DYNEX CAPITAL INC
Form 10-Q
May 10, 2017

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549
FORM 10-Q
x Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended March 31, 2017
or
o Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
Commission File Number: 1-9819
DYNEX CAPITAL, INC.
(Exact name of registrant as specified in its charter)

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes x No o

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

| | |
|---|---|
| Large accelerated filer o | Accelerated filer x |
| Non-accelerated filer o (Do not check if a smaller reporting company) | Smaller reporting company o |
| | Emerging growth company o |

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes o No x

On April 28, 2017, the registrant had 49,204,773 shares outstanding of common stock, $0.01 par value, which is the registrant's only class of common stock.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

DYNEX CAPITAL, INC.
CONSOLIDATED BALANCE SHEETS
(amounts in thousands except share data)

| ASSETS | March 31, 2017 (unaudited) | December 31, 2016 |
|---|---|---|
| Mortgage-backed securities (including pledged of $3,070,435 and $3,150,610, respectively) | $3,186,749 | $3,212,084 |
| Mortgage loans held for investment, net | 18,183 | 19,036 |
| Cash and cash equivalents | 65,943 | 74,120 |
| Restricted cash | 34,822 | 24,769 |
| Derivative assets | 272 | 28,534 |
| Principal receivable on investments | 4,558 | 11,978 |
| Accrued interest receivable | 22,849 | 20,396 |
| Other assets, net | 6,498 | 6,814 |
| Total assets | $3,339,874 | $3,397,731 |
| | | |
| LIABILITIES AND SHAREHOLDERS’ EQUITY | | |
| Liabilities: | | |
| Repurchase agreements | $2,825,945 | $2,898,952 |
| Non-recourse collateralized financing | 6,075 | 6,440 |
| Derivative liabilities | 58 | 6,922 |
| Accrued interest payable | 2,628 | 3,156 |
| Accrued dividends payable | 10,934 | 12,268 |
| Other liabilities | 1,712 | 2,809 |
| Total liabilities | 2,847,352 | 2,930,547 |
| | | |
| Shareholders’ equity: | | |
| Preferred stock, par value $.01 per share; 50,000,000 shares authorized; 4,897,138 and 4,571,937 shares issued and outstanding, respectively ($122,428 and $114,298 aggregate liquidation preference, respectively) | $117,473 | $110,005 |
| Common stock, par value $.01 per share, 200,000,000 shares authorized; 49,203,022 and 49,153,463 shares issued and outstanding, respectively | 492 | 492 |
| Additional paid-in capital | 727,503 | 727,369 |
| Accumulated other comprehensive loss | (12,632) | (32,609) |
| Accumulated deficit | (340,314) | (338,073) |
| Total shareholders' equity | 492,522 | 467,184 |
| Total liabilities and shareholders’ equity | $3,339,874 | $3,397,731 |

See notes to the unaudited consolidated financial statements.

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DYNEX CAPITAL, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(UNAUDITED)
(amounts in thousands except per share data)

| | Three Months Ended March 31, | |
|---|---|---|
| | 2017 | 2016 |
| Interest income | $22,419 | 25,089 |
| Interest expense | 7,519 | 6,310 |
| Net interest income | 14,900 | 18,779 |
| | | |
| Gain (loss) on derivative instruments, net | 175 | (48,264 ) |
| Loss on sale of investments, net | (1,708 ) | (3,941 ) |
| Fair value adjustments, net | 10 | 24 |
| Other (expense) income, net | (46 ) | 63 |
| General and administrative expenses: | | |
| Compensation and benefits | (2,245 ) | (2,219 ) |
| Other general and administrative | (2,035 ) | (1,873 ) |
| Net income (loss) | 9,051 | (37,431 ) |
| Preferred stock dividends | (2,435 ) | (2,294 ) |
| Net income (loss) to common shareholders | $6,616 | $(39,725) |
| | | |
| Other comprehensive income: | | |
| Unrealized gain on available-for-sale investments, net | $18,368 | $37,760 |
| Reclassification adjustment for loss on sale of investments, net | 1,708 | 3,941 |
| Reclassification adjustment for de-designated cash flow hedges | (99 ) | 27 |
| Total other comprehensive income | 19,977 | 41,728 |
| Comprehensive income to common shareholders | $26,593 | $2,003 |
| | | |
| Net income (loss) per common share-basic and diluted | $0.13 | $(0.81 ) |
| Weighted average common shares-basic and diluted | 49,176 | 49,041 |

See notes to the unaudited consolidated financial statements.

DYNEX CAPITAL, INC.
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
(UNAUDITED)
($ in thousands)

| | Preferred Stock | | Common Stock | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Shares | Amount | Shares | Amount | Additional Paid-in Capital | Accumulated Other Comprehensive (Loss) Income | Accumulated Deficit | Total Shareholders' Equity |
| Balance as of December 31, 2016 | 4,571,937 | $110,005 | 49,153,463 | $492 | $727,369 | $(32,609) | $(338,073) | $467,184 |
| Stock issuance | 325,201 | 7,504 | 18,680 | — | 127 | — | — | 7,631 |
| Restricted stock granted, net of amortization | — | — | 108,446 | 1 | 536 | — | — | 537 |
| Adjustments for tax withholding on share-based compensation | — | — | (77,567) | (1) | (520) | — | — | (521) |
| Stock issuance costs | — | (36) | — | — | (9) | — | — | (45) |
| Net income | — | — | — | — | — | — | 9,051 | 9,051 |
| Dividends on preferred stock | — | — | — | — | — | — | (2,435) | (2,435) |
| Dividends on common stock | — | — | — | — | — | — | (8,857) | (8,857) |
| Other comprehensive income | — | — | — | — | — | 19,977 | — | 19,977 |
| Balance as of March 31, 2017 | 4,897,138 | $117,473 | 49,203,022 | $492 | $727,503 | $(12,632) | $(340,314) | $492,522 |

See notes to the unaudited consolidated financial statements.

DYNEX CAPITAL, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)
($ in thousands)

| | Three Months Ended March 31, | |
|---|---|---|
| | 2017 | 2016 |
| Operating activities: | | |
| Net income (loss) | $9,051 | $(37,431) |
| Adjustments to reconcile net income (loss) to cash provided by operating activities: | | |
| (Increase) decrease in accrued interest receivable | (2,453) | 613 |
| (Decrease) increase in accrued interest payable | (528) | 500 |
| (Gain) loss on derivative instruments, net | (175) | 48,264 |
| Loss on sale of investments, net | 1,708 | 3,941 |
| Fair value adjustments, net | (10) | (24) |
| Amortization of investment premiums, net | 39,862 | 37,547 |
| Other amortization and depreciation, net | 325 | 477 |
| Stock-based compensation expense | 538 | 829 |
| Decrease in other assets and liabilities, net | (1,210) | (1,112) |
| Net cash and cash equivalents provided by operating activities | 47,108 | 53,604 |
| Investing activities: | | |
| Purchase of investments | (141,436) | (4,970) |
| Principal payments received on investments | 95,546 | 92,420 |
| Proceeds from sales of investments | 57,173 | 77,530 |
| Principal payments received on mortgage loans held for investment, net | 987 | 899 |
| Distributions received from limited partnership | — | 10,737 |
| Net payments on derivatives, including terminations | 21,573 | (5,992) |
| Other investing activities | (146) | (38) |
| Net cash and cash equivalents provided by investing activities | 33,697 | 170,586 |
| Financing activities: | | |
| Borrowings under repurchase agreements | 21,748,733 | 5,403,089 |
| Repayments of repurchase agreement borrowings and FHLB advances | (21,821,740) | (5,527,490) |
| Principal payments on non-recourse collateralized financing | (370) | (305) |
| Increase in restricted cash | (10,053) | (35,674) |
| Proceeds from issuance of preferred stock | 7,504 | — |
| Proceeds from issuance of common stock | 127 | 56 |
| Cash paid for stock issuance costs | (36) | — |
| Cash paid for repurchases of common stock | — | (310) |
| Payments related to tax withholding for stock-based compensation | (521) | (485) |
| Dividends paid | (12,626) | (14,066) |
| Net cash and cash equivalents used in financing activities | (88,982) | (175,185) |
| | | |
| Net increase in cash and cash equivalents | (8,177) | 49,005 |
| Cash and cash equivalents at beginning of period | 74,120 | 33,935 |
| Cash and cash equivalents at end of period | $65,943 | $82,940 |
| Supplemental Disclosure of Cash Activity: | | |
| Cash paid for interest | $8,141 | $5,781 |

See notes to the unaudited consolidated financial statements.

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
DYNEX CAPITAL, INC.
(amounts in thousands except share data)

## NOTE 1 –ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### Organization

Dynex Capital, Inc., ("Company") was incorporated in the Commonwealth of Virginia on December 18, 1987 and commenced operations in February 1988. The Company primarily earns income from investing on a leveraged basis in mortgage-backed securities ("MBS") that are issued or guaranteed by the U.S. Government or U.S. Government sponsored agencies ("Agency MBS") and MBS issued by others ("non-Agency MBS").

### Basis of Presentation

The accompanying unaudited consolidated financial statements of Dynex Capital, Inc. and its subsidiaries (together, “Dynex” or, as appropriate, the “Company”) have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial information and with the instructions to the Quarterly Report on Form 10-Q and Article 10, Rule 10-01 of Regulation S-X promulgated by the Securities and Exchange Commission (the “SEC”). Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, all significant adjustments, consisting of normal recurring accruals, considered necessary for a fair presentation of the consolidated financial statements have been included. Operating results for the three months ended March 31, 2017 are not necessarily indicative of the results that may be expected for any other interim periods or for the entire year ending December 31, 2017. The unaudited consolidated financial statements included herein should be read in conjunction with the audited financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2016 filed with the SEC.

### Reclassifications

Certain items in the prior periods' consolidated financial statements have been reclassified to conform to the current period's presentation. The Company has reclassified amortization of stock issuance costs which was previously recorded in "proceeds from issuance of common stock, net of issuance costs" in the financing activities section of the Company's consolidated statements of cash flows for three months ended March 31, 2016. Amortization of stock issuance costs is now presented within "other operating activities" in the operating activities section of the Company's consolidated statements of cash flows. This presentation change had no effect on reported financial condition or results of operations and did not have a material impact on cash flows from operating or financing activities.

### Consolidation

The consolidated financial statements include the accounts of the Company and the accounts of its majority owned subsidiaries and variable interest entities ("VIE") for which it is the primary beneficiary. As a primary beneficiary, the Company has both the power to direct the activities that most significantly impact the economic performance of the VIE and a right to receive benefits or absorb losses of the entity that could be potentially significant to the VIE. The Company is required to reconsider its evaluation of whether to consolidate a VIE each reporting period, based upon changes in the facts and circumstances pertaining to the VIE. The Company consolidates certain trusts through which it has securitized mortgage loans as a result of not meeting the sale criteria under GAAP at the time the financial assets were transferred to the trust. All intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements as well as the reported amounts of revenue and expenses during the reported period. Actual results could differ from those estimates. The most significant estimates used by management include, but are not limited to, amortization of premiums and discounts, fair value measurements of its investments, and other-than-temporary impairments. These items are discussed further below within this note to the consolidated financial statements.

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
DYNEX CAPITAL, INC.
(amounts in thousands except share data)

Income Taxes

The Company has elected to be taxed as a real estate investment trust ("REIT") under the Internal Revenue Code of 1986 and the corresponding provisions of state law. To qualify as a REIT, the Company must meet certain tests including investing in primarily real estate-related assets and the required distribution of at least 90% of its annual REIT taxable income to stockholders after consideration of its net operating loss ("NOL") carryforward and not including taxable income retained in its taxable subsidiaries. As a REIT, the Company generally will not be subject to federal income tax on the amount of its income or capital gains that is distributed as dividends to shareholders.

The Company assesses its tax positions for all open tax years and determines whether the Company has any material unrecognized liabilities in accordance with Accounting Standards Codification ("ASC") Topic 740. The Company records these liabilities, if any, to the extent they are deemed more likely than not to have been incurred.

Net Income (Loss) Per Common Share

The Company calculates basic net income (loss) per common share by dividing net income (loss) to common shareholders for the period by weighted-average shares of common stock outstanding for that period. The Company did not have any potentially dilutive securities outstanding during the three months ended March 31, 2017 or March 31, 2016.

Holders of unvested shares of the Company's issued and outstanding restricted common stock are eligible to receive non-forfeitable dividends. As such, these unvested shares are considered participating securities as per ASC Topic 260-10 and therefore are included in the computation of basic net income (loss) per common share using the two-class method. Upon vesting, restrictions on transfer expire on each share of restricted stock, and each such share of restricted stock represents one unrestricted share of common stock.

Because the Company's 8.50% Series A Cumulative Redeemable Preferred Stock (the “Series A Preferred Stock”) and 7.625% Series B Cumulative Redeemable Preferred Stock (the “Series B Preferred Stock”) are redeemable at the Company's option for cash only and may convert into shares of common stock only upon a change of control of the Company, the effect of those shares and their related dividends is excluded from the calculation of diluted net income (loss) per common share.

Cash and Cash Equivalents

Cash and cash equivalents include cash on hand and highly liquid investments with original maturities of three months or less.

Restricted Cash

Restricted cash consists of cash the Company has pledged to cover initial and variation margin with its financing and derivative counterparties.

Mortgage-Backed Securities

The Company invests in Agency and non-Agency RMBS, CMBS and CMBS IO securities, all of which are designated as available-for-sale ("AFS"). All of the Company’s MBS are recorded at fair value on the consolidated balance sheet. Changes in unrealized gain (loss) on the Company's MBS are reported in other comprehensive income ("OCI") until each security is collected, disposed of, or determined to be other than temporarily impaired. Although the Company generally intends to hold its AFS securities until maturity, it may sell any of these securities as part of the overall management of its business. Upon the sale of an AFS security, any unrealized gain or loss is reclassified out of accumulated other comprehensive income ("AOCI") into net income as a realized "gain (loss) on sale of investments, net" using the specific identification method.

The Company’s MBS pledged as collateral against repurchase agreements and derivative instruments are included in MBS on the consolidated balance sheets with the fair value of the MBS pledged disclosed parenthetically.

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
DYNEX CAPITAL, INC.
(amounts in thousands except share data)

Interest Income, Premium Amortization, and Discount Accretion. Interest income on MBS is accrued based on the outstanding principal balance (or notional balance in the case of interest-only, or "IO", securities) and their contractual terms. Premiums and discounts on Agency MBS as well as any non-Agency MBS rated 'AA' and higher at the time of purchase are amortized into interest income over the expected life of such securities using the effective yield method and adjustments to premium amortization are made for actual cash payments as well as changes in projected future cash payments. The Company's projections of future cash payments are based on input and analysis received from external sources and internal models, and include assumptions about the amount and timing of loan prepayment rates, fluctuations in interest rates, credit losses, and other factors. On at least a quarterly basis, the Company reviews and makes any necessary adjustments to its cash flow projections and updates the yield recognized on these assets.

The Company holds certain non-Agency MBS that had credit ratings of less than 'AA' at the time of purchase or were not rated by any of the nationally recognized credit rating agencies. A portion of these non-Agency MBS were purchased at discounts to their par value, which management does not believe to be substantial. The discount is accreted into income over the security's expected life, which reflects management's estimate of the security's projected cash flows. Future changes in the timing of projected cash flows or differences arising between projected cash flows and actual cash flows received may result in a prospective change in the effective yield on those securities.

Determination of MBS Fair Value. The Company estimates the fair value of the majority of its MBS based upon prices obtained from third-party pricing services and broker quotes. The remainder of the Company's MBS are valued by discounting the estimated future cash flows derived from cash flow models that utilize information such as the security's coupon rate, estimated prepayment speeds, expected weighted average life, collateral composition, estimated future interest rates, expected losses, and credit enhancements as well as certain other relevant information. Refer to Note 5 for further discussion of MBS fair value measurements.

Other-than-Temporary Impairment. MBS is considered impaired when its fair value is less than its amortized cost. The Company evaluates all of its impaired MBS for other-than-temporary impairments ("OTTI") on at least a quarterly basis. An impairment is considered other-than-temporary if: (1) the Company intends to sell the MBS; (2) it is more likely than not that the Company will be required to sell the MBS before its fair value recovers; or (3) the Company does not expect to recover the full amortized cost basis of the MBS. If either of the first two conditions is met, the entire amount of the impairment is recognized in earnings. If the impairment is solely due to the inability to fully recover the amortized cost basis, the security is further analyzed to quantify any credit loss, which is the difference between the present value of cash flows expected to be collected on the MBS and its amortized cost. The credit loss, if any, is then recognized in earnings, while the balance of impairment related to other factors is recognized in other comprehensive income.

Following the recognition of an OTTI through earnings, a new cost basis is established for the security. Any subsequent recoveries in fair value may be accreted back into the amortized cost basis of the MBS on a prospective basis through interest income. Please see Note 2 for additional information related to the Company's evaluation for OTTI.

Repurchase Agreements

The Company's repurchase agreements, which are used to finance its purchases of MBS, are accounted for as secured borrowings under which the Company pledges its securities as collateral to secure a loan, which is equal in value to a specified percentage of the estimated fair value of the pledged collateral. The Company retains beneficial ownership of the pledged collateral. At the maturity of a repurchase agreement, the Company is required to repay the loan and concurrently receives back its pledged collateral from the lender or, with the consent of the lender, the Company may renew the agreement at the then prevailing financing rate. A repurchase agreement lender may require the Company to pledge additional collateral in the event of a decline in the fair value of the collateral pledged. Repurchase agreement financing is recourse to the Company and the assets pledged. Most of the Company's repurchase agreements are based on the September 1996 version of the Bond Market Association Master Repurchase Agreement, which generally provides that the lender, as buyer, is responsible for obtaining collateral valuations from a generally recognized source agreed to by both the Company and the lender, or, in an instance when such source is not available, the value determination is made by the lender.

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
DYNEX CAPITAL, INC.
(amounts in thousands except share data)

Derivative Instruments

The Company's derivative instruments are accounted for at the fair value of their unit of account. Derivative instruments in a gain position are reported as derivative assets and derivative instruments in a loss position are reported as derivative liabilities on the Company's consolidated balance sheet. All periodic interest costs and changes in fair value of derivative instruments, including gains and losses realized upon termination or maturity, are recorded in "gain (loss) on derivative instruments, net" on the Company's consolidated statement of comprehensive income. Cash receipts and payments related to derivative instruments are classified in the investing activities section of our consolidated statements of cash flows in accordance with the underlying nature or purpose of the derivative transactions.

The majority of the Company's interest rate swaps are centrally cleared through the Chicago Mercantile Exchange ("CME") with the rest being subject to bilateral agreements between the Company and the swap counterparty. The Company's CME cleared swaps require that the Company post initial margin as determined by the CME, and in addition, variation margin is exchanged, typically in cash, for changes in the fair value of the CME cleared swaps. Beginning in January 2017, as a result of a change in the CME's rulebook, the exchange of variation margin for CME cleared swaps is legally considered to be the settlement of the derivative itself as opposed to a pledge of collateral. Accordingly, beginning in 2017, the Company accounts for the daily exchange of variation margin associated with its CME cleared interest rate swaps as a direct reduction to the carrying value of the related derivative asset or liability. The carrying value of CME cleared interest rate swaps in the Company's consolidated balance sheets is the unsettled fair value of those instruments.

Please refer to Note 4 for additional information regarding the Company's derivative instruments.

Although MBS have characteristics that meet the definition of a derivative instrument, ASC Topic 815 specifically excludes these instruments from its scope because they are accounted for as debt securities under ASC Topic 320.

Share-Based Compensation

Pursuant to the Company’s 2009 Stock and Incentive Plan, the Company may grant share-based compensation to eligible employees, directors or consultants or advisers to the Company, including stock awards, stock options, stock appreciation rights, dividend equivalent rights, performance shares, and restricted stock units. The Company's restricted stock currently issued and outstanding under this plan may be settled only in shares of its common stock, and therefore are treated as equity awards with their fair value measured at the grant date and recognized as compensation cost over the requisite service period with a corresponding credit to shareholders' equity. The requisite service period is the period during which an employee is required to provide service in exchange for an award, which is equivalent to the vesting period specified in the terms of the time-based restricted stock award. None of the Company's restricted stock awards have performance based conditions. The Company does not currently have any share-based compensation issued or outstanding other than restricted stock.

Contingencies

In the normal course of business, there may be various lawsuits, claims, and other contingencies pending against the Company. On a quarterly basis, the Company evaluates whether to establish provisions for estimated losses from those matters. The Company recognizes a liability for a contingent loss when: (a) the underlying causal event has occurred prior to the balance sheet date; (b) it is probable that a loss has been incurred; and (c) there is a reasonable basis for estimating that loss. A liability is not recognized for a contingent loss when it is only possible or remotely possible that a loss has been incurred, however, possible contingent losses shall be disclosed. If the contingent loss (or an additional loss in excess of any accrual) is at least a reasonable possibility and material, then the Company discloses a reasonable estimate of the possible loss or range of loss, if such reasonable estimate can be made. If the Company cannot make a reasonable estimate of the possible material loss, or range of loss, then that fact is disclosed.

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
DYNEX CAPITAL, INC.
(amounts in thousands except share data)

Recent Accounting Pronouncements

The Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2017-08, Receivables-Nonrefundable Fees and Other Costs, which shortens the amortization period for certain callable debt securities held at a premium, requiring the premium to be amortized to the earliest call date. The amendments in this ASU are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018 and early adoption is permitted. The amendments in this Update should be applied using the modified-retrospective transition approach and will require disclosures for the change in accounting principle. The Company is currently evaluating the impact of this ASU on its consolidated financial statements.

NOTE 2 – MORTGAGE-BACKED SECURITIES

The majority of the Company's MBS are pledged as collateral for the Company's secured borrowings. The following tables present the Company’s MBS by investment type as of the dates indicated:

| | March 31, 2017 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Par | Net Premium (Discount) | Amortized Cost | Gross Unrealized Gain | Gross Unrealized Loss | Fair Value | WAC (1) |
| RMBS: | | | | | | | |
| Agency | $1,033,735 | $48,373 | $1,082,108 | $ 2,914 | $(10,343) | $1,074,679 | 3.04% |
| Non-Agency | 26,442 | (10) | 26,432 | 94 | (36) | 26,490 | 3.85% |
| | 1,060,177 | 48,363 | 1,108,540 | 3,008 | (10,379) | 1,101,169 | |
| CMBS: | | | | | | | |
| Agency | 1,243,516 | 13,814 | 1,257,330 | 5,435 | (24,387) | 1,238,378 | 3.10% |
| Non-Agency | 78,927 | (6,279) | 72,648 | 5,155 | — | 77,803 | 4.71% |
| | 1,322,443 | 7,535 | 1,329,978 | 10,590 | (24,387) | 1,316,181 | |
| CMBS IO (2): | | | | | | | |
| Agency | — | 407,346 | 407,346 | 5,822 | (627) | 412,541 | 0.78% |
| Non-Agency | — | 353,737 | 353,737 | 4,121 | (1,000) | 356,858 | 0.71% |
| | — | 761,083 | 761,083 | 9,943 | (1,627) | 769,399 | |
| Total AFS securities: | $2,382,620 | $816,981 | $3,199,601 | $ 23,541 | $(36,393) | $3,186,749 | |

(1) The weighted average coupon ("WAC") is the gross interest rate of the pool of mortgages underlying the security weighted by the outstanding principal balance (or by notional balance in the case of an IO security).

(2) The notional balance for Agency CMBS IO and non-Agency CMBS IO was $13,680,888 and $11,172,716, respectively, as of March 31, 2017.

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
DYNEX CAPITAL, INC.
(amounts in thousands except share data)

| | December 31, 2016 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Par | Net Premium (Discount) | Amortized Cost | Gross Unrealized Gain | Gross Unrealized Loss | Fair Value | WAC (1) |
| RMBS: | | | | | | | |
| Agency | $1,157,258 | $57,066 | $1,214,324 | $ 2,832 | $(15,951) | $1,201,205 | 3.05% |
| Non-Agency | 33,572 | (24) | 33,548 | 64 | (50) | 33,562 | 3.58% |
| | 1,190,830 | 57,042 | 1,247,872 | 2,896 | (16,001) | 1,234,767 | |
| CMBS: | | | | | | | |
| Agency | 1,152,586 | 13,868 | 1,166,454 | 6,209 | (28,108) | 1,144,555 | 3.12% |
| Non-Agency | 79,467 | (6,718) | 72,749 | 5,467 | — | 78,216 | 4.72% |
| | 1,232,053 | 7,150 | 1,239,203 | 11,676 | (28,108) | 1,222,771 | |
| CMBS IO (2): | | | | | | | |
| Agency | — | 411,737 | 411,737 | 3,523 | (3,362) | 411,898 | 0.67% |
| Non-Agency | — | 346,155 | 346,155 | 1,548 | (5,055) | 342,648 | 0.61% |
| | — | 757,892 | 757,892 | 5,071 | (8,417) | 754,546 | |
| Total AFS securities: | $2,422,883 | $822,084 | $3,244,967 | $ 19,643 | $(52,526) | $3,212,084 | |

(1) The WAC is the gross interest rate of the pool of mortgages underlying the security weighted by the outstanding principal balance (or by notional balance in the case of an IO security).

(2) The notional balance for the Agency CMBS IO and non-Agency CMBS IO was $13,106,912 and $10,884,964, respectively, as of December 31, 2016.

Actual maturities of MBS are affected by the contractual lives of the underlying mortgage collateral, periodic payments of principal, prepayments of principal, and the payment priority structure of the security; therefore, actual maturities are generally shorter than the securities' stated contractual maturities.

The following table presents information regarding the sales included in "loss on sale of investments, net" on the Company's consolidated statements of comprehensive income for the periods indicated:

| | Three Months Ended March 31, | | | |
|---|---|---|---|---|
| | 2017 | | 2016 | |
| | Proceeds Received | Realized Gain (Loss) | Proceeds Received | Realized Gain (Loss) |
| Agency RMBS | $57,164 | $(1,708) | $43,890 | $(2,713) |
| Non-Agency CMBS | — | — | 33,640 | (1,228) |
| | $57,164 | $(1,708) | $77,530 | $(3,941) |

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The following table presents certain information for those MBS in an unrealized loss position as of the dates indicated:

| | March 31, 2017 | | | December 31, 2016 | | |
|---|---|---|---|---|---|---|
| | Fair Value | Gross Unrealized Losses | # of Securities | Fair Value | Gross Unrealized Losses | # of Securities |
| Continuous unrealized loss position for less than 12 months: | | | | | | |
| Agency MBS | $1,568,683 | $(29,494) | 113 | $1,738,094 | $(38,469) | 133 |
| Non-Agency MBS | 65,013 | (379) | 13 | 205,484 | (2,773) | 48 |
| | | | | | | |
| Continuous unrealized loss position for 12 months or longer: | | | | | | |
| Agency MBS | $384,677 | $(5,865) | 60 | $427,405 | $(8,952) | 72 |
| Non-Agency MBS | 38,726 | (658) | 17 | 81,660 | (2,332) | 26 |

Because the principal related to Agency MBS is guaranteed by the government-sponsored entities Fannie Mae and Freddie Mac which have the implicit guarantee of the U.S. government, the Company does not consider any of the unrealized losses on its Agency MBS to be credit related. Although the unrealized losses are not credit related, the Company assesses its ability and intent to hold any Agency MBS with an unrealized loss until the recovery in its value. This assessment is based on the amount of the unrealized loss and significance of the related investment as well as the Company’s current leverage and anticipated liquidity. Based on this analysis, the Company has determined that the unrealized losses on its Agency MBS as of March 31, 2017 and December 31, 2016 were temporary.

The Company reviews any non-Agency MBS in an unrealized loss position to evaluate whether any decline in fair value represents an OTTI. The evaluation includes a review of the credit ratings of these non-Agency MBS and the seasoning of the mortgage loans collateralizing these securities as well as the estimated future cash flows which include projected losses. The Company performed this evaluation for the non-Agency MBS in an unrealized loss position and has determined that there have not been any adverse changes in the timing or amount of estimated future cash flows that necessitate a recognition of OTTI amounts as of March 31, 2017 or December 31, 2016.

NOTE 3 – REPURCHASE AGREEMENTS

The Company’s repurchase agreements outstanding as of March 31, 2017 and December 31, 2016 are summarized in the following tables:

| | March 31, 2017 | | | December 31, 2016 | | |
|---|---|---|---|---|---|---|
| Collateral Type | Balance | Weighted Average Rate | Fair Value of Collateral Pledged | Balance | Weighted Average Rate | Fair Value of Collateral Pledged |
| Agency RMBS | $1,020,367 | 0.90 % | $1,055,641 | $1,157,302 | 0.82 % | $1,191,147 |
| Non-Agency RMBS | 20,800 | 2.18 % | 24,944 | 26,149 | 1.98 % | 31,952 |
| Agency CMBS | 1,068,251 | 0.90 % | 1,146,915 | 1,005,726 | 0.82 % | 1,095,002 |
| Non-Agency CMBS | 65,327 | 1.85 % | 77,198 | 66,881 | 1.63 % | 77,840 |
| Agency CMBS IO | 344,828 | 1.82 % | 406,244 | 346,892 | 1.57 % | 407,481 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Non-Agency CMBS IO | 302,002 | 1.88 % | 354,283 | 291,199 | 1.67 % | 341,139 |
| Securitization financing bond | 4,370 | 2.21 % | 4,850 | 4,803 | 2.00 % | 5,278 |
| Total repurchase agreements | $2,825,945 | 1.15 % | $3,070,075 | $2,898,952 | 1.03 % | $3,149,839 |

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DYNEX CAPITAL, INC.
(amounts in thousands except share data)

As of March 31, 2017, the weighted average remaining term to maturity of our repurchase agreements was 18 days compared to 20 days as of December 31, 2016. The following table provides a summary of the original term to maturity of our secured borrowings as of March 31, 2017 and December 31, 2016:

| Original Term to Maturity | March 31, 2017 | December 31, 2016 |
|---|---|---|
| Less than 30 days | $1,056,924 | $ 910,937 |
| 30 to 90 days | 1,717,686 | 533,112 |
| 91 to 180 days | 51,335 | 1,454,903 |
| 181 to 364 days | — | — |
| 1 year or longer | — | — |
| | $2,825,945 | $ 2,898,952 |

The following table lists the counterparties with whom the Company had over 10% of its shareholders' equity at risk (defined as the excess of collateral pledged over the borrowings outstanding):

| | March 31, 2017 | | |
|---|---|---|---|
| Counterparty Name | Balance | Weighted Average Rate | Equity at Risk |
| Wells Fargo Bank, N. A. and affiliates | $358,267 | 1.85 % | $64,695 |

Of the amount outstanding with Wells Fargo Bank, N.A. and affiliates, $345,672 is under a committed repurchase facility which has an aggregate maximum borrowing capacity of $350,000 and is scheduled to mature on August 6, 2018, subject to early termination provisions contained in the master repurchase agreement. The facility is collateralized primarily by CMBS IO, and its weighted average borrowing rate as of March 31, 2017 was 1.85%.

As of March 31, 2017, the Company had repurchase agreement amounts outstanding with 18 of its 31 available repurchase agreement counterparties. The Company's counterparties, as set forth in the master repurchase agreement with the counterparty, require the Company to comply with various customary operating and financial covenants, including, but not limited to, minimum net worth, maximum declines in net worth in a given period, and maximum leverage requirements as well as maintaining the Company's REIT status. In addition, some of the agreements contain cross default features, whereby default under an agreement with one lender simultaneously causes default under agreements with other lenders. To the extent that the Company fails to comply with the covenants contained in these financing agreements or is otherwise found to be in default under the terms of such agreements, the counterparty has the right to accelerate amounts due under the master repurchase agreement. The Company was in full compliance with all covenants as of March 31, 2017.

The Company's repurchase agreements are subject to underlying agreements with master netting or similar arrangements, which provide for the right of offset in the event of default or in the event of bankruptcy of either party to the transactions. The Company reports its repurchase agreements to these arrangements on a gross basis. The following tables present information regarding the Company's repurchase agreements as if the Company had presented them on a net basis as of March 31, 2017 and December 31, 2016:

| | Gross Amount of Recognized Liabilities | Gross Amount Offset in the | Net Amount of Liabilities Presented | Gross Amount Not Offset in the Balance Sheet (1) | Net Amount |
|---|---|---|---|---|---|

| | | Balance Sheet | in the Balance Sheet | Financial Instruments Posted as Collateral | Cash Posted as Collateral | |
|---|---|---|---|---|---|---|
| March 31, 2017 | | | | | | |
| Repurchase agreements | $ 2,825,945 | $ — | $ 2,825,945 | $ (2,825,945) | $ — | $ — |
| December 31, 2016: | | | | | | |
| Repurchase agreements | $ 2,898,952 | $ — | $ 2,898,952 | $ (2,898,952) | $ — | $ — |

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NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
DYNEX CAPITAL, INC.
(amounts in thousands except share data)

(1) Amounts disclosed for collateral received by or posted to the same counterparty include cash and the fair value of MBS up to and not exceeding the net amount of the asset or liability presented in the balance sheet. The fair value of the actual collateral received by or posted to the same counterparty may exceed the amounts presented.

Please see Note 4 for information related to the Company's derivatives which are also subject to underlying agreements with master netting or similar arrangements.

NOTE 4 – DERIVATIVES

The Company utilizes derivative instruments to economically hedge a portion of its exposure to interest rate risk. As of March 31, 2017, the Company primarily uses pay-fixed interest rate swaps to hedge its exposure to changes in interest rates and uses receive-fixed interest rate swaps to offset a portion of its pay-fixed interest rate swaps in order to manage its overall hedge position. The objective of the Company's risk management strategy is to mitigate declines in book value resulting from fluctuations in the fair value of the Company's assets from changing interest rates and to protect some portion of the Company's earnings from rising interest rates. Please refer to Note 1 for information related to the Company's accounting policy for its derivative instruments.

The table below summarizes information about the Company’s derivative instruments treated as trading instruments on its consolidated balance sheet as of the dates indicated:

| | | March 31, 2017 | | | December 31, 2016 | | |
|---|---|---|---|---|---|---|---|
| Trading Instruments | Balance Sheet Location | Fair Value (1) | Notional | WAVG Net Pay-Fixed Rate (2) | Fair Value | Notional | WAVG Net Pay-Fixed Rate (2) |
| Interest rate swaps | Derivative assets | $272 | $3,695,000 | 1.61 % | $28,534 | $2,670,000 | 1.41 % |
| Interest rate swaps | Derivative liabilities | (58 ) | 850,000 | 2.13 % | (6,922 ) | 1,210,000 | 1.96 % |

(1) Refer to Note 1 regarding information on a change in the CME rulebook. Amounts reported on the consolidated balance sheet as of March 31, 2017 reflect the netting of the derivative asset or liability with the related collateral received or posted, respectively. The gross amounts comparable to December 31, 2016 for the derivative asset and derivative liabilities as of March 31, 2017 were $24,828 and $(6,133), respectively.

(2) Weighted average net pay fixed rate is weighted by the notional amount of pay fixed interest rate swaps, net of receive-fixed interest rate swaps held as of date indicated.

The notional amount of pay-fixed interest rate swaps included in the table above that were forward starting was $2,675,000 at a weighted average pay-fixed rate of 2.16% as of March 31, 2017 compared to $2,725,000 at a weighted average pay-fixed rate of 2.18% as of December 31, 2016.

The following table summarizes the notional activity related to derivative instruments for the period indicated:

| | Notional receive-fixed interest rate swaps | Notional pay-fixed interest rate swaps | Total Notional |
|---|---|---|---|
| As of December 31, 2016 | $ 425,000 | $3,455,000 | $3,880,000 |
| Additions | $ — | $1,400,000 | $1,400,000 |
| Settlements, terminations, or expirations | $ (300,000 ) | $(435,000 ) | $(735,000 ) |

| | | | |
|---|---|---|---|
| As of March 31, 2017 | $ 125,000 | $4,420,000 | $4,545,000 |

The table below provides detail of the Company's "gain (loss) on derivative instruments, net" by type of derivative for the periods indicated:

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(amounts in thousands except share data)

| | Three Months Ended March 31, | |
|---|---|---|
| Type of Derivative Instrument | 2017 | 2016 |
| Receive-fixed interest rate swaps | $(134) | $10,534 |
| Pay-fixed interest rate swaps | 309 | (46,612) |
| Eurodollar futures | — | (12,186) |
| Gain (loss) on derivative instruments, net | $175 | $(48,264) |

There is a net unrealized gain of $572 remaining in AOCI on the Company's consolidated balance sheet as of March 31, 2017 which represents the activity related to interest rate swap agreements while they were previously designated as cash flow hedges, and this amount will be recognized in the Company's net income as an adjustment to "interest expense" over the remaining contractual life of the agreements. The Company estimates a credit of $217 will be reclassified to net income as a reduction of "interest expense" within the next 12 months.

A portion of the Company's interest rate swaps were entered into under bilateral agreements which contain cross-default provisions with other agreements between the parties. In addition, these bilateral agreements contain financial and operational covenants similar to those contained in our repurchase agreements as described in Note 3. The Company was in compliance with all covenants with respect to bilateral agreements under which interest rate swaps were entered into as of March 31, 2017.

The Company's derivatives are subject to underlying agreements with master netting or similar arrangements, which provide for the right of offset in the event of default or in the event of bankruptcy of either party to the transactions. The Company reports its derivative assets and liabilities subject to these arrangements on a gross basis. The following tables present information regarding those derivative assets and liabilities subject to such arrangements as if the Company had presented them on a net basis as of March 31, 2017 and December 31, 2016:

| | Offsetting of Assets | | | | | |
|---|---|---|---|---|---|---|
| | | | | Gross Amount Not Offset in the Balance Sheet (1) | | |
| | Gross Amount of Recognized Assets | Gross Amount Offset in the Balance Sheet | Net Amount of Assets Presented in the Balance Sheet | Financial Instruments Received as Collateral | Cash Received as Collateral | Net Amount |
| March 31, 2017 | | | | | | |
| Derivative assets | $272 | $ — | $ 272 | $(29) | $— | $ 243 |
| December 31, 2016: | | | | | | |
| Derivative assets | $28,534 | $ — | $ 28,534 | $(6,449) | $(22,085) | $ — |

| | Offsetting of Liabilities | | | | |
|---|---|---|---|---|---|
| | Gross Amount of Recognized | Gross Amount Offset in the | Net Amount of Liabilities Presented | Gross Amount Not Offset in the Balance Sheet (1) | Net Amount |

| | Liabilities | Balance Sheet | in the Balance Sheet | Financial Instruments Posted as Collateral | Cash Posted as Collateral | |
|---|---|---|---|---|---|---|
| March 31, 2017 | | | | | | |
| Derivative liabilities | $ 58 | $ — | $ 58 | $ (58) | $ — | $ — |
| December 31, 2016: | | | | | | |
| Derivative liabilities | $ 6,922 | $ — | $ 6,922 | $ (6,913) | $ — | $ 9 |

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
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(amounts in thousands except share data)

(1) Amounts disclosed for collateral received by or posted to the same counterparty include cash and the fair value of MBS up to and not exceeding the net amount of the asset or liability presented in the balance sheet. The fair value of the actual collateral received by or posted to the same counterparty may exceed the amounts presented.

Please see Note 3 for information related to the Company's repurchase agreements which are also subject to underlying agreements with master netting or similar arrangements.

NOTE 5 – FAIR VALUE OF FINANCIAL INSTRUMENTS

ASC Topic 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC Topic 820 clarifies that fair value should be based on the assumptions market participants would use when pricing an asset or liability and also requires an entity to consider all aspects of nonperformance risk, including the entity's own credit standing, when measuring fair value of a liability. ASC Topic 820 established a valuation hierarchy of three levels as follows:

- Level 1 – Inputs are unadjusted, quoted prices in active markets for identical assets or liabilities as of the measurement date.
- Level 2 – Inputs include quoted prices in active markets for similar assets or liabilities; quoted prices in inactive markets for identical or similar assets or liabilities; or inputs either directly observable or indirectly observable through correlation with market data at the measurement date and for the duration of the instrument's anticipated life.
- Level 3 – Unobservable inputs are supported by little or no market activity. The unobservable inputs represent management's best estimate of how market participants would price the asset or liability at the measurement date. Consideration is given to the risk inherent in the valuation technique and the risk inherent in the inputs to the model.

The Company reviews the classification of its financial instruments within the fair value hierarchy on a quarterly basis, and management may conclude that its financial instruments should be reclassified to a different level in the future if a change in type of inputs occurs.

The following table presents the fair value of the Company's assets and liabilities presented on its consolidated balance sheets, segregated by the hierarchy level of the fair value estimate, that are measured at fair value on a recurring basis as of the dates indicated:

| | March 31, 2017 | | | |
|---|---|---|---|---|
| | Fair Value | Level 1 - Unadjusted Quoted Prices in Active Markets | Level 2 - Observable Inputs | Level 3 - Unobservable Inputs |
| Assets: | | | | |
| Mortgage-backed securities | $3,186,749 | $ — | $3,176,247 | $ 10,502 |
| Derivative assets | 272 | — | 272 | — |
| Total assets carried at fair value | $3,187,021 | $ — | $3,176,519 | $ 10,502 |
| Liabilities: | | | | |
| Derivative liabilities | $58 | $ — | $58 | $ — |
| Total liabilities carried at fair value | $58 | $ — | $58 | $ — |

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(amounts in thousands except share data)

| | December 31, 2016 | | | |
|---|---|---|---|---|
| | Fair Value | Level 1 - Unadjusted Quoted Prices in Active Markets | Level 2 - Observable Inputs | Level 3 - Unobservable Inputs |
| Assets: | | | | |
| Mortgage-backed securities | $3,212,084 | $ — | $3,201,157 | $ 10,927 |
| Derivative assets | 28,534 | — | 28,534 | — |
| Total assets carried at fair value | $3,240,618 | $ — | $3,229,691 | $ 10,927 |
| Liabilities: | | | | |
| Derivative liabilities | $6,922 | $ — | $6,922 | $ — |
| Total liabilities carried at fair value | $6,922 | $ — | $6,922 | $ — |

As of March 31, 2017 and December 31, 2016, the Company’s derivative assets and liabilities consisted only of interest rate swaps. Interest rate swaps are valued using the income approach with the primary input being the forward interest rate swap curve, which is considered an observable input, and thus their fair values are considered Level 2 measurements as of March 31, 2017 and December 31, 2016.

The fair value measurements for a majority of the Company's MBS are considered Level 2. These Level 2 securities are substantially similar to securities that either are actively traded or have been recently traded in their respective markets. The Company receives a price evaluation for each of its MBS from a primary pricing service selected by the Company. To determine each security's valuation, the primary pricing service uses either a market approach, which uses observable prices and other relevant information that is generated by market transactions of identical or similar securities, or an income approach, which uses valuation techniques to convert future amounts to a single, discounted present value amount. The Company also reviews the assumptions and inputs utilized in the valuation techniques of its primary pricing service. Examples of these observable inputs and assumptions include market interest rates, credit spreads, and projected prepayment speeds, among other things. The Company compares the price received from its primary pricing service to other prices received from additional third party pricing services and multiple broker quotes for reasonableness.

The Company owns certain non-Agency MBS for which there are not sufficiently recent trades of substantially similar securities, and their fair value measurements are thus considered Level 3. The Company determines the fair value of its Level 3 securities by discounting the estimated future cash flows derived from cash flow models using significant inputs which are determined by the Company when market observable inputs are not available. Information utilized in those pricing models include the security’s credit rating, coupon rate, estimated prepayment speeds, expected weighted average life, collateral composition, estimated future interest rates, expected credit losses, and credit enhancement as well as certain other relevant information. Significant changes in any of these inputs in isolation may result in a significantly different fair value measurement. Level 3 assets are generally most sensitive to the default rate and severity assumptions.

The table below presents quantitative information about the significant unobservable inputs used in the fair value measurement for the Company's Level 3 non-Agency CMBS and RMBS as of March 31, 2017:

Unobservable Inputs

| | Prepayment Speed | Default Rate | Severity | Discount Rate |
|---|---|---|---|---|
| Non-Agency CMBS (1) | 0 CPY | — | — | 10.7 % |
| Non-Agency RMBS | 10 CPR | 1.0 % | 20.0 % | 6.3 % |

(1) As of March 31, 2017, there are too few loans collateralizing our non-Agency CMBS to reasonably apply average prepayment speed, average default rate, or average severity. The loans were individually evaluated for prepayment and default in projecting the cash flows. Based on that review, the loans are expected to pay as scheduled.

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(amounts in thousands except share data)

The activity of the instruments measured at fair value on a recurring basis using Level 3 inputs is presented in the following table for the period indicated:

| | Level 3 Fair Value | | |
|---|---|---|---|
| | Non-Agency CMBS | Non-Agency RMBS | Total assets |
| Balance as of December 31, 2016 | $9,669 | $ 1,258 | $10,927 |
| Unrealized loss included in OCI (1) | (377) | (3) | (380) |
| Principal payments | (383) | (44) | (427) |
| Accretion | 382 | — | 382 |
| Balance as of March 31, 2017 | $9,291 | $ 1,211 | $10,502 |

(1) Amount included in "unrealized gain on available-for-sale investments, net" on consolidated statements of comprehensive income (loss).

The following table presents a summary of the carrying value and estimated fair values of the Company's financial instruments as of the dates indicated:

| | March 31, 2017 | | December 31, 2016 | |
|---|---|---|---|---|
| | Carrying Value | Fair Value | Carrying Value | Fair Value |
| Assets: | | | | |
| Mortgage-backed securities | $3,186,749 | $3,186,749 | $3,212,084 | $3,212,084 |
| Mortgage loans held for investment, net(1) | 18,183 | 15,120 | 19,036 | 15,971 |
| Derivative assets | 272 | 272 | 28,534 | 28,534 |
| Liabilities: | | | | |
| Repurchase agreements (2) | $2,825,945 | $2,825,945 | $2,898,952 | $2,898,952 |
| Non-recourse collateralized financing (1) | 6,075 | 6,024 | 6,440 | 6,357 |
| Derivative liabilities | 58 | 58 | 6,922 | 6,922 |

(1) The Company determines the fair value of its mortgage loans held for investment, net and its non-recourse collateralized financing using internally developed cash flow models with inputs similar to those used to estimate the fair value of the Company's Level 3 non-Agency MBS.
(2) The carrying value of repurchase agreements generally approximates fair value due to their short term maturities.

NOTE 6 – SHAREHOLDERS' EQUITY AND SHARE-BASED COMPENSATION

Preferred Stock

The Company's articles of incorporation authorize the issuance of up to 50,000,000 shares of preferred stock, par value $0.01 per share, of which the Company's Board of Directors has designated 8,000,000 shares of 8.50% Series A Preferred Stock and 7,000,000 shares of 7.625% Series B Preferred Stock, (the Series A Preferred Stock and the Series B Preferred Stock collectively, the "Preferred Stock"). The Company had 2,300,000 shares of its Series A Preferred Stock and 2,597,138 shares of its Series B Preferred Stock issued and outstanding as of March 31, 2017 compared to 2,300,000 shares of Series A Preferred Stock and 2,271,937 shares of Series B Preferred Stock as of December 31, 2016.

The Preferred Stock has no maturity and will remain outstanding indefinitely unless redeemed or otherwise repurchased or converted into common stock pursuant to the terms of the Preferred Stock. Except under certain limited circumstances, the Company may not redeem the Series A Preferred Stock prior to July 31, 2017 or the Series B Preferred Stock prior to April 30, 2018. On or after these dates, at any time and from time to time, the Preferred Stock may be redeemed in whole, or in part, at the Company's option at a cash redemption price of $25.00 per share plus any accumulated and unpaid dividends. Because the Preferred Stock is redeemable only at the option of the issuer, it is classified as equity on the Company's consolidated balance sheet. The Series A Preferred Stock pays a cumulative cash dividend equivalent to 8.50% of the $25.00 liquidation preference

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per share each year and the Series B Preferred Stock pays a cumulative cash dividend equivalent to 7.625% of the $25.00 liquidation preference per share each year. The Company announced that it will pay its regular quarterly dividends on its Preferred Stock for the first quarter on April 15, 2017 to shareholders of record as of April 1, 2017.

Common Stock

The Company declared a first quarter common stock dividend of $0.18 per share payable on April 28, 2017 to shareholders of record as of April 5, 2017.

2009 Stock and Incentive Plan. Of the 2,500,000 shares of common stock authorized for issuance under its 2009 Stock and Incentive Plan, the Company had 815,682 available for issuance as of March 31, 2017. Total stock-based compensation expense recognized by the Company for the three months ended March 31, 2017 was $538 compared to $829 for the three months ended March 31, 2016.

The following table presents a rollforward of the restricted stock activity for the periods indicated:

| | Three Months Ended March 31, | | | |
|---|---|---|---|---|
| | 2017 | | 2016 | |
| | Shares | Weighted Average Grant Date Fair Value Per Share | Shares | Weighted Average Grant Date Fair Value Per Share |
| Restricted stock outstanding as of beginning of period | 553,396 | $ 7.55 | 696,597 | $ 8.54 |
| Restricted stock granted | 108,446 | 6.77 | 168,720 | 6.22 |
| Restricted stock vested | (275,691) | 7.94 | (317,831) | 8.87 |
| Restricted stock outstanding as of end of period | 386,151 | $ 7.05 | 547,486 | $ 7.63 |

As of March 31, 2017, the grant date fair value of the Company’s remaining nonvested restricted stock is $2,334 which will be amortized into compensation expense over a weighted average period of 1.7 years.

NOTE 7 – SUBSEQUENT EVENTS

Management has evaluated events and circumstances occurring as of and through the date this Quarterly Report on Form 10-Q was filed with the SEC and has determined that there have been no significant events or circumstances that qualify as a "recognized" or "nonrecognized" subsequent event as defined by ASC Topic 855.

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

The following discussion should be read in conjunction with our unaudited financial statements and the accompanying notes included in Part 1, Item 1. “Financial Statements” in this Quarterly Report on Form 10-Q and our audited financial statements and the accompanying notes included in Part II, Item 8 in our Annual Report on Form 10-K for the year ended December 31, 2016. References herein to “Dynex,” the “Company,” “we,” “us,” and “our” include Dynex Capital, Inc. a its consolidated subsidiaries, unless the context otherwise requires. In addition to current and historical information, the following discussion and analysis contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements relate to our future business, financial condition or results of operations. For a description of certain factors that may have a significant impact on our future business, financial condition or results of operations, see “Forward-Looking Statements” at the end of this discussion and analysis.

For a complete description of our business including our operating policies, investment philosophy and strategy, financing and hedging strategies, and other important information, please refer to Part I, Item 1 of our Annual Report on Form 10-K for the year ended December 31, 2016.

EXECUTIVE OVERVIEW

Company Overview

We are an internally managed mortgage real estate investment trust, or mortgage REIT, which invests in residential and commercial mortgage-backed securities on a leveraged basis. Our common stock is traded on the New York Stock Exchange ("NYSE") under the symbol "DX". Our objective is to provide attractive risk-adjusted returns to our shareholders over the long term that are reflective of a leveraged, high quality fixed income portfolio with a focus on capital preservation. We seek to provide returns to our shareholders primarily through regular quarterly dividends, and also through capital appreciation.

We also have two series of preferred stock outstanding, our 8.50% Series A Cumulative Redeemable Preferred Stock (the "Series A Preferred Stock") which is traded on the NYSE under the symbol "DXPRA", and our 7.625% Series B Cumulative Redeemable Preferred Stock (the "Series B Preferred Stock") which is traded on the NYSE under the symbol "DXPRB".

We invest in Agency and non-Agency mortgage-backed securities (“MBS”) consisting of residential MBS (“RMBS”), commercial MBS (“CMBS”) and CMBS interest-only ("IO") securities. Agency MBS have a guaranty of principal payment by an agency of the U.S. government or a U.S. government-sponsored entity ("GSE") such as Fannie Mae and Freddie Mac. Non-Agency MBS have no such guaranty of payment. Our investments in non-Agency MBS are generally higher quality senior or mezzanine classes (typically rated 'A' or better by one or more of the nationally recognized statistical rating organizations) because they are typically more liquid (i.e., they are more easily converted into cash either through sales or pledges as collateral for repurchase agreement borrowings) and have less exposure to credit losses than lower-rated non-Agency MBS.

We invest and manage our capital pursuant to Operating Policies approved by our Board of Directors. We use leverage to enhance the returns on our invested capital by pledging our investments as collateral for borrowings such as repurchase agreements as discussed further below. We also use derivative instruments to attempt to mitigate our exposure to adverse changes in interest rates as discussed further below.

RMBS. Our Agency RMBS investments include MBS collateralized by adjustable-rate mortgage loans ("ARMs"), which have interest rates that generally will adjust at least annually to an increment over a specified interest rate index, and hybrid adjustable-rate mortgage loans ("hybrid ARMs"), which are loans that have a fixed rate of interest for a specified period (typically three to ten years) and then adjust their interest rate at least annually to an increment over a specified interest rate index. Agency ARMs also include hybrid Agency ARMs that are past their fixed-rate periods or within twelve months of their initial reset period. We may also invest in fixed-rate Agency RMBS from time to time. Substantially all of our ARMs reset based on the one-year LIBOR index.

Non-Agency RMBS are collateralized by non-conforming residential mortgage loans and are tranched into different credit classes of securities with payments to junior classes subordinate to senior classes. We generally invest in senior classes of non-Agency RMBS which may include unrated securities. Some of the non-Agency RMBS that we invest in may be collateralized by loans which are delinquent, the repayment of which is expected to come from foreclosure and liquidation of the underlying real estate. We seek to invest in non-Agency RMBS that we judge to have sufficiently high collateralization to be likely to protect the principal balance of our investment from credit losses on the underlying loans.

CMBS. The majority of our CMBS investments are primarily fixed-rate Agency-issued securities backed by multifamily housing loans. The remainder of our CMBS portfolio contains both Agency and non-Agency issued securities backed by other commercial real estate property types such as office building, retail, hospitality, and health care. Loans underlying CMBS generally are geographically diverse, are fixed-rate, mature in eight to eighteen years and have amortization terms of up to 30 years. Typically these loans have some form of prepayment protection provisions (such as prepayment lock-out) or prepayment compensation provisions (such as yield maintenance or prepayment penalty). Yield maintenance and prepayment penalty requirements are intended to create an economic disincentive for the loans to prepay. Non-Agency CMBS also includes securities that are backed by pools of single-family rental homes which have variable-rates that reset monthly based on an index rate, such as LIBOR.

CMBS IO. CMBS IO are interest-only securities issued as part of a CMBS securitization and represent the right to receive a portion of the monthly interest payments (but not principal cash flows) on the unpaid principal balance of the underlying pool of commercial mortgage loans. We invest in both Agency-issued and non-Agency issued CMBS IO. The loans collateralizing CMBS IO pools are very similar in composition to the pools of loans that generally collateralize CMBS as discussed above. Since CMBS IO securities have no principal associated with them, the interest payments received are based on the unpaid principal balance of the underlying pool of mortgage loans, which is often referred to as the notional amount. Most loans in these securities have some form of prepayment protection from early repayment including absolute loan prepayment lock-outs, loan prepayment penalties, or yield maintenance requirements similar to CMBS described above. There are no prepayment protections, however, if the loan defaults and is partially or wholly repaid earlier as a result of loss mitigation actions taken by the underlying loan servicer, and therefore yields on CMBS IO investments are dependent upon the underlying loan performance. Because Agency-issued MBS generally contain higher credit quality loans, Agency CMBS IO are expected to have a lower risk of default than non-Agency CMBS IO.

Financing. We finance our investments primarily through the use of uncommitted repurchase agreements which are provided principally by major financial institutions and broker-dealers. We pledge our MBS as collateral to secure the amounts borrowed from our counterparties. These repurchase agreements generally have original terms to maturity of overnight to six months, though in some instances we may enter into longer-dated maturities depending on market conditions. We pay interest on our repurchase agreement borrowings at a rate usually based on a spread to LIBOR and fixed for the term of the borrowing. Borrowings under these repurchase agreements are renewable at the discretion of our lenders and do not contain guaranteed roll-over terms. One of our repurchase agreement lenders provides a committed repurchase agreement financing facility to us with an aggregate borrowing capacity of $350.0 million that expires on August 6, 2018.

Hedging. We use derivative instruments to hedge our exposure to changes in interest rates. Such exposure results from our ownership of primarily fixed-rate investments that are financed with repurchase agreements which have significantly shorter maturities than the weighted average life of our investments. Changes in interest rates can impact the market value of our investments (and therefore book value per common share), net interest income, and net income. In a period of rising interest rates, our earnings and cash flow may be negatively impacted by borrowing costs increasing faster than interest income from our assets, and our book value may decline as a result of declining market values of our MBS. Currently, we are using interest rate swap agreements in an attempt to mitigate our exposure to changes in interest rates.

Factors that Affect Our Results of Operations and Financial Condition

Our financial performance is driven by the performance of our investment portfolio and related funding and derivative hedging activity. Our financial performance is measured by net interest income, net income, comprehensive income, book value per common share and core net operating income (a non-GAAP measure). Our financial performance may be impacted by multiple factors, many of which are related to macroeconomic conditions, geopolitical conditions, central bank and government policy, and other factors beyond our control. These factors include, but are not limited to, the absolute level of interest rates, the relative slope of interest rate curves, changes in market expectations of future interest rates, actual and estimated future prepayment rates on our investments, competition for investments, economic conditions and their impact on the credit performance of our investments, and market required yields as reflected by market credit spreads. All of these factors are influenced by market forces and generally are exacerbated during periods of market volatility.

The performance of our investment portfolio, the cost and availability of financing and the availability of investments at acceptable risk-adjusted returns could also be influenced by regulatory actions and regulatory policy measures of the U.S. government including, but not limited to, the Federal Housing Finance Administration ("FHFA"), the U. S. Department of the Treasury (the "Treasury"), and the Board of Governors of the Federal Reserve System (the "Federal Reserve") and could also be influenced by reactions in U.S. markets from activities of central banks around the world.

Our business model may also be impacted by other factors such as the availability and cost of financing and the state of the overall credit markets. Reductions in the availability of financing for our investments could significantly impact our business and force us to sell assets that we otherwise would not sell, potentially at losses depending on market conditions. Regulatory developments since the 2008 financial crisis have impacted large U.S. domiciled banks and their broker dealer subsidiaries by requiring such entities to hold more capital against their assets, including reverse repurchase agreements. In general, this has led to reduced lending capacity in the repurchase agreement market and higher costs. Other factors that could also impact our business include changes in regulatory requirements, including requirements to qualify for registration under the 1940 Act, and REIT requirements.

We believe that regulatory impacts on financial institutions, many of which are our trading and financing counterparties, continue to pose a threat to the overall liquidity in the capital markets. In particular, higher capital requirements under U.S. banking regulations and limitations on the proprietary trading activities of large U.S. financial institutions under the Dodd-Frank Wall Street Reform and Consumer Protection Act ("the "Dodd-Frank Act") could result in reduced liquidity in times of market stress. While the Federal Reserve continues to reinvest principal payments received on its Agency RMBS portfolio, we believe it is unlikely that this activity would provide enough liquidity to the market in times of stress, which could result in volatile asset prices. Further, the impact on market liquidity of our investments and the financing markets could be negatively impacted if the Federal Reserve's Federal Open Market Committee (or "FOMC") suddenly changes market expectations of the targeted Federal Funds Rate or takes other actions which have the effect of tightening monetary policy.

To complement the performance of our investment portfolio, we regularly review our existing operations to determine whether our investment strategy or business model should change, including through a change in our investment portfolio, our targeted investments, and our risk position. We may also consider reallocating our capital resources to other assets or portfolios that better align with our long-term strategy, expanding our capital base, or merger, acquisition or divestiture opportunities. We analyze and evaluate potential business opportunities that we identify or are presented to us, including possible merger, acquisition, or divestiture transactions, that are a strategic fit for our investment strategy or asset allocation or otherwise maximize value for our shareholders. Pursuing such an opportunity or transaction could require us to issue additional equity or debt securities.

As discussed above, investing in mortgage-related securities on a leveraged basis subjects us to a number of risks including interest rate risk, prepayment and reinvestment risk, credit risk, market value risk and liquidity risk, which are discussed in "Liquidity and Capital Resources" within this Item 2 and in Part I, Item 3 of this Quarterly Report on Form 10-Q as well as in Item 1A, "Risk Factors" of Part I of our Annual Report on Form 10-K for the year ended December 31, 2016. Please see these Items for a detailed discussion of these risks and the potential impact on our results of operations and financial condition.

Market Conditions and Recent Activity

During the first quarter of 2017, macroeconomic conditions continued to modestly improve in the U.S. and developed markets. As a result of improvement in the U.S., the FOMC increased its targeted Federal Funds Rate by 0.25% in March 2017 after increasing it by the same amount in December 2016. Although the FOMC increased interest rates, market volatility was generally lower than in recent quarters and credit spreads tightened as show in the following table:

| Investment Type: | March 31, 2016 | June 30, 2016 | September 30, 2016 | December 31, 2016 | March 31, 2017 |
|---|---|---|---|---|---|
| Agency ARM 5/1 (Agency RMBS) | 32 | 38 | 32 | 19 | 24 |
| Agency DUS (Agency CMBS) | 86 | 94 | 80 | 76 | 67 |
| Freddie K AAA IO (Agency CMBS IO) | 260 | 255 | 230 | 200 | 150 |
| AAA CMBS IO (Non-Agency CMBS IO) | 265 | 240 | 215 | 195 | 145 |
| Freddie K B (Non-Agency CMBS) | 420 | 325 | 265 | 295 | 220 |

The U.S. Treasury yield curve flattened during the first quarter of 2017 and interest rate swap spreads widened. The chart below shows the highest and lowest rates during the three months ended March 31, 2017 as well as the rates as of March 31, 2017 and December 31, 2016 for the indicated U.S. Treasury securities:

The chart below shows the highest and lowest swap rates during the three months ended March 31, 2017 as well as the swap rates as of March 31, 2017 and December 31, 2016:

Highlights of the First Quarter of 2017

During the first quarter of 2017, comprehensive income to common shareholders of $26.6 million was comprised of net income to common shareholders of $6.6 million and other comprehensive income ("OCI") of $20.0 million. Net income to common shareholders included net interest income of $14.9 million, a decline of approximately 7.5% from the fourth quarter of 2016, primarily due to higher financing costs, lower prepayment penalty compensation from CMBS, and higher premium amortization on RMBS. Net income to common shareholders also included realized losses on sales of MBS of $(1.7) million, operating expenses of $(4.3) million, and preferred dividends of $(2.4) million. OCI consists primarily of changes in the fair value of MBS, which increased a net $18.4 million during the first quarter of 2017 as a result of credit spread tightening, as discussed above in "Market Conditions and Recent Activity".

Core net operating income to common shareholders is a non-GAAP measure management uses as an estimate of the net interest earnings of the Company's investments, including net periodic interest costs of current pay interest rate swaps, after operating expenses. Core net operating income declined $(2.5) million, or approximately 25%, from the fourth quarter of 2016 due to the decline in net interest income discussed in the preceding paragraph, an increase in net periodic interest cost on interest rate swaps and increases in operating expenses. Periodic interest costs on interest rate swaps increased as we added interest rate swaps with a notional of $665.0 million, net of terminated interest rate swaps in order to hedge our repurchase agreement financing costs, given the likelihood for higher short-term interest rates as a result of improving economic data in the U.S. Please see "Non-GAAP Financial Measures" at the end of "Executive Overview" for additional important information about non-GAAP measures as well as a reconciliation of GAAP net income to core net operating income for the periods discussed.

Book value per common share increased $0.34 to $7.52 as of March 31, 2017. This increase was driven primarily by the increase in fair value of MBS mentioned above, but partially offset by dividends declared in excess of core net operating income and capital stock activity. Economic return on book value was 7.2% for the first quarter of 2017. Economic return on book value is calculated by dividing (i) the sum of dividends declared per common share and the change in book value per common share by (ii) beginning book value per common share.

Management Outlook

The Company's outlook has changed little from the end of 2016. The U.S. economy continues to improve making capital markets more comfortable in investing in risk assets. Central bank and government policies (and in particular fiscal policy) continue to be dominating factors for interest rates and credit spreads. The FOMC appears to be on a path to increase the Federal Funds rate multiple times over the balance of 2017, which we expect to result in an increase in our cost of funds if these increases occur. We continue to believe that high levels of global debt will put pressure on growth and remain a destabilizing threat to the world economy, particularly if left unmanaged, and may ultimately impact the amount and timing of FOMC increases in the Federal Funds rate. The probability of a change in the Federal Reserve's MBS and U.S. Treasury securities portfolio reinvestment strategy has increased. Regulatory uncertainty remains elevated. For these reasons, we believe that there continues to be a high risk of interest rate and spread volatility in the near term. As such, we have maintained conservative leverage levels in light of our high credit quality investment portfolio in order to reduce market value risk to our capital and also to be in a position to invest capital if spreads widen.

We continue to believe that there are many tailwinds for our business model. Demographic trends in the U.S. are driving a significant increase in household formation, creating more demand in multifamily and single family housing. As government participation in the housing market shrinks, there will be an increased need for private capital and expertise in the housing finance system. Global demographic aging trends are driving demand for assets that generate income. Fundamentally, this supports the assets in which we invest and also could be a source of capital for us to potentially grow our portfolio. We also intend to capitalize on opportunities for investing capital as government and regulatory policies shift while realizing that such shifts may occur over a period of several years. We will continue seeking ways to diversify funding sources if the regulatory environment becomes more favorable, and we will also actively manage our hedge instruments to attempt to mitigate the impact on our costs of funds if the Federal Funds rate increases during 2017 as currently projected.

Non-GAAP Financial Measures

In addition to the Company's operating results presented in accordance with GAAP, the information presented within Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations" of this Quarterly Report on Form 10-Q contains the following non-GAAP financial measures: core net operating income to common shareholders (including per common share), adjusted interest expense and adjusted cost of funds, and adjusted net interest income and spread. Management uses core net operating income (including per common share) as an estimate of the net interest earnings from our investments after operating expenses. In addition to core net operating income, management uses adjusted interest expense, adjusted cost of funds, adjusted net interest income, and adjusted net interest spread because management considers net periodic interest costs related to the Company's derivative instruments as an additional cost of using repurchase agreements to finance investments. Because these measures are used in the Company's internal analysis of financial and operating performance, management believes that they provide greater transparency to our investors of management's view of our economic performance. Management also believes that the presentation of these measures, when analyzed in conjunction with the Company's GAAP operating results, allows investors to more effectively evaluate and compare the performance of the Company to that of its peers even though peer companies may present non-GAAP measures on a different basis than the Company's. Because these non-GAAP financial measures exclude certain items used to compute GAAP net income to common shareholders and GAAP interest expense, these non-GAAP financial measures should be considered as a supplement to, and not as a substitute for, the Company's GAAP results as reported on its consolidated statements of comprehensive income. In addition, because not all companies use identical calculations, the Company's presentation of non-GAAP financial measures may not be comparable to other similarly-titled measures of other companies.

Schedules reconciling adjusted interest expense, adjusted cost of funds, adjusted net interest income, and adjusted net interest spread to their related GAAP financial measures are provided within "Results of Operations". The following table presents a reconciliation of our GAAP net income to common shareholders to our core net operating income to common shareholders for the periods presented:

| | Three Months Ended | |
|---|---|---|
| ($ in thousands, except per share amounts) | March 31, 2017 | December 31, 2016 |
| GAAP net income to common shareholders | $6,616 | $66,758 |
| Less: | | |
| Accretion of de-designated cash flow hedges [1] | (99) | (99) |
| Change in fair value of derivative instruments, net | (790) | (56,686) |
| Loss on sale of investments, net | 1,708 | — |
| Fair value adjustments, net | (10) | (17) |
| Core net operating income to common shareholders | $7,425 | $9,956 |
| | | |
| Weighted average common shares outstanding | 49,176 | 49,151 |
| Core net operating income per common share | $0.15 | $0.20 |

(1) Included in GAAP interest expense and relates to the amortization of the balance remaining in accumulated other comprehensive loss as of June 30, 2013 as a result of discontinuing cash flow hedge accounting.

CRITICAL ACCOUNTING POLICIES

The discussion and analysis of our financial condition and results of operations are based in large part upon our consolidated financial statements, which have been prepared in accordance with GAAP. The preparation of our consolidated financial statements requires management to make estimates, judgments and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and disclosure of contingent assets and liabilities. We base these estimates and judgments on historical experience and assumptions believed to be reasonable under current facts and circumstances. Actual results, however, may differ from the estimated amounts we have recorded. Critical accounting policies are defined as those that require management's most difficult, subjective or complex judgments, and which may result in materially different results under different assumptions and conditions. Our accounting policies that require the most significant management estimates, judgments, or assumptions, or that management believes includes the most significant uncertainties, and are considered most critical to our results of operations or financial position relate to fair value measurements, amortization of investment premiums, and other-than-temporary impairments. Our critical accounting policies are discussed in Part II, Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations” of our Annual Report on Form 10-K for the year ended December 31, 2016 under “Critical Accounting Policies”. There have been no significant changes in our critical accounting policies during the three months ended March 31, 2017.

FINANCIAL CONDITION

The following chart presents the amortized cost of our MBS investments by collateral type as of the end of each period presented:

In addition to the sections below, please refer to Note 2 of the Notes to the Unaudited Consolidated Financial Statements contained within this Quarterly Report on Form 10-Q for additional information relating to our MBS. The following sections provide additional information on our investment portfolio as well as related financing.

During the first quarter of 2017, our portfolio composition continued to shift towards CMBS as we allocated capital returned on hybrid ARMs to primarily Agency CMBS. Our overall portfolio declined slightly from the end of 2016 as we reinvested less investment capital than we received back during the quarter. Subsequent to the end of the first quarter of 2017, we began modestly investing in to-be-announced forward contracts as a means of investing in Agency fixed-rate MBS given the attractive relative value opportunity in that asset.

CMBS

Our Agency CMBS are collateralized primarily by fixed rate mortgage loans secured by multifamily properties. Our non-Agency CMBS are collateralized by fixed rate mortgage loans secured by properties such as office, single-family rental, retail, and multifamily. Both Agency and non-Agency CMBS will generally have some form of prepayment protection provisions (such as prepayment lock-outs) or prepayment compensation provisions (such as yield maintenance or prepayment penalties) to prevent early voluntary prepayment of principal.

Activity related to our CMBS for the three months ended March 31, 2017 is as follows:

| ($ in thousands) | Agency CMBS | Non-Agency CMBS | Total |
|---|---|---|---|
| Balance as of December 31, 2016 | $1,144,555 | $ 78,216 | $1,222,771 |
| Purchases | 103,139 | — | 103,139 |
| Principal payments | (11,222) | (540) | (11,762) |
| Sales | — | — | — |
| (Premium amortization) discount accretion, net | (1,087) | 439 | (648) |
| Change in fair value | 2,993 | (312) | 2,681 |
| Balance as of March 31, 2017 | $1,238,378 | $ 77,803 | $1,316,181 |

Since Agency CMBS are guaranteed by the GSEs with respect to return of principal, our credit exposure is limited to any premium on those securities. Non-Agency CMBS are not guaranteed and therefore our entire investment is exposed to credit losses from the underlying loans collateralizing the CMBS. The following table presents the par value, amortized cost, and weighted average months to estimated maturity of our CMBS investments as of the dates indicated by year of origination:

| | March 31, 2017 | | | December 31, 2016 | | |
|---|---|---|---|---|---|---|
| ($ in thousands) | Par Value | Amortized Cost | Months to Estimated Maturity (1) | Par Value | Amortized Cost | Months to Estimated Maturity (1) |
| Year of Origination: | | | | | | |
| 2008 and prior | $50,141 | $45,617 | 35 | $57,771 | $53,161 | 34 |
| 2009 to 2012 | 191,188 | 196,532 | 30 | 193,061 | 198,916 | 33 |
| 2013 to 2014 | 42,575 | 42,976 | 92 | 42,760 | 43,176 | 95 |
| 2015 | 681,745 | 685,175 | 108 | 683,680 | 687,214 | 111 |
| 2016 | 254,642 | 256,542 | 119 | 254,781 | 256,736 | 122 |
| 2017 | 102,152 | 103,136 | 121 | — | — | — |
| | $1,322,443 | $1,329,978 | 97 | $1,232,053 | $1,239,203 | 97 |

(1) Months to estimated maturity is an average weighted by the amortized cost of the investment.

The majority of the collateral underlying our non-Agency CMBS is comprised of single-family rental and multifamily properties. The following charts present the collateral underlying our non-Agency CMBS by property type as of the dates indicated:

The collateral underlying our non-Agency CMBS investments is geographically dispersed in order to mitigate exposure to any particular region of the country. The U.S. state with the largest percentage of collateral underlying our non-Agency CMBS was Texas at 16% as of March 31, 2017, unchanged compared to December 31, 2016. The following charts present the geographic diversification of the collateral underlying our non-Agency CMBS by the top 5 states as of the dates indicated:

CMBS IO

The majority of our CMBS IO investments are collateralized primarily by fixed rate mortgage loans. Agency CMBS IO are exclusively collateralized by multifamily properties and are issued by securitization trusts sponsored by one of the GSEs. Non-Agency CMBS IO are secured by multifamily properties as well as office, retail, and hotel. Both types of CMBS IO have some form of prepayment protection (such as prepayment lock-outs or defeasance requirements) or prepayment compensation provisions (such as yield maintenance or prepayment penalties). Our CMBS IO investments are investment grade-rated with the majority rated 'AAA' by at least one of the nationally recognized statistical ratings organizations.

Activity related to our CMBS IO for the three months ended March 31, 2017 is as follows:

| ($ in thousands) [1] | Agency CMBS IO | Non-Agency CMBS IO | Total |
|---|---|---|---|
| Balance as of December 31, 2016 | $411,898 | $ 342,648 | $754,546 |
| Purchases | 15,232 | 23,065 | 38,297 |
| Sales | — | — | — |
| Premium amortization, net | (19,623 ) | (15,482 ) | (35,105 ) |
| Change in fair value | 5,034 | 6,627 | 11,661 |
| Balance as of March 31, 2017 | $412,541 | $ 356,858 | $769,399 |

(1) Amounts shown for CMBS IO represent premium only and exclude underlying notional balances.

Because income earned from CMBS IO is based on interest payments received on the underlying commercial mortgage loan pools, our return on these investments may be negatively impacted by any change in scheduled cash flows such as modifications of the mortgage loans or involuntary prepayments including defaults, foreclosures, and liquidations on or of the underlying mortgage loans prior to its contractual maturity date. In order to manage our exposure to credit performance, we generally invest in senior tranches of these securities and where we have evaluated the credit profile of the underlying loan pool and can monitor credit performance. In addition, to address changes in market fundamentals and the composition of mortgage loans collateralizing an investment, we consider the year of origination of the loans underlying CMBS IO in our selection of investments. The following table presents our CMBS IO investments as of March 31, 2017 by year of origination:

| ($ in thousands) | March 31, 2017 | | | December 31, 2016 | | |
|---|---|---|---|---|---|---|
| | Amortized Cost | Fair Value | Remaining WAL [1] | Amortized Cost | Fair Value | Remaining WAL [1] |
| Year of Origination: | | | | | | |
| 2010 | $8,656 | $9,237 | 18 | $9,456 | $9,858 | 19 |
| 2011 | 32,640 | 34,415 | 22 | 35,130 | 36,897 | 23 |
| 2012 | 95,536 | 97,043 | 25 | 102,378 | 103,675 | 27 |
| 2013 | 122,835 | 123,952 | 32 | 128,891 | 129,011 | 33 |
| 2014 | 197,140 | 198,548 | 38 | 201,802 | 200,260 | 39 |
| 2015 | 192,351 | 193,814 | 44 | 198,016 | 194,886 | 45 |
| 2016 | 83,499 | 83,733 | 51 | 82,219 | 79,959 | 87 |
| 2017 | 28,426 | 28,657 | 53 | — | — | — |
| | $761,083 | $769,399 | 38 | $757,892 | $754,546 | 42 |

(1) Remaining weighted average life ("WAL") represents an estimate of the number of months of interest earnings remaining for the investments by year of origination.

Approximately half of the collateral underlying our non-Agency CMBS IO is comprised of retail and multifamily properties. The following charts present the property type of the collateral underlying our non-Agency CMBS IO as of the dates indicated:

The collateral underlying our non-Agency CMBS IO investments is geographically dispersed in order to mitigate exposure to any particular region of the country. The U.S. state with the largest percentage of collateral underlying our non-Agency CMBS IO was California at 14% as of March 31, 2017, unchanged compared to December 31, 2016. The following charts present the geographic diversification of the collateral underlying our non-Agency CMBS IO by the top 5 states as of the dates indicated:

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RMBS

Activity related to our RMBS for the three months ended March 31, 2017 is as follows:

| ($ in thousands) | Agency RMBS | Non-Agency RMBS | Total |
|---|---|---|---|
| Balance as of December 31, 2016 | $1,201,205 | $ 33,562 | $1,234,767 |
| Purchases | — | — | — |
| Principal payments | (69,234 | | |