASB issued an amendment to the guidance on reporting credit losses for assets measured at amortized cost and available-for-sale securities. We are required to adopt the new guidance in the first quarter of 2020. Early adoption is permitted. We are currently evaluating the potential impacts of the new guidance on our consolidated financial statements, as well as available transition methods.

In August 2016, the FASB issued new guidance that is intended to reduce diversity in practice in how certain transactions are classified in the statement of cash flows. We are required to adopt the new guidance in the first quarter of 2018. Early adoption is permitted, provided that all of the amendments are adopted at the same period. We are currently evaluating the potential impacts of the new guidance on our consolidated financial statements.

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## Results of Operations

The table below presents certain information from our consolidated statements of operations for the years ended December 31, 2016, 2015 and 2014.

In thousands except share amounts	Years Ended December 31,		
	2016	2015	2014
<b>Interest Income</b>			
Mortgage-backed and credit risk transfer securities	456,444	523,893	589,499
Residential loans <sup>(1)</sup>	—	110,908	88,073
Commercial loans	22,238	15,331	9,508
Total interest income	478,682	650,132	687,080
<b>Interest Expense</b>			
Repurchase agreements	124,000	166,892	188,699
Secured loans	10,887	6,579	2,576
Exchangeable senior notes	22,467	22,461	22,461
Asset-backed securities <sup>(1)</sup>	—	82,041	68,159
Total interest expense	157,354	277,973	281,895
Net interest income	321,328	372,159	405,185
Reduction in provision for loan losses	—	(213	) (142
Net interest income after reduction in provision for loan losses	321,328	372,372	405,327
<b>Other income (loss)</b>			
Gain (loss) on investments, net	(17,542	) (18,005	) (84,407
Equity in earnings of unconsolidated ventures	2,392	12,630	6,786
Gain (loss) on derivative instruments, net	(62,815	) (219,048	) (487,469
Realized and unrealized credit derivative income (loss), net	61,143	19,782	(2,866
Other investment income (loss), net	(5,002	) 944	(2,045
Total other income (loss)	(21,824	) (203,697	) (570,001
<b>Expenses</b>			
Management fee — related party	34,541	38,632	37,599
General and administrative	7,265	7,769	9,191
Consolidated securitization trusts <sup>(1)</sup>	—	8,219	6,076
Total expenses	41,806	54,620	52,866
Net income (loss)	257,698	114,055	(217,540
Net income (loss) attributable to non-controlling interest	3,287	1,344	(2,482
Net income (loss) attributable to Invesco Mortgage Capital Inc.	254,411	112,711	(215,058
Dividends to preferred stockholders	22,864	22,864	17,378
Net income (loss) attributable to common stockholders	231,547	89,847	(232,436
<b>Earnings per share:</b>			
Net income (loss) attributable to common stockholders			
Basic	2.07	0.74	(1.89
Diluted	1.98	0.74	(1.89
<b>Weighted average number of shares of common stock:</b>			
Basic	111,973,404	121,377,585	123,104,934
Diluted	130,254,003	122,843,838	124,529,934

The consolidated statements of operations for years ended December 31, 2015 and 2014 include income and (1) expenses of consolidated VIEs. We deconsolidated these VIEs in 2015. Refer to Note 2 - “Summary of Significant Accounting Policies” of our consolidated financial statements for further discussion.





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## Net Income Summary

For the year ended December 31, 2016, our net income attributable to common stockholders was \$231.5 million (2015: \$89.8 million net income; 2014: \$232.4 million net loss), or \$2.07 basic and \$1.98 diluted net income per average share available to common stockholders (2015: \$0.74 basic and diluted net income per average share available to common stockholders; 2014: \$1.89 basic and diluted net loss per average share available to common stockholders).

The change in net income attributable to common stockholders for the year ended December 31, 2016 versus net income attributable to common stockholders for the year ended December 31, 2015 is primarily attributable to realized and unrealized losses on derivative instruments of \$62.8 million in 2016 versus a \$219.0 million loss in 2015. The change in net income attributable to common stockholders for the year ended December 31, 2016 versus 2015 is also primarily attributable to lower net interest income of \$321.3 million in 2016 period versus \$372.2 million in 2015. Net interest income in 2016 were lower than in 2015 primarily due to the impact of the deconsolidation of our consolidated residential securitizations ("Residential Securitizations") in December 2015 as discussed below.

Our net income (loss) attributable to common shareholders for the years ended December 31, 2015 and 2014 include interest income, interest expense and securitization trust expenses of our consolidated Residential Securitizations. On December 9, 2015, we completed the sale of certain beneficial interests in our Residential Securitizations and deconsolidated the Residential Securitizations.

The following table summarizes the net income (loss) of the Residential Securitizations excluding the loss on deconsolidation.

\$ in thousands	Years ended	
	December 31,	
	2015	2014
Interest income - Residential loans	110,908	88,073
Interest expense - Asset-backed securities	82,041	68,159
Net interest income	28,867	19,914
Reduction in provision for loan losses	(213 )	(142 )
Net interest income after reduction in provision for loan losses	29,080	20,056
Expenses - Consolidated securitization trusts	8,219	6,076
Net income	20,861	13,980

The change in net income attributable to common stockholders for the year ended December 31, 2015 versus net loss attributable to common stockholders for the year ended December 31, 2014 is primarily attributable to lower realized and unrealized losses on derivative instruments and lower losses on sales of investments in 2015.

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## Interest Income and Average Earning Asset Yield

The table below presents certain information for our average earning assets as of and for the years ended December 31, 2016, 2015 and 2014.

\$ in thousands	As of and for the Years Ended			
	December 31,			
	2016	2015	2014	
Average Balances <sup>(1)</sup> :				
Agency RMBS:				
15 year fixed-rate, at amortized cost	2,722,301	1,698,573	1,450,316	
30 year fixed-rate, at amortized cost	3,646,480	4,368,662	5,723,270	
ARM, at amortized cost	353,937	446,714	475,401	
Hybrid ARM, at amortized cost	2,800,812	3,219,463	2,452,062	
Agency-CMO, at amortized cost	375,888	423,409	476,636	
Non-Agency RMBS, at amortized cost	2,167,679	2,660,689	3,214,891	
GSE CRT, at amortized cost	650,189	665,471	478,929	
CMBS, at amortized cost	2,582,003	3,173,737	2,947,733	
U.S. Treasury securities, at amortized cost	45,375	—	—	
Residential loans, at amortized cost	—	3,198,666	2,473,258	
Commercial loans, at amortized cost	265,708	166,150	109,551	
Average earning assets	15,610,372	20,021,534	19,802,047	
Average Earning Asset Yields <sup>(2)</sup> :				
Agency RMBS:				
15 year fixed-rate	1.98	% 2.23	% 2.66	%
30 year fixed-rate	2.72	% 2.80	% 3.05	%
ARM	2.28	% 2.30	% 2.30	%
Hybrid ARM	2.12	% 2.13	% 2.28	%
Agency-CMO	2.47	% 3.16	% 3.56	%
Non-Agency RMBS	4.97	% 4.85	% 4.91	%
GSE CRT <sup>(3)</sup>	0.98	% 0.54	% 0.50	%
CMBS	4.30	% 4.37	% 4.47	%
U.S. Treasury securities	1.15	% —	% —	%
Residential loans	—	% 3.47	% 3.57	%
Commercial loans	8.35	% 8.36	% 8.56	%
Average earning asset yields	3.07	% 3.25	% 3.47	%

(1) Average amounts for each period are based on weighted month-end balances.

(2) Average earning asset yield for the period was calculated by dividing interest income, including amortization of premiums and discounts, by our average of the amortized cost of the investments. All yields are annualized.

GSE CRT average earning asset yield excludes coupon interest associated with embedded derivatives on securities (3) not accounted for under the fair value option that is recorded as realized and unrealized credit derivative income (loss), net under U.S. GAAP.

Our primary source of income is interest earned on our investment portfolio. We had average earning assets of approximately \$15.6 billion (2015: \$20.0 billion; 2014: \$19.8 billion) and earned interest income of \$478.7 million (2015: \$650.1 million; 2014: \$687.1 million) during 2016. The yield on our average investment portfolio was 3.07% (2015: 3.25%; 2014: 3.47%).

Average earning assets and interest income declined during the year ended December 31, 2016 compared to 2015 primarily due to the deconsolidation of our Residential Securitizations in December 2015. The decrease in our earning asset



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yields for 2016 and 2015 was primarily attributable to portfolio reallocation to lower duration Agency RMBS. Our asset allocation to Agency RMBS increased from 51% as of December 31, 2015 to 63% as of December 31, 2016. Our average earning assets were relatively unchanged for 2015 compared to 2014. The change in our earning asset yields for 2015 versus 2014 was primarily attributable to portfolio reallocation to lower duration Agency RMBS.

Prepayment Speeds

Our RMBS and GSE CRT portfolio is subject to inherent prepayment risk primarily driven by changes in interest rates, which impacts the amount of premium and discount on the purchase of these securities that is recognized into interest income. Expected future prepayment speeds on our RMBS and GSE CRT portfolio are estimated on a quarterly basis. Generally, in an environment of falling interest rates, prepayment speeds will increase as homeowners are more likely to prepay their existing mortgage and refinance into a lower borrowing rate. If the actual prepayment speed during the period is faster than estimated, the amortization on securities purchased at a premium to par value will be accelerated, resulting in lower interest income recognized. Conversely, for securities purchased at a discount to par value, interest income will be reduced in periods where prepayment speeds were slower than expected. The following tables provide the three month constant prepayment rate for our RMBS and GSE CRTs throughout 2016, 2015 and 2014.

	Three Months Ended			
	December 31, 2016	September 30, 2016	June 30, 2016	March 31, 2016
15 year Agency RMBS	8.9	9.5	10.4	10.2
30 year Agency RMBS	17.6	16.2	13.7	10.8
Agency Hybrid ARM RMBS	20.5	21.7	18.4	12.5
Non-Agency RMBS	17.9	16.5	15.2	11.1
GSE CRT	21.0	17.9	14.0	9.2
Weighted average CPR	16.3	16.1	14.9	11.2
	Three Months Ended			
	December 31, 2015	September 30, 2015	June 30, 2015	March 31, 2015
15 year Agency RMBS	10.7	13.1	10.7	9.4
30 year Agency RMBS	12.5	14.8	13.9	11.1
Agency Hybrid ARM RMBS	13.9	15.2	17.3	14.2
Non-Agency RMBS	12.5	15.3	14.0	10.3
GSE CRT	10.5	12.6	13.9	9.5
Weighted average CPR	12.6	14.7	14.4	11.4
	Three Months Ended			
	December 31, 2014	September 30, 2014	June 30, 2014	March 31, 2014
15 year Agency RMBS	11.9	12.9	12.3	9.8
30 year Agency RMBS	11.8	12.0	9.4	7.2
Agency Hybrid ARM RMBS	14.3	13.0	9.4	5.9
Non-Agency RMBS	10.7	11.9	11.2	10.5
GSE CRT	7.7	8.2	4.5	4.3
Weighted average CPR	12.0	12.1	10.0	8.2

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We recognized \$118.2 million and \$117.3 million of net premium amortization during the years ended December 31, 2016 and 2015, respectively, on our RMBS and GSE CRT portfolio. Although weighted average prepayment speeds were higher during the year ended December 31, 2016 than 2015, net premium amortization was relatively constant because of lower average earning assets following share repurchases.

We recognized \$117.3 million and \$113.9 million of net premium amortization during the years ended December 31, 2015 and 2014, respectively, on our RMBS and GSE CRT portfolio. The increase in net premium amortization compared to 2014 reflects higher premium amortization on Agency securities and lower discount accretion on Non-Agency securities due to faster speeds in 2015 and changes in portfolio composition.

Our interest income is subject to interest rate risk. Refer to Item 7A. “Quantitative and Qualitative Disclosures about Market Risk” for more information relating to interest rate risk and its impact on our operating results.

**Interest Expense and the Cost of Funds**

The table below presents the components of interest expense for the years ended December 31, 2016, 2015 and 2014.

\$ in thousands	For the Years Ended		
	December 31,		
	2016	2015	2014
Interest Expense			
Interest expense on repurchase agreements outstanding	118,846	100,135	103,523
Amortization of net deferred (gain) loss on de-designated interest rate swaps	5,154	66,757	85,176
Repurchase agreements interest expense	124,000	166,892	188,699
Secured loans	10,887	6,579	2,576
Exchangeable senior notes	22,467	22,461	22,461
Asset-backed securities	—	82,041	68,159
Total interest expense	157,354	277,973	281,895

We enter into repurchase agreements to finance the majority of our target assets. These agreements are secured by our Agency RMBS, non-Agency RMBS, GSE CRTs and CMBS. In addition, these agreements are generally settled on a short-term basis, usually from one to twelve months, and bear interest at rates that have historically moved in close relationship to LIBOR. At each settlement date, we typically refinance each repurchase agreement at the market interest rate at that time.

Our repurchase agreement interest expense includes amortization of deferred gains and losses on de-designated interest rate swaps as summarized in the table above. Amortization of net deferred losses on de-designated interest rate swaps increased our total interest expense by \$5.2 million (2015: \$66.8 million; 2014: \$85.2 million) during the year ended December 31, 2016. Amounts recorded in AOCI before we discontinued cash flow hedge accounting for our interest rate swaps are reclassified to interest expense on repurchase agreements on the consolidated statements of operations as interest is accrued and paid on the related repurchase agreements over the remaining life of the interest rate swap agreements. During the next twelve months, we estimate that \$25.5 million of net deferred gains on de-designated interest rate swaps will be reclassified from other comprehensive income and recorded as a decrease to interest expense.

Interest expense for our secured loans increased for the year ended December 31, 2016 compared to 2015 primarily due to higher borrowing rates as a result of the December 2015 increase in the Federal Funds interest rate as well as higher average balances. For the year ended December 31, 2016, IAS Services LLC had a weighted average borrowing rate of 0.66% as compared to 0.41% for the year ended December 31, 2015 as well as weighted average borrowings of \$1.65 billion compared to \$1.6 billion for the year ended December 31, 2015. Interest expense for our secured loans increased for the year ended December 31, 2015 compared to 2014 primarily due to higher average borrowings. For the year ended December 31, 2015, IAS Services LLC had weighted average borrowings of \$1.6 billion compared to weighted average borrowings of \$707.8 million for the year ended December 31, 2014.

Our total interest expense decreased for the year ended December 31, 2016 compared to 2015 primarily due to an \$82.0 million decrease in interest expense on asset-backed securities as a result of the deconsolidation of our Residential Securitizations in December 2015. In addition to the deconsolidation, amortization of net deferred losses on de-designated interest rate swaps decreased by \$61.6 million for the year ended December 31, 2016. These

decreases were offset by an \$18.7 million increase in interest expense on repurchase agreements outstanding due to higher borrowing rates.

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The decrease in total interest expense for the year ended December 31, 2015 compared to 2014 is primarily due to an \$18.4 million decrease in amortization of net deferred losses on de-designated interest rate swaps offset by a \$13.9 million increase in asset-backed securities interest expense. Interest expense on asset-backed securities rose in 2015 due to the consolidation of eleven securitization trusts versus ten securitization trusts in 2014.

The table below presents certain information related to our borrowings and cost of funds as of and for the years ended December 31, 2016, 2015 and 2014.

\$ in thousands	As of and for the Years Ended			
	December 31,			
	2016	2015	2014	
Average Borrowings*:				
Agency RMBS <sup>(1)</sup>	8,872,694	9,118,307	9,444,028	
Non-Agency RMBS	1,750,730	2,439,849	2,821,132	
GSE CRT	459,738	484,414	351,900	
CMBS <sup>(1)</sup>	2,176,963	2,632,338	2,305,970	
U.S. Treasury securities	54,882	—	—	
Exchangeable senior notes	395,910	393,440	390,989	
Asset-backed securities	—	2,774,833	2,174,149	
Total borrowed funds	13,710,917	17,843,181	17,488,168	
Maximum borrowings during the period <sup>(2)</sup>	14,381,178	18,416,608	18,202,497	
Average Cost of Funds <sup>(3)</sup> :				
Agency RMBS <sup>(1)</sup>	0.69	% 0.39	% 0.34	%
Non-Agency RMBS	1.90	% 1.58	% 1.54	%
GSE CRT	2.14	% 1.73	% 1.52	%
CMBS <sup>(1)</sup>	1.14	% 0.93	% 1.11	%
U.S. Treasury securities	0.25	% —	% —	%
Exchangeable senior notes	5.67	% 5.71	% 5.74	%
Asset-backed securities	—	% 2.96	% 3.13	%
Cost of funds	1.15	% 1.56	% 1.61	%
Effective cost of funds (non-GAAP measure) <sup>(4)</sup>	1.87	% 2.22	% 2.27	%

\* Average amounts for each period are based on weighted month-end balances.

(1) Agency RMBS and CMBS average borrowing and average cost of funds include borrowings under repurchase agreements and secured loans.

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

(3) Average cost of funds is calculated by dividing annualized interest expense excluding amortization of net deferred gain (loss) on de-designated interest rate swaps by our average borrowings.

(4) For a reconciliation of cost of funds to effective cost of funds, see "Non-GAAP Financial Measures".

The change in average borrowed funds and our cost of funds for 2016 versus 2015 was primarily the result of deconsolidation of our Residential Securitizations in December 2015 and a decline in average repurchase agreement borrowings. Average borrowed funds and average cost of funds on asset-backed securities were \$2.8 billion and 2.96%, respectively, for the year ended December 31, 2015. In addition, average repurchase agreement borrowings declined by \$1.4 billion in 2016 compared to 2015. The change in average borrowed funds for 2015 versus 2014 was primarily the result of a decrease in our average repurchase agreement borrowings for Agency RMBS offset by an increase in average borrowings for asset-backed securities. The decrease in our cost of funds was primarily due to shifting some of our financing for CMBS from repurchase agreement borrowing to secured loans in 2015 versus 2014.



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## Net Interest Income

The table below presents the components of net interest income for the years ended December 31, 2016, 2015 and 2014.

\$ in thousands	For the Years Ended		
	December 31,		
	2016	2015	2014
Interest Income			
Mortgage-backed and credit risk transfer securities	456,444	523,893	589,499
Residential loans	—	110,908	88,073
Commercial loans	22,238	15,331	9,508
Total interest income	478,682	650,132	687,080
Interest Expense			
Interest expense on repurchase agreements outstanding	118,846	100,135	103,523
Amortization of net deferred (gain) loss on de-designated interest rate swaps	5,154	66,757	85,176
Repurchase agreements interest expense	124,000	166,892	188,699
Secured loans	10,887	6,579	2,576
Exchangeable senior notes	22,467	22,461	22,461
Asset-backed securities	—	82,041	68,159
Total interest expense	157,354	277,973	281,895
Net interest income	321,328	372,159	405,185

Our net interest income, which equals interest income less interest expense, for the year ended December 31, 2016, totaled \$321.3 million (2015: \$372.2 million; 2014: \$405.2 million). The decrease in net interest income for the year ended December 31, 2016 compared to 2015 was primarily due lower overall portfolio balance and reinvesting cash flows from repayment of principal and interest on our higher yielding credit assets and 30 year fixed-rate Agency RMBS portfolio into 15 year fixed-rate Agency RMBS. Our net interest rate margin for the year ended December 31, 2016, which equals our average earning asset yields for the period less the average cost of funds for the period, was 1.92% (2015: 1.69%; 2014: 1.86%). The increase in net interest rate margin for 2016 versus 2015 was primarily due to lower amortization of net deferred losses on de-designated interest rate swaps into interest expense.

The decrease in net interest income was primarily due to the decline in average investment portfolio yield in 2015 compared to 2014. The decline in net interest margin was primarily the result of increased average borrowings in the form of asset-backed securities issued by securitization trusts in 2015 versus 2014.

Refer to the table in the "Interest Income and Average Earning Asset Yield" section above for changes in average portfolio balance and yields.

## Provision for Loan Losses

We evaluate the collectibility of our commercial loans held-for investment using the factors described in Note 2 - "Summary of Significant Accounting Policies" of our consolidated financial statements in Part IV, Item 15 of this Report. We determined that no provision for loan losses for our commercial loans was required as of December 31, 2016.

Our provision for loan losses for the years ended December 31, 2015 and 2014 was solely for residential loans held-for-investment by consolidated securitization trusts. We did not have a provision for residential loan losses as of December 31, 2016 because we deconsolidated our Residential Securitizations in December 2015.

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## Gain (Loss) on Investments, net

The table below summarizes the components of gain (loss) on investments, net for the years ended December 31, 2016, 2015 and 2014.

\$ in thousands	Years Ended December 31,		
	2016	2015	2014
Realized gains and losses on sale of investments	(7,439 )	2,232	(76,669)
Other-than-temporary impairment losses	(8,909 )	—	—
Net unrealized gains and losses on MBS accounted for under the fair value option	(5,791 )	(558 )	(7,738 )
Net unrealized gains and losses on GSE CRT accounted for under the fair value option	4,598	(56 )	—
Net unrealized gains and losses on trading securities	(1 )	—	—
Total gain (loss) on deconsolidation of VIEs, net	—	(19,623)	—
Total	(17,542)	(18,005)	(84,407)

As part of our investment process, all of our mortgage-backed and credit risk transfer securities are continuously reviewed to determine if they continue to meet our risk and return targets. This process involves looking at changing market assumptions and the impact those assumptions will have on the individual securities.

We assess our investment securities for other-than-temporary impairment on a quarterly basis. When the fair value of an investment is less than its amortized cost at the balance sheet date of the reporting period for which impairment is assessed, the impairment is designated as either "temporary" or "other-than-temporary." For additional information regarding our assessment analysis of other-than temporary impairment on our investment securities, refer to Note 4 – "Mortgage-Backed and Credit Risk Transfer Securities" of our consolidated financial statements.

We recorded \$8.9 million in other-temporary-impairments ("OTTI") on RMBS interest-only and non-Agency RMBS securities for the year ended December 31, 2016. We did not record any OTTI for the years ended December 31, 2015 and 2014.

We have elected the fair value option for all of our MBS purchased on or after September 1, 2016 and all of our GSE CRTs purchased on or after August 24, 2015. Prior to September 1, 2016, we had also elected the fair value option for our RMBS IOs. Under the fair value option, changes in fair value are recognized in income in the consolidated statements of operations.

We recorded a loss of \$19.6 million in our consolidated statement of operations related to the deconsolidation of our Residential Securitizations in December 2015. The deconsolidation of the Residential Securitizations did not qualify for presentation and disclosure as discontinued operations. The following table presents the components of the loss on deconsolidation.

\$ in thousands	As of December 9, 2015
Gain (loss) related to derecognition of Residential Securitizations, net	(13,260 )
Gain (loss) related to remeasurement of retained interest, net	3,068
Gain (loss) on sale of the securities, net	(9,431 )
Total gain (loss) on deconsolidation of VIEs, net	(19,623 )
Equity in Earnings of Unconsolidated Ventures	

For the year ended December 31, 2016, we recorded equity in earnings of unconsolidated ventures of \$2.4 million (2015: \$12.6 million; 2014: \$6.8 million). Equity in earnings of unconsolidated ventures decreased \$10.2 million in 2016 compared to 2015 primarily due to lower realized and unrealized gains on underlying portfolio investments than in the 2015 period.

Equity in earnings of unconsolidated ventures increased \$5.8 million in 2015 compared to 2014 primarily due to higher realized and unrealized gains on underlying portfolio investments than in the 2014 period.

## Gain (Loss) on Derivative Instruments, net

Our objectives in using interest rate derivatives are to add stability to interest expense and to manage our exposure to interest rate movements on our floating rate repurchase agreements and secured loans. To accomplish these objectives, we



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primarily use interest rate derivative instruments, including interest rate swaps, interest rate swaptions, U.S. Treasury futures contracts and TBAs as part of our interest rate risk management strategy.

We also use currency forward contracts to help mitigate the potential impact of changes in foreign currency exchange rates on our investments denominated in foreign currencies.

We record all derivatives on our consolidated balance sheets at fair value. At the inception of a derivative contract, we determine whether the instrument will be part of a qualifying hedge accounting relationship or whether we will account for the contract as a trading instrument. We have elected not to apply hedge accounting to any derivative contracts entered into after January 1, 2014. Changes in the fair value of our derivatives are recorded in gain (loss) on derivative instruments, net in our consolidated statements of operations. Net interest paid or received under our interest rate swaps is also recognized in gain (loss) on derivative instruments, net in our consolidated statements of operations.

The tables below summarize the components of our gain (loss) on derivative instruments, net for the years ended December 31, 2016, 2015 and 2014:

\$ in thousands	Year ended December 31, 2016			
	Realized gain (loss) on derivative instruments, net	Contractual interest expense	Unrealized gain (loss), net	Gain (loss) on derivative instruments, net
Derivative not designated as hedging instrument				
Interest Rate Swaps	(69,090)	(104,804 )	100,503	(73,391 )
Interest Rate Swaptions	(1,485 )	—	1,485	—
Currency Forward Contracts	12,632	—	(2,056 )	10,576
Total	(57,943)	(104,804 )	99,932	(62,815 )

\$ in thousands	Year ended December 31, 2015			
	Realized gain (loss) on derivative instruments, net	Contractual interest expense	Unrealized gain (loss), net	Gain (loss) on derivative instruments, net
Derivative not designated as hedging instrument				
Interest Rate Swaps	(31,881)	(184,373 )	(554 )	(216,808 )
Interest Rate Swaptions	(10,328)	—	8,521	(1,807 )
TBAs	(2,292 )	—	558	(1,734 )
Futures Contracts	(943 )	—	(90 )	(1,033 )
Currency Forward Contracts	1,172	—	1,162	2,334
Total	(44,272)	(184,373 )	9,597	(219,048 )

\$ in thousands	Year ended December 31, 2014			
	Realized gain (loss) on derivative instruments, net	Contractual interest expense	Unrealized gain (loss), net	Gain (loss) on derivative instruments, net
Derivative not designated as hedging instrument				
Interest Rate Swaps	(28,758)	(199,783 )	(223,944 )	(452,485 )
Interest Rate Swaptions	(23,275)	—	10,906	(12,369 )
TBAs	(10,843)	—	(558 )	(11,401 )

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Futures Contracts	(11,489)	—	(2,502)	)	(13,991)	)	
Currency Forward Contracts	2,178	—	599		2,777		
Total	(72,187)	(199,783)	)	(215,499)	)	(487,469)	)

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As of December 31, 2016 and 2015, we held the following interest rate swaps whereby we receive interest at a one-month and three-month LIBOR rate:

\$ in thousands	December 31, 2016				December 31, 2015			
	Notional Amounts	Average Fixed Pay Rate	Average Receive Rate	Average Maturity (Years)	Notional Amounts (1)	Average Fixed Pay Rate	Average Receive Rate	Average Maturity (Years)
Interest Rate Swaps	6,500,000	2.14 %	0.79 %	4.64	9,850,000	2.07 %	0.36 %	3.65

(1) Excludes \$1.6 billion of notional amounts for interest rate swaps with forward start dates of February 2016, May 2016 and June 2016.

During the year ended December 31, 2016, we terminated swaps with a notional amount of \$5.0 billion and realized losses of \$69.1 million. The terminated swaps were predominantly maturing in 2016 and offered little protection from rising rates. Additionally, our investment and repurchase agreement balances decreased due to asset sales to facilitate stock repurchases, further reducing our need for hedging. Our overall interest rate risk did not change materially as a result of the swap terminations. As a result of swap terminations, our contractual net interest expense decreased from \$184.4 million in 2015 to \$104.8 million in 2016.

Realized and Unrealized Credit Derivative Income (Loss), net

The table below summarizes the components of realized and unrealized credit derivative income (loss), net for the years ended December 31, 2016, 2015 and 2014.

\$ in thousands	Years Ended		
	December 31, 2016	December 31, 2015	December 31, 2014
GSE CRT embedded derivative coupon interest	24,343	24,822	17,536
Gain (loss) on settlement of GSE CRT embedded derivatives	(6,017 )	(2,184 )	—
Change in fair value of GSE CRT embedded derivatives	42,817	(4,227 )	(21,495)
Credit Default Swap ("CDS") premium income	—	723	1,351
Realized gain (loss) on settlement of CDS	—	1,044	—
Change in fair value of CDS	—	(396 )	(258 )
Total	61,143	19,782	(2,866 )

During the year ended December 31, 2016, we recorded an unrealized gain on the change in the fair value of our GSE CRT embedded derivatives compared to an unrealized loss in the year ended December 31, 2015. The increase in the value of our GSE CRT holdings during the year ended December 31, 2016 primarily resulted from broad credit spread tightening, increasing market demand for floating rate securities and positive rating actions by two nationally recognized statistical rating organizations.

During the year ended December 31, 2015, we recorded a \$4.2 million loss compared to a \$21.5 million loss in 2014. The change in the fair value of GSE CRT embedded derivatives during the year ended December 31, 2015 primarily resulted from credit spreads generally tightening in the first half of the year and credit spreads generally widening in the second half of the year, ending the year with a modest decrease in prices as compared to the beginning of the year.

We terminated our sole CDS contract in October 2015 in exchange for a payment to us of \$1 million.

Other Investment Income (Loss), net

Other investment income (loss), net primarily consists of quarterly dividends from FHLBI stock and foreign exchange rate gains and losses related to commercial loan investments denominated in a foreign currency. The table below summarizes the components of other investment income (loss), net for the years ended December 31, 2016, 2015 and 2014.

Years Ended  
December 31,

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\$ in thousands	2016	2015	2014
FHLBI dividend income	3,185	2,819	701
Gain (loss) on foreign currency transactions, net	(8,187)	(1,875)	(2,746)
Total	(5,002)	944	(2,045)

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We are required to purchase and hold a certain amount of FHLBI stock, which is based, in part, upon the outstanding principal balance of secured advances from the FHLBI. We earn dividend income on our investment in FHLBI stock, and the amount of our dividend income varies based upon the number of shares that we are required to own.

We incurred foreign currency losses on the revaluation of a commercial loan investment (notional amount of £34.5 million) for the year ended December 31, 2016 due to the significant decline in the Pound Sterling/ U.S. Dollar foreign exchange rate over the last twelve months. Foreign currency losses for the year ended December 31, 2015 and 2014 relate to a foreign currency loan which prepaid in the second quarter 2015. We enter into currency forward contracts as an economic hedge against our foreign currency exposure. Changes in the fair value of our currency forward contracts are recognized in gain (loss) derivative instruments, net in the consolidated statements of operations. During the years ended December 31, 2016, 2015 and 2014, we recognized net gains of \$10.6 million, \$2.3 million and \$2.8 million, respectively, on our currency forward contracts.

Expenses

For the year ended December 31, 2016, we incurred management fees of \$34.5 million (2015: \$38.6 million; 2014: \$37.6 million), which are payable to our Manager under our management agreement. Management fees decreased for the year ended December 31, 2016 compared to 2015 due to (i) a cumulative one-time adjustment of \$2.3 million related to a prior adjustment for the accounting for premiums and discounts associated with non-Agency RMBS not of high credit quality and (ii) the full year impact of shares repurchased in the second half of 2015 and first quarter of 2016. We repurchased 9.5 million shares of common stock in the second half of 2015 and 2.1 million shares of common stock in the first quarter of 2016.

The increase in 2015 management fees of \$1.0 million compared to 2014 is primarily due to the full year impact of our September 2014 Series B Preferred Stock offering and the impact of the July 2015 change in our management fee calculation, which was partially offset by distributions in excess of earnings and the repurchase of 9.5 million shares of common stock in the second half of 2015. Refer to Note 12 – “Related Party Transactions” of our consolidated financial statements for a discussion of our relationship with our Manager and a description of how our management fees are calculated.

For the year ended December 31, 2016, our general and administrative expenses not covered under our management agreement amounted to \$7.3 million (2015: \$7.8 million; 2014: \$9.2 million). General and administrative expenses not covered under our management agreement primarily consist of directors and officers insurance, legal costs, accounting, auditing and tax services, filing fees, organization expenses associated with our consolidated securitization trusts and miscellaneous general and administrative costs. During 2015, we incurred expenses for third party consulting, accounting, auditing and legal fees of approximately \$950,000 related to the restatement of our financial statements. During 2014, we incurred approximately \$1.0 million of offering costs related to our consolidated Residential Securitizations. Excluding restatement-related expenses in 2015 and residential securitization offering costs in 2014, general and administrative expenses decreased approximately \$1.4 million in 2015 primarily due to lower legal and transaction costs associated with new commercial loans in 2015 and higher income tax expense associated with our taxable REIT subsidiary in 2014.

We deconsolidated our Residential Securitizations in December 2015 and therefore did not incur any consolidated securitization trust expenses in 2016. For the year ended December 31, 2015, consolidated securitization trust expenses totaled \$8.2 million (2014: \$6.1 million). Consolidated securitization trust expenses consist of direct operating expenses incurred by consolidated Residential Securitizations. Prior to the deconsolidation, we consolidated eleven Residential Securitizations as of December 31, 2015 and ten Residential Securitizations as of December 31, 2014. The \$2.1 million increase in securitization trust expenses for the year ended December 31, 2015 is primarily due to the full year impact of Residential Securitizations consolidated in 2014.



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## Net Income (Loss) after Preferred Dividends and Return on Average Equity

For the year ended December 31, 2016, our net income after preferred dividends was \$234.8 million (2015: \$91.2 million net income; 2014: \$234.9 million net loss) and our annualized income on average equity was 11.50% (2015: 3.91% income; 2014: 9.72% loss).

For the year ended December 31, 2016, the change in net income (loss) after preferred dividends and return on average equity was primarily attributable to realized and unrealized losses on derivatives instruments of \$62.8 million in 2016 versus \$219.0 million in 2015. For the year ended December 31, 2016, we recognized unrealized gains for the change in fair value of our interest rates swaps of \$100.5 million compared to unrealized losses of \$554,000 for the year ended December 31, 2015. In addition, during the year ended December 31, 2016, we recognized amortization of net deferred losses on de-designated interest rate swaps previously recognized in other comprehensive income of \$5.2 million versus \$66.8 million in 2015.

For the year ended December 31, 2015, the change in net income (loss) after preferred dividends and return on average equity was primarily attributable to realized and unrealized losses on derivatives instruments of \$219.0 million in 2015 versus \$487.5 million in 2014. For the year ended December 31, 2015, we recognized unrealized losses for the change in fair value of our interest rates swaps of \$554,000 compared to unrealized losses of \$223.9 million for the year ended December 31, 2014. In addition, during the year ended December 31, 2015, we recognized amortization of net deferred losses on de-designated interest rate swaps previously recognized in other comprehensive income of \$66.8 million versus \$85.2 million in 2014.

## Non-GAAP Financial Measures

We are presenting the following non-GAAP financial measures: core earnings (and by calculation, core earnings per common share), effective interest income (and by calculation, effective yield), effective interest expense (and by calculation, effective cost of funds), effective net interest income (and by calculation, effective interest rate margin), and repurchase agreement debt-to-equity ratio. Our management uses these non-GAAP financial measures in our internal analysis of results and believes these measures are useful to investors for the reasons explained below. The most directly comparable U.S. GAAP measures are net income (loss) attributable to common stockholders (and by calculation, basic earnings (loss) per common share), total interest income (and by calculation, earning asset yield), total interest expense (and by calculation, cost of funds), net interest income (and by calculation, net interest rate margin) and debt-to-equity ratio. Certain prior period U.S. GAAP and non-GAAP financial measures have been revised to correct immaterial errors in accounting for premiums and discounts on non-Agency RMBS not of high credit quality. For further information, see Note 17 - "Revision of Previously Issued Financial Statements" of our consolidated financial statements in Part IV, Item 15. of this Report.

These non-GAAP financial measures should not be considered as substitutes for any measures derived in accordance with U.S. GAAP and may not be comparable to other similarly titled measures of other companies. An analysis of any non-GAAP financial measure should be made in conjunction with results presented in accordance with U.S. GAAP. Additional reconciling items may be added in the future to these non-GAAP measures if deemed appropriate.

## Core Earnings

We calculate core earnings as U.S. GAAP net income (loss) attributable to common stockholders adjusted for (gain) loss on investments, net; realized (gain) loss on derivative instruments, net; unrealized (gain) loss on derivative instruments, net; realized and unrealized (gain) loss on GSE CRT embedded derivatives, net; (gain) loss on foreign currency transactions, net; amortization of net deferred (gain) loss on de-designated interest rate swaps; and cumulative adjustments attributable to non-controlling interest. We record changes in the valuation of our mortgage-backed securities, excluding securities for which we elected the fair value option and the valuation assigned to the debt host contract associated with our GSE CRTs in other comprehensive income on our consolidated balance sheets.

We believe the presentation of core earnings provides a consistent measure of operating performance by excluding the impact of gains and losses described above from operating results. We believe that providing transparency into core earnings enables our investors to consistently measure, evaluate and compare our operating performance to that of our peers over multiple reporting periods. However, we caution that core earnings should not be considered as an alternative to net income (determined in accordance with U.S. GAAP), or as an indication of our cash flow from

operating activities (determined in accordance with U.S. GAAP), a measure of our liquidity, or as an indication of amounts available to fund our cash needs, including our ability to make cash distributions.

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The table below provides a reconciliation of U.S. GAAP net income (loss) attributable to common stockholders to core earnings for the following periods:

\$ in thousands, except per share data	Years Ended December 31,		
	2016	2015	2014
Net income (loss) attributable to common stockholders	231,547	89,847	(232,436)
Adjustments:			
(Gain) loss on investments, net	17,542	18,005	84,407
Realized (gain) loss on derivative instruments, net <sup>(1)</sup>	57,943	44,272	72,187
Unrealized (gain) loss on derivative instruments, net <sup>(1)</sup>	(99,932)	(9,597)	215,499
Realized and unrealized (gain) loss on GSE CRT embedded derivatives, net <sup>(2)</sup>	(36,800)	6,411	21,495
(Gain) loss on foreign currency transactions, net <sup>(3)</sup>	8,187	1,875	2,746
Amortization of net deferred loss on de-designated interest rate swaps <sup>(4)</sup>	5,154	66,757	85,176
Subtotal	(47,906)	127,723	481,510
Cumulative adjustments attributable to non-controlling interest	653	(1,461)	(5,500)
Core earnings attributable to common stockholders	184,294	216,109	243,574
Basic earnings (loss) per common share	2.07	0.74	(1.89)
Core earnings per share attributable to common stockholders <sup>(5)</sup>	1.65	1.78	1.98

(1) U.S. GAAP gain (loss) on derivative instruments, net on the consolidated statements of operations includes the following components:

\$ in thousands	Years Ended December 31,		
	2016	2015	2014
Realized gain (loss) on derivative instruments, net	(57,943)	(44,272)	(72,187)
Unrealized gain (loss) on derivative instruments, net	99,932	9,597	(215,499)
Contractual net interest expense	(104,804)	(184,373)	(199,783)
Gain (loss) on derivative instruments, net	(62,815)	(219,048)	(487,469)

(2) U.S. GAAP realized and unrealized credit derivative income (loss), net on the consolidated statements of operations includes the following components:

\$ in thousands	Years Ended December 31,		
	2016	2015	2014
Realized and unrealized gain (loss) on GSE CRT embedded derivatives, net	36,800	(6,411)	(21,495)
GSE CRT embedded derivative coupon interest	24,343	24,822	17,536
Unrealized gain (loss) on CDS contract	—	648	(258)
CDS premium fee income	—	723	1,351
Realized and unrealized credit derivative income (loss), net	61,143	19,782	(2,866)

(3) U.S. GAAP other investment income (loss), net on the consolidated statements of operations includes the following components:

\$ in thousands	Years Ended December 31,		
	2016	2015	2014
FHLBI dividend income	3,185	2,819	701
Gain (loss) on foreign currency transactions, net	(8,187)	(1,875)	(2,746)
Other investment income (loss), net	(5,002)	944	(2,045)



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- (4) U.S. GAAP repurchase agreements interest expense on the consolidated statements of operations includes the following components:

\$ in thousands	Years Ended December		
	31, 2016	2015	2014
Interest expense on repurchase agreements outstanding	118,846	100,135	103,523
Amortization of net deferred (gain) loss on de-designated interest rate swaps	5,154	66,757	85,176
Repurchase agreements interest expense	124,000	166,892	188,699

- (5) Core earnings per share attributable to common stockholders is equal to core earnings divided by the basic weighted average number of common shares outstanding.

Core earnings for the year ended December 31, 2016 decreased from 2015 primarily due to lower overall portfolio balance and reinvesting cash flows from repayment of principal and interest on our higher yielding credit assets and 30 year fixed-rate Agency RMBS portfolio into 15 year fixed-rate Agency RMBS. Our average earning assets decreased from \$20.0 billion for the year ended December 31, 2015 to \$15.6 billion for the year ended December 31, 2016.

Core earnings for the year ended December 31, 2015 decreased compared to 2014 primarily due to lower effective interest rate margin for the year ended December 31, 2015. Our effective interest rate margin for the year ended December 31, 2015 was 1.15% as compared to 1.29% for the year ended December 31, 2014.

**Effective Interest Income / Effective Yield/ Effective Interest Expense / Effective Cost of Funds / Effective Net Interest Income / Effective Interest Rate Margin**

We calculate effective interest income (and by calculation, effective yield) as U.S. GAAP total interest income adjusted for GSE CRT embedded derivative coupon interest recorded as realized and unrealized credit derivative income (loss), net. We account for GSE CRTs purchased prior to August 24, 2015 as hybrid financial instruments, but we have elected the fair value option for GSE CRTs purchased on or after August 24, 2015. Under U.S. GAAP, coupon interest on GSE CRTs accounted for using the fair value option is recorded as interest income, whereas coupon interest on GSE CRTs accounted for as hybrid financial instruments is recorded as realized and unrealized credit derivative income (loss). We add back GSE CRT embedded derivative coupon interest to our total interest income because we consider GSE CRT embedded derivative coupon interest a current component of our total interest income irrespective of whether we elected the fair value option for the GSE CRT or accounted for the GSE CRT as a hybrid financial instrument.

We calculate effective interest expense (and by calculation, effective cost of funds) as U.S. GAAP total interest expense adjusted for net interest expense on our interest rate swaps that is recorded in gain (loss) on derivative instruments, net and the amortization of net deferred gains (losses) on de-designated interest rate swaps that is recorded as repurchase agreements interest expense. We view our interest rate swaps as an economic hedge against increases in future market interest rates on our floating rate borrowings. We add back the net payments we make on our interest rate swap agreements to our total U.S. GAAP interest expense because we use interest rate swaps to add stability to interest expense. We exclude the amortization of net deferred gains (losses) on de-designated interest rate swaps from our calculation of effective interest expense because we do not consider the amortization a current component of our borrowing costs.

We calculate effective net interest income (and by calculation, effective interest rate margin) as U.S. GAAP net interest income adjusted for net interest expense on our interest rate swaps that is recorded as gain (loss) on derivative instruments, the amortization of net deferred gains (losses) on de-designated interest rate swaps that is recorded as repurchase agreement interest expense and GSE CRT embedded derivative coupon interest that is recorded as realized and unrealized credit derivative income (loss), net.

We believe the presentation of effective interest income, effective yield, effective interest expense, effective cost of funds, effective net interest income and effective interest rate margin measures, when considered together with U.S.

GAAP financial measures, provide information that is useful to investors in understanding our borrowing costs and operating performance.

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The following table reconciles total interest income to effective interest income and yield to effective yield for the following periods:

\$ in thousands	Years Ended December 31,								
	2016			2015			2014		
	Reconciliation	Yield/Effective Yield	%	Reconciliation	Yield/Effective Yield	%	Reconciliation	Yield/Effective Yield	%
Total interest income	478,682	3.07	%	650,132	3.25	%	687,080	3.47	%
Add: GSE CRT embedded derivative coupon interest recorded as realized and unrealized credit derivative income (loss), net	24,343	0.15	%	24,822	0.12	%	17,536	0.09	%
Effective interest income	503,025	3.22	%	674,954	3.37	%	704,616	3.56	%

Our effective interest income and effective yield for the year ended December 31, 2016 decreased from 2015 primarily due to the deconsolidation of our Residential Securitizations in December 2015. Interest income and average earning asset yield on residential loans was \$110.9 million and 3.47% for the year ended December 31, 2015. In addition, our yield on average earning assets declined from 3.25% in 2015 to 3.07% in 2016. Our effective interest income and effective yield decreased for the year ended December 31, 2015 compared to 2014 was primarily attributable to portfolio reallocation to lower duration Agency RMBS.

The following table reconciles total interest expense to effective interest expense and cost of funds to effective cost of funds for the following periods:

\$ in thousands	Years Ended December 31,								
	2016			2015			2014		
	Reconciliation	Cost of Funds / Effective Cost of Funds	%	Reconciliation	Cost of Funds / Effective Cost of Funds	%	Reconciliation	Cost of Funds / Effective Cost of Funds	%
Total interest expense	157,354	1.15	%	277,973	1.56	%	281,895	1.61	%
Less: Amortization of net deferred loss on de-designated interest rate swaps	(5,154 )	(0.04 )	%	(66,757 )	(0.37 )	%	(85,176 )	(0.48 )	%
Add: Contractual net interest expense on interest rate swaps recorded as gain (loss) on derivative instruments, net	104,804	0.76	%	184,373	1.03	%	199,783	1.14	%
Effective interest expense	257,004	1.87	%	395,589	2.22	%	396,502	2.27	%

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Our effective interest expense and effective cost of funds for the year ended December 31, 2016 decreased from 2015 primarily due to (i) the deconsolidation of our Residential Securitizations in December 2015, and (ii) a decrease in net interest expense on interest rate swaps. The impacts of the deconsolidation of our Residential Securitizations and lower interest rate swap expense were partially offset by an \$18.7 million increase in interest expense on repurchase agreements outstanding due to higher borrowing rates. We incurred \$82.0 million of interest expense on asset-backed securities issued by the Residential Securitizations for the year ended December 31, 2015. We did not incur any interest expense on asset-backed securities for the year ended December 31, 2016. Net interest expense on interest rate swaps decreased from \$184.4 million for the year ended December 31, 2015 to \$104.8 million for the year ended December 31, 2016 because we repositioned our hedging portfolio commencing in the first quarter of 2016. During the year ended December 31, 2016, we terminated swaps with a notional amount of \$5.0 billion. The terminated swaps were predominately maturing in 2016 and offered little protection from rising rates. Additionally, our average earning assets and average repurchase agreement borrowings had decreased due to asset sales to facilitate stock repurchases, further reducing our need for hedging.

Our effective interest expense was relatively unchanged for the year ended December 31, 2015 compared to 2014. Our effective cost of funds decreased in 2015 versus 2014 primarily due to shifting some of our financing for purchases of our CMBS from repurchase agreement borrowing to secured loans in 2015.

The following table reconciles net interest income to effective net interest income and net interest rate margin to effective interest rate margin for the following periods:

	Years Ended December 31, 2016			2015			2014		
	Reconciliation	Net Interest Rate Margin / Effective Interest Rate Margin		Reconciliation	Net Interest Rate Margin / Effective Interest Rate Margin		Reconciliation	Net Interest Rate Margin / Effective Interest Rate Margin	
\$ in thousands									
Net interest income	321,328	1.92 %		372,159	1.69 %		405,185	1.86 %	
Add: Amortization of net deferred loss on de-designated interest rate swaps	5,154	0.04 %		66,757	0.37 %		85,176	0.48 %	
Add: GSE CRT embedded derivative coupon interest recorded as realized and unrealized credit derivative income (loss), net	24,343	0.15 %		24,822	0.12 %		17,536	0.09 %	
Less: Contractual net interest expense on interest rate swaps recorded as gain (loss) on derivative instruments, net	(104,804)	(0.76 )%		(184,373)	(1.03 )%		(199,783)	(1.14 )%	
Effective net interest income	246,021	1.35 %		279,365	1.15 %		308,114	1.29 %	

Effective net interest income decreased from \$279.4 million for the year ended December 31, 2015 to \$246.0 million for the year ended December 31, 2016. The decrease in effective net interest income was primarily due to maturity and paydowns of high yielding assets, a lower overall portfolio balance and portfolio reallocation from 30 year fixed-rate Agency RMBS to 15 year fixed-rate Agency RMBS. The increase in effective interest rate margin for the year ended December 31, 2016 versus 2015 was primarily due to lower contractual net interest expense on interest rate swaps in the 2016 period. Net interest expense on interest rate swaps decreased because we repositioned our hedging portfolio commencing in the first quarter of 2016.

The decline in effective net interest income and effective interest rate margin in 2015 versus 2014 was primarily driven by lower net interest income attributable to portfolio reallocation to lower duration Agency RMBS.





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## Repurchase Agreement Debt-to-Equity Ratio

The tables below show the allocation of our equity to our targeted assets, our debt-to-equity ratio, and our repurchase agreement debt-to-equity ratio as of December 31, 2016 and December 31, 2015. We present a repurchase agreement debt-to-equity ratio, a non-GAAP financial measure of leverage, because the mortgage REIT industry primarily uses repurchase agreements, which typically mature within one year, to finance investments. We believe that presenting our repurchase agreement debt-to-equity ratio, when considered together with our U.S. GAAP financial measure, provides information that is useful to investors in understanding our refinancing risks, and gives investors a comparable statistic to those other mortgage REITs who almost exclusively borrow using short-term repurchase agreements that are subject to refinancing risk.

December 31, 2016

\$ in thousands	Agency RMBS	Residential Credit <sup>(1)</sup>	Commercial Credit <sup>(2)</sup>	Exchangeable	
				Senior Notes and Other	Total
Investments	9,665,860	2,763,751	2,858,376	—	15,287,987
Cash and cash equivalents <sup>(3)</sup>	76,067	49,582	36,139	—	161,788
Derivative assets, at fair value <sup>(4)</sup>	3,085	—	101	—	3,186
Other assets	179,931	9,381	63,465	500	253,277
Total assets	9,924,943	2,822,714	2,958,081	500	15,706,238
Repurchase agreements	8,148,220	2,067,731	944,718	—	11,160,669
Secured loans <sup>(5)</sup>	500,150	—	1,149,850	—	1,650,000
Exchangeable senior notes	—	—	—	397,041	397,041
Derivative liabilities, at fair value	133,832	—	396	—	134,228
Other liabilities	52,047	21,389	14,791	5,889	94,116
Total liabilities	8,834,249	2,089,120	2,109,755	402,930	13,436,054
Total equity (allocated)	1,090,694	733,594	848,326	(402,430)	2,270,184
Adjustments to calculate repurchase agreement debt-to-equity:					
Net equity in unsecured assets and exchangeable senior notes <sup>(6)</sup>	—	—	(306,656)	402,430	95,774
Collateral pledged against secured loans	(585,504)	—	(1,346,078)	—	(1,931,582)
Secured loans	500,150	—	1,149,850	—	1,650,000
Equity related to repurchase agreement debt	1,005,340	733,594	345,442	—	2,084,376
Debt-to-equity ratio <sup>(7)</sup>	7.9	2.8	2.5	NA	5.8
Repurchase agreement debt-to-equity ratio <sup>(8)</sup>	8.1	2.8	2.7	NA	5.4

(1) Investments in non-Agency RMBS and GSE CRT are included in residential credit.

(2) Investments in CMBS, commercial loans and investments in unconsolidated joint ventures are included in commercial credit.

(3) Cash and cash equivalents is allocated based on a percentage of equity for Agency RMBS, residential credit and commercial credit.

(4) Derivative assets are allocated based on the hedging strategy for each class.

(5) Secured loans are allocated based on amount of collateral pledged.

(6) Net equity in unsecured assets and exchangeable senior notes includes commercial loans, investments in unconsolidated joint ventures, exchangeable senior notes and other.

(7) Debt-to-equity ratio is calculated as the ratio of total debt (sum of repurchase agreements, secured loans and exchangeable senior notes) to total equity.

(8) Repurchase agreement debt-to-equity ratio is calculated as the ratio of repurchase agreements to equity related to repurchase agreement debt.



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December 31, 2015

\$ in thousands	Agency RMBS	Residential Credit <sup>(1)</sup>	Commercial Credit <sup>(2)</sup>	Exchangeable Senior Notes	Total
Investments	9,799,257	3,350,714	3,163,439	—	16,313,410
Cash and cash equivalents <sup>(3)</sup>	23,484	16,586	13,129	—	53,199
Derivative assets, at fair value <sup>(4)</sup>	6,795	—	1,864	—	8,659
Other assets	316,072	9,780	66,189	—	392,041
Total assets	10,145,608	3,377,080	3,244,621	—	16,767,309
Repurchase agreements	8,389,643	2,565,515	1,170,890	—	12,126,048
Secured loans <sup>(5)</sup>	472,983	—	1,177,017	—	1,650,000
Exchangeable senior notes	—	—	—	394,573	394,573
Derivative liabilities, at fair value	238,045	—	103	—	238,148
Other liabilities	46,165	22,540	17,038	5,889	91,632
Total liabilities	9,146,836	2,588,055	2,365,048	400,462	14,500,401
Total equity (allocated)	998,772	789,025	879,573	(400,462)	2,266,908
Adjustments to calculate repurchase agreement debt-to-equity:					
Net equity in unsecured assets and exchangeable senior notes <sup>(6)</sup>	—	—	(250,522)	400,462	149,940
Collateral pledged against secured loans	(558,894)	—	(1,390,805)	—	(1,949,699)
Secured loans	472,983	—	1,177,017	—	1,650,000
Equity related to repurchase agreement debt	912,861	789,025	415,263	—	2,117,149
Debt-to-equity ratio <sup>(7)</sup>	8.9	3.3	2.7	NA	6.3
Repurchase agreement debt-to-equity ratio <sup>(8)</sup>	9.2	3.3	2.8	NA	5.7

(1) Investments in non-Agency RMBS and GSE CRT are included in residential credit.

(2) Investments in CMBS, commercial loans and investments in unconsolidated joint ventures are included in commercial credit.

(3) Cash and cash equivalents is allocated based on a percentage of equity for Agency RMBS, residential credit and commercial credit.

(4) Derivative assets are allocated based on the hedging strategy for each class.

(5) Secured loans are allocated based on amount of collateral pledged.

(6) Net equity in unsecured assets and exchangeable senior notes includes commercial loans, investments in unconsolidated joint ventures and exchangeable senior notes.

(7) Debt-to-equity ratio is calculated as the ratio of total debt (sum of repurchase agreements, secured loans and exchangeable senior notes) to total equity.

(8) Repurchase agreement debt-to-equity ratio is calculated as the ratio of repurchase agreements to equity related to repurchase agreement debt.

**Liquidity and Capital Resources**

Liquidity is a measurement of our ability to meet potential cash requirements, including ongoing commitments to pay dividends, fund investments, repayment of borrowings and other general business needs. Our primary sources of funds for liquidity consist of the net proceeds from our common and preferred equity offerings, net cash provided by operating activities, proceeds from repurchase agreements and other financing arrangements and future issuances of equity and/or debt securities.

We currently believe that we have sufficient liquidity and capital resources available for the acquisition of additional investments, repayments on borrowings, margin requirements and the payment of cash dividends as required for continued qualification as a REIT. We generally maintain liquidity to pay down borrowings under repurchase

arrangements to reduce borrowing costs and otherwise efficiently manage our long-term investment capital. Because the level of these borrowings can be adjusted on a daily basis, the level of cash and cash equivalents carried on our consolidated balance sheets is significantly less important than our potential liquidity available under borrowing arrangements. However, there can be no assurance that we will maintain sufficient levels of liquidity to meet any margin calls.

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We held cash and cash equivalents of \$161.8 million at December 31, 2016 (2015: \$53.2 million). Our cash and cash equivalents increased due to normal fluctuations in cash balances related to the timing of principal and interest payments, repayments of debt, and asset purchases and sales.

Our operating activities provided net cash of approximately \$329.7 million for the year ended December 31, 2016 (2015: \$358.6 million; 2014: \$379.7 million). Cash provided by operating activities decreased due to the decline in our average assets during the year ended December 31, 2016 as compared to the year ended December 31, 2015. Cash provided by operating activities decreased due to the decline in our average assets during the year ended December 31, 2015 as compared to the year ended December 31, 2014.

Our investing activities provided net cash of \$949.0 million for the year ended December 31, 2016 (2015: provided net cash of \$1.2 billion; 2014: used net cash of \$912.4 million). During the year ended December 31, 2016 we utilized cash to purchase \$2.7 billion of MBS and GSE CRT securities. In addition, during the year ended December 31, 2016 we originated or purchased commercial loans of \$87.2 million. Cash used to fund these purchases was more than offset by proceeds from MBS and GSE CRT sales of \$1.0 billion, principal payments from MBS and GSE CRT securities of \$2.6 billion and principal repayments from commercial loans held-for investment of \$15.0 million. During the year ended December 31, 2015 we utilized cash to purchase \$2.4 billion of MBS and GSE CRT securities and \$372.3 million of residential loans. In addition, during the year ended December 31, 2015, we originated or purchased commercial loans of \$158.0 million. Cash used to fund these purchases was more than offset by proceeds from MBS and GSE CRT sales of \$907.2 million, principal payments from MBS and GSE CRT securities of \$2.6 billion and principal payments from residential loans held-for-investment of \$549.6 million and principal repayments from commercial loans held-for investment of \$92.8 million.

During the year ended December 31, 2014 we utilized cash to purchase \$4.3 billion of MBS and GSE CRT securities and \$1.8 billion of residential loans. In addition, during the year ended December 31, 2014, we originated or purchased commercial loans of \$83.5 million. Cash used to fund these purchases was partially offset by proceeds from MBS and GSE CRT sales of \$3.3 billion, principal payments from MBS and GSE CRT securities of \$1.9 billion and principal payments from residential loans held-for-investment of \$255.7 million.

Our financing activities used net cash of \$1.2 billion for the year ended December 31, 2016 (2015: used net cash of \$1.7 billion; 2014: provided net cash of \$486.3 million). Our financing activities for the year ended December 31, 2016 primarily consisted of net principal repayments on our repurchase agreements of \$966.8 million. In addition, we paid dividends and distributions of \$204.5 million and repurchased 2.1 million shares of common stock for \$25.0 million.

Our financing activities for the year ended December 31, 2015 primarily consisted of net principal repayments on our repurchase agreements of \$1.5 billion and net principal repayments of ABS issued by securitization trusts of \$182.1 million, offset by net proceeds from our secured FHLBI advances of \$400.0 million. In addition, we paid dividends and distributions of \$239.4 million and repurchased 9.5 million shares of common stock for \$125.6 million.

Our financing activities for the year ended December 31, 2014 primarily consisted of net principal repayments on our repurchase agreements of \$1.8 billion, offset by net proceeds from our secured FHLBI advances of \$1.25 billion, net proceeds from ABS issued by securitization trusts of \$1.3 billion; and net proceeds of \$149.9 million from our Series B Preferred Stock offering. In addition, we paid dividends and distributions of \$264.5 million and repurchased \$1.4 million shares of common stock for \$21.1 million.

As of December 31, 2016, our wholly-owned subsidiary, IAS Services LLC, had \$1.65 billion in outstanding secured advances from the FHLBI. As of December 31, 2016, the FHLBI advances were collateralized by CMBS and Agency RMBS with a fair value of \$1.3 billion and \$585.5 million, respectively.

As of December 31, 2016, the average margin requirement (weighted by borrowing amount), or the percentage amount by which the collateral value must exceed the loan amount (also refer to as the “haircut”) under our repurchase agreements was 5.0% for Agency RMBS, 20.6% for non-Agency RMBS, 25.3% for GSE CRT, and 18.7% for CMBS. Across our repurchase agreement facilities, the haircuts range from a low of 4% to a high of 20% for Agency RMBS, a low of 10% to a high of 50% for non-Agency RMBS, a low of 23% to a high of 30% for GSE CRT, and a low of 15% to a high of 25% for CMBS. Our effective cost of funds (non-GAAP measure) was 1.87% and 2.22% as of December 31, 2016 and 2015, respectively. Declines in the value of our securities portfolio can trigger margin calls by

our lenders under our repurchase agreements. An event of default or termination event would give some of our counterparties the option to terminate all repurchase transactions existing with us and require any amount due by us to the counterparties to be payable immediately.

Our total debt-to-equity ratio, which includes longer term financing, was 5.8x as of December 31, 2016 (2015: 6.3x). We have reduced our debt-to-equity ratio over the last twelve months.

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In December 2011, our board of directors approved a share repurchase program with no stated expiration date. Shares of our common stock may be purchased in the open market, including through block purchases, or through privately negotiated transactions, or pursuant to any trading plan that may be adopted in accordance with Rules 10b5-1 and 10b-18 of the Securities Exchange Act of 1934, as amended. The timing, manner, price and amount of any repurchases will be determined at our discretion and the program may be suspended, terminated or modified at any time for any reason. The program does not obligate us to acquire any specific number of shares, and all repurchases will be made in accordance with Rule 10b-18, which sets certain restrictions on the method, timing, price and volume of stock repurchases.

During the year ended December 31, 2016, we repurchased 2,063,451 (2015: 9,539,251) shares of our common stock at an average repurchase price of \$12.12 (2015: \$13.17) per share for a net cost of \$25.0 million (2015: \$125.6 million), including acquisition expenses. As of December 31, 2016, we had authority to purchase 18,239,082 shares of our common stock through our share repurchase program.

Effective April 1, 2016, we replaced our dividend reinvestment stock purchase plan ("DRSPP") with a direct stock purchase plan and dividend reinvestment program administered by an affiliate of our transfer agent, Computershare Trust Company. Prior to termination, we issued 3,201 (2015:12,945) shares of common stock in 2016 at an average price of \$11.08 (2015: \$14.75) with total proceeds of approximately \$35,000 (2015: \$191,000). No shares of common stock were issued under the waiver feature of the DRSPP.

### Effects of Margin Requirements, Leverage and Credit Spreads

Our securities have values that fluctuate according to market conditions and, as discussed above, the market value of our securities will decrease as prevailing interest rates or credit spreads increase. When the value of the securities pledged to secure a repurchase loan decreases to the point where the positive difference between the collateral value and the loan amount is less than the haircut, our lenders may issue a "margin call," which means that the lender will require us to pay the margin call in cash or pledge additional collateral to meet that margin call. Under our repurchase facilities, our lenders have full discretion to determine the value of the securities we pledge to them. Most of our lenders will value securities based on recent trades in the market. Lenders also issue margin calls as the published current principal balance factors change on the pool of mortgages underlying the securities pledged as collateral when scheduled and unscheduled paydowns are announced monthly.

We experience margin calls in the ordinary course of our business. In seeking to effectively manage the margin requirements established by our lenders, we maintain a position of cash and unpledged securities. We refer to this position as our liquidity. The level of liquidity we have available to meet margin calls is directly affected by our leverage levels, our haircuts and the price changes on our securities. If interest rates increase as a result of a yield curve shift or for another reason or if credit spreads widen, then the prices of our collateral (and our unpledged assets that constitute our liquidity) will decline, we will experience margin calls, and we will use our liquidity to meet the margin calls. There can be no assurance that we will maintain sufficient levels of liquidity to meet any margin calls. If our haircuts increase, our liquidity will proportionately decrease. In addition, if we increase our borrowings, our liquidity will decrease by the amount of additional haircut on the increased level of indebtedness.

We intend to maintain a level of liquidity in relation to our assets that enables us to meet reasonably anticipated margin calls but that also allows us to be substantially invested in securities. We may misjudge the appropriate amount of our liquidity by maintaining excessive liquidity, which would lower our investment returns, or by maintaining insufficient liquidity, which would force us to liquidate assets into unfavorable market conditions and harm our results of operations and financial condition.

We are subject to financial covenants in connection with our lending, derivatives and other agreements we enter into in the normal course of our business. We intend to continue to operate in a manner which complies with all of our financial covenants. Our lending and derivative agreements provide that we may be declared in default of our obligations if our leverage ratio exceeds certain thresholds and we fail to maintain stockholders' equity or market value above certain thresholds over specified time periods.

### Forward-Looking Statements Regarding Liquidity

Based upon our current portfolio, leverage rate and available borrowing arrangements, we believe that cash flow from operations and available borrowing capacity will be sufficient to enable us to meet anticipated short-term (one year or



less) liquidity requirements to fund our investment activities, pay fees under our management agreement, fund our distributions to stockholders and for other general corporate expenses.

Our ability to meet our long-term (greater than one year) liquidity and capital resource requirements will be subject to obtaining additional debt financing. We may increase our capital resources by obtaining long-term credit facilities or through public or private offerings of equity or debt securities, possibly including classes of preferred stock, common stock, and senior or subordinated notes. Such financing will depend on market conditions for capital raises and our ability to invest such offering

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proceeds. If we are unable to renew, replace or expand our sources of financing on substantially similar terms, it may have an adverse effect on our business and results of operations.

**Contractual Obligations**

We have entered into an agreement with our Manager pursuant to which our Manager is entitled to receive a management fee and the reimbursement of certain expenses. The management fee is calculated and payable quarterly in arrears in an amount equal to 1.50% of our stockholders' equity, per annum. Refer to Note 12 – “Related Party Transactions” of our consolidated financial statements for a description of adjustments made to our stockholders' equity for purposes of calculating our management fee. Our Manager uses the proceeds from its management fee in part to pay compensation to its officers and personnel who, notwithstanding that certain of those individuals are also our officers, receive no cash compensation directly from us. We are required to reimburse our Manager for operating expenses related to us incurred by our Manager, including certain salary expenses and other expenses relating to legal, accounting, due diligence and other services. Our reimbursement obligation is not subject to any dollar limitation. Refer to Note 12 – “Related Party Transactions” of our consolidated financial statements for details of our reimbursements to our Manager.

As of December 31, 2016, we had the following contractual obligations:

\$ in thousands	Payments Due by Period				
	Total	Less than 1 year	1-3 years	3-5 years	After 5 years
Repurchase agreements	11,160,669	11,160,669	—	—	—
Secured loans	1,650,000	—	—	400,000	1,250,000
Exchangeable senior notes	400,000	—	400,000	—	—
Total contractual obligations <sup>(1)</sup>	13,210,669	11,160,669	400,000	400,000	1,250,000

<sup>(1)</sup> Excluded from total contractual obligations are the amounts due to our Manager under our management agreement, as those obligations do not have fixed and determinable payments.

As of December 31, 2016, we have approximately \$21.5 million, \$30.0 million and \$91.9 million in contractual interest payments related to our repurchase agreements, exchangeable senior notes and secured loans, respectively.

**Off-Balance Sheet Arrangements**

We have committed to invest up to \$121.6 million in unconsolidated ventures sponsored by an affiliate of our Manager. The unconsolidated ventures are structured as partnerships, and we invest in the partnerships as a limited partner. As of December 31, 2016, \$106.1 million of our commitment has been called. We are committed to fund \$15.5 million in additional capital to fund future investments and to cover future expenses should they occur.

As of December 31, 2016, we have unfunded commitments on our existing commercial loans of \$9.7 million (2015: \$2.1 million).

**Stockholders' Equity**

During the year ended December 31, 2016, we issued 3,201 (2015:12,945) shares of common stock at an average price of \$11.08 (2015: \$14.75) under the DRSP. We received total proceeds of approximately \$35,000 (2015: \$191,000).

During the year ended December 31, 2016, we repurchased 2,063,451 (2015: 9,539,251) shares of our common stock at an average repurchase price of \$12.12 (2015: \$13.17) per share for a net cost of \$25.0 million (2015: \$125.6 million), including acquisition expenses. As of December 31, 2016, we had authority to purchase 18,239,082 shares of our common stock through this program.

**Share-Based Compensation**

We have authorized 1,000,000 shares of common stock for issuance to our independent directors and the executive officers and employees of our Manager and its affiliates under the terms of our 2009 Equity Incentive Plan (the “Incentive Plan”). Unless terminated earlier, the Incentive Plan will terminate in 2019, but will continue to govern the unexpired awards. As of December 31, 2016, 825,641 shares of common stock remain available for future issuance under the Incentive Plan.

We recognized compensation expense of approximately \$340,000 (2015: \$340,000; 2014: \$282,000) related to awards to our independent directors for the year ended December 31, 2016. During the year ended December 31, 2016, we

issued 25,068 shares (2015: 23,776 shares; 2014: 14,632 shares) of common stock pursuant to the Incentive Plan to our independent directors.

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The fair market value of the shares granted was determined by the closing stock market price on the date of the grant. The grants vested immediately.

We recognized compensation expense of approximately \$100,000 (2015: \$219,000; 2014: \$290,000) for the year ended December 31, 2016 related to restricted stock units awarded to employees of our Manager and its affiliates which is reimbursed by our Manager under the terms of our management agreement. At December 31, 2016 there was approximately \$187,000 of total unrecognized compensation cost related to restricted stock unit awards that is expected to be recognized over a period of up to 38 months, with a weighted-average remaining vesting period of 15 months.

The following table summarizes the activity related to restricted stock units awarded to employees of our Manager and its affiliates for the year ended December 31, 2016.

	Year Ended December 31, 2016	
	Restricted Stock Units	Weighted Average Grant Date Fair Value <sup>(1)</sup>
Unvested at the beginning of the year	40,814	\$ 17.29
Shares granted during the year	21,099	11.28
Shares forfeited during the year	(27,193)	14.43
Shares vested during the year	(15,913)	17.66
Unvested at the end of the year	18,807	\$ 14.37

(1) The grant date fair value of restricted stock awards is based on the closing market price of our common stock at the grant date.

**Dividends**

We intend to continue to make regular quarterly distributions to holders of our common stock and preferred stock. U.S. federal income tax law generally requires that a REIT distribute at least 90% of its REIT taxable income annually, determined without regard to the deduction for dividends paid and excluding net capital gains, and that it pay tax at regular corporate rates to the extent that it annually distributes less than 100% of its taxable income. Before we pay any dividend, whether for U.S. federal income tax purposes or otherwise, we must first meet both our operating requirements and debt service on our repurchase agreements and other debt payable. If our cash available for distribution is less than our taxable income, we could be required to sell assets or borrow funds to make cash distributions, or we may make a portion of the required distribution in the form of a taxable stock distribution or distribution of debt securities.

**Inflation**

Virtually all of our assets and liabilities are sensitive to interest rates. As a result, interest rates and other factors influence our performance far more than inflation. Changes in interest rates do not necessarily correlate with inflation rates or changes in inflation rates.

**Unrelated Business Taxable Income**

We have not engaged in transactions that would result in a portion of our income being treated as unrelated business taxable income.

**Other Matters**

We believe that we satisfied each of the asset tests in Section 856(c)(4) of the Internal Revenue Code of 1986, as amended (the "Code") at the end of each calendar quarter in 2016. We also believe that our revenue qualifies for the 75% source of income test and for the 95% source of income test rules for the period ended December 31, 2016. Consequently, we believe we met the REIT income and asset test as of December 31, 2016. We also met all REIT requirements regarding the ownership of our common stock and the distribution of dividends of our net income as of December 31, 2016. Therefore, as of December 31, 2016, we believe that we qualified as a REIT under the Code.

At all times, we intend to conduct our business so that neither we nor our Operating Partnership nor the subsidiaries of our Operating Partnership are required to register as an investment company under the 1940 Act. If we were required to register as an investment company, then our use of leverage would be substantially reduced. Because we are a holding company that conducts our business through our Operating Partnership and the Operating Partnership's wholly-owned or majority-owned subsidiaries, the securities issued by these subsidiaries that are excepted from the definition of "investment company" under

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Section 3(c)(1) or Section 3(c)(7) of the 1940 Act, together with any other investment securities the Operating Partnership may own, may not have a combined value in excess of 40% of the value of the Operating Partnership's total assets (exclusive of U.S. government securities and cash items) on an unconsolidated basis. This requirement limits the types of businesses in which we are permitted to engage in through our subsidiaries. In addition, we believe neither we nor the Operating Partnership are considered an investment company under Section 3(a)(1)(A) of the 1940 Act because they do not engage primarily or hold themselves out as being engaged primarily in the business of investing, reinvesting or trading in securities. Rather, through the Operating Partnership's wholly-owned or majority-owned subsidiaries, we and the Operating Partnership are primarily engaged in the non-investment company businesses of these subsidiaries. IAS Asset I LLC and certain of the Operating Partnership's other subsidiaries that we may form in the future rely upon the exclusion from the definition of "investment company" under the 1940 Act provided by Section 3(c)(5)(C) of the 1940 Act, which is available for entities "primarily engaged in the business of purchasing or otherwise acquiring mortgages and other liens on and interests in real estate." This exclusion generally requires that at least 55% of each subsidiary's portfolio be comprised of qualifying assets and at least 80% be comprised of qualifying assets and real estate-related assets (and no more than 20% comprised of miscellaneous assets). We calculate that as of December 31, 2016, we conducted our business so as not to be regulated as an investment company under the 1940 Act.

### Item 7A. Quantitative and Qualitative Disclosures about Market Risk.

The primary components of our market risk are related to interest rate, principal prepayment and market value. While we do not seek to avoid risk completely, we believe the risk can be quantified from historical experience and we seek to actively manage that risk, to earn sufficient compensation to justify taking those risks and to maintain capital levels consistent with the risks we undertake.

#### Interest Rate Risk

Interest rate risk is highly sensitive to many factors, including governmental, monetary and tax policies, domestic and international economic and political considerations, and other factors beyond our control. We are subject to interest rate risk in connection with our investments and our repurchase agreements. Our repurchase agreements are typically of limited duration and will be periodically refinanced at current market rates. We mitigate this risk through utilization of derivative contracts, primarily interest rate swap agreements, TBAs and futures contracts.

#### Interest Rate Effect on Net Interest Income

Our operating results depend in large part upon differences between the yields earned on our investments and our cost of borrowing and interest rate hedging activities. Most of our repurchase agreements provide financing based on a floating rate of interest calculated on a fixed spread over LIBOR. The fixed spread will vary depending on the type of underlying asset which collateralizes the financing. Accordingly, the portion of our portfolio which consists of floating interest rate assets are match-funded utilizing our expected sources of short-term financing, while our fixed interest rate assets are not match-funded. During periods of rising interest rates, the borrowing costs associated with our investments tend to increase while the income earned on our fixed interest rate investments may remain substantially unchanged. This increase in borrowing costs results in the narrowing of the net interest spread between the related assets and borrowings and may even result in losses. Further, during this portion of the interest rate and credit cycles, defaults could increase and result in credit losses to us, which could adversely affect our liquidity and operating results. Such delinquencies or defaults could also have an adverse effect on the spread between interest-earning assets and interest-bearing liabilities.

Hedging techniques are partly based on assumed levels of prepayments of our RMBS. If prepayments are slower or faster than assumed, the life of the RMBS will be longer or shorter, which would reduce the effectiveness of any hedging strategies we may use and may cause losses on such transactions. Hedging strategies involving the use of derivative securities are highly complex and may produce volatile returns.

#### Interest Rate Effects on Fair Value

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

We primarily assess our interest rate risk by estimating the duration of our assets and the duration of our liabilities. Duration measures the market price volatility of financial instruments as interest rates change. We generally calculate duration using various financial models and empirical data. Different models and methodologies can produce different duration numbers for the same securities.

The impact of changing interest rates on fair value can change significantly when interest rates change materially. Therefore, the volatility in the fair value of our assets could increase significantly in the event interest rates change materially.

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In addition, other factors impact the fair value of our interest rate-sensitive investments and hedging instruments, such as the shape of the yield curve, market expectations as to future interest rate changes and other market conditions. Accordingly, changes in actual interest rates may have a material adverse effect on us.

### Spread Risk

We employ a variety of spread risk management techniques that seek to mitigate the influences of spread changes on our book value and our liquidity to help us achieve our investment objectives. We refer to the difference between interest rates on our investments and interest rates on risk free instruments as spreads. The yield on our investments changes over time due to the level of risk free interest rates, the creditworthiness of the security, and the price of the perceived risk. The change in the market yield of our interest rate hedges also changes primarily with the level of risk free interest rates. We manage spread risk through careful asset selection, sector allocation, regulating our portfolio value-at-risk, and maintaining adequate liquidity. Changes in spreads impact our book value and our liquidity and could cause us to sell assets and to change our investment strategy in order to maintain liquidity and preserve book value.

### Prepayment Risk

As we receive prepayments of principal on our investments, premiums paid on these investments are amortized against interest income. In general, an increase in prepayment rates will accelerate the amortization of purchase premiums, thereby reducing the interest income earned on the investments. Conversely, discounts on such investments are accreted into interest income. In general, an increase in prepayment rates will accelerate the accretion of purchase discounts, thereby increasing the interest income earned on the investments.

### Extension Risk

We compute the projected weighted-average life of our investments based upon assumptions regarding the rate at which the borrowers will prepay the underlying mortgages. In general, when a fixed-rate or hybrid adjustable-rate security is acquired with borrowings, we may, but are not required to, enter into an interest rate swap agreement or other hedging instrument that effectively fixes our borrowing costs for a period close to the anticipated average life of the fixed-rate portion of the related assets. This strategy is designed to protect us from rising interest rates, because the borrowing costs are fixed for the duration of the fixed-rate portion of the related target asset.

However, if prepayment rates decrease in a rising interest rate environment, then the life of the fixed-rate portion of the related assets could extend beyond the term of the swap agreement or other hedging instrument. This could have a negative impact on our results from operations, as borrowing costs would no longer be fixed after the end of the hedging instrument, while the income earned on the hybrid adjustable-rate assets would remain fixed. This situation may also cause the market value of our hybrid adjustable-rate assets to decline, with little or no offsetting gain from the related hedging transactions. In extreme situations, we may be forced to sell assets to maintain adequate liquidity, which could cause us to incur losses.

### Market Risk

#### Market Value Risk

Our available-for-sale securities are reflected at their estimated fair value with unrealized gains and losses excluded from earnings and reported in other comprehensive income pursuant to ASC Topic 320. The estimated fair value of these securities fluctuates primarily due to changes in interest rates and other factors. Generally, in a rising interest rate environment, the estimated fair value of these securities would be expected to decrease; conversely, in a decreasing interest rate environment, the estimated fair value of these securities would be expected to increase. The sensitivity analysis table presented below shows the estimated impact of an instantaneous parallel shift in the yield curve, up and down 50 and 100 basis points, on the market value of our interest rate-sensitive investments and net interest income, including net interest paid or received under interest rate swaps, at December 31, 2016, assuming a static portfolio. When evaluating the impact of changes in interest rates, prepayment assumptions and principal reinvestment rates are adjusted based on our Manager's expectations. The analysis presented utilized assumptions, models and estimates of our Manager based on our Manager's judgment and experience.





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Change in Interest Rates	Percentage Change in Projected Net Interest Income	Percentage Change in Projected Portfolio Value
+1.00%	(20.86 )%	(1.43 )%
+0.50%	(5.81 )%	(0.53 )%
-0.50%	3.04 %	0.83 %
-1.00%	(7.38 )%	1.15 %

Certain assumptions have been made in connection with the calculation of the information set forth in the foregoing interest rate sensitivity table and, as such, there can be no assurance that assumed events will occur or that other events will not occur that would affect the outcomes. The base interest rate scenario assumes interest rates at December 31, 2016. Furthermore, while we generally expect to retain such assets and the associated interest rate risk to maturity, future purchases and sales of assets could materially change our interest rate risk profile.

Given the low interest rates at December 31, 2016, we applied a floor of 0% for all anticipated interest rates included in our assumptions. Because of this floor, we anticipate that any hypothetical interest rate shock decrease would have a limited positive impact on our funding costs; however, because prepayment speeds are unaffected by this floor, we expect that any increase in our prepayment speeds (occurring as a result of any interest rate decrease or otherwise) could result in an acceleration of our premium amortization on Agency and interest-only securities purchased at a premium, and accretion of discount on our non-Agency RMBS purchased at a discount. As a result, because this floor limits the positive impact of any interest rate decrease on our funding costs, hypothetical interest rate decreases could cause the fair value of our financial instruments and our net interest income to decline.

The information set forth in the interest rate sensitivity table above and all related disclosures constitutes forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act. Actual results could differ significantly from those estimated in the foregoing interest rate sensitivity table.

**Real Estate Risk**

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

**Credit Risk**

We believe that our investment strategy will generally keep our credit losses and financing costs low. However, we retain the risk of potential credit losses on all of our residential and commercial mortgage investments. We seek to manage this risk through our pre-acquisition due diligence process. In addition, we re-evaluate the credit risk inherent in our investments on a regular basis pursuant to fundamental considerations such as GDP, unemployment, interest rates, retail sales, store closings/openings, corporate earnings, housing inventory, affordability and regional home price trends. We also review key loan credit metrics including, but not limited to, payment status, current loan-to-value ratios, current borrower credit scores and debt yields. These characteristics assist in determining the likelihood and severity of loan loss as well as prepayment and extension expectations. We then perform structural analysis under multiple scenarios to establish likely cash flow profiles and credit enhancement levels relative to collateral performance projections. This analysis allows us to quantify our opinions of credit quality and fundamental value, which are key drivers of portfolio management decisions.

**Foreign Exchange Rate Risk**

We have an investment in a commercial loan denominated in foreign currency and an investment in an unconsolidated joint venture whose net assets and results of operations are exposed to foreign currency translation risk when translated in U.S. dollars upon consolidation. We seek to hedge our foreign currency exposures by purchasing currency forward contracts.

Risk Management

To the extent consistent with maintaining our REIT qualification, we seek to manage risk exposure to protect our investment portfolio against the effects of major interest rate changes. We generally seek to manage this risk by:

- monitoring and adjusting, if necessary, the reset index and interest rate related to our target assets and our financings;

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attempting to structure our financing agreements to have a range of different maturities, terms, amortizations and interest rate adjustment periods;

- using hedging instruments, primarily interest rate swap agreements but also financial futures, options, interest rate cap agreements, floors and forward sales to adjust the interest rate sensitivity of our target assets and our borrowings; and
- actively managing, on an aggregate basis, the interest rate indices, interest rate adjustment periods, and gross reset margins of our target assets and the interest rate indices and adjustment periods of our financings.

### Item 8. Financial Statements and Supplementary Data.

The financial statements and supplementary data are included under Item 15 of this Report.

### Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

None.

### Item 9A. Controls and Procedures.

#### Disclosure Controls and Procedures

Our management is responsible for establishing and maintaining disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act. We have evaluated, with the participation of our principal executive officer and principal financial officer, the effectiveness of our disclosure controls and procedures as of December 31, 2016. Based upon our evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the applicable rules and forms, and that it is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives.

#### Management's Annual Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in the Exchange Act, Rules 13a-15(f) and 15d-15(f). Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Under the supervision and with the participation of the principal executive officer and principal financial officer, management assessed the effectiveness of our internal control over financial reporting as of December 31, 2016. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control - Integrated Framework (2013). Based on this assessment, management concluded that our internal control over financial reporting was effective as of December 31, 2016. Our independent registered public accounting firm, PricewaterhouseCoopers LLP, audited the effectiveness of our internal control over financial reporting as of December 31, 2016. Their report dated February 21, 2017, which is included herein, expressed an unqualified opinion on the effectiveness of our internal control over financial reporting.

#### Changes in Internal Control over Financial Reporting

There has been no change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act) during the quarter ended December 31, 2016 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

### Item 9B. Other Information.

None.



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PART III

Item 10. Directors, Executive Officers and Corporate Governance.

We will provide information that is responsive to certain portions of this Item 10 in our definitive proxy statement or in an amendment to this Report not later than 120 days after the end of the fiscal year covered by this Report, in either case under the captions “Information about Director Nominees,” “Information about the Executive Officers of the Company,” “Corporate Governance,” “Information about the Board and its Committees,” “Section 16(a) Beneficial Ownership Reporting Compliance,” and possibly elsewhere therein. That information is incorporated into this Item 10 by reference.

Each year, the chief executive officer of each company listed on the New York Stock Exchange (“NYSE”) must certify to the NYSE that he or she is not aware of any violation by us of NYSE corporate governance listing standards as of the date of certification, qualifying the certification to the extent necessary. Our chief executive officer submitted this certification to the NYSE in 2016 as required pursuant to Section 303A of the NYSE Listed Company Manual and will submit a similar certification within 30 days of our 2017 annual stockholders’ meeting. In addition, we have filed, as exhibits to this Report, the certifications of our chief executive officer and chief financial officer required under Section 302 and 906 of the Sarbanes-Oxley Act of 2002.

Item 11. Executive Compensation.

We will provide information that is responsive to this Item 11 in our definitive proxy statement or in an amendment to this Report not later than 120 days after the end of the fiscal year covered by this Report, in either case under the captions “Information About the Board and Its Committees - Director Compensation,” “Executive Compensation,” “Compensation Committee Interlocks and Insider Participation,” and possibly elsewhere therein. That information is incorporated into this Item 11 by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

We will provide information that is responsive to this Item 12 in our definitive proxy statement or in an amendment to this Report not later than 120 days after the end of the fiscal year covered by this Report, in either case under the caption “Security Ownership of Principal Stockholders,” “Security Ownership of Management,” and possibly elsewhere therein. That information is incorporated into this Item 12 by reference.

Item 13. Certain Relationships and Related Transactions, and Director Independence.

We will provide information that is responsive to this Item 13 in our definitive proxy statement or in an amendment to this Report not later than 120 days after the end of the fiscal year covered by this Report, in either case under the captions “Corporate Governance,” “Certain Relationships and Related Transactions,” “Related Person Transaction Policy,” and possibly elsewhere therein. That information is incorporated into this Item 13 by reference.

Item 14. Principal Accounting Fees and Services.

We will provide information that is responsive to this Item 14 in our definitive proxy statement or in an amendment to this Report not later than 120 days after the end of the fiscal year covered by this Report, in either case under the captions “Fees Paid to Independent Registered Public Accounting Firm,” “Pre-Approval Process and Policy,” and possibly elsewhere therein. That information is incorporated into this Item 14 by reference.

PART IV

Item 15. Exhibits, Financial Statement Schedules.

(a)(1) Financial Statements: The financial statements contained herein are set forth on pages 81-129 of this Report.

(a)(2) Financial Statement Schedules: Refer to Index to Financial Statement Schedules contained herein on page 78 of this Report.

(a)(3) Exhibits: Refer to Exhibit Index starting on page 76 of this Report.

Item 16. Form 10-K Summary.

Not applicable.

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Exhibit Index

Exhibit No.	Description
3.1	Articles of Amendment and Restatement of Invesco Mortgage Capital Inc., incorporated by reference to Exhibit 3.1 to our Quarterly Report on Form 10-Q, filed with the SEC on August 12, 2009.
3.2	Articles Supplementary of 7.75% Series A Cumulative Redeemable Preferred Stock, incorporated by reference to Exhibit 3.3 to our Registration Statement on Form 8-A, filed with the SEC on July 23, 2012.
3.3	Articles Supplementary of 7.75% Fixed-to-Floating Series B Cumulative Redeemable Preferred Stock, incorporated by reference to Exhibit 3.3 to the Registrant's Registration Statement on Form 8-A, filed with the SEC on September 8, 2014.
3.4	Amended and Restated Bylaws of Invesco Mortgage Capital Inc., incorporated by reference to Exhibit 3.1 to the Current Report on Form 8-K, filed with the SEC on February 17, 2017.
4.1	Specimen Common Stock Certificate of Invesco Mortgage Capital Inc., incorporated by reference to Exhibit 4.1 to Pre-Effective Amendment No. 8.
4.2	Specimen 7.75% Series A Cumulative Redeemable Preferred Stock Certificate, incorporated by reference to Exhibit 4.1 to our Registration Statement on Form 8-A, filed with the SEC on July 23, 2012.
4.3	Specimen 7.75% Series B Fixed-to-Floating Cumulative Redeemable Preferred Stock Certificate, incorporated by reference to Exhibit 4.1 to the Registrant's Registration Statement on Form 8-A, filed with the SEC on September 8, 2014.
4.4	Indenture, dated March 12, 2013, by and among IAS Operating Partnership LP, as issuer, Invesco Mortgage Capital Inc., as guarantor, and The Bank of New York Mellon Trust Company, N.A., as trustee, including the form of 5.00% Exchangeable Senior Notes due 2018 and the related guarantee, incorporated by reference to Exhibit 4.1 to our Current Report on Form 8-K, filed with the SEC on March 15, 2013.
10.1	Registration Rights Agreement, dated as of July 1, 2009, among Invesco Mortgage Capital Inc. (formally known as Invesco Agency Securities Inc.), Invesco Advisers, Inc. (formally known as Invesco Institutional (N.A.), Inc.) and Invesco Investments (Bermuda) Ltd., incorporated by reference to Exhibit 10.1 to our Quarterly Report on Form 10-Q, filed with the SEC on August 12, 2009.
10.2	Registration Rights Agreement, dated March 12, 2013, among IAS Operating Partnership LP, Invesco Mortgage Capital Inc., Credit Suisse Securities (USA) LLC, Citigroup Global Markets Inc. and Merrill Lynch, Pierce, Fenner & Smith Incorporated, incorporated by reference to Exhibit 4.1 to our Current Report on Form 8-K, filed with the SEC on March 15, 2013.
10.3	Management Agreement, dated as of July 1, 2009, among Invesco Advisers, Inc. (formally known as Invesco Institutional (N.A.), Inc.), Invesco Mortgage Capital Inc. and IAS Operating Partnership LP., incorporated by reference to Exhibit 10.2 to our Quarterly Report on Form 10-Q, filed with the SEC on August 12, 2009.
10.4	Amendment to Management Agreement, dated as of May 24, 2011, by and among Invesco Advisers, Inc. (formally known as Invesco Institutional (N.A.), Inc.), Invesco Mortgage Capital Inc., IAS Operating Partnership LP., and IAS Asset I LLC, incorporated by reference to Exhibit 10.1 to our Quarterly Report on

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Form 10-Q, filed with the SEC on August 9, 2011.

10.5 Second Amendment to Management Agreement, dated as of July 1, 2015, by and among Invesco Advisers, Inc., Invesco Mortgage Capital Inc., and IAS Operating Partnership LP., incorporated by reference to Exhibit 10.1 to our Quarterly Report on Form 10-Q, filed with the SEC on August 17, 2015.

10.6 First Amended and Restated Agreement of Limited Partnership, dated as of July 1, 2009, of IAS Operating Partnership LP., incorporated by reference to Exhibit 10.3 to our Quarterly Report on Form 10-Q, filed with the SEC on August 12, 2009.

10.7 First Amendment to First Amended and Restated Agreement of Limited Partnership of IAS Operating Partnership LP, dated as of July 23, 2012, incorporated by reference to Exhibit 10.5 to our Annual Report on Form 10-K, filed with the SEC on March 1, 2013.

10.8 Second Amendment to First Amended and Restated Agreement of Limited Partnership of IAS Operating Partnership LP, dated September 8, 2014.

§ 10.9 Invesco Mortgage Capital Inc. Amended and Restated 2009 Equity Incentive Plan, incorporated by reference to Exhibit 10.1 to our Current Report on Form 8-K, filed with the SEC on February 19, 2016.



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§ Amendment No. 1 to Invesco Mortgage Capital Inc. 2009 Equity Incentive Plan, incorporated by reference to  
10.10 Exhibit 10.1 to our Quarterly Report on Form 10-Q, filed with the SEC on August 13, 2010.

§ Form of Restricted Common Stock Award Agreement, incorporated by reference to Exhibit 4.1 to  
10.11 Pre-Effective Amendment No. 8.

§ Form of Restricted Stock Unit Award Agreement, incorporated by reference to Exhibit 10.7 to our Annual  
10.12 Report on Form 10-K, filed with the SEC on March 24, 2010.

21.1 Subsidiaries of the Registrant.

23.1 Consent of PricewaterhouseCoopers LLP.

23.2 Consent of Grant Thornton LLP.

31.1 Certification of Richard J. King pursuant to Rule 13a-14(a), as adopted pursuant to Section 302 of the  
Sarbanes-Oxley Act of 2002.

31.2 Certification of Richard Lee Phegley, Jr. pursuant to Rule 13a-14(a), as adopted pursuant to Section 302 of the  
Sarbanes-Oxley Act of 2002.

32.1 Certification of Richard J. King pursuant to Rule 13a-14(b) and 18 U.S.C. Section 1350, as adopted pursuant  
to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification of Richard Lee Phegley, Jr. pursuant to Rule 13a-14(b) and 18 U.S.C. Section 1350, as adopted  
pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

101 The following series of audited XBRL-formatted documents are collectively included herewith as Exhibit 101.  
The financial information is extracted from Invesco Mortgage Capital Inc.'s audited consolidated financial  
statements and notes that are included in this Form 10-K/A Report.

101.INS XBRL Instance Document

101.SCH XBRL Taxonomy Extension Schema Document

101.CAL XBRL Taxonomy Calculation Linkbase Document

101.LAB XBRL Taxonomy Label Linkbase Document

101.PRE XBRL Taxonomy Presentation Linkbase Document

101.DEF XBRL Taxonomy Definition Linkbase Document

§ Management contract or compensatory plan or arrangement.

(b) Exhibits: Refer to (a)(3) above.

(c) Financial Statement Schedules: Refer to (a)(2) above.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of  
Invesco Mortgage Capital Inc.

In our opinion, the accompanying consolidated balance sheet as of December 31, 2016 and the related consolidated statements of operations, comprehensive income (loss), equity, and cash flows for the year then ended present fairly, in all material respects, the financial position of Invesco Mortgage Capital Inc. and its subsidiaries at December 31, 2016, and the results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the accompanying index as of and for the year ended December 31, 2016, presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2016, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements and financial statement schedule, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Annual Report on Internal Control over Financial Reporting appearing under Item 9A. Our responsibility is to express opinions on these financial statements, on the financial statement schedule, and on the Company's internal control over financial reporting based on our integrated audit. We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audit of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

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

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

/s/ PRICEWATERHOUSECOOPERS LLP

Atlanta, Georgia  
February 21, 2017

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders  
Invesco Mortgage Capital Inc.

We have audited the accompanying consolidated balance sheet of Invesco Mortgage Capital Inc. (a Maryland corporation) and subsidiaries (the “Company”) as of December 31, 2015, and the related consolidated statements of operations, comprehensive income (loss), equity, and cash flows for the years ended December 31, 2015 and 2014. Our audits of the basic consolidated financial statements included the financial statement schedule listed in the index appearing under Item 15(a)(2). These financial statements and financial statement schedule are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Invesco Mortgage Capital Inc. and subsidiaries as of December 31, 2015, and the results of their operations and their cash flows for the years ended December 31, 2015 and 2014, in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

/s/ GRANT THORNTON LLP

Iselin, New Jersey  
February 22, 2016 (Except for Note 17 - Revision of Previously Issued Financial Statements, which is as of February 21, 2017)

Table of ContentsINVESCO MORTGAGE CAPITAL INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS

	As of	
	December	December
In thousands except share amounts	31, 2016	31, 2015
<b>ASSETS</b>		
Mortgage-backed and credit risk transfer securities, at fair value (including pledged securities of \$14,422,198 and \$15,553,934, respectively)	14,981,331	16,065,935
Commercial loans, held-for-investment	273,355	209,062
Cash and cash equivalents	161,788	53,199
Due from counterparties	86,450	110,009
Investment related receivable	43,886	154,594
Accrued interest receivable	46,945	50,779
Derivative assets, at fair value	3,186	8,659
Other assets	109,297	115,072
Total assets	15,706,238	16,767,309
<b>LIABILITIES AND EQUITY</b>		
Liabilities:		
Repurchase agreements	11,160,669	12,126,048
Secured loans	1,650,000	1,650,000
Exchangeable senior notes	397,041	394,573
Derivative liabilities, at fair value	134,228	238,148
Dividends and distributions payable	50,924	51,734
Investment related payable	9,232	167
Accrued interest payable	21,066	21,604
Collateral held payable	1,700	4,900
Accounts payable and accrued expenses	1,534	2,376
Due to affiliate	9,660	10,851
Total liabilities	13,436,054	14,500,401
Commitments and contingencies (See Note 16)		
Equity:		
Preferred Stock, par value \$0.01 per share; 50,000,000 shares authorized:		
7.75% Series A Cumulative Redeemable Preferred Stock: 5,600,000 shares issued and outstanding (\$140,000 aggregate liquidation preference)	135,356	135,356
7.75% Fixed-to-Floating Series B Cumulative Redeemable Preferred Stock: 6,200,000 shares issued and outstanding (\$155,000 aggregate liquidation preference)	149,860	149,860
Common Stock, par value \$0.01 per share; 450,000,000 shares authorized; 111,594,595 and 113,619,471 shares issued and outstanding, respectively	1,116	1,136
Additional paid in capital	2,379,863	2,407,372
Accumulated other comprehensive income	293,668	318,624
Retained earnings (distributions in excess of earnings)	(718,303 )	(771,313 )
Total stockholders' equity	2,241,560	2,241,035
Non-controlling interest	28,624	25,873
Total equity	2,270,184	2,266,908
Total liabilities and equity	15,706,238	16,767,309

The accompanying notes are an integral part of these consolidated financial statements.



Table of ContentsINVESCO MORTGAGE CAPITAL INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS

Years Ended December 31,

In thousands except share amounts	2016	2015	2014
Interest Income			
Mortgage-backed and credit risk transfer securities	456,444	523,893	589,499
Residential loans <sup>(1)</sup>	—	110,908	88,073
Commercial loans	22,238	15,331	9,508
Total interest income	478,682	650,132	687,080
Interest Expense			
Repurchase agreements	124,000	166,892	188,699
Secured loans	10,887	6,579	2,576
Exchangeable senior notes	22,467	22,461	22,461
Asset-backed securities <sup>(1)</sup>	—	82,041	68,159
Total interest expense	157,354	277,973	281,895
Net interest income	321,328	372,159	405,185
Reduction in provision for loan losses	—	(213	) (142
Net interest income after reduction in provision for loan losses	321,328	372,372	405,327
Other income (loss)			
Gain (loss) on investments, net	(17,542	) (18,005	) (84,407
Equity in earnings of unconsolidated ventures	2,392	12,630	6,786
Gain (loss) on derivative instruments, net	(62,815	) (219,048	) (487,469
Realized and unrealized credit derivative income (loss), net	61,143	19,782	(2,866
Other investment income (loss), net	(5,002	) 944	(2,045
Total other income (loss)	(21,824	) (203,697	) (570,001
Expenses			
Management fee — related party	34,541	38,632	37,599
General and administrative	7,265	7,769	9,191
Consolidated securitization trusts <sup>(1)</sup>	—	8,219	6,076
Total expenses	41,806	54,620	52,866
Net income (loss)	257,698	114,055	(217,540
Net income (loss) attributable to non-controlling interest	3,287	1,344	(2,482
Net income (loss) attributable to Invesco Mortgage Capital Inc.	254,411	112,711	(215,058
Dividends to preferred stockholders	22,864	22,864	17,378
Net income (loss) attributable to common stockholders	231,547	89,847	(232,436
Earnings per share:			
Net income (loss) attributable to common stockholders			
Basic	2.07	0.74	(1.89
Diluted	1.98	0.74	(1.89
Weighted average number of shares of common stock:			
Basic	111,973,404	121,377,585	123,104,934
Diluted	130,254,003	122,843,838	124,529,934

The consolidated statements of operations for the years ended December 31, 2015 and 2014 include income and (1) expenses of consolidated variable interest entities ("VIEs"). We deconsolidated these VIEs in 2015. Refer to Note 2 - "Summary of Significant Accounting Policies" for further discussion.

The accompanying notes are an integral part of these consolidated financial statements.





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INVESCO MORTGAGE CAPITAL INC. AND SUBSIDIARIES  
 CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

	Years Ended December 31,		
	2016	2015	2014
In thousands			
Net income (loss)	257,698	114,055	(217,540)
Other comprehensive income (loss):			
Unrealized gain (loss) on mortgage-backed and credit risk transfer securities, net	(37,632 )	(191,053 )	420,761
Reclassification of unrealized (gain) loss on sale of mortgage-backed and credit risk transfer securities to gain (loss) on investments, net	6,134	(7,484 )	77,898
Reclassification of amortization of net deferred (gain) loss on de-designated interest rate swaps to repurchase agreements interest expense	5,154	66,757	85,176
Currency translation adjustments on investment in unconsolidated venture	128	(32 )	—
Total other comprehensive income (loss)	(26,216 )	(131,812 )	583,835
Comprehensive income (loss)	231,482	(17,757 )	366,295
Less: Comprehensive (income) loss attributable to non-controlling interest	(2,939 )	245	(4,188 )
Less: Dividends to preferred stockholders	(22,864 )	(22,864 )	(17,378 )
Comprehensive income (loss) attributable to common stockholders	205,679	(40,376 )	344,729

The accompanying notes are an integral part of these consolidated financial statements.

Table of ContentsINVESCO MORTGAGE CAPITAL INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF EQUITY

In thousands except share amounts	Series A Preferred Stock		Series B Preferred Stock		Common Stock		Attributable to Common Stockholders			Total Stockholder Equity	N In
	Shares	Amount	Shares	Amount	Shares	Amount	Additional Paid in Capital	Accumulated Other Comprehensive Income (loss)	Retained Earnings (Distributions in excess of earnings)		
Balance at December 31, 2013	5,600,000	135,356	—	—	124,510,246	1,245	2,552,464	(128,318)	(184,632)	2,376,115	2
Net income (loss)	—	—	—	—	—	—	—	—	(215,058)	(215,058)	(2)
Other comprehensive income (loss)	—	—	—	—	—	—	—	577,165	—	577,165	6
Proceeds from issuance of common stock, net of offering costs	—	—	—	—	15,505	—	256	—	—	256	—
Proceeds from issuance of preferred stock, net of offering costs	—	—	6,200,000	149,860	—	—	—	—	—	149,860	—
Repurchase of shares of common stock	—	—	—	—	(1,438,213)	(14)	(21,116)	—	—	(21,130)	—
Stock awards	—	—	—	—	22,916	—	—	—	—	—	—
Common stock dividends	—	—	—	—	—	—	—	—	(240,041)	(240,041)	—
Common unit dividends	—	—	—	—	—	—	—	—	—	—	(2)
Preferred stock dividends	—	—	—	—	—	—	—	—	(17,378)	(17,378)	—
Amortization of equity-based compensation	—	—	—	—	—	—	526	—	—	526	6
Balance at December 31, 2014	5,600,000	135,356	6,200,000	149,860	123,110,454	1,231	2,532,130	448,847	(657,109)	2,610,315	2
Net income (loss)	—	—	—	—	—	—	—	—	112,711	112,711	1
Other comprehensive income (loss)	—	—	—	—	—	—	—	(130,223)	—	(130,223)	(1)
	—	—	—	—	12,945	—	191	—	—	191	—

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Proceeds from issuance of common stock, net of offering costs											
Repurchase of shares of common stock	—	—	—	—	(9,539,251 )	(95 )	(125,500 )	—	—	(125,595 )	—
Stock awards	—	—	—	—	35,323	—	—	—	—	—	—
Common stock dividends	—	—	—	—	—	—	—	—	(204,051)	(204,051 )	—
Common unit dividends	—	—	—	—	—	—	—	—	—	—	(2
Preferred stock dividends	—	—	—	—	—	—	—	—	(22,864 )	(22,864 )	—
Amortization of equity-based compensation	—	—	—	—	—	—	551	—	—	551	6